FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

December 23, 1997

Notice 97-121

TO: The Chief Executive Officer of each financial institution and others concerned in the Eleventh Federal Reserve District

SUBJECT

Proposed Revisions to the Official Staff Commentary on Regulation Z (Truth in Lending)

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on proposed revisions to the Official Staff Commentary on Regulation Z (*Truth in Lending*). The commentary applies and interprets the requirements of the regulation.

The proposed revisions:

- address increased rates for credit card accounts triggered by events such as late payments or exceeding credit limits;
- provide guidance on "same-as-cash" transactions in open-end plans;
- address how creditors may determine whether credit is an open-end plan or a closed-end transaction; and
- discuss issues such as the treatment of annuity costs in reverse mortgage transactions and transaction fees imposed on checking accounts with overdraft protection.

The Board must receive comments by January 20, 1998. Please address comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. All comments should refer to Docket No. R-0992.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

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ATTACHMENT

A copy of the Board's notice as it appears on pages 64769–75, Vol. 62, No. 236 of the *Federal Register* dated December 9, 1997, is attached.

MORE INFORMATION

For more information regarding Regulation Z, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–0992]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; official staff interpretation.

SUMMARY: The Board is publishing for comment proposed revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z. The proposed update addresses increased rates for credit card accounts triggered by events such as late payments or exceeding credit limits. It provides guidance on "same-as-cash" transactions in open-end plans. It also addresses how creditors may determine whether credit is an open-end plan or a closed-end transaction. In addition, the proposed update discusses issues such as the treatment of annuity costs in reverse mortgage transactions and transaction fees imposed on checking accounts with overdraft protection.

DATES: Comments must be received on or before January 20, 1998.

ADDRESSES: Comments should refer to Docket No. R–0992, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B–2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP–500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: For Subparts A and B (open-end credit), Jane E. Ahrens, Senior Attorney, or Obrea O. Poindexter, Staff Attorney; for Subparts A, C, and E (closed-end credit and reverse mortgages), Ms. Ahrens or James A. Michaels, Senior Attorney, or Michael E. Hentrel, Staff Attorney; Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452–3667 or 452–2412; for users of Telecommunications Device for the Deaf (TDD) *only*, Diane Jenkins at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA; 15 U.S.C. 1601 *et seq.*) is to promote the informed use of consumer credit by providing for disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (the APR). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. The TILA requires additional disclosures for loans secured by a consumer's home and permits consumers to rescind certain transactions that involve their principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR Part 226).

The Board's official staff commentary (12 CFR Part 226 (Supp. I)) interprets the regulation, and provides guidance to creditors in applying the regulation to specific transactions. The commentary is a substitute for individual staff interpretations; it is updated periodically to address significant questions that arise. The Board expects to adopt revisions to the commentary in final form in March 1998; to the extent the revisions impose new requirements on creditors, compliance would be optional until October 1, 1998, the effective date for mandatory compliance.

II. Proposed Revisions

Subpart A—General

Section 226.2—Definitions and Rules of Construction

2(a) Definitions

2(a)(2) Advertisement

Comment 2(a)(2)–1 is revised to address communications to consumers about existing accounts. In response to requests for guidance, the proposed comment provides examples of communications that are and are not advertisements.

2(a)(18) Downpayment

Proposed comment 2(a)(18)–3 gives guidance on how a creditor discloses the downpayment in a credit sale if a trade-in is involved and if the amount of the existing lien on the trade-in exceeds its value. The comment clarifies that creditors should disclose zero and not a negative amount.

2(a)(20) Open-end Credit

The Board has been asked by Attorneys General of several states to provide additional guidance concerning how to determine whether credit is an open-end plan or a closed-end transaction. The Attorneys General are concerned that some retailers selling big-ticket items have established questionable "revolving charge accounts" to finance the purchase of such items, resulting in consumers making major purchases without adequate information about the true cost of the transactions. Proposed comment 2(a)(20)–3 includes factors that creditors, particularly those engaged in credit sales, should consider in determining the difference between an open-end plan and a closed-end transaction. Proposed comment 2(a)(20)–5 clarifies when a line of credit is not self-replenishing.

2(a)(24) Residential Mortgage Transaction

Comment 2(a)(24)–5 is revised for clarity. No substantive change is intended.

Proposed comment 2(a)(24)–7 clarifies that the definition of a residential mortgage transaction includes a loan for financing the construction of a primary dwelling on land already owned by the consumer.

Section 226.4—Finance Charge

4(a) Definition

4(a)(2) Special Rule: Closing Agent Charges

Comment 4(a)(2)–2 is revised to address charges to conduct a closing for a real estate-secured transaction. Creditors may exclude from the finance charge a lump-sum settlement or closing fee that includes a charge for conducting or attending a closing if the lump-sum fee is primarily for services listed in § 226.4(c)(7), even if the lump-sum fee includes incidental costs for services that are otherwise considered finance charges. The comment clarifies that charges for conducting or attending the closing are finance charges and may not be excluded from the finance charge unless the charge is incidental to the lump-sum fee.

4(b) Examples of Finance Charges

Paragraph 4(b)(2)

Comment 4(b)(2)–1 is revised to clarify that a service charge on a checking or other transaction account with a credit feature is a finance charge only if the charge on the account exceeds the charge for a similar account without a credit feature.

4(d) Insurance

Comment 4(d)–11 is revised for clarification. Under § 226.4(d), amounts paid for insurance or debt cancellation coverage may be excluded from the finance charge if the creditor discloses the fee or premium for the initial term of coverage, among other conditions. Comment 4(d)–11 contains examples of what constitutes the initial term of coverage, and also gives creditors, in certain circumstances, the option of providing the cost disclosure for one year of coverage if it is clearly labeled as such.

The proposed revision clarifies that the initial term of coverage is based on the period that the insurer or creditor is initially obligated to provide. It also clarifies that the fact that a consumer is permitted to cancel the coverage at any time does not signify that creditor may treat the initial term of coverage for purposes of this regulation as the period covered by the consumer's first payment. Where the fee or premium for the coverage is assessed periodically and the consumer is under no obligation to continue making the payments, creditors have the option of providing disclosures on the basis of one year of coverage. Creditors also have this option if the initial term of the insurance is not clear.

Subpart B—Open-end Credit

Section 226.5a—Credit and Charge Card Applications and Solicitations

5a(b) Required Disclosures

5a(b)(1) Annual Percentage Rate

Proposed comment 5a(b)(1)–7 clarifies that if the APR will increase upon a stated event (such as the consumer's making a late payment or exceeding the credit limit), the card issuer must disclose the increased rate, along with the condition for increasing the rate. Providing only a general description of the condition, such as stating that the rate will increase if the consumer "fails to remain in good standing," is not an adequate description.

5a(b)(9) Late-Payment Fee

Proposed comment 5a(b)(9)–2 addresses cross references to the APR disclosure required under § 226.5a(b)(1), where the APR will increase due to a late payment.

5a(b)(10) Over-the-Limit Fee

Proposed comment 5a(b)(10)–2 addresses cross references to the APR disclosure required under § 226.5a(b)(1), where the APR will increase if the credit limit is exceeded.

Section 226.6—Initial Disclosure Statement

6(a) Finance Charge

6(a)(2) Annual Percentage Rate

Proposed comment 6(a)(2)-11 clarifies that if the APR will increase upon a stated event (such as the consumer's making a late payment or exceeding the credit limit), the card issuer must include the increased rate in the disclosures required under § 226.6(a)(2), along with the condition that will trigger the increase.

Section 226.7—Periodic Statement

Some creditors offer open-end plans with a deferred payment feature that allows consumers to avoid finance charges if the purchase balance is paid by a certain date. An example of these "same as cash" features would permit a consumer purchasing a $500 item in January to avoid any finance charge on the purchase if the $500 balance is paid by March 31. Proposed comment 7–3 gives guidance on same-as-cash transactions. To ease compliance, three cross-references to the proposed comment are added to provisions of § 226.7 addressing balances to which periodic rates are applied, the amount of the finance charge, and free-ride periods. Comment is requested on whether to add a similar cross-reference under § 226.5(b)(2), which addresses the timing of periodic statements for open-end plans offering free-ride periods.

Section 226.14—Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements

Revisions to two comments are proposed. Comment 14(c)–5 addresses the calculation of the APRs for multifeatured plans that charge transaction fees in addition to periodic rates. In response to requests for guidance, the comment clarifies that creditors may separately consider each feature in calculating the denominator.

Multifeatured plans are defined to include plans with features such as purchases, cash advances, or overdraft checking, or plans with groups of transactions with different pricing structures. (See comment 7–1). Creditors may disclose APRs separately for each feature or may state a composite APR for the whole plan. Some creditors offer cash advances with fees that vary if the cash advance is obtained by check, at a proprietary ATM, or at a foreign financial institution. They treat each fee structure as a "feature." Appendix F gives instructions for calculating the APR when the finance charge includes interest and transaction fees. Appendix F requires creditors to include in the denominator: (1) the balance subject to a transaction fee, plus (2) the balance subject to periodic rates, less the amount of the balance subject to a transaction charge. The appendix is silent on calculating the denominator when separate features are involved.

Comment 14(c)–5 clarifies that separate features may be considered in calculating the denominator. The proposal does not attempt to define "feature" for purposes of the APR calculation. Comment is requested on how to retain flexibility for creditors in defining features of an open-end plan while guarding against distinctions among account services that artificially lower the APR on a consumer's periodic statement. An example of distinctions that serve to lower the APR is the situation where the creditor treats as individual features each possible

method of obtaining a cash advance, even though there are no real differences in pricing or operational characteristics. Comment is also requested on whether a creditor should separately disclose the balances related to each feature under § 226.7(e), if features are treated separately for purposes of calculating the denominator in the APR computation.

Comment 14(c)–10 addresses the treatment of fees imposed on transactions that occur late in a billing cycle and are impracticable to post until the following billing cycle. The comment would be revised to provide broader guidance for calculating the APR when finance charges posted in the billing cycle include charges relating to activity in prior cycles, such as adjustments relating to error resolution. It is intended to provide uniformity and simplify compliance for the variety of circumstances under which adjustments may occur. For instances in which adjustments from prior cycles would produce a negative APR in the current cycle, the comment incorporates the calculation rule from § 226.14(c)(3)—the APR should never be less than the APR corresponding to the periodic rate imposed on the account.

Subpart C—Closed-end Credit

Section 226.18—Content of Disclosures

18(g) Payment Schedule

Proposed comment 18(g)–4 clarifies the requirements for disclosing the timing of payments. It explains that creditors must include the calendar date when the beginning payment is due and clarifies that reference to the occurrence of a particular event, for example, disclosing that the first payment is due "30 days after the completion of construction," is not sufficient. If a precise date is unknown, the creditor must estimate a date and label the disclosure as an estimate.

Subpart E—Special Rules for Certain Home Mortgage Transactions

Section 226.33—Requirements for Reverse Mortgages

33(c) Projected Total Cost of Credit

33(c)(1) Costs to Consumer

Under § 226.33, the disclosed cost of a reverse mortgage transaction must contain all costs and charges paid by the consumer, including the cost of any annuity, whether the annuity purchase is mandatory or voluntary or whether it is made through the creditor or a third party. In implementing this rule, the Board stated its belief that the Congress intended a broad application of the terms "costs and charges." (60 FR 15468, March 24, 1995.) Proposed comment 33(c)(1)–2 provides further guidance for determining when an annuity is purchased as part of a reverse mortgage transaction.

III. Form of Comment Letters

Comment letters should refer to Docket No. R–0992, and, when possible, should use a standard typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3½ inch or 5¼ inch computer diskettes in any IBM-compatible DOS-based format.

List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions to the text of the staff commentary. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets. Comments are numbered to comply with new **Federal Register** publication rules.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR Part 226 as follows:

PART 226—TRUTH IN LENDING (REGULATION Z)

1. The authority citation for part 226 continues to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637(c)(5).

2. In Supplement I to Part 226, under *Section 226.2—Definitions and Rules of Construction,* the following amendments would be made:

a. Under *Paragraph 2(a)(2) Advertisement.,* paragraph 1. would be revised;

b. Under *Paragraph 2(a)(18) Downpayment.,* a new paragraph 3. would be added;

c. Under *Paragraph 2(a)(20) Open-end credit.,* paragraphs 3. and 5. would be revised; and

d. Under *Paragraph (2)(a)(24) Residential mortgage transaction.,* paragraph 5. would be revised and a new paragraph 7. would be added.

The additions and revisions would read as follows:

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Supplement I—Official Staff Interpretations

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Subpart A—General

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§ 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 that availability of credit transactions, whether in visual, oral, or print media, are covered by the regulation.

i. Examples include:

A. Messages in a newspaper, magazine, leaflet, promotional flyer, or catalog.

B. Announcements on radio, television, or public address system.

C. Direct mail literature or other printed material on any exterior or interior sign.

D. Point-of-sale displays.

E. Telephone solicitations.

F. Price tags that contain credit information.

G. Letters sent to customers as part of an organized solicitation of business.

H. Messages on checking account statements offering auto loans at a stated annual percentage rate.

I. Communications promoting a new open-end plan or closed-end transaction.

ii. The term does *not* include:

A. 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.

B. Informational material, for example, interest rate and loan term memos, distributed only to business entities.

C. 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.

D. News articles the use of which is controlled by the news medium.

E. Market research or educational materials that do not solicit business.

►F. Communications about an existing account (for example, a promotion in connection with an existing credit card account).◄

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2(a)(18) Downpayment.

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►3. *Effect of existing liens.* In a credit sale, the "downpayment" may only be used to reduce the cash price. For example, when the existing lien on an automobile to be traded in exceeds the value of the automobile, creditors must disclose a zero rather than a negative number. To illustrate, assume a consumer owes $10,000 on an existing automobile loan and that the trade-in value

of the automobile is only $8,000, leaving a $2,000 deficit. The creditor should disclose a downpayment of $0, not -$2,000.◄

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

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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.

►i. *Factors.* Each credit plan may differ, and no one factor will determine whether a creditor reasonably contemplates repeated transactions. Some of the factors to be considered in determining whether a creditor could reasonably contemplate repeated transactions are:

A. Whether the line of credit is limited to the purchase of a certain product if it is a product that consumers would not likely purchase in multiples. The greater the variety of products available for purchase under the credit line, the more likely it is that the creditor reasonably contemplates repeated transactions. Some creditors may not offer a variety of products for purchase, but given the nature of the creditor's products or services, it is nonetheless likely that consumers will make repeated purchases—as in the case of gasoline companies that issue credit cards.

B. Whether the creditor establishes a line of credit for the purpose of enabling the consumer to purchase a designated item. It is more likely that a creditor reasonably contemplates repeated transactions if a consumer may use the credit to purchase any one of a number of items. For example, if a retailer of pianos establishes a line of credit for the purpose of the consumer purchasing a piano, it is unlikely that the creditor can reasonably contemplate repeated transactions.

C. If the creditor establishes a line of credit to finance the consumer's purchase of a designated item, the amount of the transaction relative to the credit made available to the consumer. The larger the amount of the transaction, the less likely it is that the creditor reasonably contemplates repeated transactions. For example, if a retailer of satellite dishes makes credit of $5,000 available to a consumer for the purchase of a satellite dish, and the cost of the satellite dish is $4,500, it is not likely the creditor contemplates repeated transactions. The fact that the retailer sells other products that are nominal in amount (compared with the cost of the major purchase) is not a sufficient basis to contemplate repeated transactions.

D. The extent to which a creditor reasonably solicits customers with its line of credit to make additional purchases under the credit line. For example, if a home improvement contractor issues a private label credit card with a $10,000 limit to a consumer paying for roof repairs in the amount of $9,000, and sends monthly solicitations for aluminum siding, the creditor does not reasonably contemplate repeated transactions.

E. Whether the creditor has information on consumers with the credit line showing that consumers have made repeat purchases. The more information that shows that consumers have made repeat purchases, the more likely it is that the creditor reasonably contemplates repeated transactions.

ii. *Standard.*◄ 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:

A. 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.

B. 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.

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5. *Reusable line.* i. 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. ►However, a line of credit generally is not self-replenishing where the initial line of credit is less than, or not much more than, the amount of an item purchased to open the credit line or, based on the minimum monthly payments, the principal reduction is so nominal that the credit line is not reusable for an extended period of time.◄ 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.

ii. For example:

A. 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.

iii. 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. (The rules in § 226.5b(f), however, limit the ability of a creditor to suspend credit advances for home equity plans.) While consumers should have a reasonable expectation of obtaining credit as long as they remain current and within any present credit limits, further extensions of credit need not be an absolute right in order for the plan to meet the self-replenishing criterion.

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2(a)(24) Residential mortgage transaction.

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5. *Acquisition.* ►i. A residential mortgage transaction finances the acquisition of a consumer's principal dwelling. The term does not include a transaction involving a consumer's principal dwelling if the consumer had previously purchased and acquired some title to the dwelling, even though the consumer had not acquired full legal title.

ii. Examples of transactions involving a previously acquired dwelling include the financing of a balloon payment due under a land sale contract and an extension of credit made to a joint owner of property to buy out the other joint owner's interest. In these instances, disclosures are not required under § 226.18(q) or § 226.19(a) (assumability policies and early disclosures for residential mortgage transactions). However, the rescission rules of §§ 226.15 and 226.23 do apply to these new transactions.

iii. In other cases, the disclosure and rescission rules do not apply. For example, where a buyer enters into a written agreement with the creditor holding the seller's mortgage allowing the buyer to assume the mortgage where the buyer previously purchased the property and agreed with the seller to make the mortgage payments, § 226.20(b) does not apply (assumptions involving residential mortgages). ◄[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 a 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 regulations are not applicable, for example, the exceptions to the right of rescission (§§ 226.23(f)(1) and 226.15(f)(1), the early disclosure requirement (§ 226.19(a)), and the disclosure concerning assumability (§ 226.18(q)). In the following situation, by contrast, since the transaction is not a residential mortgage transaction, no disclosures are required by § 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.

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►7. *Construction on previously acquired vacant land.* A residential mortgage transaction includes a loan to finance the construction of a consumer's principal dwelling on a vacant lot previously acquired by the consumer.◄

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3. In Supplement I to Part 226, under *Section 226.4—Finance Charge,* the following amendments would be made:

a. Under *Paragraph 4(a)(2).,* paragraph 2. would be revised;

b. Under *Paragraph 4(b)(2).,* paragraph 1. would be revised; and

c. Under *Paragraph 4(d) Insurance and debt cancellation coverage.,* paragraph 11. would be revised; paragraph 12. would be redesignated as paragraph 13.; and a new paragraph 12. would be added.

The revisions and additions would read as follows:

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226.4 Finance Charge.

4(a) Definition.

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4(a)(2) Special rule: closing agent charges.

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2. *Required closing agent.* If the creditor requires the use of a closing agent, fees charged by the closing agent are included in the finance charge only if the creditor requires the particular service, requires the imposition of the charge, or retains a portion of the charge. Fees charged by a third-party closing agent may be otherwise excluded from the finance charge under § 226.4. For example, a fee that would be paid in a comparable cash transaction may be excluded under § 226.4(a)[;]►. A charge for conducting or attending a closing is a finance charge and may be excluded only if the charge is included in and incidental to◄ a lump-sum fee for real estate closing costs [may be] excluded under § 226.4(c)(7).

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4(b) Examples of finance charges.

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Paragraph 4(b)(2).

1. *Checking account charges.*►A checking or transaction account charge imposed in connection with a credit feature is a finance charge under § 226.4(b)(2) to the extent the charge exceeds the charge for a similar account without a credit feature. If a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under § 226.4(b)(2). To illustrate:

i. A $5 service charge is imposed on an account with an overdraft line of credit, while a $3 service charge is imposed on an account without a credit feature; the $2 difference is a finance charge.

ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning the item on a similar account without a credit feature; the $5 charge is not a finance charge. ◄[The checking or transaction account charges discussed in § 226.4(b)(2) include, for example, the following situations:

• An account with an overdraft line of credit incurs a $4.50 service charge, while an account without a credit feature has a $2.50 service charge; the $2.00 difference is a finance charge. If the difference is not related to account activity, however, it may be excludable as a participation fee. (See the commentary to § 226.4(c)(4).)

• A service charge of $5.00 for each item that triggers an overdraft credit line is a finance charge. However, a charge imposed uniformly for any item that overdraws a checking account, regardless of whether the items are paid or returned and whether the account has a credit feature or not, is not a finance charge.]

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4(d) Insurance and debt cancellation coverage.

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11. *Initial term.* i. The initial term of the insurance ►or debt cancellation◄ coverage determines the period for which a premium amount ►or fee◄ must be disclosed, ►unless the one-year option discussed under comment 4(d)-12 is available. For purposes of § 226.4(d), the initial term is the period for which the insurer or creditor is obligated to provide coverage, even though the consumer may be allowed to cancel the coverage before that term expires.

ii. For example:

A. The initial term of a property insurance policy on an automobile that is written for one year is one year even though monthly premiums are paid and the term of the credit transaction is four years.

B. The initial term of an insurance policy is the full term of the credit transaction if the consumer pays or finances a single premium in advance.◄ [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. *Initial term; alternative.* i. A creditor has the option of providing cost disclosures on the basis of one year of insurance or debt cancellation coverage instead of a longer initial term (provided the premium or fee is clearly labeled as being for one year) if:

A. The initial term is not clear, or

B. The consumer has agreed to pay a premium or fee that is assessed periodically but the consumer is under no obligation to continue the coverage after making the initial payment.

ii. For example:

A. A credit life insurance policy providing coverage for a 30-year mortgage loan has an initial term of 30 years even though premium payments are made monthly and the consumer is not required to continue the coverage after making the initial payment. The creditor has the option of making disclosures on the basis of coverage for one-year.◄

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4. In Supplement I to Part 226, under *Section 226.5a—Credit and Charge Card Applications and Solicitations,* the following amendments would be made:

a. Under *Paragraph 5a(b)(1) Annual Percentage Rate.*, a new paragraph 7. is added;

b. Under *Paragraph 5a(b)(9) Late Payment Fee.*, a new paragraph 2. is added; and

c. Under *Paragraph 5a(b)(10) Over-the-Limit Fee.*, a new paragraph 2. is added.

The additions would read as follows:

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Subpart B—Open End Credit

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§ 226.5a Credit and Charge Card Applications and Solicitations.

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5a(b) Required Disclosures.

5a(b)(1) Annual Percentage Rate.

* * * * *

►7. *Increased penalty rates.* If the initial rate will increase upon the occurrence of a specified event such as a late payment or an extension of credit that exceeds the credit limit, the card issuer must disclose along with the initial rate the increased penalty rate that would apply. The issuer must also disclose the specific condition or conditions for imposing the increased rate, such as "22% APR, if 60 days late." The issuer may disclose the period for which the increased rate will remain in effect, such as "until you make three timely payments." A creditor need not disclose an increased rate that is imposed when credit privileges are permanently terminated.◄

* * * * *

5a(b)(9) Late Payment Fee.

* * * * *

►2. *Increased penalty rates.* If the annual percentage rate will increase as a result of late payments, the disclosures under § 226.5a(b)(9) must include a reference to the disclosures required under § 226.5a(b)(1).◄

5a(b)(10) Over-the-Limit Fee.

* * * * *

►2. *Increased penalty rates.* If the annual percentage rate will increase as a result of the cardholder's exceeding the credit limit, the disclosures under § 226.5a(b)(10) must

include a reference to the disclosures required under § 226.5a(b)(1).◄

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5. In Supplement I to Part 226, *Section 226.6—Initial Disclosure Statement*, under *Paragraph 6(a)(2).*, a new paragraph 11. would be added to read as follows:

* * * * *

Section 226.6—Initial Disclosure Statement

* * * * *

6(a) Finance charge.

* * * * *

Paragraph 6(a)(2).

* * * * *

►11. *Increased penalty rates.* If the annual percentage rate will increase upon the occurrence of a specified event such as a late payment or an extension of credit that exceeds the credit limit, the creditor must disclose along with the initial rate the increased penalty rate that would apply. The issuer must also disclose the specific condition for imposing the increased rate, such as "22% APR, if 60 days late." The issuer may disclose the period for which the increased rate will remain in effect. A creditor need not disclose an increased rate that is imposed when credit privileges are permanently terminated.◄

* * * * *

6. In Supplement I to Part 226, under *Section 226.7—Periodic Statement,* the following amendments would be made:

a. Under introductory text, a new paragraph 3. would be added;

b. Under *Paragraph 7(e) Balance on which finance charge computed.*, a new paragraph 10. would be added;

c. Under *Paragraph 7(f) Amount of finance charge.*, a new paragraph 9. would be added; and

d. Under *Paragraph 7(j) Free-ride period.*, a new paragraph 2. would be added.

The additions would read as follows:

* * * * *

§ 226.7 Periodic Statement.

* * * * *

►3. *Same-as-cash transactions.* Some creditors offer a deferred payment feature for purchases in which consumers avoid finance charges if the purchase balance is paid in full by a certain date. For example, no finance charge is imposed on a $500 purchase made in January if the $500 balance is paid by March 31.

i. *Balances subject to periodic rates.* Under § 226.7(e), creditors must disclose the balances subject to periodic rates during a billing cycle. The deferred payment balance ($500 in this example) is not subject to a periodic rate for billing cycles between the date of purchase and the payment due date. Periodic statements sent for those billing cycles should not include the deferred payment balance in the balance disclosed under § 226.7(e). At the creditor's option, this amount may be disclosed on periodic statements provided it is identified by a term other than the term used to identify the balance disclosed under § 226.7(e).

ii. *Amount of finance charge.* Under § 226.7(f), creditors must disclose finance charges imposed during a billing cycle. For some same-as-cash purchases, the creditor may impose a finance charge from the date of purchase if the deferred payment balance ($500 in this example) is not paid in full by the due date, but will not impose finance charges for billing cycles between the date of purchase and the payment due date. Periodic statements for billing cycles preceding the payment due date should not include in the finance charge disclosed under § 226.7(f) the amounts a consumer may owe if the deferred payment balance is not paid in full by the payment due date. In this example, the February periodic statement should not identify as finance charges interest attributable to the $500 January purchase. At the creditor's option, this amount may be disclosed on periodic statements provided it is identified by a term other than "finance charge."

iii. *Free-ride period.* Assuming monthly billing cycles ending at month-end and a free-ride period ending on the 25th of the following month, here are two examples illustrating how a creditor may comply with the requirement to disclose the free-ride period applicable to a deferred payment balance ($500 in this example), and with the 14-day rule for mailing or delivering periodic statements before imposing finance charges (see § 226.5):

A. The creditor could include the $500 purchase on the periodic statement reflecting account activity for February and sent on March 1 and identify March 31 as the payment due date for the $500 purchase. (The creditor could also identify March 31 as the payment due date for any other amounts due on March 25.)

B. The creditor could include the $500 purchase on the periodic statement reflecting activity for March and sent on April 1 and identify April 25 as the payment due date for the $500 purchase, permitting the consumer to avoid finance charges if the $500 is paid in full by April 25.◄

* * * * *

7(e) Balance on which finance charge computed.

* * * * *

►10. *Same-as-cash transactions.* See comment 7–3(i).◄

7(f) Amount of finance charge.

* * * * *

►9. *Same-as-cash transactions.* See comment 7–3(ii).◄

* * * * *

7(j) *Free-ride period.*

* * * * *

►2. *Same-as-cash transactions.* See comment 7–3(iii).◄

* * * * *

7. In Supplement I to Part 226, *Section 226.14—Determination of Annual Percentage Rate,* under *Paragraph 14(c) Annual percentage rate for periodic statements.*, paragraph 5. and paragraph 10. would revised to read as follows:

* * * * *

§ 226.14 Determination of Annual Percentage Rate.

* * * * *

14(c) Annual percentage rate for periodic statements.

* * * * *

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

A. A loan fee of $10 imposed on a particular advance.

B. A charge of 3% of the amount of each transaction.

ii. 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. ►In a multifeatured plan, creditors may separately consider each bona fide feature in the calculation of the denominator.◄ For further explanation and examples of how to determine the components of this formula, see appendix F.

* * * * *

10. ◄*Prior-cycle adjustments.* i. The annual percentage rate reflects the finance charges imposed during the billing cycle. However, finance charges imposed during the billing cycle may relate to activity in a prior cycle. Examples of circumstances when this may occur are:

A. A cash advance that occurs on the last day of a billing cycle on an account that uses the transaction date to figure finance charges, and it is impracticable to post the transaction until the following cycle.

B. An adjustment to the finance charge is made following the resolution of a billing error dispute.

C. A consumer fails to pay the purchase balance under a deferred payment feature by the payment due date, and finance charges are imposed from the date of purchase.

ii. Finance charges relating to activity in prior cycles should be reflected in the annual percentage rate for the billing cycle in which the charges are posted. If the creditor uses the quotient method to calculate the annual percentage rate, the numerator would include the amount of any transaction charges plus any other finance charges posted during the billing cycle. Balances relating to the finance charge adjustment may be included in the denominator if permitted by the legal obligation, the transaction was impracticable to post in the previous cycle due to its timing, or the charge relates to an adjustment such as the resolution of a billing error dispute or an unintentional posting error. An annual percentage rate calculated under this paragraph shall not be less than the highest rate determined by multiplying each periodic rate imposed during the billing cycle by the number of periods in a year.◄ [*Transactions at end of billing cycle.* The annual percentage rate reflects transactions and charges imposed during the billing cycle. However, it may be impracticable to post a transaction that occurs at the end of a billing cycle until the following cycle, such as a cash advance that occurs on the last day of a billing cycle and is posted to the account in the following cycle. A card issuer that uses the date of the

transaction to figure finance charges should calculate the annual percentage rate as follows for the billing cycle in which the transaction and charges are posted:

i. The denominator is calculated as if the transaction occurred on the first day of the billing cycle; and

ii. The numerator includes the amount of the transaction charge plus all finance charges derived from the application of the periodic rate to the amount of the transaction (including all charges from a prior cycle).]

* * * * *

8. In Supplement I to Part 226, *Section 226.18—Content of Disclosures,* under *Paragraph 18(g) Payment schedule.,* the 18(g) heading would be revised, and a new paragraph 4. would be added to read as follows:

* * * * *

Subpart C—Closed End Credit

* * * * *

§ 226.18 Content of Disclosures.

* * * * *

[Paragraph] 18(g) Payment schedule.

* * * * *

►4. *Timing of payments.* Creditors must disclose when payments are due, including the calendar date that the beginning payment is due. For example, a creditor may disclose that payments are due "monthly beginning on July 1, 1998." A reference to the occurrence of a particular event, for example, disclosing that the first payment is due "30 days after the completion of construction," is not sufficient. If the beginning-payment date is unknown, the creditor must use an estimated date and label the disclosure as an estimate pursuant to § 226.17(c).◄

* * * * *

9. In Supplement I to Part 226, *Section 226.33—Requirements for Reverse Mortgages,* under *Paragraph 33(c)(1) Costs to consumer,* in paragraph 2., a new sentence is added at the end of the paragraph to read as follows:

* * * * *

Subpart E—Special Rules for Certain Home Mortgage Transactions

§ 226.33 Requirements for Reverse Mortgages.

* * * * *

33(c) Projected total cost of credit.

Paragraph 33(c)(1) Costs to consumer.

* * * * *

2. *Annuity costs.* * * * ►For example, this includes the costs of an annuity that a creditor offers, arranges, assists the consumer in purchasing, or that the creditor is aware the consumer is purchasing as a part of the transaction.◄

* * * * *

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, December 1, 1997.

William W. Wiles,

Secretary of the Board.

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