

FEDERAL RESERVE SYSTEM
12 CFR Part 226
[Regulation Z; Docket No. R-1050]
Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

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 update addresses short-term cash advances commonly called "payday loans" and includes technical revisions.

DATES: Comments must be received on or before January 10, 2000.

ADDRESSES: Comments, which should refer to Docket No. R-1050, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments addressed to Ms. Johnson may also be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. weekdays, and to the security control room at all other times. The mail room and the security control room, both in the Board's Eccles Building, are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments may be inspected in room MP-500 in the Board's Martin Building between 9:00 a.m. and 5:00 p.m., pursuant to the Board's Rules Regarding the Availability of Information, 12 CFR part 261.

FOR FURTHER INFORMATION CONTACT: Natalie E. Taylor, Michael E. Hentrel, or David A. Stein, Staff Attorneys; Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for users of Telecommunications Device for the Deaf (TDD) only, contact Diane Jenkins 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 providing for disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate. Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping for credit. TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions that involve their principal dwelling. In addition, the act regulates certain practices of creditors. The act is implemented by the Board's Regulation Z (12 CFR part 226).

The Board's official staff commentary (12 CFR part 226 (Supp. I)) interprets the regulation, and provides guidance to creditors in applying the regulation to specific transactions. The commentary is a substitute for individual staff interpretations; it is updated periodically to address significant questions that arise. The Board expects to adopt revisions to the commentary in final form in March 2000; to the extent the revisions impose new requirements on creditors, compliance would be optional until October 1, 2000, the effective date for mandatory compliance.

II. Proposed Revisions

Subpart A -- General

Section 226.2 -- Definitions and Rules of Construction

2(a) Definitions

2(a)(14) Credit

The Board has been asked to clarify whether "payday loans"--also known as "cash advance loans," "check advance loans," and "post-dated check loans"--constitute credit for purposes of TILA. Typically in such transactions, a short-term cash advance is made to a consumer in exchange for the consumer's personal check in the amount of the advance, plus a fee; sometimes the advance is made in exchange for the consumer's authorization to debit electronically the consumer's checking account in the amount of the advance, plus a fee. The transaction occurs with knowledge by both parties that the amount advanced is not, or may not be, available from the consumer's checking account at the time of the transaction. Thus, the parties agree that the consumer's check will not be cashed or the account electronically debited until a designated future date. On that date, the consumer usually has the option to

repay the obligation by allowing the party advancing the funds to cash the check or electronically debit the consumer's checking account, or by providing cash or some other means of payment. The consumer may also have the option to defer repayment beyond the initial period by paying an additional fee.

Section 226.2(a)(14) defines credit as the right to defer the payment of debt or the right to incur debt and defer its payment. In the case of payday loans, this includes the agreement to defer cashing the check or debiting the consumer's account. Comment 2(a)(14)-2 would be added to clarify that payday loan transactions constitute credit for purposes of TILA. Persons that regularly extend payday loans and impose a finance charge are required to provide TILA disclosures to consumers.

Subpart C -- Closed-End Credit

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

19(b) Certain variable-rate transactions

In December 1997, the Board revised the requirements in § 226.19(b)(2) concerning the disclosure of a fifteen-year historical example of interest rates and payments. (62 FR 63441, December 1, 1997.) The amendments to § 226.19(b)(2) provide creditors with the option of giving a statement that the periodic payments may increase or decrease substantially together with the maximum interest rate and payment amount for a \$10,000 loan amount in lieu of having to give the fifteen-year historical example.

The Board proposes technical amendments to comment 19(b)-5 to conform the citations in the comment to § 226.19(b)(2), as amended. No substantive change is intended.

Subpart E -- Special Rules for Certain Home Mortgage Transactions

Section 226.32 -- Requirements for Certain Closed-end Home Mortgages

32(a) Coverage

32(a)(1)(ii)

TILA imposes additional disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. See § 226.32. Creditors must follow the rules in § 226.32 if the total points and fees payable by the consumer at or before loan closing exceed the greater of \$400 or 8 percent of the total loan amount. The Board is required to adjust the \$400 amount each year. The adjusted amount for 2000 (\$451) is published elsewhere in today's *Federal Register* and would be added to comment 32(a)(1)(ii)-2.

III. Form of Comment Letters

Comment letters should refer to Docket No. R-1050, and, when possible, should use a standard typeface with a font size of 10 or 12. This will enable the Board to convert the text to 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 computer diskettes in any IBM-compatible DOS- or Windows-based format.

List of Subjects in 12 CFR Part 226

Advertising, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions to the text of the staff commentary. 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 *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).

2. In Supplement I to Part 226, under Section 226.2--Definitions and Rules of Construction, under 2(a)(14) Credit., a new paragraph 2. would be added to read as follows:

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SUPPLEMENT I TO PART 226—OFFICIAL STAFF INTERPRETATIONS

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SUBPART A--GENERAL

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Section 226.2--Definitions and Rules of Construction

2(a) Definitions.

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2(a)(14) Credit.

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2. Payday loans. Credit includes a payday loan transaction in which a short-term cash advance is made to a consumer in exchange for the consumer's personal check, in the amount of the advance plus a fee, or in exchange for the consumer's authorization to debit the consumer's checking account, for the amount of the advance plus a fee. In both instances the parties agree that the check will not be cashed, or that the consumer's checking account will not be debited, until a designated future date.

3. In Supplement I to Part 226, Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions, under 19(b) Certain variable-rate transactions, paragraph 5. would be amended to read as follows:

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SUBPART C--CLOSED-END CREDIT

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

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19(b) Certain variable-rate transactions.

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5. Examples of variable-rate transactions. The following transactions, if they have a term greater than one year and are secured by the consumer's principal dwelling, constitute variable-rate transactions subject to the disclosure requirements of § 226.19(b).

i. Renewable balloon-payment instruments where the creditor is both unconditionally obligated to renew the balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control) and has the option of increasing the interest rate at the time of renewal. (See comment 17(c)(1)-11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.)

ii. Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures under § 226.19(b)(1) and 226.19(b)(2)(v), (viii), (ix), [(x) and (xiii)] and (xii) are not applicable to such loans.

iii. "Price level adjusted mortgages" or other indexed mortgages that have a fixed rate of interest but provide for periodic adjustments to payments and the loan balance to reflect changes in an index measuring prices or inflation. The disclosures under § 226.19(b)(1) are not applicable to such loans, nor are the following provisions to the extent

they relate to the determination of the interest rate by the addition of a margin, changes in the interest-rate, or interest-rate discounts: Section 226.19(b)(2)(i), (iii), (iv), (v), (vi), (vii), (viii), and (ix)[, and (x)]. (See comments 20(c)-2 and 30-1 regarding the inapplicability of variable-rate adjustment notices and interest-rate limitations to price-level-adjusted or similar mortgages.)

iv. Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

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4. In Supplement I to Part 226, Section 226.32--Requirements for Certain Closed-End Home Mortgages, under 32(a)(1)(ii), paragraph 2.v. would be added to read as follows:

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SUBPART E--SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

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Section 226.32--Requirements for Certain Closed-End Home Mortgages

32(a) Coverage.

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Paragraph 32(a)(1)(ii).

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2. Annual adjustment of \$400 amount. * * *

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v. For 2000, \$451, reflecting a 2.3 percent increase in the CPI-U from June 1998 to June 1999, rounded to the nearest whole dollar.

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By order of the Board of Governors of the Federal Reserve System, acting through the Secretary of the Board under delegated authority, November 1, 1999.

(signed)
Jennifer J. Johnson
Secretary of the Board