FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–1286]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending Regulation Z, which implements the Truth in Lending Act (TILA), and the staff commentary to the regulation, following a comprehensive review of TILA's rules for open-end (revolving) credit that is not home-secured. Consumer testing was conducted as a part of the review.

Except as otherwise noted, the changes apply solely to open-end credit. Disclosures accompanying credit card applications and solicitations must highlight fees and reasons penalty rates might be applied, such as for paying late. Creditors are required to summarize key terms at account opening and when terms are changed. Specific fees are identified that must be disclosed to consumers in writing before an account is opened, and creditors are given flexibility regarding how and when to disclose other fees imposed as part of the open-end plan. Costs for interest and fees are separately identified for the cycle and year to date. Creditors are required to give 45 days' advance notice prior to certain changes in terms and before the rate applicable to a consumer's account is increased as a penalty. Rules of general applicability such as the definition of open-end credit, dispute resolution procedures, and payment processing limitations apply to all open-end plans, including home-equity lines of credit. Rules regarding the disclosure of debt cancellation and debt suspension agreements are revised for both closed-end and open-end credit transactions. Loans taken against employer-sponsored retirement plans are exempt from TILA coverage.

DATES: The rule is effective July 1, 2010.

FOR FURTHER INFORMATION CONTACT: Benjamin K. Olson, Attorney, Amy Burke or Vivian Wong, Senior Attorneys, or Krista Ayoub, Ky Tran-Trong, or John Wood, Counsels, 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 (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background on TILA and Regulation Z

Congress enacted the Truth in Lending Act (TILA) based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. The purposes of TILA are (1) to provide a meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit; and (2) to protect consumers against inaccurate and unfair credit billing and credit card practices.

TILA's disclosures differ depending on whether consumer credit is an open-end (revolving) plan or a closed-end (installment) loan. TILA also contains procedural and substantive protections for consumers. TILA is implemented by the Board's Regulation Z. An Official Staff Commentary interprets the requirements of Regulation Z. By statute, creditors that follow in good faith Board or official staff interpretations are insulated from civil liability, criminal penalties, or administrative sanction.

II. Summary of Major Changes

The goal of the amendments to Regulation Z is to improve the effectiveness of the disclosures that creditors provide to consumers at application and throughout the life of an open-end (not home-secured) account. The changes are the result of the Board's review of the provisions that apply to open-end (not home-secured) credit. The Board is adopting changes to format, timing, and content requirements for the five main types of open-end credit disclosures governed by Regulation Z: (1) Credit and charge card application and solicitation disclosures; (2) account-opening disclosures; (3) periodic statement disclosures; (4) change-in-terms notices; and (5) advertising provisions. The Board is also adopting additional protections that complement rules issued by the Board and other federal banking agencies published elsewhere in today's **Federal Register** regarding certain credit card practices.

Applications and solicitations. Format and content changes are adopted to make the credit and charge card application and solicitation disclosures more meaningful and easier for consumers to use. The changes include:

- Adopting new format requirements for the summary table, including rules regarding: type size and use of boldface type for certain key terms, and placement of information.
- Revising content, including: a requirement that creditors disclose the duration that penalty rates may be in effect, a shorter disclosure about variable rates, new descriptions when a grace period is offered on purchases or when no grace period is offered, and a reference to consumer education materials on the Board's Web site.

Account-opening disclosures. Requirements for cost disclosures provided at account opening are adopted to make the information more conspicuous and easier to read. The changes include:

- Disclosing certain key terms in a summary table at account opening, in order to summarize for consumers key information that is most important to informed decision-making. The table is substantially similar to the table required for credit and charge card applications and solicitations.
- Adopting a different approach to disclosing fees, to provide greater clarity for identifying fees that must be disclosed. In addition, creditors would have flexibility to disclose charges (other than those in the summary table) in writing or orally.

Periodic statement disclosures. Revisions are adopted to make disclosures on periodic statements more understandable, primarily by making changes to the format requirements, such as by grouping fees and interest charges together. The changes include:

- Itemizing interest charges for different types of transactions, such as purchases and cash advances, grouping interest charges and fees separately, and providing separate totals of fees and interest for the month and year-to-date.
- Eliminating the requirement to disclose an ''effective APR.''
- Requiring disclosure of the effect of making only the minimum required payment on the time to repay balances, as required by the Bankruptcy Act.

Changes in consumer's interest rate and other account terms. The final rule expands the circumstances under which consumers receive written notice of changes in the terms (e.g., an increase in the interest rate) applicable to their accounts, and increase the amount of time these notices must be sent before the change becomes effective. The changes include:

- Increasing advance notice before a changed term can be imposed from 15 to 45 days, to better allow consumers to obtain alternative financing or change their account usage.
- Requiring creditors to provide 45 days' prior notice before the creditor increases a rate either due to a change in the terms applicable to the consumer's account or due to the consumer's delinquency or default or as a penalty.
- When a change-in-terms notice accompanies a periodic statement, requiring

2(a)(24) Residential Mortgage Transaction

Comment 2(a)(24)–1, which identifies key provisions affected by the term ''residential mortgage transaction,'' and comment 2(a)(24)–5.ii., which provides guidance on transactions financing the acquisition of a consumer's principal dwelling, are revised from the June 2007 Proposal to conform to changes adopted by the Board in the July 2008 Final HOEPA Rule to address certain mortgage practices and disclosures. 73 FR 44522, 44605, July 30, 2008.

Section 226.3 Exempt Transactions

Section 226.3 implements TILA Section 104 and provides exemptions for certain classes of transactions specified in the statute. 15 U.S.C. 1603.

In June 2007, the Board proposed several substantive and technical revisions to § 226.3 as described below. The Board also proposed to move the substance of footnote 4 to the commentary. *See* comment 3–1. No comments were received on moving footnote 4 to the commentary, and that change is adopted in the final rule.

3(a) Business, Commercial, Agricultural, or Organizational Credit

Section 226.3(a) provides, in part, that the regulation does not apply to extensions of credit primarily for business, commercial or agricultural purposes. As the Board noted in the supplementary information to the June 2007 Proposal, questions have arisen from time to time regarding whether transactions made for business purposes on a consumer-purpose credit card are exempt from TILA. The Board proposed to add a new comment 3(a)–2 to clarify transactions made for business purposes on a consumer-purpose credit card are covered by TILA (and, conversely, that purchases made for consumer purposes on a business-purpose credit card are exempt from TILA). The Board received several comments on proposed comment 3(a)–2. One consumer group and one large financial institution commented in support of the change. One industry trade association stated that the proposed clarification was anomalous given the general exclusion of business credit from TILA coverage. The Board acknowledges that this clarification will result in certain business purpose transactions being subject to TILA, and certain consumer purpose transactions being exempt from TILA. However, the Board believes that the determination as to whether a credit card account is primarily for consumer purposes or business purposes is best made when an account is opened (or when an account is reclassified as a business-purpose or consumer-purpose account) and that comment 3(a)–2 provides important clarification and certainty to consumers and creditors. In addition, determining whether specific transactions charged to the credit card account are for consumer or business purposes could be operationally difficult and burdensome for issuers. Accordingly, the Board adopts new comment 3(a)–2 as proposed with several technical revisions described below. Other sections of the commentary regarding § 226.3(a) are renumbered accordingly. The Board also adopts new comment 3(a)–7, which provides guidance on credit card renewals consistent with new comment 3(a)–2, as proposed.

The examples in proposed comment 3(a)–2 contained several references to credit plans, which are deleted from the final rule as unnecessary because comment 3(a)–2 was intended to address only credit cards. Credit plans are addressed by the examples in redesignated comment 3(a)–3, which is unaffected by this rulemaking.

3(g) Employer-Sponsored Retirement Plans

The Board has received questions from time to time regarding the applicability of TILA to loans taken against employer-sponsored retirement plans. Pursuant to TILA Section 104(5), the Board has the authority to exempt transactions for which it determines that coverage is not necessary in order to carry out the purposes of TILA. 15 U.S.C. 1603(5). The Board also has the authority pursuant to TILA Section 105(a) to provide adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of TILA. 15 U.S.C. 1604(a).

The June 2007 Proposal included a new § 226.3(g), which would have exempted loans taken by employees against their employer-sponsored retirement plans qualified under Section 401(a) of the Internal Revenue Code and tax-sheltered annuities under Section 403(b) of the Internal Revenue Code, provided that the extension of credit is comprised of fully-vested funds from such participant's account and is made in compliance with the Internal Revenue Code. 26 U.S.C. 1 *et seq.*; 26 U.S.C. 401(a); 26 U.S.C. 403(b). The Board stated several reasons for this proposed exemption in the supplementary information to the June 2007 Proposal, including the fact that the consumer's interest and principal payments on such a loan are reinvested in the consumer's own account and there is no third-party creditor imposing finance charges on the consumer. In addition, the costs of a loan taken against assets invested in a 401(k) plan, for example, are not comparable to the costs of a third-party loan product, because a consumer pays the interest on a 401(k) loan to himself or herself rather than to a third party.

The Board received several comments regarding proposed § 226.3(g), which generally supported the proposed exemption for loans taken by employees against their employer-sponsored retirement plans. Two commenters asked the Board to expand the proposed exemption to include loans taken against governmental 457(b) plans, which are a type of retirement plan offered by certain state and local government employers. 26 U.S.C. 457(b). The comments noted that governmental 457(b) plans may permit participant loans, subject to the requirements of section 72(p) of the Internal Revenue Code (26 U.S.C. 1 *et seq.*), which are the same requirements that are applicable to qualified 401(a) plans and 403(b) plans. The comments also stated that the Board's reasons for proposing the exemption apply equally to governmental 457(b) plans. The final rule expands the scope of the exemption to include loans taken against governmental 457(b) plans. The exemption for loans taken against employer-sponsored retirement plans was intended to cover all such similar plans, and the omission of governmental 457(b) plans from the proposed exemption was unintentional. The Board believes the rationales stated above and in the June 2007 Proposal for the proposed exemption for qualified 401(a) plans and 403(b) plans apply equally to governmental 457(b) plans.

In addition to the rationales stated above, another reason given for the proposed exception in the June 2007 Proposal was a statement that plan administration fees must be disclosed under applicable Department of Labor regulations. One commenter noted that the Department of Labor regulations cited in the supplementary information to the June 2007 Proposal do not apply to governmental 403(b) plans, governmental 457(b) plans, and certain other 403(b) programs that are not subject to the Employee Retirement Income Security Act of 1974 (ERISA). 29 U.S.C. 1001 *et seq.* The commenter asked for clarification regarding whether the exemption will apply to loans taken from plans and programs which are not subject to ERISA. Section 226.3(g) itself does not contain a reference to ERISA or the Department of Labor regulations pertaining to ERISA, and, accordingly, the exemption applies even if the particular plan is not subject to ERISA. For the other reasons stated above and in the June 2007 Proposal, the Board believes that the exemption for the plans specified in new § 226.3(g) is appropriate even for those plans to which ERISA disclosure requirements do not apply.

Section 226.4 Finance Charge

Various provisions of TILA and Regulation Z specify how and when the cost of consumer credit expressed as a dollar amount, the ''finance charge,'' is to be disclosed. The rules for determining which charges make up the finance charge are set forth in TILA Section 106 and Regulation Z § 226.4. 15 U.S.C. 1605. Some rules apply only to open-end credit and others apply only to closed-end credit, while some apply to both. With limited exceptions, the Board did not propose in June 2007 to change § 226.4 for either closed-end credit or open-end credit. The areas in which the Board did propose to revise § 226.4 and related commentary relate to (1) transaction charges imposed by credit card issuers, such as charges for obtaining cash advances from automated teller machines (ATMs) and for making purchases in foreign currencies or foreign countries, and (2) charges for credit insurance, debt cancellation coverage, and debt suspension coverage.

4(a) Definition

Transaction charges. Under the definition of ''finance charge'' in TILA Section 106 and Regulation Z § 226.4(a), a charge specific to a credit transaction is ordinarily a finance charge. 15 U.S.C. 1605. *See also* § 226.4(b)(2). However, under current comment 4(a)–4, a fee charged by a card issuer for using an ATM to obtain a cash advance on a credit card account is not a finance charge to the extent that it does not exceed the charge imposed by the card issuer on its cardholders for using the ATM to withdraw cash from a consumer asset account, such as a checking or savings account. Another comment indicates that the fee is an ''other charge.'' *See* current comment 6(b)–1.vi. Accordingly, the fee must be disclosed at account opening and on the periodic statement, but it is not labeled as a ''finance charge'' nor is it included in the effective APR.

In the June 2007 Proposal, the Board proposed new comment 4(a)–4 to address questions that have been raised about the scope and application of the existing comment. For example, assume the issuer assesses an ATM fee for one kind of deposit account (for example, an account with a low minimum balance) but not for another. The existing comment does not indicate which account is the proper basis for comparison, nor is it clear in all cases which account should be the appropriate one to use.

Questions have also been raised about whether disclosure of an ATM cash advance fee pursuant to comments 4(a)–4 and 6(b)–1.vi. is meaningful to consumers. Under the comments, the disclosure a consumer receives after incurring a fee for taking a cash advance through an ATM depends on whether the credit card issuer provides asset accounts and offers debit cards on those accounts and whether the fee for using the ATM for the cash advance exceeds the fee for using the ATM for a cash withdrawal from an asset account. It is not clear that these distinctions are meaningful to consumers.

In addition, questions have arisen about the proper disclosure of fees that cardholders are assessed for making purchases in a foreign currency or outside the United States—for example, when the cardholder travels abroad. The question has arisen in litigation between consumers and major card issuers.[11] Some card issuers have reasoned by analogy to comment 4(a)–4 that a foreign transaction fee is not a finance charge if the fee does not exceed the issuer's fee for using a debit card for the same purchase. Some card issuers disclose the foreign transaction fee as a finance charge and include it in the effective APR, but others do not.

The uncertainty about proper disclosure of charges for foreign transactions and for cash advances from ATMs reflects the inherent complexity of seeking to distinguish transactions that are ''comparable cash transactions'' to credit card transactions from transactions that are not. In June 2007, the Board proposed to replace comment 4(a)–4 with a new comment of the same number stating a simple interpretive rule that any transaction fee on a credit card plan is a finance charge, regardless of whether the issuer imposes the same or lesser charge on withdrawals of funds from an asset account, such as a checking or savings account. The proposed comment would have provided as examples of such finance charges a fee imposed by the issuer for taking a cash advance at an ATM,[12] as well as a fee imposed by the issuer for foreign transactions. The Board stated its belief that clearer guidance might result from a new and simpler approach that treats as a finance charge any fee charged by credit card issuers for transactions on their credit card plans, and accordingly proposed new comment 4(a)–4.

Few commenters addressed proposed comment 4(a)–4. Some commenters supported the proposed comment, including a financial institution (although the commenter noted that its support of the proposal was predicated on the effective APR disclosure requirements being eliminated, as the Board proposed under one alternative). Other commenters opposed the proposed comment, some expressing concern that including all transaction fees as finance charges might cause the effective APR to exceed statutory interest rate limits contained in other laws (for example, the 18 percent statutory interest rate ceiling applicable to federal credit unions).

One commenter stated particular concerns about the proposed inclusion of foreign transaction fees as finance charges. The commenter stated that the settlements in the litigation referenced above have already resolved the issues involved and that adopting the proposal would cause disruption to disclosure practices established under the settlements. A consumer group that supported including all transaction fees in the finance charge noted its concern that the positive effect of the proposal would be nullified by specifying a limited list of fees that must be disclosed in writing at account opening (*see* the section-by-section analysis to § 226.6(b)(2) and (b)(3), below), and by eliminating the effective APR assuming the Board adopted that alternative. The commenter urged the Board to go further and include a number of other types of fees in the finance charge.

The Board is adopting proposed comment 4(a)–4 with some changes for clarification. As adopted in final form, comment 4(a)–4 includes language clarifying that foreign transaction fees include charges imposed when transactions are made in foreign currencies and converted to U.S. dollars, as well as charges imposed when transactions are made in U.S. dollars outside the United States and charges imposed when transactions are made (whether in a foreign currency or

[11] *See, e.g.*, Third Consolidated Amended Class Action Complaint at 47–48, *In re Currency Conversion Fee Antitrust Litigation*, MDL Docket No. 1409 (S.D.N.Y.). The court approved a settlement on a preliminary basis on November 8, 2006. *See also, e.g., LiPuma* v. *American Express Company*, 406 F. Supp. 2d 1298 (S.D.Fla. 2005).

[12] The change to comment 4(a)–4 does not affect disclosure of ATM fees assessed by institutions other than the credit card issuer. *See* proposed § 226.6(b)(1)(ii)(A), adopted in the final rule as § 226.6(b)(3)(iii)(A).

deferred portion of a downpayment may be treated as part of the downpayment if it is payable not later than the due date of the second otherwise regularly scheduled payment and is not subject to a finance charge.

(19) *Dwelling* means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence.

(20) *Open-end credit* means consumer credit extended by a creditor under a plan in which:

(i) The creditor reasonably contemplates repeated transactions;

(ii) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and

(iii) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

(21) *Periodic rate* means a rate of finance charge that is or may be imposed by a creditor on a balance for a day, week, month, or other subdivision of a year.

(22) *Person* means a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit.

(23) *Prepaid finance charge* means any finance charge paid separately in cash or by check before or at consummation of a transaction, or withheld from the proceeds of the credit at any time.

(24) *Residential mortgage transaction* means a transaction in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract, or equivalent consensual security interest is created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling.

(25) *Security interest* means an interest in property that secures performance of a consumer credit obligation and that is recognized by state or federal law. It does not include incidental interests such as interests in proceeds, accessions, additions, fixtures, insurance proceeds (whether or not the creditor is a loss payee or beneficiary), premium rebates, or interests in after-acquired property. For purposes of disclosures under § 226.6 and § 226.18, the term does not include an interest that arises solely by operation of law. However, for purposes of the right of rescission under § 226.15 and § 226.23, the term does include interests that arise solely by operation of law.

(26) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

(b) *Rules of construction.* For purposes of this regulation, the following rules of construction apply:

(1) Where appropriate, the singular form of a word includes the plural form and plural includes singular.

(2) Where the words *obligation* and *transaction* are used in the regulation, they refer to a consumer credit obligation or transaction, depending upon the context. Where the word *credit* is used in the regulation, it means *consumer credit* unless the context clearly indicates otherwise.

(3) Unless defined in this regulation, the words used have the meanings given to them by state law or contract.

(4) Footnotes have the same legal effect as the text of the regulation.

(5) Where the word *amount* is used in this regulation to describe disclosure requirements, it refers to a numerical amount.

■ 4. Section 226.3 is revised to read as follows:

§ 226.3 Exempt transactions.

This regulation does not apply to the following: [4]

(a) *Business, commercial, agricultural, or organizational credit.* (1) An extension of credit primarily for a business, commercial or agricultural purpose.

(2) An extension of credit to other than a natural person, including credit to government agencies or instrumentalities.

(b) *Credit over $25,000 not secured by real property or a dwelling.* An extension of credit not secured by real property, or by personal property used or expected to be used as the principal dwelling of the consumer, in which the amount financed exceeds $25,000 or in which there is an express written commitment to extend credit in excess of $25,000.

(c) *Public utility credit.* An extension of credit that involves public utility services provided through pipe, wire, other connected facilities, or radio or similar transmission (including extensions of such facilities), if the charges for service, delayed payment, or any discounts for prompt payment are filed with or regulated by any government unit. The financing of durable goods or home improvements by a public utility is not exempt.

(d) *Securities or commodities accounts.* Transactions in securities or commodities accounts in which credit is extended by a broker-dealer registered with the Securities and Exchange Commission or the Commodity Futures Trading Commission.

(e) *Home fuel budget plans.* An installment agreement for the purchase of home fuels in which no finance charge is imposed.

(f) *Student loan programs.* Loans made, insured, or guaranteed pursuant to a program authorized by title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 *et seq.*).

(g) *Employer-sponsored retirement plans.* An extension of credit to a participant in an employer-sponsored retirement plan qualified under section 401(a) of the Internal Revenue Code, a tax-sheltered annuity under section 403(b) of the Internal Revenue Code, or an eligible governmental deferred compensation plan under section 457(b) of the Internal Revenue Code (26 U.S.C. 401(a); 26 U.S.C. 403(b); 26 U.S.C. 457(b)), provided that the extension of credit is comprised of fully vested funds from such participant's account and is made in compliance with the Internal Revenue Code (26 U.S.C. 1 *et seq.*).

■ 5. Section 226.4 is revised to read as follows:

§ 226.4 Finance charge.

(a) *Definition.* The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction.

(1) *Charges by third parties.* The finance charge includes fees and amounts charged by someone other than the creditor, unless otherwise excluded under this section, if the creditor:

(i) Requires the use of a third party as a condition of or an incident to the extension of credit, even if the consumer can choose the third party; or

(ii) Retains a portion of the third-party charge, to the extent of the portion retained.

(2) *Special rule; closing agent charges.* Fees charged by a third party that conducts the loan closing (such as a settlement agent, attorney, or escrow or title company) are finance charges only if the creditor—

(i) Requires the particular services for which the consumer is charged;

(ii) Requires the imposition of the charge; or

(iii) Retains a portion of the third-party charge, to the extent of the portion retained.

[4] [Reserved]