FEDERAL RESERVE press release

For immediate release December 8, 1994

The Federal Reserve Board today issued for public comment proposed revisions to the official staff commentary to its Truth in Lending Regulation Z. Comment should be received by February 1, 1995.

The proposed revisions would clarify regulatory provisions or provide further guidance on issues of general interest, such as the treatment of various fees and taxes associated with real estate-secured loans, including charges by third parties, and a creditor's responsibilities when investigating a claim of unauthorized use of a credit card.

A copy of the proposed revisions is attached.

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FEDERAL RESERVE SYSTEM

12 CFR Part 226

DEC 0 8 1994

[Regulation Z; Docket No. R-0863]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; official staff interpretation.

SUMMARY: The Board is publishing for comment proposed revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z. The proposed revisions would clarify regulatory provisions or provide further guidance on issues of general interest, such as the treatment of various fees and taxes associated with real estate-secured loans and a creditor's responsibilities when investigating a claim of unauthorized use of a credit card.

DATES: Comments must be received on or before February 1, 1995.

ADDRESSES: Comments should refer to Docket No. R-0863, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

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FOR FURTHER INFORMATION CONTACT: For Subparts A and B (open-end credit), Jane Jensen Gell or Obrea O. Poindexter, Staff Attorneys; for Subparts A and C (closed-end credit), Kyung Cho-Miller, Sheilah A. Goodman, or Natalie E. Taylor, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for the hearing impaired only, Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA; 15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose credit terms and the cost of credit as an annual percentage rate (APR). The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling. It also imposes limitations on some credit transactions secured by a consumer's principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR part 226). The regulation authorizes the issuance of official staff interpretations of the regulations. (See Appendix C to Regulation Z.)

The Board is publishing proposed amendments to the commentary to Regulation Z. The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions and is a substitute for individual staff interpretations. It is updated periodically to address significant questions that arise. It is expected that this update will be

adopted in final form in March 1995 with compliance optional until October 1, 1995, the effective date for mandatory compliance.

II. Proposed Commentary

SUBPART A -- General

SECTION 226.2 -- Definitions and Rules of Construction

2(a) Definitions

2(a)(17) Creditor

Paragraph 2(a)(17)(i)

Comment 2(a)(17)(i)-8 would be revised to provide further guidance on the identity of the creditor for participant loans from an employee savings plan, such as 401(k) plans. Under applicable law, it is the plan that extends the credit, not the trust or trustee receiving and disbursing plan funds. Therefore, for purposes of the TILA, the plan is deemed to be the creditor.

SECTION 226.4 -- Finance Charge

4(a) Definition

Comment 4(a)-1 would be revised to indicate to creditors that section 12 of the Real Estate Settlement Procedures Act (RESPA; 12 U.S.C. 2610) prohibits fees from being charged for preparing TILA disclosure statements in RESPA-covered transactions.

Comment 4(a)-3 would be revised to provide additional guidance on when fees charged by a third party are finance charges.

4(c) Charges Excluded from the Finance Charge

Paragraph 4(c)(7)

Comment 4(c)(7)-1 would be revised to clarify the interplay of the fourth and fifth sentences, dealing with a lump sum charge for services. Proposed new language makes clear that a lawyer's attendance at a closing or a charge for conducting the closing is entirely excluded from the finance charge, even though fees for the incidental services might not be excluded if they were imposed separately; this is an exception to the general rule on the treatment of lump sum fees.

Proposed comment 4(c)(7)-2 would clarify that real estate or residential mortgage transaction charges excludable under § 226.4(c)(7) are those charges imposed in connection with the initial decision to grant credit and paid prior to or at consummation or loan closing -- for example, a fee to search for tax liens on the property or to determine if flood insurance is required. Additional fees assessed during the loan term to monitor a consumer's continued compliance with contract provisions, such as paying property taxes or purchasing flood insurance, are not excludable under § 226.4(c)(7). These recurring administrative fees, paid by the consumer to protect the creditor's security interest, are finance charges.

4(e) Certain Security Interest Charges

Comment 4(e)-1 would be revised to clarify that the security interest charges excludable as finance charges are those that relate to the agreement between the creditor and the consumer. When a creditor sells or otherwise assigns the consumer's obligation to a third party and the fee to record the assignment is imposed on the consumer, that fee is not excludable from the finance charge under § 226.4(e).

SUBPART B -- Open-End Credit

SECTION 226.5 -- General Disclosure Requirements

5(b) Time of Disclosures

5(b)(1) Initial Disclosures

Comment 5(b)(1)-1 provides that initial disclosures must be provided before the consumer makes the first purchase under an open-end plan; the proposed revision provides an example to illustrate that when a consumer makes a purchase and opens an account contemporaneously with a retailer, for example, disclosures must be given to the consumer at that time.

Proposed comment 5(b)(1)-5 addresses the timing of disclosures for open-end credit plan solicitations that offer consumers an option to transfer outstanding balances with other creditors.

SECTION 226.6 -- Initial Disclosure Statement

6(b) Other Charges

Comment 6(b)-1 would be revised to state that a fee imposed for terminating an open-end credit plan must be disclosed as an "other charge." Under § 226.6(b) of the regulation, significant charges related to the plan (that are not finance charges) must be disclosed.

While a termination fee might technically meet the definition of a finance charge, there is no detriment to the consumer for a creditor to disclose this fee as a significant charge under § 226.6(b) -- other charges -- rather than a finance charge under § 226.4. There seems to be little benefit to the consumer's receiving an APR (disproportionately high in some

cases) on what might be the last periodic statement under an active plan for a fee imposed when the consumer closes the account.

SECTION 226.12 -- Special Credit Card Rules

12(b) Liability of Cardholder for Unauthorized Use

Proposed comments 12(b)-2 and -3 address a card issuer's rights and responsibilities in responding to a claim of unauthorized use under § 226.12. Proposed comment 12(b)-2 clarifies that card issuers are not required to impose any liability. Proposed comment 12(b)-3 clarifies that a card issuer wishing to impose liability must investigate claims in a reasonable manner.

Proposed comment 12(b)-3 lists some of the steps that card issuers may take in the investigation of a claim. For example, card issuers may request that a cardholder provide information needed to resolve the claim. But a card issuer cannot automatically deny a claim based on a cardholder's failure, for instance, to submit a signed statement or notarized document, or to file a police report. The steps appropriate for investigating particular claims may differ, and card issuers are not required to take certain minimum steps on all claim investigations. Specific comment is solicited on the proposed approach for providing guidance that identifies, by example, actions that card issuers may take in a reasonable investigation of a claim of unauthorized use.

SECTION 226.15 -- Right of Rescission

15(a) Consumer's Right to Rescind

Paragraph 15(a)(1)

Comments 15(a)(1)-5 and -6 would be revised to provide further guidance on the right to rescind a transaction secured by a consumer's principal dwelling. The right of rescission does not apply to residential mortgage transactions. (See § 226.15(f)(1).) Proposed comment 15(a)(1)-5 adds examples of transactions that are and are not rescindable.

Comment 15(a)(1)-6 -- which contains an exception to the "one principal dwelling" rule of comment 15(a)(1)-5 -- would be revised to clarify that a credit transaction secured by the equity in the consumer's current principal dwelling, not by the new home, is subject to the rescission requirements of § 226.15.

15(d) Effects of Rescission

Consumers who rescind transactions are refunded any fees that they paid to obtain the loan. Comment 15(d)(2)-1 would be revised to clarify that broker fees, although paid by the consumer to a third party, must be refunded by the creditor to the consumer if the consumer rescinds the transaction.

SECTION 226.16 -- Advertising

16(d) Additional Requirements for Home Equity Plans

Proposed comment 16(d)-7 would clarify disclosure requirements for balloon payments in home equity plan advertisements. Commentary to § 226.5b(d)(5)(ii) provides that for plans in which a balloon payment will occur if the consumer makes only the minimum payments, the disclosure must state that fact. The proposed comment would apply this requirement to

advertisements, since the regulatory provisions on treatment of balloon payments in home equity advertising and in disclosures are generally parallel.

SUBPART C -- Closed-end Credit

SECTION 226.17 -- General Disclosures

17(a) Form of Disclosures

Paragraph 17(a)(1)

Comment 17(a)(1)-5 would be revised to include a late payment fee on a single payment loan as information directly related to the segregated disclosures. Section 226.18(l) requires disclosure of a late payment fee only if a dollar or percentage charge may be imposed before maturity due to a late payment, other than a deferral or extension charge. Creditors suggest that the only distinction between requiring the fee to be reflected on a loan that has not matured, as compared with a loan that has matured, is of a technical nature. Disclosure of a late payment fee is information valuable to a consumer obligated on a single payment loan that would not distract from or obscure the segregated disclosures.

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(4)

Section 226.17(c)(4) allows creditors to disregard in the payment schedule and other calculations small variations in the first payment due to a long or short first period. Proposed comment 17(c)(4)-4 clarifies that prepaid finance charges, such as odd days interest paid at or prior to closing, may not be considered as the first payment on a loan. Thus, creditors cannot disregard any irregularity in disclosing such finance charges in the payment schedule.

17(f) Early Disclosures

Comment 226.17(f)-1 would be revised to clarify that redisclosure is not only required if the annual percentage rate in the consummated transaction differs from the disclosed rate by more than the allowable 1/8 or 1/4 of 1 percent tolerance, but also if the early disclosures were not indicated as estimates, and consummated terms other than the rate differ from the terms disclosed.

SECTION 226.18 -- Content of Disclosures

18(c) Itemization of Amount Financed

Paragraph 18(c)(1)(iv)

Proposed comment 18(c)(1)(iv)-2 clarifies disclosure requirements under the TILA that are affected by new rules under the Real Estate Settlement Procedures Act (RESPA; 12 U.S.C. 2601). In October 1994, the Department of Housing and Urban Development (HUD), which implements RESPA through Regulation X (24 CFR Part 3500), amended its regulation to implement new procedures for calculating the amount consumers must pay into escrow accounts associated with RESPA-covered home mortgage loans (59 FR 53890, October 26, 1994). These procedures are being phased in over time for existing escrow accounts; all new escrow accounts established on or after April 24, 1995 must comply with the new procedures. Eventually, all lenders will be required to use an aggregate accounting method instead of a single-item method for RESPA transactions. The use of the aggregate method will affect disclosure requirements under Regulation Z.

Currently, in calculating the amounts required to be paid into escrow accounts at closing, lenders use what is referred to as the single-item analysis. (Property taxes, insurance, and mortgage insurance premiums are common examples of escrow items.) Under single-

item analysis, lenders account separately for each item to be collected at closing and held in escrow.

Under the aggregate accounting method, rather than accounting for each item separately, the amount for escrow is determined as a whole. This will make it difficult for a creditor to determine how much of the aggregate amount is actually allocated to each escrow item.

Regardless of how they collect the funds under RESPA, lenders will continue to disclose escrow items on the HUD settlement statement using the single-item analysis. If the amount actually collected at settlement is affected by the aggregate accounting method, the settlement statement will reflect the adjustment on a separate line in the 1000 series. Mortgage insurance premiums, one of the items typically paid at settlement and included in the escrow account, are listed on line 1002 of the HUD statement. This amount is also a prepaid finance charge under Regulation Z.

If a creditor is collecting the settlement charges using aggregate analysis the amount actually collected may be less than the amount listed on line 1002. Guidance has been requested on what amount lenders should use as the prepaid finance charge, since the amount disclosed is not precisely the amount collected. Various alternatives have been considered to ensure as accurate and uniform a disclosure as possible. The proposed comment provides that creditors may use the amount on line 1002, without adjustment, to calculate the prepaid finance charge under the TILA. This approach will ease compliance and provide consumers with an easily identifiable amount for the mortgage insurance. While this method does slightly overstate the amount of the prepaid finance charge for mortgage insurance,

nonetheless this method seems to provide the more accurate and equitable treatment possible given the problems associated with identifying the amount of any single item in an aggregate accounting analysis. Comment is solicited on the use of the figure in line 1002 as the amount for the prepaid finance charge for mortgage insurance along with any other concerns the shift to aggregate accounting raises for lenders under Regulation Z.

18(d) Finance Charge

Proposed comment 18(d)-2 states that although there is no specific tolerance for the amount financed, an error in that figure -- resulting from an error in a finance charge that is a component part of the amount financed -- does not violate the act or the regulation provided the finance charge disclosed under § 226.18(d) is within the permissible tolerance provided in footnote 41 of the regulation. The same interpretation would apply to other disclosures for which the regulation provides no specific tolerance, such as the total of payments.

SECTION 226.19 -- Certain Residential Mortgage Transactions

19(b) Certain Variable-Rate Transactions

Paragraph 19(b)(2)(vii)

Proposed comment 19(b)(2)(vii)-2 states that loans with more than one way to trigger negative amortization are separate variable-rate loan programs requiring disclosures under § 226.19(b)(2)(viii) and (x) to the extent they vary from each other. For example, a loan that provides for monthly interest rate changes but only annual payment changes, or automatic payment caps for a set period of time, or an option for the borrower to cap the amount of monthly payments whenever the new payment would exceed the old payment by more than a certain margin, consists of three separate variable-rate programs. Each program may trigger

negative amortization. For the program that gives the borrower an option to cap monthly payments, the creditor must fully disclose the rules relating to the payment cap option, including the effects of exercising it (such as negative amortization occurs and the principal balance will increase), except that the disclosure in § 19(b)(2)(vii) need not be given for the option.

SECTION 226.22 -- Determination of the Annual Percentage Rate

22(a) Accuracy of the Annual Percentage Rate

Paragraph 22(a)(1)

Comment 22(a)(1)-5 would be revised to correct an erroneous footnote reference.

SECTION 226.23 -- Right of Rescission

23(a) Consumer's Right to Rescind

Paragraph 23(a)(1)

The right of rescission does not apply to residential mortgage transactions. (See § 226.23(f)(1).) Comments 23(a)(1)-3 and -4 would be revised to provide further guidance on the right to rescind a transaction secured by a consumer's principal dwelling. Proposed comment 23(a)(1)-3 adds examples of transactions that are and are not rescindable.

Comment 23(a)(1)-4 -- which contains an exception to the "one principal dwelling" rule in comment 23(a)(1)-3 -- would be revised to clarify that a credit transaction secured by the equity in the consumer's current principal dwelling, not by the new home, is subject to the rescission requirements of § 226.23.

23(d) Effects of Rescission

Paragraph 23(d)(2)

Consumers who rescind transactions are refunded any fees that they paid to obtain the loan. Comment 23(d)(2)-1 would be revised to clarify that broker fees, although paid by the consumer to a third party, must be refunded by the creditor to the consumer if the consumer rescinds the transaction.

23(f) Exempt Transactions

Paragraph 23(f)(4)

Section 226.23(f)(2) exempts refinancings by the original creditor, to whom the obligation was originally payable. (See definition of a creditor under TILA in § 226.2(a)(17).) Comment 23(f)-4 would be revised to clarify that in a merger, consolidation, or acquisition, the successor institution is considered the original creditor for purposes of the exemption in § 226.23(f)(2). For example, if two lending institutions merge, the resulting institution is considered the original creditor for refinancings of any mortgage loans that were made by either of the two institutions. In refinancing transactions, any creditor that is not the original creditor for the obligation being refinanced must deliver the general rescission notice (model form H-8).

APPENDIX J -- Annual Percentage Rate Computations for Closed-end Credit Transactions

In the reference section, the 1981 changes paragraph would be revised to make a technical correction to the second sentence. Paragraph (b)(5)(vi) does not permit creditors to use either the 12-month or the 365-day unit period methods "in all cases" where the transaction term equals a whole number of months, but only in a single-advance, single-

payment transaction in which the term is less than a year and is equal to a whole number of months.

III. Form of Comment Letters

Comment letters should refer to Docket No. R-0863, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text in machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3 1/2 inch or 5 1/4 inch computer diskettes in any IBM-compatible DOS-based format.

List of Subjects in 12 CFR Part 226

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

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

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

PART 226 -- TRUTH IN LENDING (REGULATION Z)

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

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

Supplement I--Official Staff Interpretations

Subpart A--General

2. Under Section 226.2--Definitions and Rules of Construction, under Paragraph 2(a)(17)(i)., paragraph 8. would be revised to read as follows:

Section 226.2--Definitions and Rules of Construction

* * * * *

Paragraph 2(a)(17)(i).

* * * * *

8. Loans from employee savings plan. Some employee savings plans permit participants to borrow money up to a certain percentage of their account balances[.]▸, and use a trust to administer the receipt and disbursement of funds. The plan (not the trust or the trustee) is the creditor for purposes of this regulation. Thus, unless◂ [Unless] each participant's account is an individual ▸plan and◂ trust ▸, such as an individual retirement account◂, the numerical tests should be applied to the plan as a whole rather than to the individual accounts, even if the loan amount is determined by reference to the balance in an individual account and the repayments are credited to the individual account.

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3. Under Section 226.4--Finance Charge, the following amendments would be made:

a. Under 4(a) Definition., paragraphs 1. and 3. would be revised;

b. Under Paragraph 4(c)(7)., paragraph 1. would be revised and a new paragraph 2. would be added; and

c. Under (4)(e) Certain security interest charges., paragraph 1. would be revised.

The revisions and additions would read as follows:

Section 226.4--Finance Charge

4(a) Definition.

1. Charges in comparable cash transactions. Charges imposed uniformly in cash and credit transactions are not finance charges. In determining whether an item is a finance charge, the creditor should compare the credit transaction in question with a similar cash transaction. A creditor financing the sale of property or services may compare charges with those payable in a similar cash transaction by the seller of the property or service.

►i.◄ For example, the following items are not finance charges:

►A.◄ Taxes, license fees, or registration fees paid by both cash and credit customers.

►B.◄ Discounts that are available to cash and credit customers, such as quantity discounts.

►C.◄ Discounts available to a particular group of consumers because they meet certain criteria, such as being members of an organization or having accounts at a particular financial institution. This is the case even if an individual must pay cash to obtain the discount, provided credit customers who are members of the group and don't qualify for the discount pay no more than the non-member cash customers.

►D.◄ Charges for a service policy, auto club membership, or policy of insurance against latent defects offered to or required of both cash and credit customers for the same price.

►ii.◄ In contrast, the following items are finance charges:

►(A)◄ Inspection and handling fees for the staged disbursement of construction loan proceeds.

▸(B)◂ Fees for preparing a Truth in Lending disclosure statement ▸, if permitted by law (for example, the Real Estate Settlement Procedures Act (RESPA) prohibits such charges in certain transactions secured by real property).

▸(C)◂ Charges for a required maintenance or service contract imposed only in a credit transaction.

▸iii.◂ If the charge in a credit transaction exceeds the charge imposed in a comparable cash transaction, only the difference is a finance charge. For example:

▸(A)◂ If an escrow agent is used in both cash and credit sales of real estate and the agent's charge is $100 in a cash transaction and $150 in a credit transaction, only $50 is a finance charge.

* * * * *

3. Charges by third parties.

▸ i. Third party charges paid by the consumer are not finance charges if the creditor does not retain the charges or require the service. For example:

A. A state or local tax on the credit transaction paid by the consumer, even if the tax is collected by the creditor; and

B. A fee for a courier charged by an independent closing agent to send a document to the title company or some other party, provided that the creditor has not required the use of the courier.

ii. In contrast, third party charges are finance charges (unless otherwise excluded) if the creditor requires the service as a condition of making the loan, even if the consumer can choose the service provider. Examples are:

A. The cost of required mortgage insurance, even if the consumer is allowed to choose the insurer; and

B. A mortgage broker fee when the use of a broker is required, such as when a consumer cannot get the same loan terms and conditions directly through the creditor (for example, the consumer is offered a loan for 8 percent only by using a broker; otherwise, the particular loan is offered at 9 percent).◂ [Charges imposed on the consumer by someone other than the creditor for services not required by the creditor are not finance charges, as long as the creditor does not retain the charges.

In contrast, charges imposed on the consumer by someone other than the creditor are finance charges (unless otherwise excluded) if the creditor requires the services of the third party. For example:

• A fee charged by a loan broker if the consumer cannot obtain the same credit terms from the creditor without using a broker.

For example:

• A fee charged by a loan broker to a consumer, provided the creditor does not require the use of a broker (even if the creditor knows of the loan broker's involvement or compensates the broker).

• A tax imposed by a state or other governmental body on the credit transaction that is payable by the consumer (even if the tax is collected by the creditor).]

* * * * *

Paragraph 4(c)(7).

1. Real estate or residential mortgage transaction charges. The list of charges in

§ 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. If a lump sum is charged for several services and includes a charge that is not excludable, a portion of the total should be allocated to that service and included in the finance charge. ▸However, a◂ [A] charge for a lawyer's attendance at the closing or a charge for conducting the closing (for example, by a title company) is excluded from the finance charge if the charge is primarily for services related to items listed in § 226.4(c)(7) (for example, reviewing or completing documents), even if other incidental services such as explaining various documents or disbursing funds for the parties, are performed. ▸The entire charge is excluded even though a fee for the incidental services would be a finance charge if it was imposed separately.◂ In all cases, charges excluded under § 226.4(c)(7) must be bona fide and reasonable.

▸2. Charges assessed during the loan term. The exclusion in § 226.4(c)(7) for charges imposed in real estate or residential mortgage transactions is not available for fees to be assessed periodically during the loan term. For example, a fee to be assessed at intervals during a 30-year loan (whether collected at closing or when the service is rendered) for determining current tax lien status or flood insurance requirements is a finance charge. In contrast, where such fees are imposed solely in connection with the creditor's initial decision to grant credit, the fees are excluded from the finance charge under § 226.4(c)(7).◂

* * * * *

4(e) Certain security interest charges.

1. Examples. ▸Only sums actually paid to public officials are excludable from the finance charge under § 226.4(e)(1).◂ Examples of ▸excludable◂ charges ▸are◂ [excludable from the finance charge under § 226.4(e)(1) include]:

▸i.◂ Charges for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents▸ that evidence the obligation between the creditor and the consumer◂;

▸ii.◂ Stamps evidencing payment of taxes on property if the stamps are required to file a security agreement on the property; and

▸iii. An intangible tax on the property if the payment of the tax is required to file a security agreement on the property.◂

[Only sums actually paid to public officials are excludable under § 226.4(e)(1).]

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Subpart B--Open-End Credit

4. Under Section 226.5--General Disclosure Requirements, under 5(b)(1) Initial disclosures., in paragraph 1., the first and second sentences would be revised, and a new paragraph 5. would be added to read as follows:

Section 226.5--General Disclosure Requirements

* * * * *

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, the initial disclosures must be given before the consumer makes the first purchase ▸(such as when consumers open credit plans and make purchases contemporaneously at retail stores)◂, receives the first advance, or pays any fees or charges under the plan other than an application fee or refundable membership fee (see below).* * *

* * * * *

▸5. Balance transfers. A creditor that solicits the transfer by a consumer of outstanding balances from an existing account to a new open-end plan must comply with § 226.6 before the consumer authorizes the balance transfer. Card issuers that are subject to the requirements of § 226.5a may establish procedures that comply with both sections in a single disclosure statement.◂

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5. Under Section 226.6--Initial Disclosure Statement, under 6(b) Other charges., paragraph 1. would be revised to read as follows:

Section 226.6--Initial disclosure statement

* * * * *

6(b) Other charges.

1. General; examples of other charges. Under § 226.6(b), significant charges related to the plan (that are not finance charges) must also be disclosed. For example:

▸i.◂ Late payment and over-the-credit-limit charges.

▸ii.◂ Fees for providing documentary evidence of transactions requested under § 226.13 (billing error resolution).

▸iii.◂ Charges imposed in connection with real estate transactions such as title, appraisal, and credit report fees. (See § 226.4(c)(7).).

▸iv.◂ A tax imposed on the credit transaction by a state or other governmental body, such as a documentary stamp tax on cash advances. (See the commentary to § 226.4(a).).

▸v.◂ Membership or participation fees for a package of services that includes an open-end credit feature, unless the fee is required whether or not the open-end credit feature is included. For example, a membership fee to join a credit union would not be an "other charge," even if membership is required to apply for credit.

▸vi.◂ Automated teller machine (ATM) charges described in comment 4(a)-5 that are not finance charges.

▸vii. Charges imposed for the termination of an open-end credit plan.◂

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6. Under Section 226.12--Special Credit Card Provisions, under 12(b) Liability of cardholder for unauthorized use., new paragraphs 2. and 3. would be added to read as follows:

Section 226.12--Special Credit Card Provisions

* * * * *

12(b) Liability of cardholder for unauthorized use.

* * * * *

▸2. Imposing liability. A card issuer is not required to impose liability on a cardholder for the unauthorized use of a credit card; if the card issuer does not seek to impose liability, the issuer need not conduct any investigation of the cardholder's claim.

3. Reasonable investigation. If a card issuer seeks to impose liability when a claim of unauthorized use is made by a cardholder, the card issuer must conduct a reasonable investigation of the claim. In conducting its investigation, the card issuer may reasonably request the cardholder's cooperation, but the card issuer may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request. The steps necessary for investigating claims may differ, but actions such as the following represent steps that a card issuer may take, as appropriate, in conducting a reasonable investigation:

i. Reviewing the types or amounts of purchases made in relation to the cardholder's previous purchasing pattern.

ii. Reviewing where the purchases were delivered in relation to the cardholder's residence or place of business.

iii. Reviewing where the purchases were made in relation to where the cardholder resides or has normally shopped.

iv. Comparing any signature on credit slips for the purchases to the signature of the cardholder or an authorized user in the card issuer's records including other credit slips.

v. Requesting a written, signed statement from the cardholder or authorized user.

vi. Advising the cardholder that an appearance may be required in a court action against the person who allegedly used the card without authority.

vii. Requesting a copy of a police report, if one was filed.◂

* * * * *

7. Under Section 226.15 --Right of Rescission, the following amendments would be made:

a. Under Paragraph 15(a)(1)., in paragraph 5., the third sentence is revised, and new text is added following the third sentence;

b. Under Paragraph 15(a)(1)., paragraph 6. would be revised; and

c. Under Paragraph 15(d)(2)., in paragraph 1., the third sentence would be revised.

The additions and revisions would read as follows:

Section 226.15--Right of Rescission

* * * * *

Paragraph 15(a)(1)

* * * * *

5. Principal dwelling. * * * When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling [when] ▸if◂ it secures the open-end credit line. ▸In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, an advance on an open-end line to finance B and secured by B is a residential mortgage transaction.◂ * * *

6. Special rule for principal dwelling. When the consumer is acquiring or constructing a new principal dwelling, [any] ▸a◂ credit plan or extension ▸that is subject to Regulation Z and is◂

secured by the equity in the consumer's current principal dwelling (for example, an advance to be used as a bridge loan) is still subject to the right of rescission. ▸For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a loan to finance B and secured by A is subject to the right of rescission. But a credit transaction secured by both A and B is a residential mortgage transaction and is not rescindable.◂

* * * * *

Paragraph 15(d)(2).

1. Refunds to consumer. * * * "Any amount" includes finance charges already accrued, as well as other charges such as ▸broker fees,◂ application and commitment fees▸,◂ or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party. * * *

* * * * *

8. Under Section 226.16--Advertising, under 16(d) Additional Requirements for Home Equity Plans, a new paragraph 7. would be added to read as follows:

Section 226.16--Advertising

* * * * *

16(d) Additional Requirements for Home Equity Plans

* * * * *

▸7. Balloon payment. In programs where a balloon payment will occur if only the minimum payments under the plan are made, the advertisement must state that a balloon payment will

result. (See comment 5b(d)(5)(ii)-3 regarding disclosure requirements for a balloon payment.)◂

* * * * *

Subpart C--Closed-end Credit

9. Under Section 226.17--General Disclosure Requirements, the following amendments would be made:

a. Under Paragraph 17(a)(1)., paragraph 5. would be revised;

b. Under Paragraph 17(c)(4)., a new paragraph 4 would be added; and

c. Under 17(f) Early disclosures., paragraph 1. would be revised.

The revisions and additions would read as follows:

Section 226.17--General Disclosure Requirements

* * * * *

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 relation information includes, for example, the following:

▸i.◂ A description of a grace period after which a late payment charge will be imposed. For example, the disclosure given under § 226.18(l) may state that a late charge will apply to "any payment received more than 15 days after the due date."

►ii.◄ 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 § 226.18(m).

►iii.◄ 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 events will occur at a certain time.

►iv.◄ 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.

►v.◄ 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."

►vi.◄ 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."

►vii.◄ A statement that the borrower may pay a minimum finance charge upon prepayment in a simple-interest transaction. For example, when state law prohibits penalties, but would allow a minimum finance charge in the event to prepayment, the creditor may make the § 226.18(k)(1) disclosure by stating, "You may be charged a minimum finance charge."

►viii.◄ 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." (See the commentary to § 226.18(f)(1)(iii).)

►ix.◄ 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."

►x.◄ A statement that a due-on-sale clause or other conditions on assumption are contained in the loan document. For example, the disclosure given under § 226.18(q) may state, "Someone buying your home may, subject to conditions in the due-on-sale clause contained in the loan document, assume the remainder of the mortgage on the original terms."

►xi.◄ If a state or Federal law prohibits prepayment penalties and excludes the charging of interest after prepayment from coverage as a penalty, a statement that the borrower may have to pay interest for some period after prepayment in full. The disclosure given under § 226.18(k) may state, for example, "If you prepay your loan on other than the regular installment date, you may be assessed interest charges until the end of the month."

►xii.◄ More than one hypothetical example under § 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.

►xiii.◄ The disclosures set forth under § 226.18(f)(1) for variable-rate transactions subject to § 226.18(f)(2).

►xiv.◄ A statement whether or not a subsequent purchaser of the property securing an obligation may be permitted to assume the remaining obligation on its original terms.

▸xv. A late-payment fee disclosure under § 226.18(l) on a single payment loan.◂

* * * * *

Paragraph 17(c)(4).

* * * * *

▸4. Relation to prepaid finance charges. Prepaid finance charges paid prior to or at closing may not be treated as the first payment period on a loan. Thus, creditors may not disregard an irregularity in disclosing such finance charges.◂

* * * * *

17(f) Early disclosures.

1. Change in rate ▸or other terms◂. [No redisclosure] ▸Redisclosure◂ is required for changes that occur between the time disclosures are made and consummation, [unless] ▸if◂ the annual percentage rate in the consummated transaction exceeds the limits prescribed in section 226. 22(a) (1/8 of 1 percentage point in regular transactions and 1/4 of 1 percentage point in irregular transactions). ▸Redisclosure is also required, even if the APR is within the permitted tolerance, if the disclosures were not based on estimates in accordance with section 226.17(c)(2) and labelled as such.◂ To illustrate:

▸i.◂ If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage varies by more than 1/8 of 1 percentage point from the disclosed annual percentage rate, the creditor must either redisclose the changed terms or furnish a complete set of new disclosures before consummation. Redisclosure is required even if the disclosures made on July 1 are based on estimates and marked as such; and

►ii. If disclosures are made on January 15, the transaction is consummated on February 10, and the finance charge increased by $35 but the disclosed annual percentage rate is within the permitted tolerance, the creditor must at least redisclose the changed terms. (See § 226.18(d) and footnote 41 of this part.)◄

* * * * *

10. Under Section 226.18--Content of Disclosures, the following amendments would be made:

a. Under Paragraph 18(c)(1)(iv)., a new paragraph 2. would be added; and

b. Under 18(d) Finance charge., paragraph 2 would be revised.

The additions and revisions would read as follows:

Section 226.18--Content of Disclosures

* * * * *

Paragraph 18(c)(1)(iv).

* * * * *

►2. Prepaid mortgage insurance premiums. RESPA requires creditors to give consumers a settlement statement disclosing the costs associated with mortgage loan transactions. Included on the settlement statement are mortgage insurance premiums collected at settlement, which are prepaid finance charges. In calculating the total amount of prepaid finance charges, creditors should use the amount for mortgage insurance that is listed on the line for mortgage insurance on the settlement statement, without adjustment, even if the actual amount collected at settlement varies because of RESPA's escrow accounting rules.◄

18(d) Finance charge.

* * * * *

2. Tolerance. A tolerance for the finance charge is provided in footnote 41▸ of this part. When a miscalculation of the amount financed, or of some other numerical disclosure for which the regulation provides no specific tolerance, results from an error in a finance charge that constitutes a part of that amount, the miscalculated amount financed or other numerical disclosure does not violate the act or the regulation if the finance charge disclosed under § 226.18(d) is within the permissible tolerance under footnote 41 of this part◂.

* * * * *

11. Under Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions, under Paragraph 19(b)(2)(vii)., in paragraph 2., new text is added following the second sentence to read as follows:

Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions

* * * * *

Paragraph 19(b)(2)(vii).

* * * * *

2. Negative amortization and interest rate carryover. * * * ▸Loans that provide for more than one way to trigger negative amortization are separate variable-rate programs requiring separate disclosures. (See the commentary to § 226.19(b)(2) and 226.19(b)(3) for a discussion on the definition of variable-rate loan programs and the format for disclosure). If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur and the principal

loan balance will increase); however, the disclosure in § 226.19(b)(2)(viii) need not be provided.◂ * * *

* * * * *

12. Under Section 226.22--Determination of the Annual Percentage Rate, under Paragraph 22(a)(1)., in paragraph 5., the reference to footnote "45a" is revised to read "45d".

13. Under Section 226.23--Right of Rescission, the following amendments would be made:

a. Under Paragraph 23(a)(1)., in paragraph 3. , the fourth sentence is revised and new text is added following the fourth sentence;

b. Under Paragraph 23(a)(1)., paragraph 4. is revised;

c. Under Paragraph 23(d)(2)., in paragraph 1., the third sentence is revised; and

d. Under 23(f) Exempt transactions., in paragraph 4., new text is added following the first sentence, and new a sentence is added at the end of the paragraph.

The revisions would read as follows:

Section 226.23--Right of Rescission

* * * * *

Paragraph 23(a)(1).

* * * * *

3. Principal dwelling. * * * When a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within one year or upon completion of construction, the new dwelling is considered the principal dwelling [when] ▸if◂ it secures the

acquisition or construction loan. ▸In that case, the transaction secured by the new dwelling is a residential mortgage transaction and is not rescindable. For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, an construction loan to finance B and secured by B is a residential mortgage transaction.◂ * * *

4. Special rule for principal dwelling. When the consumer is acquiring or constructing a new principal dwelling, [any] ▸a◂ loan ▸(subject to Regulation Z)◂ secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is still subject to the right of rescission [regardless of the purpose of that loan]. ▸For example, if a consumer whose principal dwelling is currently A builds B, to be occupied by the consumer upon completion of construction, a construction loan to finance B and secured by A is subject to the right of rescission. But a credit transaction secured by both A and B is a residential mortgage transaction and is not rescindable.◂

* * * * *

Paragraph 23(d)(2).

1. Refunds to consumer. * * * "Any amount" includes finance charges already accrued, as well as other charges such as ▸broker fees,◂ application and commitment fees▸,◂ or fees for a title search or appraisal, whether paid to the creditor, paid directly to a third party, or passed on from the creditor to the third party. * * *

* * * * *

23(f) Exempt transactions

* * * * *

4. New advances. * * * ▸The creditor to whom the obligation was initially made payable is the original creditor. In a merger, consolidation, or acquisition, the successor institution is considered the original creditor for purposes of the exemption in § 226.23(f)(2). ◂ * * * ▸In refinancing transactions, any creditor that was not the original creditor for the obligation being refinanced must deliver the general rescission notice (model form H-8).◂

* * * * *

14. Under **Appendix J**, under the subheading References, under 1981 changes:, the second sentence would be revised to read as follows:

APPENDIX J--Annual Percentage Rate Computations for Closed-End Credit Transactions

* * * * *

References

* * * * *

1981 changes: * * * Paragraph (b)(5)(vi) has been revised to permit creditors ▸in single-advance, single-payment transactions in which the term is less than a year and is equal to a whole number of months◂ [in all cases where the transaction term equals a whole number of months], to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

[TRUTH IN LENDING]

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, December 8, 1994.

(Signed) William W. Wiles

William W. Wiles,
Secretary of the Board.
[FR Doc. 94-00000 Filed 00-00-94; 8:45 am]
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refinancing transactions, any creditor that was not the original creditor for the obligation being refinanced must deliver the general rescission notice (model form H-8).◄

* * * * *

14. Under **Appendix J**, under paragraph References the paragraph 1981 changes would be revised to read as follows:

APPENDIX J -- Annual percentage rate computations for closed-end credit transactions

* * * * *

References

* * * * *

1981 changes: * * * Paragraph (b)(5)(vi) has been revised to permit creditors ►in single-advance, single-payment transactions in which the term is less than a year and is equal to a whole number of months◄ [in all cases where the transaction term equals a whole number of months], to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, December __, 1994.

William W. Wiles,
Secretary of the Board.
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APPROVED UNDER
DELEGATED AUTHORITY

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