FEDERAL RESERVE BANK OF DALLAS
DALLAS, TEXAS 75222

Circular No. 70-235
November 6, 1970

INTERPRETATION AND PROPOSED AMENDMENTS TO REGULATION Z
CREDIT CARD AMENDMENTS TO TRUTH IN LENDING ACT

To All Banks, Other Creditors, and Others Concerned in the Eleventh Federal Reserve District:

The Board of Governors of the Federal Reserve System announced on October 29, 1970, the adoption of one interpretation of its Truth Lending Regulation Z and the issuance of three proposed amendments to the regulation for public comment.

The Board fixed December 4 as the deadline for receipt of comments on the three proposed amendments.

The interpretation is printed on the reverse. The Board's press release and copies of the proposed amendments are attached.

You are also advised that on October 26, 1970, the President signed into law P. L. 91-508, Title V of which adds several provisions on the subject of credit cards to the Truth in Lending Act. A copy of Title V of P. L. 91-508, containing these credit card provisions, is also included with this circular.

Yours very truly,

P. E. Coldwell
President

Enclosures

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTERPRETATION OF REGULATION Z

§ 226.406 **Seller's points and discounts under Regulation Z**

(a) Section 226.4(a) of Regulation Z includes in the finance charge any charge "payable directly or indirectly by the customer, and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit . . ." The question arises as to the proper treatment of discounts paid by the seller, including points imposed on the seller by the lender in connection with a real estate transaction.

(b) Under the general rule in § 226.4(a), any such discount, to the extent it is passed on to the buyer through an increase in the selling price, must be included in the finance charge. However, as a practical matter, it may be difficult to determine whether or not a discount paid by the seller in connection with a real estate transaction has been, in fact, passed along to the customer as a part of the purchase price of the property. The same situation may exist in other cases, for example, those in which the creditor sells at a discount obligations payable in more than four instalments.

(c) The Board has concluded that in any such transaction coming within its administrative enforcement authority, where seller's points or discounts were, in fact, passed along to the customer or buyer and the amount thereof was not disclosed as a finance charge, the Board will take such action as may be appropriate in the circumstances. However, it will not attempt to prescribe rules creating a presumption that all discounts or points are passed on to the customer or buyer and hence must be included in the finance charge in any particular class or transaction. On the other hand, the inclusion of seller's points or discounts in the finance charge will be acceptable to the Board as a correct disclosure under Regulation Z.

(d) This position relates only to the Board's administrative enforcement procedures and it is not intended in any way to restrict or prejudice the rights of any customer or buyer to bring an action under sections 130 and 131 of the Act where he has reason to believe he is or was required to pay directly or indirectly a finance charge imposed directly or indirectly by the creditor of the transaction and the amount of that finance charge was not disclosed to him.

FEDERAL RESERVE
press release

For immediate release October 29, 1970.

The Board of Governors of the Federal Reserve System today announced the adoption of one interpretation to its Truth in Lending Regulation Z and issued three proposed amendments of the Regulation for public comment.

The interpretation issued by the Board spells out that all points and discounts paid to a creditor by a seller in connection with a consumer credit transaction must be included in the finance charge to the extent they are passed on to the customer. One example is the points paid by the seller to assure an extension of credit in a real estate transaction. However, the Board will not presume that all points and discounts are passed on to the buyer.

Amendments proposed by the Board would:

1. Provide that creditors must give 15 days notice to active customers of any change in terms of an open-end account. At present, creditors must give 30 days notice of any change in terms to all customers, whether they have active or inactive accounts. Under the proposal, inactive accounts must be notified when they become active and before any increase in finance charges is imposed against the account. Under an amendment issued on

October 23, no notice is required if the only change is the reduction in the periodic rate or rates applicable to the account.

2. Permit modification of the rescission notice used in credit sales of vacant lots by substituting the word "homesite" for "home."

3. Permit the advertising of meaningful credit terms applicable under FHA Section 235 financing but prohibit advertising of payments or annual percentage rate which would be misleading to most prospective customers.

The Board fixed December 4 as the deadline for receipt of comments on the three proposed amendments.

Copies of the interpretation and proposed amendments are attached.

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FEDERAL RESERVE SYSTEM

[12 CFR Part 226]

[Reg. Z]

TRUTH IN LENDING

Changes in Open End Credit Accounts; Notice of Opportunity to Rescind Certain Vacant Lot Transactions; Advertising of FHA Section 235 Financing.

Pursuant to the authority contained in the Truth in Lending Act (15 U.S.C. 1601), the Board of Governors is considering amending Part 226 in the following respects:

1a. By amending § 226.7(e) to read as follows:

§ 226.7 Open End Credit Accounts--Specific Disclosures

* * * * *

(e) Change in terms. Not later than 15 days prior to the beginning date of the billing cycle in which any change is to be made in the terms previously disclosed to the customer of an open end credit account, the creditor shall mail or deliver a written disclosure of such change to each customer required to be furnished a statement under paragraph (b) of this section. Such disclosure shall be mailed or delivered to each other customer not later than the date of mailing or delivery of the next required billing statement on his account. However, if the periodic rate, or any minimum, fixed, check service, transaction, activity, or similar charge is increased, the increased amount may not be imposed on any customer without notice at least 15 days prior to the beginning date of the billing cycle in which the charge is imposed. No notice is necessary if the only change is a reduction in the periodic rate or rates applicable to the account.

b. The main purpose of the proposed amendment is to allow creditors of an open end credit account to modify the terms of the account without the necessity of notifying inactive as well as active customers. The present requirements of Regulation Z necessitate a costly notification process and have inhibited creditors from making changes advantageous to consumers. The proposed amendment would require prior notice to active accounts, but would cut the period to 15 days to allow notification to be included with the next previous billing statement. Accounts inactive at the time of the change would receive a notice when they became active. However, if the change involved an increase in the periodic rate or in any minimum, fixed, check service, transaction, activity, or similar charge, the increased amount may not be collected from any customer not receiving notice at least 15 days prior to the beginning of the billing cycle in which that increased amount is imposed. On October 23, 1970, the Board amended § 226.7(e) to permit creditors to reduce the periodic rate or rates applicable to open end credit accounts without the necessity of advance notice to the customer.

2a. By amending § 226.9(b) to read as follows.

§ 226.9 Right to Rescind Certain Transactions

* * * * *

(b) Notice of opportunity to rescind. Whenever a customer has the right to rescind a transaction under paragraph (a) of this section, the creditor shall give notice of that fact to the customer by furnishing the customer with two copies of the notice set out below, one of which

may be used by the customer to cancel the transaction. Such notice shall be printed in capital and lower case letters of not less than 12 point bold-faced type on one side of a separate statement which identifies the transaction to which it relates. Such statement shall also set forth the entire paragraph (d) of this section, "Effect of rescission." If such paragraph appears on the reverse side of the statement, the face of the statement shall state: "See reverse side for important information about your right of rescission." Before furnishing copies of the notice to the customer, the creditor shall complete both copies with the name of the creditor, the address of the creditor's place of business, the date of consummation of the transaction, and the date, not earlier than the third business day following the date of the transaction, by which the customer may give notice of cancellation. Where the real property on which the security interest may arise does not include a dwelling, the creditor may substitute the word "homesite" for "home" where that word appears in the notice.

Notice to customer required by Federal law:

You have entered into a transaction on (date) which may result in a lien, mortgage, or other security interest on your home. You have a legal right under Federal law to cancel this transaction, if you desire to do so, without any penalty or obligation within three business days from the above date or any later date on which all material disclosures required under the Truth in Lending Act have been given to you. If you so cancel the transaction, any lien, mortgage, or other security

interest on your home arising from this transaction is automatically void. You are also entitled to receive a refund of any downpayment or other consideration if you cancel. If you decide to cancel this transaction, you may do so by notifying

_____ (Name of creditor) _____

at (Address of creditor's place of business) by mail or telegram sent not later than midnight of _____ (date) _____. You may also use any other form of written notice identifying the transaction if it is delivered to the above address not later than that time. This notice may be used for that purpose by dating and signing below.

I hereby cancel this transaction.

_____ (date) _____ (customer's signature)

b. The amendment consists of adding a sentence following the substantive part of § 226.9(b) and prior to the text of the required notice. The purpose of the amendment is to allow creditors in vacant lot transactions subject to the rescission provisions of the Truth in Lending Act and Regulation Z to substitute the word "homesite" in the specified notice for the word "home."

3a. By adding § 226.10(e) to read as follows:

§ 226.10 Advertising Credit Terms

* * * * *

(e) Advertising of FHA Section 235 financing. No advertisement to aid, promote, or assist directly or indirectly the sale of residential real estate under Title II, Section 235, of the National Housing Act

(12 U.S.C. 1715z) shall state the amount of any payment scheduled to repay the indebtedness in any extension of credit under that program or the amount of the finance charge expressed as an annual percentage rate. All other information specified in subparagraph (d)(2) of this section shall be stated when required by that subparagraph. Any advertisement shall clearly identify those credit terms which apply to the FHA Section 235 assistance program.

b. The purpose of the proposed amendment is to enable sellers to advertise the terms which are applicable to most qualified purchasers under the section 235 Federal assistance program of Title II of the National Housing Act (such as the downpayment and number of payments) without having to show a figure for the amount of payments or annual percentage rate as presently required by § 226.10(d) of Regulation Z. The purpose of the prohibition against stating any payment amount and annual percentage rate is to prevent misleading advertisement caused by the wide variation in actual amounts and rates applicable to individual customers as a result of variation in the amount of the Federal subsidy.

To aid in the consideration of these matters by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than December 4, 1970. Such material

will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.

By order of the Board of Governors, October 23, 1970.

(Signed) Kenneth A. Kenyon

Kenneth A. Kenyon
Deputy Secretary

[SEAL]

AMENDMENT TO THE TRUTH IN LENDING ACT

Title V, Public Law 91-508, signed into law on October 26, 1970, is reproduced below:

TITLE V — PROVISIONS RELATING TO CREDIT CARDS

SEC. 501. Section 103 of the Truth in Lending Act (82 Stat. 146) is amended by redesignating subsections (j), (k), and (l) as subsections (p), (q), and (r), respectively, and by adding after subsection (i) the following:

(j) The term "adequate notice," as used in section 133, means a printed notice to a cardholder which sets forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning. Such notice may be given to a cardholder by printing the notice on any credit card, or on each periodic statement of account, issued to the cardholder, or by any other means reasonably assuring the receipt thereof by the cardholder.

(k) The term "credit card" means any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit.

(l) The term "accepted credit card" means any credit card which the cardholder has requested and received or has signed or has used, or authorized another to use, for the purpose of obtaining money, property, labor, or services on credit.

(m) The term "cardholder" means any person to whom a credit card is issued or any person who has agreed with the card issuer to pay obligations arising from the issuance of a credit card to another person.

(n) The term "card issuer" means any person who issues a credit card, or the agent of such person with respect to such card.

(o) The term "unauthorized use," as used in section 133, means a use of a credit card by a person other than the cardholder who does not have actual, implied, or apparent authority for such use and from which the cardholder receives no benefit.

SEC. 502. (a) The Truth in Lending Act (82 Stat. 146) is amended by adding after section 131 the following sections:

§ 132. Issuance of credit cards

No credit card shall be issued except in response to a request or application therefor. This prohibition does not apply to the issuance of a credit card in renewal of, or in substitution for, an accepted credit card.

§ 133. Liability of holder of credit card

(a) A cardholder shall be liable for the unauthorized use of a credit card only if the card is an accepted credit card, the liability is not in excess of $50, the card issuer gives adequate notice to the cardholder of the potential liability, the card issuer has provided the cardholder with a self-addressed, prestamped notification to be mailed by the cardholder in the event of the loss or theft of the credit card, and the unauthorized use occurs before the cardholder has notified the card issuer that an unauthorized use of the credit card has occurred or may occur as the result of loss, theft, or otherwise. Notwithstanding the foregoing, no cardholder shall be liable for the unauthorized use of any credit card which was issued on or after the effective date of this section, and, after the expiration of twelve months following such effective date, no cardholder shall be liable for the unauthorized use of any credit card regardless of the date of its issuance, unless (1) the conditions of liability specified in the preceding sentence are met, and (2) the card issuer has provided a method whereby the user of such card can be identified as the person authorized to use it. For the purposes of this section, a cardholder notifies a card issuer by taking such steps as may be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information whether or not any particular officer, employee, or agent of the card issuer does in fact receive such information.

(b) In any action by a card issuer to enforce liability for the use of a credit card, the burden of proof is upon the card issuer to show that the use was authorized or, if the use was unauthorized, then the burden of proof is upon the card issuer to show that the conditions of liability for the unauthorized use of a credit card, as set forth in subsection (a), have been met.

(c) Nothing in this section imposes liability upon a cardholder for the unauthorized use of a credit card in excess of his liability for such use under other applicable law or under any agreement with the card issuer.

(d) Except as provided in this section, a cardholder incurs no liability from the unauthorized use of a credit card.

§ 134. Fraudulent use of credit card

Whoever, in a transaction affecting interstate or foreign commerce, uses any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain goods or services, or both, having a retail value aggregating $5,000 or more, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

(b) The table of contents of chapter 2 of the Truth in Lending Act is amended by adding at the end thereof the following:

132. Issuance of credit cards.

133. Liability of holder of credit card.

134. Fraudulent use of credit card.

SEC. 503. The amendments to the Truth in Lending Act made by this title become effective as follows:

(1) Section 132 of such Act takes effect upon the date of enactment of this title.

(2) Section 133 of such Act takes effect upon the expiration of 90 days after such date of enactment.

(3) Section 134 of such Act applies to offenses committed on or after such date of enactment.