FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6339
May 27, 1969]

Interpretations of Regulation Z

To All State Member Banks, and Others Concerned,
in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System announced yesterday the approval of interpretations of provisions in its Truth in Lending Regulation Z, which goes into effect on July 1. A copy of each interpretation is printed below. They will be published shortly in the *Federal Register* and *Federal Reserve Bulletin.*

Additional copies of this circular will be furnished upon request.

ALFRED HAYES, *President.*

§ 226.202 Security interest—confession of judgment—cognovit notes

(a) Under § 226.2(z) "security interest" is defined to include confessed liens whether or not recorded and, in general, to include any interest in property which secures payment or performance of an obligation. In certain transactions involving a security interest, under § 226.9 the customer has a right of rescission.

(b) In some of the states, confession of judgment clauses or cognovit provisions are lawful and make it possible for the holder of an obligation containing such clause or provision to record a lien on property of the obligor simply by recordation entry of judgment; the obligor is afforded no opportunity to enter a defense against such action prior to entry of the judgment.

(c) Since confession of judgment clauses and cognovit provisions in such states have the effect of depriving the obligor of the right to be notified of a pending action and to enter a defense in a judicial proceeding *before* judgment may be entered or recorded against him, such clauses and provisions in those states are security interests under § 226.2(z) and for the purposes of § 226.7(a)(7), § 226.8(b)(5), and § 226.9. This is the case even if the judgment cannot be entered until after a default by the obligor.

(d) Confession of judgment clauses and cognovit provisions which, by their terms, exclude a lien on all real property which is used or is expected to be used as the principal residence of the customer, would not bring a transaction under the provisions of § 226.9.

(Interprets and applies 15 U.S.C. 1602)

§ 226.203 Open end credit distinguished from other credit

(a) The fundamental qualification for "open end credit" under § 226.2(r) is that consumer credit be extended on an account pursuant to a plan under which (1) the creditor may permit the customer to make purchases or obtain loans from time to time directly or indirectly from the creditor, as the plan may provide; (2) the customer has the privilege of paying the balance in full or in instalments; and (3) a finance charge may be computed by the creditor from time to time on an outstanding unpaid balance. Under an open end credit account plan, it is contemplated that there will or may be repetitive transactions on a revolving basis.

(b) In certain cases, a form of contract or note relating to a single transaction provides that the finance charge will be computed from time to time by application of a rate to the unpaid balance and stipulates required minimum periodic payments. However, the obligor has the privilege of making larger and more frequent payments than stipulated or paying the obligation in full at any time without penalty. The question arises as to whether the creditor should make disclosures in such circumstances under § 226.7 for open end credit accounts or under § 226.8 for credit other than open end.

(c) Although the terms of such a contract or note meet the second and third requirements for such a plan, they do not meet the first of such requirements nor the basic qualification that consumer credit be extended on an account pursuant to a plan. Therefore, disclosures in this case are required to be made under § 226.8.

(Interprets and applies 15 U.S.C. 1602)

§ 226.301 Agricultural purposes—when exempt from the Regulation

(a) Under § 226.3(a), the Regulation does not apply to "Extensions of credit to organizations, including governments, or for business or commercial purposes, other than agricultural purposes." The definition of "organization" in § 226.2(s) includes a corporation, trust, estate, partnership, cooperative, or association as well as governmental entities. The question arises as to whether the Regulation applies to extensions of credit to organizations, including governments, for agricultural purposes.

(b) Extensions of credit to organizations, including governments, for agricultural purposes are exempt from the Regulation.

(Interprets and applies 15 U.S.C. 1603)

§ 226.403 Disclosure of cost of property insurance when not obtainable from or through the creditor

(a) In many cases a creditor requires insurance against loss or damage to property or liability arising out of its use but such insurance is not obtainable from or through him. The question arises under § 226.4(a)(6) as to whether such a creditor must make any disclosures to avoid having to include the insurance premium in the finance charge.

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(b) Irrespective of whether such insurance may be obtained from or through the creditor, if the creditor requires property insurance and wishes to exclude the cost from the finance charge, he is required to state clearly and conspicuously to the customer that he may choose the person through which the insurance is to be obtained. However, if the insurance is not obtainable from or through the creditor, he is not required to disclose the cost of that insurance, unless, of course, the premiums are included in the "amount financed," in which case it would have to be disclosed under § 226.8(c)(4) or (d)(1), as the case may be.

(Interprets and applies 15 U.S.C. 1605)

§ 226.502 Annual percentage rate on single add-on rate transactions

(a) The application of a single add-on rate to transactions of varying maturities, when converted to an annual percentage rate determined by the actuarial method, results in minor variations. Such annual percentage rate variations on maturities up to sixty months are so insignificant that separate computations are unwarranted.

(b) The question arises as to whether a creditor may disclose a single annual percentage rate on all such transactions based upon the highest rate which will arise from the application of the same single add-on rate to each of such transactions.

(c) When the same add-on rate is applied to all transactions within a range of maturities up to 60 months, and provided that all payments on each transaction are equal in amount and due at equal intervals of time within the limits provided by § 226.5(d), a single annual percentage rate may be disclosed, in which case it shall be the highest annual percentage rate that may be applicable to any such transactions.

(Interprets and applies 15 U.S.C. 1606)

§ 226.805 Series of sales as distinguished from refinancing, consolidating, or increasing

(a) The question arises as to the distinction between the provisions of § 226.8(h), series of sales, and the provisions of § 226.8(j), refinancing, consolidating, or increasing.

(b) Section 226.8(h) is applicable *only* when a credit sale is made pursuant to an agreement which provides for the addition of a current (or new) sale to an existing outstanding balance. In such cases, and provided that all of the requirements of § 226.8(h)(1) and (2) are met, the disclosures may be made at any time not later than the date the first payment for that sale is due.

(c) If there is no agreement, or if the agreement does *not* meet all of the requirements of § 226.8(h), the disclosures required in connection with any subsequent sale, which is added to a previously outstanding balance shall be made under the provisions of § 226.8(j). For example, the fact that an agreement provides a method of computing an unearned portion of the finance charge in the event of prepayment, but does not otherwise meet the requirements of § 226.8(h), will not qualify transactions made pursuant to that agreement for disclosure under the terms of § 226.8(h).

(Interprets and applies 15 U.S.C. 1638)

§ 226.806 Deposit balances applied toward satisfaction of customer's obligation

(a) Section 226.8(e)(2) provides that required deposit balances must be deducted under § 226.8(c)(6) and excluded under § 226.8(d)(1) in determining the amount financed. Subdivision (ii) of § 226.8(e)(2) provides an exception in the case of Morris Plan type transactions in which payments in the transaction are made and accumulated in a deposit account which is then wholly applied to satisfy the obligation.

(b) Unless the deposit balance account is created for the sole purpose of accumulating payments and then being applied toward satisfaction of the customer's obligation in the transaction, such deposit balance does not fall within the exception provided in subdivision (ii).

(c) In any case in which a deposit balance qualifies for this exception, each deposit made into the account shall be considered the same as a payment on the obligation for the purpose of computations and disclosures.

(Interprets and applies 15 U.S.C. 1638 and 15 U.S.C. 1639)

§ 226.901 Waiver of security interests—effect on the right of rescission

(a) Section 226.9(a) provides for a right of rescission "in the case of any [consumer] credit transaction in which a security interest is or will be retained or acquired in any real property which is used or is expected to be used as the principal residence of the customer." Under § 226.2(z) security interests include mechanic's and materialmen's liens. If a creditor effectively waives his right to retain, or to acquire such a lien, he has not retained or acquired such security interest. The question arises, however, of whether waiver of a creditor's lien rights is effective to remove a transaction from the scope of rescission when lien rights which are not waived arise in favor of subcontractors, workmen, or others who are not creditors in the transaction.

(b) The fact that the creditor waives his lien rights does not, in itself, determine whether or not the transaction is rescindable. If *all* security interests are effectively waived, the transaction is not rescindable. On the other hand, if as a result of the transaction, a security interest is or will be retained or acquired by a subcontractor, workman, or other person, the transaction is rescindable. In the latter case the creditor would be responsible for delivering the rescission notice as well as other applicable disclosures, delaying performance as provided under § 226.9(c), and identifying himself as the creditor on the rescission notice. The subcontractors, workmen, and others would not be responsible for delivering rescission notices to the customer.

(Interprets and applies 15 U.S.C. 1635)

§ 226.902 "Customers" and joint owners of property under the right of rescission

(a) Section 226.9(f) provides that, for the purposes of the right of rescission, "customer" shall include two or more customers where joint ownership is involved. The question arises whether this means that all joint owners of record, regardless of whether or not they are parties to the transaction, are customers for this purpose, and whether each of such owners of record (1) must receive disclosure and a notice of the right of rescission, (2) may exercise the right of rescission, and (3) must join in signing a waiver if one is appropriately taken by the creditor.

(b) Under § 226.9(f) where there are joint owners, the right to receive disclosures and notice of the right of rescission, the right to rescind, and the need to sign a waiver of such right, apply only to those joint owners who are parties to the transaction.

(Interprets and applies 15 U.S.C. 1635)