FEDERAL RESERVE
press release

For immediate release. January 29, 1970.

The Board of Governors of the Federal Reserve System today issued eight interpretations of provisions in its Truth in Lending Regulation Z including three changes in interpretations issued previously. Interpretations issued today relate to:

Premiums for vendor's single interest insurance required by creditor (amendment to previous interpretation).

Credit for business or commercial purposes--more than 4 family housing units.

Renewals of notes (amendment to previous interpretation).

Disclosures on multiple advance loans.

Premiums for insurance added to an existing balance.

Disclosure for demand loans.

Mortgages with demand features.

Refinancing and increasing--disclosures and effects on the right of rescission (amendment to previous interpretation).

A copy of each interpretation is attached.

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TITLE 12 - BANKS AND BANKING

CHAPTER II - FEDERAL RESERVE SYSTEM

SUBCHAPTER A - BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Z]

PART 226 - TRUTH IN LENDING

Miscellaneous Interpretations

Interpretation § 226.404 is amended to read as follows:

§ 226.404 Premiums for vendor's single interest insurance required by creditor

The question arises whether charges or premiums for single interest insurance (Vendor's Single Interest Insurance) written in connection with a credit transaction may be excluded from the finance charge under § 226.4(a)(6) if the insurer waives subrogation.

If the insurer waives all right of subrogation against the customer in a single interest policy of insurance against loss of or damage to property (which may include coverage for skip, concealment, conversion, and embezzlement) written in connection with a credit transaction, and the creditor complies with the requirements of § 226.4(a)(6), charges or premiums for such insurance may be excluded from the amount of the finance charge on that transaction. However, if the insurer does not so waive subrogation in such policy of insurance, the charges or premiums shall be included in the finance charge.

(Interprets and applies 15 U.S.C. 1605)

§ 226.302 Credit for business or commercial purposes--more than 4 family housing units

Under § 226.3(a), extensions of credit for business or commercial purposes, other than agricultural purposes, are not subject to Regulation Z. The question arises as to whether an extension of credit relating to a dwelling (as defined in § 226.2(p)) which contains more than 4 family housing units is an extension of credit for business or commercial purposes.

Credit extended to an owner of a dwelling containing more than 4 family housing units for the purpose of acquiring, financing, refinancing, improving, or maintaining that dwelling is an extension of credit for business or commercial purposes.

(Interprets and applies 15 U.S.C. 1603)

Interpretation § 226.811 is amended to read as follows:

§ 226.811 Renewals of notes

Any renewal of an extension of credit providing for payment of the full principal sum on a specified date shall not be considered a refinancing under § 226. (j), and no disclosures need be made in connection with such renewal, provided:

(i) All disclosures required under this Part were made in connection with the original extension of credit or a prior renewal thereof;

(ii) The amount of the renewal does not exceed the amount of the unpaid balance plus any accrued and unpaid finance charge;

(iii) The annual percentage rate (or rates) previously disclosed is not increased; and

(iv) The period for which renewal is made does not exceed by more than 4 days the period of the extension of credit for which disclosures were made.

In instances in which disclosures are required to be made and renewal is made by mail, the creditor may not know whether the customer will reduce his obligation by a payment on principal or, if reduced, the amount of that reduction. The question arises as to what disclosures should be made by mail to the customer in these circumstances.

If the creditor knows the amount of the principal payment, all disclosures should be made on the basis of the resulting new amount financed. If, however, the creditor does not know whether the customer will reduce his original obligation, or if so, by how much, he should disclose on the assumption that there will be no reduction. In such circumstances, at the creditors option, he may make one or more additional disclosures based on one or more examples of graduated

principal reduction. For example, if a single payment note for $1,000 at 7% is proposed to be renewed for $1,000 at 8% for 3 months, in addition to the other required disclosures, the creditor should disclose an amount financed of $1,000 with a finance charge of $20, and may, in addition, disclose that with a principal payment of $300 the amount financed would be $700 with a finance charge of $14, and with a principal payment of $500 the amount financed would be $500 with a finance charge of $10.

(Interprets and applies 15 U.S.C. 1639)

§ 226.813 Disclosures on multiple advance loans

In connection with construction and other multiple advance loans under § 226.8(i), which are payable in a single sum or permanently financed by the same creditor at maturity of the construction phase with interest only payable up to such maturity, and in which either the amount or date of an advance is not determinable, the question arises whether a method might be utilized to estimate the information to be disclosed under § 226.8(b)(2) and (3) and (d)(3).

In such cases, at the creditor's option, required information may be estimated and disclosed as follows:

(1) The following mathematical equations based upon assumed continuous advances may be utilized in estimating the amount of the interest component of the finance charge and the annual percentage rate by substituting the appropriate numerical amounts for the following symbols in the equations:

(i) Symbols:

L = Amount of loan commitment.

r = Stated annual interest rate expressed as a decimal figure.

n = Number of interest payments to be made to maturity.

m = Number of interest periods (unit-periods) in 1 year.

? = Total amount of any prepaid finance charge under § 226.8(e).

B = Amount of any required deposit balance under § 226.8(e).

(ii) If interest is computed from the date of each advance on only the amounts advanced:

$$\text{Estimated annual percentage rate} = \frac{nrL + 2mP}{n(L - 2P - 2B)}$$

$$\text{Estimated interest finance charge} = \frac{nrL}{2m}$$

(iii) If interest is computed on the full amount of the commitment without regard for the dates of disbursements or actual amounts disbursed:

$$\text{Estimated annual percentage rate} = \frac{2nrL + 2mP}{n(L - 2P - 2B)}$$

$$\text{Estimated interest finance charge} = \frac{nrL}{m}$$

(2) If the equations under subdivision (ii) of paragraph (1) are utilized, the amounts of any required interest payments during the construction phase may be omitte. in making the disclosures required under § 226.8(b)(3); however, if the equations under subdivision (iii) of paragraph (1) are utilized, then the amount of each scheduled interest payment shall be disclosed as required under § 226.8(b)(3).

(3) In the case of a combination construction loan and permanent financing provided by the same creditor:

(i) The amount of interest finance charge to be paid prior to the due date of the first amortization payment shall be estimated as prescribed under subdivisions (ii) or (iii) of paragraph (1) as the case may be and shall be treated as prepaid finance charge for computational purposes; and

(ii) Estimation of the annual percentage rate shall be made without regard to the number of interest only payments to be made, assuming the first payment period to be that interval between the date the finance charge begins to accrue and the date the first amortization payment is due.

4. Disclosures made in accordance with this interpretation, when made along with the other disclosures required under § 226.8(b) and (d), shall constitute "all other material disclosures required under this Part" referred to under § 226.9(a):

Example I

A $20,000 construction loan commitment on which the precise dates or amounts of advances are not determinable. The obligation bears a stated 6% interest rate and interest is to be paid monthly on the amounts advanced, and the total of the amounts advanced under the commitment plus any unpaid interest is due and payable at the end of nine months from the date the finance charge begins to accrue. There is a loan fee of 1% ($200), but there is no required deposit balance. Substituting these terms for the symbols, the equations become:

$$\frac{(9 \times .06 \times 20{,}000)+(2 \times 12 \times 200)}{9 \times [(20{,}000 - (2 \times 200)]} =$$

.0884 or 8.84% or 8-3/4% estimated annual percentage rate.

$\frac{9 \times .06 \times 20{,}000}{2 \times 12}$ = 450 or $450 estimated interest finance charge component of the finance charge.

If the terms stated in the example were changed so that interest would be computed on the full amount of the commitment from the date the finance charge begins to accrue without regard for the dates of disbursements or actual amounts of funds disbursed, the equations under (iii) above become:

$\frac{(2 \times 9 \times .06 \times 20{,}000)+(2 \times 12 \times 200)}{9 \times [(20{,}000 - (2 \times 200)]}$ = .1497 or 14.97% or 15% estimated annual percentage rate.

$\frac{9 \times .06 \times 20{,}000}{12}$ = 900 or $900 estimated interest finance charge component of the finance charge. This interest would be payable in 9 monthly payments of $100 each.

Example II

A $20,000 construction loan followed by permanent financing in same amount. Six per cent interest. One point loan fee. Nine months to maturity of construction phase. Nine monthly payments of interest only during construction phase. Twenty-year maturity on permanent financing to be amortized in 240 equal monthly payments including interest and principal.

From mortgage amortization tables:

Amortization of a $20,000 6% 20-year loan in 240 equal monthly payments including interest and principal requires each monthly payment to be $143.29.

Total of 240 payments = 240 x $143.29 = $34,389.60

Subtract amount of loan principal	$20,000.00
Interest finance charge on permanent financing	$14,389.60

Add:	Estimated interest finance charge on construction phase (pursuant to subdivision (ii))	450.00
Add:	Loan fee 1 point	200.00
	Estimated finance charge	$15,039.60

(If the interest on the construction phase is computed on the full amount of the commitment for the full time to maturity without regard for the dates of disbursements or actual amounts disbursed pursuant to subdivision (iii), the estimated interest finance charge for the construction phase would be $900.00 which would result in a total estimated finance charge of $15,489.60.)

Loan fee 1 point prepaid finance charge	$ 200.00
For computational purposes consider interest to be paid on construction phase as prepaid (not to be disclosed as prepaid).	$ 450.00
Total amount treated as prepaid finance charge for computational purposes	$ 650.00

	Computational Purposes	Disclosure Purposes
Amount of loan	$20,000	$20,000
Deduct total of estimated finance charge treated as prepaid	$ 650	
Deduct actual amount of prepaid finance charge		$ 200
Estimated amount financed for computational purposes	$19,350	
Amount financed to be disclosed		$19,800

Adjust first payment period (period of construction loan plus period from maturity date of construction loan to due date of first amortization payment) by dividing the period of the construction loan by 2 and adding the period of time between the maturity date of the construction loan and the date the first amortization payment is due.

9 months divided by 2 = 4 1/2 months plus 1 month = 5 1/2 months

From Appendix A (page A2) of Volume I of the Board's Annual Percentage Rate Tables, read across to 5 months and on the line below opposite 15 days (1/2 month) read + 9.0. This adjustment should be added to the number of regular amortization payments to determine the number of payments in utilizing the Annual Percentage Rate Tables:

240 monthly payments + adjustment 9.0 = 249

Following the directions on page 1 of Volume I:

Estimated finance charge $15,039.60 x 100 = $1,503,960 which should be divided by the estimated amount financed for computational purposes:

$1,503,960 ÷ 19,350 = $77.72 estimated finance charge per $100 of estimated amount financed for computational purposes.

Refer to page 309M of Volume I, read down number of payments column to 249; read across to 78.71 (which is nearest to $77.72 computed above), and read up to 6.25% which is the estimated annual percentage rate to be disclosed.

In the example where the interest on the construction phase is computed on the full amount of the commitment without regard for the dates of advances or actual amounts advanced, the estimated finance charge per

$100 of amount financed is $81.96. On page 309M of Volume I, read down to the 249th payment line and across to $32.39 which is the nearest amount to $81.96, and read up to 6.50% which is the estimated annual percentage rate to be disclosed.

(Interprets and applies 15 U.S.C. 1638 and 15 U.S.C. 1639)

§ 226.814 Premiums for insurance added to an existing balance

Subsequent to the consummation of a consumer credit transaction the customer may wish to purchase optional insurance in connection with the obligation. Typically, mortgage life and disability insurance may be offered to the customer at some date after consummation under a plan in which the lender will advance the amount of the premium due and add that amount to the existing unpaid balance of the obligation. Generally, each instalment on the original obligation paid during the period before the next premium is due will be increased proportionately to liquidate the amount of the additional advance plus any finance charge. Additional advances are made automatically for renewal premiums as they become due unless the borrower requests discontinuance of the coverage. The question arises as to the required disclosures.

In such cases the insurance agreement may be considered a single separate transaction, and the disclosures required under § 226.8, at the creditor's option, need be made only prior to the time the agreement is executed and only with respect to the amount of the initial advance. For example, a mortgage life and disability insurance plan in which the annual premium advanced was $145 repayable in 12 monthly instalments of $12.61 added to the regular monthly mortgage payments would be disclosed as an "amount financed" of $145, a "finance charge" of $6.32, and a "total of payments" of $151.32. Additional disclosures as applicable under § 226.8 would, of course, be made. If, as in some cases, only a portion of the advance is liquidated during the premium period with the remainder payable at the end of the mortgage contract, the creditor would likewise calculate the amount of finance charge which would accrue on the advance until paid in full.

principal reduction. For example, if a single payment note for $1,000 at 7% is proposed to be renewed for $1,000 at 8% for 3 months, in addition to the other required disclosures, the creditor should disclose an amount financed of $1,000 with a finance charge of $20, and may, in addition, disclose that with a principal payment of $300 the amount financed would be $700 with a finance charge of $14, and with a principal payment of $500 the amount financed would be $500 with a finance charge of $10.

(Interprets and applies 15 U.S.C. 1639)

§ 226.815 Disclosure for demand loans

Section 226.8(b)(3) requires a creditor to disclose the number, amount and due dates or periods of payments scheduled to repay an extension of credit other than open end and, in appropriate cases, the total of payments. The question arises as to how these requirements should be met in the case of demand loans.

Section 226.4(g) provides that for the purpose of calculating the finance charge and annual percentage rate, demand loans are considered to have a one-half year maturity unless the obligation is alternatively payable upon a stated maturity, in which case the stated maturity shall be used.

In order to comply with the requirements of § 226.8(b)(3), if no alternative maturity date is specified, the creditor need disclose only the due dates or periods of payments of all scheduled interest payments for the first one-half year. In such cases, the creditor need not disclose the number, amounts or total of payments or identify any balloon payment. Effective May 1, 1970, creditors shall disclose the fact that the obligation is payable on demand.

If an alternative maturity date is specified, all disclosures required under § 226.8(b)(3) shall be made, using that date.

(Interprets and applies 15 U.S.C. 1639)

§ 226.816 Mortgages with demand features

In some cases real estate mortgages are written for a stated period, for example one year, with the provision that they shall be payable on demand after expiration of that period, provided that until such demand is made the principal and interest shall be paid in scheduled periodic instalments until paid in full. The obligation is thus payable according to a specified amortization schedule subject to the holder's right to demand payment after the stated period.

The question arises whether the creditor may make disclosures based on the specified amortization schedule or whether disclosures must be made on the basis of the maturity established by the expiration of the stated period.

In such cases the creditor may make disclosures based on the specified amortization schedule, provided he discloses clearly and conspicuously that the obligation is payable on demand after the stated period together with the fact that disclosures are made on the basis of the specified amortization schedule. Otherwise, disclosures shall be based upon the earliest date demand for payment in full may be made under the terms of the mortgage showing the unpaid balance due at that time as a "balloon payment."

The disclosure requirements of this interpretation shall become effective May 1, 1970.

(Interprets and applies 15 U.S.C. 1639)

Interpretation § 226.903 is amended to read as follows:

§ 226.903 Refinancing and increasing--disclosures and effects on the right of rescission

In some cases the creditor of an obligation will refinance that obligation at the request of a customer by permitting the customer to execute a new note, contract, or other document evidencing the transaction under the terms of which one or more of the original credit terms, including the maturity date of the obligation, are changed. Except as provided in § 226.811,[1/] such refinancing constitutes a new transaction, and all disclosures required under § 226.8 must be made. The question arises as to whether that transaction is subject to the right of rescission under § 226.9 where the obligation is already secured by a security interest in real property which is used or expected to be used as the principal residence of that customer.

If the amount of such new transaction does not exceed the amount of the unpaid balance plus any accrued and unpaid finance charge on the existing obligation, § 226.9 does not apply to the transaction.

If, however, such new transaction is for an increased amount, that is, for an amount in excess of the amount of the unpaid balance plus any accrued and unpaid finance charge on the existing obligation, § 226.9 applies to the transaction. However, such right of rescission applies only to such excess and does not affect the existing obligation (or related security interest) for the unpaid balance plus accrued unpaid finance charge.

[1/] The underscored language was inserted to conform this interpretation to interpretation § 226.811, as amended.

If a transaction is refinanced by a creditor other than the creditor of the existing obligation, the entire transaction is subject to § 226.9.

(Interprets and applies 15 U.S.C. 1639)

Dated at Washington, D. C., the 28th day of January, 1970.

By order of the Board of Governors.

(SEAL)

(Signed) Kenneth A. Kenyon
Kenneth A. Kenyon,
Deputy Secretary.