

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 8401 ]  
August 10, 1978 ]

AMENDMENT TO AND INTERPRETATION OF REGULATION Z  
Notice of Right of Rescission in Open End Credit Plans

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

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System announcing an exemption from the notice-of-rescission provisions of Regulation Z, "Truth-in-Lending," for individual transactions under certain open end credit plans secured by a customer's residence:

The Board of Governors of the Federal Reserve System today [July 26, 1978] amended its Regulation Z—Truth in Lending—concerning the "cooling off" period for consumers who pledge their home as security in open end credit arrangements.

Truth in Lending requires that where a home is used as collateral for a consumer loan the lender must give notice that the borrower has a three-day period in which to cancel the deal.

Lenders have asked the Board how this notice should be given when they extend open end credit that is secured by an interest in a consumer's home. Credit card and overdraft checking arrangements are examples of open end credit.

The amendment exempts from the notice requirement of Regulation Z individual transactions under an open end credit arrangement when the creditor and the seller are not the same or related persons. The exemption applies, for example, to use of a bank credit card to purchase merchandise from a retail seller.

To qualify for this exemption under arrangements where the creditor and seller are not the same person, the amendment requires that customers must be notified of their right to cancel mortgage-secured open end credit plans in four instances:

- When an open end credit plan is first opened,
- Whenever the credit limit is increased,
- Whenever the terms of the account are changed, and
- Whenever a security interest in a home is added to an existing open end credit arrangement.

Customers must also be reminded annually that their homes have been pledged as security for such accounts.

When the creditor and seller of goods and services are the same or related persons (for example, in the case of a revolving charge account established with a merchant under which the customer may only buy goods or services from that merchant) Regulation Z specifies that notice of the right of rescission must be given whenever a transaction occurs on an open end account secured by the customer's home.

The change in Regulation Z adopted by the Board is a modification of an amendment proposed by the Board December 5, 1977.

Enclosed is a copy of the amendment to Regulation Z, together with a Board interpretation of the amendment that contains sample notices that creditors may use to comply with certain requirements of the amendment. Questions regarding this matter may be directed to our Consumer Affairs Division (Tel. No. 212-791-5921).

PAUL A. VOLCKER,  
*President.*

# Board of Governors of the Federal Reserve System

## TRUTH IN LENDING

### AMENDMENT TO AND INTERPRETATION OF REGULATION Z

(effective August 3, 1978)

[6210-01]

#### Title 12—Banks and Banking

#### CHAPTER II—FEDERAL RESERVE SYSTEM

#### SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Z; Docket No. R-0134]

#### PART 226—TRUTH IN LENDING

##### Right of Rescission

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule and interpretation.

**SUMMARY:** The Board hereby adopts an amendment to § 226.9(g) of Regulation Z creating an exception to the rescission provisions of the regulation for individual transactions under certain open end credit plans secured by consumers' residences. The amendment applies only to open end transactions in which the creditor and the seller are not the same or related persons. Concurrently, the Board is issuing an official Board interpretation of the amendment.

Regulation Z provides that in the case of any credit transaction in which a security interest is retained or acquired in the principal residence of the consumer, the consumer shall have 3 business days from consummation of the transaction in which to rescind the transaction. The creditor is required to disclose this right to the consumer and may not disburse the proceeds of the credit transaction, except in escrow, during the 3-day period.

The Board finds that requiring the right of rescission, notice of that right, and the 3-day cooling off period in connection with each individual transaction under certain types of open end credit plans secured by consumers' residences unduly complicates compliance with Regulation Z, hampers creditors that desire to offer such credit plans, and, thereby, may prevent consumers from utilizing the equity in their homes to obtain open

end credit. The amendment, which is designed to remedy these problems, exempts from the rescission provisions of Regulation Z individual transactions on an open end credit account secured by the customer's residence if the creditor provides an appropriate disclosure, as specified in the amendment, upon the opening of such an account, prior to any increase in the line of credit associated with the account, prior to a change in the terms of the account, and at the time of an addition of a security interest in the customer's residence to an existing open end account. Additionally, a disclosure must be provided at least annually reminding customers of such accounts that their homes stand as security for their accounts.

The interpretation of the amendment, which is issued herewith, provides sample disclosures which creditors may use to achieve compliance with certain of the amendment's requirements.

**EFFECTIVE DATE:** August 3, 1978.

**FOR FURTHER INFORMATION CONTACT:**

Glenn E. Loney, Section Chief, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, 202-452-3867.

**SUPPLEMENTARY INFORMATION:** Section 226.9(a) of Regulation Z provides that a customer shall have the right to rescind any 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. The right to rescind continues for 3 business days from the consummation of the transaction or the delivery of all specified disclosures, whichever is later. Under § 226.9(b), whenever a customer has the right to rescind a transaction, the creditor must provide a disclosure of that right in the form prescribed by the regulation. Under § 226.9(c), the creditor must delay its performance (i.e., refrain from disbursing the proceeds of the credit transaction) until the rescission period has expired and

the creditor has satisfied itself that the customer has not exercised the right of rescission.

Several creditors that desired to offer open end credit plans secured by consumers' residences asserted that requiring the right of rescission, disclosure of that right, and the 3-day cooling off period in connection with each individual transaction under an open end account secured by the customer's residence presented operational problems which prevented the extension of such credit. It was pointed out that in connection with 3-party credit transactions under an open end plan (e.g., use of a cash advance check to obtain goods or services from a party other than the creditor of the open end account), the customer decides when and for what purpose to use the credit, and the creditor can neither readily provide disclosure of the right of rescission nor effectively delay its performance for the requisite 3 days. In an effort to alleviate these difficulties without depriving consumers of the protection of their homes intended by Congress when it created the right of rescission, the Board proposed an amendment to Regulation Z which it now adopts, with modifications, in final form.

As a result of comments received in response to its proposal and based upon its own analysis, the Board believes that the amendment, including the modifications discussed below, will facilitate compliance with Regulation Z by creditors that wish to offer open end credit plans secured by consumers' residences and will afford continued protection for consumers who enter into such plans. Perhaps most significantly, the Board feels that the amendment will enable consumers to utilize the equity in their homes to obtain the convenience and flexibility offered by open end credit which might otherwise be unavailable to them.

Under the amendment, individual transactions on an open end credit account secured by the customer's residence are not subject to the right of rescission if the creditor provides the customer with the applicable disclo-

For Regulation Z to be complete, retain:

- 1) Regulation Z pamphlet, amended to March 23, 1977.
- 2) Amendments effective April 11, 1977, July 20, 1977, October 10, 1977, March 28, 1978, and April 21, 1978.
- 3) Amendment effective May 30, 1978 (date of publication in the *Federal Register*).
- 4) This slip sheet.

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sure prescribed in the amendment at the time the disclosures required by § 226.7(a) of Regulation Z are required to be made, prior to any increase in the line of credit associated with the account, prior to a change in terms (within the meaning of § 226.7(f) of the regulation) of the account, and at the time of an addition of a security interest in the customer's residence to an existing open end account. A disclosure reminding customers of such accounts that their homes stand as security for their accounts must also be provided at least annually.

The amendment as adopted by the Board includes certain modifications of the original proposal. The amendment applies only to open end credit transactions in which the creditor of the open end credit plan and the seller of goods or services purchased by means of the plan are not the same or related persons. A change in the terms of an open end account secured by the customer's residence has been added to the amendment as an occasion on which a disclosure must be provided to the customer. An annual disclosure reminding customers of the security interest in their homes is also required.

The Board has restricted the applicability of the amendment to transactions on open end credit plans in which the creditor and the seller are not the same or related persons for two reasons. First, the Board feels that the operational problems attendant to providing the right of rescission in connection with individual transactions on an open end credit account where the creditor and the seller are not the same or related persons do not arise where the creditor is also the seller. Second, the possibility of undue influence by the creditor is less in transactions in which the creditor and the seller are unrelated because the customer chooses when and for what purpose to use the open end account and the seller obtains no interest in the customer's home.

The Board believes that a change in the terms of an open end account, within the meaning of § 226.7(f) of Regulation Z, merits a notice reminding the customer that his or her residence stands as security for the account. As pointed out by the Federal Reserve Bank of Cleveland, which suggested this modification of the amendment, if the notice is not required prior to a change in terms, a customer could find that his or her residence stands as security for extensions of credit, some of the terms of which were imposed unilaterally by the creditor.

Under the amendment as adopted, a creditor may not change the terms of a customer's open end account (within the meaning of § 226.7(f) of Regulation Z) without affording the customer an opportunity to refuse the change in terms and repay any existing obligation on the account under the existing

terms of the account. However, if the customer refuses the change in terms, the creditor need not extend any further credit on the account.

The Board is concerned that customers of open end credit plans which are subject to the amendment may, after a period of time, lose sight of the fact that their accounts are secured by their homes. For this reason, the Board has required that a disclosure be provided annually to customers of open end accounts which fall within the amendment.

Several comments on the amendment as originally proposed suggested that the disclosure of the right of rescission prescribed by § 226.9(b) of Regulation Z is inappropriate for some of the occasions on which disclosure would be required under the amendment and could cause confusion among consumers. The amendment as adopted, therefore, specifies that the disclosure required by § 226.9(b) is to be used in connection with the opening of an account and the addition of a security interest in a consumer's residence to an existing account. The amendment also prescribes disclosures to be furnished to a consumer prior to an increase in the line of credit or a change in the terms of the consumer's account and at least once each calendar year to remind the consumer that the consumer's home stands as security for the account.

Simultaneously with the adoption of this amendment to Regulation Z, the Board is issuing an official Board interpretation of the regulation, § 226.904, which provides sample disclosures which creditors may use in order to satisfy the requirements, as to form and content, of §§ 226.9(g)(6) (iii) and (iv) of the regulation as amended.

Finally, it should be noted that when a disclosure under the amendment is furnished to a consumer prior to an increase in the line of credit or a change in the terms of the consumer's account, the effect of the disclosure is prospective only and the consumer is not thereby entitled to void the creditor's security interest in the consumer's residence insofar as it secures prior extensions of credit on the account. Similarly, the disclosure furnished to a consumer prior to the addition of a security interest in the consumer's residence to a preexisting open end account would not enable the consumer to rescind prior transactions on the account. Likewise, the required annual disclosure would not enable consumers to rescind any prior transactions or cancel any existing obligation on their accounts or void any security interest insofar as it secured those existing obligations.

Therefore, pursuant to the authority granted in 15 U.S.C § 1604 (1970):

The Board hereby amends § 226.9(g) of Regulation Z, 12 CFR 226, as follows:

#### AMENDMENT

§ 226.9 Right to rescind certain transactions.

- \* . \* . \*
- (g) Exceptions to general rule. \* \* \*
  - (6) Individual transactions under an open end credit account: *Provided*,
    - (i) That the creditor and the seller are not the same or related persons.<sup>144</sup>
    - (ii) That the creditor provides the disclosure required by § 226.9(b) at the time the disclosures required under § 226.7(a) are required to be made, or, if the security interest is not retained or acquired at the time the § 226.7(a) disclosures are required to be made, at the time the security interest is retained or acquired.
    - (iii) That the creditor does not change the terms of a customer's account within the meaning of § 226.7(f) or increase the customer's line of credit without affording the customer the opportunity to refuse the change in terms or the increase. If the customer refuses the change in terms, the creditor need not extend any further credit on the account; however, the customer shall have the right to repay any existing obligation on the account under the then existing terms of the account. At the time a disclosure of a change in terms under § 226.7(f) is required to be made or prior to an increase in the customer's line of credit, the creditor shall provide the customer with two copies of a disclosure setting forth, as applicable: The fact that the creditor intends to change the terms or increase the line of credit of the customer's account; the fact that the account is secured by the customer's real property; and the fact that the customer may refuse the change in terms and repay any existing obligation under the then existing terms of the account, or refuse the increase in the line of credit, by giving the creditor written notice within 3 business days of the date of the disclosure.
    - (iv) That at least once each calendar year the creditor furnishes to the customer a disclosure of the fact that the customer's account is secured by the customer's real property and that failure to pay any outstanding balance in accordance with the terms of the account could result in the loss of the customer's real property.
    - (v) That each disclosure provided pursuant hereto is made on one side of a statement separate from any other documents, that the disclosure sets forth the name of the creditor and, in the case of the disclosures required by paragraph (g)(6)(iii) of this section, the creditor's address, the date on

<sup>144</sup> For purposes of § 226.9(g)(6) a person is related to a creditor if that person would be deemed related to the creditor under footnote 9b to § 226.7(k).

which the disclosure is furnished to the customer, the date by which the customer should give notice of refusal of the increase in the line of credit or the change in terms of the account, and the fact that one copy of the disclosure can be used for that purpose. [End of amendment.]

The Board hereby adopts the following official board interpretation of regulation Z, 12 CFR Part 226:

### INTERPRETATION

#### SECTION 226.904—RIGHT OF RESCISSION FOR CERTAIN OPEN END CREDIT ACCOUNTS

Section 226.9(g)(6) provides an exception to the right of rescission for individual transactions on an open end credit account provided, among other things, that the disclosures required by that section are made at the times specified. The question arises as to what disclosures will satisfy the requirements of §§ 226.9(g)(6) (iii) and (iv).

The disclosures set forth below, if accurate and when properly completed, will satisfy the requirements, as to form and content, of the indicated sections of the regulation. No specific type size or style is required. If the real property on which the security interest may arise does not include a

dwelling, the creditor may substitute such words as "the property you are purchasing" for "your home" or "lot" for "home" where these words appear in the disclosure.

Section 226.9(g)(6)(iii) (increase in line of credit).

#### NOTICE TO CUSTOMER REQUIRED BY FEDERAL LAW

(Name of creditor) \_\_\_\_\_  
Has approved an increase in the amount of credit available to you on your open end account secured by your home. Any additional credit you use will also be secured by your home. You have a right to refuse to accept this increase. You may exercise this right within three business days from (date disclosure delivered to customer) by notifying us at (address of creditor's place of business) by mail or telegram sent not later than midnight of (date). You may also use any other form of written notice to refuse the increase if it is delivered to the above address not later than that time. This notice may be used for that purpose by dating and signing below.

I hereby refuse the increase in the credit available on my account; (date) (customer's signature).

Section 226.9(g)(6)(iii) (change in terms).

#### NOTICE TO CUSTOMER REQUIRED BY FEDERAL LAW

(Name of creditor) \_\_\_\_\_  
Intends to change the terms of your open end credit account which is secured by your home. You have a right to refuse to accept

this change in terms. If you refuse this change in terms, we have the right to refuse to extend any further credit on your open end account and may require you to repay any existing obligation on your account under the present terms of the account. You may exercise your right to refuse the change in terms within three business days of (date disclosure delivered to customer) by notifying us at (address of creditor's place of business) by mail or telegram sent not later than midnight of (date). You may also use any other form of written notice to refuse the change in terms if it is delivered to the above address not later than that time. This notice may be used for that purpose by dating and signing below.

I hereby refuse the change in the terms of my account; (date) (customer's signature).

Section 226.9(g)(6)(iv) (annual disclosure).

#### NOTICE TO CUSTOMER REQUIRED BY FEDERAL LAW

This is to remind you that your open end credit account with (name of creditor) is secured by a lien, mortgage, or other security interest on your home. This means that your failure to pay any outstanding balance in accordance with the terms of the account could result in the loss of your home.

By order of the Board of Governors,  
July 26, 1978.

THEODORE E. ALLISON,  
*Secretary of the Board.*

[FR Doc. 78-21570 Filed 8-2-78; 8:45 am]