FEDERAL RESERVE BANK OF CHICAGO
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Circular No. 2949
October 20, 1981

To All Depository Institutions in the
Seventh Federal Reserve District:

REGULATION Z
TRUTH IN LENDING
OFFICIAL STAFF COMMENTARY

The Board of Governors of the Federal Reserve System has published an official staff commentary to the simplified Regulation Z. This commentary became effective October 13, 1981 and it applies and interprets the requirements of Regulation Z with respect to open-end and closed-end consumer credit. The commentary was proposed last May (see our Circular No. 2903, dated May 29, 1981).

Copies of the Board's press release and an abbreviated version of the commentary are enclosed. The full text of the commentary will become available upon request in late November from the Circulars and Publications Division at (312) 322-5302.

Please contact John L. Bergstrom, (312) 322-5910, or Ronald K. Gareiss, (312) 322-5911, Consumer Affairs Division, for further information.

Consumer Affairs Division
Federal Reserve Bank of Chicago

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FEDERAL RESERVE press release

For immediate release October 6, 1981

The Federal Reserve Board's staff today published an official staff commentary that follows up and interprets the Board's simplified Regulation Z, which implements the Truth in Lending Simplification and Reform Act.

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

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

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

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

CREATIVE MORTGAGE FINANCING

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

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--Where the seller makes the payment, the staff commentary takes the position that the disclosures by the lender should be at the higher rate (unless the credit contract actually reflects the lower rate, in which case the disclosures are to be based on the composite rate).

--Where the consumer makes the buydown payment, the commentary takes the position that this amount is part of the finance charge and disclosures must show the effects on the rate of the buydown, including a composite rate during the buydown period and the higher rate thereafter.

--Where the consumer and a third party share in the buydown payment the consumer's portion is to be included in the finance charge and disclosures must reflect the effects of the consumer's payment, while the third party's portion has no effect on disclosures unless the contract reflects the lower rate.

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

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

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

Attachment

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FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

TRUTH IN LENDING

Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

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

EFFECTIVE DATE: October 13, 1981.

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

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

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

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

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

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

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

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

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

INTRODUCTION

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

SUBPART A (GENERAL)

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

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- Comment 4(a)-2 specifically excludes from the finance charge assignment discounts that are not separately imposed on the consumer.

- Comment 4(a)-3 excludes from the finance charge taxes imposed on a credit obligation that are payable by the consumer.

- Comment 4(a)-4 explains when a consumer's forfeiture of interest constitutes a finance charge.

- Comments 4(b)(7) and (8)-1 and -2 describe what constitutes insurance "written in connection with" the credit transaction.

- Comment 4(b)(9)-2 describes the exception for cash discounts found in § 167(b) of the act.

- Comment 4(c)(1)-1 clarifies the treatment of application fees.

- Comments 4(d)-2 and -3 explain insurance disclosure responsibilities.

- Comment 4(d)-7 clarifies how a creditor may obtain authorization when a number of insurance options are available and who may sign an insurance authorization.

SUBPART B (OPEN-END CREDIT)

- Comments 5(a)(1)-1 and -2 clarify the format requirements for initial disclosures and periodic statements.

- Comment 5(b)(2)(ii)-3 clarifies that a creditor may permit (but not require) consumers to call for their periodic statements.

- Comments 6(a)(2)-2 through -9 provide guidelines on disclosure requirements for variable rate plans.

- Comment 7-1 deals with multifeatured plans.

- Comments 7(d)-1 and -2 provide further examples of what periodic rates must be disclosed.

- Comment 7(f)-1 modifies the rule on disclosures of the total finance charge due to the application of periodic rates.

- Comment 8(a)-3 gives additional options for "transaction dates" in mail or telephone orders.

- Comment 9(a)(2)-1 modifies the timing requirements when a creditor changes from a long-form to a short-form notice and vice versa.

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- Comment 9(c)(1)-5 clarifies that a copy of the security agreement that describes the collateral added to or substituted on an account may be used as a notice of the changed term.

- Comment 9(d)-1 has been added to cross-reference the statutory ban on credit card surcharges.

- Comment 11-1 permits a creditor to fulfill its obligations by making a good faith effort to refund any credit balance prior to the passage of 6 months.

- Comment 11(b)-1 clarifies that a creditor need not honor standing orders requesting refunds of any credit balance on the consumer's account.

- Comment 15(a)-5 and -6 clarify the meaning of "principal dwelling" as it relates to the right of rescission.

SUBPART C (CLOSED-END CREDIT)

- Comment 17(a)(1)-5 provides an expanded list of material considered directly related to required disclosures.

- Comments 17(c)(1)-3, -4 and -5 provide a more complete discussion of "buydowns."

- Comments 17(c)(1)-6 and -7 detail the treatment of "wrap-around" financing.

- Comment 17(c)(2)-2 permits a general statement that most or all disclosures are estimates, where applicable.

- Comment 17(c)(6)-5 explains the treatment of "points" in multiple-advance construction loans.

- Comment 17(i)-4 is a new comment discussing the treatment of loan origination fees on student credit extensions.

- Comment 18(c)-2 provides further guidance on varying the disclosure of the itemization of the amount financed.

- Comment 18(f)(1)-1 clarifies the treatment of an index to which a variable rate transaction may be tied.

- Comment 18(j)-1 clarifies that the total sale price disclosure may be modified for a variable rate transaction.

- Comment 19(a)-4 explains the appropriate treatment of loan applications that cannot be approved on their original terms.

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- Comment 19(b)-2 permits a creditor to highlight the changed terms when giving a complete set of new disclosures.

- Comment 20(b)-6 is a new comment explaining changes in terms that do and do not destroy the existing obligation for purposes of assumptions.

- Comments 23(a)(1)-3 and -4 clarify the meaning of "principal dwelling" as it relates to the right of rescission.

- Comment 24(b)-3 explains the correct treatment of "buydowns" in advertising.

SUBPART D (MISCELLANEOUS)

- Comment 26(b)-1 permits oral disclosure of other charges in closed-end credit when the annual percentage rate cannot be precisely determined.

- Comment 27-1 clarifies the treatment of Spanish-language disclosures in Puerto Rico.

* * * * *

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

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