St-Cir No. 10260-A

September 29, 1988

To the Addressee:

Enclosed -- for depository institutions in the Second Federal Reserve District and others maintaining sets of regulations of the Board of Governors of the Federal Reserve System -- is a copy of (1) a revised printing of the Board's Regulation Q, "Interest on Deposits," as amended effective April 1, 1986 (no changes have been made in the Regulation since that date); and (2) the Board's Official Staff Commentary on Regulation Z, "Truth in Lending," revised effective April 1, 1988.

Circulars Division
FEDERAL RESERVE BANK OF NEW YORK

2519C

Board of Governers of the Federal Reserve System

At-Cir. No. 10260-A

Regulation Q
Interest on Deposits

12 CFR 217; as amended effective April 1, 1986

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the Federal Reserve District in which the inquiry arises.

May 1988

Contents

Regulation Q
Interest on Deposits

12 CFR 217; as amended effective April 1, 1986

SECTION 217.1—Authority, Purpose, and Scope

(a) *Authority.* This regulation is issued under the authority of section 19 of the Federal Reserve Act (12 USC 371, 371a, 371b, 461), section 7 of the International Banking Act of 1978 (12 USC 3105), and section 11 of the Federal Reserve Act (12 USC 248), unless otherwise noted.

(b) *Purpose.* This regulation prohibits the payment of interest on demand deposits by member banks and other depository institutions within the scope of this regulation and sets forth requirements concerning the advertisement of interest on deposits by member banks and these other institutions.

(c) *Scope.* (1) This regulation applies to state-chartered banks that are members of the Federal Reserve under section 9 of the Federal Reserve Act (12 USC 321 et seq.) and to all national banks. The regulation also applies to any federal branch or agency of a foreign bank and to a state uninsured branch or agency of a foreign bank in the same manner and to the same extent as if the branch or agency were a member bank, except as may be otherwise provided by the Board, if—

(i) its parent foreign bank has total worldwide consolidated bank assets in excess of $1 billion;

(ii) its parent foreign bank is controlled by a foreign company which owns or controls foreign banks that in the aggregate have total worldwide consolidated bank assets in excess of $1 billion; or

(iii) its parent foreign bank is controlled by a group of foreign companies that own or control foreign banks that in the aggregate have total worldwide consolidated bank assets in excess of $1 billion.

(2) For deposits held by a member bank or a foreign bank, this regulation does not apply to "any deposit that is payable only at an office located outside of the United States" (i.e., the states of the United States and the Disrict of Columbia) as defined in section 204.2(t) of the Board's Regulation D, Reserve Requirements of Depository Institutions (12 CFR 204).

SECTION 217.2—Definitions

For purposes of this part, the following definitions apply unless otherwise specified:

(a) *"Demand deposit"* means any deposit that is considered to be a "demand deposit" under section 204.2(b) of the Board's Regulation D, Reserve Requirements of Depository Institutions (12 CFR 204).

(b) *"Deposit"* means any liability of a member bank that is considered to be a "deposit" under section 204.2(a) of the Board's Regulation D, Reserve Requirements of Depository Institutions (12 CFR 204).

(c) *"Foreign bank"* means any bank that is considered to be a "foreign bank" under section 204.2(o) of the Board's Regulation D, Reserve Requirements of Depository Institutions (12 CFR 204).

(d) *"Interest"* means any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A member bank's absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

SECTION 217.3—Interest on Demand Deposits

No member bank of the Federal Reserve System shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit.[1]

[1] A member bank may continue to pay interest on a time deposit for not more than 10 calendar days (1) where the member bank has provided in the time deposit contract that, if the deposit or any portion thereof is withdrawn not more than 10 calendar days after a maturity date (one business day for "IBF time deposits" as defined in section 204.8(a)(2) of Regulation D), interest will continue to be paid for such period; or (2) for a period between a maturity date and the date of renewal of the deposit, provided that such certificate is renewed within 10 calendar days after maturity.

SECTION 217.4—Miscellaneous

(a) *Early withdrawal penalty.* At the time a depositor enters into a time deposit contract with a member bank, the bank shall provide a written statement of the effect of any early withdrawal penalty which shall (1) state clearly that the customer has contracted to keep the funds on deposit for the stated maturity and (2) describe fully and clearly how such penalty provisions apply to time deposits in such bank, in the event the bank, notwithstanding the contract provisions, permits payment before maturity. Such statement shall be expressly called to the attention of the customer.

(b) *Payment of interest.* On each automatically renewable certificate, passbook, or other document representing a time deposit, the bank shall have printed or stamped a conspicuous statement indicating that the contract will be renewed automatically upon maturity and indicating the terms of such renewal.

SECTION 217.5

[Reserved]

SECTION 217.6—Advertising of Interest on Deposits

Every advertisement, announcement, or solicitation relating to the interest paid on deposits in member banks shall be governed by the following rules:

(a) *Annual rate of simple interest.* Interest rates shall be stated in terms of the annual rate of simple interest. In no case shall a rate be advertised that is in excess of the applicable maximum rate for the particular deposit.

(b) *Percentage yields based on one year.* Where a percentage yield achieved by compounding interest during one year is advertised, the annual rate of simple interest shall be stated with equal prominence, together with a reference to the basis of compounding. No member bank shall advertise a percentage yield based on the effect of grace periods permitted in section 217.3(d).

(c) *Percentage yields based on periods in excess of one year.* No advertisement shall include any indication of a total percentage yield, compounded or simple, based on a period in excess of a year, or an average annual percentage yield achieved by compounding during a period in excess of a year.

(d) *Time or amount requirements.* If an advertised rate is payable only on deposits that meet time or amount requirements, such requirements shall be clearly and conspicuously stated. Where the time requirement for an advertised rate is in excess of a year, the required number of years for the rate to apply shall be stated with equal prominence, together with an indication of any lower rate or rates that will apply if the deposit is withdrawn at an earlier maturity.

(e) *Penalty for early withdrawals.* Any advertisement, announcement, or solicitation relating to interest paid by a member bank on time deposits shall include clear and conspicuous notice that the bank is prohibited from allowing payment of a time deposit before maturity unless substantial interest is forfeited. Such notice may state that—

"Substantial interest penalty is required for early withdrawal."

(f) *Profit.* The term "profit" shall not be used in referring to interest paid on deposits.

(g) *Accuracy of advertising.* No member bank shall make any advertisement, announcement, or solicitation relating to the interest paid on deposits that is inaccurate or misleading or that misrepresents its deposit contracts.

(h) *Solicitation of deposits for banks.* Any person or organization that solicits deposits for a member bank shall be bound by the rules contained in this section with respect to any advertisement, announcement, or solicitation relating to such deposits. No such person or organization shall advertise a percentage yield on any deposit it solicits for a member bank that is not authorized to be paid and advertised by such bank.

Federal Reserve Act

Dispersed throughout 12 USC; ch. 6, 38 Stat. 251 (December 23, 1913)

SECTION 19—Bank Reserves

(a) The Board is authorized for the purposes of this section to define the terms used in this section, to determine what shall be deemed a payment of interest, to determine what types of obligations, whether issued directly by a member bank or indirectly by an affiliate of a member bank or by other means, and, regardless of the use of the proceeds, shall be deemed a deposit, and to prescribe such regulations as it may deem necessary to effectuate the purposes of this section and to prevent evasions thereof.

[12 USC 461(a). As amended by acts of June 21, 1917 (40 Stat. 239) (which completely revised this section); Aug. 23, 1935 (49 Stat. 714); Sept. 21, 1966 (80 Stat. 823) (as amended by acts of Sept. 21, 1967 (81 Stat. 226) and Sept. 21, 1968 (82 Stat. 856)); Dec. 23, 1969 (83 Stat. 374); Oct. 29, 1974 (88 Stat. 1557); and March 31, 1980 (94 Stat. 133, 138). The amendment inserting the words "and, regardless of the use of the proceeds," made by the act of Oct. 29, 1974, "shall not apply to any bank holding company which has filed prior to the date of enactment of this Act an irrevocable declaration with the Board of Governors of the Federal Reserve System to divest itself of all of its banks under section 4 of the Bank Holding Company Act, or to any debt obligation which is an exempted security under section 3(a)(3) of the Securities Act of 1933" (12 USC 461 note).]

* * * * *

(i) No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand: *Provided,* That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract entered into in good faith which is in force on the date on which the bank becomes subject to the provisions of this paragraph; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this paragraph, and every member bank shall take such action as may be necessary to conform to this paragraph as soon as possible consistently with its contractual obligations: *Provided further,* That this paragraph shall not apply to any deposit of such bank which is payable only at an office thereof located outside of the States of the United States and the District of Columbia: *Provided further,* That until the expiration of two years after the date of enactment of the Banking Act of 1935 this paragraph shall not apply (1) to any deposit made by a savings bank as defined in section 12B of this Act, as amended, or by a mutual savings bank, or (2) to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, or to any deposit of trust funds if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law. So much of existing law as requires the payment of interest with respect to any funds deposited by the United States, by any Territory, District, or possession thereof (including the Philippine Islands), or by any public instrumentality, agency, or officer of the foregoing, as is inconsistent with the provisions of this section as amended, is hereby repealed.

[12 USC 371a. As added by act of June 16, 1933 (48 Stat. 181); and amended by acts of Aug. 23, 1935 (49 Stat. 714); Sept. 21, 1966 (80 Stat. 824) (as amended by acts of Sept. 21, 1967 (81 Stat. 226) and Sept. 21, 1968 (82 Stat. 856)); Dec. 28, 1979 (93 Stat. 1233); and March 31, 1980 (94 Stat. 145). The Banking Act of 1935, referred to in this paragraph, was approved Aug. 23, 1935. Section 12B was withdrawn and enacted as a separate act of Sept. 21, 1950; for definition of "savings bank" under the act, see 12 USC 1813 (g). Presidential Proclamation No. 2695 of July 4, 1946 (60 Stat. 1352; 12 USC 1394 note) recognizes the independence of the Philippine Islands. Therefore the words "(including the Philippine Islands)" have been omitted from the U.S. Code.

Section 2 of Public Law 93–100 of Aug. 16, 1973 (12 USC 1832) as amended by acts of Feb. 27, 1976 (90 Stat. 197); Nov. 10, 1978 (92 Stat. 3712); Dec. 28, 1979 (93 Stat. 1235); March 31, 1980 (94 Stat. 146); Oct. 15, 1982 (96 Stat. 1540); and Aug. 10, 1987 (101 Stat. 579) provides as follows:

> (a)(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties.
>
> (2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit, and with respect to deposits of public funds by an officer, employee, or

agent of the United States, any State, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

(b) For purposes of this section, the term "depository institution" means—

(1) any insured bank as defined in section 3 of the Federal Deposit Insurance Act;

(2) any State bank as defined in section 3 of the Federal Deposit Insurance Act;

(3) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act;

(4) any savings bank as defined in section 3 of the Federal Deposit Insurance Act;

(5) any insured institution as defined in section 401 of the National Housing Act; and

(6) any building and loan association or savings and loan association organized and operated according to the laws of the State in which it is chartered or organized; and, for purposes of this paragraph, the term "State" means any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands.

(c) Any depository institution which violates this section shall be fined $1,000 for each violation.]

(j) The Board may from time to time, after consulting with the Board of Directors of the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, prescribe rules governing the advertisement of interest on deposits by member banks on time and savings deposits. The provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia. During the period commencing on October 15, 1962, and ending on October 15, 1968, the provisions of this paragraph shall not apply to the rate of interest which may be paid by member banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.

[12 USC 371b. As added by act of June 16, 1933 (48 Stat. 182). Amended by acts of Aug. 23, 1935 (49 Stat. 714); Oct. 15, 1962 (76 Stat. 953); July 21, 1965 (79 Stat. 244); Sept. 21, 1966 (80 Stat. 824) (as amended by acts of Sept. 21, 1967 (81 Stat. 226) and Sept. 21, 1968 (82 Stat. 856), Joint Resolution of Sept. 22, 1969 (83 Stat. 115); Act of Dec. 23, 1969 (83 Stat 371), Joint Resolution of March 31, 1971 (85 Stat. 13); and act of May 18, 1971 (85 Stat. 38)), Sept. 21, 1968 (82 Stat. 856); July 6, 1973 (87 Stat. 147); Aug. 16, 1973 (87 Stat. 342); Oct. 28, 1974 (88 Stat. 1505); Dec. 31, 1975 (89 Stat. 1124); April 19, 1977 (91 Stat. 49); and Nov. 16, 1977 (91 Stat. 1387).]

Board of Governors of the Federal Reserve System

St-lib. no 10260-A

Official Staff Commentary on Regulation Z Truth in Lending

As amended effective April 1, 1988

Any inquiry relating to Regulation Z should be addressed to the Federal Reserve Bank of the Federal Reserve District in which the inquiry arises.

June 1988

Contents

Official Staff Commentary on Regulation Z

As revised effective April 1, 1988*

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. Good faith compliance with this commentary affords protection from liability under section 130(f) of the Truth in Lending Act. Section 130(f) (15 USC 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 October 1, 1982 only insofar as they interpret that regulation. When compliance with revised Regulation Z becomes mandatory on October 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 section 226.18(b) are futher divided by subparagraph, 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 appendixes 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

* Reliance on the revisions optional until October 1, 1988.

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, lay-away 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 semiannual 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 section 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 section 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 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 sytem
- 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 materials that do not solicit business

2. *Persons covered.* All "persons" must comply with the advertising provisions in sections 226.16 and 226.24, not just those that meet the definition of creditor in section 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 section 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)(4) "Billing Cycle" or "Cycle"

1. *Intervals.* In open-end credit plans, the billing cycle determines the intervals for which periodic disclosure statements are required; 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 ac-

tivity. 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 four 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 section 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's merely accepting credit cards for purchases or a bank's 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 section 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 is-

suers 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 section 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 section 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 section 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 four 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 sections 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 section 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 section 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. A contractual commitment agreement, for example, that under applicable law binds the consumer to the credit terms would be consummation. Consummation, however, 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
- Any card, key, plate, or other device that is used in order to obtain petroleum products for business purposes from a wholesale distribution facility or to gain access to that facility, and that is required to be used without regard to payment terms.

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 section 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 section 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 section 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 section 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 four 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 two 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 section 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 four 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 four 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 it 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 eight times and credit secured by a dwelling three 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 five 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 three 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.

8. *Loans from employee savings plans.* Some employee savings plans permit participants to borrow money up to a certain percentage of their account balances. Unless each participant's account is an individual trust, the numerical 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.

Paragraph 2(a)(17)(iii)

1. *Card issuers subject to subpart B.* Section 226.2(a)(17)(iii) 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)(iv)

1. *Card issuers subject to subparts B and C.* Section 226.2(a)(17)(iv) includes as creditors card issuers extending closed-end credit

in which there is a finance charge or an agreement to pay in more than four 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. (See the commentary to section 226.2(a)(23).)

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

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

If the pickup 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 pickup payment is treated, the total of payments under section 226.18(h) must equal the sum of the payments disclosed under section 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 sections 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 section 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 three* 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 subaccounts 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, multifeatured 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 use the plan only 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 may meet the definition of open-end credit even though a finance charge is not normally imposed, provided the creditor has the right, under the plan, to impose a finance charge from time to time on the outstanding balance. For example, in some plans, such as certain "china club" plans, a finance charge is not imposed if the consumer pays all or a specified portion of the outstanding balance within a given time period. Such a plan could meet the finance-charge criterion, if the creditor has the right to impose a finance charge, 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 full 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. The creditor may verify credit information such as the consumer's continued income and employment status or 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, 1-½ percent 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 1/360 of an annual rate as their periodic rate. These creditors:

- May disclose a 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 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 section 226.18(b) in computing the disclosed amount financed, and must be disclosed if the creditor provides an itemization of the amount financed under section 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 be either paid separately in cash or check or withheld from the proceeds. Prepaid finance charges include any portion of the finance charge paid prior to or at closing or settlement.

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 section 226.18(b).

4. *Allocation of lump-sum payments.* In a credit sale transaction involving a lump-sum payment by the consumer and a discount or other item that is a finance charge under section 226.4, the discount or other item is a prepaid finance charge to the extent the lump-sum payment is not applied to the cash price. For example, a seller sells property to a consumer for $10,000, requires the consumer to pay $3,000 at the time of the purchase, and finances the remainder as a closed-end credit transaction. The cash price of the property is $9,000. The seller is the creditor in the transaction and therefore the $1,000 difference between the credit and cash prices (the discount) is a finance charge. (See the commentary to sections 226.4(b)(9) and 226.4(c)(5).) If the creditor applies the entire $3,000 to the cash price and adds the $1,000 finance charge to the interest on the $6,000 to arrive at the total finance charge, all of the $3,000 lump-sum payment is a downpayment and the discount is not a prepaid finance charge. However, if the creditor only applies $2,000 of the lump-sum payment to the cash price, then $2,000 of the $3,000 is a downpayment and the $1,000 discount is a prepaid finance charge.

2(a)(24) "Residential Mortgage Transaction"

1. *Relation to other sections.* This term is important in six 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 226.20(b)—disclosure requirements for assumptions
- 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 have only *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 sections 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 section 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 five advances. The creditor gives six sets of disclosures (five for the construction phase and one 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.

5. *Acquisition.* A transaction is not "to finance the acquisition" of the consumer's principal dwelling (and therefore is not a residential mortgage transaction) if the consumer had previously purchased the dwelling and acquired some title to the dwelling, even though the consumer has not acquired full legal title. Thus, the following types of transactions are not residential mortgage transactions:

- The financing of a balloon payment due under a land sale contract
- An extension of credit made to a joint owner of property to buy out the other joint owner's interest

As a result, in giving the disclosures for these transactions several provisions of the regulation are not applicable, for example, the exceptions to the right of rescission (sections 226.23(f)(1) and 226.15(f)(1)), the early disclosure requirement (section 226.19(a)), and the disclosure concerning assumability (section 226.18(q)). In the following situation, by contrast, since the transaction is not a residential mortgage transaction, no disclosures are required by section 226.20(b) and therefore the right of rescission does not apply:

- A written agreement between a creditor holding a seller's mortgage and the buyer of the property which allows the buyer to assume the mortgage, where the buyer previously purchased the property and agreed with the seller to make the mortgage payments.

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 in-

terest 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. (But see the discussion of exclusions elsewhere in the commentary to section 226.2(a)(25).)

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 section 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. If the creditor is unsure whether a particular interest is one of the excluded interests, the creditor may, at its option, consider such interests as security interests for Truth in Lending purposes.

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: § 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 section 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 213).

Several terms are now defined elsewhere in the regulation or commentary rather than in section 226.2. For example, "finance charge" is described and explained in section 226.4, and "agricultural purpose" is discussed in the commentary to section 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" and "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. This definition was deleted effective October 1, 1982.

"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 four 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 two housing units.
- Credit extended to improve or maintain the rental property is deemed to be for business purposes if it contains more than four housing units. Since the amended statute defines "dwelling" to include one to four 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 section 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 section 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.

If a security interest is taken at a later time in any real property, or in personal property used or expected to be used as the consumer's principal dwelling, the plan would no longer be exempt. The creditor must comply with all of the requirements of the regulation, including, for example, providing the consumer with an initial disclosure statement. If the security interest being added is in the consumer's principal dwelling, the creditor must also give the consumer the right to rescind the security interest. (See the commentary to section 226.15 concerning the right of rescission.)

3. *Closed-end credit—subsequent changes.* A closed-end loan for over $25,000 may later be rewritten for $25,000 or less, or a security interest in real property or in personal property used or expected to be used as the consumer's principal dwelling 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. (See the commentary to section 226.23(a)(1) regarding the right of rescission when a security interest in a consumer's principal dwelling is added to a previously exempt transaction.)

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.

3(f) Student Loan Programs

1. *Coverage.* This exemption applies to the Guaranteed Student Loan program (administered by the federal government, state and private nonprofit agencies), the Auxiliary Loans to Assist Students (also known as PLUS) program, and the National Direct Student Loan program.

References

Statute: §§ 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 section 226.302, concerning credit relating to structures containing more than four 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 section 226.4(b)(6).)

3. *Charges by third parties.* Charges imposed on the consumer by someone other than the creditor for services not required by the creditor are not finance charges as long as the creditor does not retain the 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 section 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 percent interest. The creditor charges the consumer an interest rate of 6 percent 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 percent interest but has only $4,000. The financial institution offers to lend the consumer $6,000 at an interest rate of 6 percent but will pay the 15 percent 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 percent. In addition, the agreement states that the creditor will pay 0 percent 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).

5. *Treatment of fees for use of automated teller machines.* Any charge imposed on a cardholder by a card issuer for the use of an automated teller machine (ATM) to obtain a cash advance (whether in a proprietary, shared, interchange, or other system) is not a finance charge to the extent that it does not exceed the charge imposed by the card issuer on its cardholders for using the ATM to withdraw cash from a consumer asset account, such as a checking or savings account. (See the commentary to section 226.6(b).)

4(b) Examples of Finance Charges

1. *Relationship to other provisions.* Charges or fees shown as examples of finance charges in section 226.4(b) may be excludable under section 226.4(c), (d), or (e). For example:

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

Paragraph 4(b)(2)

1. *Checking account charges.* The checking or transaction account charges discussed in section 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 section 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 section 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 section 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.

2. *Residual-value insurance.* Where a creditor requires a consumer to maintain residual-value insurance or where the creditor is a beneficiary of a residual-value insurance policy written in connection with an extension of credit (as is the case in some forms of automobile balloon-payment financing, for example), the premiums for the insurance must be included in the finance charge for the period that the insurance is to be maintained. If a creditor pays for residual-value insurance and absorbs the payment as a cost of doing business, such costs are not considered finance charges. (See comment 4(a)-2.)

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

1. *Preexisting insurance policy.* The insurance discussed in section 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 section 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 section 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 section 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 section 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 percent discount for payment by cash, a 10 percent discount for payment by check, and a 5 percent discount for payment by a particular credit card. None of these discounts is a finance charge.

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

3. *Determination of the regular price.* The "regular price" is critical in determining whether the difference between the price charged to cash customers and credit customers is a "discount" or a "surcharge," as these terms are defined in amended section 103 of the act. The "regular price" is defined in section 103 of the act as "the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit account or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted. . . ." For example, in the sale of motor vehicle fuel, the tagged or posted price is the price displayed at the pump. As a result, the

higher price (the open-end credit or credit card price) must be displayed at the pump, either alone or along with the cash price. Service station operators may designate separate pumps or separate islands as being for either cash or credit purchases and display only the appropriate prices at the various pumps. If a pump is capable of displaying on its meter either a cash or a credit price depending upon the consumer's means of payment, both the cash price and the credit price must be displayed at the pump. A service station operator may display the cash price of fuel by itself on a curb sign, as long as the sign clearly indicates that the price is limited to cash purchases.

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 section 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 section 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 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—periodic basis.* The participation fees mentioned in section 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, annual, or other periodic basis; a one-time, non-recurring fee imposed at the time an account is opened is not a fee that is charged on a periodic basis, and may not be treated as a participation fee.

2. *Participation fees—exclusions.* Minimum monthly charges, charges for non-use of a credit card, and other charges based on either

account activity or the amount of credit available under the plan are not excluded from the finance charge by section 226.4(c)(4). Thus, for example, a fee that is charged and then refunded to the consumer based on the extent to which the consumer uses the credit available would be a finance charge. (See the commentary to section 226.4(b)(2). Also, see comment 14(c)-7 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.)

Paragraph 4(c)(5)

1. *Seller's points.* The seller's points mentioned in section 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 noncreditor 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.

2. *Other seller-paid amounts.* Mortgage insurance premiums and other charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. In such cases, the creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available, as called for by the estimate provisions of the regulation.

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 section 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 section 226.4(a).)

Paragraph 4(c)(7)

1. *Real estate or residential mortgage transaction charges.* The list of charges in section 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. If a lump sum is charged for several services and includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. A charge for a lawyer's attendance at the closing or a charge for conducting the closing (for example, by a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in section 226.4(c)(7) (for example, reviewing or completing documents), even if other incidental services, such as explaining various documents or disbursing funds for the parties, are performed. In all cases, charges excluded under section 226.4(c)(7) must be bona fide and reasonable.

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 section 226.17(a).

2. *Timing of disclosures.* If disclosures are given early, for example under section 226.17(f) or section 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 section 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 preexisting policy instead, no premium is included in the finance charge. See the commentary to section 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 section 226.4.

7. *Signatures.* If the creditor offers a number of insurance options under section 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 section 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 section 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 section 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 nonexcludable coverages and included in the finance charge. However, such allocation is not required if the total premium in fact attributable to all of the non-VSI coverages included in the policy is $1.00 or less (or $5.00 or less in the case of a multiyear policy).

11. *Initial term.* The initial term of insurance coverage determines the period for which a premium amount must be disclosed. In some cases the initial term is clear, for example, a property insurance policy on an automobile written for one year (even though the term of the credit transaction is four years) or a credit life insurance policy for the term of the credit transaction purchased by paying or financing a single premium. In other cases, however, it may not be clear what the initial term of the insurance is, for example, when the consumer agrees to pay a premium that is assessed periodically and the consumer is under no obligation to continue making the payments. In cases such as this, the cost disclosure may be made on the basis of a premium for one year of insurance coverage. The premium must be clearly labeled as being for one year.

12. *Loss-of-income insurance.* The loss-of-income insurance mentioned in section 226.4(d) includes involuntary unemployment insurance, which provides that some or all of the consumer's payments will be made if the consumer becomes unemployed involuntarily.

4(e) Certain Security Interest Charges

1. *Examples.* Examples of charges excludable from the finance charge under section 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 section 226.4(e)(1).

2. *Itemization.* The various charges described in section 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 section 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. *Nonfiling insurance.* The exclusion in section 226.4(e)(2) is available only if nonfiling insurance is purchased. If the creditor collects and simply retains a fee as a sort of "self-insurance" against nonfiling, it may not be excluded from the finance charge. If the nonfiling insurance premium exceeds the amount of

the fees excludable from the finance charge under section 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 nonfiling 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 on 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, section 226.4 reflects amendments to section 106 of the act and makes certain other changes in the rules for determining the finance charge. For example, section 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 dif-

ferent 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", when required to be used with a number, must be disclosed more conspicuously than other required disclosures, except in the two cases provided in footnote 9. At the creditor's option, "finance charge" and "annual percentage rate" may also be disclosed more conspicuously than the other required disclosures even when the regulation does not so require. The following examples illustrate these rules:

- In disclosing the annual percentage rate as required by section 226.6(a)(2), the term "annual percentage rate" is subject to the "more conspicuous" rule.
- In disclosing the amount of the finance charge, required by section 226.7(f), the term "finance charge" is subject to the "more conspicuous" rule.
- Although neither "finance charge" nor "annual percentage rate" need be emphasized when used as part of general informational material or in textual descriptions of other terms, emphasis is permissible in such cases. For example, when the terms appear as part of the explanations required under section 226.6(a)(3) and (4), they may be equally conspicuous as the disclosures required under sections 226.6(a)(2) and 226.7(g).

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

3. *Disclosure of figures—exception to "more conspicuous" rule.* The terms "annual percentage rate" and "finance charge" need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs).

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, the initial disclosures must be given before the consumer makes the first purchase, receives the first advance, or pays any fees or charges under the plan other than an application fee or refundable membership fee (see below).

- If the consumer pays a membership fee before receiving the Truth in Lending disclosures, or the consumer agrees to the imposition of a membership fee at the time of application and the Truth in Lending disclosure statement is not given at that time, disclosures are timely as long as the consumer, after receiving the disclosures, can reject the plan. The creditor must refund the membership fee if it has been paid, or clear the account if it has been debited to the consumer's account.
- If the consumer receives a cash advance check at the same time the Truth in Lending disclosures are provided, disclosures are still timely if the consumer can, after

receiving the disclosures, return the cash advance check to the creditor without obligation (for example, without paying finance charges).

- Initial disclosures need not be given before the imposition of an application fee under section 226.4(c)(1).
- If, after receiving the disclosures, the consumer uses the account, pays a fee, or negotiates a cash advance check, the creditor may consider the account not rejected for purposes of this section.

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. No new initial disclosures are required, however, when the account is closed merely to assign it a new number (for example, when a credit card is reported lost or stolen) and the "new" account then continues on the same terms.

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 section 226.6 must be given before the consumer becomes obligated on the open-end credit plan. (See the commentary to section 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 section 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 section 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 determined by applicable state or other law.
- The fact that a term or 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 term or 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 section 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
- 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

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 section 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 section 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: §§ 121(a) through (c), 122(a) and (b), 124, 127(a) and (b), and 163(a)

Other sections: §§ 226.6, 226.7, and 226.9
Previous regulation: §§ 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 multipage, 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 two sets of disclosures; however, the language need not be identical. For example, in making the disclosure under section 226.6(a)(3), the creditor may refer to the "outstanding balance at the end of the billing cycle," while the disclosure for section 226.7(i) refers to the "ending balance" or "new balance."

2. *Separate initial disclosures permitted.* In a certain open-end credit program involving more than one creditor—a card issuer of travel-and-entertainment cards and a financial institution—the consumer has the option to pay the card issuer directly or to transfer to the financial institution all or part of the amount owing. In this case, the creditors may send separate initial disclosure statements.

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 two rates (a 1.5 percent periodic rate on purchase balances of $0-$500, while balances above $500 are subject to a 1 percent periodic rate). Of course, the creditor must give a range of balances disclosure for the purchase feature.

2. *Variable-rate disclosures—coverage.* This section covers open-end credit plans under which rate changes are part of the plan and are tied to an index or formula. A creditor would use variable-rate disclosures (and thus be excused from the requirement of giving a change-in-terms notice when rate increases occur as disclosed) for plans involving rate changes such as the following:

- Rate changes that are tied to the rate the creditor pays on its six-month money market certificates
- Rate changes that are tied to Treasury bill rates

- Rate changes that are tied to changes in the creditor's commercial lending rate

In contrast, the creditor's contract reservation to increase the rate without reference to such an index or formula (for example, a plan that simply provides that the creditor reserves the right to raise its rates) would not be considered a variable-rate plan for Truth in Lending disclosure purposes. Moreover, an open-end credit plan in which the employee receives a lower rate contingent upon employment (that is, with the rate to be increased upon termination of employment) is not a variable-rate plan. (With regard to such employee preferential-rate plans, however, see comment 9(c)-1, which provides that if the specific change that would occur is disclosed on the initial disclosure statement, no notice of a change in terms need be given when the term later changes as disclosed.)

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 section 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 section 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. (A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See section 226.30 and the commentary to that section.) 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 percent annual percentage rate."
- "Not more than $\frac{1}{2}$ percent 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.

10. *Discounted variable-rate plans.* In some variable-rate plans, 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 forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent, or the creditor may disregard the index or formula and set the initial rate at 9 percent.

- When creditors use an initial rate that is not calculated using the index or formula for later rate adjustments, the initial disclosure statement should reflect: (1) the initial rate (expressed as a periodic rate and a corresponding annual percentage rate), together with a statement of how long it will remain in effect; (2) the current rate that would have been applied using the index or formula (also expressed as a periodic rate and a corresponding annual percentage rate); and (3) the other variable-rate information required by footnote 12 to section 226.6(a)(2).
- In disclosing the current periodic and annual percentage rates that would be applied using the index or formula, the creditor may use any of the disclosure options described in comment 6(a)(2)–3.

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 section 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 section 226.4(c)(7).)

6(b) Other Charges

1. *General; examples of other charges.* Under section 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 section 226.13 (billing-error resolution)
- Charges imposed in connection with real estate transactions such as title, appraisal, and credit-report fees (See section 226.4(c)(7).)
- 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 section 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.
- Automated teller machine (ATM) charges described in comment 4(a)-5 that are not finance charges

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 section 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
- Charges for submitting as payment a check that is later returned unpaid (see commentary to section 226.4(c)(2)
- Charges imposed on a cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system (See also comment 7(b)-2.)
- Taxes and filing or notary fees excluded from the finance charge under section 226.4(e)

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 interests 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." (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) 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 preexisting 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 inital disclosure statement that security will be required if the balance exceeds $1,000, and the creditor must provide a change-in-terms notice under section 226.9(c) at the time the security is taken. (See comment 6(c)-2.)

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: § 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 section 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.

2. *Separate periodic statements permitted.* In a certain open-end credit program involving more than one creditor—a card issuer of travel-and-entertainment cards and a financial institution—the consumer has the option to pay the card issuer directly or to transfer to the financial institution all or part of the amount owing. In this case, the creditors may send separate periodic statements that reflect the separate obligations owed to each.

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 transactions under section 226.7(b) for multifeatured plans, creditors may, for example, choose to arrange transactions by feature (such as disclosing sale transactions separately from cash advance transactions) or in some other clear manner, such as by arranging the transactions in general chronological order.

2. *Automated teller machine (ATM) charges imposed by other institutions in shared or interchange systems.* A charge imposed on the cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system and included by the terminal-operating institution in the amount of the transaction need not be separately disclosed on the periodic statement.

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 section 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.* If only one date is disclosed (that is, the crediting date as required by the regulation), no further identification of that date is necessary. More than one date may be disclosed for a single entry, as long as it is clear which date represents the date on which credit was given.

4. *Totals.* Where the creditor lists the credits made to the account during the billing cycle, the creditor need not disclose total figures for the amounts credited.

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 section 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 section 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 percent applied to the outstanding balance and a required credit life insurance component calculated at 0.1 percent 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 percent monthly, 18 percent annual percentage rate; 0.1 percent monthly, 1.2 percent annual percentage rate)
- Disclose one composite periodic rate (that is, 1.6 percent 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 percent transaction fee and a 1 percent 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 two 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 percent applied to the first $500, and a monthly periodic rate of 1 percent to the remainder. This option to disclose a combined balance does not apply when the finance charge is computed by applying the split rates to each day's balance (in contrast, for example, to applying the rates to the average daily balance). In that case, the balances must be disclosed using any of the options that are available if two or more daily rates are imposed. (See comment 7(e)-5.)

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. *Multifeatured plans.* In a multifeatured plan, the creditor must disclose a separate balance (or balances, as applicable) to which a periodic rate was applied for each feature or group of features subject to different periodic rates or different balance computation methods. Separate balances are not required, however, merely because a "free-ride" period is available for some features but not others. A total balance for the entire plan is optional. This does not affect how many balances the creditor must disclose—or may disclose—within each feature. (See, for example, comment 7(e)-5.)

5. *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 two 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
  - —two 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) multi-

plying each of the results by the applicable daily periodic rate, and (3) adding these products together.

6. *Explanation of balance-computation method.* See the commentary to section 226.6(a)(3).

7. *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.

8. *Nondeduction 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.").

9. *Use of one balance-computation method explanation when multiple balances disclosed.* Sometimes the creditor will disclose more than one balance to which a periodic rate was applied, even though each balance was computed using the same balance-computation method. For example, if a plan involves purchases and cash advances that are subject to different rates, more than one balance must be disclosed, even though the same computation method is used for determining the balance for each feature. In these cases, one explanation of the balance-computation method is sufficient. Sometimes the creditor separately discloses the portions of the balance that are subject to different rates because different portions of the balance fall within two or more balance ranges, even when a combined balance disclosure would be permitted under comment 7(e)-2. In these cases, one explanation of the balance-computation method is also sufficient (assuming, of course, that all portions of the balance were computed using the same method).

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, five 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 percent per month on the first $500 of a balance and 1 percent 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.

8. *Start-up fees.* Points, loan fees, and similar finance charges relating to the opening of the account that are paid prior to the issuance of the first periodic statement need not be disclosed on the periodic statement. If, however, these charges are financed as part of the plan, including charges that are paid out of the first advance, the charges must be disclosed as part of the finance charge on the first periodic statement. However, they need not be factored into the annual percentage rate. (See footnote 33 in the regulation.)

7(g) Annual Percentage Rate

1. *Rate same as corresponding annual percentage rate.* See comment 7(d)-5.

2. *Multifeatured plans.* In a multifeatured plan, the actual annual percentage rate that reflects the finance charge imposed during the cycle may be separately stated for each feature or may be described as a composite for the whole plan.

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. Similarly, "closing costs" or "settlement costs," for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under section 226.4(c)(7), if the same term (such as "closing costs") was used in the initial disclosures and if the creditor chose to itemize and individually disclose the costs included in that term. Even though the taxes and filing or notary fees excluded from the finance charge under section 226.4(e) are not required to be disclosed as "other charges" under section 226.6(b), these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the "closing costs" or "settlement costs" on the initial disclosure statement. (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.

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-credit-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.

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 section 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 the required address is provided in a clear and conspicuous manner.

References

Statute: § 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 section 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" (nonfinance 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 section 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 "fac-

simile 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.* For purposes of identifying transactions, 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 seller is not related to the creditor merely because the seller and the creditor have an agreement authorizing the seller to honor the creditor's credit card.

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 "nonrelated" sellers and creditors.

7. *Credit insurance offered through the creditor.* When credit insurance that is not part of the finance charge (for example, voluntary credit life insurance) is offered to the consumer through the creditor but is actually provided by another company, the creditor has the option of identifying the premiums in one of two ways on the periodic statement. The creditor may describe the premiums using either the rule in section 226.8(a)(2) for "related" sellers and creditors, or the rule in section 226.8(a)(3) for "nonrelated" sellers and creditors. This means, therefore, that the creditor may identify the insurance either by providing, under section 226.8(a)(2), a brief identification of the services provided (for example, "credit life insurance"), or by disclosing, under section 226.8(a)(3), the name and address of the company providing the insurance (for example, ABC Insurance Company, New York, New York). In either event, the creditor would, of course, also provide the amount and the date of the transaction.

8. *Transactions involving creditors and sellers with corporate connections.* In a credit card plan established for use primarily with sellers that have no corporate connection with the creditor, the creditor may describe all transactions under the plan by using the rules in section 226.8(a)(3)—creditor and seller not same or related persons—including transactions involving a seller that has a corporate connection with the creditor. In other credit card plans, the creditor may describe transactions involving a seller that has a corporate connection with the creditor, such as subsidiary-parent, using the rules in section 226.8(a)(3) where it is unlikely that the consumer would know of the corporate connection between the creditor and the seller—for example, where the names of the creditor and the seller are not similar, and the periodic statement is issued in the name of the creditor only.

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 section 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 section 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 section 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 section 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.

5. *Date of transaction—foreign transactions.* In a foreign transaction, the debiting date may be considered the transaction date.

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

seller 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"

4. *Date of transaction—foreign transactions.* See comment 8(a)(2)-5.

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 section 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 section 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 under the creditor's contract reservation right to increase the periodic rate.

2. *State law issues.* Examples of issues not addressed by section 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 section 226.6 or increases the minimum payment, unless an exception under section 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 midcycle 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 mailed or delivered as late as the effective date of the change—in two 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. This provision is intended for use in the unusual instance when a consumer substitutes collateral or when the creditor can advance additional credit only if a change relatively unique to that consumer is made, such as the consumer's providing additional security or paying an increased minimum-payment amount. Therefore, the following are not "agreements" between the consumer and the creditor for purposes of section 226.9(c)(1): the consumer's general acceptance of the creditor's contract reservation of the right to change terms; the consumer's use of the account (which might imply acceptance of its terms under state law); and the consumer's acceptance of a unilateral term change that is not particular to that consumer, but rather is of general applicability to consumers with that type of account.

4. *Form of change-in-terms notice.* A complete new set of the initial disclosures containing the changed term complies with section 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 or payments 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. The change-in-terms notice may be combined with the notice offering the reduction. For example, the periodic statement reflecting the reduction or skip feature may also be used to notify the consumer of the resumption of the original schedule or rate, either by stating explicitly when the higher payment or charges resume or by indicating the duration of the skip option. Language such as "You may skip your October payment," or "We will waive your

finance charges for January" may serve as the change-in-terms notice.

9(d) Finance Charge Imposed at Time of Transaction

1. *Disclosure prior to imposition.* A person imposing a finance charge at the time of honoring a consumer's credit card must disclose the amount of the charge, or an explanation of how the charge will be determined, prior to its imposition. This must be disclosed before the consumer becomes obligated for property or services that may be paid for by use of a credit card. For example, disclosure must be given before the consumer has dinner at a restaurant, stays overnight at a hotel, or makes a deposit guaranteeing the purchase of property or services.

References

Statute: § 127(a)(7)
Other sections: §§ 226.4 through 226.7 and appendix G
Previous regulation: § 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 section 226.708 on switching the type of billing-rights statement used have been modified.

Under section 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 section 226.9(c)(2). But the provision reverses interpretation section 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, section 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 section 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 or 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 for preauthorized electronic fund transfer. (See section 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 nonconforming payments.* If the creditor accepts a nonconforming 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 section 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
- Payment may be 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: § 226.7
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 five days in which to credit nonconforming payments, whereas the previous regulation required the crediting of such payments promptly, with an outside limit of five days. The five 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 section 226.11 by:

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

2. *Amount of refund.* The phrase "any part of the credit balance remaining in the account" in section 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 six 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: §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"; section 226.11 of the revised regulation implements the amendments to section 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 seven 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 five business days. This provision also implements the amended statute by requiring a good faith effort to refund the credit balance after six 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 sections 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 section 226.2 and used in section 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 reencoding 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.

8. *Unsolicited issuance of PINs.* A card issuer may issue personal identification numbers (PINs) to existing credit cardholders without a specific request from the cardholders, provided the PINs cannot be used alone to obtain credit. For example, the PINs may be necessary if consumers wish to use their existing credit cards at automated teller machines or at merchant locations with point-of-sale terminals that require PINs.

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 reissuance 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 section 226.12(b)(2)(ii) may be given, for example, with the initial disclosures under section 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 section 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 section 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 section 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.

3. *Relationship to section 226.13.* The liability protections afforded to cardholders in section 226.12 do not depend upon the cardholder's following the error-resolution procedures in section 226.13. For example, the written-notification and time-limit requirements of section 226.13 do not affect the section 226.12 protections.

12(b)(5) Business Use of Credit Cards

1. *Agreement for higher liability for business use cards.* The card issuer may not rely on section 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 section 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 section 226.13.* The section 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 nondelivery of goods, may also constitute "billing errors" under section 226.13, that section operates independently of section 226.12(c). The cardholder whose asserted billing error involves undelivered goods may institute the error-resolution procedures of section 226.13; but whether or not the cardholder has done so, the cardholder may assert claims or defenses under section 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 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 off-

set and would contravene the prohibition in section 226.12(d)(1), unless done in the context of one of the exceptions specified in section 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 section 226.12(d)(2), a security interest must be affirmatively agreed to by the consumer and must be disclosed in the issuer's initial disclosures under section 226.6. The security interest must not be the functional equivalent of a right of offset; as a result, routinely including in agreements contract language indicating that consumers are giving a security interest in any deposit accounts maintained with the issuer does not result in a security interest that falls within the exception in section 226.12(d)(2). For a security interest to qualify for the exception under section 226.12(d)(2) the following conditions must be met:

- The consumer must be aware that granting a security interest is a condition for the credit card account (or for more favorable account terms) and must specifically intend to grant a security interest in a deposit account. Indicia of the consumer's awareness and intent could include, for example:
  - —Separate signature or initials on the agreement indicating that a security interest is being given.
  - —Placement of the security agreement on a separate page, or otherwise separating the security interest provisions from other contract and disclosure provisions.
  - —Reference to a specific amount of deposited funds or to a specific deposit account number.
- The security interest must be obtainable and enforceable by creditors generally. If other creditors could not obtain a security interest in the consumer's deposit accounts to the same extent as the card issuer, the security interest is prohibited by section 226.12(d)(2).

2. *Security interest—after-acquired property.* As used in section 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 excep-*

tion. With regard to automatic debit plans under section 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 section 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 section 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 channel" refers to any network or interchange system used for the processing of the original charge slips (or equivalent information concerning the transactions).

Paragraph 12(e)(2)

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

References

Statute: §§ 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 section 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 section 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 seven-business-day and three-business-day standards has been deleted from section 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 section 161(d) of the Truth in Lending Act and section 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 section 161(e) of the act. (Any failure to comply may also be a violation subject to the liability provisions of section 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

Paragraph 13(a)(1)

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 section 226.13(a) or a request for additional clarification under section 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 two actual billing cycles occurring after receipt of the billing error notice, not a measure of time equal to two 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 two 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 section 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.* If the creditor reflects any disputed amount or related finance or other charges on the periodic statement, and is therefore required to make the disclosure under footnote 30, the creditor may comply with that disclosure requirement by indicating that payment of any disputed amount is not required pending resolution. Making a disclosure that only refers to the disputed amount would, of course, in no way affect the consumer's right under section 226.13(d)(1) to withhold related finance and other changes. The disclosure under footnote 30 need not appear in any specific place on the periodic statement, need not state the specific amount that the consumer may withhold, and may be preprinted on the periodic statement.

3. *Imposition of additional charges on undisputed amounts.* The consumer's withholding of the disputed amount from the total bill cannot subject undisputed balances (including new purchases or cash advances made during the present or subsequent cycles) to the imposition of finance or other charges. For example, if on an account with a free-ride period (that is, an account in which paying the new balance in full allows the consumer to avoid the imposition of additional finance charges), 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 any undisputed amounts, even if the creditor determines later that no billing error occurred. Furthermore, finance or other charges may not be imposed on any new purchases or advances that, absent the unpaid disputed balance, would not have finance or other charges imposed on them. Finance or other charges that would have been incurred

even if the consumer had paid the disputed amount would not be affected.

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

- Interinstitutional 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
- Intrainstitutional 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 three-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 section 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 re-

quired under section 226.13(g)(1), provided it is sent within the time limit for resolution. (See commentary to section 226.13(e).)

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. As explained in the commentary to section 226.13(d)(1), even if the creditor later determines that no billing error occurred, the creditor may not include finance or other charges that are imposed on undisputed balances solely as a result of a consumer's withholding payment of a disputed amount.

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 section 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 sections 226.6(a)(1) and 226.7(j) to pay the amount due under section 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 section 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 section 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 section 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.

3. *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 section 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 section 205.11(e) with any finance or other charges incurred as a result of the alleged error.
- The provision of section 226.13(d) and (g) apply only to the credit portion of the transaction.

References

Statute: §§ 161 and 162
Other sections: §§ 226.6 through 226.8
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 section 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 two 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 sections 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 percent may be stated as 14.33 percent or as 14.3 percent, or even as $14\frac{1}{4}$ percent; but it could not be stated as 14.2 percent or 14 percent, 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 by section 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.

5. *Good faith reliance on faulty calculation tools.* Footnote 31a absolves a creditor of liability for an error in the annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the footnote is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.

14(b) Annual Percentage Rate for Initial Disclosures and for Advertising Purposes

1. *Corresponding annual percentage rate computation.* For initial disclosures (under section 226.6) and for advertising (under section 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 section 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 section 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 section 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" method. 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 $1\frac{1}{2}$ percent on balances up to $500, and 1 percent 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 x .015) plus $3.00 (300 x .01), for a total finance charge of $10.50. The annual percentage rate for this period may be disclosed either as 18 percent on $500 and 12 percent on $300, or as 15.75 percent 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 percent (1/40 x 12).

4. *No balance.* Footnote 32 to section 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 percent 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. *Daily rate with specific transaction charge.* Section 226.14(c)(3) sets forth an acceptable method for calculating the annual percentage rate if the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate. This section includes the requirement that the creditor follow the rules in appendix F in calculating the annual percentage rate, especially footnote 1 to appendix F, which addresses the daily rate/transaction charge situation by providing that the "average of daily balances" shall be used instead of the "sum of the balances."

7. *Charges related to opening, renewing, or continuing account.* Footnote 33 is applicable to section 226.14(c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to specific activity on the account, but relate solely to the opening, renewing, or continuing of the account. For example, an annual fee to renew an open-end credit account that is a percentage of the credit limit on the account, or that is charged only to consumers who have not used their credit card for a certain dollar amount in transactions during the preceding year, would not be included in the calculation of the annual percentage rate, even though the fee may not be excluded from the finance charge under section 226.4(c)(4). (See comment 4(c)(4)-2). 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.

8. *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 percent of the amount of each transaction), then the method in section 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 section 226.14(c)(2) is appropriate.

9. *Small finance charges.* Section 226.14(c)(4) gives the creditor an alternative to section 226.14(c)(2) and (c)(3) if small finance charges (50 cents or less) are involved; that is, if the finance charge includes minimum or fixed fees not due to the application of a periodic rate and the total finance charge for the cycle does not exceed 50 cents. For example, while a monthly activity fee of 50 cents on a balance of $20 would produce an annual percentage rate of 30 percent under the rule in section 226.14(c)(2), the creditor may disclose an annual percentage rate of 18 percent if the periodic rate generally applicable to all balances is $1\frac{1}{2}$ percent per month. This option is consistent with the provision in footnote 11 to sections 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 method.* 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 section 226.14(c)(1)(ii) does not work when a daily rate is being applied to a series of

daily balances, section 226.14(d) gives the creditor two alternative ways to figure the annual percentage rate—either of which satisfies the requirement in section 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, see comment 14(c)-6 for guidance on an appropriate calculation method.

References

Statute: § 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 section 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 section 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, section 125(e) of the act provides an exception: 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.

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 section 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 section 226.6(c), it may still give rise to the right of rescission.

4. *Consumer.* To be a consumer within the meaning of section 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 section 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 section 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 section 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 section 226.15(b).

Paragraph 15(a)(3)

1. *Rescission period.* The period within which the consumer may exercise the right to rescind runs for three business days from the last of three 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 section 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 section 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 three-day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

- The expiration of three 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 a purchase money note and mortgage or retains legal title through a device such as an installment sale contract

Transfer of all the consumer's interest includes such transfers 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 section 125 of the act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of section 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 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 two 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 section 226.15(b)(1) through (5). The requirement in section 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 section 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 three-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

A creditor may, however, continue to allow transactions under an existing open-end credit plan during a rescission period that results solely from the addition of a security interest in the consumer's principal dwelling. (See comment 15(c)-3 for other actions that may be taken during the delay period.)

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. Unless otherwise prohibited, such as by state law, 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 section 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 only 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 section 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 ensure 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 section 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 three-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 ad-

vances 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 three-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 section 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 section 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: §§ 113, 125, and 130 and the Housing and Community Development Technical Amendments Act of 1984 § 205 (Pub. L. 98-479).
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 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.

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 section 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.

2. *Expressing the annual percentage rate in abbreviated form.* Whenever the annual percentage rate is used in an advertisement for open-end credit, it may be expressed using a readily understandable abbreviation such as APR.

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. *Terms requiring additional disclosures.* In section 226.16(b) the phrase "the terms required to be disclosed under section 226.6" refers to the terms in section 226.6(a) and 226.6(b).

2. *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 section 226.16(b).

3. *Implicit terms.* Section 226.16(b) applies even if the triggering term is not stated explicitly, but may be readily determined from the advertisement.

4. *Membership fees.* A membership fee is not a triggering term nor need it be disclosed under section 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.)

5. *Variable-rate plans.* In disclosing the annual percentage rate in an advertisement for a variable-rate plan, as required by section 226.16(b)(2), the creditor may use an insert showing the current rate, may give the rate as of a specified recent date, or may disclose an estimated rate under section 226.5(c). The additional requirement in section 226.16(b)(2) to disclose the variable-rate feature may be satisfied by disclosing that "the annual percentage rate may vary" or a similar statement, but the advertisement need not include the information required by footnote 12 to section 226.6(a)(2).

6. *Discounted variable-rate plans—disclosure of the annual percentage rates.* The advertised annual percentage rates for discounted variable-rate plans must, in accordance with comment 6(a)(2)–10, include both the initial rate (with the statement of how long it will remain

in effect) and the current indexed rate (with the statement that this second rate may vary). The options listed in comment 16(b)–4 may be used in disclosing the current indexed rate.

7. *Triggering terms.* The following are examples of terms that trigger additional disclosures:

- "Small monthly service charge on the remaining balance."
- "12 percent Annual Percentage Rate."
- "A $15 annual membership fee buys you $2,000 in credit."

8. *Minimum, fixed, transaction, activity, or similar charge.* The charges to be disclosed under section 226.16(b)(1) are those that are considered finance charges under section 226.4.

16(c) Catalogs and Multiple-Page Advertisements

1. *Definition.* The multiple-page advertisements to which section 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 section 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 section 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 section 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 percent is applied to balances of $500 or less, and a 1 percent rate is applied to balances greater than $500.

References

Statute: §§ 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 section 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 section 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

(The general segregation requirement described in this subparagraph does not apply to the disclosures required under sections 226.19(b) and 226.20(c) although the disclosures must be clear and conspicuous.)

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 section 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 section 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 section 226.18(c), however, must be separate from the other segregated disclosures under section 226.18. If a creditor chooses to include the security-interest charges required to be itemized under sections 226.4(e) and 226.18(o) in the amount-financed itemization, it need not list these charges elsewhere.

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 section 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 section 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 five years, the disclosures may state that the loan will become payable on demand in five years.
- 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."
- A statement that the borrower may pay a minimum finance charge upon prepayment in a simple-interest transaction. For example, when state law prohibits penalties, but would allow a minimum finance charge in the event of prepayment, the creditor may make the section 226.18(k)(1) disclosure by stating, "You may be charged a minimum finance charge."
- A brief reference to negative amortization in variable-rate transactions. For example, in the variable-rate disclosure, the creditor may include a short statement such as "Unpaid interest will be added to principal." (See the commentary to section 226.18(f)(1)(iii).)

- A brief caption identifying the disclosures. For example, the disclosures may bear a general title such as "Federal Truth in Lending Disclosures" or a descriptive title such as "Real Estate Loan Disclosures."
- A statement that a due-on-sale clause or other conditions on assumption are contained in the loan document. For example, the disclosure given under section 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."
- If a state or federal law prohibits prepayment penalties and excludes the charging of interest after prepayment from coverage as a penalty, a statement that the borrower may have to pay interest for some period after prepayment in full. The disclosure given under section 226.18(k) may state, for example, "If you prepay your loan on other than the regular installment date, you may be assessed interest charges until the end of the month."
- More than one hypothetical example under section 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.

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 section 226.18 (except the itemization of the amount financed under section 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 section 226.18(f)
- The demand feature disclosure under section 226.18(i)
- A reference to the possibility of a security interest arising from a spreader clause, under section 226.18(m)
- The assumption policy disclosure under section 226.18(q)
- The required deposit disclosure under section 226.18(r)

7. *Balloon-payment financing with leasing characteristics.* In certain credit sale or loan transactions, a consumer may reduce the dollar amount of the payments to be made during the course of the transaction by agreeing to make, at the end of the loan term, a large final payment based on the expected residual value of the property. The consumer may have a number of options with respect to the final payment, including, among other things, retaining the property and making the final payment, refinancing the final payment, or transferring the property to the creditor in lieu of the final payment. Such transactions may have some of the characteristics of lease transactions subject to Regulation M, but are considered credit transactions where the consumer assumes the indicia of ownership, including the risks, burdens and benefits of ownership upon consummation. These transactions are governed by the disclosure requirements of this regulation instead of Regulation M. Creditors should not include in the segregated Truth in Lending disclosures additional information. Thus, disclosures should show the large final payment in the payment schedule and should not, for example, reflect the other options available to the consumer at maturity.

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 section 226.18. For example, when the disclosures are included on the contract document, those two 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 section 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 section 226.18(k) or a required deposit under section 226.18(r).
- The creditor's identity under section 226.18(a) may, but need not, be more prominently displayed than the finance charge and annual percentage rate.
- The terms need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs).

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 and variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year under section 226.19. (See the commentary to section 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 section 226.19(b) for the timing rules for additional disclosures required upon the conversion to a variable-rate transaction secured by a consumer's principal dwelling with a term greater than one year.) If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to section 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 determined by applicable state law or other law. (Certain transactions are specifically addressed in this commentary. See, for example, the discussion of buydown transactions elsewhere in the commentary to section 226.17(c).)

- The fact that a term or 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 term or contract did not reflect the legal obligation.

2. *Modification of 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. 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 offers a preferential rate, such as an employee preferred rate the disclosures should reflect the terms of the legal obligation. (See the commentary to section 226.19(b) for an example of a preferred-rate transaction that is a variable-rate transaction.
- 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 percent 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 two years of the mortgage, giving the consumer an effective rate of 12 percent 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 two 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 consumer and the bank and the consumer is legally bound to the 15 percent rate from the outset, the disclosures given by the bank must not reflect the seller buydown in any way. For example, the annual percentage rate and payment schedule would not take into account the reduction in the interest rate and payment level for the first two years resulting from the buydown.

4. *Consumer buydowns.* In certain transactions, the consumer may pay an amount to the creditor to reduce the payments or obtain a lower interest rate on the transaction. Consumer buydowns must be reflected in the disclosures given for that transaction. To illustrate, in a mortgage transaction, the creditor and consumer agree to a note specifying a 14 percent interest rate. However, in a separate document, the consumer agrees to pay an amount to the creditor at consummation, in return for a reduction in the interest rate to 12 percent for a portion of the mortgage term. The amount paid by the consumer may be deposited in an escrow account or may be retained by the creditor. Depending upon the buydown plan, the consumer's prepayment of the obligation may or may not result in a portion of the amount being credited or refunded to the consumer. In the disclosures given for the mortgage, the creditor must reflect the terms of the buydown agreement. For example:

- The amount paid by the customer is a prepaid finance charge (even if deposited in an escrow account).
- A composite annual percentage rate must be calculated, taking into account both interest rates, as well as the effect of the prepaid finance charge.
- The payment schedule must reflect the multiple payment levels resulting from the buydown.

5. *Split buydowns.* In certain transactions, a third party (such as a seller) and a consumer both pay an amount to the creditor to reduce the interest rate. The creditor must include the portion paid by the consumer in the finance charge and disclose the corresponding multiple payment levels and composite annual percentage rate. The portion paid by the third party and the corresponding reduction in interest rate, however, should not be reflected in

the disclosures unless the lower rate is reflected in the credit contract. (See the discussion on third-party and consumer buydown transactions elsewhere in the commentary to section 226.17(c).)

6. *Wraparound financing.* Wraparound transactions, usually loans, involve the creditor's wrapping the outstanding balance on an existing loan and advancing additional funds to the consumer. The preexisting loan, which is wrapped, may be to the same consumer or to a different consumer. In either case, the consumer makes a single payment to the new creditor, who makes the payments on the preexisting loan to the original creditor. Wraparound loans or sales are considered new single-advance transactions, with an amount financed equalling the sum of the new funds advanced by the wrap creditor and the remaining principal owed to the original creditor on the preexisting loan. In disclosing the itemization of the amount financed, the creditor may use a label such as "the amount that will be paid to creditor X" to describe the remaining principal balance on the preexisting loan. This approach to Truth in Lending calculations has no effect on calculations required by other statutes, such as state usury laws.

7. *Wraparound financing with balloon payments.* For wraparound transactions involving a large final payment of the new funds before the maturity of the preexisting loan, the amount financed is the sum of the new funds and the remaining principal on the preexisting loan. The disclosures should be based on the shorter term of the wrap loan, with a large final payment of both the new funds and the total remaining principal on the preexisting loan (although only the wrap loan will actually be paid off at that time.)

8. *Basis of disclosures in variable-rate transactions.* The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. However, in a variable-rate transaction with either a seller buydown that is reflected in the credit contract or a consumer buydown, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the lower rate for the buydown period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to section 226.17(c) for a discussion of buydown transactions and the commentary to section 226.19(a)(2) for a discussion of the redisclosure in certain residential mortgage transactions with a variable-rate feature).

9. *Use of estimates in variable-rate transactions.* The variable-rate feature does not, by itself, make the disclosures estimates.

10. *Discounted and premium 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 charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, 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 Treasury bill rate at consummation is 10 percent, the creditor may forgo 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 interest 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 charged 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 rate changes are based on the index value in effect 45 days before the change date, creditors may use the index value in effect not more than 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 $\frac{1}{4}$ of 1 percent applies, in accordance with section 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 interest 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 $266,463.32 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.

  —Same loan as above, except with a $7\frac{1}{2}$ percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

This paragraph does not apply to variable-rate loans in which the initial interest 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 should base its disclosures on the initial rate.

11. *Other variable-rate transactions.* Examples of variable-rate transactions include:

- Renegotiable-rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, where the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate. Disclosures must be given for the longer term of the obligation, with all disclosures calculated on the basis of the rate in effect at the time of consummation of the transaction.
- "Shared-equity" or "shared-appreciation" mortgages that have a fixed rate of interest and an appreciation share based on the consumer's equity in the mortgaged property. The appreciation share is payable in a lump sum at a specified time. Disclosures must be based on the fixed interest rate. (As discussed in the commentary to section 226.2, other types of shared-equity arrangements are not considered "credit" and are not subject to Regulation Z.)
- Preferred-rate loans where the terms of the

legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures are to be based on the preferred rate.

Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

12. *Graduated-payment adjustable-rate mortgages.* These mortgages involve both a variable interest rate and scheduled variations in payment amounts during the loan term. For example, under these plans, a series of graduated payments may be scheduled before rate adjustments affect payment amounts, or the initial scheduled payment may remain constant for a set period before rate adjustments affect the payment amount. In any case, the initial payment amount may be insufficient to cover the scheduled interest, causing negative amortization from the outset of the transaction. In these transactions, the disclosures should treat these features as follows:

- The finance charge includes the amount of negative amortization based on the assumption that the rate in effect at consummation remains unchanged.
- The amount financed does not include the amount of negative amortization.
- As in any variable-rate transaction, the annual percentage rate is based on the terms in effect at consummation.
- The schedule of payments discloses the amount of any scheduled initial payments followed by an adjusted level of payments based on the initial interest rate. Since some mortgage plans contain limits on the amount of the payment adjustment, the payment schedule may require several different levels of payments, even with the assumption that the original interest rate does not increase.

13. *Growth-equity mortgages.* Also referred to as payment-escalated mortgages, these mortgage plans involve scheduled payment increases to prematurely amortize the loan. The initial payment amount is determined as for a long-term loan with a fixed interest rate. Payment increases are scheduled periodically, based on changes in an index. The larger payments result in accelerated amortization of the loan. In disclosing these mortgage plans, creditors may either—

- estimate the amount of payment increases, based on the best information reasonably available, or
- disclose by analogy to the variable-rate disclosures in section 226.18(f)(1).

(This discussion does not apply to growth-equity mortgages in which the amount of payment increases can be accurately determined at the time of disclosure. For these mortgages, as for graduated-payment mortgages, disclosures should reflect the scheduled increases in payments.)

14. *Morris Plan transactions.* When a deposit account is created for the sole purpose of accumulating payments and then is applied to satisfy entirely the consumer's obligation in the transaction, each deposit made into the account is considered the same as a payment on a loan for purposes of making disclosures.

15. *Number of transactions.* Creditors have flexibility in handling credit extensions that may be viewed as multiple transactions. For example:

- When a creditor finances the credit sale of a radio and a television on the same day, the creditor may disclose the sales as either one or two credit sale transactions.
- When a creditor finances a loan along with a credit sale of health insurance, the creditor may disclose in one of several ways: a single credit sale transaction, a single loan transaction, or a loan and a credit sale transaction.
- The separate financing of a downpayment in a credit sale transaction may, but need not, be disclosed as two transactions (a credit sale and a separate transaction for the financing of the downpayment).

Paragraph 17(c)(2)

1. *Basis for estimates.* 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 the disclosures are made. The "reasonably available" standard requires that the creditor, acting in good faith, exercise due diligence in obtaining information. For example, the creditor must at a minimum utilize generally accepted calculation tools but need not invest in the most sophisticated computer program to make a particular type of calculation. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to the consumer for the time of consummation, to insurance companies for the cost of insurance, or to realtors for taxes and escrow fees. The creditor may utilize estimates in making disclosures even though the creditor knows that more precise information will be available by the point of consummation. However, new disclosures may be required under section 226.17(f) or 226.19.

2. *Labelling estimates.* Estimates must be designated as such in the segregated disclosures. Even though other disclosures are based on the same assumption on which a specific estimated disclosure was based, the creditor has some flexibility in labelling the estimates. Generally, only the particular disclosure for which the exact information is unknown is labelled as an estimate. However, when several disclosures are affected because of the unknown information, the creditor has the option of labelling either every affected disclosure or only the disclosure primarily affected. For example, when the finance charge is unknown because the date of consummation is unknown, the creditor must label the finance charge as an estimate and may also label as estimates the total of payments and the payment schedule. When many disclosures are estimates, the creditor may use a general statement, such as "all numerical disclosures except the late payment disclosure are estimates," as a method to label those disclosures as estimates.

3. *Simple-interest transactions.* If consumers do not make timely payments in a simple-interest transaction, some of the amounts calculated for Truth in Lending disclosures will differ from amounts that consumers will actually pay over the term of the transaction. Creditors may label disclosures as estimates in these transactions. For example, because the finance charge and total of payments may be larger than disclosed if consumers make late payments, creditors may label the finance charge and total of payments as estimates. On the other hand, creditors may choose not to label disclosures as estimates and may base all disclosures on the assumption that payments will be made on time, disregarding any possible inaccuracies resulting from consumers' payment patterns.

Paragraph 17(c)(3)

1. *Minor variations.* Section 226.17(c)(3) allows creditors to disregard certain factors in calculating and making disclosures. For example:

- Creditors may ignore the effects of collecting payments in whole cents. Because payments cannot be collected in fractional cents, it is often difficult to amortize exactly an obligation with equal payments; the amount of the last payment may require adjustment to account for the rounding of the other payments to whole cents.
- Creditors may base their disclosures on calculation tools that assume that all months have an equal number of days, even if their practice is to take account of the variations in months for purposes of collecting interest. For example, a creditor may use a calculation tool based on a 360-day year, when it in fact collects interest by applying a factor of 1/365 of the annual rate to 365 days. This rule does not, however, authorize creditors to ignore, for disclosure purposes, the effects of applying 1/360 of an annual rate to 365 days.

2. *Use of special rules.* A creditor may utilize the special rules in section 226.17(c)(3) for purposes of calculating and making all disclosures for a transaction or may, at its option, use the special rules for some disclosures and not others.

Paragraph 17(c)(4)

1. *Payment schedule irregularities.* When one or more payments in a transaction differ from the others because of a long or short first peri-

od, the variations may be ignored in disclosing the payment schedule, finance charge, annual percentage rate, and other terms. For example:

- A 36-month auto loan might be consummated on June 8 with payments due on July 1 and the first of each succeeding month. The creditor may base its calculations on a payment schedule that assumes 36 equal intervals and 36 equal installment payments, even though a precise computation would produce slightly different amounts because of the shorter first period.
- By contrast, in the same example, if the first payment were not scheduled until August 1, the irregular first period would exceed the limits in section 226.17(c)(4); the creditor could not use the special rule and could not ignore the extra days in the first period in calculating its disclosures.

2. *Measuring odd periods.* In determining whether a transaction may take advantage of the rule in section 226.17(c)(4), the creditor must measure the variation against a regular period. For purposes of that rule:

- The first period is the period from the date on which the finance charge begins to be earned to the date of the first payment.
- The term is the period from the date on which the finance charge begins to be earned to the date of the final payment.
- The regular period is the most common interval between payments in the transaction.

In transactions involving regular periods that are monthly, semimonthly, or multiples of a month, the length of the irregular and regular periods may be calculated on the basis of either the actual number of days or an assumed 30-day month. In other transactions, the length of the periods is based on the actual number of days.

3. *Use of special rules.* A creditor may utilize the special rules in section 226.17(c)(4) for purposes of calculating and making some disclosures but may elect not to do so for all of the disclosures. For example, the variations may be ignored in calculating and disclosing the annual percentage rate but taken into account in calculating and disclosing the finance charge and payment schedule.

Paragraph 17(c)(5)

1. *Demand disclosures.* Disclosures for demand obligations are based on an assumed one-year term, unless an alternate maturity date is stated in the legal obligation. Whether an alternate maturity date is stated in the legal obligation is determined by applicable law. An alternate maturity date is not inferred from an informal principal reduction agreement or a similar understanding between the parties. However, when the note itself specifies a principal reduction schedule (for example, "payable on demand or $2,000 plus interest quarterly"), an alternate maturity is stated and the disclosures must reflect that date.

2. *Future event as maturity date.* An obligation whose maturity date is determined solely by a future event, as for example a loan payable only on the sale of property, is not a demand obligation. Because no demand feature is contained in the obligation, demand disclosures under section 226.18(i) are inapplicable. The disclosures should be based on the creditor's estimate of the time at which the specified event will occur, and may indicate the basis for the creditor's estimate, as noted in the commentary to section 226.17(a).

3. *Demand after stated period.* Most demand transactions contain a demand feature that may be exercised at any point during the term, but certain transactions convert to demand status only after a fixed period. For example, in states prohibiting due-on-sale clauses, the Federal National Mortgage Association (FNMA) requires mortgages that it purchases to include a call option rider that may be exercised after 7 years. These mortgages are generally written as long-term obligations but contain a demand feature that may be exercised only within a 30-day period at 7 years. The disclosures for these transactions should be based upon the legally agreed-upon maturity date. Thus, if a mortgage containing the 7-year FNMA call option is written as a 20-year obligation, the disclosures should be based on the 20-year term, with the

demand feature disclosed under section 226.18(i).

4. *Balloon mortgages.* Balloon payment mortgages, with payments based on a long-term amortization schedule and a large final payment due after a shorter term, are not demand obligations unless a demand feature is specifically contained in the contract. For example, a mortgage with a term of 5 years and a payment schedule based on 20 years would not be treated as a mortgage with a demand feature, in the absence of any contractual demand provisions. In this type of mortgage, disclosures should be based on the 5-year term.

Paragraph 17(c)(6)

1. *Series of advances.* Section 226.17(c)(6)(i) deals with a series of advances under an agreement to extend credit up to a certain amount. A creditor may treat all of the advances as a single transaction or disclose each advance as a separate transaction. If these advances are treated as one transaction and the timing and amounts of advances are unknown, creditors must make disclosures based on estimates, as provided in section 226.17(c)(2). If the advances are disclosed separately, disclosures must be provided before each advance occurs, with the disclosures for the first advance provided by consummation.

2. *Construction loans.* Section 226.17(c)(6)(ii) provides a flexible rule for disclosure of construction loans that may be permanently financed. These transactions have two distinct phases, similar to two separate transactions. The construction loan may be for initial construction or subsequent construction, such as rehabilitation or remodelling. The construction period usually involves several disbursements of funds at times and in amounts that are unknown at the beginning of that period, with the consumer paying only accrued interest until construction is completed. Unless the obligation is paid at that time, the loan then converts to permanent financing in which the loan amount is amortized just as in a standard mortgage transaction. Section 226.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for the two phases. This rule is available whether the consumer is initially obligated to accept construction financing only or is obligated to accept both construction and permanent financing from the outset. If the consumer is obligated on both phases and the creditor chooses to give two sets of disclosures, both sets must be given to the consumer initially, because both transactions would be consummated at that time. (Appendix D provides a method of calculating the annual percentage rate and other disclosures for construction loans, which may be used, at the creditor's option, in disclosing construction financing.)

3. *Multiple-advance construction loans.* Section 226.17(c)(6)(i) and (ii) are not mutually exclusive. For example, in a transaction that finances the construction of a dwelling that may be permanently financed by the same creditor, the construction phase may consist of a series of advances under an agreement to extend credit up to a certain amount. In these cases, the creditor may disclose the construction phase as either one or more than one transaction and also disclose the permanent financing as a separate transaction.

4. *Residential mortgage transaction.* See the commentary to section 226.2(a)(24) for a discussion of the effect of section 226.17(c)(6) on the definition of a residential mortgage transaction.

5. *Allocation of points.* When a creditor utilizes the special rule in section 226.17(c)(6) to disclose credit extensions as multiple transactions, buyer's points or similar amounts imposed on the consumer must be allocated for purposes of calculating disclosures. While such amounts should not be taken into account more than once in making calculations, they may be allocated between the transactions in any manner the creditor chooses. For example, if a construction-permanent loan is subject to five points imposed on the consumer and the creditor chooses to disclose the two phases separately, the five points may be allocated entirely to the construction loan, entirely to the permanent loan, or divided in any manner between the two. However, the entire

five points may not be applied twice, that is, to both the construction and the permanent phases.

17(d) Multiple Creditors; Multiple Consumers

1. *Multiple creditors.* If a credit transaction involves more than one creditor:

- The 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.
- All disclosures for the transaction must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure. For example, if one of the creditors is the seller, the total sale price disclosure under section 226.18(j) must be made, even though the disclosing creditor is not the seller.

2. *Multiple consumers.* When two consumers are joint obligors with primary liability on an obligation, the disclosures may be given to either one of them. If one consumer is merely a surety or guarantor, the disclosures must be given to the principal debtor. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under section 226.23, although the disclosures required under section 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program.

17(e) Effect of Subsequent Events

1. *Events causing inaccuracies.* Inaccuracies in disclosures are not violations if attributable to events occurring after the 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 make new disclosures under sections 226.17(f) or 226.19 if the events occurred between disclosure and consummation or under section 226.20 if the events occurred after consummation.

17(f) Early Disclosures

1. *Change in rate.* No redisclosure is required for changes that occur between the time disclosures are made and consummation, unless the annual percentage rate in the consummated transaction exceeds the limits prescribed in section 226.22(a) ($\frac{1}{8}$ of 1 percentage point in regular transactions and $\frac{1}{4}$ of 1 percentage point in irregular transactions). To illustrate:

- If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than $\frac{1}{8}$ of 1 percentage point from the disclosed annual percentage rate, the creditor must either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such.

2. *Variable rate.* The addition of a variable-rate feature to the credit terms, after early disclosures are given, requires new disclosures.

3. *Content of new disclosures.* If redisclosure is required, the creditor has the option of either providing a complete set of new disclosures or providing disclosures of only the terms that vary from those originally disclosed. (See the commentary to section 226.19(a)(2).)

4. *Special rules.* In residential mortgage transactions subject to section 226.19, the creditor must redisclose if, between the delivery of the required early disclosures and consummation, the annual percentage rate changes by more than a stated tolerance. When subsequent events occur *after* consummation, new disclosures are required only if there is a refinancing or an assumption within the meaning of section 226.20.

17(g) Mail or Telephone Orders—Delay in Disclosures

1. *Conditions for use.* When the creditor receives a mail or telephone request for credit, the creditor may delay making the disclosures until the first payment is due if the following conditions are met:

- The credit request is initiated without face-to-face or direct telephone solicitation. (Creditors may, however, use the special rule when credit requests are solicited by mail.)
- The creditor has supplied the specified credit information about its credit terms either to the individual consumer or to the public generally. That information may be distributed through advertisements, catalogs, brochures, special mailers, or similar means.

2. *Insurance.* The location requirements for the insurance disclosures under section 226.18(n) permit them to appear apart from the other disclosures. Therefore, a creditor may mail an insurance authorization to the consumer and then prepare the other disclosures to reflect whether or not the authorization is completed by the consumer. Creditors may also disclose the insurance cost on a unit-cost basis, if the transaction meets the requirements of section 226.17(g).

17(h) Series of Sales—Delay in Disclosures

1. *Applicability.* The creditor may delay the disclosures for individual credit sales in a series of such sales until the first payment is due on the current sale, assuming the two conditions in this paragraph are met. If those conditions are not met, the general timing rules in section 226.17(b) apply.

2. *Basis of disclosures.* Creditors structuring disclosures for a series of sales under section 226.17(h) may compute the total sale price as either:

- The cash price for the sale plus that portion of the finance charge and other charges applicable to that sale; or
- The cash price for the sale, other charges applicable to the sale, and the total finance charge and outstanding principal.

17(i) Interim Student Credit Extensions

1. *Definition.* Student credit plans involve extensions of credit for education purposes where the repayment amount and schedule are not known at the time credit is advanced. These plans include loans made under any student credit plan, whether government or private, where the repayment period does not begin immediately. (Certain student credit plans that meet this definition are exempt from Regulation Z. See section 226.3(f). Creditors in interim student credit extensions need not disclose the terms set forth in this paragraph at the time the credit is actually extended but must make complete disclosures at the time the creditor and consumer agree upon the repayment schedule for the total obligation. At that time, a new set of disclosures must be made of all applicable items under section 226.18.

2. *Basis of disclosures.* The disclosures given at the time of execution of the interim note should reflect two annual percentage rates, one for the interim period and one for the repayment period. The use of section 226.17(i) in making disclosures does not, by itself, make those disclosures estimates. Any portion of the finance charge, such as statutory interest, that is attributable to the interim period and is paid by the student (either as a prepaid finance charge, periodically during the interim period, in one payment at the end of the interim period, or capitalized at the beginning of the repayment period) must be reflected in the interim annual percentage rate. Interest subsidies, such as payments made by either a state or the federal government on an interim loan, must be excluded in computing the annual percentage rate on the interim obligation, when the consumer has no contingent liability for payment of those amounts. Any finance charges that are paid separately by the student at the outset or withheld from the proceeds of the loan are prepaid finance charges. An example of this type of charge is the loan guarantee fee. The sum of the prepaid finance charges is deducted from the loan proceeds to determine the amount financed and included in the calculation of the finance charge.

3. *Consolidation.* Consolidation of the interim student credit extensions through a renewal note with a set repayment schedule is treated as a new transaction with disclosures made as they would be for a refinancing. Any unearned portion of the finance charge must be reflected in the new finance charge and annual

percentage rate, and is not added to the new amount financed. In itemizing the amount financed under section 226.18(c), the creditor may combine the principal balances remaining on the interim extensions at the time of consolidation and categorize them as the amount paid on the consumer's account.

4. *Approved student credit forms.* See the commentary to appendix H regarding disclosure forms approved for use in certain student credit programs.

References

Statute: §§ 121, 122, 124, and 128, and the Higher Education Act of 1965 (20 USC 1071) as amended by Public Law 97-35, August 13, 1981

Other sections: § 226.2 and appendix H

Previous regulation: §§ 226.6 and 226.8

1981 changes: With few exceptions, the disclosures must now appear apart from all other information and may not be interspersed with that information. The disclosures must be based on the legal obligation between the parties, rather than any side agreement.

The assumed maturity period for demand loans has been increased from six months to one year. Any alternate maturity date must be stated in the legal obligation rather than inferred from the documents, in order to form a basis for disclosures.

In multiple-advance transactions, a series of advances up to a certain amount and construction loans that may be permanently financed may be disclosed, at the creditor's option, as either a single transaction or several transactions. Appendix D is applicable only to multiple advances for the construction of a dwelling, whereas its predecessor, interpretation section 226.813, could be used for all multiple-advance transactions.

If disclosures are made before the date of consummation, the creditor need not provide updated disclosures at consummation unless the annual percentage rate has changed beyond certain limits or a variable rate feature has been added.

SECTION 226.18—Content of Disclosures

1. *As applicable.* The disclosures required by this section need be made only as applicable. Any disclosure not relevant to a particular transaction may be eliminated entirely. For example:

- In a loan transaction, the creditor may delete disclosure of the total sale price.
- In a credit sale requiring disclosure of the total sale price under section 226.18(j), the creditor may delete any reference to a downpayment where no downpayment is involved.

Where the amounts of several numerical disclosures are the same, the "as applicable" language also permits creditors to combine the terms, so long as it is done in a clear and conspicuous manner. For example:

- In a transaction in which the amount financed equals the total of payments, the creditor may disclose "amount financed/total of payments," together with descriptive language, followed by a single amount.
- However, if the terms are separated on the disclosure statement and separate space is provided for each amount, both disclosures must be completed, even though the same amount is entered in each space.

2. *Format.* See the commentary to section 226.17 and appendix H for a discussion of the format to be used in making these disclosures, as well as acceptable modifications.

18(a) Creditor

1. *Identification of creditor.* The creditor making the disclosures must be identified. This disclosure may, at the creditor's option, appear apart from the other disclosures. Use of the creditor's name is sufficient, but the creditor may also include an address and/or telephone number. In transactions with multiple creditors, any one of them may make the disclosures; the one doing so must be identified.

18(b) Amount Financed

1. *Disclosure required.* The net amount of credit extended must be disclosed using the term "amount financed" and a descriptive explanation similar to the phrase in the regulation.

2. *Rebates and loan premiums.* In a loan transaction, the creditor may offer a premium in the form of cash or merchandise to prospective borrowers. Similarly, in a credit sale transaction, a seller's or manufacturer's rebate may be offered to prospective purchasers of the creditor's goods or services. At the creditor's option, these amounts may be either reflected in the Truth in Lending disclosures or disregarded in the disclosures. If the creditor chooses to reflect them in the section 226.18 disclosures, rather than disregard them, they may be taken into account in any manner as part of those disclosures.

Paragraph 18(b)(1)

1. *Downpayments.* A downpayment is defined in section 226.2(a)(18) to include, at the creditor's option, certain deferred downpayments or pickup payments. A deferred downpayment that meets the criteria set forth in the definition may be treated as part of the downpayment, at the creditor's option.

- Deferred downpayments that are not treated as part of the downpayment (either because they do not meet the definition or because the creditor simply chooses not to treat them as downpayments) are included in the amount financed.
- Deferred downpayments that are treated as part of the downpayment are not part of the amount financed under section 226.18(b)(1).

Paragraph 18(b)(2)

1. *Adding other amounts.* Fees or other charges that are not part of the finance charge and that are financed rather than paid separately at consummation of the transaction are included in the amount financed. Typical examples are real estate settlement charges and premiums for voluntary credit life and disability insurance excluded from the finance charge under section 226.4. This paragraph does not include any amounts already accounted for under section 226.18(b)(1), such as taxes, tag and title fees, or the costs of accessories or service policies that the creditor includes in the cash price.

Paragraph 18(b)(3)

1. *Prepaid finance charges.* Prepaid finance charges that are paid separately in cash or by check should be deducted under section 226.18(b)(3) in calculating the amount financed. To illustrate:

- A consumer applies for a loan of $2,500 with a $40 loan fee. The face amount of the note is $2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of section 226.18(b)(1) is $2,500 and $40 should be deducted under section 226.18(b)(3), thereby yielding an amount financed of $2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the note. Creditors have the option, when the charges are not add-on or discount charges, of determining a principal loan amount under section 226.18(b)(1) that either includes or does not include the amount of the finance charges. (Thus the principal loan amount may, but need not, be determined to equal the face amount of the note.) When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under section 226.18(b)(3). When the finance charges are not included in the principal loan amount, they should not be deducted under section 226.18(b)(3). The following examples illustrate the application of section 226.18(b) to this type of transaction. Each example assumes a loan request of $2,500 with a loan fee of $40; the creditor assesses the loan fee by increasing the face amount of the note to $2,540.

- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,540, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under

section 226.18(b)(3), thereby obtaining an amount financed of $2,500.
- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under section 226.18(b)(3), thereby obtaining an amount financed of $2,500.

The same rules apply when the creditor does not increase the face amount of the note by the amount of the charge but collects the charge by withholding it from the amount advanced to the consumer. To illustrate, the following examples assume a loan request of $2,500 with a loan fee of $40; the creditor prepares a note for $2,500 and advances $2,460 to the consumer.

- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,500, it has included the loan fee in the principal loan amount and should deduct $40 as a preapid finance charge under section 226.18(b)(3), thereby obtaining an amount financed of $2,460.
- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,460, it has not included the loan fee in the principal loan amount and should not deduct any amount under section 226.18(b)(3), thereby obtaining an amount financed of $2,460.

Thus in the examples where the creditor derives the net amount of credit by determining a principal loan amount that does not include the amount of the finance charge, no subtraction is appropriate. Creditors should note, however, that although the charges are not subtracted as prepaid finance charges in those examples, they are nonetheless finance charges and must be treated as such.

2. *Add-on or discount charges.* All finance charges must be deducted from the amount of credit in calculating the amount financed. If the principal loan amount reflects finance charges that meet the definition of a prepaid finance charge in section 226.2, those charges are included in the section 226.18(b)(1) amount and deducted under section 226.18(b)(3). However, if the principal loan amount includes finance charges that do not meet the definition of a prepaid finance charge, the section 226.18(b)(1) amount must exclude those finance charges. The following examples illustrate the application of section 226.18(b) to these types of transactions. Each example assumes a loan request of $1,000 for one year, subject to a 6 percent precomputed interest rate, with a $10 loan fee paid separately at consummation.

- The creditor assesses add-on interest of $60 which is added to the $1,000 in loan proceeds for an obligation with a face amount of $1,060. The principal for purposes of section 226.18(b)(1) is $1,000, no amounts are added under section 226.18(b)(2), and the $10 loan fee is a prepaid finance charge to be deducted under section 226.18(b)(3). The amount financed is $990.
- The creditor assesses discount interest of $60 and distributes $940 to the consumer, who is liable for an obligation with a face amount of $1,000. The principal under section 226.18(b)(1) is $940, which results in an amount financed of $930, after deduction of the $10 prepaid finance charge under section 226.18(b)(3).
- The creditor assesses $60 in discount interest by increasing the face amount of the obligation to $1,060, with the consumer receiving $1,000. The principal under section 226.18(b)(1) is thus $1,000 and the amount financed $990, after deducting the $10 prepaid finance charge under section 226.18(b)(3).

18(c) Itemization of Amount Financed

1. *Disclosure required.* The creditor has two alternatives in complying with section 226.18(c):

- The creditor may inform the consumer, on the segregated disclosures, that a written itemization of the amount financed will be provided on request, furnishing the itemization only if the customer in fact requests it.
- The creditor may provide an itemization

as a matter of course, without notifying the consumer of the right to receive it or waiting for a request.

Whether given as a matter of course or only on request, the itemization must be provided at the same time as the other disclosures required by section 226.18, although separate from those disclosures.

2. *Additional information.* Section 226.18(c) establishes only a minimum standard for the material to be included in the itemization of the amount financed. Creditors have considerable flexibility in revising or supplementing the information listed in section 226.18(c) and shown in model form H-3, although no changes are required. The creditor may, for example, do one or more of the following:

- Include amounts that reflect payments not part of the amount financed. For example, escrow items and certain insurance premiums may be included, as discussed in the commentary to section 226.18(g).
- Organize the categories in any order. For example, the creditor may rearrange the terms in a mathematical progression that depicts the arithmetic relationship of the terms.
- Add categories. For example, in a credit sale, the creditor may include the cash price and the downpayment.
- Further itemize each category. For example, the amount paid directly to the consumer may be subdivided into the amount given by check and the amount credited to the consumer's savings account.
- Label categories with different language from that shown in section 226.18(c). For example, an amount paid on the consumer's account may be revised to specifically identify the account as "your auto loan with us."
- Delete, leave blank, mark "N/A" or otherwise note inapplicable categories in the itemization. For example, in a credit sale with no prepaid finance charges or amounts paid to others, the amount financed may consist of only the cash price less downpayment. In this case, the itemization may be composed of only a single category and all other categories may be eliminated.

3. *Amounts appropriate to more than one category.* When an amount may appropriately be placed in any of several categories and the creditor does not wish to revise the categories shown in section 226.18(c), the creditor has considerable flexibility in determining where to show the amount. For example:

- In a credit sale, the portion of the purchase price being financed by the creditor may be viewed as either an amount paid to the consumer or an amount paid on the consumer's account.

4. *RESPA transactions.* The Real Estate Settlement Procedures Act (RESPA) requires creditors to provide good faith estimates of closing costs. Transactions subject to RESPA are exempt from the requirements of section 226.18(c), when the creditor complies with the good faith estimates requirement of RESPA. The itemization of the amount financed need not be given, even though the content and timing of the good faith estimates under RESPA differ from the section 226.18(c) requirement.

Paragraph 18(c)(1)(i)

1. *Amounts paid to consumer.* This encompasses funds given to the consumer in the form of cash or a check, including joint proceeds checks, as well as funds placed in an asset account. It may include money in an interest-bearing account even if that amount is considered a required deposit under section 226.18(r). For example, in a transaction with total loan proceeds of $500, the consumer receives a check for $300 and $200 is required by the creditor to be put into an interest-bearing account. Whether or not the $200 is a required deposit, it is part of the amount financed. At the creditor's option, it may be broken out and labelled in the itemization of the amount financed.

Paragraph 18(c)(1)(ii)

1. *Amounts credited to consumer's account.* The term "consumer's account" refers to an account in the nature of a debt with that creditor. It may include, for example, an unpaid

balance on a prior loan, a credit sale balance or other amounts owing to that creditor. It does not include asset accounts of the consumer such as savings or checking accounts.

Paragraph 18(c)(1)(iii)

1. *Amounts paid to others.* This includes, for example, tag and title fees; amounts paid to insurance companies for insurance premiums; security interest fees, and amounts paid to credit bureaus, appraisers or public officials. When several types of insurance premiums are financed, they may, at the creditor's option, be combined and listed in one sum, labelled "insurance" or similar term. This includes, but is not limited to, different types of insurance premiums paid to one company and different types of insurance premiums paid to different companies. Except for insurance companies and other categories noted in footnote 40, third parties must be identified by name.

Paragraph 18(c)(1)(iv)

1. *Prepaid finance charge.* Prepaid finance charges that are deducted under section 226.18(b)(3) must be disclosed under this section. The prepaid finance charges must be shown as a total amount but may, at the creditor's option, also be further itemized and described. All amounts must be reflected in this total, even if portions of the prepaid finance charge are also reflected elsewhere. For example, if at consummation the creditor collects interim interest of $30 and a credit report fee of $10, a total prepaid finance charge of $40 must be shown. At the creditor's option, the credit report fee paid to a third party may also be shown elsewhere as an amount included in section 226.18(c)(1)(iii). The creditor may also further describe the two components of the prepaid finance charge, although no itemization of this element is required by section 226.18(c)(1)(iv).

18(d) Finance Charge

1. *Disclosure required.* The creditor must disclose the finance charge as a dollar amount, using the term "finance charge," and must include a brief description similar to that in section 226.18(d). The creditor may, but need not, further modify the descriptor for variable-rate transactions with a phrase such as "which is subject to change." The finance charge must be shown on the disclosures only as a total amount; the elements of the finance charge must not be itemized in the segregated disclosures, although the regulation does not prohibit their itemization elsewhere.

2. *Tolerance.* A tolerance for the finance charge is provided in footnote 41.

18(e) Annual Percentage Rate

1. *Disclosure required.* The creditor must disclose the cost of the credit as an annual rate, using the term "annual percentage rate," plus a brief descriptive phrase comparable to that used in section 226.18(e). For variable-rate transactions, the descriptor may be further modified with a phrase such as "which is subject to change." Under section 226.17(a), the terms "annual percentage rate" and "finance charge" must be more conspicuous than the other required disclosures.

2. *Exception.* Footnote 42 provides an exception for certain transactions in which no annual percentage rate disclosure is required.

18(f) Variable Rate

1. *Coverage.* The requirements of section 226.18(f) apply to all transactions in which the terms of the legal obligation allow the creditor to increase the rate originally disclosed to the consumer. It includes not only increases in the interest rate but also increases in other components, such as the rate of required credit life insurance. The provisions, however, do not apply to increases resulting from delinquency (including late payment), default, assumption, acceleration or transfer of the collateral. Section 226.18(f)(1) applies to variable-rate transactions that are not secured by the consumer's principal dwelling and to those that are secured by the principal dwelling but have a term of one year or less. Section 226.18(f)(2) applies to variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. Moreover, transactions subject to section 226.18(f)(2) are subject to the

special early-disclosure requirements of section 226.19(b). (However, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) and not to the requirements of sections 226.18(f)(2) and 226.19(b) regardless of the general coverage of those sections.) Creditors are permitted under footnote 43 to substitute in any variable-rate transaction the disclosures required under section 226.19(b) for those disclosures ordinarily required under section 226.18(f)(1). Creditors who provide variable-rate disclosures under section 226.19(b) must comply with all of the requirements of that section, including the timing of disclosures, and must also provide the disclosures required under section 226.18(f)(2). Creditors utilizing footnote 43 may, but need not, also provide disclosures pursuant to section 226.20(c). (Substitution of disclosures under section 226.18(f)(1) in transactions subject to section 226.19(b) is not permitted under the footnote.)

Paragraph 18(f)(1)

1. *Terms used in disclosure.* In describing the variable-rate feature, the creditor need not use any prescribed terminology. For example, limitations and hypothetical examples may be described in terms of interest rates rather than annual percentage rates. The model forms in appendix H provide examples of ways in which the variable-rate disclosures may be made.

Paragraph 18(f)(1)(i)

1. *Circumstances.* The circumstances under which the rate may increase include identification of any index to which the rate is tied, as well as any conditions or events on which the increase is contingent.

- When no specific index is used, any identifiable factors used to determine whether to increase the rate must be disclosed.
- When the increase in the rate is purely discretionary, the fact that any increase is within the creditor's discretion must be disclosed.
- When the index is internally defined (for example, by that creditor's prime rate), the creditor may comply with this requirement by either a brief description of that index or a statement that any increase is in the discretion of the creditor. An externally defined index, however, must be identified.

2. *Conversion feature.* In variable-rate transactions with an option permitting consumers to convert to a fixed-rate transaction, the conversion option is a variable-rate feature that must be disclosed. In making disclosures under section 226.18(f)(1), creditors should disclose the fact that the rate may increase upon conversion; identify the index or formula used to set the fixed rate; and state any limitations on and effects of an increase resulting from conversion that differ from other variable-rate features. Because section 226.18 (f)(1)(iv) requires only one hypothetical example (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example need not be given.

Paragraph 18(f)(1)(ii)

1. *Limitations.* This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. When there are no limitations, the creditor may, but need not, disclose that fact. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See section 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

Paragraph 18(f)(1)(iii)

1. *Effects.* Disclosure of the effect of an increase refers to an increase in the number or amount of payments or an increase in the final payment. In addition, the creditor may make a brief reference to negative amortization that may result from a rate increase. (See the commentary to section 226.17(a)(1) regarding directly related information.) If the effect cannot be determined, the creditor must provide a statement of the possible effects. For example, if the exercise of the variable-rate feature

may result in either more or larger payments, both possibilities must be noted.

Paragraph 18(f)(1)(iv)

1. *Hypothetical example.* The example may, at the creditor's option, appear apart from the other disclosures. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. In transactions with more than one variable-rate feature, only one hypothetical example need be provided. (See the commentary to section 226.17(a)(1) regarding disclosure of more than one hypothetical example as directly related information.)

2. *Hypothetical example not required.* The creditor need not provide a hypothetical example in the following transactions with a variable-rate feature:

- Demand obligations with no alternate maturity date
- Interim student credit extensions
- Multiple-advance construction loans disclosed pursuant to appendix D, part I

Paragraph 18(f)(2)

1. *Disclosure required.* In variable-rate transactions that have a term greater than one year and are secured by the consumer's principal dwelling, the creditor must give special early disclosures under section 226.19(b) in addition to the later disclosures required under section 226.18(f)(2). The disclosures under section 226.18(f)(2) must state that the transaction has a variable-rate feature and that variable-rate disclosures have been provided earlier.

18(g) Payment Schedule

1. *Amounts included in repayment schedule.* The repayment schedule should reflect all components of the finance charge, not merely the portion attributable to interest. A prepaid finance charge, however, should not be shown in the repayment schedule as a separate payment. The payments may include amounts beyond the amount financed and finance charge. For example, the disclosed payments may, at the creditor's option, reflect certain insurance premiums where the premiums are not part of either the amount financed or the finance charge, as well as real estate escrow amounts such as taxes added to the payment in mortgage transactions.

2. *Deferred downpayments.* As discussed in the commentary to section 226.2(a)(18), deferred downpayments or pickup payments that meet the conditions set forth in the definition of downpayment may be treated as part of the downpayment. Even if treated as a downpayment, that amount may nevertheless be disclosed as part of the payment schedule, at the creditor's option.

3. *Total number of payments.* In disclosing the number of payments for transactions with more than one payment level, creditors may but need not disclose as a single figure the total number of payments for all levels. For example, in a transaction calling for 108 payments of $350, 240 payments of $335, and 12 payments of $330, the creditor need not state that there will be a total of 360 payments.

Paragraph 18(g)(1)

1. *Demand obligations.* In demand obligations with no alternate maturity date, the creditor has the option of disclosing only the due dates or periods of scheduled interest payments in the first year (for example, "interest payable quarterly" or "interest due the first of each month"). The amounts of the interest payments need not be shown.

Paragraph 18(g)(2)

1. *Abbreviated disclosure.* The creditor may disclose an abbreviated payment schedule when the amount of each regularly scheduled payment (other than the first or last payment) includes an equal amount to be applied on principal and a finance charge computed by application of a rate to the decreasing unpaid balance. This option is also available when mortgage-guarantee insurance premiums, paid either monthly or annually, cause variations in the amount of the scheduled payments, reflecting the continual decrease or increase in the premium due. In addition, in

transactions where payments vary because interest and principal are paid at different intervals, the two series of payments may be disclosed separately and the abbreviated payment schedule may be used for the interest payments. For example, in transactions with fixed quarterly principal payments and monthly interest payments based on the outstanding principal balance, the amount of the interest payments will change quarterly as principal declines. In such cases the creditor may treat the interest and principal payments as two separate series of payments, separately disclosing the number, amount, and due dates of principal payments, and, using the abbreviated payment schedule, the number, amount, and due dates of interest payments. This option may be used when interest and principal are scheduled to be paid on the same date of the month as well as on different dates of the month. The creditor using this alternative must disclose the dollar amount of the highest and lowest payments and make reference to the variation in payments.

2. *Combined payment-schedule disclosures.* Creditors may combine the option in this paragraph with the general payment-schedule requirements in transactions where only a portion of the payment schedule meets the conditions of section 226.18(g)(2). For example, in a graduated-payment mortgage where payments rise sharply for five years and then decline over the next 25 years because of decreasing mortgage insurance premiums, the first five years would be disclosed under the general rule in section 226.18(g) and the next 25 years according to the abbreviated schedule in section 226.18(g)(2).

3. *Effect on other disclosures.* Section 226.18(g)(2) applies only to the payment schedule disclosure. The actual amounts of payments must be taken into account in calculating and disclosing the finance charge and the annual percentage rate.

18(h) Total of Payments

1. *Disclosure required.* The total of payments must be disclosed using that term, along with a descriptive phrase similar to the one in the regulation. The descriptive explanation may be revised to reflect a variable-rate feature with a brief phrase such as "based on the current annual percentage rate which may change."

2. *Calculation of total of payments.* The total of payments is the sum of the payments disclosed under section 226.18(g). For example, if the creditor disclosed a deferred portion of the downpayment as part of the payment schedule, that payment must be reflected in the total disclosed under this paragraph.

3. *Exception.* Footnote 44 permits creditors to omit disclosure of the total of payments in single-payment transactions. This exception does not apply to a transaction calling for a single payment of principal combined with periodic payments of interest.

4. *Demand obligations.* In demand obligations with no alternate maturity date, the creditor may omit disclosure of payment amounts under section 226.18(g)(1). In those transactions, the creditor need not disclose the total of payments.

18(i) Demand Feature

1. *Disclosure requirements.* The disclosure requirements of this provision apply not only to transactions payable on demand from the outset, but also to transactions that are not payable on demand at the time of consummation but convert to a demand status after a stated period. In demand obligations in which the disclosures are based on an assumed maturity of one year under section 226.17(c)(5), that fact must also be stated. Appendix H contains model clauses that may be used in making this disclosure.

2. *Covered demand features.* The type of demand feature triggering the disclosures required by section 226.18(i) includes only those demand features contemplated by the parties as part of the legal obligation. For example, this provision does not apply to transactions that convert to a demand status as a result of the consumer's default. A due-on-sale clause is not considered a demand feature.

3. *Relationship to payment schedule disclosures.* As provided in section 226.18(g)(1), in

demand obligations with no alternate maturity date, the creditor need only disclose the due dates or payment periods of any scheduled interest payments for the first year. If the demand obligation states an alternate maturity, however, the disclosed payment schedule must reflect that stated term; the special rule in section 226.18(g)(1) is not available.

18(j) Total Sale Price

1. *Disclosure required.* In a credit sale transaction, the "total sale price" must be disclosed using that term, along with a descriptive explanation similar to the one in the regulation. For variable-rate transactions, the descriptive phrase may, at the creditor's option, be modified to reflect the variable-rate feature. For example, the descriptor may read: "The total cost of your purchase on credit, which is subject to change, including your downpayment of . . . ." The reference to a downpayment may be eliminated in transactions calling for no downpayment.

2. *Calculation of total sale price.* The figure to be disclosed is the sum of the cash price, other charges added under section 226.18(b)(2), and the finance charge disclosed under section 226.18(d).

18(k) Prepayment

1. *Disclosure required.* The creditor must give a definitive statement of whether or not a penalty will be imposed or a rebate will be given.

- The fact that no penalty will be imposed may not simply be inferred from the absence of a penalty disclosure; the creditor must indicate that prepayment will not result in a penalty.
- If a penalty or refund is possible for one type of prepayment, even though not for all, a positive disclosure is required. This applies to any type of prepayment, whether voluntary or involuntary as in the case of prepayments resulting from acceleration.
- Any difference in rebate or penalty policy, depending on whether prepayment is voluntary or not, must not be disclosed with the segregated disclosures.

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, mortgages with mortgage-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.

3. *Prepaid finance charge.* The existence of a prepaid finance charge in a transaction does not, by itself, require a disclosure under section 226.18(k). A prepaid finance charge is not considered a penalty under section 226.18(k)(1), nor does it require a disclosure under section 226.18(k)(2). At its option, however, a creditor may consider a prepaid finance charge to be under section 226.18(k)(2). If a disclosure is made under section 226.18(k)(2) with respect to a prepaid finance charge or other finance charge, the creditor may further identify that finance charge. For example, the disclosure may state that the borrower "will not be entitled to a refund of the prepaid finance charge" or some other term that describes the finance charge.

Paragraph 18(k)(1)

1. *Penalty.* This applies only to those transactions in which the interest calculation takes account of all scheduled reductions in principal, as well as transactions in which interest calculations are made daily. The term "penalty" as used here encompasses only those charges that are assessed strictly because of the prepayment in full of a simple-interest obligation, as an addition to all other amounts. Items which are penalties include, for example:

- Interest charges for any period after prepayment in full is made. (See the commentary to section 226.17(a)(1) regarding disclosure of interest charges assessed for periods after prepayment in full as directly related information.)
- A minimum finance charge in a simple-interest transaction. (See the commentary to section 226.17(a)(1) regarding the dis-

closure of a minimum finance charge as directly related information.)

Items which are not penalties include, for example:

- Loan-guarantee fees
- Interim interest on a student loan

Paragraph 18(k)(2)

1. *Rebate of finance charge.* This applies to any finance charges that do not take account of each reduction in the principal balance of an obligation. This category includes, for example:

- Precomputed finance charges such as add-on charges
- Charges that take account of some but not all reductions in principal, such as mortgage guarantee insurance assessed on the basis of an annual declining balance, when the principal is reduced on a monthly basis

No description of the method of computing earned or unearned finance charges is required or permitted as part of the segregated disclosures under this section.

18(*l*) Late Payment

1. *Definition.* This paragraph requires a disclosure only if charges are added to individual delinquent installments by a creditor who otherwise considers the transaction ongoing on its original terms. Late payment charges do not include:

- The right of acceleration
- Fees imposed for actual collection costs, such as repossession charges or attorney's fees
- Deferral and extension charges
- The continued accrual of simple interest at the contract rate after the payment due date. However, an increase in the interest rate is a late payment charge to the extent of the increase.

2. *Content of disclosure.* Many state laws authorize the calculation of late charges on the basis of either a percentage or a specified dollar amount and permit imposition of the lesser or greater of the two charges. The disclosure made under section 226.18(*l*) may reflect this alternative. For example, stating that the charge in the event of a late payment is 5 percent of the late amount, not to exceed $5.00, is sufficient. Many creditors also permit a grace period during which no late charge will be assessed; this fact may be disclosed as directly related information. (See the commentary to section 226.17(a).)

18(m) Security Interest

1. *Purchase-money transactions.* When the collateral is the item purchased as part of, or with the proceeds of, the credit transaction, section 226.18(m) requires only a general identification such as "the property purchased in this transaction." However, the creditor may identify the property by item or type instead of identifying it more generally with a phrase such as "the property purchased in this transaction." For example, a creditor may identify collateral as "a motor vehicle," or as "the property purchased in this transaction." Any transaction in which the credit is being used to purchase the collateral is considered a purchase-money transaction and the abbreviated property identification may be used, whether the obligation is treated as a loan or a credit sale.

2. *Non-purchase-money transactions.* In non-purchase-money transactions, the property subject to the security interest must be identified by item or type. This disclosure is satisfied by a general disclosure of the category of property subject to the security interest, such as "motor vehicles," "securities," "certain household items," or "household goods." (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) At the creditor's option, however, a more precise identification of the property or goods may be provided.

3. *Mixed collateral.* In some transactions in which the credit is used to purchase the collateral, the creditor may also take other property of the consumer as security. In those cases, a combined disclosure must be provided, consisting of an identification of the purchase money collateral consistent with comment 18(m)-1 and a specific identification of the

other collateral consistent with comment 18(m)-2.

4. *After-acquired property.* An after-acquired property clause is not a security interest to be disclosed under section 226.18(m).

5. *Spreader clause.* The fact that collateral for preexisting credit 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. The disclosure may be made 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.

6. *Terms used in disclosure.* No specified terminology is required in disclosing a security interest. Although the disclosure may, at the creditor's option, use the term "security interest," the creditor may designate its interest by using, for example, "pledge," "lien," or "mortgage."

7. *Collateral from third party.* In certain transactions, the consumer's obligation may be secured by collateral belonging to a third party. For example, a loan to a student may be secured by an interest in the property of the student's parents. In such cases, the security interest is taken in connection with the transaction and must be disclosed, even though the property encumbered is owned by someone other than the consumer.

18(n) Insurance

1. *Location.* This disclosure may, at the creditor's option, appear apart from the other disclosures. It may appear with any other information, including the amount-financed itemization, any information prescribed by state law, or other supplementary material. When this information is disclosed with the other segregated disclosures, however, no additional explanatory material may be included.

18(o) Certain Security Interest Charges

1. *Format.* No special format is required for these disclosures; under section 226.4(e), taxes and fees paid to government officials with respect to a security interest may be aggregated, or may be broken down by individual charge. For example, the disclosure could be labelled "filing fees and taxes," and all funds disbursed for such purposes may be aggregated in a single disclosure. This disclosure may appear, at the creditor's option, apart from the other required disclosures. The inclusion of this information on a statement required under the Real Estate Settlement Procedures Act is sufficient disclosure for purposes of Truth in Lending.

18(p) Contract Reference

1. *Content.* Creditors may substitute, for the phrase "appropriate contract document," a reference to specific transaction documents in which the additional information is found, such as "promissory note" or "retail installment sale contract." A creditor may, at its option, delete inapplicable items in the contract reference, as for example when the contract documents contain no information regarding the right of acceleration.

18(q) Assumption Policy

1. *Policy statement.* In many mortgages, the creditor cannot determine, at the time disclosure must be made, whether a loan may be assumable at a future date on its original terms. For example, the assumption clause commonly used in mortgages sold to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation conditions an assumption on a variety of factors such as the creditworthiness of the subsequent borrower, the potential for impairment of the lender's security, and execution of an assumption agreement by the subsequent borrower. In cases where uncertainty exists as to the future assumability of a mortgage, the disclosure under section 226.18(q) should reflect that fact. In making disclosures in such cases, the creditor may use phrases such as "subject to conditions," "under certain circumstances," or "depending on future condi-

tions." The creditor may provide a brief reference to more specific criteria such as a due-on-sale clause, although a complete explanation of all conditions is not appropriate. For example, the disclosure may state, "Someone buying your home may be allowed to assume the mortgage on its original terms, subject to certain conditions, such as payment of an assumption fee." See comment 17(a)(1)-5 for an example of a reference to a due-on-sale clause.

2. *Original terms.* The phrase "original terms" for purposes of section 226.18(q) does not preclude the imposition of an assumption fee, but a modification of the basic credit agreement, such as a change in the contract interest rate, represents different terms.

18(r) Required Deposit

1. *Disclosure required.* The creditor must inform the consumer of the existence of a required deposit. (Appendix H provides a model clause that may be used in making that disclosure.) Footnote 45 describes three types of deposits that need not be considered required deposits. Use of the phrase "need not" permits creditors to include the disclosure even in cases where there is doubt as to whether the deposit constitutes a required deposit.

2. *Pledged-account mortgages.* In these transactions, a consumer pledges as collateral funds that the consumer deposits in an account held by the creditor. The creditor withdraws sums from that account to supplement the consumer's periodic payments. Creditors may treat these pledged accounts as required deposits or they may treat them as consumer buydowns in accordance with the commentary to section 226.17(c)(1).

3. *Escrow accounts.* The escrow exception in footnote 45 applies, for example, to accounts for such items as maintenance fees, repairs, or improvements, whether in a realty or a nonrealty transaction. (See the commentary to section 226.17(c)(1) regarding the use of escrow accounts in consumer buydown transactions.)

4. *Interest-bearing accounts.* When a deposit earns at least 5 percent interest per year, no disclosure is required under section 226.18 (r). This exception applies whether the deposit is held by the creditor or by a third party.

5. *Morris Plan transactions.* A deposit under a Morris Plan, in which a deposit account is created for the sole purpose of accumulating payments and this is applied to satisfy entirely the consumer's obligation in the transaction, is not a required deposit.

6. *Examples of amounts excluded.* The following are among the types of deposits that need not be treated as required deposits:

- Requirement that a borrower be a customer or a member even if that involves a fee or a minimum balance
- Required property insurance escrow on a mobile home transaction
- Refund of interest when the obligation is paid in full
- Deposits that are immediately available to the consumer
- Funds deposited with the creditor to be disbursed (for example, for construction) before the loan proceeds are advanced
- Escrow of condominium fees
- Escrow of loan proceeds to be released when the repairs are completed

References

Statute: § 128, the Garn–St. Germain Depository Institutions Act of 1982 (Pub. L. 97–320) and the Real Estate Settlement Procedures Act (12 USC 2602)

Other sections: §§ 226.2, 226.17, and appendix H

Other regulations: 12 CFR 545.6-2(a) and 12 CFR 29

Previous regulation: §§ 226.4 and 226.8

1981 changes: Five of the required disclosures must be explained to the consumer in a manner similar to the descriptive phrases shown in the regulation. A written itemization of the amount financed need not be provided unless the consumer requests it. The finance charge must be provided in all transactions, including real estate transactions, but must be shown only as a total amount. The disclosed finance charge is considered accurate if it is within a specified range.

The variable-rate hypothetical is required in all variable-rate transactions and may be either general or transaction-specific. The penalty and rebate disclosures in the event of prepayment have been modified and combined. The requirement of an explanation of how the rebates or penalties are computed has been eliminated. The late payment disclosure has also been narrowed to include only charges imposed before maturity for late payments.

The information required in the security interest disclosure has been decreased by the deletion of the type of security interest and a reduction in the property description requirement. The disclosure of the required deposit is limited to a statement that the annual percentage rate does not reflect the required deposit; the presence of a required deposit has no effect on the annual percentage rate.

Two disclosure requirements have been added: a reference to the contract documents for additional information and, in a residential mortgage transaction, a statement of the creditor's assumption policy.

SECTION 226.19—Certain Residential Mortgage Transactions

19(a)(1) Time of Disclosure

1. *Coverage.* This section requires early disclosure of credit terms in residential mortgage transactions that are also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by this section, a transaction must be both a residential mortgage transaction under section 226.2(a) and a federally related mortgage loan under RESPA. "Federally related mortgage loan" is defined under RESPA (12 USC 2602) and Regulation X (24 CFR 3500.5(b)), and is subject to any interpretations by HUD.

2. *Timing and use of estimates.* Truth in Lending disclosures must be given (a) before consummation or (b) within three business days after the creditor receives the consumer's written application, whichever is earlier. The three-day period for disclosing credit terms coincides with the time period within which creditors subject to RESPA must provide good faith estimates of settlement costs. If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under section 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (See the commentary to section 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms, in accordance with the commentary to section 226.17(a)(1).)

3. *Written application.* Creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) in deciding whether a "written application" has been received. In general, Regulation X requires disclosures "to every person from whom the Lender receives or for whom it prepares a written application on an application form or forms normally used by the Lender for a Federally Related Mortgage Loan" (24 CFR 3500.6(a)). An application is received when it reaches the creditor in any of the ways applications are normally transmitted—by mail, hand delivery, or through an intermediary agent or broker. If an application reaches the creditor through an intermediary agent or broker, the application is received when it reaches the creditor, rather than when it reaches the agent or broker.

4. *Exceptions.* The creditor may determine within the three-day period that the application will not or cannot be approved on the terms requested, as, for example, when a consumer applies for a type or amount of credit that the creditor does not offer, or the consumer's application cannot be approved for some other reason. In that case, the creditor need not make the disclosures under this section. If the creditor fails to provide early disclosures and the transaction is later consummated on the original terms, the creditor will be in violation of this provision. If, however,

the consumer amends the application because of the creditor's unwillingness to approve it on its original terms, no violation occurs for not providing disclosures based on the original terms. But the amended application is a new application subject to this section.

5. *Itemization of amount financed.* In many residential mortgage transactions, the itemization of the amount financed required by section 226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed, either with the disclosures provided within three days after application or with the disclosures given at consummation or settlement.

19(a)(2) Redisclosure Required

1. *Conditions for redisclosure.* Creditors must make new disclosures if the annual percentage rate at consummation differs from the estimate originally disclosed by more than $\frac{1}{8}$ of 1 percentage point in regular transactions or $\frac{1}{4}$ of 1 percentage point in irregular transactions, as defined in section 226.22. The creditor must also redisclose if a variable rate feature is added to the credit terms after the original disclosures have been made. The creditor has the option of redisclosing information under other circumstances, if it wishes to do so.

2. *Content of new disclosures.* If redisclosure is required, the creditor may provide a complete set of new disclosures, or may redisclose only the terms that vary from those originally disclosed. If the creditor chooses to provide a complete set of new disclosures, the creditor may but need not highlight the new terms, provided that the disclosures comply with the format requirements of section 226.17(a). If the creditor chooses to disclose only the new terms, all the new terms must be disclosed. For example, a different annual percentage rate will almost always produce a different finance charge, and often a new schedule of payments; all of these changes would have to be disclosed. If, in addition, unrelated terms such as the amount financed or prepayment penalty vary from those originally disclosed, the accurate terms must be disclosed. However, no new disclosures are required if the *only* inaccuracies involve estimates other than the annual percentage rate, and no variable rate feature has been added.

3. *Timing.* Redisclosures, when necessary, must be given no later than "consummation or settlement." "Consummation" is defined in section 226.2(a). "Date of settlement" is defined in Regulation X (24 CFR 3500.2(a)) and is subject to any interpretations issued under RESPA and Regulation X.

4. *Basis of disclosures.* In some cases, a creditor may delay redisclosure until settlement, which may be at a time later than consummation. If a creditor chooses to redisclose at settlement, disclosures may be based on the terms in effect at settlement, rather than at consummation. For example, in a variable-rate transaction, a creditor may choose to base disclosures on the terms in effect at settlement despite the general rule in the commentary to section 18(f) that variable-rate disclosures should be based on the terms in effect at consummation.

19(b) Certain Variable-Rate Transactions

1. *Coverage.* Section 226.19(b) applies to all closed-end variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. The requirements of this section apply not only to transactions financing the initial acquisition of the consumer's principal dwelling, but also to any other closed-end variable-rate transaction secured by the principal dwelling. Closed-end variable-rate transactions that are not secured by the principal dwelling, or are secured by the principal dwelling but have a term of one year or less, are subject to the disclosure requirements of section 226.18(f)(1) rather than those of section 226.19(b). (Furthermore, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) rather than those of section 226.19(b) regardless of the general coverage of those sections.) For purposes of this section, the term of a vari-

able-rate demand loan is determined in accordance with the commentary to section 226.17(c)(5).

2. *Timing.* A creditor must give the disclosures required under this section at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. In cases where a creditor receives a written application through an intermediary agent or broker, however, footnote 45b provides a substitute timing rule requiring the creditor to deliver the disclosures or place them in the mail not later than three business days after the creditor receives the consumer's written application. This three-day rule also applies where the creditor takes an application over the telephone. If, however, the consumer merely requests an application over the telephone, the creditor must include the early disclosures required under this section with the application that is sent to the consumer. In cases where the creditor solicits applications through the mail, the creditor must also send the disclosures required under this section if an application form is included with the solicitation. In cases where an open-end credit account will convert to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section may be given at the time of conversion. (See the commentary to section 226.20(a) for information on the timing requirements for 226.19(b)(2) disclosures when a variable-rate feature is later added to a transaction.)

3. *Other variable-rate regulations.* Transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other federal agencies are exempt from the requirements of section 226.19(b), by virtue of footnote 45a, and are exempt from the requirements of section 226.20(c), by virtue of footnote 45c. Those variable-rate regulations include the regulations issued by the Federal Home Loan Bank Board and those issued by the Department of Housing and Urban Development. The exception in footnotes 45a and 45c 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 (12 USC 3801 et seq.) 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.

4. *Examples of variable-rate transactions.* The following transactions, if they have a term greater than one year and are secured by the consumer's principal dwelling, constitute variable-rate transactions subject to the disclosure requirements of section 226.19(b).

- Renegotiable-rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, where the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate.
- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures under section 226.19(b)(1) and 226.19(b)(2)(v), (viii), (ix), (x) and (xiii) are not applicable to such loans.

Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

Paragraph 19(b)(1)

1. *Substitutes.* Creditors who wish to use publications other than the *Consumer Handbook on Adjustable Rate Mortgages* must make a good faith determination that their brochures are suitable substitutes to the *Consumer Handbook.* A substitute is suitable if it is, at a minimum, comparable to the *Consumer Handbook* in substance and comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the *Consumer Handbook.*

2. *Applicability.* The *Consumer Handbook* need not be given for variable-rate transac-

tions subject to this section in which the underlying interest rate is fixed. (See comment 19(b)-4 for an example of a variable-rate transaction where the underlying interest rate is fixed.)

Paragraph 19(b)(2)

1. *Disclosure for each variable-rate program.* A creditor must provide disclosures to the consumer that fully and separately describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers who express a general interest in a creditor's ARM programs. These disclosures must be given at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. If the consumer subsequently expresses an interest in other available variable-rate loan programs subject to section 226.19(b)(2), the creditor must provide disclosures for such additional programs. The creditor, of course, is permitted to give the consumer information about additional programs subject to section 226.19(b) initially. An individual program disclosure may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for the particular program. In addition, these disclosures may be inserted or printed in the *Consumer Handbook* (or a suitable substitute) as long as they are identified as the creditor's loan-program disclosures.

2. *Variable-rate loan program defined.* If the identification, the presence or absence, or the exact value of a loan feature must be disclosed under this section, variable-rate loans that differ as to such features constitute separate loan programs. For example, separate loan-program disclosures would be required based on differences in any of the following loan features:

- The index or other formula used to calculate interest rate adjustments
- The rules relating to changes in the index value, interest rate, payments, and loan balance
- The presence or absence of, and the amount of, rate or payment caps
- The presence of a demand feature
- The possibility of negative amortization
- The possibility of interest rate carryover
- The frequency of interest rate and payment adjustments
- The presence of a discount feature

In addition, if a loan feature such as the term of the loan must be taken into account in preparing the disclosures required by section 226.19(b)(2)(viii) and (x), variable-rate loans that differ as to that feature constitute separate programs and require separate loan-program disclosures under section 226.19(b)(2). If, however, a representative value may be given for a loan feature or the feature need not be disclosed under section 226.19(b)(2), variable-rate loans that differ as to such features do not constitute separate loan programs. For example, separate program disclosures would not be required based on differences in the following loan features:

- The amount of a discount
- The amount of a margin

3. *As applicable.* The disclosures required by this section need only be made as applicable. Any disclosure not relevant to a particular transaction may be eliminated. For example, if the transaction does not contain a demand feature, the disclosure required under section 226.19(b)(2)(xi) need not be given. As used in this section, "payment" refers only to a payment based on the interest rate, loan balance, and loan term and does not refer to payment of other elements such as mortgage insurance premiums.

4. *Revisions.* A creditor must revise the disclosures required under this section once a year as soon as reasonably possible after the new index value becomes available. Revisions to the disclosures also are required when the loan program changes.

Paragraph 19(b)(2)(i)

1. *Change in interest rate, payment, or term.* A creditor must disclose the fact that the terms of the legal obligation permit the creditor, after consummation of the transaction, to increase (or decrease) the interest rate, pay-

ment, or term of the loan initially disclosed to the consumer. For example, the disclosures for a variable-rate program in which the interest rate and payment (but not loan term) can change might read, "Your interest rate and payment can change yearly." In transactions where the term of the loan may change due to rate fluctuations, the creditor must state that fact.

Paragraph 19(b)(2)(ii)

1. *Identification of index or formula.* If a creditor ties interest rate changes to a particular index, this fact must be disclosed, along with a source of information about the index. For example, if a creditor uses the weekly average yield on U.S. Treasury securities adjusted to a constant maturity as its index, the disclosure might read, "Your index is the weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year published weekly in the *Wall Street Journal.*" If no particular index is used, the creditor must briefly describe the formula used to calculate interest rate changes.

2. *Changes at creditor's discretion.* If interest rate changes are at the creditor's discretion, this fact must be disclosed. If an index is internally defined, such as by a creditor's prime rate, the creditor should either briefly describe that index or state that interest rate changes are at the creditor's discretion.

Paragraph 19(b)(2)(iii)

1. *Determination of interest rate and payment.* This provision requires an explanation of how the creditor will determine the consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, "Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term." If applicable, the creditor should also disclose that the rate and payment will be rounded.

Paragraph 19(b)(2)(iv)

1. *Current margin value and interest rate.* Because the disclosures can be prepared in advance, the interest rate and margin may be several months old when the disclosures are delivered. A statement, therefore, is required alerting consumers to the fact that they should inquire about the current margin value applied to the index and the current interest rate. For example, the disclosure might state, "Ask us for our current interest rate and margin."

Paragraph 19(b)(2)(v)

1. *Discounted and premium interest rate.* 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 charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact. For example, if a creditor discounted a consumer's initial rate, the disclosure might state, "Your initial interest rate is not based on the index used to make later adjustments." (See the commentary to section 226.17(c)(1) for a further discussion of discounted and premium variable-rate transactions). In addition, the disclosure must suggest that consumers inquire about the amount that the program is currently discounted. For example, the disclosure might state, "Ask us for the amount our adjustable-rate mortgages are currently discounted." (See the commentary to section 226.19(b)(2)(viii) for a discussion of how to reflect the discount or premium in the historical example.)

Paragraph 19(b)(2)(vi)

1. *Frequency.* The frequency of interest rate and payment adjustments must be disclosed. If interest rate changes will be imposed more frequently or at different intervals than payment changes, a creditor must disclose the frequency and timing of both types of changes. For example, in a variable-rate transaction where interest rate changes are made monthly, but payment changes occur on an annual basis, this fact must be disclosed.

Paragraph 19(b)(2)(vii)

1. *Rate and payment caps.* The creditor must disclose limits on changes (increases or decreases) in the interest rate or payment. If an initial discount is not taken into account in applying overall or periodic rate limitations, that fact must be disclosed. If separate overall or periodic limitations apply to interest rate increases resulting from other events, such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations must also be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See section 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

2. *Negative amortization and interest rate carryover.* A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, "If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount." In addition, the creditor must disclose the existence of any interest rate carryover provisions. Interest rate carryover exists when a change in the index rate that is not imposed at the time of an adjustment because, for example, it exceeds an adjustment limitation, is carried over and incorporated into the calculation of future rate adjustments. For example, if the index rises 3 percentage points during the year and the loan contains a 2 percentage point cap on annual changes (increases or decreases) in the interest rate, interest rate carryover exists if the creditor may impose the additional percentage point the following year as an addition to the rate derived by using the index or formula. In such cases, the creditor must disclose the fact that changes in the index will be carried over to subsequent interest rate adjustment dates. The disclosure might state, "Changes in the index not passed on as changes in the interest rate will be carried over and applied to subsequent interest rate adjustments."

3. *Conversion option.* If a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the creditor must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The creditor must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined. The creditor should identify any index or other measure or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the creditor may use information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the creditor. The information may be used until the program disclosures are otherwise revised. Although the rules relating to the conversion option must be disclosed, the effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rate and payments.

4. *Preferred-rate loans.* Section 226.19(b) applies to preferred-rate loans, where the rate will increase upon the occurrence of some event, such as an employee leaving the creditor's employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose the event that would allow the creditor to increase the rate such as that the rate may increase if the employee leaves the creditor's employ. The creditor must also disclose the rules relating to termination of the preferred rate, such as that fees may be charged when the rate is changed and how the new rate will be determined.

Paragraph 19(b)(2)(viii)

1. *Index movement.* This section requires a creditor to provide an historical example, based on a $10,000 loan amount originating in 1977, showing how interest rate changes implemented according to the terms of the loan program would have affected payments and the loan balance at the end of each year during a 15-year period. (In all cases, the creditor need only calculate the payments and loan balance for the term of the loan. For example,

in a five-year loan, a creditor would show the payments and loan balance for the five-year term, from 1977 to 1981, with a zero loan balance reflected for 1981. For the remaining ten years, 1982–1991, the creditor need only show the remaining index values, margin, and interest rate.) Pursuant to this section, the creditor must provide a history of index values for the preceding 15 years. Initially, the disclosures would give the index values from 1977 to the present. Each year thereafter, the revised program disclosures should include an additional year's index value until 15 years of values are shown. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values are available in giving a history and payment example. In all cases, only one index value per year need be shown. Thus, in transactions where interest rate adjustments are implemented more frequently than once per year, a creditor may assume that the interest rate and payment resulting from the index value chosen will stay in effect for the entire year for purposes of calculating the loan balance as of the end of the year and for reflecting other loan program terms. In cases where interest rate changes are at the creditor's discretion (see the commentary to section 226.19(b)(2)(ii)), the creditor must provide a history of the rates imposed for the preceding 15 years, beginning with the rates in 1977. In giving this history, the creditor need only go back as far as the creditor's rates can reasonably be determined.

2. *Selection of index values.* The historical example must reflect the method by which index values are determined under the program. If a creditor uses an average of index values or any other index formula, the history given should reflect those values. The creditor should select one date or, when an average of single values is used as an index, one period and should base the example on index values measured as of that same date or period for each year shown in the history. A date or period at any time during the year may be selected, but the same date or period must be used for each year in the historical example. For example, a creditor could use values for the first business day in July or for the first week ending in July for each of the 15 years shown in the example.

3. *Selection of margin.* For purposes of the disclosure required under section 226.19(b)(2)(viii), a creditor may select a representative margin that has been used during the six months preceding preparation of the disclosures, and should disclose that the margin is one that the creditor has used recently. The margin selected may be used until a creditor revises the disclosure form.

4. *Amount of discount or premium.* For purposes of the disclosure required under section 226.19(b)(2)(viii), a creditor may select a discount or premium (amount and term) that has been used during the six months preceding preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the historical example for as long as the discount or premium is in effect. A creditor may assume that a discount that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example. For example, a 3-month discount may be treated as being in effect for the entire first year of the example; a 15-month discount may be treated as being in effect for the first two years of the example. In illustrating the effect of the discount or premium, creditors should adjust the value of the interest rate in the historical example, and should not adjust the margin or index values. For example, if during the six months preceding preparation of the disclosures the fully indexed rate would have been 10 percent but the first year's rate under the program was 8 percent, the creditor would discount the first interest rate in the historical example by 2 percentage points.

Paragraph 19(b)(2)(ix)

1. *Calculation of payments.* A creditor is required to include a statement on the disclosure form that explains how a consumer may calculate his or her actual monthly payments for a loan amount other than $10,000. The example should be based upon the most recent payment shown in the historical example. The creditor, however, is not required to calculate the consumer's payments. (See the model clauses in appendix H-4(C).)

Paragraph 19(b)(2)(x)

1. *Initial and maximum interest rate and payment.* The disclosure form must state the initial and maximum interest rates and payments for a $10,000 loan originated at the most recent interest rate (index value plus margin) shown in the historical example. In calculating the maximum payments under this paragraph, a creditor should assume that the interest rate increases as rapidly as possible under the loan program, and the maximum payment disclosed should reflect the amortization of the loan during this period. Thus, in a loan with 2 percentage point annual (and 5 percentage point overall) interest rate limitations or "caps," the maximum interest rate would be 5 percentage points higher than the most recent rate shown in the historical example. Moreover, the loan would not reach the maximum interest rate until the fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed would reflect the amortization of the loan during this period. If the loan program includes a discounted or premium initial interest rate, the most recent rate shown in the historical example should be adjusted by the amount of the discount or premium reflected elsewhere in the disclosure for purposes of the requirements of this paragraph. Furthermore, this disclosure should state the amount by which the most recent rate has been adjusted. (See the commentary to section 226.19(b)(2)(viii) regarding disclosure of the amount of a discount or premium.) The creditor may use an interest rate applicable to the program that is more recent than the latest rate shown in the historical example.

Paragraph 19(b)(2)(xi)

1. *Demand feature.* If a variable-rate loan subject to section 226.19(b) requirements contains a demand feature, this fact must be disclosed. (Pursuant to section 226.18(i), creditors would also disclose the demand feature in the standard disclosures given later.)

Paragraph 19(b)(2)(xii)

1. *Adjustment notices.* A creditor must disclose to the consumer the type of information that will be contained in subsequent notices of adjustments and when such notices will be provided. (See the commentary to section 226.20(c) regarding notices of adjustments.) For example, the disclosure might state, "You will be notified at least 25, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the index and interest rates, payment amount, and loan balance." In transactions where there may be interest rate adjustments without accompanying payment adjustments in a year, the disclosure might read, "You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance."

Paragraph 19(b)(2)(xiii)

1. *Multiple loan programs.* A creditor that offers multiple variable-rate loan programs is required to have disclosures for each variable-rate loan program subject to section 226.19(b)(2). Unless disclosures for all of its variable-rate programs are provided initially, the creditor must inform the consumer that other closed-end variable-rate programs exist and that disclosure forms are available for these additional loan programs. For example, the disclosure form might state, "Information on other adjustable-rate mortgage programs is available upon request."

References

Statute: § 128(b)(2) and the Real Estate Settlement Procedures Act (12 USC 2602)
Other sections: §§ 226.2, 226.17, and 226.22
Other regulations: Regulation X (24 CFR 3500.2(a), 3500.5(b), and 3500.6(a))
Previous regulation: None
1981 changes: This section implements section 128(b)(2), a new provision that requires early disclosure of credit terms in certain mortgage transactions.

SECTION 226.20—Subsequent Disclosure Requirements

20(a) Refinancings

1. *Definition.* A refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law. The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.

- Changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation.
- A substitution of agreements that meets the refinancing definition will require new disclosures, even if the substitution does not substantially alter the prior credit terms.

2. *Exceptions.* A transaction is subject to section 226.20(a) only if it meets the general definition of a refinancing. Section 226.20(a)(1) through (5) lists five events that are not treated as refinancings, even if they are accomplished by cancellation of the old obligation and substitution of a new one.

3. *Variable rate.* If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, a renegotiable rate mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. However, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either:

- Increases the rate based on a variable-rate feature that was not previously disclosed, or
- Adds a variable-rate feature to the obligation.

If either of these two events occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under section 226.19(b) also must be given at that time.

4. *Unearned finance charge.* In a transaction involving precomputed finance charges, the creditor must include in the finance charge on the refinanced obligation any unearned portion of the original finance charge that is not rebated to the consumer or credited against the underlying obligation. For example, in a transaction with an add-on finance charge, a creditor advances new money to a consumer in a fashion that extinguishes the original obligation and replaces it with a new one. The creditor neither refunds the unearned finance charge on the original obligation to the consumer nor credits it to the remaining balance on the old obligation. Under these circumstances, the unearned finance charge must be included in the finance charge on the new obligation and reflected in the annual percentage rate disclosed on refinancing. Accrued but unpaid finance charges are included in the amount financed in the new obligation.

5. *Coverage.* Section 226.20(a) applies only to refinancings undertaken by the original creditor or a holder or servicer of the original obligation. A "refinancing" by any other person is a new transaction under the regulation, not a refinancing under this section.

Paragraph 20(a)(1)

1. *Renewal.* This exception applies both to obligations with a single payment of principal and interest and to obligations with periodic payments of interest and a final payment of principal. In determining whether a new obligation replacing an old one is a renewal of the original terms or a refinancing, the creditor may consider it a renewal even if:

- Accrued unpaid interest is added to the principal balance
- Changes are made in the terms of renewal

- resulting from the factors listed in section 226.17(c)(3)
- The principal at renewal is reduced by a curtailment of the obligation

Paragraph 20(a)(2)

1. *Annual-percentage-rate reduction.* A reduction in the annual percentage rate with a corresponding change in the payment schedule is not a refinancing. If the annual percentage rate is subsequently increased (even though it remains below its original level) and the increase is effected in such a way that the old obligation is satisfied and replaced, new disclosures must then be made.

2. *Corresponding change.* A corresponding change in the payment schedule to implement a lower annual percentage rate would be a shortening of the maturity, or a reduction in the payment amount or the number of payments of an obligation. The exception in section 226.20(a)(2) does not apply if the maturity is lengthened, or if the payment amount or number of payments is increased beyond that remaining on the existing transaction.

Paragraph 20(a)(3)

1. *Court agreements.* This exception includes, for example, agreements such as reaffirmations of debts discharged in bankruptcy, settlement agreements, and post-judgment agreements. (See the commentary to section 226.2(a)(14) for a discussion of court-approved agreements that are not considered "credit.")

Paragraph 20(a)(4)

1. *Workout agreements.* A workout agreement is not a refinancing unless the annual percentage rate is increased or additional credit is advanced beyond amounts already accrued plus insurance premiums.

Paragraph 20(a)(5)

1. *Insurance renewal.* The renewal of optional insurance added to an existing credit transaction is not a refinancing, assuming that appropriate Truth in Lending disclosures were provided for the initial purchase of the insurance.

20(b) Assumptions

1. *General definition.* An assumption as defined in section 226.20(b) is a new transaction and new disclosures must be made to the subsequent consumer. An assumption under the regulation requires the following three elements:

- A residential mortgage transaction
- An express acceptance of the subsequent consumer by the creditor
- A written agreement

The assumption of a nonexempt consumer credit obligation requires no disclosures unless all three elements are present. For example, an automobile dealer need not provide Truth in Lending disclosures to a customer who assumes an existing obligation secured by an automobile. However, a residential mortgage transaction with the elements described in section 226.20(b) is an assumption that calls for new disclosures; the disclosures must be given whether or not the assumption is accompanied by changes in the terms of the obligation. (See comment 2(a)(24)-5 for a discussion of assumptions that are not considered residential mortgage transactions.)

2. *Existing residential mortgage transaction.* A transaction may be a residential mortgage transaction as to one consumer and not to the other consumer. In that case, the creditor must look to the assuming consumer in determining whether a residential mortgage transaction exists. To illustrate:

- The original consumer obtained a mortgage to purchase a home for vacation purposes. The loan was not a residential mortgage transaction as to that consumer. The mortgage is assumed by a consumer who will use the home as a principal dwelling. As to that consumer, the loan is a residential mortgage transaction. For purposes of section 226.20(b), the assumed loan is an "existing residential mortgage transaction" requiring disclosures, if the other criteria for an assumption are met.

3. *Express agreement.* "Expressly agrees" means that the creditor's agreement must relate specifically to the new debtor and must unequivocally accept that debtor as a primary

obligor. The following events are not construed to be express agreements between the creditor and the subsequent consumer:

- Approval of creditworthiness
- Notification of a change in records
- Mailing of a coupon book to the subsequent consumer
- Acceptance of payments from the new consumer

4. *Retention of original consumer.* The retention of the original consumer as an obligor in some capacity does not prevent the change from being an assumption, provided the new consumer becomes a primary obligor. But the mere addition of a guarantor to an obligation for which the original consumer remains primarily liable does not give rise to an assumption. However, if neither party is designated as the primary obligor but the creditor accepts payment from the subsequent consumer, an assumption exists for purposes of section 226.20(b).

5. *Status of parties.* Section 226.20(b) applies only if the previous debtor was a consumer and the obligation is assumed by another consumer. It does not apply, for example, when an individual takes over the obligation of a corporation.

6. *Disclosures.* For transactions that are assumptions within this provision, the creditor must make disclosures based on the "remaining obligation." For example:

- The amount financed is the remaining principal balance plus any arrearages or other accrued charges from the original transaction.
- If the finance charge is computed from time to time by application of a percentage rate to an unpaid balance, in determining the amount of the finance charge and the annual percentage rate to be disclosed, the creditor should disregard any prepaid finance charges paid by the original obligor but must include in the finance charge any prepaid finance charge imposed in connection with the assumption.
- If the creditor requires the assuming consumer to pay any charges as a condition of the assumption, those sums are prepaid finance charges as to that consumer, unless exempt from the finance charge under section 226.4.

If a transaction involves add-on or discount finance charges, the creditor may make abbreviated disclosures, as outlined in section 226.20(b)(1) through (5). Creditors providing disclosures pursuant to this section for assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term longer than one year need not provide new disclosures under sections 226.18(f)(2)(ii) or 226.19(b). In such transactions, a creditor may disclose the variable-rate feature solely in accordance with section 226.18(f)(1).

7. *Abbreviated disclosures.* The abbreviated disclosures permitted for assumptions of transactions involving add-on or discount finance charges must be made clearly and conspicuously in writing in a form that the consumer may keep. However, the creditor need not comply with the segregation requirement of section 226.17(a)(1). The terms "annual percentage rate" and "total of payments," when disclosed according to section 226.20(b)(4) and (5), are not subject to the description requirements of section 226.18(e) and (h). The term "annual percentage rate" disclosed under section 226.20(b)(4) need not be more conspicuous than other disclosures.

20(c) Variable-Rate Adjustments

1. *Timing of adjustment notices.* This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to section 226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the no-

tice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to section 226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to section 226.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

2. *Exceptions.* Section 226.20(c) does not apply to "shared-equity" or "shared-appreciation" mortgages.

Paragraph 20(c)(1)

1. *Current and prior interest rates.* The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount ("current rate") and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice ("prior rates"). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.

Paragraph 20(c)(2)

1. *Current and prior index values.* This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in section 226.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.

Paragraph 20(c)(3)

1. *Unapplied index increases.* The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate is applicable only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

Paragraph 20(c)(4)

1. *Contractual effects of the adjustment.* The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under section 226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

Paragraph 20(c)(5)

1. *Fully amortizing payment.* A disclosure is required if the payment disclosed in section 226.20(c)(4) is not sufficient to pay off the loan balance (including capitalized interest) in the remaining term of the loan at the adjusted interest rate. In such cases, the adjustment notice must state the payment required to fully amortize the loan over the remainder of the term. (This paragraph does not apply if the new payment disclosed in section 226.20(c)(4) is fully amortizing but the final payment will be a different amount due to rounding.)

References

Statute: None
Other sections: § 226.2
Previous regulations: § 226.8(j) through (*l*), and interpretation §§ 226.807, 226.811, 226.814, and 226.817
1981 changes: While the previous regulation treated virtually any change in terms as a refinancing requiring new disclosures, this regulation limits refinancings to transactions in which the entire original obligation is extinguished and replaced by a new one. Redisclosure is no longer required for deferrals or extensions.

The assumption provision retains the substance of section 226.8(k) and interpretation section 226.807 of the previous regulation, but limits its scope to residential mortgage transactions.

SECTION 226.21—Treatment of Credit Balances

1. *Credit balance.* A credit balance arises whenever the creditor receives or holds funds in an account in excess of the total balance due from the consumer on that account. A balance might result, for example, from the debtor's paying off a loan by transmitting funds in excess of the total balance owed on the account, or from the early payoff of a loan entitling the consumer to a rebate of insurance premiums and finance charges. However, section 226.21 does not determine whether the creditor in fact owes or holds sums for the consumer. For example, if a creditor has no obligation to rebate any portion of precomputed finance charges on prepayment, the consumer's early payoff would not create a credit balance with respect to those charges. Similarly, nothing in this provision interferes with any rights the creditor may have under the contract or under state law with respect to set-off, cross-collateralization, or similar provisions.

2. *Total balance due.* The phrase "total balance due" refers to the total outstanding balance. Thus, this provision does not apply where the consumer has simply paid an amount in excess of the payment due for a given period.

3. *Timing of refund.* The creditor may also fulfill its obligation under this section by:

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

Paragraph 21(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 21(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 six 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 226.21 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: § 165
Other sections: None.
Previous regulation: None
1981 changes: This section implements section 165 of the act, which was expanded by the 1980 statutory amendments to apply to closed-end as well as open-end credit.

SECTION 226.22—Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraph 22(a)(1)

1. *Calculation method.* The regulation recognizes both the actuarial method and the United States Rule Method (U.S. Rule) as measures of an exact annual percentage rate. Both methods yield the same annual percentage rate when payment intervals are equal. They differ in their treatment of unpaid accrued interest.

2. *Actuarial method.* When no payment is made, or when the payment is insufficient to pay the accumulated finance charge, the actuarial method requires that the unpaid finance charge be added to the amount financed and thereby capitalized. Interest is computed on interest since in succeeding periods the interest rate is applied to the unpaid balance including the unpaid finance charge. Appendix J provides instructions and examples for calculating the annual percentage rate using the actuarial method.

3. *U.S. Rule.* The U.S. Rule produces no compounding of interest in that any unpaid accrued interest is accumulated separately and is not added to principal. In addition, under the U.S. Rule, no interest calculation is made until a payment is received.

4. *Basis for calculations.* When a transaction involves "step rates" or "split rates"—that is, different rates applied at different times or to different portions of the principal balance—a single composite annual percentage rate must be calculated and disclosed for the entire transaction. Assume, for example, a step-rate transaction in which a $10,000 loan is repayable in five years at 10 percent interest for the first two years, 12 percent for years 3 and 4, and 14 percent for year 5. The monthly payments are $210.71 during the first two years of the term, $220.25 for years 3 and 4, and $222.59 for year 5. The composite annual percentage rate, using a calculator with a "discounted cash flow analysis" or "internal rate of return" function, is 10.75 percent.

5. *Good faith reliance on faulty calculation tools.* Footnote 45a absolves a creditor of liability for an error in the annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the footnote is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.

Paragraph 22(a)(2)

1. *Regular transactions.* The annual percentage rate for a regular transaction is considered accurate if it varies in either direction by not more than $\frac{1}{8}$ of 1 percentage point from the actual annual percentage rate. For example, when the exact annual percentage rate is determined to be $10\frac{1}{8}$ percent, a disclosed annual percentage rate from 10 percent to $10\frac{1}{4}$ percent, or the decimal equivalent, is deemed to comply with the regulation.

Paragraph 22(a)(3)

1. *Irregular transactions.* The annual percentage rate for an irregular transaction is considered accurate if it varies in either direction by not more than $\frac{1}{4}$ of 1 percentage point from the actual annual percentage rate. This tolerance is intended for more complex transactions that do not call for a single advance and a regular series of equal payments at equal intervals. The $\frac{1}{4}$ of 1 percentage point tolerance may be used, for example, in a construction loan where advances are made as construction progresses, or in a transaction where payments vary to reflect the consumer's seasonal income. It may also be used in transactions with graduated payment schedules where the contract commits the consumer to several series of payments in different amounts. It does not apply, however, to loans with variable-rate features where the initial

disclosures are based on a regular amortization schedule over the life of the loan, even though payments may later change because of the variable-rate feature.

22(b) Computation Tools

Paragraph 22(b)(1)

1. *Board tables.* Volumes I and II of the Board's Annual Percentage Rate Tables provide a means of calculating annual percentage rates for regular and irregular transactions, respectively. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation, even where use of the tables produces a rate that falls outside the general standard of accuracy. To illustrate:

- Volume I may be used for single-advance transactions with completely regular payment schedules or with payment schedules that are regular except for an odd first payment, odd first period or odd final payment. When used for a transaction with a large final balloon payment, volume I may produce a rate that is considerably higher than the exact rate produced using a computer program based directly on appendix J. However, the volume I rate—produced using certain adjustments in that volume—is considered to be in compliance.

Paragraph 22(b)(2)

1. *Other calculation tools.* Creditors need not use the Board tables in calculating the annual percentage rates. Any computation tools may be used, so long as they produce annual percentage rates within $\frac{1}{8}$ or $\frac{1}{4}$ of 1 percentage point, as applicable, of the precise actuarial or U.S. Rule annual percentage rate.

22(c) Single Add-On Rate Transactions

1. *General rule.* Creditors applying a single add-on rate to all transactions up to 60 months in length may disclose the same annual percentage rate for all those transactions, although the actual annual percentage rate varies according to the length of the transaction. Creditors utilizing this provision must show the highest of those rates. For example:

- An add-on rate of 10 percent converted to an annual percentage rate produces the following actual annual percentage rates at various maturities: at 3 months, 14.94 percent; at 21 months, 18.18 percent; and at 60 months, 17.27 percent. The creditor must disclose an annual percentage rate of 18.18 percent (the highest annual percentage rate) for any transaction up to five years, even though that rate is precise only for a transaction of 21 months.

22(d) Certain Transactions Involving Ranges of Balances

1. *General rule.* Creditors applying a fixed dollar finance charge to all balances within a specified range of balances may understate the annual percentage rate by up to 8 percent of that rate by disclosing for all those balances the annual percentage rate computed on the median balance within that range. For example:

- If a finance charge of $9 applies to all balances between $91 and $100, an annual percentage rate of 10 percent (the rate on the median balance) may be disclosed as the annual percentage rate for all balances, even though a $9 finance charge applied to the lowest balance ($91) would actually produce an annual percentage rate of 10.7 percent.

References

Statute: § 107
Other sections: § 226.17(c)(4) and appendix J
Previous regulation: § 226.5(b) through (e)
1981 changes: The section now provides a larger tolerance ($\frac{1}{4}$ of 1 percentage point) for irregular transactions.

SECTION 226.23—Right of Rescission

1. *Transactions not covered.* Credit extensions that are not subject to the regulation are not covered by section 226.23 even if a customer's principal dwelling is the collateral securing the credit. For example, the right of rescission does not apply to a business-purpose loan, even though the loan is secured by the customer's principal dwelling.

23(a) Consumer's Right to Rescind

Paragraph 23(a)(1)

1. *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 the 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 is merely paid with the proceeds of the consumer's unsecured bank loan
- 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 section 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 section 226.18(m), it may still give rise to the right of rescission.

2. *Consumer.* To be a consumer within the meaning of section 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 signs a credit contract, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

3. *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 acquisition or construction loan. "Dwelling," as defined in section 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.

4. *Special rule for principal dwelling.* When the consumer is acquiring or constructing a new principal dwelling, *any* loan secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is still subject to the right of rescission regardless of the purpose of that loan.

5. *Addition of a security interest.* Under footnote 47, the addition of a security interest in a consumer's principal dwelling to an existing obligation is rescindable even if the existing obligation is not satisfied and replaced by a new obligation, and even if the existing obligation was previously exempt (because it was credit over $25,000 not secured by real property or a consumer's principal dwelling). The right of rescission applies only to the added security interest, however, and not to the original obligation. In those situations, only the section 226.23(b) notice need be delivered, not new material disclosures; the rescission period will begin to run from the delivery of the notice.

Paragraph 23(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 un-

der section 226.23(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 section 226.23(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 section 226.23(b).

Paragraph 23(a)(3)

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

- Consummation of the transaction
- Delivery of all material disclosures
- Delivery to the consumer of the required rescission notice

For example, if a transaction is consummated 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 transaction consummated 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 48 sets forth the material disclosures that must be provided before the rescission period can begin to run. Failure to provide information regarding the annual percentage rate also includes failure to inform the consumer of the existence of a variable-rate feature. Failure to give the other required disclosures does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.

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

- The expiration of three years after consummation of the transaction
- 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 a purchase money note and mortgage or retains legal title through a device such as an installment sale contract

Transfer of all the consumer's interest includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foresclosure sale would terminate an unexpired right to rescind. As provided in section 125 of the act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. 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 23(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 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.

23(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 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 two copies of the rescission notice and one copy of the disclosures.

2. *Format.* The notice must be on a separate piece of paper but may appear with other information such as the itemization of the amount financed. The material must be clear and conspicuous, but no minimum type size or other technical requirements are imposed. The notices in appendix H provide models that creditors may use in giving the notice.

3. *Content.* The notice must include all of the information outlined in section 226.23(b)(1) through (5). The requirement in section 226.23(b) that the transaction be identified may be met by providing the date of the transaction. The creditor may provide a separate form that the consumer may use to exercise the right of rescission, or that form may be combined with the other rescission disclosures, as illustrated in appendix H. 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 section 226.23(b) need not be given before consummation of the transaction. The creditor may deliver the notice after the transaction is consummated, 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 transaction was consummated on May 10, the three-business day rescission period will run from May 15.

23(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 loan proceeds to the consumer
- Begin performing services for the consumer
- Deliver materials to the consumer

2. *Escrow.* The creditor may disburse loan proceeds 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. *Actions during the delay period.* Section 226.23(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

- Prepare the loan check
- Perfect the security interest
- Prepare to discount or assign the contract to a third party
- Accrue finance charges during the delay period

4. *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.

23(d) Effects of Rescission

Paragraph 23(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 section 226.23(d)(2), how-

ever, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

Paragraph 23(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 credit transaction. 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.

2. *Amounts not refundable to consumer.* Creditors need not return any money given by the consumer to a third party outside of the credit transaction, such as costs incurred for a building permit or for a zoning variance. Similarly, the term "any amount" does not apply to any money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under section 226.23(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 credit transaction, the creditor must ensure 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 23(d)(3)

1. *Property exchange.* Once the creditor has fulfilled its obligations under section 226.23(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 lumber or fixtures 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.

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 23(d)(4)

1. *Modifications.* The procedures outlined in section 226.23(d)(2) and (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.

23(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.

23(f) Exempt Transactions

1. *Residential mortgage transaction.* Any transaction to construct or acquire a principal dwelling, whether considered real or personal property, is exempt. (See the commentary to section 226.23(a).) For example, a credit transaction to acquire a mobile home or houseboat to be used as the consumer's principal dwelling would not be rescindable.

2. *Lien status.* The lien status of the mortgage is irrelevant for purposes of the exemption in section 226.23(f)(1); the fact that a loan has junior lien status does not by itself preclude application of this exemption. For example, a home buyer may assume the existing first mortgage and create a second mortgage to finance the balance of the purchase price. Such a transaction would not be rescindable.

3. *Combined-purpose transaction.* A loan to acquire a principal dwelling and make improvements to that dwelling is exempt if treated as one transaction. If, on the other hand, the loan for the acquisition of the principal dwelling and the subsequent advances for improvements are treated as more than one transaction, then only the transaction that finances the acquisition of that dwelling is exempt.

4. *New advances.* The exemption in section 226.23(f)(2) applies only to refinancings (including consolidations) by the original creditor. If the refinancing involves a new advance of money, the amount of the new advance is rescindable. In determining whether there is a new advance, a creditor may rely on the amount financed, refinancing costs, and other figures stated in the latest Truth in Lending disclosures provided to the consumer and is not required to use, for example, more precise information that may only become available when the loan is closed. For purposes of the right of rescission, a new advance does not include amounts attributed solely to the costs of the refinancing. These amounts would include section 226.4(c)(7) charges (such as attorney's fees and title examination and insurance fees, if bona fide and reasonable in amount), as well as insurance premiums and other charges that are not finance charges. (Finance charges on the new transaction—points, for example—would not be considered in determining whether there is a new advance of money in a refinancing since finance charges are not part of the amount financed.) To illustrate, if the sum of the outstanding principal balance plus the earned unpaid finance charge is $50,000 and the new amount financed is $51,000, then the refinancing would be exempt if the extra $1,000 is attributed solely to costs financed in connection with the refinancing that are not finance charges. Of course, if new advances of money are made (for example, to pay for home improvements) and the consumer exercises the right of rescission, the consumer must be placed in the same position as he or she was in prior to entering into the new credit transaction. Thus, all amounts of money (which would include all the costs of the refinancing) already paid by the consumer to the creditor or to a third party as part of the refinancing would have to be refunded to the consumer. (See the commentary to 226.23(d)(2) for a discussion of refunds to consumers.) A model rescission notice applicable to transactions involving new advances appears in appendix H.

5. *State creditors.* Cities and other political subdivisions of states acting as creditors are not exempted from this section.

6. *Multiple advances.* Just as new disclosures need not be made for subsequent advances when treated as one transaction, no new rescission rights arise so long as the appropriate notice and disclosures are given at the outset of the transaction. For example, the creditor extends credit for home improvements secured by the consumer's principal dwelling, with advances made as repairs progress. As permitted by section 226.17(c)(6), the creditor makes a single set of disclosures at the beginning of the construction period, rather than separate disclosures for each advance. The right of rescission does not arise with each advance. However, if the advances are treated as separate transactions, the right of rescission applies to each advance.

7. *Spreader clauses.* 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," subsequent loans made are separate transactions and are subject to the right of rescission. Those loans are rescindable unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent transactions.

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 section 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. Rescission rights under section 226.15 are unaffected.

References

Statute: §§ 113, 125, and 130
Other sections: § 226.2 and appendix H
Previous regulation: § 226.9
1981 changes: 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 notice of the right to rescind.

SECTION 226.24—Advertising

1. *Clear and conspicuous standard.* This section is subject to the general "clear and conspicuous" standard for this subpart 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. For example, a merchandise tag that is an advertisement under the regulation complies with this section if the necessary credit terms are on both sides of the tag, so long as each side is accessible.

24(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. This provision 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.

24(b) Advertisement of Rate of Finance Charge

1. *Annual percentage rate.* Advertised rates must be stated in terms of an "annual percentage rate," as defined in section 226.22. Even though state or local law permits the use of add-on, discount, time-price differential, or other methods of stating rates, advertisements must state them as annual percentage rates. Unlike the transactional disclosure of the annual percentage rate under section 226.18(e), the advertised annual percentage rate need not include a descriptive explanation of the term and may be expressed using the abbreviation APR. The advertisement must state that the rate is subject to increase after consummation if that is the case, but the advertisement need not describe the rate increase, its limits, or how it would affect the payment schedule. As under section 226.18(f), relating to disclosure of a variable rate, the rate increase disclosure requirement in this provision does not apply to any rate increase due to delinquency (including late payment), default, acceleration, assumption, or transfer of collateral.

2. *Simple or periodic rates.* The advertisement may not simultaneously state any other rate, except that a simple annual rate or periodic rate applicable to an unpaid balance may appear along with (but not more conspicuously than) the annual percentage rate. For example:

- In an advertisement for real estate, a simple interest rate may be shown in the same type size as the annual percentage rate for the advertised credit.

3. *Buydowns.* When a third party (such as a

seller) or a creditor wishes to promote the availability of reduced interest rates (consumer or seller buydowns), the advertised annual percentage rate must be determined in accordance with the rules in the commentary to section 226.17(c) regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period without triggering the additional disclosures under section 226.24(c)(2). For example, the advertisement may state that "with this buydown arrangement, your monthly payments for the first three years of the mortgage term will be only $350" or "this buydown arrangement will reduce your monthly payments for the first three years of the mortgage term by $150."

4. *Effective rates.* In some transactions the consumer's payments may be based upon an interest rate lower than the rate at which interest is accruing. The lower rate may be referred to as the effective rate, payment rate, or qualifying rate. A creditor or seller may advertise such rates by stating the term of the reduced payment schedule, the interest rate upon which the reduced payments are calculated, the rate at which the interest is in fact accruing, and the annual percentage rate. The advertised annual percentage rate that must accompany this rate must take into account the interest that will accrue but will not be paid during this period. For example, an advertisement may state, "An effective first-year interest rate of 10 percent. Interest being earned at 14 percent. Annual percentage rate 15 percent."

5. *Discounted variable-rate transactions.* The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 18(f)–8 regarding the basis of transactional disclosures for such financing. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced initial rate, provided the advertisement shows the limited term to which the reduced rate applies.

- Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 18(f)–8, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.
- The advertisement may also show the effect of the discount on the payment schedule for the discount period without triggering the additional disclosures under section 226.24(c). For example, the advertisement may state that "with this discount, your monthly payments for the first year of the mortgage term will be only $577" or "this discount will reduce your monthly payments for the first year of mortgage term by $223."

24(c) Advertisement of Terms That Require Additional Disclosures

1. *General rule.* Under section 226.24(c)(1), whenever certain triggering terms appear in credit advertisements, the additional credit terms enumerated in section 226.24(c)(2) must also appear. These provisions apply even if the triggering term is not stated explicitly but may be readily determined from the advertisement. For example, an advertisement may state "80 percent financing available," which is in fact indicating that a 20 percent downpayment is required.

Paragraph 24(c)(1)

1. *Downpayment.* The dollar amount of a downpayment or a statement of the downpayment as a percentage of the price requires further information. By virtue of the definition of "downpayment" in section 226.2, this triggering term is limited to credit sale transactions. It includes such statements as:

- "Only 5 percent down"
- "As low as $100 down"
- "Total move-in costs of $800"

This provision applies only if a downpayment is actually required; statements such as "no downpayment" or "no trade-in required" do not trigger the additional disclosures under this paragraph.

2. *Payment period.* The number of payments required or the total period of repayment includes such statements as:

- "48-month payment terms"
- "30-year mortgage"
- "Repayment in as many as 36 monthly installments"

But it does not include such statements as "pay weekly," "monthly payment terms arranged," or "take years to repay," since these statements do not indicate a time period over which a loan may be financed.

3. *Payment amount.* The dollar amount of any payment includes statements such as:

- "Payable in installments of $103"
- "$25 weekly"
- "$1,200 balance payable in 10 equal installments"

In the last example, the amount of each payment is readily determinable, even though not explicitly stated. But statements such as "monthly payments to suit your needs" or "regular monthly payments" are not covered.

4. *Finance charge.* The dollar amount of the finance charge or any portion of it includes statements such as:

- "$500 total cost of credit"
- "$2 monthly carrying charge"
- "$50,000 mortgages, two points to the borrower"

In the last example, the $1,000 prepaid finance charge can be readily determined from the information given. Statements of the annual percentage rate or statements that there is no particular charge for credit (such as "no closing costs") are not triggering terms under this paragraph.

Paragraph 24(c)(2)

1. *Disclosure of downpayment.* The total downpayment as a dollar amount or percentage must be shown, but the word "downpayment" need not be used in making this disclosure. For example, "10 percent cash required from buyer" or "credit terms require minimum $100 trade-in" would suffice.

2. *Disclosure of repayment terms.* While the phrase "terms of repayment" generally has the same meaning as the "payment schedule" required to be disclosed under section 226.18(g), section 226.24(c)(2)(ii) provides greater flexibility to creditors in making this disclosure for advertising purposes. Repayment terms may be expressed in a variety of ways in addition to an exact repayment schedule; this is particularly true for advertisements that do not contemplate a single specific transaction. For example:

- A creditor may use a unit-cost approach in making the required disclosure, such as "48 monthly payments of $27.83 per $1,000 borrowed."
- In an advertisement for credit secured by a dwelling, when any series of payments varies because of a graduated payment feature or because of the inclusion of mortgage insurance premiums, a creditor may state the number and timing of payments, the amounts of the largest and smallest of those payments, and the fact that other payments will vary between those amounts.

3. *Annual percentage rate.* The advertised annual percentage rate may be expressed using the abbreviation APR. The advertisement must also state, if applicable, that the annual percentage rate is subject to increase after consummation.

4. *Use of examples.* Footnote 49 authorizes the use of illustrative credit transactions to make the necessary disclosures under section 226.24(c)(2). That is, where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions, so long as each example contains all of the applicable terms required by section 226.24(c). The examples must be labelled as such and must reflect representative credit terms that are made available by the creditor to present and prospective customers.

24(d) Catalogs and Multiple-Page Advertisements

1. *Definition.* The multiple-page advertisements to which this section 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 section 226.24(d).

2. *General.* Section 226.24(d) 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 section 226.24(c)(1). A list of different annual percentage rates applicable to different balances, for example, does not trigger further disclosures under section 226.24(c)(2) and so is not covered by section 226.24(d).

3. *Representative examples.* The table or schedule must state all the necessary information for a representative sampling of amounts of credit. This must reflect amounts of credit the creditor actually offers, up to and including the higher-priced items. This does not mean that the chart must make the disclosures for the single most expensive item the seller offers, but only that the chart cannot be limited to information about less expensive sales when the seller commonly offers a distinct level of more expensive goods or services. The range of transactions shown in the table or schedule in a particular catalog or multiple-page advertisement need not exceed the range of transactions actually offered in that advertisement.

References

Statute: §§ 141, 142, and 144
Other sections: §§ 226.2, 226.4, and 226.22
Previous regulation: §226.10(a), (b), and (d)
1981 changes: This section retains the advertising rules in a form very similar to the previous regulation, but with certain changes to reflect the 1980 statutory amendments. For example, if triggering terms appear in any advertisement, the additional disclosures required no longer include the cash price. The special rule for FHA section 235 financing has been eliminated, as well as the rule for advertising credit payable in more than four installments with no identified finance charge. Interpretation section 226.1002, requiring disclosure of representative amounts of credit in catalogs and multiple-page advertisements, has been incorporated in simplified form in section 226.24(d).

Unlike the previous regulation, if the advertised annual percentage rate is subject to increase, that fact must now be disclosed.

SUBPART D—MISCELLANEOUS

SECTION 226.25—Record Retention

25(a) General Rule

1. *Evidence of required actions.* The creditor must retain evidence that it performed the required actions as well as made the required disclosures. This includes, for example, evidence that the creditor properly handled adverse credit reports in connection with amounts subject to a billing dispute under section 226.13, and properly handled the refunding of credit balances under sections 226.11 and 226.21.

2. *Methods of retaining evidence.* Adequate evidence of compliance does not necessarily mean actual paper copies of disclosure statements or other business records. The evidence may be retained on microfilm, microfiche, or by any other method that reproduces records accurately (including computer programs). The creditor need retain only enough information to reconstruct the required disclosures or other records. Thus, for example, the creditor need not retain each open-end periodic statement, so long as the specific information on each statement can be retrieved.

References

Statute: §§ 105 and 108
Other sections: Appendix I
Previous regulation: § 226.6(i)
1981 changes: Section 226.25 substitutes a uniform two-year record-retention rule for the

previous requirement that certain creditors retain records through at least one compliance examination. It also states more explicitly that the record-retention requirements apply to evidence of required actions.

SECTION 226.26—Use of Annual Percentage Rate in Oral Disclosures

1. *Application of rules.* The restrictions of section 226.26 apply only if the creditor chooses to respond orally to the consumer's request for credit cost information. Nothing in the regulation requires the creditor to supply rate information orally. If the creditor volunteers information (including rate information) through oral solicitations directed generally to prospective customers, as through a telephone solicitation, those communications may be advertisements subject to the rules in sections 226.16 and 226.24.

26(a) Open-End Credit

1. *Information that may be given.* The creditor may state periodic rates in addition to the required annual percentage rate, but it need not do so. If the annual percentage rate is unknown because transaction charges, loan fees, or similar finance charges may be imposed, the creditor must give the corresponding annual percentage rate (that is, the periodic rate multiplied by the number of periods in a year, as described in sections 226.6(a)(2) and 226.7(d)). In such cases, the creditor may, but need not, also give the consumer information about other finance charges and other charges.

26(b) Closed-End Credit

1. *Information that may be given.* The creditor may state other annual or periodic rates that are applied to an unpaid balance, along with the required annual percentage rate. This rule permits disclosure of a simple interest rate, for example, but not an add-on, discount, or similar rate. If the creditor cannot give a precise annual percentage rate in its oral response because of variables in the transaction, it must give the annual percentage rate for a comparable sample transaction; in this case, other cost information may, but need not, be given. For example, the creditor may be unable to state a precise annual percentage rate for a mortgage loan without knowing the exact amount to be financed, the amount of loan fees or mortgage insurance premiums, or similar factors. In this situation, the creditor should state an annual percentage rate for a sample transaction; it may also provide information about the consumer's specific case, such as the contract interest rate, points, other finance charges, and other charges.

References

Statute: § 146
Other sections: §§ 226.6(a)(2) and 226.7(d)
Previous regulation: Interpretation § 226.101
1981 changes: This section implements amended section 146 of the act, which added a provision dealing with oral disclosures, and incorporates interpretation section 226.101.

SECTION 226.27—Spanish-Language Disclosures

1. *Subsequent disclosures.* If a creditor in Puerto Rico provides initial disclosures in Spanish, subsequent disclosures need not be in Spanish. For example, if the creditor gave Spanish-language initial disclosures, periodic statements and change-in-terms notices may be made in English.

2. *Permissible uses.* If a creditor other than in Puerto Rico provides translations of the required disclosures—either because it is required to do so by state, federal, or local law, or because it chooses to do so—the translations are not inconsistent per se with the disclosures under this regulation, and they may be provided as additional information. In both cases, the English language disclosures required by this regulation must be clear and conspicuous, and the closed-end disclosures in English must be properly segregated in accordance with section 226.17(a)(1).

References

Statute: None
Other sections: None
Previous regulation: § 226.6(a)

1981 changes: No substantive change

SECTION 226.28—Effect on State Laws

28(a) Inconsistent Disclosure Requirements

1. *General.* There are three sets of preemption criteria; one applies to the general disclosure and advertising rules of the regulation, and two apply to the credit-billing provisions. Section 226.28 also provides for Board determinations of preemption.

2. *Rules for chapters 1, 2, and 3.* The standard for judging whether state laws that cover the types of requirements in chapters 1 (General Provisions), 2 (Credit Transactions), and 3 (Credit Advertising) of the act are inconsistent and therefore preempted, is contradiction of the federal law. Examples of laws that would be preempted include:

- A state law that requires use of the term "finance charge" but defines the term to include fees that the federal law excludes or to exclude fees the federal law includes
- A state law that requires a label such as "nominal annual interest rate" to be used for what the federal law calls the "annual percentage rate"

3. *Laws not contradictory to chapters 1, 2, and 3.* Generally, state law requirements that call for the disclosure of items of information not covered by the federal law, or that require more detailed disclosures, do not contradict the federal requirements. Examples of laws that are not preempted include:

- A state law that requires disclosure of the minimum periodic payment for open-end credit, even though not required by section 226.7.
- A state law that requires contracts to contain warnings such as: "Read this contract before you sign. Do not sign if any spaces are left blank. You are entitled to a copy of this contract."

Similarly, a state law that requires itemization of the amount financed does not automatically contradict the permissive itemization under section 226.18(c). However, a state law requirement that the itemization appear with the disclosure of the amount financed in the segregated closed-end credit disclosures is inconsistent, and this location requirement would be preempted.

4. *Creditor's options.* Before the Board makes a determination about a specific state law, the creditor has certain options. Since the prohibition against giving the state disclosures does not apply until the Board makes its determination, the creditor may choose to give state disclosures until the Board formally determines that the state law is inconsistent. (The Board will provide sufficient time for creditors to revise forms and procedures as necessary to conform to its determinations.)

- Under this first approach, as in all cases, the federal disclosures must be clear and conspicuous, and the closed-end disclosures must be properly segregated in accordance with section 226.17(a)(1).
- This ability to give state disclosures relieves any uncertainty that the creditor might have prior to Board determinations of inconsistency.

As a second option, the creditor may apply the preemption standards to a state law, conclude that it is inconsistent, and choose not to give the state-required disclosures. However, nothing in section 226.28(a) provides the creditor with immunity for violations of state law if the creditor chooses *not* to make state disclosures and the Board later determines that the state law is not preempted.

5. *Rules for correction of billing errors and regulation of credit reports.* The preemption criteria for the fair credit billing provisions set forth in section 226.28 have two parts. With respect to the rules on correction of billing errors and regulation of credit reports (which are in section 226.13), section 226.28(a)(2)(i) provides that a state law is inconsistent and preempted if its requirements are different from the federal law. An exception is made, however, for state laws that allow the consumer to inquire about an account and require the creditor to respond to such inquiries beyond the time limits in the federal law. Such a state law is not preempted with respect to the extra time period. For example, section 226.13

requires the consumer to submit a written notice of billing error within 60 days after 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 section 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 sections 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 section 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 limitations of section 226.12(c)(3)(ii) would not be preempted.

In the last two 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.

8. *Preemption determination—Arizona.* Effective October 1, 1983, the Board has determined that the following provisions in the state law of Arizona are preempted by the federal law:

- Section 44–287 B.5—Disclosure of final cash price balance. This provision is preempted in those transactions in which the amount of the final cash price balance is the same as the federal amount financed, since in such transactions the state law requires the use of a term different from the federal term to represent the same amount.
- Section 44–287 B.6—Disclosure of finance charge. This provision is preempted in those transactions in which the amount of the finance charge is different from the amount of the federal finance charge, since in such transactions the state law requires the use of the same term as the federal law to represent a different amount.
- Section 44–287 B.7—Disclosure of the time balance. The time balance disclosure provision is preempted in those transactions in which the amount is the same as the amount of the federal total of payments, since in such transactions the state law requires the use of a term different from the federal term to represent the same amount.

9. *Preemption determination—Florida.* Effective October 1, 1983, the Board has determined that the following provisions in the state law of Florida are preempted by the federal law:

- Sections 520.07(2)(f) and 520.34(2)(f)—Disclosure of amount financed. This disclosure is preempted in those transactions in which the amount is different from the federal amount financed, since in such transactions the state law requires the use of the same term as the federal law to represent a different amount.
- Sections 520.07(2)(g), 520.34(2)(g), and 520.35(2)(d)—Disclosure of finance charge and a description of its components. The finance charge disclosure is pre-

empted in those transactions in which the amount of the finance charge is different from the federal amount, since in such transactions the state law requires the use of the same term as the federal law to represent a different amount. The requirement to describe or itemize the components of the finance charge, which is also included in these provisions, is not preempted.

- Sections 520.07(2)(h) and 520.34(2)(h)—Disclosure of total of payments. The total of payments disclosure is preempted in those transactions in which the amount differs from the amount of the federal total of payments, since in such transactions the state law requires the use of the same term as the federal law to represent a different amount from the federal law.
- Sections 520.07(2)(i) and 520.34(2)(i)—Disclosure of deferred payment price. This disclosure is preempted in those transactions in which the amount is the same as the federal total sale price, since in such transactions the state law requires the use of a different term from the federal law to represent the same amount as the federal law.

10. *Preemption determination—Missouri.* Effective October 1, 1983, the Board has determined that the following provisions in the state law of Missouri are preempted by the federal law:

- Sections 365.070–6(9) and 408.260–5(6)—Disclosure of principal balance. This disclosure is preempted in those transactions in which the amount of the principal balance is the same as the federal amount financed, since in such transactions the state law requires the use of a term different from the federal term to represent the same amount.
- Sections 365.070–6(10) and 408.260–5(7)—Disclosure of time price differential and time charge, respectively. These disclosures are preempted in those transactions in which the amount is the same as the federal finance charge, since in such transactions the state law requires the use of a term different from the federal law to represent the same amount.
- Sections 365.070–2 and 408.260–2—Use of the terms "time price differential" and "time charge" in certain notices to the buyer. In those transactions in which the state disclosure of the time price differential or time charge is preempted, the use of the terms in this notice also is preempted. The notice itself is not preempted.
- Sections 365.070–6(11) and 408.260–5(8)—Disclosure of time balance. The time balance disclosure is preempted in those transactions in which the amount is the same as the amount of the federal total of payments, since in such transactions the state law requires the use of a different term from the federal law to represent the same amount.
- Sections 365.070–6(12) and 408.260–5(9)—Disclosure of time sale price. This disclosure is preempted in those transactions in which the amount is the same as the federal total sale price, since in such transactions the state law requires the use of a different term from the federal law to represent the same amount.

11. *Preemption determination—Mississippi.* Effective October 1, 1984, the Board has determined that the following provision in the state law of Mississippi is preempted by the federal law:

- Section 63–19–31(2)(g)—Disclosure of finance charge. This disclosure is preempted in those cases in which the term "finance charge" would be used under state law to describe a different amount than the finance charge disclosed under federal law.

12. *Preemption determination—South Carolina.* Effective October 1, 1984, the Board has determined that the following provision in the state law of South Carolina is preempted by the federal law:

- Section 37–10–102(c)—Disclosure of due-on-sale clause. This provision is preempted, but only to the extent that the creditor is required to include the disclosure with the segregated federal disclosures. If the creditor may comply with the state law by placing the due-on-sale notice apart from the federal disclosures, the state law is not preempted.

13. *Preemption determination—Arizona.* Effective October 1, 1986, the Board has determined that the following provision in the state law of Arizona is preempted by the federal law:

- Section 6–621A.2—Use of the term "the total sum of $________" in certain notices provided to borrowers. This term describes the same item that is disclosed under federal law as the "total of payments." Since the state law requires the use of a different term than federal law to describe the same item, the state-required term is preempted. The notice itself is not preempted.

(Note: The state disclosure notice that incorporated the above preempted term was amended on May 4, 1987, to provide that disclosures must now be made pursuant to the federal disclosure provisions.)

14. *Preemption determination—Indiana.* Effective October 1, 1988, the Board has determined that the following provision in the state law of Indiana is preempted by the federal law:

- Section 23–2–5–8—Inclusion of the loan broker's fees and charges in the calculation of, among other items, the finance charge and annual percentage rate disclosed to potential borrowers. This disclosure is inconsistent with sections 106(a) and 226.4(a) of the federal statute and regulation, respectively, and is preempted in those instances where the use of the same term would disclose a different amount than that required to be disclosed under federal law.

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 section 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: §§ 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 section 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 section 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 section 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.

4. *Exemptions granted.* Effective October 1, 1982, the Board has granted the following exemptions from portions of the revised Truth in Lending Act:

- *Maine.* Credit or lease transactions subject to the Maine Consumer Credit Code and its implementing regulations are exempt from chapters 2, 4 and 5 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor or lessor.)
- *Connecticut.* Credit transactions subject to the Connecticut Truth in Lending Act are exempt from chapters 2 and 4 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)
- *Massachusetts.* Credit transactions subject to the Massachusetts Truth in Lending Act are exempt from chapters 2 and 4 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)
- *Oklahoma.* Credit or lease transactions subject to the Oklahoma Consumer Credit Code are exempt from chapters 2 and 5 of the federal act. (The exemption does not apply to sections 132 through 135 of the federal act, nor does it apply to transactions in which a federally chartered institution is a creditor or lessor.)
- *Wyoming.* Credit transactions subject to the Wyoming Consumer Credit Code are exempt from chapter 2 of the federal act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

29(b) Civil Liability

1. *Not eligible for exemption.* The provision that an exemption may not extend to sections 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: §§ 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.

SECTION 226.30—Limitation on Rates

1. *Scope of coverage.* The requirement of this section applies to consumer credit obligations secured by a dwelling (as "dwelling" is defined in section 226.2(a)(19)) in which the annual percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge—whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of credit obligations subject to this section include:

- Dwelling-secured credit obligations that require variable-rate disclosures under the regulation because the interest rate may increase during the term of the obligation.
- Dwelling-secured open-end credit plans that are not considered variable-rate obligations for purposes of disclosure under the regulation but where the creditor reserves the contractual right to increase the interest rate—periodic rate and corresponding annual percentage rate—during the term of the plan.

In contrast, credit obligations in which there is no contractual right to increase the interest rate during the term of the obligation are not subject to this section. Examples include:

- "Shared-equity" or "shared-appreciation" mortgage loans that have a fixed rate of interest and a shared-appreciation feature based on the consumer's equity in the mortgaged property. (The appreciation share is payable in a lump sum at a specified time.)
- Dwelling-secured fixed-rate closed-end balloon-payment mortgage loans and dwelling-secured fixed-rate open-end plans with a stated term that the creditor may, but does not have a legal obligation to, renew at maturity. (Contrast with the renegotiable-rate instrument described in comment 17(c)(1)–11.)
- Dwelling-secured fixed-rate closed-end multiple-advance transactions in which each advance is disclosed as a separate transaction.

The requirement of this section does not apply to credit obligations entered into prior to December 9, 1987. Consequently, new advances under open-end credit plans existing prior to December 9, 1987, are not subject to this section.

2. *Refinanced obligations.* On or after December 9, 1987, when a credit obligation is refinanced, as defined in section 226.20(a), the new obligation is subject to this section if it is dwelling-secured and allows for increases in the interest rate.

3. *Assumptions.* On or after December 9, 1987, when a credit obligation is assumed, as defined in section 226.20(b), the obligation becomes subject to this section if its is dwelling-secured and allows for increases in the interest rate.

4. *Modifications of obligations.* The modification of an obligation, regardless of when the obligation was entered into, is generally not covered by this section. For example, increasing the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective date of the rule does not make the obligation subject to this section. If, however, a security interest in a dwelling is added on or after December 9, 1987, to a credit obligation that allows for interest rate increases, the obligation becomes subject to this section. Similarly, if a variable–interest rate feature is added to a dwelling-secured credit obligation, the obligation becomes subject to this section.

5. *Land trusts.* In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)–8).) If a consumer-purpose loan that allows for interest rate increases is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to this section.

6. *Relationship to other sections.* Unless otherwise provided for in the commentary to this section, other provisions of the regulation such as definitions, exemptions, rules, and interpretations, also apply to this section where appropriate. To illustrate:

- An adjustable-interest-rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally section 226.3(a).)
- Creditors subject to this section are only those that fall within the definition of a creditor in section 226.2(a)(17).

7. *Consumer credit contract.* Creditors are required to specify a lifetime maximum interest rate in their credit contracts—the instrument that creates personal liability and generally contains the terms and conditions of the agreement (for example, a promissory note or home-equity line of credit agreement). In some states, the signing of a commitment letter may create a binding obligation, for example, constituting "consummation" as defined in section 226.2(a)(13). The maximum interest rate must be included in the credit contract, but a creditor may include the rate ceiling in the commitment instrument as well.

8. *Manner of stating the maximum interest rate.* The maximum interest rate must be stated either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the

obligation, what the rate ceiling will be over the term of the obligation. For example, the following statements would be sufficiently specific:

- The maximum interest rate will not exceed X%.
- The interest rate will never be higher than X percentage points above the initial rate of Y%.
- The interest rate will not exceed X%, or X percentage points above [a rate to be determined at some future point in time], whichever is less.
- The maximum interest rate will not exceed X%, or the state usury ceiling, whichever is less.

The following statements would not comply with this section:

- The interest rate will never be higher than X percentage points over the prevailing market rate.
- The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].
- The interest rate will not exceed the state usury ceiling, which is currently X%.

A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under an open-end credit plan, this normally would be the corresponding annual percentage rate. (See generally section 226.6(a)(2).)

9. *Multiple interest rate ceilings.* Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable-rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable-rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable-rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. *Interest rate charged after default.* State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default is subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. *Increasing the maximum interest rate—general rule.* Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation subject to this section unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan, a creditor may not increase the rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan has a fixed maturity and a creditor renews the plan at maturity, or converts the plan to closed-end credit, without having a legal obligation to renew or convert, a new maximum interest rate may be set at that time. If, under the initial agreement, the creditor is obligated to renew or convert the plan, the maximum interest rate originally imposed cannot be increased upon renewal or conversion (unless, of course, a new obligation is entered into). For a closed-end credit transaction, a new maximum interest rate may be set only if the transaction is satisfied and replaced by a new obligation. (The exceptions in section 226.20(a)(1)–(5) which limit what transactions are considered refinancings for purposes of disclosure do not apply with respect to increasing a rate ceiling that has been imposed; if a transaction is satisfied and replaced, the rate ceiling may be increased.)

12. *Increasing the maximum interest rate—assumption of an obligation.* If an obligation subject to this section is assumed by a new obligor and the original obligor is released from liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule applies whether or not the transaction constitutes an assumption as defined in section 226.20(b).)

13. *Transition rules.* Under footnote 50, if creditors properly include the maximum rate in their credit contracts, creditors need not revise their truth in lending disclosure statement

forms to add the disclosures about limitations on rate increases as part of the variable-rate disclosures, until October 1, 1988. On or after that date, creditors must have the maximum rate set forth in their credit contracts and, where applicable, as part of their truth in lending disclosures.

References

Statute: Competitive Equality Banking Act of 1987, Pub. L. No 100-86, 101 Stat. 552
Other sections: §§ 226.6, 226.18, and 226.19
Previous regulation: None
1987 changes: This section implements section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552, which provides that, effective December 9, 1987. adjustable-rate mortgages must include a limitation on the interest rate that may apply during the term of the mortgage loan. An adjustable-rate mortgage loan is defined in section 1204 as "any loan secured by a lien on a one-to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time, adjust the rate of interest." The rule in this section incorporates section 1204 into Regulation Z and limits the scope of section 1204 to dwelling-secured consumer credit subject to the Truth in Lending Act, in which a creditor has the contractual right to increase the interest rate during the term of the credit obligation.

APPENDIX A—Effect on State Laws

1. *Who may make requests.* Appendix A sets forth the procedures for preemption determinations. As discussed in section 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: §§ 111 and 171(a)
Other sections: § 226.28
Previous regulation: §§ 226.6(b) and 226.70 (supplement V, § 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 section 226.29 and are discussed in the commentary to that section.

References

Statute: §§ 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, § 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: §§ 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 or timing of advances is unknown at consummation of the transaction. This appendix reflects the approach taken in section 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. Appendix D may also be used in multiple-advance transactions other than construction loans, when the amounts or timing of advances is unknown at consummation.

2. *Variable-rate multiple-advance loans.* The hypothetical disclosure required in most variable-rate transactions by section 226.18(f)(4) is not required for multiple-advance loans disclosed pursuant to appendix D, part I.

3. *Calculation of the total of payments.* When disclosures are made pursuant to appendix D, the total of payments may reflect either the sum of the payments or the sum of the amount financed and the finance charge.

4. *Annual percentage rate.* Appendix D does not require the use of volume I of the Board's Annual Percentage Rate Tables for calculation of the annual percentate rate. Creditors utilizing appendix D in making calculations and disclosures may use other computation tools to determine the estimated annual percentage rate, based on the finance charge and payment schedule obtained by use of the appendix.

5. *Interest reserves.* In a multiple-advance construction loan, a creditor may establish an "interest reserve" to ensure that interest is paid as it accrues by designating a portion of the loan to be used for paying the interest that accrues on the loan. An interest reserve is not treated as a prepaid finance charge, whether the interest reserve is the same as or different from the estimated interest figure calculated under appendix D.

- If a creditor permits a consumer to make interest payments as they become due, the interest reserve should be disregarded in the disclosures and calculations under appendix D.
- If a creditor requires the establishment of an interest reserve and automatically deducts interest payments from the reserve amount rather than allow the consumer to make interest payments as they become due, the fact that interest will accrue on those interest payments as well as the other loan proceeds must be reflected in the calculations and disclosures. To reflect the effects of such compounding, a creditor should first calculate interest on the commitment amount (exclusive of the interest reserve) and then add the figure obtained by assuming that one-half of that interest is outstanding at the contract interest rate for the entire construction period. For example, using the example shown under paragraph A, part I of appendix D, the estimated interest would be $1,117.68 ($1093.75 plus an additional $23.93 calculated by assuming half of $1093.75 is outstanding at the contract interest rate for the entire construction period), and the estimated annual percentage rate would be 21.18 percent.

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 or analogous types of transactions.

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 Plans

1. *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, see comment 14(c)-6 for guidance on an appropriate calculation method.

References

Statute: § 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.

APPENDIXES 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 sequences of the disclosures
- Not using bold type for headings
- Incorporating certain state "plain English" requirements
- Deleting inapplicable disclosures by whiting 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 section 226.6 and the periodic disclosures under section 226.7. As is clear from the models given, "shorthand" 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 a 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 section 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 to the commentary on appendixes 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 savings 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 three 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 section 226.17 and "directly related" information as set forth in the commentary to section 226.17(a).

The creditor may also delete or, on multipurpose 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 "nonfiling insurance" disclosures (See samples H-11 and H-12.)
- The prepayment penalty or rebate disclosures (See samples H-12 and H-14.)
- The total sale price (See samples H-11 through H-15.)

Other permissible changes include:

- Adding the creditor's address or telephone number (See the commentary to section 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 section 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 section 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 section 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(A).* This model contains the variable-rate model clauses applicable to transactions subject to section 226.18(f)(1) 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 percent, with a corresponding $150 increase in the payment, or creditors may state that the rate will increase to 16 percent, with a corresponding payment of $850.

5. *Model H-4(B).* This model clause illustrates the variable-rate disclosure required under section 226.18(f)(2), which would alert consumers to the fact that the transaction contains a variable-rate feature and that disclosures were provided earlier.

6. *Model H-4(C).* This model clause illustrates the early disclosures required generally under section 226.19(b). It includes information on how the consumer's interest rate is determined and how it can change over the term of the loan, and explains changes that may occur in the borrower's monthly payment. The model clause also contains an example of how to disclose historical changes in the index or formula values used to compute interest rates for the preceding 15 years. In addition, the model clause illustrates the disclosure of the initial and maximum interest rates and payments for a loan originated at the most recent rate shown in the historical example.

7. *Model H-4(D).* This model clause illustrates the adjustment notice required under section 226.20(c) and provides examples of payment-change notices and annual notices of interest rate changes.

8. *Model H-5.* This contains the demand feature clause.

9. *Model H-6.* This contains the assumption clause.

10. *Model H-7.* This contains the required-deposit clause.

11. *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 three 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.

12. *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.

13. *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 percent add-on interest rate and a term of three 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.

14. *Sample H-11.* This sample illustrates an installment loan. The amount of the loan is $5,000. There is a 12 percent simple interest rate and a term of two 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 ($26.67) is collected with the first payment. The remaining 23 monthly payments are equal.

15. *Sample H-12.* This sample illustrates a refinancing and consolidation loan. The amount of the loan is $5,000. There is a 15 percent simple interest rate and a term of three 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.

16. *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 section 226.18(c).)

17. *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 percent. 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 section 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 seven-year call option required by the Federal National Mortgage Association (FNMA) in states where due-on-sale clauses are prohibited.

18. *Sample H-14.* This sample disclosure form illustrates the disclosures under section 226.19(b) for a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year. The sample form shows a creditor how to adapt the model clauses in appendix H-4(C) to the creditor's own particular variable-rate program. The sample disclosure form describes the features

of a specific variable-rate mortgage program and alerts the consumer to the fact that information on the creditor's other closed-end variable-rate programs is available upon request. It includes information on how the interest rate is determined and how it can change over time, and explains how the monthly payment can change based on a $10,000 loan amount, payable in 360 monthly installments, based on historical changes in the values for the weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year. Index values are measured as of the first week ending in July for the years 1977 through 1987. This reflects the requirement that the index history be based on values for the same date or period each year beginning with index values for 1977. The sample disclosure also illustrates the requirement under section 226.19(b)(2)(x) that the initial and the maximum interest rates and payments be shown for a $10,000 loan originated at the most recent rate shown in the historical example. In the sample, the loan is assumed to have an initial interest rate of 9.71 percent (which was the interest rate in 1987 for the example shown) and to have 2 percentage point annual (and 5 percentage point overall) interest rate limitations or caps. Thus, the maximum amount that the interest rate could rise under this program is 5 percentage points higher than the 9.71 percent initial rate to 14.71 percent, and the monthly payment could rise from $85.62 to a maximum of $123.31. The loan would not reach the maximum interest rate until its fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

19. *Sample H-15.* This sample illustrates a graduated payment mortgage with a five-year graduation period and a $7\frac{1}{2}$ percent yearly increase in payments. The loan amount is $44,900, payable in 360 monthly installments at a simple interest rate of 14.75 percent. 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 $\frac{1}{4}$ of 1 percent of the outstanding principal balance under an annual reduction plan. The abbreviated disclosure permitted under section 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.

20. *HRSA–500–1 9–82.* Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–500–1 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all Health Education Assistance Loans (HEAL) with a variable interest rate that are interim student credit extensions as defined in Regulation Z.

21. *HRSA–500–2 9–82.* Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–500–2 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a fixed interest rate that are interim student credit extensions as defined in Regulation Z.

22. *HRSA–502–1 9–82.* Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–502–1 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a variable interest rate in which the borrower has reached prepayment status and is making payments of both interest and principal.

23. *HRSA–502–2 9–82.* Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–502–2 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a fixed interest rate in which the borrower has reached repayment status and is making payments of both interest and principal.

References

Statute: §§ 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: § 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: § 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.