

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9163]
[October 19, 1981]

REGULATION Z — TRUTH IN LENDING

Official Staff Commentary

To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System has issued an official staff commentary on its Regulation Z, "Truth in Lending," which is designed to consolidate and replace all individual interpretations of the regulation. The following is quoted from the text of a statement issued by the Board of Governors announcing the commentary:

The commentary applies the requirements of Truth in Lending with respect to both open-end and closed-end consumer credit. It deals with the substance of some 1,500 Board and staff interpretations that have been issued, at the request of consumers and creditors, since the Act became effective over a decade ago and with certain recent developments in consumer credit financing. The commentary is expected to replace all individual interpretations and to be the sole vehicle for interpreting Regulation Z.

Compliance with the simplified regulation becomes mandatory April 1, 1982, a year after its publication, but creditors may begin to comply with it immediately.

The Board believes that the attempt to issue highly specific interpretations in the past led to an accumulation of interpretations that by their number and complexity complicated rather than facilitated compliance. The proposed new commentary focuses on providing guidance with wide application together with illustrative examples.

In its final form the staff commentary on Regulation Z provides rules for applying the disclosure requirements of Truth in Lending to a number of recent developments in the field of consumer credit financing. These include developments involving "creative" mortgage financing.

Creative mortgage financing

"Buydowns" of mortgage interest rates (where the seller, borrower or both reduce the rate for the first few years of the mortgage by means of a lump sum payment to the lender at the outset):

- Where the *seller* makes the payment, the staff commentary takes the position that the disclosures by the lender should be at the higher rate (unless the credit contract actually reflects the lower rate, in which case the disclosures are to be based on the composite rate).
- Where the *consumer* makes the buydown payment, the commentary takes the position that this amount is part of the finance charge and disclosures must show the effects on the rate of the buydown, including a composite rate during the buydown period and the higher rate thereafter.
- Where the *consumer and a third party* share in the buydown payment the consumer's portion is to be included in the finance charge and disclosures must reflect the effects of the consumer's payment, while the third party's portion has no effect on disclosures unless the contract reflects the lower rate.

(OVER)

“Wraparound” mortgages (where a creditor “wraps” an additional advance around the outstanding balance on an existing loan and charges interest on the entire face amount of the new mortgage, with the consumer making a single payment to the new creditor and the new creditor makes payments on the existing loan):

The staff commentary treats a wraparound mortgage — whether it has the same maturity as the pre-existing loan or a shorter maturity with a balloon payment at the end — as a single-advance transaction, with the amount financed combining the pre-existing loan and the new advance.

The notice concerning the commentary explains its general purposes and intent, notes that the Board will submit for public comment a proposed amendment to Regulation Z dealing with the definition of arranger of credit covering real estate brokers who arrange credit, and lists the principal subjects dealt with by the commentary.

Enclosed is a copy of a summary of the official staff commentary. The complete text of the commentary — which is enclosed for member banks in this District — has been published in the October 9, 1981 issue of the *Federal Register*. It will be sent to other depository institutions when printed copies become available.

ANTHONY M. SOLOMON,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

TRUTH IN LENDING

Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

SUMMARY: In accordance with Appendix C to 12 CFR Part 226, the staff of the Federal Reserve Board is publishing a final official staff commentary to Regulation Z, as revised effective April 1, 1981. A proposed version of the commentary was published in the Federal Register on May 27, 1981 (46 FR 28560). The commentary applies and interprets the requirements of the revised Regulation Z to open-end and closed-end consumer credit and is intended to substitute for individual Board and staff interpretations of the regulation. Good faith compliance with the commentary affords protection from civil liability under § 130(f) of the act.

EFFECTIVE DATE: October 13, 1981.

FOR FURTHER INFORMATION CONTACT: The following attorneys in the Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3667 or (202) 452-3867:

Subpart A	Ruth Amberg Gerald Hurst Steven Zeisel	Subpart C and Appendices	Rugenia Silver Susan Werthan Claudia Yarus Steven Zeisel
Subpart B and Appendices	Ruth Amberg Jesse Filkins Lynn Goldfaden Gerald Hurst Barbara Ranagan John Wood	Subpart D and Appendices	Lynn Goldfaden Rugenia Silver

SUPPLEMENTARY INFORMATION: (1) Introduction. Effective April 1, 1981, the Board substantially revised Regulation Z, which implements the Truth in Lending Act (46 FR 20848, April 7, 1981). The revisions reflect amendments made by the Truth in Lending Simplification and Reform Act (Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221). Creditors may begin complying with the revised regulation immediately, but compliance does not become mandatory until April 1, 1982. Before that date, creditors may continue to comply with the regulation as it existed prior to those amendments ("previous Regulation Z"). Board and staff interpretations issued under previous Regulation Z will remain effective until April 1, 1982, but only insofar as they interpret the previous regulation.

The commentary modifies the staff's approach to providing interpretations of Regulation Z. Under the previous regulation, individual staff opinions were issued in response to inquiries about specific fact situations and were normally limited to those facts. Over time, more than 1,500 separate opinions were issued. While this commentary provides specific guidance and examples, it employs language of somewhat more general application for use by the widest possible audience. The commentary attempts to provide sufficient guidance without overburdening the industry with excessive detail and multiple research sources. Periodic updates will address new questions and provide a vehicle for any additional staff interpretations. In this way, every question appropriate for commentary treatment will be addressed within a reasonable time.

Many previous opinion letters have been adopted, in substance, as interpretations of the revised regulation and are reflected in the commentary. Many others have not been adopted because they have been rendered invalid by regulatory changes or, if they are still valid, because they are inappropriate for inclusion in an official commentary. Therefore, previous staff opinion letters, whether official or unofficial, can provide no certain guidance in complying with the revised regulation. They were issued as interpretations of previous Regulation Z only and are entirely superseded by this commentary for purposes of interpreting the revised Regulation Z. Of course, they may still be utilized by courts and administrative agencies in determining liability for violations of the previous regulation.

A proposed version of the commentary was published in the Federal Register on May 27, 1981 (46 FR 28560) and elicited over 200 responses from consumer, industry, and government representatives. Numerous changes to the substance of the proposal were requested; many have been adopted in the final commentary. Since some responses reflected confusion about the meaning of certain provisions, those provisions have been revised and clarified. In addition, many minor editorial and structural changes suggested by commenters have been incorporated.

Because of substantive and editorial changes, some sections of the commentary were restructured, and comments were added or deleted as necessary. As a result, the location of a comment may differ from its original location in the proposal. In general, the staff has attempted to place comments in the single most appropriate and useful place, providing cross-references where necessary.

One significant change from the proposal that deserves special mention involves the definition of an arranger of credit. The proposed commentary interpreted the definition to cover real estate brokers involved in seller-financed transactions. The Board has determined, however, that the significance of the definition warrants further public comment. Therefore, the Board will be publishing in the Federal Register a notice of proposed rulemaking to amend the revised regulation. The proposed amendment to § 226.2(a)(3), if adopted, would clarify the definition of "arranger of credit," particularly in regard to the treatment of real estate brokers who arrange sales involving seller financing.

Some other provisions in the commentary that significantly differ from the proposal are listed below. The list is not exhaustive; it is intended merely to give examples of the types of changes that have been made.

INTRODUCTION

- An introduction has been added to the commentary to cover information of general applicability and rules of transition from the previous regulation.

SUBPART A (GENERAL)

- Comment 2(a)(3)-2 describes the content of disclosures made by an arranger of credit.
- Comment 2(a)(14)-1 identifies several types of transactions that are not considered credit for purposes of the regulation.
- Comment 2(a)(16)-5 permits student credit transactions to be treated as either loans or credit sales.
- Comment 2(a)(17)(i)-2 clarifies that assignees of consumer contracts are not creditors.
- Comment 2(a)(22)-2 explains that an attorney and his or her client are considered the same person for purposes of the regulation.
- Comments 2(a)(24)-3 and -4 clarify the meaning of "residential mortgage transaction."
- Comments 2(a)(25)-1 and -4 further explain the definition of "security interest."
- Comment 3(a)-2 expands the list of factors to consider in determining the purpose of a credit extension and modifies the examples of business- and consumer-purpose credit.
- Comment 3(a)-3 expands the definition of non-owner-occupied rental property.
- Comments 3(a)-5 and 3(b)-3 explain when the refinancing of previously exempt transactions are subject to the regulation.
- Comment 3(b)-2 describes how the exemption for credit over \$25,000 applies to open-end credit.

- Comment 4(a)-2 specifically excludes from the finance charge assignment discounts that are not separately imposed on the consumer.
- Comment 4(a)-3 excludes from the finance charge taxes imposed on a credit obligation that are payable by the consumer.
- Comment 4(a)-4 explains when a consumer's forfeiture of interest constitutes a finance charge.
- Comments 4(b)(7) and (8)-1 and -2 describe what constitutes insurance "written in connection with" the credit transaction.
- Comment 4(b)(9)-2 describes the exception for cash discounts found in § 167(b) of the act.
- Comment 4(c)(1)-1 clarifies the treatment of application fees.
- Comments 4(d)-2 and -3 explain insurance disclosure responsibilities.
- Comment 4(d)-7 clarifies how a creditor may obtain authorization when a number of insurance options are available and who may sign an insurance authorization.

SUBPART B (OPEN-END CREDIT)

- Comments 5(a)(1)-1 and -2 clarify the format requirements for initial disclosures and periodic statements.
- Comment 5(b)(2)(ii)-3 clarifies that a creditor may permit (but not require) consumers to call for their periodic statements.
- Comments 6(a)(2)-2 through -9 provide guidelines on disclosure requirements for variable rate plans.
- Comment 7-1 deals with multifeatured plans.
- Comments 7(d)-1 and -2 provide further examples of what periodic rates must be disclosed.
- Comment 7(f)-1 modifies the rule on disclosures of the total finance charge due to the application of periodic rates.
- Comment 8(a)-3 gives additional options for "transaction dates" in mail or telephone orders.
- Comment 9(a)(2)-1 modifies the timing requirements when a creditor changes from a long-form to a short-form notice and vice versa.

- Comment 9(c)(1)-5 clarifies that a copy of the security agreement that describes the collateral added to or substituted on an account may be used as a notice of the changed term.
- Comment 9(d)-1 has been added to cross-reference the statutory ban on credit card surcharges.
- Comment 11-1 permits a creditor to fulfill its obligations by making a good faith effort to refund any credit balance prior to the passage of 6 months.
- Comment 11(b)-1 clarifies that a creditor need not honor standing orders requesting refunds of any credit balance on the consumer's account.
- Comment 15(a)-5 and -6 clarify the meaning of "principal dwelling" as it relates to the right of rescission.

SUBPART C (CLOSED-END CREDIT)

- Comment 17(a)(1)-5 provides an expanded list of material considered directly related to required disclosures.
- Comments 17(c)(1)-3, -4 and -5 provide a more complete discussion of "buydowns."
- Comments 17(c)(1)-6 and -7 detail the treatment of "wrap-around" financing.
- Comment 17(c)(2)-2 permits a general statement that most or all disclosures are estimates, where applicable.
- Comment 17(c)(6)-5 explains the treatment of "points" in multiple-advance construction loans.
- Comment 17(i)-4 is a new comment discussing the treatment of loan origination fees on student credit extensions.
- Comment 18(c)-2 provides further guidance on varying the disclosure of the itemization of the amount financed.
- Comment 18(f)(1)-1 clarifies the treatment of an index to which a variable rate transaction may be tied.
- Comment 18(j)-1 clarifies that the total sale price disclosure may be modified for a variable rate transaction.
- Comment 19(a)-4 explains the appropriate treatment of loan applications that cannot be approved on their original terms.

- Comment 19(b)-2 permits a creditor to highlight the changed terms when giving a complete set of new disclosures.
- Comment 20(b)-6 is a new comment explaining changes in terms that do and do not destroy the existing obligation for purposes of assumptions.
- Comments 23(a)(1)-3 and -4 clarify the meaning of "principal dwelling" as it relates to the right of rescission.
- Comment 24(b)-3 explains the correct treatment of "buydowns" in advertising.

SUBPART D (MISCELLANEOUS)

- Comment 26(b)-1 permits oral disclosure of other charges in closed-end credit when the annual percentage rate cannot be precisely determined.
- Comment 27-1 clarifies the treatment of Spanish-language disclosures in Puerto Rico.

* * * * *

[NOTE: The complete text of the commentary can be obtained from any Federal Reserve Bank or from the Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.]

FRASER REGISTER

Friday
October 9, 1981

Part IV

Federal Reserve System

Truth in Lending; Official Staff
Commentary

[Ref. Cir. No. 9163]

FEDERAL RESERVE SYSTEM**12 CFR Part 226****[Reg. Z; TIL-1]****Truth in Lending; Official Staff Commentary****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Official staff interpretation.

SUMMARY: In accordance with Appendix C to 12 CFR Part 226, the staff of the Federal Reserve Board is publishing a final official staff commentary to Regulation Z, as revised effective April 1, 1981. A proposed version of the commentary was published in the *Federal Register* on May 27, 1981 (46 FR 28560). The commentary applies and interprets the requirements of the revised Regulation Z to open-end and closed-end consumer credit and is intended to substitute for individual Board and staff interpretations of the regulation. Good faith compliance with the commentary affords protection from civil liability under section 130(f) of the act.

EFFECTIVE DATE: October 13, 1981.**FOR FURTHER INFORMATION CONTACT:**

The following attorneys in the Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3667 or (202) 452-3867:

Subpart A:

Ruth Amberg, Gerald Hurst, Steven Zeisel

Subpart B and Appendices:

Ruth Amberg, Jesse Filkins, Lynn Goldfaden, Gerald Hurst, Barbara Ranagan, John Wood

Subpart C and Appendices:

Rugenia Silver, Susan Werthan, Claudia Yarus, Steven Zeisel

Subpart D and Appendices:

Lynn Goldfaden, Rugenia Silver

SUPPLEMENTARY INFORMATION: (1)

Introduction. Effective April 1, 1981, the Board substantially revised Regulation Z, which implements the Truth in Lending Act (46 FR 20848, April 7, 1981). The revisions reflect amendments made by the Truth in Lending Simplification and Reform Act (Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221). Creditors may begin complying with the revised regulation immediately, but compliance does not become mandatory until April 1, 1982. Before that date, creditors may continue to comply with the regulation as it existed prior to those amendments ("previous Regulation Z"). Board and staff

interpretations issued under previous Regulation Z will remain effective until April 1, 1982, but only insofar as they interpret the previous regulation.

The commentary modifies the staff's approach to providing interpretations of Regulation Z. Under the previous regulation, individual staff opinions were issued in response to inquiries about specific fact situations and were normally limited to those facts. Over time, more than 1,500 separate opinions were issued. While this commentary provides specific guidance and examples, it employs language of somewhat more general application for use by the widest possible audience. The commentary attempts to provide sufficient guidance without overburdening the industry with excessive detail and multiple research sources. Periodic updates will address new questions and provide a vehicle for any additional staff interpretations. In this way, every question appropriate for commentary treatment will be addressed within a reasonable time.

Many previous opinion letters have been adopted, in substance, as interpretations of the revised regulation and are reflected in the commentary. Many others have not been adopted because they have been rendered invalid by regulatory changes or, if they are still valid, because they are inappropriate for inclusion in an official commentary. Therefore, previous staff opinion letters, whether official or unofficial, can provide no certain guidance in complying with the revised regulation. They were issued as interpretations of previous Regulation Z only and are entirely superseded by this commentary for purposes of interpreting the revised Regulation Z. Of course, they may still be utilized by courts and administrative agencies in determining liability for violations of the previous regulation.

A proposed version of the commentary was published in the *Federal Register* on May 27, 1981 (46 FR 28560) and elicited over 200 responses from consumer, industry, and government representatives. Numerous changes to the substance of the proposal were requested; many have been adopted in the final commentary. Since some responses reflected confusion about the meaning of certain provisions, those provisions have been revised and clarified. In addition, many minor editorial and structural changes suggested by commenters have been incorporated.

Because of substantive and editorial changes, some sections of the commentary were restructured, and comments were added or deleted as

necessary. As a result, the location of a comment may differ from its original location in the proposal. In general, the staff has attempted to place comments in the single most appropriate and useful place, providing cross-references where necessary.

One significant change from the proposal that deserves special mention involves the definition of an arranger of credit. The proposed commentary interpreted the definition to cover real estate brokers involved in seller-financed transactions. The Board has determined, however, that the significance of the definition warrants further public comment. Therefore, the Board will be publishing in the *Federal Register* a notice of proposed rulemaking to amend the revised regulation. The proposed amendment to § 226.2(a)(3), if adopted, would clarify the definition of "arranger of credit," particularly in regard to the treatment of real estate brokers who arrange sales involving seller financing.

Some other provisions in the commentary that significantly differ from the proposal are listed below. The list is not exhaustive; it is intended merely to give examples of the types of changes that have been made.

INTRODUCTION

- An introduction has been added to the commentary to cover information of general applicability and rules of transition from the previous regulation.

Subpart A (General)

- Comment 2(a)(3)-2 describes the content of disclosures made by an arranger of credit.
- Comment 2(a)(14)-1 identifies several types of transactions that are not considered credit for purposes of the regulation.
- Comment 2(a)(16)-5 permits student credit transactions to be treated as either loans or credit sales.
- Comment 2(a)(17)(i)-2 clarifies that assignees of consumer contracts are not creditors.
- Comment 2(a)(22)-2 explains that an attorney and his or her client are considered the same person for purposes of the regulation.
- Comments 2(a)(24)-3 and -4 clarify the meaning of "residential mortgage transaction."
- Comments 2(a)(25)-1 and -4 further explain the definition of "security interest."
- Comment 3(a)-2 expands the list of factors to consider in determining the purpose of a credit extension and modifies the examples of

business- and consumer-purpose credit.

- Comment 3(a)-3 expands the definition of non-owner-occupied rental property.
- Comments 3(a)-5 and 3(b)-3 explain when the refinancing of previously exempt transactions are subject to the regulation.
- Comment 3(b)-2 describes how the exemption for credit over \$25,000 applies to open-end credit.
- Comment 4(a)-2 specifically excludes from the finance charge assignment discounts that are not separately imposed on the consumer.
- Comment 4(a)-3 excludes from the finance charge taxes imposed on a credit obligation that are payable by the consumer.
- Comment 4(a)-4 explains when a consumer's forfeiture of interest constitutes a finance charge.
- Comments 4(b) (7) and (8)-1 and -2 describe what constitutes insurance "written in connection with" the credit transaction.
- Comment 4(b)(9)-2 describes the exception for cash discounts found in § 167(b) of the act.
- Comment 4(c)(1)-1 clarifies the treatment of application fees.
- Comments 4(d)-2 and -3 explain insurance disclosure responsibilities.
- Comment 4(d)-7 clarifies how a creditor may obtain authorization when a number of insurance options are available and who may sign an insurance authorization.

Subpart B (Open-End Credit)

- Comments 5(a)(1)-1 and -2 clarify the format requirements for initial disclosures and periodic statements.
- Comment 5(b)(2)(ii)-3 clarifies that a creditor may permit (but not require) consumers to call for their periodic statements.
- Comments 6(a)(2)-2 through -9 provide guidelines on disclosure requirements for variable rate plans.
- Comment 7-1 deals with multifeatured plans.
- Comments 7(d)-1 and -2 provide further examples of what periodic rates must be disclosed.
- Comment 7(f)-1 modifies the rule on disclosures of the total finance charge due to the application of periodic rates.
- Comment 8(a)-3 gives additional options for "transaction dates" in mail or telephone orders.
- Comment 9(a)(2)-1 modifies the timing requirements when a creditor changes from a long-form to a short-

form notice and vice versa.

- Comment 9(c)(1)-5 clarifies that a copy of the security agreement that describes the collateral added to or substituted on an account may be used as a notice of the changed term.
- Comment 9(d)-1 has been added to cross-reference the statutory ban on credit card surcharges.
- Comment 11-1 permits a creditor to fulfill its obligations by making a good faith effort to refund any credit balance prior to the passage of 6 months.
- Comment 11(b)-1 clarifies that a creditor need not honor standing orders requesting refunds of any credit balance on the consumer's account.
- Comments 15(a)-5 and -6 clarify the meaning of "principal dwelling" as it relates to the right of rescission.

Subpart C (Closed-End Credit)

- Comment 17(a)(1)-5 provides an expanded list of material considered directly related to required disclosures.
- Comments 17(c)(1)-3, -4 and -5 provide a more complete discussion of "buydowns."
- Comments 17(c)(1)-6 and -7 detail the treatment of "wrap-around" financing.
- Comment 17(c)(2)-2 permits a general statement that most or all disclosures are estimates, where applicable.
- Comment 17(c)(6)-5 explains the treatment of "points" in multiple-advance construction loans.
- Comment 17(i)-4 is a new comment discussing the treatment of loan origination fees on student credit extensions.
- Comment 18(c)-2 provides further guidance on varying the disclosure of the itemization of the amount financed.
- Comment 18(f)(1)-1 clarifies the treatment of an index to which a variable rate transaction may be tied.
- Comment 18(j)-1 clarifies that the total sale price disclosure may be modified for a variable rate transaction.
- Comment 19(a)-4 explains the appropriate treatment of loan applications that cannot be approved on their original terms.
- Comment 19(b)-2 permits a creditor to highlight the changed terms when giving a complete set of new disclosures.
- Comment 20(b)-6 is a new comment explaining changes in terms that do and do not destroy the existing

obligation for purposes of assumptions.

- Comments 23(a)(1)-3 and -4 clarify the meaning of "principal dwelling" as it relates to the right of rescission.
- Comment 24(b)-3 explains the correct treatment of "buydowns" in advertising.

Subpart D (Miscellaneous)

- Comment 26(b)-1 permits oral disclosure of other charges in closed-end credit when the annual percentage rate cannot be precisely determined.
- Comment 27-1 clarifies the treatment of Spanish-language disclosures in Puerto Rico.

(2) *Authority.* 15 U.S.C. 1640(f).

12 CFR Part 226, TIL-1—Official Staff Commentary to Regulation Z

INTRODUCTION

1. *Official status.* This commentary is the vehicle by which the staff of the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation Z, as revised effective April 1, 1981. Good faith compliance with this commentary affords protection from liability under 130(f) of the Truth in Lending Act. Section 130(f) (15 U.S.C. 1640) protects creditors from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System.

2. *Procedure for requesting interpretations.* Under Appendix C of the regulation, anyone may request an official staff interpretation. Interpretations that are adopted will be incorporated in this commentary following publication in the **Federal Register**. No official staff interpretations are expected to be issued other than by means of this commentary.

3. *Status of previous interpretations.* All statements and opinions issued by the Federal Reserve Board and its staff interpreting previous Regulation Z remain effective until April 1, 1982, only insofar as they interpret that regulation. When compliance with revised Regulation Z becomes mandatory on April 1, 1982, the Board and staff interpretations of the previous regulation will be entirely superseded by the revised regulation and this commentary except with regard to liability under the previous regulation.

4. *Rules of construction.* (a) Lists that appear in the commentary may be exhaustive or illustrative; the

appropriate construction should be clear from the context. In most cases, illustrative lists are introduced by phrases such as "including, but not limited to," "among other things," "for example," or "such as."

(b) Throughout the commentary and regulation, reference to the regulation should be construed to refer to revised Regulation Z, unless the context indicates that a reference to previous Regulation Z is also intended.

(c) Throughout the commentary, reference to "this section" or "this paragraph" means the section or paragraph in the regulation that is the subject of the comment.

5. *Comment designations.* Each comment in the commentary is identified by a number and the regulatory section or paragraph which it interprets. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. For example, some of the comments to § 226.18(b) are further divided by paragraph, such as Comment 18(b)(1)-1 and Comment 18(b)(2)-1. In other cases, comments have more general application and are designated, for example, as Comment 18-1 or Comment 18(b)-1. This introduction may be cited as Comments I-1 through I-7. The appendices may be cited as Comments App. A-1 through App. J-2.

6. *Cross-references.* The following cross-references to related material appear at the end of each section of the commentary: (a) "Statute"—those sections of the Truth in Lending Act on which the regulatory provision is based (and any other relevant statutes); (b) "Other sections"—other provisions in the regulation necessary to understand that section; (c) "Previous regulation"—parallel provisions in previous Regulation Z; and (d) "1981 changes"—a brief description of the major changes made by the 1981 revisions to Regulation Z. Where appropriate a fifth category ("Other regulations") provides cross-references to other regulations.

7. *Transition rules.* (a) Though compliance with the revised regulation is not mandatory until April 1, 1982, creditors may begin complying as of April 1, 1981. During the intervening year, a creditor may convert its entire operation to the new requirements at one time, or it may convert to the new requirements in stages. In general, however, a creditor may not mix the regulatory requirements when making disclosures for a particular closed-end transaction or open-end account; all the disclosures for a single closed-end transaction (or open-end account) must be made in accordance with the

previous regulation, or all the disclosures must be made in accordance with the revised regulation. As an exception to the general rule, the revised rescission rules and the revised advertising rules may be followed even if the disclosures are based on the previous regulation. For purposes of this regulation, the creditor is not required to take any particular action beyond the requirements of the revised regulation to indicate its conversion to the revised regulation.

(b) The revised regulation may be relied on to determine if any disclosures are required for a particular transaction or to determine if a person is a "creditor" subject to Truth in Lending requirements, whether or not other operations have been converted to the revised regulation. For example, layaway plans are not subject to the revised regulation, nor are oral agreements to lend money if there is no finance charge. These provisions may be relied on even if the creditor is making other disclosures under the previous regulation. The new rules governing whether or not disclosures must be made for refinancings and assumptions are also available to a creditor that has not yet converted its operations to the revised regulation.

(c) In addition to the above rules, applicable to both open-end and closed-end credit, the following guidelines are relevant to open-end credit:

- The creditor need not remake initial disclosures that were made under the previous regulation, even if the revised periodic statements contain terminology that is inconsistent with those initial disclosures.
- A creditor may add inserts to its old open-end forms in order to convert them to the revised rules until such time as the old forms are used up.
- No change-in-terms notice is required for changes resulting from the conversion to the revised regulation.
- The previous billing rights statements are substantially similar to the revised billing rights statements and may continue to be used, except that, if the creditor has an automatic debit program, it must use the revised automatic debit provision.
- For those creditors wishing to use the annual billing rights statement, the creditor may count from the date on which it sent its last statement under the previous regulation in determining when to give the first statement under the new regulation. For example, if the creditor sent a semi-annual

statement in June 1981, and converts to the new regulation in October 1981, the creditor must give the billing rights statement sometime in 1982, and it must not be fewer than 6 nor more than 18 months after the June statement.

- Section 226.11 of the revised regulation affects only credit balances that are created on or after the date the creditor converts the account to the revised regulation.

Subpart A—General

Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability

1(c) Coverage.

1. *Foreign applicability.* Regulation Z applies to all persons (including branches of foreign banks and sellers located in the United States) that extend consumer credit to residents (including resident aliens) of any state as defined in § 226.2. If an account is located in the United States and credit is extended to a U.S. resident, the transaction is subject to the regulation. This will be the case whether or not a particular advance or purchase on the account takes place in the United States and whether or not the extender of credit is chartered or based in the United States or a foreign country. Thus, a U.S. resident's use in Europe of a credit card issued by a bank in the consumer's home town is covered by the regulation. The regulation does not apply to a foreign branch of a U.S. bank when the foreign branch extends credit to a U.S. citizen residing or visiting abroad or to a foreign national abroad.

References

Statute: § 102.

Other sections: None.

Previous regulation: § 226.1.

1981 changes: A discussion of coverage has been added to § 226.1 so that the reader will understand from the start what is subject to the regulation. Language has also been added to explain the reorganization of the regulation into subparts that group together the provisions relating to general matters, open-end credit, closed-end credit, and miscellaneous rules. The provisions on consumer leasing have been issued by the Board as a separate regulation, Regulation M (12 CFR Part 213).

Section 226.2—Definitions and Rules of Construction

2(a) Definitions.

2(a)(2) "Advertisement".

1. *Coverage.* Only commercial messages that promote consumer credit

transactions requiring disclosures are advertisements. Messages inviting, offering, or otherwise announcing generally to prospective customers the availability of credit transactions, whether in visual, oral, or print media, are covered by the regulation. Examples include:

- Messages in a newspaper, magazine, leaflet, promotional flyer, or catalog.
- Announcements on radio, television, or public address system.
- Direct mail literature or other printed material on any exterior or interior sign.
- Point-of-sale displays.
- Telephone solicitations.
- Price tags that contain credit information.
- Letters sent to customers as part of an organized solicitation of business.
- Messages on checking account statements offering auto loans at a stated annual percentage rate.

The term does *not* include:

- Direct personal contacts, such as follow-up letters, cost estimates for individual consumers, or oral or written communication relating to the negotiation of a specific transaction.
- Informational material, for example, interest rate and loan term memos, distributed only to business entities.
- Notices required by federal or state law, if the law mandates that specific information be displayed and only the information so mandated is included in the notice.
- News articles the use of which is controlled by the news medium.
- Market research or educational material that do not solicit business.

2. Persons covered. All "persons" must comply with the advertising provisions in §§ 226.16 and 226.24, not just those that meet the definition of creditor in § 226.2(a)(17). Thus, home builders, merchants, and others who are not themselves creditors must comply with the advertising provisions of the regulation if they advertise consumer credit transactions. However, under § 145 of the act, the owner and the personnel of the medium, in which an advertisement appears, or through which it is disseminated, are not subject to civil liability for violations.

2(a)(3) "Arranger of credit".

1. Coverage. An arranger of credit is an intermediary between the nonprofessional extender of credit and the consumer. There can be an arranger only if the credit arranged involves a finance charge or is payable by written agreement in more than 4 installments and the person actually extending the

credit is someone who does not meet the definition of creditor.

Note.—The Board is considering a regulatory amendment to § 226.2(a)(3) that, if adopted, would clarify the definition of "arranger of credit," particularly with regard to real estate brokers involved with seller-financing of homes.

2. Content of disclosures. If the arranger makes the disclosures, the disclosures should be based on the assumption that the arranger and the nonprofessional extender of credit are the same person. For example, the arranger must disclose that a security interest is being taken if the extender of credit takes a security interest, even if the arranger does not. Similarly, if the extender of credit is a seller, the arranger must make credit sale disclosures.

3. Counting transactions. The definition uses the same numerical tests—25 transactions per year or 5 transactions per year when secured by a dwelling—as does the definition of creditor. See the commentary to § 226.2(a)(17)(i) for illustrations of how to count credit extensions.

4. Attorneys. When an attorney and his or her client are considered the same person (see the commentary to § 226.2(a)(22)), an attorney is not an arranger of credit as to credit extended by the client.

5. Trusts. Since a trust and its trustee are considered the same person (see the commentary to § 226.2(a)(22)), a trustee is not an arranger of credit as to credit extended by the trust. See the commentary to § 226.2(a)(17)(i) for an explanation of when a trust is a creditor.

2(a)(4) "Billing cycle" or "cycle".

1. Intervals. In open-end credit plans, the billing cycle determines the intervals at which periodic disclosure statements must be sent; these intervals are also used as measuring points for other duties of the creditor. Typically, billing cycles are monthly, but they may be more frequent or less frequent (but not less frequent than quarterly).

2. Creditors that do not bill. The term "cycle" is interchangeable with "billing cycle" for definitional purposes, since some creditors' cycles do not involve the sending of bills in the traditional sense but only statements of account activity. This is commonly the case with financial institutions when periodic payments are made through payroll deduction or through automatic debit of the consumer's asset account.

3. Equal cycles. Although cycles must be equal, there is a permissible variance to account for weekends, holidays, and differences in the number of days in months. If the actual date of each

statement does not vary by more than 4 days from a fixed "day" (for example, the third Thursday of each month) or "date" (for example, the 15th of each month) that the creditor regularly uses, the intervals between statements are considered equal. The requirement that cycles be equal applies even if the creditor applies a daily periodic rate to determine the finance charge. The requirement that intervals be equal does not apply to the transitional billing cycle that can occur when the creditor occasionally changes its billing cycles so as to establish a new statement day or date. (See the commentary to § 226.9(c).)

4. Payment reminder. The sending of a regular payment reminder (rather than a late payment notice) establishes a cycle for which the creditor must send periodic statements.

2(a)(6) "Business day".

1. Business function test. Activities that indicate that the creditor is open for substantially all of its business functions include the availability of personnel to make loan disbursements, to open new accounts, and to handle credit transaction inquiries. Activities that indicate that the creditor is not open for substantially all of its business functions include a retailer merely accepting credit cards for purchases or a bank having its customer-service windows open only for limited purposes such as deposits and withdrawals, bill paying, and related services.

2. Rescission rule. A more precise rule for what is a business day (all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a)) applies when the right of rescission is involved.

2(a)(7) "Card issuer".

1. Agent. An agent of a card issuer is considered a card issuer. Because agency relationships are traditionally defined by contract and by state or other applicable law, the regulation does not define agent. Merely providing services relating to the production of credit cards or data processing for others, however, does not make one the agent of the card issuer. In contrast, a financial institution may become the agent of the card issuer if an agreement between the institution and the card issuer provides that the cardholder may use a line of credit with the financial institution to pay obligations incurred by use of the credit card.

2(a)(8) "Cardholder".

1. General rule. A cardholder is a natural person at whose request a card is issued for consumer credit purposes or who is a co-obligor or guarantor for such a card issued to another. The

second category does not include an employee who is a co-obligor or guarantor on a card issued to the employer for business purposes, nor does it include a person who is merely the authorized user of a card issued to another.

2. Limited application of regulation. For the limited purposes of the rules on issuance of credit cards and liability for unauthorized use, a cardholder includes any person, including an organization, to whom a card is issued for any purpose—including a business, agricultural, or commercial purpose.

3. Issuance. See the commentary to § 226.12(a).

4. Dual-purpose cards and dual-card systems. Some card issuers offer dual-purpose cards that are for business as well as consumer purposes. If a card is issued to an individual for consumer purposes, the fact that an organization has guaranteed to pay the debt does not make it business credit. On the other hand, if a card is issued for business purposes, the fact that an individual sometimes uses it for consumer purchases does not subject the card issuer to the provisions on periodic statements, billing error resolution, and other protections afforded to consumer credit. Some card issuers offer dual-card systems—that is, they issue two cards to the same individual, one intended for business use, the other for consumer or personal use. With such a system, the same person may be a cardholder for general purposes when using the card issued for consumer use, and a cardholder only for the limited purposes of the restrictions on issuance and liability when using the card issued for business purposes.

2(a)(9) "Cash price".

1. Components. This amount is a starting point in computing the amount financed and the total sale price under § 226.18 for credit sales. Any charges imposed equally in cash and credit transactions may be included in the cash price, or they may be treated as other amounts financed under § 226.18(b)(2).

2. Service contracts. Service contracts include contracts for the repair or the servicing of goods, such as mechanical breakdown coverage, even if such a contract is characterized as insurance under state law.

3. Rebates. The creditor has complete flexibility in the way it treats rebates for purposes of disclosure and calculation. See the commentary to § 226.18(b).

2(a)(10) "Closed-end credit".

1. General. The coverage of this term is defined by exclusion. That is, it includes any credit arrangement that does not fall within the definition of

open-end credit. Subpart C contains the disclosure rules for closed-end credit when the obligation is subject to a finance charge or is payable by written agreement in more than 4 installments.

2(a)(11) "Consumer".

1. Scope. Guarantors, endorsers, and sureties are not generally consumers for purposes of the regulation, but they may be entitled to rescind under certain circumstances and they may have certain rights if they are obligated on credit card plans.

2. Rescission rules. For purposes of rescission under §§ 226.15 and 226.23, a consumer includes any natural person whose ownership interest in his or her principal dwelling is subject to the risk of loss. Thus, if a security interest is taken in A's ownership interest in a house and that house is A's principal dwelling, A is a consumer for purposes of rescission, even if A is not liable, either primarily or secondarily, on the underlying consumer credit transaction. An ownership interest does not include, for example, leaseholds or inchoate rights, such as dower.

3. Land trusts. Credit extended to land trusts, as described in the commentary to § 226.3(a), is considered to be extended to a natural person for purposes of the definition of consumer.

2(a)(12) "Consumer credit".

1. Primary purpose. There is no precise test for what constitutes credit offered or extended for personal, family, or household purposes, nor for what constitutes the primary purpose. See, however, the discussion of business purposes in the commentary to § 226.3(a).

2(a)(13) "Consummation".

1. State law governs. When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination. Consummation does not occur merely because the consumer has made some financial investment in the transaction (for example, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise.

2. Credit v. sale. Consummation does not occur when the consumer becomes contractually committed to a sale transaction, unless the consumer also becomes legally obligated to accept a particular credit arrangement. For example, when a consumer pays a nonrefundable deposit to purchase an automobile, a purchase contract may be created, but consummation for purposes of the regulation does not occur unless the consumer also contracts for financing at that time.

2(a)(14) "Credit".

1. Exclusions. The following situations are not considered credit for purposes of the regulation:

- Layaway plans, unless the consumer is contractually obligated to continue making payments. Whether the consumer is so obligated is a matter to be determined under applicable law. The fact that the consumer is not entitled to a refund of any amounts paid towards the cash price of the merchandise does not bring layaways within the definition of credit.
- Tax liens, tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy. However, third-party financing of such obligations (for example, a bank loan obtained to pay off a tax lien) is credit for purposes of the regulation.
- Insurance premium plans that involve payment in installments with each installment representing the payment for insurance coverage for a certain future period of time, unless the consumer is contractually obligated to continue making payments.
- Home improvement transactions that involve progress payments, if the consumer pays, as the work progresses, only for work completed and has no contractual obligation to continue making payments.
- "Borrowing" against the accrued cash value of an insurance policy or a pension account, if there is no independent obligation to repay.
- Letters of credit.
- The execution of option contracts. However, there may be an extension of credit when the option is exercised, if there is an agreement at that time to defer payment of a debt.
- Investment plans in which the party extending capital to the consumer risks the loss of the capital advanced. This includes, for example, an arrangement with a home purchaser in which the investor pays a portion of the downpayment and of the periodic mortgage payments in return for an ownership interest in the property, and shares in any gain or loss of property value.
- Mortgage assistance plans administered by a government agency in which a portion of the consumer's monthly payment amount is paid by the agency. No finance charge is imposed on the subsidy amount and that amount is due in a lump-sum payment on a set

date or upon the occurrence of certain events. (If payment is not made when due, a new note imposing a finance charge may be written, which may then be subject to the regulation.)

2(a)(15) "Credit card".

1. *Usable from time to time.* A credit card must be usable from time to time. Since this involves the possibility of repeated use of a single device, checks and similar instruments that can be used only once to obtain a single credit extension are not credit cards.

2. *Examples.* Examples of credit cards include:

- A card that guarantees checks or similar instruments, if the asset account is also tied to an overdraft line or if the instrument directly accesses a line of credit.
- A card that accesses both a credit and an asset account (that is, a debit-credit card).
- An identification card that permits the consumer to defer payment on a purchase.
- An identification card indicating loan approval that is presented to a merchant or to a lender, whether or not the consumer signs a separate promissory note for each credit extension.

In contrast, credit card does not include, for example, a check guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft.

2(a)(16) "Credit sale".

1. *Special disclosure.* If the seller is a creditor in the transaction, the transaction is a credit sale and the special credit sale disclosures (that is, the disclosures under § 226.18(j)) must be given. This applies even if there is more than one creditor in the transaction and the creditor making the disclosures is not the seller. See the commentary to § 226.17(d).

2. *Sellers who arrange credit.* If the seller of the property or services involved arranged for financing but is not a creditor as to that sale, the transaction is not a credit sale. Thus, if a seller assists the consumer in obtaining a direct loan from a financial institution and the consumer's note is payable to the financial institution, the transaction is a loan and only the financial institution is a creditor.

3. *Refinancings.* Generally, when a credit sale is refinanced within the meaning of § 226.20(a), loan disclosures should be made. However, if a new sale of goods or services is also involved, the transaction is a credit sale.

4. *Incidental sales.* Some lenders "sell" a product or service—such as

credit, property, or health insurance—as part of a loan transaction. Section 226.4 contains the rules on whether the cost of credit life, disability or property insurance is part of the finance charge. If the insurance is financed, it may be disclosed as a separate credit sale transaction or disclosed as part of the primary transaction; if the latter approach is taken, either loan or credit sale disclosures may be made. See the commentary to § 226.17(c)(1) for further discussion of this point.

5. *Credit extensions for educational purposes.* A credit extension for educational purposes in which an educational institution is the creditor may be treated as either a credit sale or a loan, regardless of whether the funds are given directly to the student, credited to the student's account, or disbursed to other persons on the student's behalf. The disclosure of the total sale price need not be given if the transaction is treated as a loan.

2(a)(17) "Creditor".

1. *General.* The definition contains 5 independent tests. If any one of the tests is met, the person is a creditor for purposes of that particular test.

Paragraph 2(a)(17)(i).

1. *Prerequisites.* This test is composed of 2 requirements, both of which must be met in order for a particular credit extension to be subject to the regulation and for the credit extension to count towards satisfaction of the numerical tests mentioned in footnote 3 to § 226.2(a)(17). *First*, there must be either or both of the following:

- A written (rather than oral) agreement to pay in more than 4 installments. A letter that merely confirms an oral agreement does not constitute a written agreement for purposes of the definition.
- A finance charge imposed for the credit. The obligation to pay the finance charge need not be in writing.

Second, the obligation must be payable to the person in order for that person to be considered a creditor. If an obligation is made payable to "bearer," the creditor is the one who initially accepts the obligation.

2. *Assignees.* If an obligation is initially payable to one person, that person is the creditor even if the obligation by its terms is simultaneously assigned to another person. For example:

- An auto dealer and a bank have a business relationship in which the bank supplies the dealer with credit sale contracts that are initially made payable to the dealer and provide for the immediate

assignment of the obligation to the bank. The dealer and purchaser execute the contract only after the bank approves the creditworthiness of the purchaser. Because the obligation is initially payable on its face to the dealer, the dealer is the only creditor in the transaction.

3. *Numerical tests.* The examples below illustrate how the numerical tests of footnote 3 are applied. The examples assume that consumer credit with a finance charge or written agreement for more than 4 installments was extended in the years in question and that the person did not extend such credit in 1982.

4. *Counting transactions.* For purposes of closed-end credit, the creditor counts each credit transaction. For open-end credit, "transactions" means accounts, so that outstanding accounts are counted instead of individual credit extensions. Normally the number of transactions is measured by the preceding calendar year; if the requisite number is met, then the person is a creditor for all transactions in the current year. However, if the person did not meet the test in the preceding year, the number of transactions is measured by the current calendar year. For example, if the person extends consumer credit 26 times in 1983, it is a creditor for purposes of the regulation for the last extension of credit in 1983 and for all extensions of consumer credit in 1984. On the other hand, if a business begins in 1983 and extends consumer credit 20 times, it is not a creditor for purposes of the regulation in 1983. If the extends consumer credit 75 times in 1984, however, it becomes a creditor for purposes of the regulation (and must begin making disclosures) after the 25th extension of credit in that year and is a creditor for all extensions of consumer credit in 1985.

5. *Relationship between consumer credit in general and credit secured by a dwelling.* Extensions of credit secured by a dwelling are counted towards the 25-extensions test. For example, if in 1983 a person extends unsecured consumer credit 23 times and consumer credit secured by a dwelling twice, it becomes a creditor for the succeeding extensions of credit, whether or not they are secured by a dwelling. On the other hand, extensions of consumer credit not secured by a dwelling are *not* counted towards the number of credit extensions secured by a dwelling. For example, if in 1983 a person extends credit not secured by a dwelling 8 times and credit secured by a dwelling 3 times, it is not a creditor.

6. *Effect of satisfying one test.* Once one of the numerical tests is satisfied,

the person is also a creditor for the other type of credit. For example, in 1983 a person extends consumer credit secured by a dwelling 5 times. That person is a creditor for all succeeding credit extensions, whether they involve credit secured by a dwelling or not.

7. *Trusts.* In the case of credit extended by trusts, each individual trust is considered a separate entity for purposes of applying the criteria. For example:

- A bank is the trustee for 3 trusts: Trust A makes 15 extensions of consumer credit annually; Trust B makes 10 extensions of consumer credit annually; and Trust C makes 30 extensions of consumer credit annually. Only Trust C is a creditor for purposes of the regulation.

With regard to the trustee's status, see the commentary to § 226.2(a)(3).

Paragraph 2(a)(17)(ii).

1. *Arranger of credit.* A person who is an arranger of credit under § 226.2(a)(3) is a creditor. The disclosures made by the arranger should be based on the assumption that the arranger and the non-professional extender of credit are the same person. See the commentary to § 226.3(a)(3).

Paragraph 2(a)(17)(iv).

1. *Card issuers subject to Subpart B.* Section 226.2(a)(17)(iv) makes certain card issuers creditors for purposes of the open-end credit provisions of the regulation. This includes, for example, the issuers of so-called travel and entertainment cards that expect repayment at the first billing and do not impose a finance charge. Since all disclosures are to be made only as applicable, such card issuers would omit finance charge disclosures. Other provisions of the regulation regarding such areas as scope, definitions, determination of which charges are finance charges, Spanish language disclosures, record retention, and use of model forms, also apply to such card issuers.

Paragraph 2(a)(17)(v).

1. *Card issuers subject to Subparts B and C.* Section 226.2(a)(17)(v) includes as creditors card issuers extending closed-end credit in which there is a finance charge or an agreement to pay in more than 4 installments. These card issuers are subject to the appropriate provisions of Subparts B and C, as well as to the general provisions.

2(a)(18) "Downpayment".

1. *Allocation.* If a consumer makes a lump-sum payment, partially to reduce the cash price and partially to pay prepaid finance charges, only the portion attributable to reducing the cash price is part of the downpayment.

2. *Pick-up payments.* Creditors may treat the deferred portion of the downpayment, often referred to as "pick-up payments," in a number of ways. If the pick-up payment is treated as part of the downpayment:

- It is subtracted in arriving at the amount financed under § 226.18(b).
- It may, but need not, be reflected in the payment schedule under § 226.18(g).

If the pick-up payment does not meet the definition (for example, if it is payable after the second regularly scheduled payment) or if the creditor chooses not to treat it as part of the downpayment:

- It must be included in the amount financed.
- It must be shown in the payment schedule.

Whichever way the pick-up payment is treated, the total of payments under § 226.18(h) must equal the sum of the payments disclosed under § 226.18(g).

2(a)(19) "Dwelling".

1. *Scope.* A dwelling need not be the consumer's principal residence to fit the definition and thus a vacation or second home could be a dwelling. However, for purposes of the definition of residential mortgage transaction and the right to rescind, a dwelling must be the principal residence of the consumer. See the commentary to §§ 226.2(a)(24), 226.15, and 226.23.

2. *Use as a residence.* Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

3. *Relation to exemptions.* Any transaction involving a security interest in a consumer's principal dwelling (as well as in any real property) remains subject to the regulation despite the general exemption in § 226.3(b) for credit extensions over \$25,000.

2(a)(20) "Open-end credit".

1. *General.* This definition describes the characteristics of open-end credit (for which the applicable disclosure and other rules are contained in Subpart B), as distinct from closed-end credit. Open-end credit is consumer credit that is extended under a plan and meets all 3 criteria set forth in the definition.

2. *Existence of a plan.* The definition requires that there be a plan, which connotes a contractual arrangement between the creditor and the consumer. Some creditors offer programs containing a number of different credit features. The consumer has a single account with the institution that can be accessed repeatedly via a number of

sub-accounts established for the different program features and rate structures. Some features of the program might be used repeatedly (for example, an overdraft line) while others might be used infrequently (such as the part of the credit line available for secured credit). If the program as a whole is subject to prescribed terms and otherwise meets the definition of open-end credit, such a program would be considered a single, multi-featured plan.

3. *Repeated transactions.* Under this criterion, the creditor must reasonably contemplate repeated transactions. This means that the credit plan must be usable from time to time and the creditor must legitimately expect that there will be repeat business rather than a one-time credit extension. The creditor must expect repeated dealings with the consumer under the credit plan as a whole, and need not believe the consumer will reuse a particular feature of the plan. A standard based on reasonable belief by a creditor necessarily includes some margin for judgmental error. The fact that a particular consumer does not return for further credit extensions does not prevent a plan from having been properly characterized as open-end. For example, if much of the customer base of a clothing store makes repeat purchases, the fact that some consumers only use the plan once would not affect the characterization of the store's plan as open-end credit. The criterion regarding repeated transactions is a question of fact to be decided in the context of the creditor's type of business and the creditor's relationship with the consumer. For example:

- It would be more reasonable for a thrift institution chartered for the benefit of its members to contemplate repeated transactions with a member, than for a seller of aluminum siding to make the same assumption about its customers.
- It would be more reasonable for a bank to make advances from a line of credit for the purchase of an automobile than for an automobile dealer to sell a car under an open-end plan.

4. *Finance charge on an outstanding balance.* The requirement that a finance charge may be computed and imposed from time to time on the outstanding balance means that there is no specific amount financed for the plan for which the finance charge, total of payments, and payment schedule can be calculated. A plan does not meet this criterion if there is no possibility that a periodic finance charge will be imposed

on the outstanding balance. Some plans, such as certain "china club" plans, feature free-ride periods if the consumer pays all or a specified portion of the outstanding balance within a given time period. For example, the creditor might not impose finance charges in any month in which the consumer pays $\frac{1}{10}$ of the balance. Thus, a plan could meet this finance charge criterion even though the consumer actually pays no finance charges during the existence of the plan because the consumer takes advantage of the option to pay the balance (either in its entirety or in installments) within the time necessary to avoid finance charges.

5. *Reusable line.* The total amount of credit that may be extended during the existence of an open-end plan is unlimited because available credit is generally replenished as earlier advances are repaid. A line of credit is self-replenishing even though the plan itself has a fixed expiration date, as long as during the plan's existence the consumer may use the line, repay, and reuse the credit without specific approval for each extension (beyond verification, for example, of credit information such as the consumer's continued income and employment status or of information for security purposes). This criterion of unlimited credit distinguishes open-end credit from a series of advances made pursuant to a closed-end credit loan commitment. For example:

- Under a closed-end commitment, the creditor might agree to lend a total of \$10,000 in a series of advances as needed by the consumer. When a consumer has borrowed the full \$10,000, no more is advanced under that particular agreement, even if there has been repayment of a portion of the debt.

This criterion does not mean that the creditor must establish a specific credit limit for the line of credit or that the line of credit must always be replenished to its original amount. The creditor may reduce a credit limit or refuse to extend new credit in a particular case due to changes in the economy, the creditor's financial condition, or the consumer's creditworthiness. While consumers should have a reasonable expectation of obtaining credit as long as they remain current and within any preset credit limits, further extensions of credit need not be an absolute right in order for the plan to meet the self-replenishing criterion.

6. *Open-end real estate mortgages.* Some credit plans call for negotiated advances under so-called open-end real estate mortgages. Each such plan must

be independently measured against the definition of open-end credit, regardless of the terminology used in the industry to describe the plan. The fact that a particular plan is called an open-end real estate mortgage, for example, does not, by itself, mean that it is open-end credit under the regulation.

2(a)(21) "Periodic rate".

1. *Basis.* The periodic rate may be stated as a percentage (for example, $1\frac{1}{2}\%$ per month) or as a decimal equivalent (for example, .015 monthly). It may be based on any portion of a year the creditor chooses. Some creditors use $\frac{1}{360}$ of an annual rate as their periodic rate. These creditors:

- May disclose a $\frac{1}{360}$ rate as a "daily" periodic rate, without further explanation, if it is in fact only applied 360 days per year. But if the creditor applies that rate for 365 days, the creditor must note that fact and, of course, disclose the true annual percentage rate.
- Would have to apply the rate to the balance to disclose the annual percentage rate with the degree of accuracy required in the regulation (that is, within $\frac{1}{8}$ of 1 percentage point of the rate based on the actual 365 days in the year).

2. *Transaction charges.* "Periodic rate" does not include initial one-time transaction charges, even if the charge is computed as a percentage of the transaction amount.

2(a)(22) "Person".

1. *Joint ventures.* A joint venture is an organization and is therefore a person.

2. *Attorneys.* An attorney and his or her client are considered to be the same person for purposes of this regulation when the attorney is acting within the scope of the attorney-client relationship with regard to a particular transaction.

3. *Trusts.* A trust and its trustee are considered to be the same person for purposes of this regulation.

2(a)(23) "Prepaid finance charge".

1. *General.* Prepaid finance charges must be taken into account under § 226.18(b) in computing the disclosed amount financed, and must be disclosed if the creditor provides an itemization of the amount financed under § 226.18(c).

2. *Examples.* Common examples of prepaid finance charges include:

- Buyer's points.
- Service fees.
- Loan fees.
- Finder's fees.
- Loan guarantee insurance.
- Credit investigation fees.

However, in order for these or any other finance charges to be considered prepaid, they must either be paid separately in cash or check or withheld from the proceeds.

3. *Exclusions.* "Add-on" and "discount" finance charges are not prepaid finance charges for purposes of this regulation. Finance charges are not "prepaid" merely because they are precomputed, whether or not a portion of the charge will be rebated to the consumer upon prepayment. See the commentary to § 226.18(b).

2(a)(24) "Residential mortgage transaction".

1. *Relation to other sections.* This term is important in 5 provisions in the regulation:

- Section 226.4(c)(7)—exclusions from the finance charge.
- Section 226.15(f)—exemption from the right of rescission.
- Section 226.18(q)—whether or not the obligation is assumable.
- Section 226.19—special timing rules.
- Section 226.23(f)—exemption from the right of rescission.

2. *Lien status.* The definition is not limited to first lien transactions. For example, a consumer might assume a paid-down first mortgage (or borrow part of the purchase price) and borrow the balance of the purchase price from a creditor who takes a second mortgage. The second mortgage transaction is a "residential mortgage transaction" if the dwelling purchased is the consumer's principal residence.

3. *Principal dwelling.* A consumer can only have one principal dwelling at a time. Thus, a vacation or other second home would not be a principal dwelling. However, if a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within a year or upon the completion of construction, the new dwelling is considered the principal dwelling for purposes of applying this definition to a particular transaction. See the commentary to §§ 226.15(a) and 226.23(a).

4. *Construction financing.* If a transaction meets the definition of a residential mortgage transaction and the creditor chooses to disclose it as several transactions under § 226.17(c)(6), each one is considered to be a residential mortgage transaction, even if different creditors are involved. For example:

- The creditor makes a construction loan to finance the initial construction of the consumer's principal dwelling, and the loan will be disbursed in 5 advances. The creditor gives 6 sets of disclosures (5 for the construction phase and 1 for the permanent phase). Each one is a residential mortgage transaction.
- One creditor finances the initial construction of the consumer's

principal dwelling and another creditor makes a loan to satisfy the construction loan and provide permanent financing. Both transactions are residential mortgage transactions.

2(a)(25) "Security interest".

1. *Threshold test.* The threshold test is whether a particular interest in property is recognized as a security interest under applicable law. The regulation does not determine whether a particular interest is a security interest under applicable law. If the creditor is unsure whether a particular interest is a security interest under applicable law (for example, if statutes and case law are either silent or inconclusive on the issue), the creditor may at its option consider such interests as security interests for Truth in Lending purposes. However, the regulation and the commentary do exclude specific interests, such as after-acquired property and accessories, from the scope of the definition regardless of their categorization under applicable law, and these named exclusions may not be disclosed as security interests under the regulation.

2. *Exclusions.* The general definition of security interest excludes three groups of interests: incidental interests, interests in after-acquired property, and interests that arise solely by operation of law. These interests may not be disclosed with the disclosures required under § 226.18, but the creditor is not precluded from preserving these rights elsewhere in the contract documents, or invoking and enforcing such rights, if it is otherwise lawful to do so.

3. *Incidental interests.* Incidental interests in property that are not security interests include, among other things:

- Assignment of rents.
- Right to condemnation proceeds.
- Interests in accessories and replacements.
- Interests in escrow accounts, such as for taxes and insurance.
- Waiver of homestead or personal property rights.

The notion of an "incidental interest" does not encompass an explicit security interest in an insurance policy if that policy is the primary collateral for the transaction—for example, in an insurance premium financing transaction.

4. *Operation of law.* Interests that arise solely by operation of law are excluded from the general definition. Also excluded are interests arising by operation of law that are merely repeated or referred to in the contract. However, if the creditor has an interest

that arises by operation of law, such as a vendor's lien, and takes an independent security interest in the same property, such as a UCC security interest, the latter interest is a disclosable security interest unless otherwise provided.

5. *Rescission rules.* Security interests that arise solely by operation of law are security interests for purposes of rescission. Examples of such interests are mechanics' and materialmen's liens.

2(b) Rules of construction.

1. *Footnotes.* Footnotes are used extensively in the regulation to provide special exceptions and more detailed explanations and examples. Material that appears in a footnote has the same legal weight as material in the body of the regulation.

References

Statute: Sec. 103.

Other sections: None.

Other regulations: Regulation E (12 CFR 205.2(d)).

Previous regulation: §§ 226.2, 226.8, and 226.9.

1981 changes: Section 226.2 implements amended § 103 of the act. Separate definitions for "comparative index of credit cost," "discount," "organization," "period," "real property," "real property transaction," "regular price," and "surcharge" have been deleted. The definitions relating specifically to consumer leases are now found in the separate consumer leasing regulation, Regulation M (12 CFR Part 213).

Several terms are now defined elsewhere in the regulation or commentary rather than in § 226.2. For example, "finance charge" is described and explained in § 226.4, and "agricultural purpose" is discussed in the commentary to § 226.3. Some terms, such as "unauthorized use," are now defined as part of the substantive sections to which they apply. Other terms previously defined, such as customer "organization," are merged into new definitions. Section 226.2 contains new definitions for "arranger of credit," "business day," "closed-end credit," "consumer," "consummation," "downpayment," "prepaid finance charge," and "residential mortgage transaction."

The major changes in the definitions are as follows:

"Arranger of credit" has a significantly different meaning. It reflects the statutory amendment that limits "arrangers" to those who regularly arrange credit extensions for persons who are not themselves creditors.

"Billing cycle" largely restates the prior definition, but requires cycles to be regular, and allows the four-day variance to be measured from a regular day as well as date. The definition also incorporates an interpretation that cycles may be no longer than quarterly.

"Business day" is new in the sense that the term previously appeared only in a footnote to the rescission provision, but it is now of general applicability.

The general rule that it is a day when the creditor is open for business is new, but the rule for rescission purposes is the same as in the previous regulation.

"Cash price" now explicitly permits inclusion of various incidental charges imposed equally in cash and credit transactions.

"Consumer" has a narrower meaning in that guarantors, sureties, and endorsers are excluded from the general definition.

"Consumer credit" reflects the new statutory exemption for agricultural credit.

"Consummation" is a significant departure from longstanding interpretations of the previous definition. It now focuses only on the time the consumer becomes contractually obligated, rather than the time the consumer pays a nonrefundable fee or suffers an economic penalty for failing to go forward with the credit transaction.

"Credit" generally parallels the previous definition, but modifies the previous interpretations of the definition by excluding more transactions.

"Creditor" reflects the statutory amendments to the act that were intended to eliminate the problem of multiple creditors in a transaction. The "regularly" standard is still used, but it is now defined in terms of the frequency of the credit extensions. The new definition also requires that there be a *written* agreement to pay in more than 4 installments if no finance charge is imposed. Finally, the obligation must be initially payable to a person for that person to be the creditor.

"Dwelling" reflects the statutory amendment that expanded the scope of the definition to include *any* residential structure, whether or not it is real property under state law.

"Open-end credit" reflects the amended statutory definition requiring that the creditor reasonably contemplate repeated transactions. The new definition no longer requires the consumer to have the privilege of paying either in installments or in full.

"Periodic rate" combines the previous definitions of "period" and "periodic rate" with clarification in the

commentary concerning transaction charges and 360-day-year factors.

"Security interest" is much narrower than the previous definition. Reflecting the legislative history of the simplification amendments, incidental interests are expressly excluded from the definition. Except for purposes of rescission, interests that arise solely by operation of law are also excluded.

Section 226.3—Exempt Transactions

3(a) Business, commercial, agricultural, or organizational credit.

1. *Primary purposes.* A creditor must determine in each case if the transaction is primarily for an exempt purpose. If some question exists as to the primary purpose for a credit extension, the creditor is, of course, free to make the disclosures, and the fact that disclosures are made under such circumstances is not controlling on the question of whether the transaction was exempt.

2. *Factors.* In determining whether credit to finance an acquisition—such as securities, antiques, or art—is primarily for business or commercial purposes (as opposed to a consumer purpose), the following factors should be considered:

- The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.
- The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.
- The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.
- The size of the transaction. The larger the transaction, the more likely it is to be business purpose.
- The borrower's statement of purpose for the loan.

Examples of business-purpose credit include:

- A loan to expand a business, even if it is secured by the borrower's residence or personal property.
- A loan to improve a principal residence by putting in a business office.
- A business account used occasionally for consumer purposes.

Examples of consumer-purpose credit include:

- Credit extensions by a company to its employees or agents if the loans are used for personal purposes.
- A loan secured by a mechanic's tools to pay a child's tuition.
- A personal account used

occasionally for business purposes.

3. *Non-owner-occupied rental property.* Credit extended to acquire, improve, or maintain rental property (regardless of the number of housing units) that is not owner-occupied is deemed to be for business purposes. This includes, for example, the acquisition of a warehouse that will be leased or a single-family house that will be rented to another person to live in. If the owner expects to occupy the property for more than 14 days during the coming year, the property cannot be considered non-owner-occupied and this special rule will not apply. For example, a beach house that the owner will occupy for a month in the coming summer and rent out the rest of the year is owner occupied and is not governed by this special rule. See Comment 3(a)-4, however, for rules relating to owner-occupied rental property.

4. *Owner-occupied rental property.* If credit is extended to acquire, improve, or maintain rental property that is or will be owner-occupied within the coming year, different rules apply:

- Credit extended to acquire the rental property is deemed to be for business purposes if it contains more than 2 housing units.
- Credit extended to improve or maintain the rental property is deemed to be for business purposes if it contains more than 4 housing units. Since the amended statute defines "dwelling" to include 1 to 4 housing units, this rule preserves the right of rescission for credit extended for purposes other than acquisition.

Neither of these rules means that an extension of credit for property containing fewer than the requisite number of units is necessarily consumer credit. In such cases, the determination of whether it is business or consumer credit should be made by considering the factors listed in Comment 3(a)-2.

5. *Business credit later refinanced.* Business-purpose credit that is exempt from the regulation may later be rewritten for consumer purposes. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor.

6. *Agricultural purpose.* An "agricultural purpose" includes the planting, propagating, nurturing, harvesting, catching, storing, exhibiting, marketing, transporting, processing, or manufacturing of food, beverages (including alcoholic beverages), flowers, trees, livestock, poultry, bees, wildlife,

fish, or shellfish by a natural person engaged in farming, fishing, or growing crops, flowers, trees, livestock, poultry, bees, or wildlife. The exemption also applies to a transaction involving real property that includes a dwelling (for example, the purchase of a farm with a homestead) if the transaction is primarily for agricultural purposes.

7. *Organizational credit.* The exemption for transactions in which the borrower is not a natural person applies, for example, to loans to corporations, partnerships, associations, churches, unions, and fraternal organizations. The exemption applies regardless of the purpose of the credit extension and regardless of the fact that a natural person may guarantee or provide security for the credit.

8. *Land trusts.* Credit extended for consumer purposes to a land trust is considered to be credit extended to a natural person rather than credit extended to an organization. In some jurisdictions, a financial institution financing a residential real estate transaction for an individual uses a land trust mechanism. Title to the property is conveyed to the land trust for which the financial institution itself is trustee. The underlying installment note is executed by the financial institution in its capacity as trustee and payment is secured by a trust deed, reflecting title in the financial institution as trustee. In some instances, the consumer executes a personal guaranty of the indebtedness. The note provides that it is payable only out of the property specifically described in the trust deed and that the trustee has no personal liability on the note. Assuming the transactions are for personal, family, or household purposes, these transactions are subject to the regulation since in substance (if not form) consumer credit is being extended.

3(b) Credit over \$25,000 not secured by real property or a dwelling.

1. *Coverage.* Since a mobile home can be a dwelling under § 226.2(a)(19), this exemption does not apply to a credit extension secured by a mobile home used or expected to be used as the principal dwelling of the consumer, even if the credit exceeds \$25,000. A loan commitment for closed-end credit in excess of \$25,000 is exempt even though the amounts actually drawn never actually reach \$25,000.

2. *Open-end credit.* An open-end credit plan is exempt under § 226.3(b) (unless secured by real property or personal property used or expected to be used as the consumer's principal dwelling) if either of the following conditions is met:

- The creditor makes a firm

commitment to lend over \$25,000 with no requirement of additional credit information for any advances.

- The initial extension of credit on the line exceeds \$25,000.

3. *Refinanced obligations.* A closed-end loan for over \$25,000 may later be rewritten for less than \$25,000 or a security interest in real property may be added to an extension of credit for over \$25,000. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor.

3(c) *Public utility credit.*

1. *Examples.* Examples of public utility services include:

- Gas, water, or electrical services.
- Cable television services.
- Installation of new sewer lines, water lines, conduits, telephone poles, or metering equipment in an area not already serviced by the utility.

The exemption does *not* apply to extensions of credit, for example:

- To purchase appliances such as gas or electric ranges, grills, or telephones.
- To finance home improvements such as new heating or air conditioning systems.

3(d) *Securities or commodities accounts.*

1. *Coverage.* This exemption does not apply to a transaction with a broker registered solely with the state, or to a separate credit extension in which the proceeds are used to purchase securities.

3(e) *Home fuel budget plans.*

1. *Definition.* Under a typical home fuel budget plan, the fuel dealer estimates the total cost of fuel for the season, bills the customer for an average monthly payment, and makes an adjustment in the final payment for any difference between the estimated and the actual cost of the fuel. Fuel is delivered as needed, no finance charge is assessed, and the customer may withdraw from the plan at any time. Under these circumstances, the arrangement is exempt from the regulation, even if a charge to cover the billing costs is imposed.

References

Statute: Secs. 103 (s) and (t) and 104.

Other sections: § 226.12 (a) and (b).

Previous regulation: § 226.3 and

Interpretations §§ 226.301 and 226.302.

1981 changes: The business credit exemption has been expanded to include credit for agricultural purposes. The rule of Interpretation § 226.302,

concerning credit relating to structures containing more than 4 housing units, has been modified and somewhat expanded by providing more exclusions for transactions involving rental property.

The exemption for transactions above \$25,000 secured by real estate has been narrowed; all transactions secured by the consumer's principal dwelling (even if not considered real property) are now subject to the regulation.

The public utility exemption now covers the financing of the extension of a utility into an area not earlier served by the utility, in addition to the financing of services.

The securities credit exemption has been extended to broker-dealers registered with the CFTC as well as the SEC.

A new exemption has been created for home fuel budget plans.

Section 226.4—*Finance Charge*

4(a) *Definition.*

1. *Charges in comparable cash transactions.* Charges imposed uniformly in cash and credit transactions are not finance charges. In determining whether an item is a finance charge, the creditor should compare the credit transaction in question with a similar cash transaction. A creditor financing the sale of property or services may compare charges with those payable in a similar cash transaction by the seller of the property or service. For example, the following items are not finance charges:

- Taxes, license fees, or registration fees paid by both cash and credit customers.
- Discounts that are available to cash and credit customers, such as quantity discounts.
- Discounts available to a particular group of consumers because they meet certain criteria, such as being members of an organization or having accounts at a particular financial institution. This is the case even if an individual must pay cash to obtain the discount, provided credit customers who are members of the group and don't qualify for the discount pay no more than the non-member cash customers.
- Charges for a service policy, auto club membership, or policy of insurance against latent defects offered to or required of both cash and credit customers for the same price.

In contrast, the following items are finance charges:

- Inspection and handling fees for the staged disbursement of construction

loan proceeds.

- Fees for preparing a Truth in Lending disclosure statement.
- Charges for a required maintenance or service contract imposed only in a credit transaction.

If the charge in a credit transaction exceeds the charge imposed in a comparable cash transaction, only the difference is a finance charge. For example:

- If an escrow agent is used in both cash and credit sales of real estate and the agent's charge is \$100 in a cash transaction and \$150 in a credit transaction, only \$50 is a finance charge.

2. *Costs of doing business.* Charges absorbed by the creditor as a cost of doing business are not finance charges, even though the creditor may take such costs into consideration in determining the interest rate to be charged or the cash price of the property or service sold. However, if the creditor separately imposes a charge on the consumer to cover certain costs, the charge is a finance charge if it otherwise meets the definition. For example:

- A discount imposed on a credit obligation when it is assigned by a seller-creditor to another party is not a finance charge as long as the discount is not separately imposed on the consumer. (See § 226.4(b)(6).)

3. *Charges by third parties.* Charges imposed by someone other than the creditor for services that are not required by the creditor are not finance charges. For example:

- A fee charged by a loan broker to a consumer, provided the creditor does not require the use of a broker (even if the creditor knows of the loan broker's involvement or compensates the loan broker).
- A tax imposed by a state or other governmental body on the credit transaction that is payable by the consumer (even if the tax is collected by the creditor).

4. *Forfeitures of interest.* If the creditor reduces the interest rate it pays or stops paying interest on the consumer's deposit account or any portion of it for the term of a credit transaction (including, for example, an overdraft on a checking account or a loan secured by a certificate of deposit), the interest lost is a finance charge. (See the commentary to § 226.4(c)(6).) For example:

- A consumer borrows \$5,000 for 90 days and secures it with a \$10,000 certificate of deposit paying 15% interest. The creditor charges the

consumer and interest rate of 6% on the loan and stops paying interest on \$5,000 of the \$10,000 certificate for the term of the loan. The interest lost is a finance charge and must be reflected in the annual percentage rate on the loan.

However, the consumer must be entitled to the interest that is not paid in order for the lost interest to be a finance charge. For example:

- A consumer wishes to buy from a financial institution a \$10,000 certificate of deposit paying 15% interest but has only \$4,000. The financial institution offers to lend the consumer \$6,000 at an interest rate of 6%, but will pay the 15% interest only on the amount of the consumer's deposit, \$4,000. The creditor's failure to pay interest on the \$6,000 does not result in an additional finance charge on the extension of credit, provided the consumer is entitled by the deposit agreement with the financial institution to interest only on the amount of the consumer's deposit.
- A consumer enters into a combined time deposit/credit agreement with a financial institution that establishes a time deposit account and an open-end line of credit. The line of credit may be used to borrow against the funds in the time deposit. The agreement provides for an interest rate on any credit extension of, for example, 1%. In addition, the agreement states that the consumer will pay 0% interest on the amount of the time deposit that corresponds to the amount of the credit extension(s). The interest that is not paid on the time deposit by the financial institution is not a finance charge (and therefore does not affect the annual percentage rate computation).

4(b) Examples of finance charges.

1. Relationship to other provisions.

Charges or fees shown as examples of finance charges in § 226.4(b) may be excludable under § 226.4(c), (d), or (e). For example:

- Premiums for credit life insurance, shown as an example of a finance charge under § 226.4(b)(7), may be excluded if the requirements of § 226.4(d)(1) are met.
- Appraisal fees mentioned in § 226.4(b)(4) are excluded for real property or residential mortgage transactions under § 226.4(c)(7).

Paragraph 4(b)(2).

1. *Checking account charges.* The checking or transaction account charges discussed in § 226.4(b)(2) include, for example, the following situations:

- An account with an overdraft line of credit incurs a \$4.50 service charge while an account without a credit feature has a \$2.50 service charge; the \$2.00 difference is a finance charge. If the difference is not related to account activity, however, it may be excludable as a participation fee. (See the commentary to § 226.4(c)(4).)
- A service charge of \$5.00 for each item that triggers an overdraft credit line is a finance charge. However, a charge imposed uniformly for any item that overdraws a checking account, regardless of whether the items are paid or returned and whether the account has a credit feature or not, is not a finance charge.

Paragraph 4(b)(3).

1. *Assumption fees.* The assumption fees mentioned in § 226.4(b)(3) are finance charges only when the assumption occurs and the fee is imposed on the new buyer. The assumption fee is a finance charge in the new buyer's transaction.

Paragraph 4(b)(5).

1. *Credit loss insurance.* Common examples of the insurance against credit loss mentioned in § 226.4(b)(5) are mortgage guaranty insurance, holder in due course insurance, and repossession insurance. Such premiums must be included in the finance charge only for the period that the creditor requires the insurance to be maintained.

Paragraphs 4(b)(7) and (8).

1. *Pre-existing insurance policy.* The insurance discussed in § 226.4(b)(7) and (8) does not include an insurance policy (such as a life or an automobile collision insurance policy) that is already owned by the consumer, even if the policy is assigned to or otherwise made payable to the creditor to satisfy an insurance requirement. Such a policy is not "written in connection with" the transaction, as long as the insurance was not purchased for use in that credit extension, since it was previously owned by the consumer.

2. *Insurance written after consummation.* In closed-end credit transactions, insurance sold after consummation is not "written in connection with" the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because the consumer requests insurance after consummation (although credit sale disclosures may be required for the insurance if it is financed).

3. *Substitution of life insurance.* The premium for a life insurance policy

purchased and assigned to satisfy a credit life insurance requirement must be included in the finance charge, but only to the extent of the cost of the credit life insurance if purchased from the creditor or the actual cost of the policy (if that is less than the cost of the insurance available from the creditor). If the creditor does not offer the required insurance, the premium to be included in the finance charge is the cost of a policy of insurance of the type, amount, and term required by the creditor.

4. *Other insurance.* Fees for required insurance not of the types described in § 226.4(b)(7) and (8) are finance charges and are not excludable. For example:

- The premium for a hospitalization insurance policy, if it is required to be purchased only in a credit transaction, is a finance charge.

Paragraph 4(b)(9).

1. *Discounts for payment by other than credit.* The discounts to induce payment by other than credit mentioned in § 226.4(b)(9) include, for example, the following situation:

- The seller of land offers individual tracts for \$10,000 each. If the purchaser pays cash, the price is \$9,000, but if the purchaser finances the tract with the seller the price is \$10,000. The \$1,000 difference is a finance charge for those who buy the tracts on credit.

2. Exception for cash discounts.

Discounts offered to induce consumers to pay for property or services by cash, check, or other means not involving the use of either an open-end credit plan or a credit card (whether open-end or closed-end credit is extended on the card) may be excluded from the finance charge under § 167(b) of the act (as amended by Pub. L. 97-25, July 27, 1981). The discount may be in whatever amount the seller desires, either as a percentage of the regular price (as defined in § 103(z) of the act, as amended) or a dollar amount. This provision applies only to transactions involving an open-end credit plan or a credit card. The merchant must offer the discount to prospective buyers whether or not they are cardholders or members of the open-end credit plan. The merchant may, however, make other distinctions. For example:

- The merchant may limit the discount to payment by cash, and not offer it for payment by check or by use of a debit card.
- The merchant may establish a discount plan that allows a 15% discount for payment by cash, a 10% discount for payment by check, and a 5% discount for payment by a

particular credit card. None of these discounts is a finance charge.

Section 171(c) of the act excludes § 167(b) discounts from treatment as a finance charge or other charge for credit under any state usury or disclosure laws.

4(c) Charges excluded from the finance charge.

Paragraph 4(c)(1).

1. *Application fees.* An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. However, if the fee is to be excluded from the finance charge under § 226.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.

Paragraph 4(c)(2).

1. *Late payment charges.* Late payment charges can be excluded from the finance charge under § 226.4(c)(2) whether or not the person imposing the charge continues to extend credit on the account or continues to provide property or services to the consumer. In determining whether a charge is for actual unanticipated late payment on a 30-day account, for example, factors to be considered include:

- The terms of the account. For example, is the consumer required by the account terms to pay the account balance in full each month? If not, the charge may be a finance charge.
- The practices of the creditor in handling the accounts. For example, regardless of the terms of the account, does the creditor allow consumers to pay the accounts over a period of time without demanding payment in full or taking other action to collect? If no effort is made to collect the full amount due, the charge may be a finance charge.

Section 226.4(c)(2) applies to late payment charges imposed for failure to make payments as agreed, as well as a failure to pay an account in full when due.

2. *Other excluded charges.* Charges for "delinquency, default, or a similar occurrence" include, for example, charges for reinstatement of credit privileges or for submitting as payment a check that is later returned unpaid.

Paragraph 4(c)(3).

1. *Assessing interest on an overdraft balance.* A charge on an overdraft balance computed by applying a rate of

interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

Paragraph 4(c)(4).

1. *Participation fees.* The participation fees mentioned in § 226.4(c)(4) do not necessarily have to be formal membership fees, nor are they limited to credit card plans. The provision applies to any credit plan in which payment of a fee is a condition of access to the plan itself, but it does not apply to fees imposed separately on individual closed-end transactions. The fee may be charged on a monthly or other periodic basis as well as annually; however, minimum monthly charges or other charges based on current account activity are not excluded from the finance charge by § 226.4(c)(4). (See the commentary to § 226.4(b)(2).)

Paragraph 4(c)(5).

1. *Seller's points.* The seller's points mentioned in § 226.4(c)(5) include any charges imposed by the creditor upon the non-creditor seller of property for providing credit to the buyer or for providing credit on certain terms. These charges are excluded from the finance charge even if they are passed on to the buyer, for example, in the form of a higher sales price. Seller's points are frequently involved in real estate transactions guaranteed or insured by governmental agencies. A "commitment fee" paid by a non-creditor seller (such as a real estate developer) to the creditor should be treated as seller's points. Buyer's points (that is, points charged to the buyer by the creditor), however, are finance charges.

Paragraph 4(c)(6).

1. *Lost interest.* Certain federal and state laws mandate a percentage differential between the interest rate paid on a deposit and the rate charged on a loan secured by that deposit. In some situations because of usury limits the creditor must reduce the interest rate paid on the deposit and, as a result, the consumer loses some of the interest that would otherwise have been earned. Under § 226.4(c)(6), such "lost interest" need not be included in the finance charge. This rule applies only to an interest reduction imposed because a rate differential is required by law and a usury limit precludes compliance by any other means. If the creditor imposes a differential that exceeds that required, only the lost interest attributable to the excess amount is a finance charge. (See the commentary to § 226.4(a).)

Paragraph 4(c)(7).

1. *Real estate or residential mortgage transaction charges.* The list of charges

in § 226.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, credit report fees include not only the cost of the report itself, but also the cost of verifying information in the report. In all cases, the charges must be bona fide and reasonable. If a Lump sum is charged for several services and includes a charge that is not excludable (for example, a charge for a lawyer's attending the closing), a portion of the total should be allocated to that service and included in the finance charge.

4(d) Insurance.

1. *General.* Section 226.4(d) permits insurance premiums and charges to be excluded from the finance charge. The required disclosures must be made in writing. The rules on location of insurance disclosures for closed-end transactions are in § 226.17(a).

2. *Timing of disclosures.* If disclosures are given early, for example under § 226.17(f) or § 226.19(a), the creditor need not redisclose if the actual premium is different at the time of consummation. If insurance disclosures are not given at the time of early disclosure and insurance is in fact written in connection with the transaction, the disclosures under § 226.4(d) must be made in order to exclude the premiums from the finance charge.

3. *Premium rate increases.* The creditor should disclose the premium amount based on the rates currently in effect and need not designate it as an estimate even if the premium rates may increase. An increase in insurance rates after consummation of a closed-end credit transaction or during the life of an open-end credit plan does not require redisclosure in order to exclude the additional premium from treatment as a finance charge.

4. *Unit-cost disclosures.* One of the transactions for which unit-cost disclosures (such as 50 cents per year for each \$100 of the amount financed) may be used in place of the total insurance premium involves a particular kind of insurance plan. For example, a consumer with a current indebtedness of \$8,000 is covered by a plan of credit life insurance coverage with a maximum of \$10,000. The consumer requests an additional \$4,000 loan to be covered by the same insurance plan. Since the \$4,000 loan exceeds, in part, the

maximum amount of indebtedness that can be covered by the plan, the creditor may properly give the insurance cost disclosures on the \$4,000 loan on a unit-cost basis.

5. *Required credit life insurance.* Credit life, accident, health, or loss-of-income insurance must be voluntary in order for the premiums or charges to be excluded from the finance charge. Whether the insurance is in fact required or optional is a factual question. If the insurance is required, the premiums must be included in the finance charge, whether the insurance is purchased from the creditor or from a third party. If the only option the creditor gives the consumer is to purchase credit life insurance from the creditor or to assign an existing life insurance policy, and the consumer purchases the credit life insurance, the premium must be included in the finance charge. (If the consumer assigns a pre-existing policy instead, no premium is included in the finance charge. See the commentary to § 226.4(b)(7) and (8).)

6. *Other types of voluntary insurance.* Insurance is not credit life, accident, health, or loss-of-income insurance if the creditor or the credit account of the consumer is not the beneficiary of the insurance coverage. If such insurance is not required by the creditor as an incident to or a condition of credit, it is not covered by § 226.4.

7. *Signatures.* If the creditor offers a number of insurance options under § 226.4(d), the creditor may provide a means for the consumer to sign or initial for each option, or it may provide for a single authorizing signature or initial with the options selected designated by some other means, such as a check mark. The insurance authorization may be signed or initialed by any consumer, as defined in § 226.2(a)(11), or by an authorized user on a credit card account.

8. *Property insurance.* To exclude property insurance premiums or charges from the finance charge, the creditor must allow the consumer to choose the insurer and disclose that fact. This disclosure must be made whether or not the property insurance is available from or through the creditor. The requirement that an option be given does not require that the insurance be readily available from other sources. The premium or charge must be disclosed only if the consumer elects to purchase the insurance from the creditor; in such a case, the creditor must also disclose the term of the property insurance coverage if it is less than the term of the obligation.

9. *Single interest insurance.* Blanket and specific single interest coverage are

treated the same for purposes of the regulation. A charge for either type of single interest insurance may be excluded from the finance charge if:

- The insurer waives any right of subrogation.
- The other requirements of § 226.4(d)(2) are met. This includes, of course, giving the consumer the option of obtaining the insurance from a person of the consumer's choice. The creditor need not ascertain whether the consumer is able to purchase the insurance from someone else.

10. *Single interest insurance defined.* The term "single interest insurance" as used in the regulation refers only to the types of coverage traditionally included in the term "vendor's single interest insurance" (or "VSI"), that is, protection of tangible property against normal property damage, concealment, confiscation, conversion, embezzlement, and skip. Some comprehensive insurance policies may include a variety of additional coverages, such as repossession insurance and holder in due course insurance. These types of coverage do not constitute single interest insurance for purposes of the regulation, and premiums for them do not qualify for exclusion from the finance charge under § 226.4(d). If a policy that is primarily VSI also provides coverages that are not VSI or other property insurance, a portion of the premiums must be allocated to the non-excludable coverages and included in the finance charge.

4(e) *Certain security interest charges.*

1. *Examples.* Examples of charges excludable from the finance charge under § 226.4(e)(1) include:
- Charges for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents.
 - Stamps evidencing payment of taxes on property if the stamps are required to file a security agreement on the property.

Only sums actually paid to public officials are excludable under § 226.4(e)(1).

2. *Itemization.* The various charges described in § 226.4(e)(1) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or "filing fees" may be used.

3. *Notary fees.* In order for a notary fee to be excluded under § 226.4(e)(1), all of the following conditions must be met:

- The document to be notarized is one

used to perfect, release, or continue a security interest.

- The document is required by law to be notarized.
- A notary is considered a public official under applicable law.
- The amount of the fee is set or authorized by law.

4. *Non-filing insurance.* The exclusion in § 226.4(e)(2) is available only if non-filing insurance is purchased. If the creditor collects and simply retains a fee as a sort of "self-insurance" against non-filing it may not be excluded from the finance charge. If the non-filing insurance premium exceeds the amount of the fees excludable from the finance charge under § 226.4(e)(1), only the excess is a finance charge. For example:

- The fee for perfecting a security interest is \$5.00 and the fee for releasing the security interest is \$3.00. The creditor charges \$10.00 for non-filing insurance. Only \$8.00 of the \$10.00 is excludable from the finance charge.

4(f) *Prohibited offsets.*

1. *Earnings on deposits or investments.* The rule that the creditor shall not deduct any earnings by the consumer or deposits or investments applies whether or not the creditor has a security interest in the property.

References

Statute: §§ 106, 167, and 171(c).

Other sections: §§ 226.9(d) and 226.12.

Previous regulation: § 226.4 and Interpretations §§ 226.401 through 226.407.

1981 changes: While generally continuing the rules under the previous regulation, § 226.4 reflects amendments to § 106 of the act and makes certain other changes in the rules for determining the finance charge. For example, § 226.4(a) expressly excludes from the finance charge amounts payable in comparable cash transactions. Section 226.8(o) of the previous regulation, dealing with discounts for prompt payment of a credit sale, was deleted in the revised regulation since the general test for a finance charge now focuses on a comparison of cash and credit transactions. With respect to various exclusions from the finance charge: application fees imposed on all applicants are no longer finance charges; continuing to extend credit to a consumer is no longer a controlling test for determining whether a late payment charge is bona fide; seller's points are not to be included in the finance charge; and the special exclusions for real estate transactions apply to all "residential mortgage transactions."

The simplified rules for excluding insurance from the finance charge allow unit-cost disclosure in certain closed-end credit transactions; permit initials as well as signatures on the authorization; permit any consumer to authorize insurance for other consumers; and delete the requirement that the authorization be separately dated.

Subpart B—Open-End Credit

Section 226.5—General Disclosure Requirements

5(a) Form of disclosures.

Paragraph 5(a)(1).

1. *Clear and conspicuous.* The "clear and conspicuous" standard requires that disclosures be in a reasonably understandable form. It does not require that disclosures be segregated from other material or located in any particular place on the disclosure statement, or that numerical amounts or percentages be in any particular type size. The standard does not prohibit:

- Pluralizing required terminology ("finance charge" and "annual percentage rate").
- Adding to the required disclosures such items as contractual provisions, explanations of contract terms, state disclosures, and translations.
- Sending promotional material with the required disclosures.
- Using commonly accepted or readily understandable abbreviations (such as "mo." for "month" or "Tx." for "Texas") in making any required disclosures.
- Using codes or symbols such as "APR" (for annual percentage rate), "FC" (for finance charge), or "Cr" (for credit balance), so long as a legend or description of the code or symbol is provided on the disclosure statement.

2. *Integrated document.* The creditor may make both the initial disclosures (§ 226.6) and the periodic statement disclosures (§ 226.7) on more than one page, and use both the front and the reverse sides, so long as the pages constitute an integrated document. An integrated document would not include disclosure pages provided to the consumer at different times or disclosures interspersed on the same page with promotional material. An integrated document would include, for example:

- Multiple pages provided in the same envelope that cover related material and are folded together, numbered consecutively, or clearly labelled to show that they relate to one another.
- A brochure that contains

disclosures and explanatory material about a range of services the creditor offers, such as credit, checking account, and electronic fund transfer features.

Paragraph 5(a)(2).

1. *When disclosures must be "more conspicuous."* The terms "finance charge" and "annual percentage rate" must be disclosed more conspicuously when required to be used with a number. For example, on the initial disclosure statement, the annual percentage rate disclosure under § 226.6(a)(2) must be "more conspicuous." The following apply to the "more conspicuous" rule:

- Neither term need be emphasized when used as part of general informational material or in textual descriptions of other terms, although emphasis is permissible in such cases. For example, when the terms appear as part of the explanations required under § 226.6(a)(3) and (4), they may be as conspicuous as the disclosures required under §§ 226.6(a)(2) and 226.7(g).
- The corresponding annual percentage rate under § 226.7(d) may be less conspicuous than the disclosure of the actual annual percentage rate (historical rate) under § 226.7(g) when the two rates differ. This is permitted by footnote 9 to § 226.5(a)(2), which excepts § 226.7(d) disclosures from the "more conspicuous" requirement.

2. *Making disclosures more conspicuous.* In disclosing the terms "finance charge" and "annual percentage rate" more conspicuously, only the words "finance charge" and "annual percentage rate" should be accentuated. For example, if the term "total finance charge" is used, only "finance charge" should be emphasized. The disclosures may be made more conspicuous by, for example:

- Capitalizing the words when other disclosures are printed in lower case.
- Putting them in bold print or a contrasting color.
- Underlining them.
- Setting them off with asterisks.
- Printing them in larger type.

5(b) Time of disclosures.

5(b)(1) Initial disclosures.

1. *Disclosure before the first transaction.* The rule that the initial disclosure statement must be furnished "before the first transaction" requires delivery of the initial disclosure statement before the consumer becomes obligated on the plan (for example, before the consumer makes the first

purchase, receives the first advance, or pays a fee under the plan). Delivery of the initial disclosure statement is timely even if a membership fee, advance, or purchase already has been posted to the consumer's account, so long as the consumer may, after receiving the disclosures, reject the plan and have no further obligation beyond returning a credit card or any money or goods.

If the consumer has paid a fee and rejects the plan after receiving the disclosures, the creditor must refund the amount paid and clear the consumer's account. Initial disclosures need not be given before the imposition of an application fee under § 226.4(c)(1).

2. *Reactivation of suspended account.* If an account is temporarily suspended (for example, because the consumer has exceeded a credit limit, or because a credit card is reported lost or stolen) and then is reactivated, no new initial disclosures are required.

3. *Reopening closed account.* If an account has been closed (for example, due to inactivity, cancellation, or expiration) and then is reopened, new initial disclosures are required.

4. *Converting closed-end to open-end credit.* If a closed-end credit transaction is converted to an open-end credit account under a written agreement with the consumer, the initial disclosures under § 226.6 must be given before the consumer becomes obligated on the open-end credit plan. (See the commentary to § 226.17 on converting open-end credit to closed-end credit.)

5(b)(2) Periodic statements.

Paragraph 5(b)(2)(i).

1. *Periodic statements not required.* Periodic statements need not be sent in the following cases:

- If the creditor adjusts an account balance so that at the end of the cycle the balance is less than \$1—so long as no finance charge has been imposed on the account for that cycle.
- If a statement was returned as undeliverable. If a new address is provided, however, within a reasonable time before the creditor must send a statement, the creditor must resume sending statements. Receiving the address at least 20 days before the end of a cycle would be a reasonable amount of time to prepare the statement for that cycle. For example, if an address is received 22 days before the end of the June cycle, the creditor must send the periodic statement for the June cycle. (See § 226.13(a)(7).)

2. Termination of credit privileges.

When an open-end account is terminated without being converted to closed-end credit under a written agreement, the creditor must continue to provide periodic statements to those consumers entitled to receive them under § 226.5(b)(2)(i) (for example, when an open-end credit plan ends and consumers are paying off outstanding balances) and must continue to follow all of the other open-end credit requirements and procedures in Subpart B.

Paragraph 5(b)(2)(ii).

1. 14-day rule. The 14-day rule for mailing or delivering periodic statements does not apply if charges (for example, transaction or activity charges) are imposed regardless of the timing of a periodic statement. The 14-day rule does apply, for example:

- If current debits retroactively become subject to finance charges when the balance is not paid in full by a specified date.
- If charges other than finance charges will accrue when the consumer does not make timely payments (for example, late payment charges or charges for exceeding a credit limit).

2. Computer malfunction. Footnote 10 does not extend to the failure to provide a periodic statement because of computer malfunction.

3. Calling for periodic statements. The creditor may permit consumers to call for their periodic statements, but may not require them to do so. If the consumer wishes to pick up the statement and the plan has a free-ride period, the statement must be made available in accordance with the 14-day rule.

5(c) Basis of disclosures and use of estimates.

1. Legal obligation. The disclosures should reflect the credit terms to which the parties are legally bound at the time of giving the disclosures.

- The legal obligation is normally determined by applicable state or other law.
- The fact that a contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that contract did not reflect the legal obligation.
- The legal obligation normally is presumed to be contained in the contract that evidences the agreement. But this may be rebutted if another agreement between the parties legally modifies that contract.

2. Estimates—obtaining information. Disclosures may be estimated when the exact information is unknown at the time disclosures are made. Information is unknown if it is not reasonably available to the creditor at the time disclosures are made. The "reasonably available" standard requires that the creditor, acting in good faith, exercise due diligence in obtaining information. In using estimates, the creditor is not required to disclose the basis for the estimated figures, but may include such explanations as additional information. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to insurance companies for the cost of insurance.

3. Estimates—redisclosure. If the creditor makes estimated disclosures, redisclosure is not required for that consumer, even though more accurate information becomes available before the first transaction. For example, in an open-end plan to be secured by real estate, the creditor may estimate the appraisal fees to be charged; such an estimate might reasonably be based on the prevailing market rates for similar appraisals. If the exact appraisal fee is determinable after the estimate is furnished but before the consumer receives the first advance under the plan, no new disclosure is necessary.

5(d) Multiple creditors; multiple consumers.

1. Multiple creditors. Under § 226.5(d):

- Creditors must choose which of them will make the disclosures.
- A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.
- Each creditor in the plan is legally responsible for seeing that the disclosures are provided.
- All disclosures for the open-end credit plan must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure.
- In some open-end credit programs involving multiple creditors, the consumer has the option (for example, at the end of a billing cycle) to pay creditor A directly or to transfer to creditor B all or part of the amount owing. If the consumer elects the latter option, the consumer no longer is obligated to creditor A for the specific amount(s) transferred. In such a case, creditor A and creditor B may send separate periodic statements that reflect the separate obligations owed to each.

2. Multiple consumers. Disclosures may be made to either obligor on a joint

account. Disclosure responsibilities are not satisfied by giving disclosures to only a surety or guarantor for a principal obligor or to an authorized user. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under § 226.15.

5(e) Effect of subsequent events.

1. Events causing inaccuracies. Inaccuracies in disclosures are not violations if attributable to events occurring after disclosures are made. For example, when the consumer fails to fulfill a prior commitment to keep the collateral insured and the creditor then provides the coverage and charges the consumer for it, such a change does not make the original disclosures inaccurate. The creditor may, however, be required to provide a new disclosure(s) under § 226.9(c).

2. Use of inserts. When changes in a creditor's plan affect required disclosures, the creditor may use inserts with outdated disclosure forms. Any insert:

- Should clearly refer to the disclosure provision it replaces.
- Need not be physically attached or affixed to the basic disclosure statement.
- May be used only until the supply of outdated forms is exhausted.

References

Statute: Secs. 121 (a) through (c), 122 (a) and (b), 124, 127 (a) and (b), and 163(a).

Other sections: Secs. 226.6, 226.7, and 226.9.

Previous regulation: Secs. 226.6 (a) and (c) through (g), and 226.7 (a) through (c).

1981 changes: Section 226.5 implements amendments to the act and reflects several simplifying changes to the regulation. The use of required terminology, except for "finance charge" and "annual percentage rate," is no longer required. Type size requirements have been deleted. Initial and periodic statement disclosures may be multi-page, so long as they constitute an integrated statement. New rules are provided for the basis of disclosures and for the use of estimates. The rules for credit plans involving multiple creditors or multiple consumers now provide that only one creditor need make the disclosures and that the disclosures need be made to only one primarily liable consumer.

Section 226.6—Initial Disclosure Statement

1. Consistent terminology. Language on the initial and periodic disclosure

statements must be close enough in meaning to enable the consumer to relate the 2 sets of disclosures; however, the language need not be identical. For example, in making the disclosure under § 226.6(a)(3), the creditor may refer to the "outstanding balance at the end of the billing cycle," while the disclosure for § 226.7(i) refers to the "ending balance" or "new balance."

6(a) Finance charge.

Paragraph 6(a)(1)

1. When finance charges accrue. Creditors may provide a general explanation about finance charges beginning to run and need not disclose a specific date. For example, a disclosure that the consumer has 30 days from the closing date to pay the new balance before finance charges will accrue on the account would describe when finance charges begin to run.

2. Free-ride periods. In disclosing whether or not a free-ride period exists, the creditor need not use "free period," "free-ride period," or any other particular descriptive phrase or term. For example, a statement that "the finance charge begins on the date the transaction is posted to your account" adequately discloses that no free-ride period exists. In the same fashion, a statement that "finance charges will be imposed on any new purchases only if they are not paid in full within 25 days after the close of the billing cycle" indicates that a free-ride period exists in the interim.

Paragraph 6(a)(2).

1. Range of balances. The range of balances disclosure is inapplicable:

- If only one periodic rate may be applied to the entire account balance.
- If only one periodic rate may be applied to the entire balance for a feature (for example, cash advances), even though the balance for another feature (purchases) may be subject to 2 rates (a 1.5% periodic rate on purchase balances of \$0-\$500, while balances above \$500 are subject to a 1% periodic rate). Of course, the creditor must give a range of balances disclosure for the purchase feature.

2. Variable rate plan defined. A variable rate plan contemplates a series of rate changes in accordance with an index that is readily verifiable by the borrower and beyond the control of the lender (for example, the Treasury bill rate). A contract right to increase the rate upon any other contingency, or at the creditor's discretion, would not be a variable rate plan. For example, an open-end credit plan in which the employee receives a lower rate contingent upon employment, with the

rate to be increased upon termination of employment, would not be a variable rate plan. Similarly, an open-end credit plan that provides for rate increases voted by the board of directors of a financial institution would not be a variable rate plan.

3. Variable rate plan—rate(s) in effect. In disclosing the rate(s) in effect at the time of the initial disclosures (as is required by § 226.6(a)(2)), the creditor may use an insert showing the current rate; may give the rate as of a specified date and then update the disclosure from time to time, for example, each calendar month; or may disclose an estimated rate under § 226.5(c).

4. Variable rate plan—additional disclosures required. In addition to disclosing the rates in effect at the time of the initial disclosures, the disclosures under footnote 12 also must be made.

5. Variable rate plan—index. The index to be used must be clearly identified; the creditor need not give, however, an explanation of how the index is determined or provide instructions for obtaining it.

6. Variable rate plan—circumstances for increase. Circumstances under which the rate(s) may increase include, for example:

- An increase in the Treasury bill rate.
- An increase in the Federal Reserve discount rate.

The creditor must disclose when the increase will take effect; for example,

- "An increase will take effect on the day that the Treasury bill rate increases," or
- "An increase in the Federal Reserve discount rate will take effect on the first day of the creditor's billing cycle."

7. Variable rate plan—limitations on increase. In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. Legal limits such as usury or rate ceilings under state or federal statutes or regulations need not be disclosed. Examples of limitations that must be disclosed include:

- "The rate on the plan will not exceed 25% annual percentage rate."
- "Not more than ½% increase in the annual percentage rate per year will occur."

8. Variable rate plan—effects of increase. Examples of effects that must be disclosed include:

- Any requirement for additional collateral if the annual percentage

rate increases beyond a specified rate.

- Any increase in the scheduled minimum periodic payment amount.

9. Variable rate plan—change-in-terms notice not required. No notice of a change in terms is required for a rate increase under a variable rate plan as defined in Comment 6(a)(2)-2.

Paragraph 6(a)(3).

1. Explanation of balance computation method. A shorthand phrase such as "previous balance method" does not suffice in explaining the balance computation method. (See Appendix G-1 for model clauses.)

2. Allocation of payments. Disclosure about the allocation of payments and other credits is not required. For example, the creditor need not disclose that payments are applied to late charges, overdue balances, and finance charges before being applied to the principal balance; or in a multifeatured plan, that payments are applied first to finance charges, then to purchases, and then to cash advances. (See Comment 7-1 for definition of multifeatured plan.)

Paragraph 6(a)(4).

1. Finance charges. In addition to disclosing the periodic rate(s) under § 226.6(a)(2), disclosure is required of any other type of finance charge that may be imposed, such as minimum, fixed, transaction, and activity charges; required insurance; or appraisal or credit report fees (unless excluded from the finance charge under § 226.4(c)(7).)

6(b) Other charges.

1. General; examples of other charges. Under § 226.6(b), significant charges related to the plan (that are not finance charges) must also be disclosed. For example:

- Late payment and over-the-credit-limit charges.
- Fees for providing documentary evidence of transactions requested under § 226.13 (billing error resolution).
- Charges imposed in connection with real estate transactions. (See § 226.4(c)(7).)
- Taxes and filing or notary fees excluded from the finance charge under § 226.4(e).
- A tax imposed on the credit transaction by a state or other governmental body, such as a documentary stamp tax on cash advances. (See the commentary to § 226.4(a).)
- Membership or participation fees for a package of services that includes an open-end credit feature, unless the fee is required whether or not the open-end credit feature is included. For example, a

membership fee to join a credit union would not be an "other charge," even if membership is required to apply for credit.

2. *Exclusions.* The following are examples of charges that are not "other charges":

- Fees charged for documentary evidence of transactions for income tax purposes.
- Amounts payable by a consumer for collection activity after default; attorney's fees, whether or not automatically imposed; foreclosure costs; post-judgment interest rates imposed by law; and reinstatement or reissuance fees.
- Premiums for voluntary credit life or disability insurance, or for property insurance, that are not part of the finance charge.
- Application fees under § 226.4(c)(1).
- A monthly service charge for a checking account with overdraft protection that is applied to all checking accounts, whether or not a credit feature is attached.

6(c) *Security interests.*

1. *General.* Disclosure is not required about the type of security interest, or about the creditor's rights with respect to that collateral. In other words, the creditor need not expand on the term "security interest." Also, since no specified terminology is required, the creditor may designate its interest by using, for example, "pledge," "lien," or "mortgage" (instead of "security interest").

2. *Identification of property.* Identification of the collateral by type is satisfied by stating, for example, "motor vehicle" or "household appliances." The creditor may, at its option, provide a more specific identification (for example, a model and serial number).

3. *Spreader clause.* The fact that collateral for pre-existing credit extensions with the institution is being used to secure the present obligation constitutes a security interest and must be disclosed. (Such security interests may be known as "spreader" or "dragnet" clauses, or as "cross-collateralization" clauses.) A specific identification of that collateral is unnecessary, but a reminder of the interest arising from the prior indebtedness is required. This may be accomplished by using language such as "collateral securing other loans with us may also secure this loan." At the creditor's option, a more specific description of the property involved may be given.

4. *Additional collateral.* If collateral is required when advances reach a certain amount, the creditor should disclose the

information available at the time of the initial disclosures. For example, if the creditor knows that a security interest will be taken in household goods if the consumer's balance exceeds \$1,000, the creditor should disclose accordingly. If the creditor knows that security will be required if the consumer's balance exceeds \$1,000, but the creditor does not know what security will be required, the creditor must disclose on the initial disclosure statement that security will be required if the balance exceeds \$1,000, and the creditor must provide a change-in-terms notice under § 226.9(c) at the time the security is taken.

5. *Collateral from third party.* In certain situations, the consumer's obligation may be secured by collateral belonging to a third party. For example, an open-end credit plan may be secured by an interest in property owned by the consumer's parents. In such cases, the security interest is taken in connection with the plan and must be disclosed, even though the property encumbered is owned by someone other than the consumer.

6(d) *Statement of billing rights.*

See the commentary to Appendix G-3.

References

Statute: Section 127(a).

Other sections: §§ 226.4, 226.5, 226.7, 226.9, 226.14, and Appendix G.

Previous regulation: § 226.7(a) and Interpretation § 226.706.

1981 changes: Section 226.6 implements the amended statute which requires disclosure of the fact that no free period exists. Disclosures about the minimum periodic payment and the Comparative Index of Credit Cost have been eliminated. The security interest disclosures have been simplified. "Other charges" no longer include voluntary credit life or disability insurance, required property insurance premiums, default charges, or fees for collection activity. Disclosures for variable rate plans are now required by the regulation, replacing Interpretation § 226.707. The regulation no longer specifies the exact language to be used for the billing rights notice; creditors may use any version "substantially similar" to the one in Appendix G.

Section 226.7—Periodic Statement

1. *Multifeatured plans.* Some plans involve a number of different features, such as purchases, cash advances, or overdraft checking. Groups of transactions subject to different finance charge terms because of the dates on which the transactions took place are treated like different features for purposes of disclosures on the periodic statements. The commentary includes

some special rules for multifeatured plans.

7(a) *Previous balance.*

1. *Credit balances.* If the previous balance is a credit balance, it must be disclosed in such a way so as to inform the consumer that it is a credit balance, rather than a debit balance.

2. *Multifeatured plans.* In a multifeatured plan, the previous balance may be disclosed either as an aggregate balance for the account or as separate balances for each feature (for example, a previous balance for purchases and a previous balance for cash advances). If separate balances are disclosed, a total previous balance is optional.

3. *Accrued finance charges allocated from payments.* Some open-end credit plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and reflected as an increase in the obligation. In such a plan, the previous balance need not reflect finance charges accrued since the last payment.

7(b) *Identification of transactions.*

1. *Multifeatured plans.* In identifying transaction under § 226.7(b), transactions may be grouped by feature (such as by disclosing sale transactions separately from cash advance transactions) or may be arranged by date.

7(c) *Credits.*

1. *Identification—sufficiency.* The creditor need not describe each credit by type (returned merchandise, rebate of finance charge, etc.)—"credit" would suffice—except if the creditor is using the periodic statement to satisfy the billing error correction notice requirement. (See the commentary to § 226.13 (e) and (f).)

2. *Format.* A creditor may list credits relating to credit extensions (payments, rebates, etc.) together with other types of credits (such as deposits to a checking account), as long as the entries are identified so as to inform the consumer which type of credit each entry represents.

3. *Date.* The crediting date need not be identified as "crediting date," unless 2 or more dates are disclosed for a single entry (for example, the posting date and the crediting date).

7(d) *Periodic rates.*

1. *Disclosure of periodic rates—whether or not actually applied.* Any periodic rate that may be used to compute finance charges (and its corresponding annual percentage rate) must be disclosed whether or not it is

applied during the billing cycle. For example:

- If the consumer's account has both a purchase feature and a cash advance feature, the creditor must disclose the rate for each, even if the consumer only makes purchases on the account during the billing cycle.
- If the rate varies (such as when it is tied to a particular index), the creditor must disclose each rate in effect during the cycle for which the statement was issued.

2. *Disclosure of periodic rates required only if imposition possible.* With regard to the periodic rate disclosure (and its corresponding annual percentage rate), only rates that *could have been imposed* during the billing cycle reflected on the periodic statement need to be disclosed. For example:

- If the creditor is changing rates effective during the next billing cycle (either because it is changing terms or because of a variable rate plan), the rates required to be disclosed under § 226.7(d) are only those in effect during the billing cycle reflected on the periodic statement. For example, if the monthly rate applied during May was 1.5 percent, but the creditor will increase the rate to 1.8 percent effective June 1, 1.5 percent (and its corresponding annual percentage rate) is the only required disclosure under § 226.7(d) for the periodic statement reflecting the May account activity.
- If the consumer has an overdraft line that might later be expanded upon the consumer's request to include secured advances, the rates for the secured advance feature need not be given until such time as the consumer has requested and received access to the additional feature.
- If rates applicable to a particular type of transaction changed after a certain date, and the old rate is only being applied to transactions that took place prior to that date, the creditor need not continue to disclose the old rate for those consumers that have no outstanding balances to which that rate could be applied.

3. *Multiple rates—same transaction.* If two or more periodic rates are applied to the *same* balance for the same type of transaction (for example, if the finance charge consists of a monthly periodic rate of 1.5% applied to the outstanding balance and a required credit life insurance component calculated at .1% per month on the same outstanding

balance), the creditor may do either of the following:

- Disclose each periodic rate, the range of balances to which it is applicable, and the corresponding annual percentage rate for each. (For example, 1.5% monthly, 18% annual percentage rate; .1% monthly, 1.2% annual percentage rate.)
 - Disclose one composite periodic rate (that is, 1.6% per month) along with the applicable range of balances and corresponding annual percentage rate.
4. *Corresponding annual percentage rate.* In disclosing the annual percentage rate that corresponds to each periodic rate, the creditor may use "corresponding annual percentage rate," "nominal annual percentage rate," "corresponding nominal annual percentage rate," or similar phrases.

5. *Rate same as actual annual percentage rate.* When the corresponding rate is the same as the actual annual percentage rate (historical rate) required to be disclosed (§ 226.7(g)), the creditor need disclose only one annual percentage rate, but must use the phrase "annual percentage rate."

6. *Ranges of balances.* See Comment 6(a)(2)-1.

7(e) *Balance on which finance charge computed.*

1. *Limitation to periodic rates.* Section 226.7(e) only requires disclosure of the balance(s) to which a periodic rate was applied and does not apply to balances on which other kinds of finance charges (such as transaction charges) were imposed. For example, if a consumer obtains a \$1,500 cash advance subject to both a 1% transaction fee and a 1% monthly periodic rate, the creditor need only disclose the balance subject to the monthly rate (which might include portions of earlier cash advances not paid off in previous cycles).

2. *Split rates applied to balance ranges.* If split rates were applied to a balance because different portions of the balance fall within 2 or more balance ranges, the creditor need not separately disclose the portions of the balance subject to such different rates since the range of balances to which the rates apply has been separately disclosed. For example, a creditor could disclose a balance of \$700 for purchases even though a monthly periodic rate of 1.5% applied to the first \$500, and a monthly periodic rate of 1% to the remainder.

3. *Monthly rate on average daily balance.* If a creditor computes a finance charge on the average daily balance by application of a monthly periodic rate or

rates, the balance is adequately disclosed if the statement gives the amount of the average daily balance on which the finance charge was computed, and also states how the balance is determined.

4. *Daily rate on daily balance.* If the finance charge is computed on the balance each day by application of one or more daily periodic rates, the balance on which the finance charge was computed may be disclosed in any of the following ways for each feature:

- If a single daily periodic rate is imposed, the balance to which it is applicable may be stated as:

—A balance for each day in the billing cycle.

—A balance for each day in the billing cycle on which the balance in the account changes.

—The sum of the daily balances during the billing cycle.

—The average daily balance during the billing cycle, in which case the creditor shall explain that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of the finance charge.

- If 2 or more daily periodic rates may be imposed, the balances to which the rates are applicable may be stated as:

—A balance for each day in the billing cycle.

—A balance for each day in the billing cycle on which the balance in the account changes.

—As 2 or more average daily balances, each applicable to the daily periodic rates imposed for the time that those rates were in effect, as long as the creditor explains that the finance charge is or may be determined by (1) multiplying each of the average balances by the number of days in the billing cycle (or if the daily rate varied during the cycle, by multiplying by the number of days the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) adding these products together. If the different rates are due to disclosed ranges of balances (see Comment 7(e)-2), the creditor need give only one average daily balance together with the additional information required by this paragraph.

5. *Explanation of balance computation method.* See the commentary to § 226.6(a)(3).

6. *Information to compute balance.* In connection with disclosing the finance

charge balance, the creditor need not give the consumer all of the information necessary to compute the balance if that information is not otherwise required to be disclosed. For example, if current purchases are included from the date they are posted to the account, the posting date need not be disclosed.

7. Non-deduction of credits. The creditor need not specifically identify the total dollar amount of credits not deducted in computing the finance charge balance. Disclosure of the amount of credits not deducted is accomplished by listing the credits (§ 226.7(c)) and indicating which credits will not be deducted in determining the balance (for example, "credits after the 15th of the month are not deducted in computing the finance charge.")

8. Multifeatured plans. In a multifeatured plan, the balance on which the finance charge was computed must be disclosed for each feature to which a periodic rate was applied. A total balance for the entire plan is optional.

7(f) Amount of finance charge.

1. Total. A total finance charge amount for the plan is not required.

2. Itemization—types of finance charges. Each type of finance charge (such as periodic rates, transaction charges, and minimum charges) imposed during the cycle must be separately itemized; for example, disclosure of only a combined finance charge attributable to both a minimum charge and transaction charges would not be permissible. Finance charges of the same type may be disclosed, however, individually or as a total. For example, 5 transaction charges of \$1 may be listed separately or as \$5.

3. Itemization—different periodic rates. Whether different periodic rates are applicable to different types of transactions or to different balance ranges, the creditor may give the finance charge attributable to each rate or may give a total finance charge amount. For example, if a creditor charges 1.5% per month on the first \$500 of a balance and 1% per month on amounts over \$500, the creditor may itemize the two components (\$7.50 and \$1.00) of the \$8.50 charge, or may disclose \$8.50.

4. Multifeatured plans. In a multifeatured plan, in disclosing the amount of the finance charge attributable to the application of periodic rates no total periodic rate disclosure for the entire plan need be given.

5. Finance charges not added to account. A finance charge that is not included in the new balance because it is payable to a third party (such as required life insurance) must still be

shown on the periodic statement as a finance charge.

6. Finance charges other than periodic rates. See Comment 6(a)(4)–1 for examples.

7. Accrued finance charges allocated from payments. Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, no disclosure is required of finance charges that have accrued since the last payment.

7(g) Annual percentage rate.

1. Rate same as corresponding annual percentage rate. See Comment 7(d)–5. Rate that reflects the finance charge imposed during the cycle may be separately stated for each feature. If separate rates are given, a composite annual percentage rate for the entire plan is optional.

7(h) Other charges.

1. Identification. In identifying any "other charges" actually imposed during the billing cycle, the type is adequately described as "late charge" or "membership fee," for example. (See Comment 6(b)–1 for examples of "other charges.")

2. Date. The date of imposing or debiting "other charges" need not be disclosed.

3. Total. Disclosure of the total amount of other charges is optional.

7(i) Closing date of billing cycle; new balance.

1. Credit balances. See Comment 7(a)–1.

2. Multifeatured plans. In a multifeatured plan, the new balance may be disclosed for each feature or for the plan as a whole. If separate new balances are disclosed, a total new balance is optional.

3. Accrued finance charges allocated from payments. Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, the new balance need not reflect finance charges accrued since the last payment.

7(j) Free-ride period.

1. Wording. Although the creditor is required to indicate any time period the consumer may have to pay the balance outstanding without incurring additional finance charges, no specific wording is required, so long as the language used is consistent with that used on the initial disclosure statement. For example, "To avoid additional finance charges, pay

the new balance before " would suffice.

7(k) Address for notice of billing errors.

1. Wording. The periodic statement must contain the address for consumers to use in asserting billing errors under § 226.13. Since all disclosures must be "clear," the statement should indicate the general purpose for the address, although no elaborate explanation or particular wording is required.

2. Telephone number. A telephone number may be included, but the address for billing error inquiries, which is the required disclosure, must be clear and conspicuous. One way to ensure that the address is clear and conspicuous is to include a precautionary instruction that telephoning will not preserve the consumer's billing error rights. Both of the billing rights statements in Appendix G contain such a precautionary instruction, so that a creditor could, by including either of these statements with each periodic statement, ensure that required address is provided in a clear and conspicuous manner.

References

Statute: section 127(b).

Previous regulation: § 226.7(b)(1) and Interpretation §§ 226.701, 226.703, 226.706, and 226.707.

Other sections: §§ 226.4 through 226.6, 226.8, 226.14, and Appendix G.

1981 changes: Under § 226.7, required terminology is no longer mandated except for the terms "finance charge" and "annual percentage rate." The requirement in the previous regulation about the location of disclosures has been deleted.

Under the revised § 226.7, disclosure of credits to the account no longer have to indicate the type of credit. A short disclosure for variable rate plans must be included on the periodic statement. Disclosures relating to multifeatured accounts have been clarified.

Section 226.7 now specifically requires a periodic statement disclosure of "other charges" (non-finance charges related to the plan) that are actually imposed during the billing cycle.

Disclosures about minimum charges that might be imposed on the account and about the Comparative Index of Credit Cost have been deleted.

Section 226.8—Identification of Transactions

1. Application of identification rules. Section 226.8 deals with the requirement (imposed by § 226.7(b)) for identification of each credit transaction made during the billing cycle. The rules for

identifying transactions on periodic statements vary, depending on whether:

- The transaction involves sale credit (purchases) or nonsale credit (cash advances, for example).
- An actual copy of the credit document reflecting the transaction accompanies the statement (this is the distinction between so-called "country club" and "descriptive" billing).
- The creditor and seller are the same or related persons.

2. *Sale credit.* The term "sale credit" refers to a purchase in which the consumer uses a credit card or otherwise directly accesses an open-end line of credit (see Comment 8-3 if access is by means of a check) to obtain goods or services from a merchant, whether or not the merchant is the card issuer.

"Sale credit" even includes:

- Premiums for voluntary credit life insurance whether sold by the card issuer or another person.
- The purchase of funds-transfer services (such as telegrams) from an intermediary.

3. *Nonsale credit.* The term "nonsale credit" refers to any form of loan credit including, for example:

- Cash advances.
- Overdraft checking.
- The use of a "supplemental credit device" in the form of a check or draft or the use of the overdraft feature of a debit card, even if such use is in connection with a purchase of goods or services.
- Miscellaneous debits to remedy mispostings, returned checks, and similar entries.

4. *Actual copy.* An actual copy does not include a recreated document. It includes, for example, a duplicate, carbon, or photographic copy, but does not include a so-called "facsimile draft" in which the required information is typed, printed, or otherwise recreated. If a facsimile draft is used, the creditor must follow the rules that apply when a copy of the credit document is not furnished.

5. *Same or related persons.* The term "same or related persons" refers to, for example:

- Franchised or licensed sellers of a creditor's product or service.
- Sellers who assign or sell open-end sales accounts to a creditor or arrange for such credit under a plan that allows the consumer to use the credit only in transactions with that seller.

A person is not related to the creditor merely because, for example:

- The person and the creditor have an agreement by which the person is authorized to honor the creditor's

credit card under the terms specified in the agreement.

- The person and the creditor have a corporate connection, such as subsidiary-parent, if that connection is not obvious from the names they use. For example, if XYZ card issuer owns the ABC hotel, the card issuer and the hotel are not "related."

6. *Transactions resulting from promotional material.* In describing transactions with third-party sellers resulting from promotional material mailed by the creditor, creditors may use the rules either for "related" or for "non-related" sellers and creditors.

8(a) *Sale credit.*

1. *Date—disclosure of only one date.*

If only the required date is disclosed for a transaction, the creditor need not identify it as the "transaction date." If the creditor discloses more than one date (for example, the transaction date and the posting date), the creditor must identify each.

2. *Date—disclosure of month and day only.* The month and day are sufficient disclosure of the date on which the transaction took place, unless the posting of the transaction is delayed so long that the year is needed for a clear disclosure to the consumer.

3. *When transaction takes place.* If the consumer conducts the transaction in person, the date of the transaction is the calendar date on which the consumer made the purchase or order, or secured the advance. For transactions billed to the account on an ongoing basis (other than installments to pay a precomputed amount), the date of the transaction is the date on which the amount is debited to the account. This might include, for example, monthly insurance premiums. For mail or telephone orders, a creditor may disclose as the transaction date either the invoice date, the debiting date, or the date the order was placed by telephone.

4. *Transactions not billed in full.* If sale transactions are not billed in full on any single statement, but are billed periodically in precomputed installments, the first periodic statement reflecting the transaction must show either the full amount of the transaction together with the date the transaction actually took place; or the amount of the first installment that was debited to the account together with the date of the transaction or the date on which the first installment was debited to the account. In any event, subsequent periodic statements should reflect each installment due, together with either any other identifying information required by § 226.8(a) (such as the seller's name

and address in a three-party situation) or other appropriate identifying information relating the transaction to the first billing. The debiting date for the particular installment, or the date the transaction took place, may be used as the date of the transaction on these subsequent statements.

8(a)(1) *Copy of credit document provided.*

1. *Format.* The information required by § 226.8(a)(1) may appear either on the copy of the credit document reflecting the transaction or on the periodic statement.

8(a)(2) *Copy of credit document not provided—creditor and seller same or related person(s).*

1. *Property identification—sufficiency of description.* The "brief identification" provision in § 226.8(a)(2) requires a designation that will enable the consumer to reconcile the periodic statement with the consumer's own records. In determining the sufficiency of the description, the following rules apply:

- While item-by-item descriptions are not necessary, reasonable precision is required. For example, "merchandise," "miscellaneous," "second-hand goods," or "promotional items" would not suffice.
- A reference to a department in a sales establishment that accurately conveys the identification of the types of property or services available in the department is sufficient—for example, "jewelry," "sporting goods."

2. *Property identification—number or symbol.* The "brief identification" may be made by disclosing on the periodic statement a number or symbol that is related to an identification list printed elsewhere on the statement.

3. *Property identification—additional document.* In making the "brief identification" required by § 226.8(a)(2), the creditor may identify the property by describing the transaction on a document accompanying the periodic statement (for example, on a facsimile draft). (See also footnote 17.)

4. *Small creditors.* Under footnote 18, which provides a further identification alternative to a creditor with fewer than 15,000 accounts, the creditor need count only its own accounts and not others serviced by the same data processor or other shared-service provider.

8(a)(3) *Copy of credit document not provided—creditor and seller not same or related person(s).*

1. *Seller's name.* The requirement contemplates that the seller's name will

appear on the periodic statement in essentially the same form as it appears on transaction documents provided to the consumer at the time of the sale. The seller's name may also be disclosed as, for example:

- A more complete spelling of the name that was alphabetically abbreviated on the receipt or other credit document.
- An alphabetical abbreviation of the name on the periodic statement even if the name appears in a more complete spelling on the receipt or other credit document. Terms that merely indicate the form of a business entity, such as "Inc.," "Co.," or "Ltd.," may always be omitted.

2. *Location of transaction.* The disclosure of the location where the transaction took place generally requires an indication of both the city, and the state or foreign country. If the creditor has multiple stores or branches within that city, the creditor need not identify the specific branch at which the sale occurred.

3. *No fixed location.* When no meaningful address is available because the consumer did not make the purchase at any fixed location of the seller, the creditor:

- May omit the address.
- May provide some other identifying designation, such as "aboard plane," "ABC Airways Flight," "customer's home," "telephone order," or "mail order."

8(b) *Nonsale credit.*

1. *Date of transaction.* If only one of the required dates is disclosed for a transaction, the creditor need not identify it. If the creditor discloses more than one date (for example, transaction date and debiting date), the creditor must identify each.

2. *Amount of transaction.* If credit is extended under an overdraft checking account plan or by means of a debit card with an overdraft feature, the amount to be disclosed is that of the credit extension, not the face amount of the check or the total amount of the debit/credit transaction.

3. *Amount—disclosure on cumulative basis.* If credit is extended under an overdraft checking account plan or by means of a debit card with an overdraft feature, the creditor may disclose the amount of the credit extensions on a cumulative daily basis, rather than the amount attributable to each check or each use of the debit/credit card.

4. *Identification of transaction type.* The creditor may identify a transaction by describing the type of advance it represents, such as cash advance, loan,

overdraft loan, or any readily understandable trade name for the credit program.

References

Statute: § 127(b)(2).

Previous regulation: § 226.7(k).

Other sections: §§ 226.7.

1981 changes: Section 226.8 has been streamlined and reorganized to facilitate its use. Technical detail has been deleted from the regulation for inclusion in the commentary. The regulation implements the amended § 127(b)(2) of the act by providing for protection from civil liability under certain circumstances when required information is not provided and by reducing disclosure responsibilities for certain small creditors. For descriptive billing of nonsale transactions, the regulation now permits the use of the debiting date in all cases.

Section 226.9—Subsequent Disclosure Requirements

9(a) Furnishing statement of billing rights.

9(a)(1) Annual statement.

1. *General.* The creditor may provide the annual billing rights statement:

- By sending it in one billing period per year to each consumer that gets a periodic statement for that period; or
- By sending a copy to all of its account holders sometime during the calendar year but not necessarily all in one billing period (for example, sending the annual notice in connection with renewal cards or when imposing annual membership fees).

2. *Substantially similar.* See the commentary to Appendix G-3.

9(a)(2) Alternative summary statement.

1. *Changing from long-form to short-form statement and vice versa.* If the creditor has been sending the long-form annual statement, and subsequently decides to use the alternative summary statement, the first summary statement must be sent no later than 12 months after the last long-form statement was sent. Conversely, if the creditor wants to switch to the long-form, the first long-form statement must be sent no later than 12 months after the last summary statement.

2. *Substantially similar.* See the commentary to Appendix G-4.

9(b) Disclosures for supplemental credit devices and additional features.

1. *Credit device—examples.* "Credit device" includes, for example, a blank check, payee-designated check, blank draft or order, or authorization form for issuance of a check; it does not include

a check issued payable to a consumer representing loan proceeds or the disbursement of a cash advance.

2. *Credit feature—examples.* A new credit "feature" would include, for example:

- The addition of overdraft checking to an existing account (although the regular checks that could trigger the overdraft feature are not themselves "devices").
- The option to use an existing credit card to secure cash advances, when previously the card could only be used for purchases.

Paragraph 9(b)(1).

1. *Same finance charge terms.* If the new means of accessing the account is subject to the same finance charge terms as those previously disclosed, the creditor:

- Need only provide a reminder that the new device or feature is covered by the earlier disclosures. (For example, in mailing special checks that directly access the credit line, the creditor might give a disclosure such as "Use this as you would your XYZ card to obtain a cash advance from our bank"); or
- May remake the § 226.6(a) finance charge disclosures.

Paragraph 9(b)(2).

1. *Different finance charge terms.* If the finance charge terms are different from those previously disclosed, the creditor may satisfy the requirement to give the finance charge terms either by giving a complete set of new initial disclosures reflecting the terms of the added device or feature or by giving only the finance charge disclosures for the added device or feature.

9(c) Change in terms.

1. *"Changes" initially disclosed.* No notice of a change in terms need be given if the specific change is set forth initially, such as rate increases under a properly disclosed variable rate plan; a rate increase that occurs when an employee has been under a preferential rate agreement and terminates employment; or an increase that occurs when the consumer has been under an agreement to maintain a certain balance in a savings account in order to keep a particular rate and the account balance falls below the specified minimum. In contrast, notice must be given if the contract allows the creditor to increase the rate at its discretion, but does not include specific terms for an increase (for example, when an increase may occur by vote of the board of directors).

2. *State law issues.* Examples of issues not addressed by § 226.9(c) because they are controlled by state or other applicable law include:

- The types of changes a creditor may make.
- How changed terms affect existing balances, such as when a periodic rate is changed and the consumer does not pay off the entire existing balance before the new rate takes effect.

3. *Change in billing cycle.* Whenever the creditor changes the consumer's billing cycle, it must give a change-in-terms notice if the change either affects any of the terms required to be disclosed under § 226.6 or increases the minimum payment, unless an exception under § 226.9(c)(2) applies; for example, the creditor must give advance notice if the creditor initially disclosed a 25-day free-ride period on purchases and the consumer will have fewer days during the billing cycle change.

9(c)(1) *Written notice required.*

1. *Affected consumers.* Change-in-terms notices need only go to those consumers who may be affected by the change. For example, a change in the periodic rate for check overdraft credit need not be disclosed to consumers who do not have that feature on their accounts.

2. *Timing—effective date of change.* The rule that the notice of the change in terms be provided at least 15 days before the change takes effect permits mid-cycle changes when there is clearly no retroactive effect, such as the imposition of a transaction fee. Any change in the balance computation method, in contrast, would need to be disclosed at least 15 days prior to the billing cycle in which the change is to be implemented.

3. *Timing—advance notice not required.* Advance notice of 15 days is not necessary—that is, a notice of change in terms is required, but it may be sent as late as the effective date of the change—in 2 circumstances:

- If there is an increased periodic rate or any other finance charge attributable to the consumer's delinquency or default.
- If the consumer agrees to the particular change (for example, an agreed-upon addition or substitution of collateral). But the consumer's general acceptance of the creditor's contract reservation of the right to change terms, or the consumer's use of the account (which might imply acceptance of its terms under state law), are not "agreements" between the consumer and the creditor for purposes of § 226.9(c)(1).

4. *Form of change-in-terms notice.* A complete new set of the initial disclosures containing the changed term complies with § 226.9(c) if the change is

highlighted in some way on the disclosure statement, or if the disclosure statement is accompanied by a letter or some other insert that indicates or draws attention to the term change.

5. *Security interest change—form of notice.* A copy of the security agreement that describes the collateral securing the consumer's account may be used as the notice, when the term change is the addition of a security interest or the addition or substitution of collateral.

9(c)(2) *Notice not required.*

1. *Changes not requiring notice.* The following are examples of changes that do not require a change-in-terms notice:

- A change in the consumer's credit limit.
- A change in the name of the credit card or credit card plan.
- The substitution of one insurer for another.
- A termination or suspension of credit privileges.
- Changes arising merely by operation of law; for example, if the creditor's security interest in a consumer's car automatically extends to the proceeds when the consumer sells the car.

2. *Skip features.* If a credit program allows consumers to skip or reduce one or more payments during the year, or involves temporary reductions in finance charges, no notice of the change in terms is required either prior to the reduction or upon resumption of the higher rates if these features are explained on the initial disclosure statement (including an explanation of the terms upon resumption). For example, a merchant may allow consumers to skip the December payment to encourage holiday shopping, or a teacher's credit union may not require payments during summer vacation. Otherwise, the creditor must give notice prior to resuming the original schedule or rate, even though no notice is required prior to the reduction.

9(d) *Finance charge imposed at time of transaction.*

1. *Ban on credit card surcharges.* 15 U.S.C. 1666f provides that until February 27, 1984, no seller in any sales transaction may impose a surcharge on a cardholder who elects to use a credit card instead of paying by cash, check, or similar means.

References

Statute: Section 127(a)(7).

Other sections: Sections 226.4 through 226.7 and Appendix G.

Previous regulation: Section 226.7 (d) through (f) and (j) and Interpretation §§ 226.705 and 226.708.

1981 changes: Section 226.9(a) implements the statutory change that the

long-form statement of billing rights be provided only once a year. The provision now permits two rather than one means of providing the long-form statement to consumers. The verbatim text of the annual statement is no longer required; creditors may use any version "substantially similar" to the one in Appendix G. If the creditor elects to use the alternative summary statement, the new regulation no longer requires that the long-form statement be sent upon receiving a billing error notice and at the consumer's request. The rules in § 226.708 on switching the type of billing rights statement used have been modified.

Under § 226.9(b) disclosure requirements have been streamlined when supplemental credit devices or new credit features are added to an existing open-end plan.

Section 226.9(c) substantially changes the change-in-terms rules. Change-in-terms disclosures must now be made 15 days before the effective date of the change, rather than 15 days before the billing cycle in which the change will take effect. The kinds of changes that will trigger disclosures have been reduced: change-in-terms notices are no longer required for the types of changes described in § 226.9(c)(2). But the provision reverses Interpretation § 226.705, which indicated that certain changes in the balance computation method did not require disclosure because they could result in lowered finance charges; now, any change in the balance computation method requires disclosure.

When a finance charge is imposed at the time of a transaction, § 226.9(d) only requires disclosure of the finance charge at point of sale; the amount financed and annual percentage rate figured in accordance with the closed-end credit provisions need no longer be disclosed. Furthermore, the finance charge disclosure now may be made orally by the person honoring the card.

Section 226.10—*Prompt Crediting of Payments*

10(a) *General rule.*

1. *Crediting date.* Section 226.10(a) does not require the creditor to post the payment to the consumer's account on a particular date; the creditor is only required to credit the payment as of the date of receipt.

2. *Date of receipt.* The "date of receipt" is the date that the payment instrument or other means of completing the payment reaches the creditor. For example:

- Payment by check is received when the creditor gets it, not when the

funds are collected.

- In a payroll deduction plan in which funds are deposited to an asset account held by the creditor, and from which payments are made periodically to an open-end credit account, payment is received on the date when it is debited to the asset account (rather than on the date of the deposit), provided the payroll deduction method is voluntary and the consumer retains use of the funds until the contractual payment date.
- If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the creditor gets the third-party payor's check or other transfer medium, such as an electronic fund transfer, as long as the payment meets the creditor's requirements as specified under § 226.10(b).

10(b) Specific requirements for payments.

1. *Payment requirements.* The creditor may specify requirements for making payments, such as:

- Requiring that payments be accompanied by the account number of the payment stub.
- Setting a cut-off hour for payment to be received, or set different hours for payment by mail and payments made in person.
- Specifying that only checks or money orders should be sent by mail.
- Specifying that payment is to be made in U.S. dollars.
- Specifying one particular address for receiving payments, such as a post office box.

The creditor may be prohibited, however, from specifying payment by preauthorized electronic fund transfer. (See § 913 of the Electronic Fund Transfer Act.)

2. *Payment requirements—limitations.* Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would not be reasonable to require that all payments be made in person between 10 a.m. and 11 a.m., since this would require consumers to take time-off from their jobs to deliver payments.

3. *Acceptance of non-conforming payments.* If the creditor accepts a non-conforming payment (for example, payment at a branch office, when it had specified that payment be sent to headquarters), finance charges may

accrue for the period between receipt and crediting of payments.

4. *Implied guidelines for payments.* In the absence of specified requirements for making payments (see § 226.10(b)):

- Payments may be made at any location where the creditor conducts business.
- Payments may be made any time during the creditor's normal business hours.
- Payments may be made by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the creditor and consumer have so agreed.

References

Statute: § 164.

Other sections: § 226.70.

Previous regulation: § 226.7(g).

1981 changes: Much of the explanatory detail of the previous regulation is now in the commentary. The revised regulation gives the creditor 5 days in which to credit non-conforming payments, whereas the previous regulation required the crediting of such payments promptly, with an outside limit of 5 days. The 5 days in which to credit are available whenever the creditor accepts payment that does not conform to the creditor's disclosed specifications, in contrast to the previous regulation, which only allowed deferred crediting for payments made at the wrong location.

Section 226.11—Treatment of Credit Balances

1. *Timing of refund.* The creditor may also fulfill its obligations under § 226.11 by:

- Refunding any credit balance to the consumer immediately.
- Refunding any credit balance prior to receiving a written request (under § 226.11(b)) from the consumer.
- Making a good faith effort to refund any credit balance before 6 months have passed. If that attempt is unsuccessful, the creditor need not try again to refund the credit balance at the end of the 6-month period.

2. *Amount of refund.* The phrase "any part of the credit balance remaining in the account" in § 226.11(b) and (c) means the amount of the credit balance at the time the creditor is required to make the refund. The creditor may take into consideration intervening purchases or other debits to the consumer's account (including those that have not yet been reflected on a periodic statement) that decrease or eliminate the credit balance.

Paragraph 11(b).

1. *Written requests—standing orders.* The creditor is not required to honor standing orders requesting refunds of any credit balance that may be created on the consumer's account.

Paragraph 11(c).

1. *Good faith effort to refund.* The creditor must take positive steps to return any credit balance that has remained in the account for over 6 months. This includes, if necessary, attempts to trace the consumer through the consumer's last known address or telephone number, or both.

2. *Good faith effort unsuccessful.* Section 226.11 imposes no further duties on the creditor if a good faith effort to return the balance is unsuccessful. The ultimate disposition of the credit balance (or any credit balance of \$1 or less) is to be determined under other applicable law.

References

Statute: Section 165.

Previous regulation: § 226.7(h).

1981 changes: Under the previous regulation, the creditor's duty to refund credit balances applied only to "excess payments"; § 226.10 of the revised regulation implements the amendments to § 165 of the statute which impose refunding duties on the creditor whatever the source of the credit balance. The revised regulation permits the creditor, in computing the refund, to take account of intervening debits, not just the difference between the previous balance and the overpayment as is provided in the previous regulation. The revised regulation gives the creditor 7 business days in which to make the refund after receiving the consumer's written request, whereas the previous regulation required the creditor to make the refund promptly, with an outside limit of 5 business days. This provision also implements the amended statute by requiring a good faith effort to refund the credit balance after 6 months.

Section 226.12—Special Credit Card Provisions

1. *Scope.* Sections 226.12(a) and (b) deal with the issuance and liability rules for credit cards, whether the card is intended for consumer, business, or any other purposes. Sections 226.12(a) and (b) are exceptions to the general rule that the regulation applies only to consumer credit. (See §§ 226.1 and 226.3.)

12(a) Issuance of credit cards.

Paragraph 12(a)(1).

1. *Explicit request.* A request or application for a card must be explicit. For example, a request for overdraft

privileges on a checking account does not constitute an application for a credit card with overdraft checking features.

2. *Addition of credit features.* If the consumer has a non-credit card, the addition of credit features to the card (for example, the granting of overdraft privileges on a checking account when the consumer already has a check guarantee card) constitutes issuance of a credit card.

3. *Variance of card from request.* The request or application need not correspond exactly to the card that is issued. For example:

- The name of the card requested may be different when issued.
- The card may have features in addition to those reflected in the request or application.

4. *Permissible form of request.* The request or application may be oral (in response to a telephone solicitation by a card issuer, for example) or written.

5. *Time of issuance.* A credit card may be issued in response to a request made before any cards are ready for issuance (for example, if a new program is established), even if there is some delay in issuance.

6. *Persons to whom cards may be issued.* A card issuer may issue a credit card to the person who requests it, and to anyone else for whom that person requests a card and who will be an authorized user on the requester's account. In other words, cards may be sent to consumer A on A's request, and also (on A's request) to consumers B and C, who will be authorized users on A's account. In these circumstances, the following rules apply:

- The additional cards may be imprinted in either A's name or in the names of B and C.
- No liability for unauthorized use (by persons other than B and C), not even the \$50, may be imposed on B or C since they are merely users and not "cardholders" as that term is defined in § 226.2 and used in § 226.12(b); of course, liability of up to \$50 for unauthorized use of B's and C's cards may be imposed on A.
- Whether B and C may be held liable for their own use, or on the account generally, is a matter of state or other applicable law.

7. *Issuance of non-credit cards.* The issuance of an unsolicited device that is not, but may become, a credit card, is not prohibited provided:

- The device has some substantive purpose other than obtaining credit, such as access to non-credit services offered by the issuer;
- It cannot be used as a credit card

when issued; and

- A credit capability will be added only on the recipient's request.

For example, the card issuer could send a check guarantee card on an unsolicited basis, but could not add a credit feature to that card without the consumer's specific request. The re-encoding of a debit card or other existing card that had no credit privileges when issued would be appropriate after the consumer has specifically requested a card with credit privileges. Similarly, the card issuer may add a credit feature, for example, by reprogramming the issuer's computer program or automated teller machines, or by a similar program adjustment.

Paragraph 12(a)(2).

1. *Renewal.* "Renewal" generally contemplates the regular replacement of existing cards because of, for example, security reasons or new technology or systems. It also includes the re-issuance of cards that have been suspended temporarily, but does not include the opening of a new account after a previous account was closed.

2. *Substitution—examples.* "Substitution" encompasses the replacement of one card with another because the underlying account relationship has changed in some way—such as when the card issuer has:

- Changed its name.
- Changed the name of the card.
- Changed the credit or other features available on the account. For example, the original card could be used to make purchases and obtain cash advances at teller windows. The substitute card might be usable, in addition, for obtaining cash advances through automated teller machines. (If the substitute card constitutes an access device, as defined in Regulation E, then the Regulation E issuance rules would have to be followed.)
- Substituted a card user's name on the substitute card for the cardholder's name appearing on the original card.
- Changed the merchant base. However, the new card must be honored by at least one of the persons that honored the original card.

3. *Substitution—successor card issuer.* "Substitution" also occurs when a successor card issuer replaces the original card issuer (for example, when a new card issuer purchases the accounts of the original issuer and issues its own card to replace the original one). A permissible substitution exists even if the original issuer retains the existing receivables and the new card issuer acquires the right only to

future receivables, provided use of the original card is cut off when use of the new card becomes possible.

4. *Substitution—non-credit-card plan.* A credit card that replaces a retailer's open-end credit plan *not* involving a credit card is not considered a substitute for the retailer's plan—even if the consumer used the retailer's plan. A credit card cannot be issued in these circumstances without a request or application.

5. *One-for-one rule.* An accepted card may be replaced by no more than one renewal or substitute card. For example, the card issuer may not replace a credit card permitting purchases and cash advances with two cards, one for the purchases and another for the cash advances.

6. *One-for-one rule—exception.* The regulation does not prohibit the card issuer from replacing a debit/credit card with a credit card and another card with only debit functions (or debit functions plus an associated overdraft capability), since the latter card could be issued on an unsolicited basis under Regulation E.

7. *Methods of terminating replaced card.* The card issuer need not physically retrieve the original card, provided the old card is voided in some way; for example:

- The issuer includes with the new card a notification that the existing card is no longer valid and should be destroyed immediately.
- The original card contained an expiration date.
- The card issuer, in order to preclude use of the card, reprograms computers or issues instructions to authorization centers.

8. *Incomplete replacement.* If a consumer has duplicate credit cards on the same account (Card A—one type of bank credit card, for example), the card issuer may not replace the duplicate cards with one Card A and one Card B (Card B—another type of bank credit card) unless the consumer requests Card B.

12(b) Liability of cardholder for unauthorized use.

1. *Meaning of "cardholder."* For purposes of this provision, "cardholder" includes any person (including organizations) to whom a credit card is issued for any purpose, including business. When a corporation is the cardholder, required disclosures should be provided to the corporation (as opposed to an employee user).

12(b)(1) Limitation on amount.

1. *Meaning of "authority."* Footnote 22 defines unauthorized use in terms of whether the user has "actual, implied, or apparent authority." Whether such

authority exists must be determined under state or other applicable law.

2. *Liability limits—dollar amounts.* As a general rule, the cardholder's liability for a series of unauthorized uses cannot exceed either \$50 or the value obtained through the unauthorized use before the card issuer is notified, whichever is less.

12(b)(2) Conditions of liability.

1. *Issuer's option not to comply.* A card issuer that chooses not to impose any liability on cardholders for unauthorized use need not comply with the disclosure and identification requirements discussed below.

Paragraph 12(b)(2)(ii).

1. *Disclosure of liability and means of notifying issuer.* The disclosures referred to in § 226.12(b)(2)(ii) may be given, for example, with the initial disclosures under § 226.6, on the credit card itself, or on periodic statements. They may be given at any time preceding the unauthorized use of the card.

Paragraph 12(b)(2)(iii).

1. *Means of identifying cardholder or user.* To fulfill the condition set forth in § 226.12(b)(2)(iii), the issuer must provide some method whereby the cardholder or the authorized user can be identified. This could include, for example, signature, photograph, or fingerprint on the card, or electronic or mechanical confirmation.

2. *Identification by magnetic strip.* Unless a magnetic strip (or similar device not readable without physical aids) must be used in conjunction with a secret code or the like, it would not constitute sufficient means of identification. Sufficient identification also does not exist if a "pool" or group card, issued to a corporation and signed by a corporate agent who will not be a user of the card, is intended to be used by another employee for whom no means of identification is provided.

3. *Transactions not involving card.* The cardholder may not be held liable under § 226.12(b) when the card itself (or some other sufficient means of identification of the cardholder) is not presented. Since the issuer has not provided a means to identify the user under these circumstances, the issuer has not fulfilled one of the conditions for imposing liability. For example, when merchandise is ordered by telephone by a person without authority to do so, using a credit card account number or other number only (which may be widely available), no liability may be imposed on the cardholder.

12(b)(3) Notification to card issuer.

1. *How notice must be provided.*

Notice given in a normal business manner—for example, by mail, telephone, or personal visit—is effective

even though it is not given to, or does not reach, some particular person within the issuer's organization. Notice also may be effective even though it is not given at the address or phone number disclosed by the card issuer under § 226.12(b)(2)(ii).

2. *Who must provide notice.* Notice of loss, theft, or possible unauthorized use need not be initiated by the cardholder. Notice is sufficient so long as it gives the "pertinent information" which would include the name or card number of the cardholder and an indication that unauthorized use has or may have occurred.

12(b)(5) Business use of credit cards.

1. *Agreement for higher liability for business use cards.* The card issuer may not rely on § 226.12(b)(5) if the business is clearly not in a position to provide 10 or more cards to employees (for example, if the business has only 3 employees). On the other hand, the issuer need not monitor the personnel practices of the business to make sure that it has at least 10 employees at all times.

2. *Unauthorized use by employee.* The protection afforded to an employee against liability for unauthorized use in excess of the limits set in § 226.12(b) applies only to unauthorized use by someone other than the employee. If the employee uses the card in an unauthorized manner, the regulation sets no restriction on the employee's potential liability for such use.

12(c) Right of cardholder to assert claims or defenses against card issuer.

1. *Relationship to § 226.13.* The § 226.12(c) credit card "holder in due course" provision deals with the consumer's right to assert against the card issuer a claim or defense concerning property or services purchased with a credit card, if the merchant has been unwilling to resolve the dispute. Even though certain merchandise disputes, such as non-delivery of goods, may also constitute "billing errors" under § 226.13, that section operates independently of § 226.12(c). The cardholder whose asserted billing error involves undelivered goods may institute the error resolution procedures of § 226.13; but whether or not the cardholder has done so, the cardholder may assert claims or defenses under § 226.12(c). Conversely, the consumer may pay a disputed balance and thus have no further right to assert claims and defenses, but still may assert a billing error if notice of that billing error is given in the proper time and manner. An assertion that a particular transaction resulted from unauthorized use of the

card could also be both a "defense" and a billing error.

2. *Claims and defenses assertible.* Section 226.12(c) merely preserves the consumer's right to assert against the card issuer any claims or defenses that can be asserted against the merchant. It does not determine what claims or defenses are valid as to the merchant; this determination must under be made under state or other applicable law.

12(c)(1) General rule.

1. *Situations excluded and included.* The consumer may assert claims or defenses only when the goods or services are "purchased with the credit card." This could include:

- Mail or telephone orders, if the purchase is charged to the credit card account.

But it would exclude:

- Use of a credit card to obtain a cash advance, even if the consumer then uses the money to purchase goods or services. Such a transaction would not involve "property or services purchased with the credit card."
- The purchase of goods or services by use of a check accessing an overdraft account and a credit card used solely for identification of the consumer. (On the other hand, if the credit card is used to make partial payment for the purchase and not merely for identification, the right to assert claims or defenses would apply to credit extended via the credit card, although not to the credit extended on the overdraft line.)
- Purchases made by use of a check guarantee card in conjunction with a cash advance check (or by cash advance checks alone). See footnote 24. A cash advance check is a check that, when written, does not draw on an asset account; instead, it is charged entirely to an open-end credit account.
- Purchases effected by use of either a check guarantee card or a debit card when used to draw on overdraft credit lines (see footnote 24). The debit card exemption applies whether the card accesses an asset account via point-of-sale terminals, automated teller machines, or in any other way, and whether the card qualifies as an "access device" under Regulation E or is only a paper-based debit card. If a card serves both as an ordinary credit card and also as check guarantee or debit card, a transaction will be subject to this rule on asserting claims and

defenses when used as an ordinary credit card, but not when used as a check guarantee or debit card.

12(c)(2) Adverse credit reports—prohibited.

1. *Scope of prohibition.* Although an amount in dispute may not be reported as delinquent until the matter is resolved:

- That amount may be reported as disputed.
- Nothing in this provision prohibits the card issuer from undertaking its normal collection activities for delinquent accounts.

12(c)(3) Limitations.

Paragraph 12(c)(3)(i).

1. *Resolution with merchant.* The consumer must have tried to resolve the dispute with the merchant. This does not require any special procedures or correspondence between them, and is a matter for factual determination in each case. The consumer is not required to seek satisfaction from the manufacturer of the goods involved. When the merchant is in bankruptcy proceedings, the consumer is not required to file a claim in those proceedings.

Paragraph 12(c)(3)(ii).

1. *Geographic limitation.* The question of where a transaction occurs (as in the case of mail or telephone orders, for example) is to be determined under state or other applicable law.

2. *Merchant honoring card.* The exceptions (stated in footnote 26) to the amount and geographic limitations do not apply if the merchant merely honors, or indicates through signs or advertising that it honors, a particular credit card.

12(d) Offsets by card issuer prohibited.

Paragraph 12(d)(1).

1. *"Holds" on accounts.* "Freezing" or placing a hold on funds in the cardholder's deposit account is the functional equivalent of an offset and would contravene the prohibition in § 226.12(d)(1), unless done in the context of one of the exceptions specified in § 226.12(d)(2). For example, if the terms of a security agreement permitted the card issuer to place a hold on the funds, the hold would not violate the offset prohibition. Similarly, if an order of a bankruptcy court required the card issuer to turn over deposit account funds to the trustee in bankruptcy, the issuer would not violate the regulation by placing a hold on the funds in order to comply with the court order.

2. *Funds intended as deposits.* If the consumer tenders funds as a deposit (to a checking account, for example), the card issuer may not apply the funds to repay indebtedness on the consumer's credit card account.

3. *Types of indebtedness; overdraft accounts.* The offset prohibition applies to any indebtedness arising from transactions under a credit card plan, including accrued finance charges and other charges on the account. The prohibition also applies to balances arising from transactions not using the credit card itself but taking place under plans that involve credit cards. For example, if the consumer writes a check that accesses an overdraft line of credit, the resulting indebtedness is subject to the offset prohibition since it is incurred through a credit card plan, even though the consumer did not use an associated check guarantee or debit card.

4. *When prohibition applies in case of termination of account.* The offset prohibition applies even after the card issuer terminates the cardholder's credit card privileges, if the indebtedness was incurred prior to termination. If the indebtedness was incurred after termination, the prohibition does not apply.

Paragraph 12(d)(2).

1. *Security interest—limitations.* In order to qualify for the exception stated in § 226.12(d)(2), a security interest must be affirmatively agreed to by the consumer, must be disclosed in the issuer's initial disclosures under § 226.6, and must be obtained and enforced only through procedures equally available to other creditors. For example, the consumer may offer a savings account (as an alternative to other personal property, such as an automobile) as security for credit card indebtedness. Another example of a permissible security interest in deposit account funds would be one granted by the consumer in return for an incentive offered by the issuer (for example, lower rates on the credit card account).

2. *Security interest—after-acquired property.* As used in § 226.12(d), the term "security interest" does not exclude (as it does for other Regulation Z purposes) interests in after-acquired property. Thus, a consensual security interest in deposit-account funds, including funds deposited after the granting of the security interest, would constitute a permissible exception to the prohibition on offsets.

3. *Court order.* If the card issuer obtains a judgment against the cardholder, and if state and other applicable law and the terms of the judgment do not so prohibit, the card issuer may offset the indebtedness against the cardholder's deposit account.

Paragraph 12(d)(3).

1. *Automatic payment plans—scope of exception.* With regard to automatic

debit plans under § 226.12(d)(3), the following rules apply:

- The cardholder's authorization must be in writing and signed or initialed by the cardholder.
- The authorizing language need not appear directly above or next to the cardholder's signature or initials, provided it appears on the same document and that it clearly spells out the terms of the automatic debit plan.
- If the cardholder has the option to accept or reject the automatic debit feature (such option may be required under § 913 of the Electronic Fund Transfer Act), the fact that the option exists should be clearly indicated.

2. *Automatic payment plans—additional exceptions.* The following practices are not prohibited by § 226.12(d)(1):

- Automatically deducting charges for participation in a program of banking services (one aspect of which may be a credit card plan).
- Debiting the cardholder's deposit account on the cardholder's *specific* request rather than on an *automatic* periodic basis (for example, a cardholder might check a box on the credit card bill stub, requesting the issuer to debit the cardholder's account to pay that bill).

12(e) *Prompt notification of returns and crediting of refunds.*

Paragraph 12(e)(1).

1. *Normal channels.* The term "normal channels" refers to any network or interchange system used for the processing of the original charge slips (or equivalent information concerning the transaction).

Paragraph 12(e)(2).

1. *Crediting account.* The card issuer need not actually post the refund to the consumer's account within 3 business days after receiving the credit statement, provided that it credits the account as of a date within that time period.

References

Statute: Secs. 103(1), 132, 133, 135, 162, 166, 167, 169, and 170.

Other sections: § 226.13.

Other regulations: Regulation E (12 CFR 205).

Previous regulation: § 226.13.

1981 changes: The issuance rules in § 226.12(a) make clear that cards may be sent to the person making the request and also to any other person for whom a card is requested, except that no liability for unauthorized use may be imposed on persons who are only authorized users.

The principal differences in § 226.12(b) about conditions of liability are as follows: the requirement that the cardholder be given a postage-paid, preaddressed card or envelope for notification of loss or theft has been deleted (corresponding to an amendment to the act); the required disclosures of maximum liability and of means of notification have been simplified; and the required provision of a means of identification has been changed in that the issuer now may provide a means to identify either the cardholder or the authorized user. Finally, anyone may provide the notification to the card issuer, not just the cardholder.

Section 226.12(d) on offsets clarifies that the offset prohibition does not apply to consensual security interests. The separate promptness standard which used to apply in addition to the 7-business-day and 3-business-day standards has been deleted from § 226.12(e) on prompt notification of returns. Section 226.12(f) now clarifies rules on clearing accounts.

Section 226.12(g), dealing with the relationship of the regulation to Regulation E (Electronic Fund Transfers), has been added.

Section 226.13—Billing Error Resolution

1. General prohibitions. Footnote 27 prohibits a creditor from responding to a consumer's billing error allegation by accelerating the debt or closing the account, and reflects protections authorized by § 161(d) of the Truth in Lending Act and § 701 of the Equal Credit Opportunity Act. The footnote also alerts creditors that failure to comply with the error resolution procedures may result in the forfeiture of disputed amounts as prescribed in § 161(e) of the act. (Any failure to comply may also be a violation subject to the liability provisions of § 130 of the act.)

2. Charges for error resolution. If a billing error occurred, whether as alleged or in a different amount or manner, the creditor may not impose a charge related to any aspect of the error resolution process (including charges for documentation or investigation) and must credit the consumer's account if such a charge was assessed pending resolution. Since the act grants the consumer error resolution rights, the creditor should avoid any chilling effect on the good faith assertion of errors that might result if charges are assessed when no billing error has occurred.

13(a) Definition of billing error.

1. Actual, implied, or apparent authority. Whether use of a credit card or open-end credit plan is authorized is

determined by state or other applicable law.

Paragraph 13(a)(3).

1. Coverage. Section 226.13(a)(3) covers disputes about goods or services that are "not accepted" or "not delivered . . . as agreed"; for example:

- The appearance on a periodic statement of a purchase, when the consumer refused to take delivery of goods because they did not comply with the contract.
- Delivery of property or services different from that agreed upon.
- Delivery of the wrong quantity.
- Late delivery.
- Delivery to the wrong location.

Section 226.13(a)(3) does not apply to a dispute relating to the quality of property or services that the consumer accepts. Whether acceptance occurred is determined by state or other applicable law.

Paragraph 13(a)(5).

1. Computational errors. In periodic statements that are combined with other information, the error resolution procedures are triggered only if the consumer asserts a computational billing error in the credit-related portion of the periodic statement. For example:

- If a bank combines a periodic statement reflecting the consumer's credit card transactions with the consumer's monthly checking statement, a computational error in the checking account portion of the combined statement is not a billing error.

Paragraph 13(a)(6).

1. Documentation requests. A request for documentation such as receipts or sales slips, unaccompanied by an allegation of an error under § 226.13(a) or a request for additional clarification under § 226.13(a)(6), does not trigger the error resolution procedures. For example, a request for documentation merely for purposes such as tax preparation or recordkeeping does not trigger the error resolution procedures.

13(b) Billing error notice.

1. Withdrawal. The consumer's withdrawal of a billing error notice may be oral or written.

Paragraph 13(b)(1).

1. Failure to send periodic statement—timing. If the creditor has failed to send a periodic statement, the 60-day period runs from the time the statement should have been sent. Once the statement is provided, the consumer has another 60 days to assert any billing errors reflected on it.

2. Failure to reflect credit—timing. If the periodic statement fails to reflect a credit to the account, the 60-day period runs from transmittal of the statement

on which the credit should have appeared.

3. Transmittal. If a consumer has arranged for periodic statements to be held at the financial institution until called for, the statement is "transmitted" when it is first made available to the consumer.

Paragraph 13(b)(2).

1. Identity of the consumer. The billing error notice need not specify both the name and the account number if the information supplied enables the creditor to identify the consumer's name and account.

13(c) Time for resolution; general procedures.

1. Temporary or provisional corrections. A creditor may temporarily correct the consumer's account in response to a billing error notice, but is not excused from complying with the remaining error resolution procedures within the time limits for resolution.

2. Correction without investigation. A creditor may correct a billing error in the manner and amount asserted by the consumer without the investigation or the determination normally required. The creditor must comply, however, with all other applicable provisions. If a creditor follows this procedure, no presumption is created that a billing error occurred.

Paragraph 13(c)(2).

1. Time for resolution. The phrase "two complete billing cycles" means 2 actual billing cycles occurring after receipt of the billing error notice, not a measure of time equal to 2 billing cycles. For example, if a creditor on a monthly billing cycle receives a billing error notice mid-cycle, it has the remainder of that cycle plus the next 2 full billing cycles to resolve the error.

13(d) Rules pending resolution.

1. Disputed amount. "Disputed amount" is the dollar amount alleged by the consumer to be in error. When the allegation concerns the description or identification of the transaction (such as the date or the seller's name) rather than a dollar amount, the disputed amount is the amount of the transaction or charge that corresponds to the disputed transaction identification. If the consumer alleges a failure to send a periodic statement under § 226.13(a)(7), the disputed amount is the entire balance owing.

13(d)(1) Consumer's right to withhold disputed amount; collection action prohibited.

1. Prohibited collection actions. During the error resolution period, the creditor is prohibited from trying to collect the disputed amount from the consumer. Prohibited collection actions

include, for example, instituting court action, taking a lien, or instituting attachment proceedings.

2. **Right to withhold payment.** The disclosure that payment of any disputed amount is not required pending error resolution need not appear in any specific place on the periodic statement and it need not state the specific amount that the consumer may withhold. The creditor may preprint on its periodic statement forms a statement that payment of any disputed amount is not required pending resolution.

3. **Imposition of additional charges on undisputed amounts.** The consumer's withholding of the disputed amount from the total bill cannot subject the undisputed portion to the imposition of finance or other charges. For example, if on an account with a free-ride period, a consumer disputes a \$2 item out of a total bill of \$300 and pays \$298 within the free-ride period, the consumer would not lose the free-ride as to the undisputed portion, even if the creditor determines later that no billing error occurred.

4. **Automatic payment plans—coverage.** The coverage of this provision is limited to the card issuer's intra-institutional payment plans. It does not apply to:

- Inter-institutional payment plans that permit a cardholder to pay automatically any credit card indebtedness from an asset account not held by the card issuer receiving payment.
- Intra-institutional automatic payment plans offered by financial institutions that are not credit card issuers.

5. **Automatic payment plans—time of notice.** While the card issuer does not have to restore or prevent the debiting of a disputed amount if the billing error notice arrives after the 3-business-day cut-off, the card issuer must, however, prevent the automatic debit of any part of the disputed amount that is still outstanding and unresolved at the time of the next scheduled debit date.

13(d)(2) **Adverse credit reports prohibited.**

1. **Report of dispute.** Although the creditor must not issue an adverse credit report because the consumer fails to pay the disputed amount or any related charges, the creditor may report that the amount or the account is in dispute. Also, the creditor may report the account as delinquent if undisputed amounts remain unpaid.

2. **"Person."** During the error resolution period, the creditor is prohibited from making an adverse credit report about the disputed amount

to any person—including employers, insurance companies, other creditors, and credit bureaus.

3. **Creditor's agent.** Whether an agency relationship exists between a creditor and an issuer of an adverse credit report is determined by state or other applicable law.

13(e) **Procedures if billing error occurred as asserted.**

1. **Correction of error.** The phrase "as applicable" means that the necessary corrections vary with the type of billing error that occurred. For example, a misidentified transaction (or a transaction that is identified by one of the alternative methods in § 226.8) is cured by properly identifying the transaction and crediting related finance and any other charges imposed. The creditor is not required to cancel the amount of the underlying obligation incurred by the consumer.

2. **Form of correction notice.** The written correction notice may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the periodic statement is used, the amount of the billing error must be specifically identified.

If a separate billing error correction notice is provided, the accompanying or subsequent periodic statement reflecting the corrected amount may simply identify it as "credit."

13(f) **Procedures if different billing error or no billing error occurred.**

1. **Different billing error.** Examples of a "different billing error" include:

- Differences in the amount of an error (for example, the customer asserts a \$55.00 error but the error was only \$53.00).
- Differences in other particulars asserted by the consumer (such as when a consumer asserts that a particular transaction never occurred, but the creditor determines that only the seller's name was disclosed incorrectly).

2. **Form of creditor's explanation.** The written explanation (which also may notify the consumer of corrections to the account) may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the creditor uses the periodic statement for the explanation and correction(s), the corrections must be specifically identified. If a separate explanation, including the correction notice, is provided, the enclosed or subsequent periodic statement reflecting the corrected amount may simply identify it as a "credit." The explanation

may be combined with the creditor's notice to the consumer of amounts still owing, which is required under § 226.13(g)(1), provided it is sent within the time limit for resolution. (See Comment 13(e)-1.)

13(g) **Creditor's rights and duties after resolution.**

Paragraph 13(g)(1).

1. **Amounts owed by consumer.**

Amounts the consumer still owes may include both minimum periodic payments and related finance and other charges that accrued during the resolution period.

2. **Time of notice.** The creditor need not send the notice of amount owed within the time period for resolution, although it is under a duty to send the notice promptly after resolution of the alleged error. If the creditor combines the notice of the amount owed with the explanation required under § 226.13(f)(1), the combined notice must be provided within the time limit for resolution.

Paragraph 13(g)(2).

1. The creditor need not allow any free-ride period disclosed under §§ 226.6(a)(1) and 226.7(j) to pay the amount due under § 226.13(g)(1) if no error occurred and the consumer was not entitled to a free-ride period at the time the consumer asserted the error.

Paragraph 13(g)(3).

1. **Time for payment.** The consumer has a minimum of 10 days to pay (measured from the time the consumer could reasonably be expected to have received notice of the amount owed) before the creditor may issue an adverse credit report; if an initially disclosed free-ride period allows the consumer a longer time in which to pay, the consumer has the benefit of that longer period.

Paragraph 13(g)(4).

1. **Credit reporting.** Under § 226.13(g)(4)(i) and (iii) the creditor's additional credit reporting responsibilities must be accomplished promptly. The creditor need not establish costly procedures to fulfill this requirement. For example, a creditor that reports to a credit bureau on scheduled updates need not transmit corrective information by an unscheduled computer or magnetic tape; it may provide the credit bureau with the correct information by letter or other commercially reasonable means when using the scheduled update would not be "prompt." The creditor is not responsible for ensuring that the credit bureau corrects its information immediately.

2. **Adverse report to credit bureau.** If a creditor made an adverse report to a

credit bureau that disseminated the information to other creditors, the creditor fulfills its § 226.13(g)(4)(ii) obligations by providing the consumer with the name and address of the credit bureau.

13(i) Relation to Electronic Fund Transfer Act and Regulation E.

1. *Coverage.* Credit extended directly from a non-overdraft credit line is governed solely by Regulation Z, even though a combined credit card/access device is used to obtain the extension.

2. *Incidental credit under agreement.* Credit extended incident to an electronic fund transfer under an agreement between the consumer and the financial institution is governed by § 226.13(i), which provides that certain error resolution procedures in both this regulation and Regulation E apply. Incidental credit that is not extended under an agreement between the consumer and the financial institution is governed *solely* by the error resolution procedures in Regulation E. For example:

- Credit inadvertently extended incident to an electronic fund transfer is governed solely by the Regulation E error resolution procedures, if the bank and the consumer do not have an agreement to extend credit when the consumer's account is overdrawn.

2. *Application to debit/credit transactions—examples.* If a consumer withdraws money at an automated teller machine and activates an overdraft credit feature on the checking account:

- An error asserted with respect to the transaction is subject, for error resolution purposes, to the applicable Regulation E provisions (such as timing and notice) for the entire transaction.
- The creditor need not provisionally credit the consumer's account, under § 205.11(c)(2)(i) of Regulation E, for any portion of the unpaid extension of credit.
- The creditor must credit the consumer's account under § 205.11(e) with any finance or other charges incurred as a result of the alleged error.
- The provisions of § 226.13 (d) and (g) apply only to the credit portion of the transaction.

References

Statute: Sections 161 and 162.

Other regulations: Regulation E (12 CFR 205).

Previous regulation: §§ 226.2(j) and (cc), and 226.14.

1981 changes: Section 226.13 reflects several substantive changes from the

previous regulation and a complete restructuring of the error resolution provisions. The new organization, for example, arranges the creditor's responsibilities in chronological sequence.

Section 226.13(a)(7) implements amended § 161(b) of the act, and provides that the creditor's failure to send a periodic statement to the consumer's current address is a billing error, unless the creditor received written notice of the address change fewer than 20 days (instead of 10 days) before the end of the billing cycle.

Several provisions regarding the creditor's duties after a billing error is alleged have been revised. The previous regulation immunized a creditor from liability for inadvertently taking collection action or making an adverse credit report within 2 days after receiving a billing error notice; these provisions are deleted from the revised regulation. The revised regulation no longer requires placement "on the face" of the periodic statement of the disclosure about payment of disputed amounts.

The revised regulation changes the rule in the previous regulation that a card issuer must prevent or restore an automatic debit of a disputed amount if it receives a billing error notice within 16 days after transmitting the periodic statement that reflects the alleged error. Under the revised regulation, the card issuer must prevent an automatic debit if it receives a billing error notice up to 3 days before the scheduled payment date (provided that the notice is received within the 60 days for the consumer to assert the error).

Section 226.14—Determination of Annual Percentage Rate

14(a) General rule.

1. *Tolerance.* The tolerance of $\frac{1}{8}$ of 1 percentage point above or below the annual percentage rate applies to any required disclosure of the annual percentage rate. The disclosure of the annual percentage rate is required in §§ 226.6, 226.7, 226.9, 226.15, 226.16, and 226.26.

2. *Rounding.* The regulation does not require that the annual percentage rate be calculated to any particular number of decimal places; rounding is permissible within the $\frac{1}{8}$ of 1 percent tolerance. For example, an exact annual percentage rate of 14.33333% may be stated as 14.33% or as 14.3%, or even as 14 $\frac{1}{4}$ %; but it could not be stated as 14.2% or 14%, since each varies by more than the permitted tolerance.

3. *Periodic rates.* No explicit tolerance exists for any periodic rate as such; a disclosed periodic rate may vary from

precise accuracy (for example, due to rounding) only to the extent that its annualized equivalent is within the tolerance permitted § 226.14(a). Further, a periodic rate need not be calculated to any particular number of decimal places.

4. *Finance charges.* The regulation does not prohibit creditors from assessing finance charges on balances that include prior, unpaid finance charges; state or other applicable law may do so, however.

14(b) Annual percentage rate for initial disclosures and for advertising purposes.

1. *Corresponding annual percentage rate computation.* For initial disclosures (under § 226.6) and for advertising (under § 226.16), the annual percentage rate is determined by multiplying the periodic rate by the number of periods in the year. This computation reflects the fact that, in such disclosures, the rate (known as the corresponding annual percentage rate) is prospective and does not involve any particular finance charge or periodic balance. This computation also is used to determine any annual percentage rate for oral disclosures under § 226.26(a).

14(c) Annual percentage rate for periodic statements.

1. *General rule.* Section 226.14(c) requires disclosure of the corresponding annual percentage rate for each periodic rate (under § 226.7(d)). It is figured by multiplying each periodic rate by the number of periods per year. This disclosure is like that provided on the initial disclosure statement. The periodic statement also must reflect (under § 226.7(g)) the annualized equivalent of the rate actually applied during a particular cycle (the historical rate); this rate may differ from the corresponding annual percentage rate because of the inclusion of fixed, minimum, or transaction charges. Sections 226.14 (c)(1) through (c)(4) state the computation rules for the historical rate.

2. *Periodic rates.* Section 226.14(c)(1) applies if the only finance charge imposed is due to the application of a periodic rate to a balance. The creditor may compute the annual percentage rate either:

- By multiplying each periodic rate by the number of periods in the year; or
- By the "quotient" methods. This method refers to a composite annual percentage rate when different periodic rates apply to different balances. For example, a particular plan may involve a periodic rate of 1 $\frac{1}{2}$ % on balances up to \$500, and 1% on balances over

include, for example, instituting court action, taking a lien, or instituting attachment proceedings.

2. **Right to withhold payment.** The disclosure that payment of any disputed amount is not required pending error resolution need not appear in any specific place on the periodic statement and it need not state the specific amount that the consumer may withhold. The creditor may preprint on its periodic statement forms a statement that payment of any disputed amount is not required pending resolution.

3. **Imposition of additional charges on undisputed amounts.** The consumer's withholding of the disputed amount from the total bill cannot subject the undisputed portion to the imposition of finance or other charges. For example, if on an account with a free-ride period, a consumer disputes a \$2 item out of a total bill of \$300 and pays \$298 within the free-ride period, the consumer would not lose the free-ride as to the undisputed portion, even if the creditor determines later that no billing error occurred.

4. **Automatic payment plans—coverage.** The coverage of this provision is limited to the card issuer's intra-institutional payment plans. It does not apply to:

- Inter-institutional payment plans that permit a cardholder to pay automatically any credit card indebtedness from an asset account not held by the card issuer receiving payment.
- Intra-institutional automatic payment plans offered by financial institutions that are not credit card issuers.

5. **Automatic payment plans—time of notice.** While the card issuer does not have to restore or prevent the debiting of a disputed amount if the billing error notice arrives after the 3-business-day cut-off, the card issuer must, however, prevent the automatic debit of any part of the disputed amount that is still outstanding and unresolved at the time of the next scheduled debit date.

13(d)(2) **Adverse credit reports prohibited.**

1. **Report of dispute.** Although the creditor must not issue an adverse credit report because the consumer fails to pay the disputed amount or any related charges, the creditor may report that the amount or the account is in dispute. Also, the creditor may report the account as delinquent if undisputed amounts remain unpaid.

2. **"Person."** During the error resolution period, the creditor is prohibited from making an adverse credit report about the disputed amount

to any person—including employers, insurance companies, other creditors, and credit bureaus.

3. **Creditor's agent.** Whether an agency relationship exists between a creditor and an issuer of an adverse credit report is determined by state or other applicable law.

13(e) **Procedures if billing error occurred as asserted.**

1. **Correction of error.** The phrase "as applicable" means that the necessary corrections vary with the type of billing error that occurred. For example, a misidentified transaction (or a transaction that is identified by one of the alternative methods in § 226.8) is cured by properly identifying the transaction and crediting related finance and any other charges imposed. The creditor is not required to cancel the amount of the underlying obligation incurred by the consumer.

2. **Form of correction notice.** The written correction notice may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the periodic statement is used, the amount of the billing error must be specifically identified.

If a separate billing error correction notice is provided, the accompanying or subsequent periodic statement reflecting the corrected amount may simply identify it as "credit."

13(f) **Procedures if different billing error or no billing error occurred.**

1. **Different billing error.** Examples of a "different billing error" include:

- Differences in the amount of an error (for example, the customer asserts a \$55.00 error but the error was only \$53.00).
- Differences in other particulars asserted by the consumer (such as when a consumer asserts that a particular transaction never occurred, but the creditor determines that only the seller's name was disclosed incorrectly).

2. **Form of creditor's explanation.** The written explanation (which also may notify the consumer of corrections to the account) may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the creditor uses the periodic statement for the explanation and correction(s), the corrections must be specifically identified. If a separate explanation, including the correction notice, is provided, the enclosed or subsequent periodic statement reflecting the corrected amount may simply identify it as a "credit." The explanation

may be combined with the creditor's notice to the consumer of amounts still owing, which is required under § 226.13(g)(1), provided it is sent within the time limit for resolution. (See Comment 13(e)-1.)

13(g) **Creditor's rights and duties after resolution.**

Paragraph 13(g)(1).

1. **Amounts owed by consumer.**

Amounts the consumer still owes may include both minimum periodic payments and related finance and other charges that accrued during the resolution period.

2. **Time of notice.** The creditor need not send the notice of amount owed within the time period for resolution, although it is under a duty to send the notice promptly after resolution of the alleged error. If the creditor combines the notice of the amount owed with the explanation required under § 226.13(f)(1), the combined notice must be provided within the time limit for resolution.

Paragraph 13(g)(2).

1. The creditor need not allow any free-ride period disclosed under §§ 226.6(a)(1) and 226.7(j) to pay the amount due under § 226.13(g)(1) if no error occurred and the consumer was not entitled to a free-ride period at the time the consumer asserted the error.

Paragraph 13(g)(3).

1. **Time for payment.** The consumer has a minimum of 10 days to pay (measured from the time the consumer could reasonably be expected to have received notice of the amount owed) before the creditor may issue an adverse credit report; if an initially disclosed free-ride period allows the consumer a longer time in which to pay, the consumer has the benefit of that longer period.

Paragraph 13(g)(4).

1. **Credit reporting.** Under § 226.13(g)(4)(i) and (iii) the creditor's additional credit reporting responsibilities must be accomplished promptly. The creditor need not establish costly procedures to fulfill this requirement. For example, a creditor that reports to a credit bureau on scheduled updates need not transmit corrective information by an unscheduled computer or magnetic tape; it may provide the credit bureau with the correct information by letter or other commercially reasonable means when using the scheduled update would not be "prompt." The creditor is not responsible for ensuring that the credit bureau corrects its information immediately.

2. **Adverse report to credit bureau.** If a creditor made an adverse report to a

credit bureau that disseminated the information to other creditors, the creditor fulfills its § 226.13(g)(4)(ii) obligations by providing the consumer with the name and address of the credit bureau.

13(i) Relation to Electronic Fund Transfer Act and Regulation E.

1. *Coverage.* Credit extended directly from a non-overdraft credit line is governed solely by Regulation Z, even though a combined credit card/access device is used to obtain the extension.

2. *Incidental credit under agreement.* Credit extended incident to an electronic fund transfer under an agreement between the consumer and the financial institution is governed by § 226.13(i), which provides that certain error resolution procedures in both this regulation and Regulation E apply. Incidental credit that is not extended under an agreement between the consumer and the financial institution is governed *solely* by the error resolution procedures in Regulation E. For example:

- Credit inadvertently extended incident to an electronic fund transfer is governed solely by the Regulation E error resolution procedures, if the bank and the consumer do not have an agreement to extend credit when the consumer's account is overdrawn.

2. *Application to debit/credit transactions—examples.* If a consumer withdraws money at an automated teller machine and activates an overdraft credit feature on the checking account:

- An error asserted with respect to the transaction is subject, for error resolution purposes, to the applicable Regulation E provisions (such as timing and notice) for the entire transaction.
- The creditor need not provisionally credit the consumer's account, under § 205.11(c)(2)(i) of Regulation E, for any portion of the unpaid extension of credit.
- The creditor must credit the consumer's account under § 205.11(e) with any finance or other charges incurred as a result of the alleged error.
- The provisions of § 226.13 (d) and (g) apply only to the credit portion of the transaction.

References

Statute: Sections 161 and 162.

Other regulations: Regulation E (12 CFR 205).

Previous regulation: §§ 226.2(j) and (cc), and 226.14.

1981 changes: Section 226.13 reflects several substantive changes from the

previous regulation and a complete restructuring of the error resolution provisions. The new organization, for example, arranges the creditor's responsibilities in chronological sequence.

Section 226.13(a)(7) implements amended § 161(b) of the act, and provides that the creditor's failure to send a periodic statement to the consumer's current address is a billing error, unless the creditor received written notice of the address change fewer than 20 days (instead of 10 days) before the end of the billing cycle.

Several provisions regarding the creditor's duties after a billing error is alleged have been revised. The previous regulation immunized a creditor from liability for inadvertently taking collection action or making an adverse credit report within 2 days after receiving a billing error notice; these provisions are deleted from the revised regulation. The revised regulation no longer requires placement "on the face" of the periodic statement of the disclosure about payment of disputed amounts.

The revised regulation changes the rule in the previous regulation that a card issuer must prevent or restore an automatic debit of a disputed amount if it receives a billing error notice within 16 days after transmitting the periodic statement that reflects the alleged error. Under the revised regulation, the card issuer must prevent an automatic debit if it receives a billing error notice up to 3 days before the scheduled payment date (provided that the notice is received within the 60 days for the consumer to assert the error).

Section 226.14—Determination of Annual Percentage Rate

14(a) General rule.

1. *Tolerance.* The tolerance of $\frac{1}{8}$ of 1 percentage point above or below the annual percentage rate applies to any required disclosure of the annual percentage rate. The disclosure of the annual percentage rate is required in §§ 226.6, 226.7, 226.9, 226.15, 226.16, and 226.26.

2. *Rounding.* The regulation does not require that the annual percentage rate be calculated to any particular number of decimal places; rounding is permissible within the $\frac{1}{8}$ of 1 percent tolerance. For example, an exact annual percentage rate of 14.33333% may be stated as 14.33% or as 14.3%, or even as 14 $\frac{1}{4}$ %; but it could not be stated as 14.2% or 14%, since each varies by more than the permitted tolerance.

3. *Periodic rates.* No explicit tolerance exists for any periodic rate as such; a disclosed periodic rate may vary from

precise accuracy (for example, due to rounding) only to the extent that its annualized equivalent is within the tolerance permitted § 226.14(a). Further, a periodic rate need not be calculated to any particular number of decimal places.

4. *Finance charges.* The regulation does not prohibit creditors from assessing finance charges on balances that include prior, unpaid finance charges; state or other applicable law may do so, however.

14(b) Annual percentage rate for initial disclosures and for advertising purposes.

1. *Corresponding annual percentage rate computation.* For initial disclosures (under § 226.6) and for advertising (under § 226.16), the annual percentage rate is determined by multiplying the periodic rate by the number of periods in the year. This computation reflects the fact that, in such disclosures, the rate (known as the corresponding annual percentage rate) is prospective and does not involve any particular finance charge or periodic balance. This computation also is used to determine any annual percentage rate for oral disclosures under § 226.26(a).

14(c) Annual percentage rate for periodic statements.

1. *General rule.* Section 226.14(c) requires disclosure of the corresponding annual percentage rate for each periodic rate (under § 226.7(d)). It is figured by multiplying each periodic rate by the number of periods per year. This disclosure is like that provided on the initial disclosure statement. The periodic statement also must reflect (under § 226.7(g)) the annualized equivalent of the rate actually applied during a particular cycle (the historical rate); this rate may differ from the corresponding annual percentage rate because of the inclusion of fixed, minimum, or transaction charges. Sections 226.14 (c)(1) through (c)(4) state the computation rules for the historical rate.

2. *Periodic rates.* Section 226.14(c)(1) applies if the only finance charge imposed is due to the application of a periodic rate to a balance. The creditor may compute the annual percentage rate either:

- By multiplying each periodic rate by the number of periods in the year; or
- By the "quotient" methods. This method refers to a composite annual percentage rate when different periodic rates apply to different balances. For example, a particular plan may involve a periodic rate of 1 $\frac{1}{2}$ % on balances up to \$500, and 1% on balances over

\$500. If, in a given cycle, the consumer has a balance of \$800, the finance charge would consist of \$7.50 ($500 \times .015$) plus \$3.00 ($300 \times .01$), for a total finance charge of \$10.50. The annual percentage rate for this period may be disclosed either as 18% on \$500 and 12% on \$300, or as 15.75% on a balance of \$800 (the quotient of \$10.50 divided by \$800, multiplied by 12).

3. *Charges not based on periodic rates.* Section 226.14(c)(2) applies if the finance charge imposed includes a charge not due to the application of a periodic rate (other than a charge relating to a specific transaction). For example, if the creditor imposes a minimum \$1 finance charge on all balances below \$50, and the consumer's balance was \$40 in a particular cycle, the creditor would disclose an annual percentage rate of $(30\% \frac{1}{40} \times 12)$.

4. *No balance.* Footnote 32 to § 226.14(c)(2) would apply not only when minimum charges are imposed on an account with no balance, but also to a plan in which a periodic rate is applied to advances from the date of the transaction. For example, if on May 19 the consumer pays the new balance in full from a statement dated May 1, and has no further transactions reflected on the June 1 statement, that statement would reflect a finance charge with no account balance.

5. *Transaction charges.* Section 226.14(c)(3) transaction charges include, for example:

- A loan fee of \$10 imposed on a particular advance.
- A charge of 3% of the amount of each transaction.

The reference to avoiding duplication in the computation requires that the amounts of transactions on which transaction charges were imposed not be included both in the amount of total balances and in the "other amounts on which a finance charge was imposed" figure. For further explanation and examples of how to determine the components of this formula, see Appendix F.

6. *Charges related to opening account.* Footnote 33 is applicable to § 226.14(c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to activity on the account, but relate solely to the opening of the account. Inclusion of these charges in the annual percentage rate calculation results in significant distortions of the annual percentage rate and delivery of a possibly misleading disclosure to consumers. The rule in footnote 33 applies even if the loan fee, points, or

similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

7. *Classification of charges.* If the finance charge includes a charge not due to the application of a periodic rate, the creditor must determine the proper annual percentage rate computation method according to the type of charge imposed. If the charge is tied to a specific transaction (for example, 3% of the amount of each transaction), then the method in § 226.14(c)(3) must be used. If a fixed or minimum charge is applied, that is, one not tied to any specific transaction, then the formula in § 226.14(c)(2) is appropriate.

8. *Small finance charges.* Section 226.14(c)(4) gives the creditor an alternative to § 226.14(c)(2) and (c)(3) if small (50 cents or less) minimum or fixed fees are involved. For example, while a monthly activity fee of 50 cents on a balance of \$20 would produce an annual percentage rate of 30% under the rule in § 226.14(c)(2), the creditor may disclose an annual percentage rate of 18% if the periodic rate generally applicable to all balances is $1\frac{1}{2}\%$ per month. This option is consistent with the provision in footnote 11 to §§ 226.6 and 226.7 permitting the creditor to disregard the effect of minimum charges in disclosing the ranges of balances to which periodic rates apply.

14(d) *Calculations where daily periodic rate applied.*

1. *Quotient methods.* Section 226.14(d) addresses use of a daily periodic rate(s) to determine some or all of the finance charge and use of the quotient method to determine the annual percentage rate. Since the quotient formula in § 226.14(c)(1)(ii) does not work when a daily rate is being applied to a series of daily balances, § 226.14(d) gives the creditor 2 alternative ways to figure the annual percentage rate—either of which satisfies the requirement in § 226.7(g).

2. *Daily rate with specific transaction charge.* If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, the calculation method in § 226.14(d)(2) should be used.

References

Statute: Section 107.

Other sections: §§ 226.6, 226.7, 226.9, 226.15, 226.16, and 226.26.

Previous regulation: § 226.5(a) and Interpretation §§ 226.501 and 226.506.

1981 changes: Section 226.14 reflects the statutory amendment permitting a $\frac{1}{8}$ of 1 percent tolerance for annual percentage rates. The revised regulation no longer reflects the provision dealing with finance charges imposed on

specified ranges or brackets of balances. The revised regulation includes a footnote providing that loan fees, points, or similar charges unrelated to any specific transaction are not figured into the annual percentage rate computation.

Section 226.15—Right of Rescission

1. *Transactions not covered.* Credit extensions that are not subject to the regulation are not covered by § 226.15 even if the customer's principal dwelling is the collateral securing the credit. For this purpose, "credit extensions" also would include the occurrences listed in Comment 15(a)(1)–1. For example, the right of rescission does not apply to the opening of a business-purpose credit line, even though the loan is secured by the customer's principal dwelling.

15(a) *Consumer's right to rescind.*
Paragraph 15(a)(1).

1. *Occurrences subject to right.* Under an open-end credit plan secured by the consumer's principal dwelling, the right of rescission generally arises with each of the following occurrences:

- Opening the account.
- Each credit extension.
- Increasing the credit limit.
- Adding to an existing account a security interest in the consumer's principal dwelling.
- Increasing the dollar amount of the security interest taken in the dwelling to secure the plan. For example, a consumer may open an account with a \$10,000 credit limit, \$5,000 of which is initially secured by the consumer's principal dwelling. The consumer has the right to rescind at that time and (except as noted in § 226.15(a)(1)(ii)) with each extension on the account. Later, if the creditor decides that it wants the credit line fully secured, and increases the amount of its interest in the consumer's dwelling, the consumer has the right to rescind the increase.

2. *Exceptions.* Although the consumer generally has the right to rescind with each transaction on the account, § 125(e) of the act provides an exception: until March 31, 1985, the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a previously established credit limit for the plan. The consumer will have the right to rescind each extension made after March 31, 1985, under such a secured open-end credit plan, whether that plan was established before or after that date.

3. *Security interest arising from transaction.* In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

- A security interest that is acquired by a contractor who is also extending the credit in the transaction.
- A mechanic's or materialman's lien that is retained by a subcontractor or supplier of a contractor-creditor, even when the latter has waived its own security interest in the consumer's home.

The security interest is not part of the credit transaction, and therefore the transaction is not subject to the right of rescission when, for example:

- A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but merely is paid with the proceeds of the consumer's cash advance.
- All security interests that may arise in connection with the credit transaction are validly waived.
- The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

Although liens arising by operation of law are not considered security interests for purposes of disclosure under § 226.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under § 226.6(c), it may still give rise to the right of rescission.

4. *Consumer.* To be a consumer within the meaning of § 226.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse enters into a secured plan, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

5. *Principal dwelling.* A consumer can only have one principal dwelling at a time. A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal

dwelling when it secures the open-end credit line. Dwelling, as defined in § 226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

6. *Special rule for principal dwelling.* When the consumer is acquiring or constructing a new principal dwelling, any credit plan or extension secured by the equity in the consumer's current principal dwelling (for example, an advance to be used as a bridge loan) is still subject to the right of rescission.

Paragraph 15(a)(2).

1. *Consumer's exercise of right.* The consumer must exercise the right of rescission in writing, but not necessarily on the notice supplied under § 226.15(b). Whatever the means of sending the notification of rescission—mail, telegram, or other written means—the time period for the creditor's performance under § 226.15(d)(2) does not begin to run until the notification has been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under § 226.15(b).

Paragraph 15(a)(3).

1. *Rescission period.* The period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:

- The occurrence that gives rise to the right of rescission.
- Delivery of all material disclosures that are relevant to the plan.
- Delivery to the consumer of the required rescission notice.

For example, an account is opened on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31; the rescission period will expire at midnight of the third business day after June 1—that is, Tuesday June 5. In another example, if the disclosures are given and the account is opened on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4—that is Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.

2. *Material disclosures.* Footnote 36 sets forth the material disclosures that must be provided before the rescission period can begin to run. The creditor must provide sufficient information to satisfy the requirements of § 226.6 for

these disclosures. A creditor may satisfy this requirement by giving an initial disclosure statement that complies with the regulation. Failure to give the other required initial disclosures (such as the billing rights statement) does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.

3. *Material disclosures—variable rate program.* For a variable rate program, the material disclosures also include the disclosures listed in footnote 12 to § 226.6(a)(2): the circumstances under which the rate may increase; the limitations on the increase; and the effect of an increase.

4. *Unexpired right of rescission.* When the creditor has failed to take the action necessary to start the 3-day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following 3 events:

- The expiration of 3 years after the occurrence giving rise to the right of rescission.
- Transfer of all the consumer's interest in the property.
- Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back legal title through a purchase money note and mortgage.

Transfer of all the consumer's interest includes such transfer as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in § 125 of the act, the 3-year limit may be extended by an administrative proceeding to enforce the provisions of § 226.15. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

Paragraph 15(a)(4).

1. *Joint owners.* When more than one consumer has the right to rescind a transaction, any one of them may exercise that right and cancel the transaction on behalf of all. For example, if both a husband and wife have the right to rescind a transaction, either spouse acting alone may exercise the right and both are bound by the rescission.

15(b) Notice of right to rescind.

1. *Who receives notice.* Each consumer entitled to rescind must be given:

- Two copies of the rescission notice.
- The material disclosures.

In a transaction involving joint owners, both of the whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive 2 copies of the rescission notice and one copy of the disclosures.

2. *Format.* The rescission notice may be physically separated from the material disclosures or combined with the material disclosures, so long as the information required to be included on the notice is set forth in a clear and conspicuous manner. See the model notices in Appendix G.

3. *Content.* The notice must include all of the information outlined in § 226.15(b)(1) through (5). The requirement in § 226.15(b) that the transaction or occurrence be identified may be met by providing the date of the transaction or occurrence. The notice may include additional information related to the required information, such as:

- A description of the property subject to the security interest.
- A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.
- The name and address of an agent of the creditor to receive notice of rescission.

4. *Time of providing notice.* The notice required by § 226.15(b) need not be given before the occurrence giving rise to the right of rescission. The creditor may deliver the notice after the occurrence, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the credit limit was raised on May 10, the 3-business-day rescission period will run from May 15.

15(c) *Delay of creditor's performance.*

1. *General rule.* Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

- Disburse advances to the consumer.
- Begin performing services for the consumer.
- Deliver materials to the consumer.

2. *Escrow.* The creditor may disburse advances during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as "trustee" or "escrow agent" and distribute funds to the consumer in that capacity during the delay period.

3. *Permissible actions.* Section 226.15(c) does not prevent the creditor from taking other steps during the delay,

short of beginning actual performance. The creditor may, for example:

- Prepare the cash advance check.
- Perfect the security interest.
- Accrue finance charges during the delay period.

4. *Performance by third party.* The creditor is relieved from liability for failure to delay performance if a third party with no knowledge that the rescission right has been activated provides materials or services, as long as any debt incurred for materials or services obtained by the consumer during the rescission period is not secured by the security interest in the consumer's dwelling. For example, if a consumer uses a bank credit card to purchase materials from a merchant in an amount below the floor limit, the merchant might not contact the card issuer for authorization and therefore would not know that materials should not be provided.

5. *Delay beyond rescission period.* The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

- Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.
- Obtaining a written statement from the consumer that the right has not been exercised.

When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

15(d) *Effects of rescission.*

Paragraph 15(d)(1).

1. *Termination of security interest.*

Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated, regardless of its status and whether or not it was recorded or perfected. Under § 226.15(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

2. *Extent of termination.* The creditor's security interest is void to the extent that it is related to the occurrence giving rise to the right of rescission. For example, upon rescission:

- If the consumer's right to rescind is activated by the opening of a plan, any security interest in the principal dwelling is void.
- If the right arises due to an increase in the credit limit, the security interest is void as to the amount of

credit extensions over the prior limit, but the security interest in amounts up to the original credit limit is unaffected.

- If the right arises with each individual credit extension, then the interest is void as to that extension, and other extensions are unaffected.

Paragraph 15(d)(2).

1. *Refunds to consumer.* The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the occurrence subject to the right of rescission. Any amounts of this nature already paid by the consumer must be refunded. "Any amount" includes finance charges already accrued, as well as other charges such as application and commitment fees or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party. It is irrelevant that these amounts may not represent profit to the creditor. For example;

- If the occurrence is the opening of the plan, the creditor must return any membership or application fee paid.
- If the occurrence is the increase in a credit limit or the addition of a security interest, the creditor must return any fee imposed for a new credit report or filing fees.
- If the occurrence is a credit extension, the creditors must return fees such as application, title, and appraisal or survey fees, as well as any finance charges related to the credit extension.

2. *Amounts not refundable to consumer.* Creditors need not return any money given by the consumer to a third party outside of the occurrence, such as costs incurred for a building permit or for a zoning variance. Similarly, the term "any amount" does not apply to money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under § 226.15(d)(3).

3. *Reflection of security interest termination.* The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the occurrence rescinded by the consumer, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action

refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.

Paragraph 15(d)(3).

1. *Property exchange.* Once the creditor has fulfilled its obligation under § 226.15(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if fixtures or furniture have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer *must* be tendered at the creditor's place of business. For purpose of property exchange, the following additional rules apply:

- A cash advance is considered money for purposes of this section even if the creditor knows what the consumer intends to purchase with the money.
- In a 3-party open-end credit plan (that is, if the creditor and seller are not the same or related persons), extensions by the creditor that are used by the consumer for purchases from third-party sellers are considered to be the same as cash advances for purposes of tendering value to the creditor, even though the transaction is a purchase for other purposes under the regulation. For example, if a consumer exercises the unexpired right to rescind after using a 3-party credit card for one year, the consumer would tender the amount of the purchase price for the items charged to the account, rather than tendering the items themselves to the creditor.

2. *Reasonable value.* If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.

Paragraph 15(d)(4).

1. *Modifications.* The procedures outlined in § 226.15(d)(2) and (d)(3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or

when the equities dictate, a modification might be made.

15(e) Consumer's waiver of right to rescind.

1. *Need for waiver.* To waive the right to rescind, the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.

2. *Procedure.* To waive or modify the right to rescind, the consumer must give a written statement that specifically waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.

15(f) Exempt transactions.

1. *Residential mortgage transaction.* Although residential mortgage transactions would seldom be made on bona fide open-end credit plans (under which repeated transactions must be reasonably contemplated), an advance on an open-end plan could be for a downpayment for the purchase of a dwelling that would then secure the remainder of the line. In such a case, only the particular advance for the downpayment would be exempt from the rescission right.

2. *State creditors.* Cities and other political subdivisions of states acting as creditors are not exempt from § 226.15.

3. *Spreader clause.* When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a "spreader clause" (also known as a "dragnet" or cross-collateralization clause), subsequent occurrences such as the opening of a plan or individual credit extensions are subject to the right of rescission to the same degree as if the security interest were taken directly to secure the open-end plan, unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent open-end credit extensions.

References

Statute: Secs. 113, 125, and 130.

Other sections: §§ 226.2 and

Appendix G.

Previous regulation: § 226.9.

1981 changes: Section 226.15 reflects the statutory amendments of 1980, providing for a limited right of rescission for a 3-year trial period when individual credit extensions are made in

accordance with a previously established credit limit for an open-end credit plan.

The right to rescind applies not only to real property used as the consumer's principal dwelling, but to personal property as well. The regulation provides no specific text or format for the rescission notice.

When a consumer exercises the right to rescind, the creditor now has 20 days to return a consumer's money or property and take the necessary action to terminate the security interest. The creditor has 20 days to take possession of the money or property after the consumer's tender before the consumer may keep it without further obligation.

Under the revised regulation, the waiver provision has been relaxed. The lien status of the mortgage is irrelevant for purposes of the residential mortgage transaction exemption. The exemption for agricultural loans from the right to rescind has been deleted.

Section 226.16—Advertising

1. *Clear and conspicuous standard.* Section 226.16 is subject to the general "clear and conspicuous" standard for Subpart B (see § 226.5(a)(1)) but prescribes no specific rules for the format of the necessary disclosures. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement.

16(a) Actually available terms.

1. *General rule.* To the extent that an advertisement mentions specific credit terms, it may state only those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low annual percentage rate that will not in fact be available at any time. Section 226.16(a) is not intended to inhibit the promotion of new credit programs, but to bar the advertising of terms that are not and will not be available. For example, a creditor may advertise terms that will be offered for only a limited period, or terms that will become available at a future date.

2. *Specific credit terms.* "Specific credit terms" is not limited to the disclosures required by the regulation but would include any specific components of a credit plan, such as the minimum periodic payment amount or seller's points in a plan secured by real estate.

16(b) Advertisement of terms that require additional disclosures.

1. *Use of positive terms.* An advertisement must state a credit term as a positive number in order to trigger additional disclosures. For example, "no

annual membership fee" would not trigger the additional disclosures required by § 226.16(b).

2. *Implicit terms.* Section 226.16(b) applies even if the triggering term is not stated explicitly, but may be readily determined from the advertisement. For example, a statement that "the equity in your home becomes spendable with an XYZ line of credit" implicitly states that the creditor will take a security interest in the consumer's home.

3. *Membership fees.* A membership fee is not a triggering term nor need it be disclosed under § 226.16(b)(3) if it is required for participation in the plan whether or not an open-end credit feature is attached. (See Comment 6(b)-1.)

4. *Variable rate plans.* An advertisement for a variable rate plan complies with § 226.16(b)(2) if it discloses that "the annual percentage rate may vary" or a similar statement, but the advertisement need not include the information required by footnote 12 to § 226.6(a)(2).

5. *Triggering terms.* The following are examples of terms that trigger additional disclosures:

- "Charge it—it won't be billed to your account until February."
- "Small monthly service charge on the remaining balance."
- "12% Annual Percentage Rate."
- "A \$15 annual membership fee buys you \$2,000 in credit."

16(c) Catalogs and multiple-page advertisements.

1. *Definition.* The multiple-page advertisements to which § 226.16(c) refers are advertisements consisting of a series of sequentially numbered pages—for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.16(c).

Paragraph 16(c)(1).

1. *General.* Section 226.16(c)(1) permits creditors to put credit information together in one place in a catalog or multiple-page advertisement. The rule applies only if the catalog or multiple-page advertisement contains one or more of the triggering terms from § 226.16(b).

Paragraph 16(c)(2).

1. *Table or schedule if credit terms depend on outstanding balance.* If the credit terms of a plan vary depending on the amount of the balance outstanding, rather than the amount of any property purchased, a table or schedule complies with § 226.16(c)(2) if it includes the required disclosures for representative

balances. For example, a creditor would disclose that a periodic rate of 1.5% is applied to balances of \$500 or less, and a 1% rate is applied to balances greater than \$500.

References

Statute: Secs. 141 and 143.

Previous regulation: § 226.10 (a) through (c) and Interpretation § 226.1002.

Other sections: §§ 226.2 and 226.6.

1981 changes: Section 226.16 reflects the statutory changes to § 143 of the act which reduce both the number of triggering terms and the additional disclosures required by the use of those terms. Membership or participation fees are included among the additional disclosures required when a triggering term is used. The substance of Interpretation § 226.1002, requiring disclosure of representative amounts of credit in catalogs and multiple-page advertisements, has been incorporated in simplified form in paragraph (c).

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

17(a) Form of disclosures.

Paragraph 17(a)(1).

1. *Clear and conspicuous.* This standard requires that disclosures be in a reasonably understandable form. For example, while the regulation requires no mathematical progression or format, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other. In addition, although no minimum type size is mandated, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

2. *Segregation of disclosures.* The disclosures may be grouped together and segregated from other information in a variety of ways. For example, the disclosures may appear on a separate sheet of paper or may be set off from other information on the contract or other documents:

- By outlining them in a box.
- By bold print dividing lines.
- By a different color background.
- By a different type style.

3. *Location.* The regulation imposes no specific location requirements on the segregated disclosures. For example:

- They may appear on a disclosure statement separate from all other material.
- They may be placed on the same document with the credit contract or other information, so long as they are segregated from that information.
- They may be shown on the front or

back of a document.

- They need not begin at the top of a page.
- They may be continued from one page to another.

4. Content of segregated disclosures.

Footnotes 37 and 38 contain exceptions to the requirement that the disclosures under § 226.18 be segregated from material that is not directly related to those disclosures. Footnote 37 lists the items that may be added to the segregated disclosures, even though not directly related to those disclosures. Footnote 38 lists the items required under § 226.18 that may be deleted from the segregated disclosures and appear elsewhere. Any one or more of these additions or deletions may be combined and appear either together with or separate from the segregated disclosures. The itemization of the amount financed under § 226.18(c), however, must be separate from the other segregated disclosures under § 226.18.

5. *Directly related.* The segregated disclosures may, at the creditor's option, include any information that is directly related to those disclosures. Directly related information includes, for example, the following:

- A description of a grace period after which a late payment charge will be imposed. For example, the disclosure given under § 226.18(l) may state that a late charge will apply to "any payment received more than 15 days after the due date."
- A statement that the transaction is not secured. For example, the creditor may add a category labelled "unsecured" or "not secured" to the security interest disclosures given under § 226.18(m).
- The basis for any estimates used in making disclosures. For example, if the maturity date of a loan depends solely on the occurrence of a future event, the creditor may indicate that the disclosures assume that event will occur at a certain time.
- The conditions under which a demand feature may be exercised. For example, in a loan subject to demand after 5 years, the disclosures may state that the loan will become payable on demand in 5 years.
- When a variable rate feature is disclosed on other documents under footnote 43 to § 226.18(f), a reference to the variable rate feature and/or to other documents on which the variable rate disclosures are made.

- An explanation of the use of pronouns or other references to the parties to the transaction. For example, the disclosures may state, "You" refers to the customer and "we" refers to the creditor."
- Instructions to the creditor or its employees on the use of a multiple-purpose form. For example, the disclosures may state, "Check box if applicable."

6. *Multiple-purpose forms.* The creditor may design a disclosure statement that can be used for more than one type of transaction, so long as the required disclosures for individual transactions are clear and conspicuous. (See the commentary to Appendices G and H for a discussion of the treatment of disclosures that do not apply to specific transactions.) Any disclosure listed in § 226.18 (except the itemization of the amount financed under § 226.18(c)) may be included on a standard disclosure statement even though not all of the creditor's transactions include those features. For example, the statement may include:

- The variable rate disclosure under § 226.18(f).
- The demand feature disclosure under § 226.18(i).
- A reference to the possibility of a security interest arising from a spreader clause, under § 226.18(m).
- The assumption policy disclosure under § 226.18(q).
- The required deposit disclosure under § 226.18(r).

Paragraph 17(a)(2).

1. *When disclosures must be more conspicuous.* The following rules apply to the requirement that the terms "annual percentage rate" and "finance charge" be shown more conspicuously:

- The terms must be more conspicuous only in relation to the other required disclosures under § 226.18. For example, when the disclosures are included on the contract document, those 2 terms need not be more conspicuous as compared to the heading on the contract document or information required by state law.
- The terms need not be more conspicuous except as part of the finance charge and annual percentage rate disclosures under § 226.18 (d) and (e), although they may, at the creditor's option, be highlighted wherever used in the required disclosures. For example, the terms may, but need not, be highlighted when used in disclosing a prepayment penalty under § 226.18(k) or a required deposit under § 226.18(r).

- The creditor's identity under § 226.18(a) may, but need not, be more prominently displayed than the finance charge and annual percentage rate.

2. *Making disclosures more conspicuous.* The terms "finance charge" and "annual percentage rate" may be made more conspicuous in any way that highlights them in relation to the other required disclosures. For example, they may be:

- Capitalized when other disclosures are printed in capital and lower case.
- Printed in larger type, bold print or different type face.
- Printed in a contrasting color.
- Underlined.
- Set off with asterisks.

17(b) *Time of disclosures.*

1. *Consummation.* As a general rule, disclosures must be made before "consummation" of the transaction. The disclosures need not be given by any particular time before consummation, except in certain mortgage transactions under § 226.19. (See the commentary to § 226.2(a)(13) regarding the definition of consummation.)

2. *Converting open-end to closed-end credit.* If an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. (See the commentary to § 226.5 regarding conversion of closed-end to open-end credit.)

17(c) *Basis of disclosures and use of estimates.*

Paragraph 17(c)(1).

1. *Legal obligation.* The disclosures should reflect the credit terms to which the parties are legally bound at the outset of the transaction.

- The legal obligation is normally determined by applicable state or other law, but certain transactions are specifically addressed in this commentary. (See, for example, the discussion of buydown transactions elsewhere in the commentary to § 226.17(c).)
- The fact that a credit contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that contract did not reflect the legal obligation.
- The legal obligation normally is presumed to be contained in the note or contract that evidences the agreement. But this presumption is rebutted if another agreement between the parties legally modifies

that note or contract.

2. *Modification of obligation.* If the parties informally agree to a modification of the legal obligation, the modification should not be reflected in the disclosures unless it rises to the level of a change in the terms of the legal obligation. For example:

- If the creditor-employer offers a preferential employee rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to § 226.18(f) for a discussion of whether employee transactions are variable rate transactions.)
- If the contract provides for a certain monthly payment schedule but payments are made on a voluntary payroll deduction plan or an informal principal reduction agreement, the disclosures should reflect the schedule in the contract.
- If the contract provides for regular monthly payments but the creditor informally permits the consumer to defer payments from time to time, for instance, to take account of holiday seasons or seasonal employment, the disclosures should reflect the regular monthly payments.

3. *Third-party buydowns.* In certain transactions, a seller or other third party may pay an amount, either to the creditor or to the consumer, in order to reduce the consumer's payments or buy down the interest rate for all or a portion of the credit term. For example, a consumer and a bank agree to a mortgage with an interest rate of 15% and level payments over 25 years. By a separate agreement, the seller of the property agrees to subsidize the consumer's payments for the first 2 years of the mortgage, giving the consumer an effective rate of 12% for that period.

- If the lower rate is reflected in the credit contract between the consumer and the bank, the disclosures must take the buydown into account. For example, the annual percentage rate must be a composite rate that takes account of both the lower initial rate and the higher subsequent rate, and the payment schedule disclosures must reflect the 2 payment levels. However, the amount paid by the seller would not be specifically reflected in the disclosures given by the bank, since that amount constitutes seller's points and thus is not part of the finance charge.
- If the lower rate is not reflected in the credit contract between the

transmittal of the periodic statement showing the alleged error. If a state law allows the consumer 90 days to submit a notice, the state law remains in effect to provide the extra 30 days. Any state law disclosures concerning this extended state time limit must reflect the qualifications and conform to the format specified in § 226.28(a)(2)(i). Examples of laws that would be preempted include:

- A state law that has a narrower or broader definition of "billing error."
- A state law that requires the creditor to take different steps to resolve errors.
- A state law that provides different timing rules for error resolution (subject to the exception discussed above).

6. *Rules for other fair credit billing provisions.* The second part of the criteria for fair credit billing relates to the other rules implementing chapter 4 of the act (addressed in §§ 226.4(c)(8), 226.5(b)(2)(ii), 226.6(d), 226.7(k), 226.9(a), 226.10, 226.11, 226.12 (c) through (f), 226.13, and 226.21). Section 226.28(a)(2)(ii) provides that the test of inconsistency is whether the creditor can comply with state law without violating federal law. For example:

- A state law that allows the card issuer to offset the consumer's credit-card indebtedness against funds held by the card issuer would be preempted, since § 226.12(d) prohibits such action.
- A state law that requires periodic statements to be sent more than 14 days before the end of a free-ride period would not be preempted.
- A state law that permits consumers to assert claims and defenses against the card issuer without regard to the \$50 and 100-mile limitation of § 226.12(c)(3)(ii) would not be preempted.

In the last 2 cases, compliance with state law would involve no violation of the federal law.

7. *Who may receive a chapter 4 determination.* Only states (through their authorized officials) may request and receive determinations on inconsistency with respect to the fair credit billing provisions.

28(b) *Equivalent disclosure requirements.*

1. *General.* A state disclosure may be substituted for a federal disclosure only after the Board has made a finding of substantial similarity. Thus, the creditor may not unilaterally choose to make a state disclosure in place of a federal disclosure, even if it believes that the state disclosure is substantially similar. Since the rule stated in § 226.28(b) does not extend to any requirement relating

to the finance charge or annual percentage rate, no state provision on computation, description, or disclosure of these terms may be substituted for the federal provision.

References

Statute: Secs. 111 and 171 (a) and (c).
Other sections: Appendix A.

Previous regulation: § 226.6 (b) and (c), and Interpretation § 226.604.

1981 changes: Section 226.28 implements amended § 111 of the act. The test for preemption of state laws relating to disclosure and advertising is now whether the state law "contradicts" the federal, rather than whether state requirements are "different."

The revised regulation contains no counterpart to § 226.6(c) of the previous regulation concerning placement of inconsistent disclosures. It also reflects the statutory amendment providing that once the Board determines that a state-required disclosure is inconsistent with federal law, the creditor may not make the state disclosure.

Section 226.29—State Exemptions

29(a) *General rule.*

1. *Classes eligible.* The state determines the classes of transactions for which it will request an exemption, and makes its application for those classes. Classes might be, for example, all open-end credit transactions, all open-end and closed-end transactions, or all transactions in which the creditor is a bank.

2. *Substantial similarity.* The "substantially similar" standard requires that state statutory or regulatory provisions and state interpretations of those provisions be generally the same as the federal act and Regulation Z. This includes the requirement that state provisions for reimbursement to consumers for overcharges be at least equivalent to those required in § 108 of the act. A state will be eligible for an exemption even if its law covers classes of transactions not covered by the federal law. For example, if a state's law covers agricultural credit, this will not prevent the Board from granting an exemption for consumer credit, even though agricultural credit is not covered by the federal law.

3. *Adequate enforcement.* The standard requiring adequate provision for enforcement generally means that appropriate state officials must be authorized to enforce the state law through procedures and sanctions comparable to those available to federal enforcement agencies. Furthermore, state law must make adequate provision

for enforcement of the reimbursement rules.

29(b) *Civil liability.*

1. *Not eligible for exemption.* The provision that an exemption may not extend to §§ 130 and 131 of the act assures that consumers retain access to both federal and state courts in seeking damages or civil penalties for violations, while creditors retain the defenses specified in those sections.

References

Statute: Secs. 108, 123, and 171(b).

Other sections: Appendix B.

Previous regulation: § 226.12.

1981 changes: The procedures that states must follow to seek exemptions are now located in an appendix. Exemptions under the previous regulation will be automatically revoked on April 1, 1982, when compliance with the new regulation is mandatory.

Appendix A—Effect on State Laws

1. *Who may make requests.* Appendix A sets forth the procedures for preemption determinations. As discussed in § 226.28, which contains the standards for preemption, a request for a determination of whether a state law is inconsistent with the requirements of chapters 1, 2, or 3 may be made by creditors, states, or any interested party. However, only states may request and receive determinations in connection with the fair credit billing provisions of chapter 4.

References

Statute: Secs. 111 and 171(a).

Other sections: § 226.28.

Previous regulation: §§ 226.6(b) and 226.70 (Supplement V, Section II).

1981 changes: The procedures in Appendix A were largely adapted from Supplement V, Section II of the previous regulation (§ 226.70), with changes made to streamline the procedures.

Appendix B—State Exemptions

1. *General.* Appendix B sets forth the procedures for exemption applications. The exemption standards are found in § 226.29 and are discussed in the commentary to that section.

References

Statute: Secs. 123 and 171(b).

Other sections: § 226.29.

Previous regulation: §§ 226.12, 226.50 (Supplement II), 226.60 (Supplement IV), and 226.70 (Supplement V, Section I).

1981 changes: The procedures in Appendix B represent a combination and streamlining of the procedures set forth in the supplements to the previous regulation.

Appendix C—Issuance of Staff Interpretations

1. *General.* This commentary is the vehicle for providing official staff interpretations. Individual interpretations generally will not be issued separately from the commentary.

References

Statute: Secs. 105 and 130(f).

Other sections: None.

Previous regulation: § 226.1(d).

1981 changes: Appendix C reflects the Board's intention that this commentary serve as the vehicle for interpreting the regulation, rather than individual interpretive letters.

Appendix D—Multiple-Advance Construction Loans

1. *General rule.* Appendix D provides a special procedure that creditors may use, at their option, to estimate and disclose the terms of multiple advance construction loans when the amounts and timing of advances are unknown at consummation of the transaction. This appendix reflects the approach taken in § 226.17(c)(6)(ii), which permits creditors to provide separate or combined disclosures for the construction period and for the permanent financing, if any; i.e., the construction phase and the permanent phase may be treated as one transaction or more than one transaction.

References

Statute: None.

Other sections: §§ 226.17 and 226.22.

Previous regulation: Interpretation § 226.813.

1981 changes: The use of Appendix D is limited to multiple-advance loans for construction purposes.

Appendix E—Rules for Card Issuers That Bill on a Transaction-by-Transaction Basis

Statute: None.

Previous regulation: Interpretation § 226.709.

Other sections: §§ 226.6 through 226.13, and 226.15.

1981 changes: The rules in this appendix have been streamlined and clarified to indicate how certain card issuers that bill on a transaction basis may comply with the requirements of Subpart B.

Appendix F—Annual Percentage Rate Computations for Certain Open-End Credit

Statute: Section 107.

Previous regulation: § 226.5(a)(3)(ii), footnote 5(a).

Other sections: § 226.14.

1981 changes: This appendix incorporates a sixth example in which the transaction amount exceeds the amount of the balance subject to the periodic rate.

Appendices G and H—Open-End and Closed-End Model Forms and Clauses

1. *Permissible changes.* Although use of the model forms and clauses is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to those disclosures. Creditors may make certain changes in the format or content of the forms and clauses and may delete any disclosures that are inapplicable to a transaction or a plan without losing the act's protection from liability. The rearrangement of the model forms and clauses may not be so extensive as to affect the substance, clarity, or meaningful sequence of the forms and clauses. Creditors making revisions with that effect will lose their protection from civil liability. Acceptable changes include, for example:

- Using the first person, instead of the second person, in referring to the borrower.
- Using "borrower" and "creditor" instead of pronouns.
- Rearranging the sequence of the disclosures.
- Not using bold type for headings.
- Incorporating certain state "plain English" requirements.
- Deleting inapplicable disclosures by whitening out, blocking out, filling in "N/A" (not applicable) or "0", crossing out, leaving blanks, checking a box for applicable items, or circling applicable items. (This should permit use of multipurpose standard forms.)
- Substituting appropriate references, such as "bank," "we," or a specific name, for "creditor" in the initial open-end disclosures.
- Using a vertical, rather than a horizontal, format for the boxes in the closed-end disclosures.

Appendix G—Open-End Model Forms and Clauses

1. *Model G-1.* The model disclosures in G-1 (different balance computation methods) may be used in both the initial disclosures under § 226.6 and the periodic disclosures under § 226.7. As is clear from the models given, "short-hand" descriptions of the balance computation methods are not sufficient. The phrase "a portion of" the finance charge should be included if the total finance charge includes other amounts, such as transaction charges, that are not due to the application of a periodic rate. In addition, if unpaid finance charges

are subtracted in calculating the balance, that fact must be stated so that the disclosure of the computation method is accurate. Only Model G-1(b) contains of final sentence appearing in brackets which reflects the total dollar amount of payments and credits received during the billing cycle. The other models do not contain this language because they reflect plans in which payments and credits received during the billing cycle are subtracted. If this is not the case, however, the language relating to payments and credits should be changed, and the creditor should add either the disclosure of the dollar amount as in Model G-1(b) or an indication of which credits (disclosed elsewhere on the periodic statement) will not be deducted in determining the balance. (Such an indication may also substitute for the bracketed sentence in Model G-1(b)). See the commentary to § 226.7(e).

2. *Model G-2.* This model contains the notice of liability for unauthorized use of a credit card.

3. *Models G-3 and G-4.* These set out models for the long form billing error rights statement (for use with the initial disclosures and as an annual disclosure or, at the creditor's option, with each periodic statement) and the alternative billing error rights statement (for use with each periodic statement), respectively. Creditors must provide the billing error rights statements in a form substantially similar to the models in order to comply with the regulation. The model billing rights statements may be modified in any of the ways set forth in the first paragraph of the commentary on Appendices G and H. The models may, furthermore, be modified by deleting inapplicable information, Such as:

- The paragraph concerning stopping a debit in relation to a disputed amount, if the creditor does not have the ability to debit automatically the consumer's saving or checking account for payment.
- The rights stated in the special rule for credit card purchases and any limitations on those rights.

The model billing rights statements also contain optional language that creditors may use. For example, the creditor may:

- Include a statement to the effect that notice of a billing error must be submitted on something other than the payment ticket or other material accompanying the periodic disclosures.
- Insert its address or refer to the address that appears elsewhere on

the bill.

Additional information may be included on the statements as long as it does not detract from the required disclosures. For instance, information concerning the reporting of errors in connection with a checking account may be included on a combined statement as long as the disclosures required by the regulation remain clear and conspicuous.

4. *Models G-5 through G-9.* These models set out notices of the right to rescind that would be used at different times in an open-end plan. The last paragraph of each of the rescission model forms contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, when the notice or material disclosures are delivered late or when the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional.

Appendix H—Closed-End Model Forms and Clauses

1. *Models H-1 and H-2.* Creditors may make several types of changes to closed-end model forms H-1 (credit sale) and H-2 (loan) and still be deemed to be in compliance with the regulation, provided that the required disclosures are made clearly and conspicuously. Permissible changes include the addition of the information permitted by footnote 37 to § 226.17 and "directly related" information as set forth in the commentary to § 226.17(a).

The creditor may also delete or, on multi-purpose forms, indicate inapplicable disclosures, such as:

- The itemization of the amount financed option. (See Samples H-12 through H-15.)
- The credit life and disability insurance disclosures. (See Samples H-11 and H-12.)
- The property insurance disclosures. (See Samples H-10 through H-12, and H-14.)
- The "filing fees" and "non-filing insurance" disclosures. (See Samples H-11 and H-12.)
- The prepayment penalty or rebate disclosures. (See Samples H-12 through H-14.)
- The total sale price. (See Samples H-11 and H-15.)

Other permissible changes include:

- Adding the creditor's address or telephone number. (See the commentary to § 226.18(a).)
- Combining required terms where

several numerical disclosures are the same, for instance, if the "total of payments" equals the "total sale price." (See the commentary to § 226.18.)

- Rearranging the sequence or location of the disclosures—for instance, by placing the descriptive phrases outside the boxes containing the corresponding disclosures, or by grouping the descriptors together as a glossary of terms in a separate section of the segregated disclosures; by placing the payment schedule at the top of the form; or by changing the order of the disclosures in the boxes, including the annual percentage rate and finance charge boxes.
- Using brackets, instead of checkboxes, to indicate inapplicable disclosures.
- Using a line for the consumer to initial, rather than a checkbox, to indicate an election to receive an itemization of the amount financed.
- Deleting captions for disclosures.
- Using a symbol, such as an asterisk, for estimated disclosures, instead of an "e."
- Adding a signature line to the insurance disclosures to reflect joint policies.
- Separately itemizing the filing fees.
- Revising the late charge disclosure in accordance with the commentary to § 226.18(l).

2. *Model H-3.* Creditors have considerable flexibility in filling out Model H-3 (itemization of the amount financed). Appropriate revisions, such as those set out in the commentary to § 226.18(c), may be made to this form without loss of protection from civil liability for proper use of the model forms.

3. *Models H-4 through H-7.* The model clauses are not included in the model forms although they are mandatory for certain transactions. Creditors using the model clauses when applicable to a transaction are deemed to be in compliance with the regulation with regard to that disclosure.

4. *Model H-4.* This model contains the variable rate model clauses and is intended to give creditors considerable flexibility in structuring variable rate disclosures to fit individual plans. The information about circumstances, limitations, and effects of an increase may be given in terms of the contract interest rate or the annual percentage rate. Clauses are shown for hypothetical examples based on the specific amount of the transaction and based on a representative amount. Creditors may preprint the variable rate disclosures based on a representative amount for

similar types of transactions, instead of constructing an individualized example for each transaction. In both representative examples and transaction-specific examples, creditors may refer either to the incremental change in rate, payment amount, or number of payments, or to the resulting rate, payment amount, or number of payments. For example, creditors may state that the rate will increase by 2%, with a corresponding \$150 increase in the payment, or creditors may state that the rate will increase to 16%, with a corresponding payment of \$850.

5. *Model H-5.* This contains the demand feature clause.

6. *Model H-6.* This contains the assumption clause.

7. *Model H-7.* This contains the required deposit clause.

8. *Models H-8 and H-9.* These models contain the rescission notices for a typical closed-end transaction and a refinancing, respectively. The last paragraph of each model form contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, where the notice or material disclosures are delivered late or where the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional.

9. *Sample forms.* The sample forms (H-10 through H-15) serve a different purpose than the model forms. The samples illustrate various ways of adapting the model forms to the individual transactions described in the commentary to Appendix H. The deletions and rearrangements shown relate only to the specific transactions described. As a result, the samples do not provide the general protection from civil liability provided by the model forms and clauses.

10. *Sample H-10.* This sample illustrates an automobile credit sale. The cash price is \$7,500 with a downpayment of \$1,500. There is an 8% add-on interest rate and a term of 3 years, with 36 equal monthly payments. The credit life insurance premium and the filing fees are financed by the creditor. There is a \$25 credit report fee paid by the consumer before consummation, which is a prepaid finance charge.

11. *Sample H-11.* This sample illustrates an installment loan. The amount of the loan is \$5,000. There is a 12% simple interest rate and a term of 2

years. The date of the transaction is expected to be April 15, 1981, with the first payment due on June 1, 1981. The first payment amount is labelled as an estimate since the transaction date is uncertain. The odd days' interest

12. *Sample H-12.* This sample illustrates a refinancing and consolidation loan. The amount of the loan is \$5,000. There is a 15% simple interest rate and a term of 3 years. The date of the transaction is April 1, 1981, with the first payment due on May 1, 1981. The first 35 monthly payments are equal, with an odd final payment. The credit disability insurance premium is financed. In calculating the annual percentage rate, the U.S. Rule has been used. Since an itemization of the amount financed is included with the disclosures, the statement regarding the consumer's option to receive an itemization is deleted.

13. *Samples H-13 through H-15.* These samples illustrate various mortgage transactions. They assume that the mortgages are subject to the Real Estate Settlement Procedures Act (RESPA). As a result, no option regarding the itemization of the amount financed has been included in the samples, because providing the good faith estimates of settlement costs required by RESPA satisfies Truth in Lending's amount financed itemization requirement. (See footnote 39 to § 226.18(c).)

14. *Sample H-13.* This sample illustrates a mortgage with a demand feature. The loan amount is \$44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. The 15 days of interim interest (\$294.34) is collected as a prepaid finance charge at the time of consummation of the loan (April 15, 1981). In calculating the disclosure amounts, the minor irregularities provision in § 226.17(c)(4) has been used. The property insurance premiums are not included in the payment schedule. This disclosure statement could be used for notes with the 7-year call option required by the Federal National Mortgage Association (FNMA) in states where due-on-sale clauses are prohibited.

15. *Sample H-14.* This sample illustrates a variable rate mortgage. The loan amount is \$44,900, payable in 360

monthly installments at an initial interest rate of 14.75%. All payment periods are regular. Two points (\$898) have been imposed and included in the prepaid finance charge. The note provides that the interest rate may vary with the lender's prime rate, with a maximum permissible increase of 5% over the term of the mortgage. The interest rate may not vary more frequently than once a year, and may not increase by more than 1% annually. Rate fluctuations will be reflected in the monthly payment amount.

16. *Sample H-15.* This sample illustrates a graduated payment mortgage with a 5-year graduation period and a 7½ percent yearly increase in payments. The loan amount is \$44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. Two points (\$898), as well as an initial mortgage guarantee insurance premium of \$225.00, are included in the prepaid finance charge. The mortgage guarantee insurance premiums are calculated on the basis of ¼ of 1% of the outstanding principal balance under an annual reduction plan. The abbreviated disclosure permitted under § 226.18(g)(2) is used for the payment schedule for years 6 through 30. The prepayment disclosure refers to both penalties and rebates because information about penalties is required for the simple interest portion of the obligation and information about rebates is required for the mortgage insurance portion of the obligation.

References

Statute: Secs. 105 and 130.
Other sections: §§ 226.6, 226.7, 226.9, 226.12, 226.15, 226.18, and 226.23.
Previous regulation: None.
1981 changes: The model forms and clauses have no counterpart in the previous regulation.

Appendix I—Federal Enforcement Agencies

Statute: Section 108.
Other sections: None.
Previous regulation: § 226.1(b).
1981 changes: None.

Appendix J—Annual Percentage Rate Computations for Closed-End Credit Transactions

1. *Use of Appendix J.* Appendix J sets forth the actuarial equations and instructions for calculating the annual percentage rate in closed-end credit transactions. While the formulas contained in this appendix may be directly applied to calculate the annual percentage rate for an individual transaction, they may also be utilized to program calculators and computers to perform the calculations.

2. *Relation to Board tables.* The Board's Annual Percentage Rate Tables also provide creditors with a calculation tool that applies the technical information in Appendix J. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation. Volume I of the tables may be used for credit transactions involving equal payment amounts and periods, as well as for transactions involving any of the following irregularities: odd first period, odd first payment and odd last payment. Volume II of the tables may be used for transactions that involve any type of irregularities. These tables may be obtained from any Federal Reserve Bank or from the Board in Washington, D.C. 20551, upon request.

References

Statute: Section 107.
Other sections: § 226.22.
Previous regulation: § 226.40 (Supplement I).

1981 changes: Paragraph (b)(2) has been revised to clarify that the term of the transaction never begins earlier than consummation of the transaction. Paragraph (b)(5)(vi) has been revised to permit creditors in all cases where the transaction term equals a whole number of months, to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

Board of Governors of the Federal Reserve System, October 5, 1981.

William W. Wiles,
 Secretary of the Board.

[FR Doc. 61-29374 Filed 10-8-81; 8:45 am]
 BILLING CODE 6210-01-M