FEDERAL RESERVE BANK
OF NEW YORK

[ Circular No. **9765**
December 10, 1984 ]

# REGULATIONS E AND Z

## — Amendment to Regulation Z Regarding Restrictions on Credit Card Issuance and Liability

## — Proposed Changes in the Official Staff Commentaries

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

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System announcing the adoption, effective December 31, 1984, of an amendment to Regulation Z:

> The Federal Reserve Board has announced the adoption of an amendment to Regulation Z — Truth in Lending — clarifying that *all* credit cards are subject to the provisions of the regulation regarding the issuance of credit cards and the liability for unauthorized use.
>
> The amendment becomes effective December 31, 1984.
>
> The amendment applies to credit cards issued for use in transactions that are exempt from all other provisions of Regulation Z. The amendment states that nonetheless such cards are subject to the provisions of Regulation Z that limit cardholder liability for unauthorized use of the card to $50, and that prohibit issuance of credit cards that have not been requested.
>
> The amendment principally affects credit cards issued for use in certain extensions of credit of more than $25,000, and for extensions of credit for public utility services. Such extensions of credit are generally exempt from the provisions of Regulation Z. The vast majority of credit cards affected by the amendment are telephone calling cards. The amendment will not affect the application of the exemptions noted above to other provisions of Regulation Z.

A copy of the text of the amendment to Regulation Z is enclosed.

In addition, the Board of Governors has requested comment on proposed changes in the Official Staff Commentaries on Regulation E, "Electronic Fund Transfers," and on Regulation Z, "Truth in Lending." The proposals pertain to questions that have arisen about the regulations, and include new interpretations and changes in existing interpretations of these regulations. Comments thereon should be submitted by January 31, 1985, and may be sent to our Regulations Division.

Enclosed — for depository institutions in this District — is the text of the proposals, which have been reprinted from the *Federal Register* of December 4, 1984; it will be furnished to others upon request directed to the Circulars Division of this Bank (Tel. No. 212-791-5216).

ANTHONY M. SOLOMON,
*President.*

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

# TRUTH IN LENDING

## AMENDMENT TO REGULATION Z

*(effective December 31, 1984)*

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 226**

**[Reg. Z; Doc. No. R-0501]**

**Truth in Lending; Credit Cards; Issuance and Liability**

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

**ACTION:** Final rule.

**SUMMARY:** The Board is publishing a final amendment to Regulation Z (Truth in Lending). The amendment specifically provides that credit cards issued for use with transactions that are exempt from all other provisions of the regulation are subject to the Regulation Z provisions governing the issuance of credit cards and the liability for unauthorized use. The amendment resolves any uncertainty that the issuance and liability protections apply to all credit cards regardless of use or cardholder status.

**EFFECTIVE DATE:** December 31, 1984.

**FOR FURTHER INFORMATION CONTACT:** Regarding the regulation: Ruth R. Amberg, Senior Attorney, or Lynn C. Goldfaden or Richard S. Garabedian, Staff 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. Regarding the regulatory flexibility analysis: Robert Kurtz, Economist, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452–2915.

**SUPPLEMENTARY INFORMATION:**

### (1) General

Section 226.3 of Regulation Z (12 CFR Part 226) is amended to clarify that the restriction on unsolicited issuance of credit cards in § 226.12(a) and the provision in § 226.12(b) limiting a cardholder's liability for unauthorized use of a credit card to a maximum of $50 (both based on the 1970 credit card amendments to the Truth in Lending Act) apply to credit cards issued for use in transactions that are exempt from other sections of the regulation. Action on this issue was undertaken in response to questions about the applicability of these two credit card provisions from both the public and private sectors. The amendment resolves any remaining uncertainty that the issuance and liability protections apply to all credit cards, regardless of use or cardholder status. The exempt status of a transaction with regard to all of the other provisions of the regulation is not affected by the amendment, therefore, the exemptions continue to apply to the cost disclosure, error resolution, rescission, and advertising requirements.

The Board published this amendment for public comment on January 18, 1984 (49 FR 2210) and solicited information on questions such as how to minimize creditors' compliance burdens and costs, and what other laws exist that provide protections against unsolicited issuance and liability for unauthorized use of credit cards. The Board received approximately 60 comments on the proposed amendment, including comments from 11 Federal Reserve Banks. Approximately two-thirds of the commenters supported the proposal.

### (2) Scope

The Regulation Z exemptions most likely to be affected are those for: (1) Credit extended by a regulated public utility for utility services, including credit extended by telecommunications companies, and (2) extensions of credit for more than $25,000 (if unsecured by real estate or by the consumer's principal dwelling). Business credit transactions also are generally exempt from the regulation; however, the regulation presently makes clear that the credit card provisions on unsolicited issuance and liability for unauthorized use apply to cards issued for obtaining business-purpose credit. Although the types of exempt transactions most commonly made with credit cards are business transactions and telephone calls, the amendment makes clear that *all* credit cards are covered by the provisions on issuance and liability for unauthorized use, so that the amendment also generally applies to credit cards issued for use with other types of transactions that are exempt under Regulation Z. (The regulation also exempts credit extended by registered broker-dealers for the purchase of securities and commodities, certain student loans, and home fuel budget plans.)

The vast majority of the credit cards that are affected by this amendment are telephone calling cards. Other than a number of the credit cards issued for use in consumer asset management accounts, there appear to be comparatively few cards issued for

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For this Regulation to be complete, retain:

1) Pamphlet dated April 1, 1981.
2) Amendments effective December 3, 1981, April 1, 1982, and October 1, 1982 *(printed in slip sheet dated May 1983; also includes amendments to the Truth in Lending Act).*
3) Official Staff Commentary on Regulation Z, dated December 1981 *(furnished only upon request).*
4) Official Staff Commentary updates, effective September 17, 1982, April 1, 1983, April 1, 1984, and October 16, 1984 *(furnished only upon request)*
5) This slip sheet.

[Enc. Cir. No. 9765]

consumer use with fixed credit lines over $25,000 that are not secured by real estate or a principal dwelling. (Regulation E, Electronic Fund Transfers—12 CFR Part 205—governs the issuance and liability for unauthorized use of virtually all of the cards in these consumer asset management accounts, as they involve access to asset accounts prior to accessing credit lines.) For these reasons, this discussion will focus on telephone credit cards.

**(3) Telephone Credit Cards**

The questions regarding the applicability of the credit card amendments to telephone cards take on particular importance because of the millions of telephone credit cards that have been issued in recent years; the fact that many paper telephone cards are being replaced by plastic cards which resemble and function much like retail and bank credit cards; and the legal changes in the telecommunications industry that even further expand the number of companies issuing cards. Furthermore, because of the wide spectrum of cards through which telephone services are becoming available, ranging from cards issued by traditional telephone companies to bank credit cards and travel-and-entertainment cards, both consumers and industry may have difficulty distinguishing situations in which the credit card protections apply.

The Board is concerned that, unless the credit card provisions apply to these cards, consumers who use credit cards in connection with credit programs involving exempt transactions will not have any federal protections restricting unsolicited issuance of such cards and limiting their liability for the unauthorized use of the card. Although there is no evidence of a pattern of abuse at this time, the lack of uniform, established legal protection may have a serious impact in the future in light of the scope of these programs and the indications of their continued growth. The Board received information indicating that only a few other laws provide protections against unauthorized telephone card charges, and these laws are of limited application.

The number of telephone credit cards issued by AT&T Communications, Inc. (AT&T), local Bell operating companies, and the independent telecommunications companies (not including other long-distance competitors) as of January 1984 was approximately 50 million. The number of outstanding cards has increased substantially over the last ten months as a result of AT&T's card distribution. The use of telephone credit cards is now being encouraged as the companies seek to control fraud losses and other costs associated with operator-assisted calls billed to third parties, as well as to provide consumers with easier access to telephone services. Presently, the Board understands that the major card issuers' stated policies include the issuance of cards to new customers only upon request and not imposing liability on a consumer for unauthorized charges made on a card. However, unless the credit card protections in Truth in Lending apply to these cards, it is unknown what policies will be set by these companies in the future. It is possible that the companies will reverse their past policies and seek to impose liability on the cardholder whose card is used for unauthorized calls.

Unsolicited issuance of credit cards is a different type of problem. Among the congressional findings leading to the ban on unsolicited issuance was that unsolicited cards were annoying and intrusive and that unsolicited issuance may increase the risk of extensive unauthorized use when cards are stolen before reaching the consumer. Because the vast majority of the telephone cards contain all of the information necessary for immediate use, unauthorized calls are relatively easy to make. Even if, ultimately, no liability were imposed on the consumer, the consumer not only would be subjected to the burden of proving that the card was never received, but also to the inconvenience of resolving the unauthorized billings.

The Board also believes that since credit cards used by businesses and for business purposes are subject to the protections, it is reasonable for credit cards used by consumers for personal credit transactions to be subject to the same protections. In addition, the amendment gives holders of telephone credit cards protections that are comparable to those available to consumers using other credit cards or debit cards to pay for the calls. Consumers now have the choice of a wide spectrum of cards with which to make telephone calls. Consumers who use any of these cards are in an equally difficult position to protect themselves against the risks of their cards being used fraudulently.

**(4) Effective date; transition provisions**

The amendment is generally effective on December 31, 1984. However, a limited delayed compliance date has been provided for the unsolicited issuance prohibition set forth in § 226.12(a) to minimize initial compliance costs associated with the amendment while still assuring consumer protections.

In regard to the unsolicited issuance prohibition, the Board has set a compliance date of January 29, 1985, in order to give issuers sufficient time to communicate the issuance rules throughout their organizations and to stop all procedures that might not comply, thereby avoiding inadvertent violations. The Board had solicited comment on waiving the unsolicited issuance prohibition as the AT&T Communications, Inc.'s one-time card distribution to all consumers who have either a Bell system card or a card issued by an independent company used for service over AT&T facilities; however, as distribution of the new card is substantially complete, that issue is now moot.

In its proposal, the Board solicited public comment on possible actions to minimize initial compliance costs. One issue involved outstanding cards or agreements containing language that is inconsistent with the liability limitation rules. The Board solicited comment on whether it should stipulate that card issuers not be required to replace existing cards or agreements merely to change misleading language (such as language on the card indicating that the cardholder is responsible for all charges made with the card), even though the liability limitations of Regulation Z already would be effective. Then, as new cards are issued or new agreements

printed, the language would have to be modified to accurately reflect the limits. The commenters overwhelmingly indicated their support for correction of inconsistent language on credit cards and in agreements according to normal replacement schedules rather than immediate replacement. The Board agrees that this approach should help to minimize creditors' transitional costs. Card issuers electing to impose any liability for unauthorized use on the cardholder would, of course, need to comply with the conditions of liability set forth in § 226.12(b).

**(5) Regulatory Flexibility Analysis**

The Board's Division of Research and Statistics has prepared a regulatory flexibility analysis. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452–3245.

**List of Subjects in 12 CFR Part 226**

Advertising, Banks—banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Truth in lending.

**(6) Text of Revision**

Pursuant to the authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), Regulation Z, 12 CFR Part 226, is amended by adding an Office of Management and Budget control number to § 226.1, removing footnote 4 to § 226.3(a) and adding a new footnote 4 to § 226.3 to read as follows:

**§ 226.1 Authority, purpose, coverage, organization, enforcement and liability.**

* * * * *

(Information collection requirements contained in this section have been approved by the Office of Management and Budget under OMB Control No. 7100–0199.)

* * * * *

**§ 226.3 Exempt transactions.**

This regulation does not apply to the following:[4] * * *

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[4]The provisions in § 226.12 (a) and (b) governing the issuance of credit cards and the liability for their unauthorized use apply to all credit cards, even if the credit cards are issued for use in connection with extensions of credit that otherwise are exempt under this section.

* * * * *

By order of the Board of Governors of the Federal Reserve System, November 27, 1984.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 84–31493 Filed 11–29–84; 8:45 am]

BILLING CODE 6210–01–M

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 205**

**[Reg. E; EFT-2]**

## Electronic Fund Transfers; Proposed Update to Official Staff Commentary

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

**ACTION:** Proposed official staff interpretation.

**SUMMARY:** The Board is publishing for comment proposed changes to the official staff commentary to Regulation E (Electronic Fund Transfers). The commentary applies and interprets the requirements of Regulation E and is a substitute for individual staff interpretations of the regulation. The proposed revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material.

**DATE:** Comments must be received on or before January 31, 1985.

**ADDRESS:** Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and C Streets, NW., Washington, D.C., between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include reference to EFT-2. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

**FOR FURTHER INFORMATION CONTACT:** Gerald P. Hurst or John C. Wood, Senior Attorneys, or Richard S. Garabedian, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, (202) 452-3667 or (202) 452-2412.

**SUPPLEMENTARY INFORMATION:** (1) *General.* The Electronic Fund Transfer Act (15 U.S.C. 1693 *et seq.*) governs any transfer of funds that is electronically initiated and that debits or credits a consumer's account. This statute is implemented by the Board's Regulation E (12 CFR Part 205). Effective September 24, 1981, an official staff commentary (EFT-2 Supp. II to 12 CFR Part 205) was published to interpret the regulation. The commentary is designed to provide guidance to financial institutions in applying the regulation to specific situations. The commentary is updated periodically to address significant questions that arise. There have been two updates so far, the first on April 6, 1983 (48 FR 14880), and the second on October 18, 1984 (49 FR 40794). This notice contains the proposed third update. It is expected that it will be adopted in final form in March 1985.

Certain conventions have been used to highlight the proposed revisions. New language is shown inside bold-faced arrows, while language to be deleted is set off with brackets.

(2) *Proposed revisions.* The material that has been added or revised is largely self-explanatory. Questions 7-18.5 and 11-11.5 relate to amendments to Regulation E adopted by the Board on October 11, 1984 (49 FR 40794), which cover all debit card transactions whether or not an electronic terminal is involved. The amendments also extend the time periods for resolution of errors involving point-of-sale (POS) debit card transactions; the longer periods parallel those applicable to foreign-initiated transfers.

The proposed revision of question 7-18.5 reverses the present interpretation; currently, disclosure of the longer error resolution time periods in the case of foreign-initiated transfers is not required. Transfers resulting from POS debit card transactions (unlike foreign-initiated transfers) are quite common, however, and to assure accurate disclosures and avoid confusion on the part of consumers, proposed question 7-18.5 requires financial institutions to disclose the longer error resolution periods. Since most institutions would be required to revise their error resolution disclosures for POS debit card transactions, it seems likely that making the further revision for foreign-initiated transfers would result in little or no additional expense. Consequently revised question 7-18.5 would require that the error resolution disclosures for accounts subject to foreign-initiated or POS debit card transactions state the extended time periods.

The other proposal relating to the October amendments (new question 11-11.5) discusses the meaning of POS debit card transaction for purposes of the longer error resolution periods.

Other proposed changes to the commentary respond to inquiries received by the staff. New question 2-28 addresses unauthorized transfers. New question 5-4.5 states that an institution may not issue, without request from the consumer, a validated personal identification number (PIN) to permit a debit card previously issued for POS transactions to be used at ATMs. This interpretation differs from a proposed interpretation under Regulation Z that permits such PIN issuance. The different treatment is based on the definition of an access device in Regulation E. Under Regulation E a PIN is an access device in all cases, even when it cannot be used alone to initiate an EFT; in contrast, a PIN issued to existing cardholders that cannot be used by itself to obtain credit is not a credit card under Regulation Z. (See the proposed update to the official staff commentary to Regulation Z, Truth in Lending, published elsewhere in this Federal Register issue.) The rule regarding access devices is more restrictive in part because of the consumer's potentially greater risk; for example, the consumer may be liable for as much as $500 (or even an unlimited amount) rather than only $50 as under Regulation Z. Moreover, unauthorized use of an access device entails the loss of use, and perhaps even permanent loss, of the consumer's own funds in an access account; in the case of unauthorized credit card use, only extensions of credit are involved. In addition, when the debit card was originally issued without a PIN, the consumer may not have contemplated that the card could later be used at ATMs to obtain cash.

(3) *Transition issues relating to amendments.* The staff has received other inquiries dealing with the interim period between the adoption of the POS debit card amendments in October 1984 (discussed above) and the April 16, 1985, effective date. Since guidance on these matters is needed now and will cease to be relevant after the transition period, the staff believes it is appropriate to address them separately for the proposed commentary.

Industry representatives have asked whether revised disclosures must be provided to existing customers who have already been given Regulation E disclosures for certain debit card transactions, or to customers who contract for EFT services before April 16, 1985. Revised disclosures may but need not be provided prior to April 16, 1985; however, beginning on that date, any disclosure given (e.g., initial disclosures to a new customer, or the long-form or short-form error resolution notice to an existing customer) must accurately reflect the terms and conditions of the EFT services (including debit card transactions) offered by the institution. For example, initial disclosures to new customers will have to reflect that all transfers resulting for debit card transactions are electronic fund transfers, and that the error resolution periods for POS debit card

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transactions are 20 business days and 90 calendar days (if the institution wishes to take advantage of the longer periods).

After April 16, error resolution notices, whether given annually or on periodic statements, also must reflect the longer periods. Similarly, initial disclosures and error resolution notices must reflect the exception from provisional recrediting in cases where accounts are subject to the Board's Regulation T (Credit by Brokers and Dealers). Institutions may comply by modifying appropriately the error notice forms that appear in §§ 205.7(a)(10) and 205.8(b).

An institution that wishes to use existing forms until its supplies are exhausted may reflect the changed terms and conditions by any appropriate means such as by use of an insert, attachment, or computer-generated notice on periodic statements (in the case of a short-form notice on the statement). Institutions are not required to make a special mailing of revised error resolution notices or of other disclosures.

**List of Subjects in 12 CFR Part 205**

Banks, banking, Consumer protection, Electronic fund transfers, Federal Reserve System, Penalties.

**PART 205—[AMENDED]**

*Text of revisions.* The proposed revisions to the Official Staff Commentary on Regulations E (EFT–2, Supp. II to 12 CFR Part 205) read as follows:

* * * * *

*Section 205.2—Definitions and Rules of Construction*

* * * * *

►Q 2–28: *Unauthorized transfers—forced initiation.* A consumer is forced by a robber, at gunpoint, to withdraw cash at an ATM. Do the liability limits for unauthorized transfers apply?

A: Yes. The transfer is unauthorized for purposes of Regulation E. Under those circumstances, the actions of the robber are tantamount to use of a stolen access device. (§§ 205.2(l) and 205.6)◄

* * * * *

*Section 205.5—Issuance of Access Devices*

* * * * *

►Q 5–4.5: *Unsolicited issuance—PINs.* May a financial institution issue, without a specific request, validated personal identification numbers (PINs), thus allowing consumers to use their existing debit cards at automated teller machines?

A: No Issuance of a validated PIN for an existing debit card does not meet the regulation's requirement that an unsolicited access device be unvalidated when issued. (The issuance of PINs for existing credit cards is, however, permissible under the Truth in Lending Act and Regulation Z; see Comment 12(a)(1)-8 of the Official Staff Commentary to Regulation Z.) (§§ 205.5(a) and (b) and 205.2(a))◄

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*Section 205.7—Initial Disclosure of Terms and Conditions*

* * * * *

Q 7–18.5: *Error resolution disclosure—[foreign-initiated transfers]* ►*extended time periods*◄ The regulation expands the time periods for resolving errors that involve transfers initiated outside the United States ►or transfers resulting from POS debit card transactions◄, from 10 to 20 business days and from 45 to 90 calendar days. Must the error-resolution disclosure reflect the longer time periods with respect to accounts on which [transfers may be initiated outside the United States] ►these types of transfers can be made◄?

A: A financial institution [may but need not refer to the longer time periods in the error-resolution disclosure.] ►must give error-resolution disclosures that reflect its actual procedures. An institution that takes advantage of the longer time periods applicable to POS and foreign-initiated transfer must, therefore, state them in its error-resolution disclosures. Similarly, and institution that relies on the exception from provisional recrediting (for accounts subject to Regulation T) must phrase its disclosures appropriately.◄ (§§ 205.7(a)(10), 205.8(b), and 205.11►(c)(3) and ◄(c)(4))

* * * * *

*Section 205.11—Procedures for Resolving Errors*

* * * * *

►Q 11–11.5: *POS debit card transactions.* The deadlines for investigating errors are extended for all transfers resulting from POS debit card transactions, regardless of whether an electronic terminal is involved. For purposes of these deadlines, what types of transactions can be viewed as POS debit card transactions?

A: POS debit card transactions generally take place at merchant locations, but also include mail and telephone orders of goods or services involving a debit card. Transactions at ATMs, however, are not POS even though the ATM may be in a merchant location. (§ 205.11(c)(4))◄

* * * * *

(15 U.S.C. 1693b)

Board of Governor or the Federal Reserve System, November 28, 1984.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 84–31578 Filed 12–3–84; 8:45 am]

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**12 CFR Part 226**

**[Reg. Z; TIL–1]**

## Truth in Lending; Proposed Update to Official Staff Commentary

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

**ACTION:** Proposed official staff interpretation.

**SUMMARY:** The Board is publishing for comment proposed changes to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The proposed revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material.

**DATE:** Comments must be received on or before January 31, 1985.

**ADDRESS:** Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B–2223, 20th and C Streets, NW., Washington, D.C. between 8:45 a.m. and 5:15 p.m. weekdays, Comments should include a reference to TIL–1. Comments may be inspected in Room B–1122 between 8:45 a.m. and 5:15 p.m. weekdays.

**FOR FURTHER INFORMATION CONTACT:** 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) 452–2412 or (202) 452–3867:

Subpart A—Lynn Goldfaden, Gerald Hurst

Subpart B—Richard Garabedian, Adrienne Hurt

Subpart C—Rugenia Silver, Susan Werthan

**SUPPLEMENTARY INFORMATION:**

**I. General**

The Truth in Lending Act (15 U.S.C. 1601 *et seq.*) governs consumer credit transactions and is implemented by the Board's Regulation Z (12 CFR Part 226). Effective October 13, 1981, and official staff commentary (TIL–1, Supp. I to 12 CFR Part 226) was published to interpret the regulation. The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise. There have been three general updates so far—the first in September 1982 (47 FR 41338), the second in April 1983 (48 FR 14882), and the third in April 1984 (49 FR 13482). There was also a limited update concerning fees for the use of automated teller machines, which was adopted in October 1984 (49 FR 40560). This notice contains the proposed fourth general update. It is expected that it will be

adopted in final form in March 1985 with optional compliance until the uniform effective date of October 1 for mandatory compliance.

Certain conventions have been used to highlight the proposed revision. New language is shown inside bold-faced arrows, while language that would be deleted is set off with brackets.

**II. Proposed Revisions**

Following is a brief description of the proposed revisions to the commentary:

**Subpart A—General**

*Section 226.2—Definition and Rules of Construction*

2(a) Definitions

*2(a)(15) "Credit Card"*

Comment 2(a)(15)–2 would be revised to make clear that certain types of access devices that are used at wholesale petroleum distribution terminals—whether or not credit is involved—are not considered credit cards under Regulation Z.

*2(a)(17) "Creditor"*

*Paragraph 2(a)(17)(i)*

Comment 2(a)(17)(i)–8 would be added to explain how the numerical tests for determining who is a "creditor" should be applied to loans made by employee savings plans. It provides that the numerical test should be applied to the plan as a whole rather than to the individual account.

*2(a)(20) "Open-End Credit"*

Comment 2(a)(20)–5 would be revised to correct a potential contradiction caused by the language "specific approval for each extension." Because "verification" of credit information—which is permissible under the open-end credit definition—necsssary involves "approval" if a credit extension is not denied after verifying the credit information, the "specific approval" language may be confusing. The proposal would, therefore, delete that language. The comment would continue to mean, however, that while creditors may verify credit information on an open-end credit plan before authorizing additional credit extensions, they may not undertake activities such as requiring a new application for each additional credit extension, without jeopardizing a program's status as a open-end credit Plan.

*Section 226.4—Finance Charge*

4(a) Definition

The first sentence of comment 4(a)–3 would be revised to clarify which charges by third parties are excluded from the finance charge. The revision makes clear that, in order to be excluded, the charge must be imposed on the consumer rather than the creditor and the creditor must not retain the charge.

**Subpart B—Open-End Credit**

*Section 226.7—Periodic Statement*

7(h) Other Charges

Comment 7(h)–4 would be added to make clear that, in disclosing "other charges" on the periodic statement, creditors have the flexibility to disclose them individually or as a total, as long as the charges are still itemized and identified by tape.

*Section 226.9—Subsequent Disclosure Requirements*

9(d) Finance Charge Imposed at Time of Transaction

Comment 9(d)–1 would be totally rewritten since the ban on credit card surcharges expired on February 27, 1984. Revised comment 9(d)–1 would make clear that a finance charge, such as a credit card surcharge, imposed by a person other than the card issuer for using a credit card, must be disclosed to consumers prior to their being committed to purchasing property or services, in order to satisfy the § 226.9(d)(1) requirement that the amount of that finance charge be disclosed prior to its imposition. For example, the charge must be disclosed to the consumer prior to the consumer's having dinner at a restaurant, or staying overnight at a hotel.

*Section 226.12—Special Credit Card Provisions*

12(a) Issuance of Credit Cards

*Paragraph 12(a)(1)*

Comment 12(a)(1)–8 would be added to make clear that card issuers may issue, without a specific request from the consumer, a personal identification number (PIN) to existing cardholders, provided that PIN cannot be used by itself to obtain credit. This interpretation differs from a proposed interpretation under Regulation E that prohibits such PIN issuance. The different treatment is based on the definition of an access device in Regulation E. Under Regulation E a PIN is an access device in all cases, even when it cannot be used alone to initiate an EFT; in contrast, a PIN issued to existing cardholders that cannot be used by itself to obtain credit is not a credit card under Regulation Z. The rule regarding access devices is more restrictive in part because of the consumer's potentially greater risk. See Question 5–4.5 in the proposed update to the official staff commentary to Regulation E (published elsewhere in this Federal Register issue).

*Section 226.15—Right of Rescission*

15(a) Consumer's Right to Rescind

*Paragraph 15(a)(1)*

Comment 15(a)(1)–2 would be revised to reflect the amendment to the Truth in Lending Act in Pub. L. 98–479 which permanently exempts from the right of recission individual transactions made on an open-end line of credit in accordance with a previously established credit limit.

**References**

Reference to § 205 of Pub. L. 98–479 would be added to the References section to reflect the permanent exemption from the right of rescission for individual credit extensions made on an open-end credit line.

**Subpart C—Closed-End Credit**

*Section 226.17—General Disclosure Requirements*

17(a) Form of Disclosures

*Paragraph 17(a)(1)*

The last example in comment 17(a)(1)–5 regarding due-on-sale clauses would be deleted consistent with the proposed change in position in comment 18(q)–1.

*Section 226.18—Content of Disclosures*

18(f) Variable Rate

Comment 18(f)–5 would be revised to add recent federal adjustable rate mortgage regulations to the list of variable rate regulations for which footnote 43 to § 226.18(f) may be used. Under the proposal, creditors making disclosures in accord with the rules issued by the Department of Housing and Urban Development (49 FR 23580) need not make the variable rate disclosures required by § 226.18(f).

Comment 18(f)–5 would also be revised to reflect a new citation to the variable rate regulation of the Federal Home Loan Bank Board. The revision is technical and reflects no substantive change in the comment.

Comment 18(f)–8 would be revised to clarify the application of the discounted variable rate rules to two types of variable rate transactions. First, a paragraph would be added to explain that transactions in which the only difference between the initial rate and the index rate at consummation results from a change in the index are not discounted transactions. Second, material would be added to address

plans that have a built-in delay between index changes and implementation of those changes. In calculating a composite annual percentage rate for these plans, creditors may use an index value prior to consummation as long as it incorporates the same delay used for later rate adjustments.

18(k) Prepayment

Comment 18(k)–2 would be revised to delete the example regarding student loans with loan fees, in order to make the comment more consistent with comment 18(k)–3. Comment 18(k)–2 illustrates transactions that may require disclosures under both § 226.18(k)(1), regarding penalties for prepayment of simple interest transactions, and § 226.18(k)(2), regarding rebates for prepayment of precomputed transactions. Comment 18(k)–3 clarifies that prepaid finance charges do not require rebate disclosures. Since loan fees in student loans are normally prepaid finance charges, the continued use of that type of transaction as an example of a loan requiring a rebate disclosure is inappropriate and may cause confusion. The deletion of the example is a technical revision and does not affect the substance of either comment.

18(q) Assumption Policy

The substance of comment 18(q)–1 would be deleted and replaced by a new provision which reverses the rule on assumption policy disclosure. When uncertainty exists as to the assumability of the obligation, a negative rather than affirmative disclosure would be required. It is believed that under such circumstances, a negative disclosure would be less misleading to consumers. Since this change would reverse the current position on assumption disclosures, it would be applied prospectively.

*Section 226.23—Right of Rescission*

23(f) Exempt Transactions

Comment 23(f)–8 would be added to clarify the application of the right of rescission to closed-end credit transactions arising from the conversion of an open-end credit account. Where consummation of both the closed-end and open-end credit occurs at the time the consumer enters into the open-end agreement, the closed-end disclosures may be delayed until conversion, as provided by comment 17(b)–2. Proposed comment 23(f)–8 would make clear that, if the creditor has previously complied with the rescission requirements on the open-end account, no new right of recession applies on the conversion of an account secured by the consumer's principal dwelling.

**List of Subjects in 12 CFR Part 226**

Advertising, Banks, Banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Truth in lending.

**PART 226—[AMENDED]**

*Text of revisions.* The proposed revisions to the commentary (TIL–1, Supplement 1 to 12 CFR Part 226) read as follows:

**Supplement I—Official Staff Commentary—TIL–1**

**SUBPART A—GENERAL**

* * * * *

**Section 226.2—Definitions and Rules of Construction**

*2(a) Definitions*

* * * * *

*2(a)(15) "Credit Card"*

* * * * *

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, 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] ►:

- A◄ check guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft[.]
- ►• Any card key that must be used in order to gain access to a wholesale distribution facility to obtain petroleum products for business purposes, and the use of which is required without regard to payment terms.◄

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*2(a)(17) "Creditor"*

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*Paragraph 2(a)(17)(i)*

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►*8. Loans from employee savings plans.* Some employee savings plans permit participants to borrow money up to a certain percentage of their account balances. In such cases, the numercial tests should be applied to the plan as a whole rather than to the individual accounts, even if the loan amount is determined by reference to the balance in an individual account and the repayments are credited to the individual account.◄

* * * * *

*2(a)(20) "Open-End Credit"*

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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] ►. The creditor may verify◄ 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. * * *

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*Section 226.4—Finance Charge*

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*4(a) Definition.*

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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►, provided the charges are imposed on the consumer rather than on the creditor by the third party, and the creditor does not retain the charge◄. 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 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)

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**Subpart B—Open-End Credit**

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*Section 226.7—Periodic Statement*

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*7(h) Other Charges.*

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►*4. Itemization—types of "other charges"* Each type of "other charge" (such as late payment charges, over-the-credit-limit charges, ATM fees that are not finance charges, and membership fees) imposed during the cycle must be separately itemized; for example, disclosure of only a total of "other charges" attributable to both an over-the-crtedit-limit charge and a late payment charge would not be permissible. "Other charges" of the same type may be disclosed, however, individually or as a total. For example, three ATM fees of $1 may be listed separately or as $3.◄

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*Section 226.9—Subsequent Disclosure Requirements*

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*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.] ►*Disclosure prior to imposition.* The requirement that the amount of a finance charge imposed at the time of the honoring a consumer's credit card be disclosed prior to its imposition requires a person imposing such a credit card surcharge to disclose its existence prior to the consumer's becoming obligated to purchase property or services.◄

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*Section 226.12—Special Credit Card Provisions*

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*12(a) Issuance of Credit Cards.*

*Paragraph 12(a)(1).*

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►*8. Unsolicited issuance of PINs.* A card issuer may issue to existing credit cardholders, without a specific request, personal identification numbers (PINs), thus allowing consumers to use their existing credit cards at automated teller machines, provided the PINs cannot be used alone to obtain credit.◄

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*Section 226.15—Right of Rescission*

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*15(a) Consumer's Right to Rescind.*

*Paragraph 15(a)(1).*

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2. *Exceptions.* Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the act provides an exception: [until September 30, 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. This limited rescission option is available whether or not the plan existed prior to the effective date of the act. [The consumer will have the right to rescind each extension made after September 30, 1985 under such a secured open-end credit plan, whether that plan was established before or after that date.]

* * * * *

**References**

*Statue:* §§ 113,125, [and] ►, ◄ 130 ►, and the Housing and Community Development Technical Amendments Act of 1984, (Sec. 205, Pub. L. 98–479)◄

* * * * *

*1981 Changes:* Section 226.15 reflects the statutory amendments of 1980, providing for a limited right of rescission [for a three-year trial period] when individual credit extensions are made in accordance with a previously established credit limit for an open-end credit plan. ►The 1980 amendments provided that this limited rescission right be available for a three-year trial period. However, Pub. L. 98–479 now permanently exempts such individual credit extensions from the right of rescission.◄

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**Subpart C—Closed-End Credit**

*Section 226.17—General Disclosure Requirements.*

*17(a) Form of Disclosure.*

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*Paragraph 17(a)(1).*

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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 statement that a due-on-sale clause is contained in the loan document. For example, the disclosure given your § 226.18(q) may state, "Someone buying your home may, subject to conditions in the due-on-sale clause contained in the loan document, assume the remainder of the mortgage on the original terms."]

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*Section 226.18—Content of Disclosures*

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*18(f) Variable Rate.*

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5. *Other variable-rate regulations.* Transactions in which the creditor is required to comply with and has complied with variable-rate regulations of other federal agencies are exempt from the requirements of § 226.18(f), by virtue of footnote 43. Those variable-rate regulations include the adjustable mortgage loan instrument regulation issued by the Federal Home Loan Bank Board ►(12 CFR 545.33),◄ [(12 CFR 545.6–2(a)) and] the adjustable-rate mortgage regulation issued by the Comptroller of the Currency (12 CFR Part 29) ►and the adjustable-rate mortgage regulations issued by the Department of Housing and Urban Development (24 CFR Part 203 and 24 CFR Part 234)◄. The exception in footnote 43 is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (Pub. L. 97–320) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

* * * * *

8. *Discounted variable-rate transactions.* In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate is lower than the rate would be if it were calculated using the index or formula. For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the creditor may forego the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

• When creditors use an initial rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is applied and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. ►The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that payment changes are based on the index value in effect 45 days before the change date, creditors may use the index value 45 days before consummation in calculating a composite annual percentage rate.◄

• The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.

• If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.

• Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of ¼ of 1 percent applies, in accordance with § 226.22(a)(3) of the regulation.

• Examples of discounted variable-rate transactions include:

—A 30-year loan for $100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the payment schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $226,463.32 and the total of payments $366,463.32.

—Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of $804.62, 12 payments of $950.09, and 336 payments of $1,024.34. The finance charge should be $265,234.76, and the total of payments $365,234.76.

►This paragraph does not apply to variable-rate loans in which the initial rate is set according to the index or formula used for later adjustments, but is not set at the value of the index or formula at consummation. For example, if a creditor commits to an initial

rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor may base its disclosures on the initial rate.◄

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*18(k) Prepayment.*

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2. . *Rebate-penalty disclosure.* A single transaction may involve both a precomputed finance charge and a finance charge computed by application of a rate to the unpaid balance (for example, [simple-interest student loans with loan fees and] mortgages with mortgate-guarantee insurance). In these cases, disclosures about both prepayment rebates and penalties are required. Sample form H–15 in appendix H illustrates a mortgage transaction in which both rebate and penalty disclosures are necessary.

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*18(q) Assumption Policy.*

1. *Policy statement.* [Because a creditor's assumption policy may be based on a variety of circumstances not determinable at the time the disclosure is made, the creditor may use phrases such as "subject to conditions" or "under certain circumstances" in complying with § 226.18(q). The provision requires only that the consumer be told whether or not a subsequent purchaser might be allowed to assume the obligation on its original terms and does not contemplate any explanation of the criteria or conditions for assumability. However, the creditor may state that a due-on-sale clause is contained in the loan document. (See comment 17(a)(1)–5 regarding directly related information.)] ►In making the disclosure required by this section, if uncertainty exists as to whether a subsequent purchaser will be allowed to assume the obligation on its original terms, the creditor should state that the obligation cannot be assumed on its original terms. For example, if the obligation is subject to a due-on-sale clause, it is viewed as being nonassumable for purposes of complying with this section. However, if the only uncertainty pertains to a determination of the creditworthiness of the subsequent purchaser, the obligation is viewed as being assumable and an affirmative disclosure is appropriate.◄

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*Section 226.23—Right of Rescission*

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*23(f) Exempt Transactions*

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►*8. Converting open-end to closed-end credit.* Under certain state laws, consummation of a closed-end credit transaction may occur at the time a consumer enters into the initial open-end credit agreement. As provided in the commentary to § 226.17(b), closed-end credit disclosures may be delayed under these circumstances until the conversion of the open-end account to a closed-end transaction. In accounts secured by the consumer's principal dwelling, no new right of rescission arises at the time of conversion, assuming that the right of rescission arises at the time of conversion, assuming that the right of rescission was previously provided on the open-end account pursuant to § 226.15.◄

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(15 U.S.C. 1604)

Board of Governors of the Federal Reserve System, November 28, 1984.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 84–31577 Filed 12–3–84; 8:45 am]

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