FEDERAL RESERVE BANK
OF DALLAS

DALLAS, TEXAS
75265-5906

April 12, 2002

Notice 02-17

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

SUBJECT

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

DETAILS

The Board of Governors of the Federal Reserve System has published revisions to the official staff commentary to Regulation Z, which implements the Truth in Lending Act. The revisions, which became effective April 9, 2002,

- Clarify how creditors who place Truth in Lending Act disclosures on the same document with the credit contract may satisfy the requirement for providing the disclosures in a form the consumer may keep before consummation and

- Provide guidance on disclosing costs for certain credit insurance policies and on the definition of "business day" for purposes of the right to rescind certain home-secured loans.

The Board is also publishing technical corrections to the commentary and regulation.

ATTACHMENT

A copy of the Board's notice as it appears on pages 16980–83, Vol. 67, No. 68 of the *Federal Register* dated April 9, 2002, is **attached**.

MORE INFORMATION

For more information, please contact Eugene Coy, (214) 922-6201, Banking Supervision Department. Paper copies of this notice or previous Federal Reserve Bank notices can be printed from our web site at **http://www.dallasfed.org/banking/notices/index.html**.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–1118]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z, which implements the Truth in Lending Act. The commentary applies and interprets the requirements of Regulation Z. The revisions clarify how creditors that place Truth in Lending Act disclosures on the same document with the credit contract may satisfy the requirement for providing the disclosures, in a form the consumer may keep, before consummation. In addition, the revisions provide guidance on disclosing costs for certain credit insurance policies and on the definition of ''business day'' for purposes of the right to rescind certain home-secured loans. The Board is also publishing technical corrections to the commentary and regulation.

DATES: The rule is effective April 9, 2002.

FOR FURTHER INFORMATION CONTACT: David A. Stein, Senior Attorney, or Dan S. Sokolov, 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, contact (202) 263–4869.

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. Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping for credit. TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions that involve their principal dwelling. In addition, the act regulates certain practices of creditors.

TILA 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. Good faith compliance with the commentary affords protection from liability under section 130(f) of TILA (15 U.S.C. 1640(f)). The commentary is a substitute for individual staff interpretations; it is updated periodically to address significant questions that arise.

In December 2001, the Board published for comment proposed changes to the commentary (66 FR 64381, December 13, 2001). The Board received approximately 50 comment letters. About half of the comments were from financial institutions, other creditors, and their representatives. Most of the remaining comment letters were from consumer advocates. The comment letters focused mainly on the proposed comment concerning disclosures placed on the same document with the credit contract. Although commenters generally supported the proposal, most requested additional clarifications. Commenters also supported the proposed clarification concerning disclosure of insurance premiums, but were divided on the proposed comment concerning the definition of ''business day.''

As discussed below, the commentary is being adopted substantially as proposed. In response to commenters' suggestions, some revisions have been made for clarity. In addition, several technical corrections are being made to the commentary and regulation. The

revisions represent a clarification of the existing law and do not impose new requirements.

Generally, updates to the Board's staff commentary are effective upon publication. Consistent with the requirements of TILA section 105(d), the Board typically provides an implementation period of six months or longer. During that period compliance with the published update is optional to afford creditors time to adjust their disclosure documents. The commentary revisions discussed below do not involve different disclosure requirements. Accordingly, the Board has determined that delayed implementation of the revisions is unnecessary.

II. Proposed Revisions

Subpart A—General

Section 226.2 Definitions and Rules of Construction

2(a) Definitions

2(a)(6) Business Day

Generally, when consumers have a right to rescind a home-secured loan, they may exercise the right until midnight of the third business day following consummation or the delivery of certain disclosures, whichever occurs last. For purposes of rescission, section 226.2(a)(6) defines ''business day'' to mean all calendar days except Sundays and the federal legal holidays listed in 5 U.S.C. 6103(a). The statute lists ten legal holidays; it identifies four holidays by a specific date (New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; Christmas Day, December 25). Comment 2(a)(6)-2 was proposed to clarify that for these four holidays, only the date specified in the statute is considered a legal holiday for purposes of rescission. Thus, if the date specified in the statute falls on a weekend, the Friday before the specified date or the Monday following it are considered business days even if government offices are closed in observance of the holiday.

Comments on this proposal were about evenly divided. Several industry trade associations supported the proposal. Some consumer advocates and a few commenters representing small financial institutions were concerned that confusion would result if weekdays observed as holidays are considered business days. Some commenters expressed concern that consumers might lose a day of their rescission period if they are unable to postmark or otherwise deliver their written notice of rescission on weekdays observed as holidays.

The comment is being adopted as proposed. The comment does not represent a new rule, but merely restates and clarifies the requirement contained in section 226.2(a)(6) of the regulation. Consumers' ability to exercise their right to rescind is not affected because consumers can mail a notice of rescission on the observed holiday; the notice is not required to be postmarked or delivered on that day. Consumers are not likely to be confused because the rescission notice must indicate the specific date that the rescission period expires. *See* § 226.15(b)(5), § 226.23(b)(1)(v). A creditor may extend the rescission period at its option.

Section 226.4 Finance Charge

4(d) Insurance and Debt Cancellation Coverage

Comment 4(d)–12(i) is adopted substantially as proposed. Under section 226.4(d), amounts paid for credit 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. As revised, comment 4(d)–12(i) clarifies that creditors have the option of providing disclosures on the basis of one year of coverage where the fee or premium for the coverage is assessed periodically and the consumer is under no obligation to continue the coverage. The revision clarifies that this option applies when the consumer can cancel the coverage, whether or not the consumer has made an initial payment. Those that commented on this aspect of the proposal generally supported the change.

Several industry commenters urged the Board to specify that unit-cost disclosures would be permissible when premiums for coverage on closed-end loans are assessed periodically and the coverage can be cancelled. Regulation Z permits unit-cost disclosures in closed-end transactions only in limited circumstances. See § 226.4(d)(1)(ii). Accordingly, the commenters' suggestion is beyond the scope of the proposed commentary revision.

Subpart B—Open-End Credit

Section 226.6 Initial Disclosure Statement

6(b) Other Charges

The Board is adopting a technical amendment to comment 6(b)–1 to conform the citation in paragraph vi. to comment 4(a)–4, as amended (60 FR 16771, April 3, 1995). No substantive change is intended.

Subpart C—Closed-End Credit

Section 226.17 General Disclosure Requirements

17(a) Form of Disclosures

The Board is adopting a technical amendment to footnote 38 to conform the citation regarding variable-rate disclosures to § 226.18(f)(1)(iv) of the regulation. No substantive change is intended.

17(b) Time of Disclosures

The Board proposed to add comment 17(b)–3 to clarify how creditors that use a single document for the credit contract and TILA disclosures may satisfy the requirement that disclosures be provided to the consumer before consummation in a form the consumer may keep. For the reasons discussed below, the comment is being adopted substantially as proposed.

The practice of putting TILA disclosures on the same document with the credit contract is common in connection with motor vehicle installment sales. Several recent court decisions have addressed whether creditors that use a single document must provide consumers with a separate copy of the disclosures to keep before providing a second copy that the consumer may execute to become obligated on the credit contract. The court decisions have not been uniform in their result.

The comment clarifies that creditors satisfy TILA by giving a copy of the document containing the disclosures to the consumer to read and sign. Commenters generally agreed with this aspect of the proposal. In response to commenters' suggestions, the final comment has been revised to clarify that a creditor need not give the consumer two copies.

Comment 17(b)–3 also clarifies that it is not sufficient for the creditor merely to show the document containing the TILA disclosures to the consumer before the consumer signs and becomes obligated. Rather, a creditor must give the disclosures to the consumer, so that the consumer is free to take possession of and review the disclosures in their entirety before signing.

Commenters disagreed over the extent to which the comment should address the ability of a consumer to take physical possession of, and keep, the document containing the disclosures. Consumer advocates believe that a consumer should be able to take possession of and keep the disclosure whether or not the consumer consummates the transaction at that time. Some industry commenters

contended that the creditor need only present or show the document to the consumer.

Comment 17(b)–3 is being adopted substantially as proposed. Allowing a consumer to take possession of and review TILA disclosures in their entirety—including any required information that may be on the reverse side or continued on the next page—is essential to meaningful disclosure and fulfillment of the regulation's requirement that disclosure be in a form the consumer may keep. Whether or not the consumer signs and becomes obligated, the consumer will have received a copy of the disclosures.

Some industry commenters asserted that even though creditors must provide consumers written disclosures before consummation, there is no requirement that consumers receive a copy to keep at the time the credit transaction is consummated. These commenters suggest that creditors are required only to give consumers a copy to keep within a reasonable time after consummation. The Board believes such a result would be inconsistent with the regulation's requirement that consumers receive a copy, in a form they may keep, before consummation. Under the final comment as adopted, consumers must receive a copy to keep at the time they become obligated.

A few commenters were concerned that the proposal could be interpreted to require a creditor to keep open indefinitely its offer of credit if a consumer decides not to sign and retains a copy of the unsigned document. The extent to which an offer of credit remains open is a matter of state law and is not determined by TILA.

Several commenters questioned whether the language in the proposed comment allowing consumers to ''take possession'' of the disclosures was consistent with creditors' ability to provide the disclosures electronically if the consumer consents. Comment 17(b)–3 is not intended to affect the rules governing the use of electronic communications under Regulation Z.

Subpart E—Special Rules for Certain Home Mortgage Transactions

Section 226.32 Requirements for Certain Closed-end Home Mortgages

32(c) Disclosures

The Board is republishing comment 32(c)(3)–3 in its entirety, as amended in December 2001, to reinsert language that was inadvertently deleted due to a technical error (66 FR 65604, December 20, 2001). A technical amendment is also made to comment 32(c)(4)–1 to conform a citation to section 226.19(b)(2), as amended. No substantive changes are intended.

List of Subjects in 12 CFR Part 226

Consumer protection, Disclosures, Federal Reserve System, Truth in lending.

Text of Revisions

Comments are numbered to comply with **Federal Register** publication rules. For the reasons set forth in the preamble, the Board amends 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).

§ 226.17 [Amended]

2. Section 226.17, in paragraph (a)(1), footnote 38, is amended by removing ''§ 226.18(f)(4)'' and adding ''§ 226.18(f)(1)(iv)'' in its place.

3. In Supplement I to Part 226:

a. Under *Section 226.2—Definitions and Rules of Construction, under 2(a)(6) Business Day,* paragraph 2. is revised.

b. Under *Section 226.4—Finance Charge,* under *4(d) Insurance and Debt Cancellation Coverage,* paragraph 12. is revised.

c. Under *Section 226.6—Initial Disclosure Requirements,* under *Paragraph 6(b),* paragraph 1.vi. is amended by removing ''comment 4(a)–5'' and adding ''comment 4(a)–4'' in its place.

d. Under *Section 226.17—General Disclosure Requirements,* under *17(b) Time of Disclosures,* a new paragraph 3. is added.

e. Under *Section 226.32—Requirements for Certain Closed-End Home Mortgages,* under *Paragraph 32(c)(3),* paragraph 1. is revised; and under *Paragraph 32(c)(4),* paragraph 1. is amended by removing ''§ 226.19(b)(2)(x)'' and adding § 226.19(b)(2)(viii)(B)'' in its place.

Supplement I to Part 226—Official Staff Interpretations

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Subpart A—General

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§ 226.2—Definition and Rules of Construction

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2(a)(6) Business day.

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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 U.S.C. 6103(a)) applies when the right of rescission or mortgages subject to § 226.32 are involved. (See also comment 31(c)(1)–1.) Four federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, federal offices and other entities might observe the holiday on the preceding Friday (July 3). The observed holiday (in the example, July 3) is a business day for purposes of rescission or the delivery of disclosures for certain high-cost mortgages covered by § 226.32.

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§ 226.4—Finance Charge

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4(d) Insurance and debt cancellation coverage.

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12. *Initial term; alternative.* i. *General.* A creditor has the option of providing cost disclosures on the basis of an assumed initial term 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 indefinite or 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, whether or not the consumer has made an initial payment.

ii. *Open-end plans.* For open-end plans, a creditor also has the option of providing unit-cost disclosure on the basis of a period that is less than one year if the consumer has agreed to pay a premium or fee that is assessed periodically, for example monthly, but the consumer is under no obligation to continue the coverage.

iii. *Examples.* To illustrate:

A. A credit life insurance policy providing coverage for a 30-year mortgage loan has an initial term of 30 years, even though premiums are paid monthly and the consumer is not required to continue the coverage. Disclosures may be based on the initial term, but the creditor also has the option of making disclosures on the basis of coverage for an assumed initial term of one year.

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Subpart C—Closed-End Credit

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§ 226.17—General Disclosure Requirements

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17(b) Time of disclosures.

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3. *Disclosures provided on credit contracts.* Creditors must give the required disclosures to the consumer in writing, in a form that the consumer may keep, before consummation of the transaction. *See* § 226.17(a)(1) and (b). Sometimes the disclosures are placed on the

same document with the credit contract. Creditors are not required to give the consumer two separate copies of the document before consummation, one for the consumer to keep and a second copy for the consumer to execute. The disclosure requirement is satisfied if the creditor gives a copy of the document containing the unexecuted credit contract and disclosures to the consumer to read and sign; and the consumer receives a copy to keep at the time the consumer becomes obligated. It is not sufficient for the creditor merely to show the consumer the document containing the disclosures before the consumer signs and becomes obligated. The consumer must be free to take possession of and review the document in its entirety before signing.

i. *Example.* To illustrate:

A. A creditor gives a consumer a multiple-copy form containing a credit agreement and TILA disclosures. The consumer reviews and signs the form and returns it to the creditor, who separates the copies and gives one copy to the consumer to keep. The creditor has satisfied the disclosure requirement.

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Subpart E—Special Rules for Certain Home Mortgage Transactions

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§ 226.32—Requirements for Certain Closed-End Home Mortgages

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Paragraph 32(c)(3) Regular payment; balloon payment.

1. *General.* The regular payment is the amount due from the borrower at regular intervals, such as monthly, bimonthly, quarterly, or annually. There must be at least two payments, and the payments must be in an amount and at such intervals that they fully amortize the amount owed. In disclosing the regular payment, creditors may rely on the rules set forth in § 226.18(g); however, the amounts for voluntary items, such as credit life insurance, may be included in the regular payment disclosure only if the consumer has previously agreed to the amounts.

i. If the loan has more than one payment level, the regular payment for each level must be disclosed. For example:

A. In a 30-year graduated payment mortgage where there will be payments of $300 for the first 120 months, $400 for the next 120 months, and $500 for the last 120 months, each payment amount must be disclosed, along with the length of time that the payment will be in effect.

B. If interest and principal are paid at different times, the regular amount for each must be disclosed.

C. In discounted or premium variable-rate transactions where the creditor sets the initial interest rate and later rate adjustments are determined by an index or formula, the creditor must disclose both the initial payment based on the discount or premium and the payment that will be in effect thereafter. Additional explanatory material which does not detract from the required disclosures may accompany the disclosed amounts. For example, if a monthly payment is $250 for the first six months and then increases based on an index and margin, the creditor could use language such as the following: ''Your regular monthly payment will be $250 for six months. After six months your regular monthly payment will be based on an index and margin, which currently would make your payment $350. Your actual payment at that time may be higher or lower.''

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By order of the Board of Governors of the Federal Reserve System, acting through the Director of the Division of Consumer and Community Affairs and the Secretary of the Board under delegated authority, April 2, 2002.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 02–8373 Filed 4–8–02; 8:45 am]

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