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FEDERAL RESERVE press release

For immediate release April 3, 1984

The Federal Reserve Board today made public an update to the official staff commentary on Regulation Z (Truth in Lending). This represents final action on proposed changes in the commentary published in November 1983, and takes account of comment received.

The Board's notice is attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

TRUTH IN LENDING

Official Staff Commentary Update

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form changes to the official staff commentary to Regulation Z (Truth in Lending), 12 CFR Part 226. The commentary applies and interprets the requirements of Regulation Z with regard to consumer credit transactions and is a substitute for individual staff interpretations of the regulation. The commentary revisions address a variety of questions that have arisen about the regulation, such as the proper treatment of certain mortgage guarantee insurance premiums and certain types of variable-rate transactions, and the disclosure of the "total of payments" in closed-end credit transactions. Final action is being delayed on the proposal regarding the disclosure of fees in interchange or shared systems.

DATE: April 1, 1984, but reliance optional until October 1, 1984.

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) 452-2412 or (202) 452-3867:

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Subpart D -- Rugenia Silver

SUPPLEMENTARY INFORMATION: (1) General. Effective October 13, 1981, an official staff commentary was published to interpret Regulation Z (12 CFR Part 226). The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise. This is the third update to the commentary; the first was in September 1982 (47 FR 41338) and the second was in April 1983 (48 FR 14882). The changes are effective on April 1, 1984. Although creditors are free to rely on the provisions as of that date and are protected if they do so, they need not follow the revisions until October 1, 1984, the uniform effective date provided for in § 105(d) of the revised Truth in Lending Act.

(2) Commentary revisions. Following is a brief description of the revisions to the commentary and how they differ, if at all, from those proposed.

SUBPART A - GENERAL

SECTION 226.2 -- Definitions and Rules of Construction

2(a)(17) "Creditor"

The last sentence of comment 2(a)(17)(i)-7 is deleted because it contains a cross-reference to the commentary discussing "arranger of credit," which was deleted in April 1983 (48 FR 14882). The sentence should have been deleted at that time.

SECTION 226.4 -- Finance Charge

4(b) Examples of Finance Charges

Paragraph 4(b)(2)

No final action on proposed comment 4(b)(2)-2 is being taken at this time. The proposal excepts from the finance charge certain fees imposed on cardholders for accessing credit through electronic terminals in interchange or

shared systems. Final action on this proposal is being postponed in order to consider the issues more fully and to further investigate operational concerns, as well as to consider any additional issues that might be raised in response to proposed questions 7-15.5 and 9-31.5 of the update to the Regulation E commentary (49 FR 2204). Final action is also delayed on the proposed addition to comment 6(b)-1, which provides that certain disclosure requirements would be retained for fees excepted from the finance charge.

4(c) Charges Excluded from the Finance Charge

Paragraph 4(c)(5)

Comment 4(c)(5)-2 is added to explain the correct treatment of mortgage insurance premiums and other charges when they are paid at or before settlement by the noncreditor seller. This is most likely to arise in the case of FHA mortgage insurance premiums, which the Department of Housing and Urban Development now collects in a lump sum rather than periodically. The creditor should treat the amount of the payment made by the seller as seller's points and exclude it from the finance charge.

The final comment has been revised from the proposal to eliminate some of the restrictions on the payments to which it applies and to explain the use of estimates when disclosures must be made before the creditor knows who will pay the fee.

SUBPART B - OPEN-END CREDIT

SECTION 226.6 -- Initial Disclosure Statement

6(a) Finance Charge

Comment 6(a)(2)-10 is added to address the disclosure of discounted variable-rate plans on the initial disclosure statement. The comment has been expanded from the proposal to provide examples of the types of plans covered

by the interpretation, to give additional guidance on the required disclosures, and to make clear that the creditor may use the disclosure options set forth in comment 6(a)(2)-3 in disclosing the current "indexed" rate.

The staff is aware that, in the absence of any additional interpretive material, creditors could reasonably have applied the variable-rate provisions of the commentary in different ways to discounted variable-rate plans, and that, therefore, creditors may have given different disclosures for these plans. Because of possible confusion in this area, comment 6(a)(2)-10 has been added to explain creditors' initial disclosure statement responsibilities with regard to these plans.

6(b) Other Charges

No final action is being taken at this time on the proposed addition to comment 6(b)-1. The proposal provides that certain interchange fees excepted from the finance charge under proposed comment 4(b)(2)-2 must still be disclosed as "other charges" under §§ 226.6(b) and 226.7(h). Final action is being delayed for the reasons set forth in the discussion of proposed comment 4(b)(2)-2.

SECTION 226.12 -- Special Credit Card Provisions

12(b)(3) Notification to Card Issuer

Comment 12(b)(3)-3 is added to point out that, under the regulation, the liability protections of § 226.12 are not dependent upon whether the consumer follows the error resolution procedures of § 226.13. Editorial changes were made to the proposal to clarify the relationship between §§ 226.12 and 226.13.

SECTION 226.13 -- Billing-Error Resolution

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

Language is added to comment 13(d)(1)-3 to clarify that finance or other charges cannot be imposed on undisputed balances, even in subsequent billing cycles, merely because the consumer withholds payment of a disputed amount. A sentence has been added to the proposal to further clarify this issue.

Paragraph 13(g)(1)

Comment 13(g)(1)-1 is revised to make clear that, when the creditor notifies the consumer of amounts still owed from the resolution period, the creditor may not include finance or other charges imposed on the undisputed amounts solely because the consumer withheld payment of a disputed amount.

SECTION 226.14 -- Determination of Annual Percentage Rate

14(a) General Rule

Comment 14(a)-5 is added to clarify the circumstances under which creditors may utilize footnote 31a, regarding faulty calculation tools. The comment has been expanded from the proposal to provide further guidance on the types of errors that may be subject to the footnote.

SECTION 226.16 -- Advertising

A new comment 16-2 has been added to permit open-end credit advertisers to use readily understandable abbreviations, such as "APR", as an expression of the annual percentage rate.

16(b) Advertisement of Terms That Require Additional Disclosures

Comment 16(b)-4 is modified to describe several ways of satisfying the required disclosure of the annual percentage rate in an advertisement for a variable-rate plan. Language has been added to clarify that disclosure of both the current rate and the fact that the rate may vary is required in advertisements for variable-rate open-end credit plans.

Comment 16(b)-5 is added to explain how discounted variable-rate plans may be advertised. The comment has been expanded from the proposal 1) to clarify that an advertisement for a discounted variable-rate open-end credit plan must reflect how long the initial, lower rate will be in effect; 2) to reflect that, as with any advertised variable rate, the current indexed rate must be accompanied by a disclosure that the rate may vary; and 3) to indicate that the options listed in comment 16(b)-4 for use in disclosing the annual percentage rate in an advertisement for a variable-rate plan are equally available in disclosing the current indexed rate in a discounted variable-rate plan.

SUBPART C - CLOSED-END CREDIT

SECTION 226.17 -- General Disclosure Requirements

17(b) Time of Disclosures

Comment 17(b)-2 is revised to clarify the time of disclosure when an open-end credit account is converted to a closed-end transaction. Under some state laws, consummation of the closed-end transaction is deemed to occur at the same time as the opening of the open-end credit plan, even though the conversion may occur several years later. In these cases, the closed-end credit disclosures may be given at the time of the conversion.

SECTION 226.18 -- Content of Disclosures

18(f) Variable Rate

Comment 18(f)-8 is added to address the disclosure of discounted variable-rate transactions. The comment has been expanded from the proposal to provide examples and to respond to questions raised by the comments. The examples illustrate the use of a composite annual percentage rate and its effect

on other calculations. As requested by commenters, the effect of a rate cap also has been shown in the examples.

The staff is aware that, in the absence of any additional interpretive material, creditors could reasonably have applied the variable-rate provisions of the commentary in different ways to discounted variable-rate plans, and that, in fact, creditors have given different disclosures for these transactions. Because of confusion in this area, comment 18(f)-8 has been added to explain creditors' disclosure responsibilities with regard to these transactions.

18(g) Payment Schedule

Comment 18(g)-3 is added to make clear that creditors are not required to disclose the total number of payments in a transaction involving several payment levels.

SECTION 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Comment 22(a)(1)-5 is added to clarify the circumstances under which creditors may utilize footnote 45a, regarding faulty calculation tools. The comment has been expanded from the proposal to provide further guidance on the types of errors that may be subject to the footnote.

SECTION 226.24 -- Advertising

A comment has been added to the commentary to § 226.16 to permit the use of an abbreviation for "annual percentage rate" when that term is used in advertising open-end credit. Because of a difference in regulatory language between §§ 226.16 and 226.24, a companion provision to that comment has not been adopted for advertisements of closed-end credit. The issue will be considered for inclusion in any future regulatory revision.

24(b) Advertisement of Rate of Finance Charge

Comment 24(b)-5 is added to explain how discounted variable-rate transactions may be advertised. In response to questions, the comment has been expanded from the proposal to describe more specifically the special rules for advertising these transactions, and to provide examples. Although a composite annual percentage rate must be shown, the discounted rate and payment amounts may be shown in conjunction with the higher rate and payments without triggering other terms under § 226.24(c). A sentence also has been added to the proposal stating that limits or caps on rates or payments need not be shown.

24(c) Advertisement of Terms that Require Additional Disclosures

The proposed revision to comment 24(c)(1)-1, which would have deleted the sentence limiting application of § 226.24(c)(1) to credit sales, has not been adopted. After consideration of the comments received, the staff believes that the proposed revision is not necessary or appropriate.

SUBPART D - MISCELLANEOUS

SECTION 226.28 -- Effect on State Laws

28(a) Inconsistent Disclosure Requirements

Comments 28(a)-11 and 28(a)-12 are added to reflect Board determinations on the effect of the Truth in Lending Act on the consumer credit laws of Mississippi and South Carolina.

List of Subjects in 12 CFR Part 226

Advertising; Banks, banking; Consumer protection; Credit; Federal Reserve System; Finance; Penalties; Truth in lending.

(3) Text of revisions. The revisions to the commentary (Supplement I to Part 226) read as follows:

SUPPLEMENT I - Official Staff Commentary - TIL-1

SUBPART A - GENERAL

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1. The commentary to section 226.2 is amended by removing the last sentence of comment 2(a)(17)(i)-7.

SECTION 226.2 -- Definitions and Rules of Construction

2(a) Definitions

* * * * *

2(a)(17) "Creditor"

* * * * *

Paragraph 2(a)(17)(i)

* * * * *

7. Trusts. In the case of credit extended by trusts, each individual trust is considered a separate entity for purposes of applying the criteria. For example:

- A bank is the trustee for three trusts. Trust A makes 15 extensions of consumer credit annually; Trust B makes 10 extensions of consumer credit annually; and Trust C makes 30 extensions of consumer credit annually. Only Trust C is a creditor for purposes of the regulation.

[With regard to the trustee's status, see the commentary to section 226.2(a)(3).]

* * * * *

2. The commentary to section 226.4 is amended by adding comment 4(c)(5)-2, to read as follows:

SECTION 226.4--Finance Charge

* * * * *

4(c) Charges Excluded from the Finance Charge

* * * * *

Paragraph 4(c)(5)

* * * * *

▶2. Other seller-paid amounts. Mortgage insurance premiums and other charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. In such cases, the creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available, as called for by the estimate provisions of the regulation.◀

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SUBPART B - OPEN-END CREDIT

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3. The commentary to section 226.6 is amended by adding comment 6(a)(2)-10, to read as follows:

SECTION 226.6 -- Initial Disclosure Statement

* * * * *

Paragraph 6(a)(2)

* * * * *

▶10. Discounted variable-rate plans. In some variable-rate plans, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate is lower than the rate would be if it were calculated using the index or formula.

- For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the

creditor may forego the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent, or the creditor may disregard the index or formula and set the initial rate at 9 percent.

° When creditors use an initial rate that is not calculated using the index or formula for later rate adjustments, the initial disclosure statement should reflect: 1) the initial rate (expressed as a periodic rate and a corresponding annual percentage rate), together with a statement of how long it will remain in effect; 2) the current rate that would have been applied using the index or formula (also expressed as a periodic rate and a corresponding annual percentage rate); and 3) the other variable-rate information required by footnote 12 to section 226.6(a)(2).

° In disclosing the current periodic and annual percentage rates that would be applied using the index or formula, the creditor may use any of the disclosure options described in comment 6(a)(2)-3.◀

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4. The commentary to section 226.12 is amended by adding comment 12(b)(3)-3, to read as follows:

SECTION 226.12 -- Special Credit Card Provisions

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12(b) Liability of Cardholder for Unauthorized Use

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12(b)(3) Notification to Card Issuer

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▶3. Relationship to section 226.13. The liability protections afforded to cardholders in section 226.12 do not depend upon the cardholder's following

the error resolution procedures in section 226.13. For example, the written notification and time limit requirements of section 226.13 do not affect the section 226.12 protections.◀

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5. The commentary to section 226.13 is amended by revising comments 13(d)(1)-3 and 13(g)(1)-1, to read as follows:

SECTION 226.13 -- Billing-Error Resolution

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13(d) Rules Pending Resolution

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

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3. Imposition of additional charges on undisputed amounts. The consumer's withholding of [the] ▶a◀ disputed amount from the total bill cannot subject [the] undisputed [portion] ▶ balances (including new purchases or cash advances made during the present or subsequent cycles)◀ to the imposition of finance or other charges. For example, if on an account with a free-ride period ▶ (that is, an account in which paying the new balance in full allows the consumer to avoid the imposition of additional finance charges)◀, a consumer disputes a $2 item out of a total bill of $300 and pays $298 within the free-ride period, the consumer would not lose the free-ride as to [the] ▶any◀ undisputed [portion] ▶amounts◀, even if the creditor determines later that no billing error occurred. ▶Furthermore, finance or other charges may not be imposed on any new purchases or advances that, absent the unpaid disputed balance, would not have finance or

other charges imposed on them. Finance or other charges that would have been incurred even if the consumer had paid the disputed amount would not be affected.◀

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13(g) Creditor's Rights and Duties After Resolution

Paragraph 13(g)(1)

1. Amounts owed by consumer. Amounts the consumer still owes may include both minimum periodic payments and related finance and other charges that accrued during the resolution period. ▶As explained in the commentary to section 226.13(d)(1), even if the creditor later determines that no billing error occurred, the creditor may not include finance or other charges that are imposed on undisputed balances solely as a result of a consumer's withholding payment of a disputed amount.◀

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6. The commentary to section 226.14 is amended by adding comment 14(a)-5, to read as follows:

SECTION 226.14 -- Determination of Annual Percentage Rate

14(a) General Rule

* * * * *

▶5. Good faith reliance on faulty calculation tools. Footnote 31a absolves a creditor of liability for an error in the annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the footnote is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability

for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.◀

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7. The commentary to section 226.16 is amended by adding comment 16-2, revising comment 16(b)-4, adding new comment 16(b)-5, and redesignating existing comments 16(b)-5 and 6 as 16(b)-6 and 7, to read as follows:

SECTION 226.16 -- Advertising

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▶2. Expressing the annual percentage rate in abbreviated form. Whenever the annual percentage rate is used in an advertisement for open-end credit, it may be expressed using a readily understandable abbreviation such as "APR".◀

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16(b) Advertisement of Terms That Require Additional Disclosures

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4. Variable-rate plans. ▶In disclosing the annual percentage rate in an advertisement for a variable-rate plan, as required by section 226.16(b)(2), the creditor may use an insert showing the current rate; may give the rate as of a specified recent date; or may disclose an estimated rate under section 226.5(c). The additional requirement in section 226.16(b)(2) to disclose the variable-rate feature may be satisfied by disclosing◀ [An advertisement for a variable-rate plan complies with section 226.16(b)(2) if it discloses] that "the annual percentage rate may vary" or a similar statement, but the advertisement need not include the information required by footnote 12 to section 226.6(a)(2).

▶5. Discounted variable-rate plans--disclosure of the annual percentage rates. The advertised annual percentage rates for discounted variable-rate plans must, in accordance with comment 6(a)(2)-10, include both the initial rate (with the statement of how long it will remain in effect) and the current indexed rate

(with the statement that this second rate may vary). The options listed in comment 16(b)-4 may be used in disclosing the current indexed rate.◀

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SUBPART C - CLOSED-END CREDIT

8. The commentary to section 226.17 is amended by revising comment 17(b)-2, to read as follows:

SECTION 226.17 -- General Disclosure Requirements

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17(b) Time of Disclosures

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2. Converting open-end to closed-end credit. If an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. ▶If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion.◀ (See the commentary to section 226.5 regarding conversion of closed-end to open-end credit.)

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9. The commentary to section 226.18 is amended by adding comments 18(f)-8 and 18(g)-3, to read as follows:

SECTION 226.18 -- Content of Disclosures

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18(f) Variable Rate

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▶8. Discounted variable-rate transactions. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate is lower than the rate would be if it were calculated using the index or formula. For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the creditor may forego the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

- When creditors use an initial rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is applied and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation.
- The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.
- If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.
- Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of 1/4 of 1 percent applies, in accordance with section 226.22(a)(3) of the regulation.
- Examples of discounted variable-rate transactions include:

-- A 30-year loan for $100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the payment schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $266,463.32 and the total of payments $366,463.32.

-- Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of $804.62, 12 payments of $950.09, and 336 payments of $1,024.34. The finance charge should be $265,234.76, and the total of payments $365,234.76.◀

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18(g) Payment Schedule

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▶3. Total number of payments. In disclosing the number of payments for transactions with more than one payment level, creditors may but need not disclose as a single figure the total number of payments for all levels. For example, in a transaction calling for 108 payments of $350, 240 payments

of $335, and 12 payments of $330, the creditor need not state that there will be a total of 360 payments.◀

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10. The commentary to section 226.22 is amended by adding comment 22(a)(1)-5, to read as follows:

SECTION 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraph 22(a)(1)

* * * * *

▶5. Good faith reliance on faulty calculation tools. Footnote 45a absolves a creditor of liability for an error in the annual percentage rate or finance charge that resulted from a corresponding error in a calculation tool used in good faith by the creditor. Whether or not the creditor's use of the tool was in good faith must be determined on a case-by-case basis, but the creditor must in any case have taken reasonable steps to verify the accuracy of the tool, including any instructions, before using it. Generally, the footnote is available only for errors directly attributable to the calculation tool itself, including software programs; it is not intended to absolve a creditor of liability for its own errors, or for errors arising from improper use of the tool, from incorrect data entry, or from misapplication of the law.◀

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11. The commentary to section 226.24 is amended by adding comment 24(b)-5, to read as follows:

SECTION 226.24 -- Advertising

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24(b) Advertisement of Rate of Finance Charge

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▶5. Discounted variable-rate transactions. The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 18(f)-8 regarding the basis of transactional disclosures for such financing. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced initial rate, provided the advertisement shows the limited term to which the reduced rate applies.

- Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 18(f)-8, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.
- The advertisement may also show the effect of the discount on the payment schedule for the discount period without triggering the additional disclosures under section 226.24(c). For example, the advertisement may state that "with this discount, your monthly payments for the first year of the mortgage term will be only $577" or "this discount will reduce your monthly payments for the first year of the mortgage term by $223."◀

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SUBPART D - MISCELLANEOUS

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12. The commentary to section 226.28 is amended by adding comments 28(a)-11 and 12, to read as follows:

SECTION 226.28 -- Effect on State Laws

28(a) Inconsistent Disclosure Requirements

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▶11. Preemption determination -- Mississippi. Effective October 1, 1984, the Board has determined that the following provision in the state law of Mississippi is preempted by the federal law:

- Section 63-19-31(2)(g) - Disclosure of finance charge. This disclosure is preempted in those cases in which the term "finance charge" would be used under state law to describe a different amount than the finance charge disclosed under federal law.

12. Preemption determination -- South Carolina. Effective October 1, 1984, the Board has determined that the following provision in the state law of South Carolina is preempted by the federal law:

- Section 37-10-102(c) - Disclosure of due-on-sale clause. This provision is preempted, but only to the extent that the creditor is required to include the disclosure with the segregated federal disclosures. If the creditor may comply with the state law by placing the due-on-sale notice apart from the federal disclosures, the state law is not preempted.◀

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Board of Governors of the Federal Reserve System, March 30, 1984.

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