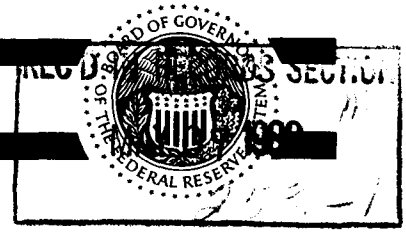
FEDERAL RESERVE press release



For immediate release May 7, 1982

The Federal Reserve Board staff today placed on the record for comment a proposed updating of its Commentary on the Board's Regulation Z.

The staff asked for comment by June 28, 1982.

The Commentary, published last October, interprets Regulation Z, as revised to conform to the Truth in Lending Simplification Act of 1980. Creditors may comply at present with revised Regulation Z and Commentary, but compliance does not become mandatory until October 1, 1982, when the revised statute becomes mandatory. The effective date of the Commentary revisions will be not earlier than April 1, 1983, in order to give creditors time for adjustment of forms and procedures.

The proposed updating of the Commentary generally gives creditors more flexibility in making disclosures, while preserving basic consumer protections. As with the Commentary itself, the proposed revisions of it are designed to provide general guidance in applying Regulation Z to specific types of transactions. Compliance with the Commentary is regarded as compliance with Regulation Z on matters covered by the Commentary.

The proposed updating of the Commentary is attached. New language is indicated by bold-face arrows. Deletions are enclosed in brackets.

The Commentary addresses, among other things, what base rate may be used in disclosures required for variable-rate open end credit plans and proposes a change that would facilitate the use of a creditor's prime rate as the base rate in such credit arrangements.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

TRUTH IN LENDING

Proposed Official Staff Commentary Update

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed official staff interpretation.

SUMMARY: In accordance with Appendix C to 12 CFR 226, the staff of the Federal Reserve Board is publishing for comment a proposed update to the official staff commentary to Regulation Z (Truth in Lending), as revised effective April 1, 1981. The commentary was published in the Federal Register on October 9, 1981 (46 FR 50288) and became effective October 13, 1981.

DATE: Comments must be received on or before June 28, 1982.

ADDRESS: Comments should be mailed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washington, D.C. between 8:45 a.m. and 5:15 p.m. To aid in their consideration, comments should include a reference to TIL-1, and discussion of each section should begin on a separate page. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

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

Subpart A - Gerald Hurst, Rugenia Silver

Subpart B and Appendices - Ruth Amberg, Jesse Filkins, Lynn Goldfaden, Gerald Hurst, John Wood

Subpart C and Appendices - Clarence Cain, Rugenia Silver, Susan Werthan, Claudia Yarus, Steven Zeisel

SUPPLEMENTARY INFORMATION: (1) General. Effective October 13, 1981, an official staff commentary was published to interpret Regulation Z, as revised effective April 1, 1981. Creditors now have the option of complying with revised Regulation Z and the commentary, but compliance does not become mandatory until October 1, 1982 (Pub.L. 97-110, December 26, 1981). The commentary is designed to provide general guidance to creditors in applying the regulation to specific transactions. Although each unique credit plan cannot be individually addressed in the commentary, periodic updates will provide the vehicle for additional staff interpretations that may be necessary as new questions arise.

In revising the commentary, an attempt is being made to avoid revisions that would require modifications to forms that have been prepared based on the existing regulation and commentary. The types of changes being proposed generally give creditors more flexibility in making disclosures, while preserving basic consumer protections. Changes generally will be made only when necessary to respond to significant questions that have arisen since the commentary's issuance or to clarify ambiguous language. Purely editorial changes are being avoided. However, because this is the first update to the commentary, some technical and editorial changes have been necessary in order to expedite adjustment to the commentary's new material and format. Although in most cases the location of comments has not been affected, some have been renumbered as a result of the deletion or addition of material.

Certain conventions have been used to highlight the revised language in the commentary. New language is highlighted by bold-faced arrows, while language that has been deleted is set off with brackets. Although the inclusion of existing commentary language adds to the length of this document, this format seems to be the most helpful way of pointing out proposed changes.

Comments must be received by June 28, 1982. In order to expedite analysis of the comments, commenters are requested to identify comments by section and paragraph numbers and to begin discussion of each section on a separate page. If comments are received on issues not raised by the proposed revisions, these comments would most likely be considered for possible inclusion in the next commentary update.

Final revisions will be published in the Federal Register; it is anticipated that final publication will be no later than the beginning of September. Although creditors will be able to rely on the revisions at that time, the applicability of the revisions will be optional until April 1, 1983, which will be specified in the final rule document. The later date will be provided to minimize any difficulties that creditors may experieince in adjusting to the revisions.

(2) Proposed Revisions. Following is a brief description of the revisions contained in the commentary update.

INTRODUCTION

Comment I-3 would be amended to reference the regulation's effective date of October 1, 1982, in accordance with Pub. L. 97-110 (December 26, 1981).

SUBPART A - GENERAL

SECTION 226.2 -- Definitions and Rules of Construction

2(a)(3) "Arranger of Credit"

Comment 2(a)(3)-6 would be added to explain the Board's recent amendment to § 226.2(a)(3) of the regulation (47 FR 7391, Feb. 19, 1982) dealing with real estate brokers.

2(a)(13) "Consummation"

Comment 2(a)(13)-1 would be revised to show that consummation may occur when the parties enter a commitment agreement that binds them to specific credit terms if under state law a contractual relationship is created. This revision should also ensure that consummation will occur no later than the time a note or contract is signed.

2(a)(23) "Prepaid Finance Charge"

Comment 2(a)(23)-2 would be revised to make clear that any portion of the finance charge paid at closing or settlement is considered a prepaid finance charge.

2(a)(24) "Residential Mortgage Transaction"

Comment 2(a)(24)-1 would be revised to add § 226.20(b) to the list of provisions using the term "residential mortgage transaction." Its omission was inadvertent.

2(a)(25) "Security Interest"

Comment 2(a)(25) would be revised to permit creditors at their option to disclose certain interests as security interests when uncertainty exists as to whether a particular interest is one of the excluded interests.

SECTION 226.4 -- Finance Charge

4(b) Examples of Finance Charge

Comment 4(b)(9)-3 would be added to explain the "regular price" definition in amended § 103(x) of the act and its relationship to cash discounts offered under § 167(b) of the act. The comment specifically discusses the displaying of prices for motor vehicle fuel.

4(c) Charges Excluded from the Finance Charge

Comment 4(c)(7)-1 would be revised to state that a charge for a lawyer's attendance at the closing is not a finance charge if the attorney attends to complete the documents.

4(d) Insurance

Comment 4(d)-11 would be added to clarify the concept of initial term of insurance coverage and to permit the initial term to be considered one year if the creditor is uncertain of the term.

SUBPART B - OPEN-END CREDIT

SECTION 226.5 -- General Disclosure Requirements

5(a) Form of Disclosures

Comment 5(a)(2)-1 would be revised to include additional examples of the application of the "more conspicuous" rule. These examples would clarify the rule; no substantive changes are intended.

5(b) Time of Disclosures

Comment 5(b)(1)-1 would be revised to explain more clearly when initial disclosures are timely if the plan involves an initial fee that is paid before the initial disclosures are given, or if the plan involves an advance made at the time that the consumer is given the initial disclosures.

5(c) Legal Obligation

Comment 5(c)-1 would be revised to clarify the meaning of the term "legal obligaiton." Comment 17(c)(1)-1, which contains a discussion of legal obligation for closed-end credit transactions, would add a sentence to show the effect of certain previous court decisions on disclosures. This issue arises in part because of the requirement that closed-end disclosures be segregated from other information, a requirement that does not exist for open-end credit. The staff solicits comment on whether a companion provision for open-end credit should be added.

5(d) Multiple Creditors; Multiple Consumers

Material that was inappropriate for commentary treatment would be deleted from comment 5(d)-1.

SECTION 226.6 - Initial Disclosure Statement

6(a) Finance Charge

Comment 6(a)(2)-2 would be revised in its description of the types of open-end credit programs for which the creditor's initial disclosure of planned rate changes excuses the creditor from the general requirement to give notices when the rate increases according to the disclosed plan. The current commentary provides that creditors may avoid these notices after giving appropriate disclosures in plans in which the rates follow an index that is "readily verifiable by the borrower and beyond the control of the lender."

A number of questions have arisen as to the interpretation and purpose of the current commentary language. In particular, some creditors have raised concerns about programs that would use certain internal rates as the index and therefore not meet the criterion that the index be beyond the lender's control. These creditors have noted that tying the rate to their commercial lending rate or to rates paid on savings instruments are customary practices. The proposal reflects these concerns, while at the same time continuing to provide guidance on the types of rate increases for which additional disclosures may be needed.

6(b) Other Charges

Language would be added to comment 6(b)-2 to provide that a charge for submitting as payment a check that is later returned unpaid would not be an other charge.

SECTION 226.7 -- Periodic Statements

7(b) Identification of Transactions

Comment 7(b)-1 would be revised to clarify that the listed ways for a creditor to identify transactions for multifeatured plans are merely examples of acceptable arrangements.

7(c) Credits

Comment 7(c)-3 would be revised to clarify when additional identification of dates is needed, and also that no specific terminology would be required for these date identifications.

7(e) Balance on Which Finance Charge Computed

Comment 7(e)-2 would be revised by indicating that the exception permitting the creditor to disclose one combined balance when split rates (or "break rates") are applied does not extend to the case in which split rates are applied to each day's balance. This change would return to the position under previous Regulation Z, and correct the inadvertent reference in current comment 7(e)-4). That reference permitted a combined balance, which would not allow verification of the finance charge attributable to periodic rates.

The last sentence of current comment 7(e)-4 would be deleted, and incorporated in comment 7(e)-2.

Comments 7(e)-4, 5, 6, and 7 of the current commentary would be redesignated as comments 7(e)-5, 6, 7, and 8, and current comment 7(e)-8, which deals with the disclosure of the periodic rate balance amount in multifeatured plans, would be redesignated as comment 7(e)-4.

Comment 7(e)-4 (current comment 7(e)-8) would be revised to give more complete guidance on when separate balances must be disclosed when a plan involves different features.

Comment 7(e)-9 would be added to clarify that the creditor could explain its balance computation method only once, even if it chooses to disclose more than one balance computed by that same method.

7(g) Annual Percentage Rate

Comment 7(g)-2 would be expanded to clarify that, in multifeatured plans, the creditor may give separate annual percentage rate disclosures for each feature or may give a composite actual annual percentage rate for the entire plan.

SECTION 226.8 -- Identification of Transactions

8(a) Sale Credit

In the last sentence of comment 8(a)(3)-2, the inadvertent reference to "creditor's" stores would be changed to "seller's" stores.

Comment 8(a)(3)-4 would be added to reflect the position under previous Regulation Z that the debiting date may be considered the transaction date for foreign transactions.

SECTION 226.9 -- Subsequent Disclosure Requirements

9(c) Change in Terms

Comment 9(c)-1 would be revised to correspond to the revisions to comment 6(a)(2)-2.

SECTION 226.13 -- Billing Error Resolution

13(d) Rules Pending Resolution

Comment 13(d)(1)-2 would be revised to clarify that, for purposes of § 226.13(d)(1), the creditor need only disclose that payment of "any disputed amount" is not required pending resolution, as was the case under the previous Regulation Z.

SECTION 226.14 -- Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements

An editorial change would be made to comment 14(c)-8 to correct the inadvertent use of the term "fees" instead of "finance charges." The change

would indicate that the optional annual percentage rate formula in § 226.14(c)(4) may be used when small finance charges, not fees, of 50 cents or less are involved.

Comment 14(c)-9 would be added merely to cross-reference comment 14(d)-2. The latter comment discusses the annual percentage rate calculation methods for plans involving both daily periodic rates and specific transaction charges.

14(d) Calculations Where Daily Periodic Rate Applied

Comment 14(d)-2 would be revised to provide alternative annual percentage rate calculation methods when the finance charge results from the application of both daily periodic rates and specific transaction charges. The comment would allow creditors to use either the method in § 226.14(c)(3) or the method in § 226.14(d)(2); comment is specifically solicited on whether the option to use the method in § 226.14(d)(2) is needed.

The § 226.14(c)(3) method includes the rules in Appendix F; the appendix gives examples for determining the denominator of the fraction in this formula. Footnote 1 to the appendix instructs creditors that apply both a daily periodic rate and a specific transaction charge to use the average of daily balances instead of the sum of the balances.

If the § 226.14(d)(2) method is used, the creditor should apply the rule that balances not be duplicated (set forth in § 226.14(c)(3) and explained in comment 14(c)-5), as well as the rule that the annual percentage rate must not be less than the largest corresponding annual percentage rate for that cycle (set forth in § 226.14(c)(3)).

SECTION 226.15 -- Right of Rescission

15(a) Consumer's Right to Rescind

Two changes are proposed for comment 15(a)-2. First, the dates in the comment, which refer to the three-year trial period in § 125(e) of the act, would be changed from March 31, 1985 to September 30, 1985 to reflect the change in the mandatory effective date of the act from April 1, 1982 to October 1, 1982. Second, a sentence would be added to clarify that the limited rescission option is available for programs whether or not they existed on the effective date of the act.

SECTION 226.16 -- Advertising

16(b) Advertisement of Terms that Require Additional Disclosures

Comment 16(b)(1)-6 would be added to make clear that charges excluded from the finance charge under § 226.4 are not required disclosures when a triggering term is used in an advertisement.

SUBPART C - CLOSED-END CREDIT

SECTION 226.17 -- General Disclosure Requirements

17(a) Form of Disclosures

Comment 17(a)-5 would add four examples of "directly related" information. The first example relating to § 226.18(k) would clarify the applicability of the § 226.18(k)(1) disclosure. For purposes of this disclosure, a minimum finance charge is considered a penalty. Some state laws prohibit creditors from charging a penalty in the event of prepayment while permitting the creditor to charge a minimum charge. In this instance the creditor may state that a minimum finance charge will be imposed. The second example relating to § 226.18(k) would enable creditors to identify which finance charge triggered the § 226.18(k)(2) prepayment disclosure.

The example relating to § 226.18(f) responds to inquiries about disclosing the fact that a variable rate feature may produce negative amortization. It permits creditors to disclose this fact when making the other required variable rate disclosures. The last example would permit the inclusion of a title for the disclosure statement.

17(c) Basis of Disclosures and Use of Estimates

Comment 17(c)(1)-1 would be revised to clarify the meaning of the term "legal obligation." A sentence would be added to show the effect of certain previous court decisions on disclosure of the legal obligation, and the sentence discussing contracts later deemed unenforceable by a court would be modified to include situations in which an individual term, rather than an entire contract, is deemed unenforceable. Portions of comments 17(c)(1)-1 and 2 would be restructured for added clarity.

Comment 17(c)(1)-4 would be revised to clarify the treatment of certain buydown plans, including the Federal National Mortgage Association's Buydown Program, as revised for commitments issued on or after February 16, 1982.

A new comment 17(c)(1)-8 would be added to clarify the treatment of adjustable rate mortgages that contain a graduated payment feature or an initial payment amount resulting in negative amortization. This comment applies to mortgages such as the graduated payment adjustable mortgage loan authorized by the Federal Home Loan Bank Board (12 CFR 545.6-4b).

New comments 17(c)(3)-2 and 17(c)(4)-2 would be added to clarify that a creditor may ignore minor variations in calculating some disclosures without being required to ignore those variations in computing all of the disclosures.

17(d) Multiple Creditors; Multiple Consumers

Material that was inappropriate for commentary treatment would be deleted from comment 17(d)-1.

17(h) Series of Sales--Delay in Disclosures

Comment 17(h)-2 would be added to address the content of disclosures for transactions under § 226.17(h).

17(i) Interim Student Credit Extensions

Comment 17(i)-1 would be amended to clarify the applicability of this provision. No substantive change would be made.

Comment 17(i)-2 would be revised to provide further guidance on the basis for interim student credit disclosures.

Comment 17(i)-5 would be added as a cross-reference to Appendix H, regarding approved disclosure forms.

SECTION 226.18 -- Content of Disclosures

18(f) Variable Rate

Comment 18(f)-2 would be amended to clarify that the disclosures in a variable-rate transaction are not considered estimates and should not be labelled as such.

Comment 18(f)-6 would be added to discuss the treatment of growth equity mortgages.

Comment 18(f)(3)-1 would be revised to include a cross-reference to comment 17(a)(1)-5, which permits the inclusion of a brief reference to negative amortization in the variable-rate disclosures.

A sentence would be added to comment 18(f)(4)-1 to clarify that the example may reflect an immediate increase only when the contract terms permit an immediate increase in the rate.

Comment 18(f)(4)-2 would contain additional examples of transactions that need not make the hypothetical disclosure required in most transactions by § 226.18(f)(4).

18(g) Payment Schedule

Comment 18(g)-1 would be revised to clarify that prepaid finance charges are not reflected in the payment schedule.

Comment 18(g)(2)-1 would be revised to clarify that the abbreviated disclosures may be employed when mortgage insurance premium payments gradually increase over a portion of the loan term. This will occur if the accrual rate exceeds the payment rate for a period and negative amortization causes the unpaid principal balance to increase. During this period, the amount of each premium payment will increase to insure the increasing principal balance. When negative amortization ends, the premiums will decrease in a traditional manner. The proposed language would permit the creditor to disclose the lowest and highest payments in the increasing series (with a reference to the variation in payments) followed by the highest and lowest payments in the decreasing series (with a reference to the variation in payments).

18(i) Demand Feature

Comment 18(i)-2 would be revised to clarify that a due-on-sale clause is not considered a demand feature requiring disclosure.

18(k) Prepayment

Comment 18(k)(1)-1 would be changed by the addition of the word "scheduled" to the first sentence. The change is to clarify that this disclosure applies not only to interest calculations made daily, but to calculations that are made other than daily while taking into account reductions in principal. A cross-reference to comment 17(a)(1)-5 would be added to point out the permitted reference to a minimum finance charge in the penalty disclosure.

Comment 18(k)(2)-1 would be revised to include a cross-reference to comment 17(a)(1)-5, which permits creditors to describe in the disclosure statement the type of finance charge subject to a rebate.

18(r) Required Deposit

A new comment 18(r)-2 would be added to address pledged account or FLIP mortgages, allowing creditors two options in disclosing those types of transactions.

SECTION 226.19 -- Certain Residential Mortgage Transactions

19(a) Time of Disclosure

Comment 19(a)-2 would be revised to conform with comment 17(a)(1)-5, regarding explanation of the basis for estimates.

SECTION 226.20 -- Subsequent Disclosure Requirements

20(a) Refinancings

The amendment to comment 20(a)-3 would clarify the current commentary position that the addition of a variable-rate feature to a previously fixed rate transaction requires new disclosures regardless of the manner in which

the change is made. The remainder of comment 20(a)-3 discusses a variable-rate transaction for which no variable-rate disclosures were ever provided.

New comment 20(a)-5 would clarify the coverage of § 226.20(a). "Refinancing," as the term is used here, refers only to a new transaction undertaken with the original creditor (or a holder or servicer of the original obligation) to replace the original obligation. The term "refinancing" is sometimes used to refer to a loan, the proceeds of which are used in whole or in part to satisfy an obligation to a different creditor. Under the regulation, that is not a refinancing but a new transaction subject to the general coverage rules and disclosure requirements of the regulation.

20(b) Assumptions

The revisions to comments 20(b)-1 and 6 would clarify the coverage of § 226.20(b). The following elements must all be present before an assumption under this section requires new disclosures:

- The original obligation must have been a consumer credit obligation that was not originally exempt.
- The assumption must be accompanied by no significant change in terms (as described in comment 20(b)-6).
- The creditor must expressly agree to the new consumer as a primary obligor.
- The agreement must be in writing.
- The transaction must be a "residential mortgage transaction" as to the new consumer.

All the above elements must be present in order to require assumption disclosures under § 226.20(b). An apparent assumption that has the first two elements but does not have all the remaining three requires no disclosures at all. However, an apparent assumption that fails to have one or both of the first two elements listed above is not subject to § 226.20(b). To determine if disclosures are required in that case, the creditor must analyze the transaction under § 226.2 and § 226.3.

SECTION 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

A sentence would be added to comment 22(a)(1)-4 to provide an example of a composite annual percentage rate for a step-rate transaction.

SECTION 226.24 -- Advertising

24(b) Advertisement of Rate of Finance Charge

Comment 24(b)-2 would be added to clarify that stating the effective simple annual payment rate for any portion of the repayment period constitutes a statement of a rate of finance charge under that section, requiring that the annual percentage rate also be stated.

APPENDIX D -- Multiple-Advance Construction Loans

Comment D-2 would be added to clarify that disclosure of a variable-rate hypothetical is not required for multiple-advance construction loans disclosed pursuant to Appendix D, Part I. (See comment 18(f)(4)-2).

Comment D-3 would be added to clarify that the total of payments disclosure under Appendix D may be calculated as either the sum of the payments or as the amount financed plus the finance charge.

Comment D-4 would be added to make it clear that under Appendix D creditors may disclose an estimated APR computed under either the actuarial method or the Volume I method.

APPENDIX F -- Annual Percentage Rate Computations for Certain Open-End Credit Plans

Comment F-1 would be added to cross-reference comment 14(d)-2. The latter comment discusses the annual percentage rate calculation methods for plans involving both daily periodic rates and specific transaction charges.

APPENDIX H -- Closed-End Model Forms and Clauses

Comments H-17 and 18 would be added to reflect the approval under section 113 of the act of two student loan disclosure forms issued by the Department of Education in conjunction with the PLUS program.

(3) Text of Proposal. The proposed revisions to the commentary read as follows:

OFFICIAL STAFF COMMENTARY -- TIL-1

INTRODUCTION ***

3. Status of previous interpretations. All statements and opinions issued by the Federal Reserve Board and its staff interpreting previous Regulation Z remain effective until [April 1,] ▶ October 1, ◀ 1982 only insofar as they interpret that regulation. When compliance with revised Regulation Z becomes mandatory on [April 1,] ▶ October 1, ◀ 1982, the Board and staff interpretations of the previous regulation will be entirely superseded by the revised regulation and this commentary except with regard to liability under the previous regulation. ***

SUBPART A - GENERAL ***

SECTION 226.2 -- Definitions and Rules of Construction

2(a) Definitions ***

2(a)(3) "Arranger of Credit" ***

▶ 6. Real estate brokers. The general definition does not include a person (such as a real estate broker or salesperson) when arranging for the seller of real property or a dwelling to finance its purchase in whole or in part, even if the obligation by its terms is simultaneously assigned by the seller to another person. However, a broker or salesperson is not exempt from coverage in all transactions. For example, a real estate broker may be a creditor in the following situations:

- The broker acts as a loan broker to arrange for someone other than the seller to extend credit, provided that the extender of credit (the person to whom the obligation is initially payable) does not meet the "creditor" definition.
- The broker extends credit itself, provided that the broker otherwise meets the "creditor" definition. ◀ ***

2(a)(13) "Consummation"

1. State law governs. When a contractual obligation on the consumer's part is created is a matter to be determined under applicable law; Regulation Z does not make this determination. ▶ Consummation occurs when, under state law, the consumer becomes contractually obligated to accept specific credit terms. A contractual commitment agreement, for example, that binds the parties to specific credit terms would be consummation. ◀ Consummation ▶, however, ◀ does not occur merely because the consumer has made some financial investment in the transaction (for example, by paying a nonrefundable fee) unless, of course, applicable law holds otherwise. ***

2(a)(23) "Prepaid Finance Charge" ***

2. Examples. Common examples of prepaid finance charges include:

- Buyer's points.
- Service fees.
- Loan fees.
- Finder's fees.
- Loan guarantee insurance.
- Credit investigation fees.

However, in order for these or any other finance charges to be considered prepaid, they must be either paid separately in cash or check or withheld from the proceeds. ▶ Prepaid finance charges include any portion of the finance charge paid at closing or settlement. ◀ ***

2(a)(24) "Residential Mortgage Transaction"

1. Relation to other sections. This term is important in [five] ▶ six ◀ provisions in the regulation:

- Section 226.4(c)(7) -- exclusions from the finance charge.
- Section 226.15(f) -- exemption from the right of rescission.
- Section 226.18(q) -- whether or not the obligation is assumable.
- Section 226.19 -- special timing rules.
- ▶ Section 226.20(b) -- disclosure requirements for assumptions. ◀
- Section 226.23(f) -- exemption from the right of rescission. ***

2(a)(25) "Security Interest" ***

2. Exclusions. The general definition of security interest excludes three groups of interests: incidental interests, interests in after-acquired property, and interests that arise solely by operation of law. These interests may not be disclosed with the disclosures required under section 226.18, but the creditor is not precluded from preserving these rights elsewhere in the contract documents, or invoking and enforcing such rights, if it is otherwise lawful to do so. ▶ If the creditor is unsure whether a particular interest is one of the excluded interests, the creditor may, at its option, consider such interests as security interests for Truth in Lending purposes. ◀ ***

SECTION 226.4 -- Finance Charge ***

4(b) Examples of Finance Charges ***

Paragraph 4(b)(9) ***

▶ 3. Determination of the regular price. The "regular price" is critical in determining whether the difference between the price charged to cash customers and credit customers is a "discount" or a "surcharge," as these terms are defined in amended § 103 of the act. The "regular price" is generally the price displayed on the merchandise being sold. In the sale of motor vehicle fuel, for example, the regular price is the price displayed at the pump. As a result, the higher price (the open-end credit or credit card price) must be displayed at the pump, either alone or along with the cash price. A service station operator may display the cash price of fuel by itself on a curb sign, as long as the sign clearly indicates that the price is limited to cash purchases. ◀ ***

4(c) Charges Excluded from the Finance Charge ***

Paragraph 4(c)(7)

1. Real estate or residential mortgage transaction charges. The list of charges in section 226.4(c)(7) applies both to residential mortgage transactions (which may include, for example, the purchase of a mobile home) and to other transactions secured by real estate. The fees are excluded from the finance charge even if the services for which the fees are imposed are performed by the creditor's employees rather than by a third party. In addition, credit report fees include not only the cost of the report itself, but also the cost of verifying information in the report. In all cases, the charges must be bona fide and reasonable. If a lump sum is charged for several services and includes a charge that is not excludable [(for example, a charge for a lawyer's attending the closing)], a portion of the total should be allocated to that service and included in the finance charge. ▶ A charge for a lawyer's attendance at the closing to insure that documents are completed and executed properly is excluded from the finance charge. ◀

4(d) Insurance ***

▶ 11. Initial term. The initial term of insurance coverage determines the period for which a premium amount must be disclosed. 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. If the creditor is unsure of the initial term of insurance coverage, the premium disclosed may be the premium for one year of insurance coverage. The premium must be clearly labeled as being for one year. ◀

SECTION 226.5 -- General Disclosure Requirements

5(a) Form of Disclosures ***

Paragraph 5(a)(2)

1. When disclosures must be "more conspicuous." The terms "finance charge" and "annual percentage rate" ▶ , when required to be used with a number, ◀ must be disclosed more conspicuously ▶ than other required disclosures, ◀ [when required to be used with a number.] ▶ except in two cases as provided in footnote 9. First, the corresponding annual percentage rate under section 226.7(d) may be less conspicuous than disclosure of the actual annual percentage rate under section 226.7(g). Second, neither term need be more conspicuous than other required disclosures under section 226.16 in advertisements. ◀ [For example, on the initial disclosure statement, the annual percentage rate disclosure under section 226.6(a)(2) must be "more conspicuous." The following apply to the "more conspicuous" rule:] ▶ At the creditor's option, "finance charge" and "annual percentage rate" may also be disclosed more conspicuously than the other required disclosures even when the regulation does not so require. The following examples illustrate these rules:

- On the initial disclosure statement, the disclosure for the annual percentage rate that corresponds to each periodic rate, required by section 226.6(a)(2), must be "more conspicuous" than other required disclosures.

- If the plan involves a minimum finance charge, it must be disclosed on the initial disclosure statement more conspicuously than other required disclosures when accompanied by the amount of the finance charge.

- On the periodic statement, the disclosure of the amount of the finance charge, required by section 226.7(f), must be "more conspicuous" than other required disclosures.

- Although neither ◀ [Neither term] ▶ "finance charge" nor "annual percentage rate" ◀ need be emphasized when used as part of general informational material or in textual descriptions of other terms, [although] emphasis is permissible in such cases. For example, when the terms appear as part of the explanations required under section 226.6(a)(3) and (4), they may be [as] ▶ equally ◀ conspicuous as the disclosures required under sections 226.6(a)(2) and 226.7(g).

[- The corresponding annual percentage rate under section 226.7(d) may be less conspicuous than the disclosure of the actual annual percentage rate (historical rate) under section 226.7(g) when the two rates differ. This is permitted by footnote 9 to section 226.5(a)(2), which excepts section 226.7(d) disclosures from the "more conspicuous" requirement.] ***

5(b) Time of Disclosures

5(b)(1) Initial Disclosures

1. Disclosure before the first transaction. The rule that the initial disclosure statement must be furnished "before the first transaction" requires delivery of the initial disclosure statement before the consumer becomes obligated on the plan (for example, before the consumer makes the first purchase, receives the first advance, or pays a fee under the plan). [Delivery of the initial disclosure statement is timely even if a membership fee, advance, or purchase already has been posted to the consumer's account, so long as the consumer may, after receiving the disclosures, reject the plan and have no further obligation beyond returning a credit card or any money or goods.]

▶ ◦ If the consumer pays a membership fee before receiving the Truth in Lending disclosures, or the consumer agrees to the imposition of a membership fee at the time of application and the Truth in Lending disclosure statement is not given at that time, disclosures are timely as long as the consumer, after receiving the disclosures, can reject the plan. The creditor must refund the membership fee, if it has been paid, or if it has been debited to the consumer's account, the creditor must clear the account.

◦ If the consumer receives a cash advance check at the same time the Truth in Lending disclosures are provided, disclosures are still timely if the consumer can, after receiving the disclosures, return the cash advance check to the creditor without obligation (for example, without paying finance charges).

◦ Initial disclosures need not be given before the imposition of an application fee under section 226.4(c)(1).

◦ If the consumer uses the account, pays a fee, or negotiates a cash advance check after receiving the disclosures, the creditor may consider the account not rejected for purposes of this section. ◀ ***

5(c) Basis of Disclosures and Use of Estimates

1. Legal obligation. The disclosures should reflect the credit terms to which the parties are legally bound at the time of giving the disclosures.

◦ The legal obligation is [normally] determined by applicable state or other law.

- The fact that a ▶ term or ◀ contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that ▶ term or ◀ contract did not reflect the legal obligation.

- The legal obligation normally is presumed to be contained in the contract that evidences the agreement. But this may be rebutted if another agreement between the parties legally modifies that contract. ***

5(d) Multiple Creditors; Multiple Consumers

1. Multiple creditors. Under section 226.5(d):

- Creditors must choose which of them will make the disclosures.

- A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.

[- Each creditor in the plan is legally responsible for seeing that the disclosures are provided.]

- All disclosures for the open-end credit plan must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure.

- In some open-end credit programs involving multiple creditors, the consumer has the option (for example, at the end of a billing cycle) to pay creditor A directly or to transfer to creditor B all or part of the amount owing. If the consumer elects the latter option, the consumer no longer is obligated to creditor A for the specific amount(s) transferred. In such a case, creditor A and creditor B may send separate periodic statements that reflect the separate obligations owed to each. ***

SECTION 226.6 -- Initial Disclosure Statement ***

Paragraph 6(a)(2) ***

[2. Variable-rate plan defined. A variable-rate plan contemplates a series of rate changes in accordance with an index that is readily verifiable by the borrower and beyond the control of the lender (for example, the Treasury bill rate). A contract right to increase the rate upon any other contingency, or at the creditor's discretion, would not be a variable-rate plan. For example, an open-end credit plan in which the employee receives a lower rate contingent upon employment, with the rate to be increased upon termination of employment, would not be a variable-rate plan. Similarly, an open-end credit plan that provides for rate increases voted by the board of directors of a financial institution would not be a variable-rate plan.]

2. Variable-rate disclosures - coverage. This section covers open-end credit plans under which rate changes are part of the plan and are tied to an index or formula. A creditor would use variable-rate disclosures (and thus be excused from the requirement of giving a change-in-terms notice when rate increases occur as disclosed) for plans involving rate changes such as the following:

- Rate changes that are tied to the rate the creditor pays on its 6-month money market certificates.
- Rate changes that are tied to treasury bill rates.
- Rate changes that are tied to changes in the creditor's commercial lending rate.

In contrast, the creditor's contract reservation to increase the rate without reference to such an index or formula (for example, a plan that simply provides that the creditor reserves the right to raise its rates) would not be considered a variable-rate plan for Truth in Lending disclosure purposes. Moreover, an open-end credit plan in which the employee receives a lower rate contingent upon employment (that is, with the rate to be increased upon termination of employment) is not a variable-rate plan. ***

6(b) Other Charges ***

2. Exclusions. The following are examples of charges that are not "other charges":

- Fees charged for documentary evidence of transactions for income tax purposes.
- Amounts payable by a consumer for collection activity after default; attorney's fees, whether or not automatically imposed; foreclosure costs; post-judgment interest rates imposed by law; and reinstatement or reissuance fees.
- Premiums for voluntary credit life or disability insurance, or for property insurance, that are not part of the finance charge.
- Application fees under section 226.4(c)(1).
- A monthly service charge for a checking account with overdraft protection that is applied to all checking accounts, whether or not a credit feature is attached.
- Charges for submitting as payment a check that is later returned unpaid. (See comment 4(c)(2)-2.) ***

SECTION 226.7 -- Periodic Statement ***

7(b) Identification of Transactions

1. Multifeatured plans. In identifying transactions under section 226.7(b) [, transactions may be grouped by feature (such as by disclosing sale transactions separately from cash advance transactions) or may be arranged by date.] ▶ for multifeatured plans, creditors may, for example, choose to arrange transactions by feature (such as disclosing sale transactions separately from cash advance transactions) or in some other clear manner, such as by arranging the transactions in general chronological order. ◀ ***

7(c) Credits ***

3. Date. [The crediting date need not be identified as "crediting date," unless two or more dates are disclosed for a single entry (for example, the posting date and the crediting date).] ▶ If only one date is disclosed (that is, the crediting date as required by the regulation), no further identification of that date is necessary. More than one date may be disclosed for a single entry, as long as it is clear which date represents the date on which credit was given. ◀ ***

7(e) Balance on which Finance Charge Computed ***

2. Split rates applied to balance ranges. If split rates were applied to a balance because different portions of the balance fall within two or more balance ranges, the creditor need not separately disclose the portions of the balance subject to such different rates since the range of balances to which the rates apply has been separately disclosed. For example, a creditor could disclose a balance of $700 for purchases even though a monthly periodic rate of 1.5 percent applied to the first $500, and a monthly periodic rate of 1 percent to the remainder. ▶ This does not apply when the finance charge is computed by applying the split rates to each day's balance. In that case, the balances must be disclosed using any of the options that are available if two or more daily rates are imposed. (See comment 7(e)-5). ◀

Comment 7(e)-8 is redesignated as 7(e)-4.

[8. Multifeatured plans. In a multifeatured plan, the balance on which the finance charge was computed must be disclosed for each feature to which a periodic rate was applied. A total balance for the entire plan is optional.]

▶ 4. Multifeatured plans. In a multifeatured plan, the creditor must disclose a separate balance (or balances, as applicable) to which a periodic rate was applied for each feature or group of features subject to different periodic rates or different balance computation methods. Separate balances are not

required, however, merely because a "free-ride" period is available for some features but not others. A total balance for the entire plan is optional. This does not affect how many balances the creditor must disclose -- or may disclose -- within each feature. (See, for example, comment 7(e)-5.) ◀ ***

Comment 7(e)-4 is redesignated as 7(e)-5.

5. Daily rate on daily balance. If the finance charge is computed on the balance each day by application of one or more daily periodic rates, the balance on which the finance charge was computed may be disclosed in any of the following ways for each feature:

- If a single daily periodic rate is imposed, the balance to which it is applicable may be stated as:

  -a balance for each day in the billing cycle

  -a balance for each day in the billing cycle on which the balance in the account changes

  -the sum of the daily balances during the billing cycle

  -the average daily balance during the billing cycle, in which case the creditor shall explain that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of the finance charge.

- If two or more daily periodic rates may be imposed, the balances to which the rates are applicable may be stated as:

  -a balance for each day in the billing cycle

  -a balance for each day in the billing cycle on which the balance in the account changes

  -as two or more average daily balances, each applicable to the daily periodic rates imposed for the time that those rates were in effect, as long as the creditor explains that the finance charge is or may be determined by (1) multiplying each of the average balances by the number of days in the billing cycle, (or if the daily rate varied during the cycle, by multiplying by the number of days the applicable rate was in effect), (2) multiplying each of the results by the applicable daily periodic rate, and (3) adding these products together. [If the different rates are due to disclosed ranges of balances

(see comment 7(e)-2), the creditor need give only one average daily balance together with the additional information required by this paragraph.]

Comments 7(e)-5, 6, and 7 are redesignated as 7(e)-6, 7, and 8 respectively.

Comment 7(e)-8 is redesignated as 7(e)-4.

▶ 9. Use of one balance computation method explanation when multiple balances disclosed. Sometimes the creditor will disclose more than one balance to which a periodic rate was applied even though each balance was computed using the same balance computation method. In these cases, one explanation of the balance computation method is sufficient. ◀ ***

7(g) Annual Percentage Rate ***

2. Multifeatured plans. In a multifeatured plan, the actual annual percentage rate that reflects the finance charge imposed during the cycle may be separately stated for each feature [.] ▶ , or may be described as a composite for the whole plan. ◀ If separate rates are given, a composite annual percentage rate for the entire plan is optional. ***

SECTION 226.8 -- Identification of Transactions. ***

8(a) Sale Credit ***

8(a)(3) Copy of Credit Document Not Provided -- Creditor and Seller Not Same or Related Person(s) ***

2. Location of transaction. The disclosure of the location where the transaction took place generally requires an indication of both the city, and the state or foreign country. If the [creditor] ▶seller◀ has multiple stores or branches within that city, the creditor need not identify the specific branch at which the sale occurred. ***

▶ 4. Date of transaction -- foreign transactions. In a foreign transaction, the debiting date may be considered the transaction date. ◀ ***

SECTION 226.9 -- Subsequent Disclosure Requirements ***

9(c) Change in Terms

1. "Changes" initially disclosed. No notice of a change in terms need be given if the specific change is set forth initially, such as: rate increases under a properly disclosed variable-rate plan, a rate increase that occurs when an

employee has been under a preferential rate agreement and terminates employment, or an increase that occurs when the consumer has been under an agreement to maintain a certain balance in a savings account in order to keep a particular rate and the account balance falls below the specified minimum. In contrast, notice must be given if the contract allows the creditor to increase the rate at its discretion but does not include specific terms for an increase (for example, when an increase may occur [by vote of the board of directors).] ▶ under the creditor's contract reservation right to increase the periodic rates.) ◀ ***

SECTION 226.13 -- Billing Error Resolution ***

13(d) Rules Pending Resolution ***

13(d)(1) Consumer's Right to Withhold Disputed Amount; Collection Action Prohibited ***

2. Right to withhold payment. ▶ If the creditor is required to make the disclosure under footnote 30, the creditor may comply with that disclosure requirement by indicating that payment of any disputed amount is not required pending resolution. Making a disclosure that only refers to disputed amount would, of course, in no way affect the consumer's right under section 226.13(d)(1) to withhold related finance and other charges. ◀ The disclosure [that payment of any disputed amount is not required pending error-resolution] ▶ under footnote 30 ◀ need not appear in any specific place on the periodic statement ▶ , ◀ [and it] need not state the specific amount that the consumer may withhold [. The creditor] ▶ and ◀ may ▶ be preprinted ◀ [preprint] on [its] ▶ the ◀ periodic statement ▶ . ◀ [forms a statement that payment of any disputed amount is not required pending resolution.] ***

SECTION 226.14 -- Determination of Annual Percentage Rate ***

14(c) Annual Percentage Rate for Periodic Statements ***

8. Small finance charges. Section 226.14(c)(4) gives the creditor an alternative to section 226.14(c)(2) and (c)(3) if small [(50 cents or less) minimum or fixed fees are involved.] ▶ finance charges (50 cents or less) are involved; that is, if the finance charge includes minimum or fixed fees not due to the application of a periodic rate and the total finance charge for the cycle does not exceed 50 cents. ◀ For example, while a monthly activity fee of 50 cents on a balance of $20 would produce an annual percentage rate of 30 percent under the rule in section 226.14(c)(2), the creditor may disclose an annual percentage rate of 18 percent if the periodic rate generally applicable to all balances is 1 1/2 percent per month. This option is consistent with the provision in footnote 11 to sections 226.6 and 226.7 permitting the creditor to disregard the effect of minimum charges in disclosing the ranges of balances to which periodic rates apply.

▶ 9. Daily rate with specific transaction charge. If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(d)-2 for guidance on the appropriate calculation methods. ◀ ***

14(d) Calculations Where Daily Periodic Rate Applied ***

2. Daily rate with specific transaction charge. If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, the calculation method in ▶ section 226.14(c)(3) ◀ [section 226.14(d)(2)] should be used. ▶ This requires a creditor to follow the rules in Appendix F in calculating the annual percentage rate, especially footnote 1 to Appendix F which addresses the daily rate/transaction charge situation by providing that the "average of daily balances" shall be used instead of the "sum of the balances."

Alternatively, the calculation method in section 226.14(d)(2) may be used. If this method is used, the creditor must also

- Apply the "without duplication" rule. (See comment 14(c)-5.)
- Disclose an annual percentage rate not less than the largest rate determined by multiplying each periodic rate imposed during the cycle by the number of periods in a year. ◀ ***

SECTION 226.15 -- Right of Rescission ***

15(a) Consumer's Right to Rescind

Paragraph 15(a)(1) ***

2. Exceptions. Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the act provides an exception: until [March 31, 1985,] ▶ September 30, 1985 ◀ the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a previously established credit limit for the plan. ▶ This limited rescission option is available whether or not the plan existed prior to the effective date of the act. ◀ The consumer will have the right to rescind each extension made after [March 31, 1985] ▶ September 30, 1985 ◀ under such a secured open-end credit plan, whether that plan was established before or after that date. ***

SECTION 226.16 -- Advertising ***

16(b) Advertisement of Terms That Require Additional Disclosures ***

▶ 6. Minimum, fixed, transaction, activity or similar charge. The charges to be disclosed under § 226.16(b)(1) are those that are considered finance charges under § 226.4. ◀ ***

SUBPART C -- CLOSED-END CREDIT

SECTION 226.17 -- General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1) ***

5. Directly related. The segregated disclosures may, at the creditor's option, include any information that is directly related to those disclosures. Directly related information includes, for example, the following:

- A description of a grace period after which a late payment charge will be imposed. For example, the disclosure given under section 226.18(l) may state that a late charge will apply to "any payment received more than 15 days after the due date."
- A statement that the transaction is not secured. For example, the creditor may add a category labelled "unsecured" or "not secured" to the security interest disclosures given under section 226.18(m).
- The basis for any estimates used in making disclosures. For example, if the maturity date of a loan depends solely on the occurrence of a future event, the creditor may indicate that the disclosures assume that event will occur at a certain time.
- The conditions under which a demand feature may be exercised. For example, in a loan subject to demand after five years, the disclosures may state that the loan will become payable on demand in five years.
- When a variable rate feature is disclosed on other documents under footnote 43 to section 226.18(f), a reference to the variable rate feature and/or to other documents on which the variable rate disclosures are made.
- An explanation of the use of pronouns or other references to the parties to the transaction. For example, the disclosures may state, "'You' refers to the customer and 'we' refers to the creditor."
- Instructions to the creditor or its employees on the use of a multiple-purpose form. For example, the disclosures may state, "Check box if applicable."
- A statement that the borrower will pay a minimum finance charge upon prepayment. For example, when state law prohibits penalties for prepayment, the creditor may make the section 226.18(k)(1) disclosure by stating "You will be charged a minimum finance charge."
- Identification of the finance charge that is subject to a rebate. For example, the disclosure given under section 226.18(k)(2) may state that the borrower "will not be entitled to a refund of the prepaid finance charge."

- A brief reference to negative amortization in variable-rate transactions. For example, in the variable-rate disclosure, the creditor may include a short statement such as "Unpaid interest will be added to principal."

- A brief caption identifying the disclosures. For example, the disclosures may bear a general title such as "Federal Truth in Lending Disclosures" or a descriptive title such as "Real Estate Loan Disclosures." ◀ ***

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(1)

1. Legal obligation. The disclosures should reflect the credit terms to which the parties are legally bound at the outset of the transaction. ▶ The legal obligation is determined by applicable state law or other law. (Certain transactions are specifically addressed in this commentary. See, for example, the discussion of buydown transactions elsewhere in the commentary to section 226.17(c).) ◀

[- The legal obligation is normally determined by applicable state or other law, but certain transactions are specifically addressed in this commentary. (See, for example, the discussion of buydown transactions elsewhere in the commentary to section 226.17(c).)]

▶- It is not a violation of the regulation for a creditor, in disclosing the legal obligation, to omit the disclosure of a term that a court with jurisdiction over the creditor has previously deemed unenforceable on the basis of equity or other grounds.◀

- The fact that a [credit] ▶ term or ◀ contract may later be deemed unenforceable by a court on the basis of equity or other grounds does not, by itself, mean that disclosures based on that ▶ term or ◀ contract did not reflect the legal obligation.

[- The legal obligation normally is presumed to be contained in the note or contract that evidences the agreement. But this presumption is rebutted if another agreement between the parties legally modifies that note or contract.]

2. Modification of obligation. ▶ The legal obligation normally is presumed to be contained in the note or contract that evidences the agreement. But this presumption is rebutted if another agreement between the parties legally modifies that note or contract.◀ If the parties informally agree to a modification of the legal obligation, the modification should not be reflected in the disclosures unless it rises to the level of a change in the terms of the legal obligation. For example:

- If the creditor-employer offers a preferential employee rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to section 226.18(f) for ▶ an example of a preferred-rate employee transaction that is a variable-rate transaction.) ◀ [a discussion of whether employee transactions are variable-rate transactions.)]

- If the contract provides for a certain monthly payment schedule but payments are made on a voluntary payroll deduction plan or an informal principal-reduction agreement, the disclosures should reflect the schedule in the contract.

- If the contract provides for regular monthly payments but the creditor informally permits the consumer to defer payments from time to time, for instance, to take account of holiday seasons or seasonal employment, the disclosures should reflect the regular monthly payments. ***

4. Consumer buydowns. In certain transactions, the consumer may pay an amount to the creditor to reduce the payments or [buy down the] ▶ obtain a lower ◀ interest rate on the transaction. Consumer buydowns must be reflected in the disclosures given for that transaction. To illustrate, in a mortgage transaction, the creditor and consumer agree to a note specifying a 14 percent interest rate. However, in a separate document, the consumer agrees to pay [four points] ▶ an amount ◀ to the creditor at consummation in return for a reduction in the interest rate to 12 percent for a portion of the mortgage term. ▶ The amount paid by the consumer may be deposited in an escrow account or may be retained by the creditor. Depending upon the buydown plan, the consumer's prepayment of the obligation may or may not result in a portion of the amount being credited or refunded to the consumer. ◀ In the disclosures given for the mortgage, the creditor must reflect the terms of the buydown agreement. For example:

- The [four points are] ▶ amount paid by the consumer is a ◀ prepaid finance charge[s] (even if deposited in an escrow account).

- A composite annual percentage rate must be calculated, taking into account both interest rates, as well as the effect of the prepaid finance charges.

- The payment schedule must reflect the multiple payment levels resulting from the buydown. ***

▶ 8. Graduated payment adjustable rate mortgages. These mortgages involve both a variable interest rate and scheduled variations in payment amounts during the loan term. Under these plans, a series of graduated payments may be scheduled before rate adjustments affect payment amounts, or the initial scheduled payment may remain constant for a set period before rate adjustments affect the payment amount. In either case, however, the initial payment amount is insufficient to cover the scheduled interest, causing negative amortization from the outset of the transaction. In these transactions, the disclosures are as follows:

- The finance charge includes the amount of negative amortization based on the assumption that the rate in effect at consummation remains unchanged.

- The amount financed does not include the amount of negative amortization, but includes only the amount of funds advanced to the consumer at the beginning of the loan term.

- As in any variable-rate transaction, the annual percentage rate is based on the terms in effect at consummation.

- The schedule of payments discloses the amount of any scheduled initial payments followed by an adjusted level of payments based on the initial interest rate. Since some mortgage plans contain limits on the amount of the payment adjustment, the payment schedule may need to contain several different levels of payments, even with the assumption that the original interest rate does not increase. ◀ ***

Comments 17(c)(1)-8 and 9 are redesignated 17(c)(1)-9 and 10, respectively.

Paragraph 17(c)(3) ***

▶ 2. Use of special rules. A creditor may utilize the special rules in section 226.17(c)(3) for purposes of calculating and making all disclosures for a transaction or may, at its option, use the special rules for some disclosures and not others. ◀

Paragraph 17(c)(4) ***

▶ 2. Use of special rule. A creditor may take advantage of this special rule for purposes of calculating and making some disclosures but may elect not to do so for all of the disclosures. For example, the variations may be ignored in calculating and disclosing the annual percentage rate but taken into account in calculating and disclosing the finance charge and payment schedule. ◀ ***

17(d) Multiple Creditors; Multiple Consumers

1. Multiple creditors. If a credit transaction involves more than one creditor:

- The creditors must choose which of them will make the disclosures.

- A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.

- [Each creditor in the transaction is legally responsible for seeing that the disclosures are provided.]

- All disclosures for the transaction must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure. For example, if one of the creditors

is the seller, the total sale price disclosure under section 226.18(j) must be made, even though the disclosing creditor is not the seller. ***

17(h) Series of Sales--Delay in Disclosures ***

▶ 2. Basis of disclosures. Creditors have flexibility in structuring disclosures for a series of sales under section 226.17(h). For example, the total sale price may be computed as the cash price for the sale plus that portion of the finance charge and other charges applicable to that sale. ◀

17(i) Interim Student Credit Extensions

1. Definition. Student credit plans involve extensions of credit for education purposes where the repayment amount and schedule are not known at the time credit is advanced. ▶ These plans include, for example, loans made under the Guaranteed Student Loan program, the PLUS program or any other student credit plan where the repayment period does not begin immediately. ◀ Creditors in interim student credit extensions need not disclose the terms set forth in this paragraph at the time the credit is actually extended but must make complete disclosures at the time the creditor and consumer agree upon the repayment schedule for the total obligation. At that time, a new set of disclosures must be made of all applicable items under section 226.18.

2. Basis of disclosures. The disclosures given at the time of execution of the interim note should reflect two annual percentage rates, one for the interim period and one for the repayment period. ▶ The disclosures should not be labelled as estimates. Any portion of the finance charge, such as statutory interest, that is attributable to the interim period and is paid by the student (either as a prepaid finance charge, periodically during the interim period, in one payment at the end of the interim period, or capitalized at the beginning of the repayment period) must be reflected in the interim annual percentage rate. ◀ Interest subsidies, such as payments made by either a state or the federal government on an interim loan, must be excluded in computing the annual percentage rate on the interim obligation, when the consumer has no contingent liability for payment of those amounts. [A loan guarantee fee that is paid separately by the student at the outset or withheld from the proceeds of the loan is a prepaid finance charge.] ▶ Any finance charges that are paid separately by the student at the outset or withheld from the proceeds of the loan are prepaid finance charges. An example of this type of charge is the loan guarantee fee. ◀ [That sum] ▶ The sum of the prepaid finance charges ◀ is deducted from the loan proceeds to determine the amount financed and included in the calculation of the finance charge. ***

▶ 5. Approved student credit forms. See the commentary to Appendix H regarding disclosure forms approved for use in certain student credit programs. ◀ ***

SECTION 226.18 -- Content of Disclosures ***

18(f) Variable Rate ***

2. Basis for disclosures. For transactions subject to the requirements of section 226.18(f), the disclosures must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. ▶ The disclosures, although subject to change, are not estimates and should not be labelled as such. ◀ However, in a variable-rate transaction with either a seller buydown that is reflected in the credit contract or a consumer buydown, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the lower rate for the buydown period and the rate that is the basis of the variable rate feature for the remainder of the term. (See the commentary to section 226.17(c) for a discussion of buydown transactions.) ***

▶ 6. Growth equity mortgages. Also referred to as payment escalated mortages, these mortgage plans involve scheduled payment increases, rather than interest rate increases. The initial payment amount is determined for a long-term loan with a fixed interest rate. The rate remains constant, but payment increases are scheduled annually, based on a percentage of a given index. Because the interest rate remains constant and additional amounts are not required to pay off increased interest, the larger payments result in accelerated amortization of the loan. In disclosing these mortgage plans, creditors may either estimate the amount of payment increases, based on the best information reasonably available, or may disclose by analogy to the variable rate disclosures. Using the latter option, creditors would indicate that the payments are subject to increase, describe the circumstances under which the payments would increase, together with limitations on the increase, and provide an example of the increase. (This discussion does not apply to growth equity mortgages in which the amount of payment increases can be accurately determined at the time of disclosure. For these mortgages, as for graduated payment mortgages, disclosures should reflect the scheduled increases in payments.) ◀ ***

Paragraph 18(f)(3)

1. Effects. Disclosure of the effect of an increase refers to an increase in the number or amount of payments or an increase in the final payment. ▶ In addition, the creditor may make a brief reference to negative amortization that may result from a rate increase. (See comment 17(a)(1)-5 regarding directly related information.) ◀ If the effect cannot be determined, the creditor must provide a statement of the possible effects. For example, if the exercise of the variable-rate feature may result in either more or larger payments, both possibilities must be noted.

Paragraph 18(f)(4)

1. Hypothetical example. The example may, at the creditor's option, appear apart from the other disclosures. The creditor may provide either a standard example that represents the general type of credit offered by that creditor

or an example that directly reflects the terms and conditions of the particular transaction. ▶ (The example, whether general or specific, should not reflect an immediate increase if the contract does not permit an immediate increase.) ◀

[2. Demand obligations. In demand obligations with no alternate maturity date, the creditor need not provide a hypothetical example.]

▶ 2. Hypothetical example not required. The creditor need not provide a hypothetical example in the following transactions with a variable rate feature:

- Demand obligations with no alternate maturity date.
- Interim student credit extensions.
- Multiple advance construction loans disclosed pursuant to Appendix D, Part I. ◀

18(g) Payment Schedule

1. Amounts included in repayment schedule. The repayment schedule should reflect all components of the finance charge, not merely the portion attributable to interest. ▶ Prepaid finance charges, however, should not be shown in the repayment schedule. ◀ The payments may include amounts beyond the amount financed and finance charge. For example, the disclosed payments may, at the creditor's option, reflect certain insurance premiums where the premiums are not part of either the amount financed or the finance charge, as well as real estate escrow amounts such as taxes added to the payment in mortgage transactions. ***

Paragraph 18(g)(2)

1. Abbreviated disclosure. The creditor may disclose an abbreviated payment schedule when the amount of each regularly scheduled payment (other than the first or last payment) includes an equal amount to be applied on principal and a finance charge computed by application of a rate to the decreasing unpaid balance. This option is also available when mortgage-guarantee insurance premiums, paid either monthly or annually, cause variations in the amount of the scheduled payments, reflecting the continual decrease ▶ or increase ◀ in the premium due. The creditor using this alternative must disclose the dollar amount of the highest and lowest payments and make reference to the variation in payments. ***

18(i) Demand Feature ***

2. Covered demand features. The type of demand feature triggering the disclosures required by section 226.18(i) includes only those demand features contemplated by the parties as part of the legal obligation. For example, this provision does not apply to transactions that convert to a demand status as a result of the consumer's default. ▶ A due-on-sale clause is not considered a demand feature. ◀ ***

18(k) Prepayment ***

Paragraph 18(k)(1)

1. Penalty. This applies only to those transactions in which the interest calculation takes account of each ▶ scheduled ◀ reduction in principal. The term "penalty" as used here encompasses only those charges that are assessed strictly because of the prepayment in full of a simple-interest obligation, as an addition to all other amounts. Items which are not penalties include, for example:

- Prepaid finance charges collected at the outset of the transaction, such as points in a mortgage loan.
- Loan guarantee fees.
- Interim interest on a student loan.

However, a minimum finance charge is a penalty in a simple-interest transaction. ▶ (See comment 17(a)(1)-5 regarding the disclosure of a minimum finance charge as directly related information.) ◀

Paragraph 18(k)(2)

1. Rebate of finance charge. This applies to any finance charges that do not take account of each reduction in the principal balance of an obligation. This category includes, for example:

- Precomputed finance charges such as add-on charges.
- Charges that take account of some but not all reductions in principal, such as mortgage guarantee insurance assessed on the basis of an annual declining balance, when the principal is reduced on a monthly basis.
- Prepaid finance charges, such as points or loan fees collected at the outset of the transaction.

▶ The creditor may identify the finance charge that is subject to a rebate. (See comment 17(a)(1)-5 regarding directly related information.) ◀ No description of the method of computing earned or unearned finance charges ▶ , however, ◀ is required or permitted as part of the segregated disclosures under this section, although such information may be provided elsewhere in the contract. ***

18(r) Required Deposit ***

▶ 2. Pledged account mortgages. In these transactions, a consumer pledges as collateral funds that the consumer deposits in an account held by the creditor. The creditor withdraws sums from this account to supplement the consumer's

monthly payments. Creditors may treat these pledged accounts as required deposits (unless the accounts are excepted under footnote 45) or they may treat them as consumer buydowns in accordance with comment 17(c)(1)-4. ◀ ***

Comments 18(r)-2, 3, 4, and 5 are redesignated 18(r)-3, 4, 5, and 6, respectively.

SECTION 226.19 -- Certain Residential Mortgage Transactions

19(a) Time of Disclosure ***

2. Timing and use of estimates. Truth in Lending disclosures must be given (a) before consummation or (b) within three business days after the creditor receives the consumer's written application, whichever is earlier. The three-day period for disclosing credit terms coincides with the time period within which creditors subject to RESPA must provide good faith estimates of settlement costs. If the creditor does not know the precise credit terms, the creditor must base the disclosures on the best information reasonably available and indicate that the disclosures are estimates under section 226.17(c)(2). If many of the disclosures are estimates, the creditor may include a statement to that effect (such as "all numerical disclosures except the late-payment disclosure are estimates") instead of separately labelling each estimate. In the alternative, the creditor may label as an estimate only the items primarily affected by unknown information. (See the commentary to section 226.17(c)(2).) The creditor may provide explanatory material concerning the estimates and the contingencies that may affect the actual terms [,either on a separate document or on the same document (but separate from the required disclosures).] ▶ in accordance with comment 17(a)(1)-5. ◀ ***

SECTION 226.20 -- Subsequent Disclosure Requirements

20(a) Refinancings ***

3. Variable rate. ▶ Even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, the addition of a variable-rate feature to an obligation is a new transaction requiring new disclosures. ◀ If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, a renegotiable rate mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. However, if the variable-rate feature was not previously disclosed, a later change in the rate results in a new transaction subject to new disclosures. ***

▶ 5. Coverage. Section 226.20(a) applies only to refinancings undertaken by the original creditor or a holder or servicer of the original obligation. A "refinancing" by any other person is a new transaction under the regulation, not a refinancing under this section. ◀ ***

20(b) Assumptions

1. General definition. An assumption as defined in section 226.20(b) is a new transaction and new disclosures must be made to the subsequent consumer. An assumption under the regulation requires the following three elements:

- A residential mortgage transaction.
- An express acceptance of the subsequent consumer by the creditor.
- A written agreement.

▶ The assumption of a non-exempt consumer credit obligation with no change in terms requires no disclosures unless all three elements are present. ◀ ***

6. Change in terms. [A change in terms destroys the existing obligation and the transaction is treated as a new transaction under the regulation, not as an assumption. A change in terms includes, for example:] ▶ In order to be covered or excluded by section 226.20(b), the assumption must involve no significant change in the terms of the existing obligation. If the adoption of the obligation by a new obligor is accompanied by a significant change in terms, whether and when disclosures must be given are governed by the general requirements for a new transaction, not by section 226.20(b). Significant changes in terms include, for example: ◀

- A change in the contract interest rate unless the change is in accordance with a variable-rate feature that was properly disclosed in the existing obligation.
- A change in the length of the term.
- The addition of points.

▶ Insignificant changes in terms ◀ [Minor changes that do not destroy the existing obligation] include, for example:

- Assumption fees for processing loan documents.
- Insurance fees.
- Credit report fees. ***

SECTION 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraph 22(a)(1) ***

4. Basis for calculations. When a transaction involves "step rates" or "split rates" -- that is, different rates applied at different times or to different portions of the principal balance -- a single composite annual percentage rate

must be calculated and disclosed for the entire transaction. ▶ Assume, for example, a $10,000 loan repayable in 5 years at 10 percent interest for the first 2 years, 12 percent for years 3 and 4, and 14 percent for year 5. The monthly payments are $210.71 during the first 2 years of the term, $220.25 for years 3 and 4, and $222.59 for year 5. The composite annual percentage rate, using a calculator with a "discounted cash flow analysis" or "internal rate of return" function, is 10.75 percent. ◀ ***

SECTION 226.24 -- Advertising ***

24(b) Advertisement of Rate of Finance Charge ***

▶ 2. Rate of finance charge. An advertisement may not state an effective rate or payment rate applicable to only a portion of the term of the transaction unless the annual percentage rate is also stated. For example, an advertisement that states "qualify at 10 1/2%" or "an effective first year interest rate of 10 1/2%" generally shows only a portion of the rate of finance charge that actually accrues during the early years of the term; the advertised annual percentage rate that must accompany this rate must take into account the interest that will accrue but not be paid during this period. On the other hand, since an advertisement that states "financing available at 3 1/2% below prime" does not state a specific rate or portion of the finance charge, section 226.24(b) does not apply and the annual percentage rate is not a required disclosure. ◀ ***

Comments 24(b)-2 and 3 are redesignated 24(b)-3 and 4, respectively.

APPENDIX D -- Multiple-Advance Construction Loans ***

2. Variable-rate construction loans. The hypothetical disclosure required in most variable-rate transactions by section 226.18(f)(4) is not required for multiple-advance construction loans disclosed pursuant to Appendix D, Part I.

3. Calculation of the total of payments. When disclosures are made pursuant to Appendix D, the total of payments may reflect either the sum of the payments or the sum of the amount financed and the finance charge.

4. Annual percentage rate. Appendix D does not require the use of Volume I of the Board's Annual Percentage Rate Tables for calculation of the annual percentage rate. Creditors utilizing Appendix D in making calculations and disclosures may use other computation tools to determine the estimated annual percentage rate, based on the finance charge and payment schedule obtained by use of the appendix. ◀ ***

APPENDIX F -- Annual Percentage Rate Computations for Certain Open-End Credit Plans

1. Daily rate with specific transaction charge. If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(d)-2 for guidance on the appropriate calculation methods. ◀ ***

APPENDIX H -- Closed-End Model Forms and Clauses ***

17. ED-876 1/82. Pursuant to section 113(a) of the amended Truth in Lending Act, Form ED-876 1/82, issued by the U.S. Department of Education for certain student loans, has been approved. The form may be used for all PLUS loans when there is no deferment before the borrower begins repayment of both principal and interest. The form may also be used for PLUS loans when the borrower qualifies for a deferment of principal payments and the annual percentage rate to be disclosed is calculated taking account of the irregular payment schedule. The form may also be used for consolidation of previous PLUS loans, whether or not the borrower had a deferment of principal payments under the earlier loans. The following changes may be made to the form:

- Reducing the size of the form.
- Adding lines to the payment schedule disclosure.
- Deleting inapplicable disclosures by whiting out, blocking out, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, or circling applicable items.

18. ED-876A 4/82. Pursuant to section 113(a) of the amended Truth in Lending Act, Form ED-876A 4/82, issued by the U.S. Department of Education for certain student loans, has been approved. This form may be used for all PLUS loans where the borrower qualifies for an immediate deferment of principal payments under the terms of the note. (See the commentary to section 226.17(i) for the basis of disclosures.) The following changes may be made to the form:

- Reducing the size of the form.
- Deleting inapplicable disclosures by whiting out, blocking out, filling in "N/A" (not applicable) or "0," crossing out, leaving blanks, or circling applicable items. ◀ ***

* * * * *

Board of Governors of the Federal Reserve System, May 6, 1982.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

[SEAL]