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Code of Federal Regulations

# 12

**Parts 220 to 299**

Revised as of January 1, 2009

# Banks and Banking

Containing a codification of documents of general applicability and future effect

As of January 1, 2009

*With Ancillaries*

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*Cite this Code:* CFR

*To cite the regulations in this volume use title, part and section number. Thus,* 12 CFR 220.1 *refers to title 12, part 220, section 1.*

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Each volume of the Code is revised at least once each calendar year and issued on a quarterly basis approximately as follows:

Title 1 through Title 16.....as of January 1
Title 17 through Title 27.....as of April 1
Title 28 through Title 41.....as of July 1
Title 42 through Title 50.....as of October 1

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RAYMOND A. MOSLEY,
*Director*,
*Office of the Federal Register*.
*January 1, 2009*.

# THIS TITLE

Title 12—BANKS AND BANKING is composed of seven volumes. The parts in these volumes are arranged in the following order: parts 1–199, 200–219, 220–299, 300–499, 500–599, part 600–899, and 900–end. The first volume containing parts 1–199 is comprised of chapter I—Comptroller of the Currency, Department of the Treasury. The second and third volumes containing parts 200–299 are comprised of chapter II—Federal Reserve System. The fourth volume containing parts 300–499 is comprised of chapter III—Federal Deposit Insurance Corporation and chapter IV—Export-Import Bank of the United States. The fifth volume containing parts 500–599 is comprised of chapter V—Office of Thrift Supervision, Department of the Treasury. The sixth volume containing parts 600–899 is comprised of chapter VI—Farm Credit Administration, chapter VII—National Credit Union Administration, chapter VIII—Federal Financing Bank. The seventh volume containing part 900–end is comprised of chapter IX—Federal Housing Finance Board, chapter XI—Federal Financial Institutions Examination Council, chapter XIV—Farm Credit System Insurance Corporation, chapter XV—Department of the Treasury, chapter XVII—Office of Federal Housing Enterprise Oversight, Department of Housing and Urban Development and chapter XVIII—Community Development Financial Institutions Fund, Department of the Treasury. The contents of these volumes represent all of the current regulations codified under this title of the CFR as of January 1, 2009.

For this volume, Jonn Lilyea was Chief Editor. The Code of Federal Regulations publication program is under the direction of Michael L. White, assisted by Ann Worley.

# Title 12—Banks and Banking

(This book contains parts 220 to 299)

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# CHAPTER II—FEDERAL RESERVE SYSTEM

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# SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## PART 220—CREDIT BY BROKERS AND DEALERS (REGULATION T)


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AUTHORITY: 15 U.S.C. 78c, 78g, 78q, and 78w.

EDITORIAL NOTE: A copy of each form referred to in this part is filed as a part of the original document. Copies are available upon request to the Board of Governors of the Federal Reserve System or any Federal Reserve Bank.

### § 220.1 Authority, purpose, and scope.

(a) *Authority and purpose*. Regulation T (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Securities Exchange Act of 1934 (the Act) (15 U.S.C.78a *et seq.*). Its principal purpose is to regulate extensions of credit by brokers and dealers; it also covers related transactions within the Board's authority under the Act. It imposes, among other obligations, initial margin requirements and payment rules on certain securities transactions.

(b) *Scope*. (1) This part provides a margin account and four special purpose accounts in which to record all financial relations between a customer and a creditor. Any transaction not specifically permitted in a special purpose account shall be recorded in a margin account.

(2) This part does not preclude any exchange, national securities association, or creditor from imposing additional requirements or taking action for its own protection.

(3) This part does not apply to:

(i) Financial relations between a customer and a creditor to the extent that they comply with a portfolio margining system under rules approved or amended by the SEC;

(ii) Credit extended by a creditor based on a good faith determination that the borrower is an exempted borrower;

(iii) Financial relations between a customer and a broker or dealer registered only under section 15C of the Act; and

(iv) Financial relations between a foreign branch of a creditor and a foreign person involving foreign securities.

[Reg. T, 63 FR 2820, Jan. 16, 1998]

### § 220.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section as follows:

*Affiliated corporation* means a corporation of which all the common stock is owned directly or indirectly by the firm or general partners and employees of the firm, or by the corporation or holders of the controlling stock and employees of the corporation, and the affiliation has been approved by the creditor's examining authority.

*Cash equivalent* means securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, bankers acceptances issued by banking institutions in the United States and payable in the United States, or money market mutual funds.

*Covered option transaction* means any transaction involving options or warrants in which the customer's risk is limited and all elements of the transaction are subject to contemporaneous exercise if:

(1) The amount at risk is held in the account in cash, cash equivalents, or via an escrow receipt; and

(2) The transaction is eligible for the cash account by the rules of the registered national securities exchange authorized to trade the option or warrant or by the rules of the creditor's examining authority in the case of an unregistered option, provided that all such rules have been approved or amended by the SEC.

*Credit balance* means the cash amount due the customer in a margin account after debiting amounts transferred to the special memorandum account.

*Creditor* means any broker or dealer (as defined in sections 3(a)(4) and 3(a)(5) of the Act), any member of a national securities exchange, or any person associated with a broker or dealer (as defined in section 3(a)(18) of the Act), except for business entities controlling or under common control with the creditor.

*Current market value* of:

(1) A security means:

(i) Throughout the day of the purchase or sale of a security, the security's total cost of purchase or the net proceeds of its sale including any commissions charged; or

(ii) At any other time, the closing sale price of the security on the preceding business day, as shown by any regularly published reporting or quotation service. If there is no closing sale price, the creditor may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day.

(2) Any other collateral means a value determined by any reasonable method.

*Customer* excludes an exempted borrower and includes:

(1) Any person or persons acting jointly:

(i) To or for whom a creditor extends, arranges, or maintains any credit; or

(ii) Who would be considered a customer of the creditor according to the ordinary usage of the trade;

(2) Any partner in a firm who would be considered a customer of the firm absent the partnership relationship; and

(3) Any joint venture in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

*Debit balance* means the cash amount owed to the creditor in a margin account after debiting amounts transferred to the special memorandum account.

*Delivery against payment, Payment against delivery, or a C.O.D. transaction* refers to an arrangement under which a creditor and a customer agree that the creditor will deliver to, or accept from, the customer, or the customer's agent, a security against full payment of the purchase price.

*Equity* means the total current market value of security positions held in the margin account plus any credit balance less the debit balance in the margin account.

*Escrow agreement* means any agreement issued in connection with a call or put option under which a bank or any person designated as a control location under paragraph (c) of SEC Rule 15c3–3 (17 CFR 240.15c3–3(c)), holding the underlying asset or required cash or cash equivalents, is obligated to deliver to the creditor (in the case of a call option) or accept from the creditor (in the case of a put option) the underlying asset or required cash or cash equivalent against payment of the exercise price upon exercise of the call or put.

*Examining authority* means:

(1) The national securities exchange or national securities association of which a creditor is a member; or

(2) If a member of more than one self-regulatory organization, the organization designated by the SEC as the examining authority for the creditor.

*Exempted borrower* means a member of a national securities exchange or a registered broker or dealer, a substantial portion of whose business consists of transactions with persons other than brokers or dealers, and includes a borrower who:

(1) Maintains at least 1000 active accounts on an annual basis for persons other than brokers, dealers, and persons associated with a broker or dealer;

(2) Earns at least $10 million in gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker or dealer; or

(3) Earns at least 10 percent of its gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker or dealer.

*Exempted securities mutual fund* means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), provided the company has at least 95 percent of its assets continuously invested in exempted securities (as defined in section 3(a)(12) of the Act).

*Foreign margin stock* means a foreign security that is an equity security that:

(1) Appears on the Board's periodically published List of Foreign Margin Stocks; or

(2) Is deemed to have a ''ready market'' under SEC Rule 15c3–1 (17 CFR 240.15c3–1) or a ''no-action'' position issued thereunder.

*Foreign person* means a person other than a United States person as defined in section 7(f) of the Act.

*Foreign security* means a security issued in a jurisdiction other than the United States.

*Good faith* with respect to:

(1) Margin means the amount of margin which a creditor would require in exercising sound credit judgment;

(2) Making a determination or accepting a statement concerning a borrower means that the creditor is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to make the determination or accept the notice or certification without inquiry, investigates and is satisfied that it is correct.

*Margin call* means a demand by a creditor to a customer for a deposit of additional cash or securities to eliminate or reduce a margin deficiency as required under this part.

*Margin deficiency* means the amount by which the required margin exceeds the equity in the margin account.

*Margin equity security* means a margin security that is an equity security (as defined in section 3(a)(11) of the Act).

*Margin excess* means the amount by which the equity in the margin account exceeds the required margin. When the margin excess is represented by securities, the current value of the securities is subject to the percentages set forth in § 220.12 (the Supplement).

*Margin security* means:

(1) Any security registered or having unlisted trading privileges on a national securities exchange;

(2) After January 1, 1999, any security listed on the Nasdaq Stock Market;

(3) Any non-equity security;

(4) Any security issued by either an open-end investment company or unit investment trust which is registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8);

(5) Any foreign margin stock;

(6) Any debt security convertible into a margin security;

(7) Until January 1, 1999, any OTC margin stock; or

(8) Until January 1, 1999, any OTC security designated as qualified for trading in the national market system under a designation plan approved by the Securities and Exchange Commission (NMS security).

*Money market mutual fund* means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8) that is considered a money market fund under SEC Rule 2a–7 (17 CFR 270.2a–7).

*Non-equity security* means a security that is not an equity security (as defined in section 3(a)(11) of the Act).

*Nonexempted security* means any security other than an exempted security (as defined in section 3(a)(12) of the Act).

*OTC margin stock* means any equity security traded over the counter that the Board has determined has the degree of national investor interest, the depth and breadth of market, the availability of information respecting the security and its issuer, and the character and permanence of the issuer to warrant being treated like an equity security treaded on a national securities exchange. An OTC stock is not considered to be an OTC margin stock unless it appears on the Board's periodically published list of OTC margin stocks.

*Payment period* means the number of business days in the standard securities settlement cycle in the United States, as defined in paragraph (a) of SEC Rule 15c6–1 (17 CFR 240.15c6–1(a)), plus two business days.

*Purpose credit* means credit for the purpose of:

(1) Buying, carrying, or trading in securities; or

(2) Buying or carrying any part of an investment contract security which shall be deemed credit for the purpose of buying or carrying the entire security.

*Short call or short put* means a call option or a put option that is issued, endorsed, or guaranteed in or for an account.

(1) A short call that is not cash-settled obligates the customer to sell the underlying asset at the exercise price upon receipt of a valid exercise notice or as otherwise required by the option contract.

(2) A short put that is not cash-settled obligates the customer to purchase the underlying asset at the exercise price upon receipt of a valid exercise notice or as otherwise required by the option contract.

(3) A short call or a short put that is cash-settled obligates the customer to pay the holder of an in the money long put or long call who has, or has been deemed to have, exercised the option the cash difference between the exercise price and the current assigned value of the option as established by the option contract.

*Underlying asset* means:

(1) The security or other asset that will be delivered upon exercise of an option; or

(2) In the case of a cash-settled option, the securities or other assets which comprise the index or other measure from which the option's value is derived.

[Reg. T, 63 FR 2821, Jan. 16, 1998]

### § 220.3 General provisions.

(a) *Records.* The creditor shall maintain a record for each account showing the full details of all transactions.

(b) *Separation of accounts*—(1) *In general.* The requirements of one account may not be met by considering items in any other account. If withdrawals of cash or securities are permitted under this part, written entries shall be made when cash or securities are used for purposes of meeting requirements in another account.

(2) *Exceptions.* Notwithstanding paragraph (b)(1) of this section:

(i) For purposes of calculating the required margin for a security in a margin account, assets held in the good faith account pursuant to § 220.6(e)(1)(i) or (ii) may serve in lieu of margin;

(ii) Transfers may be effected between the margin account and the special memorandum account pursuant to §§ 220.4 and 220.5.

(c) *Maintenance of credit.* Except as prohibited by this part, any credit initially extended in compliance with this part may be maintained regardless of:

(1) Reductions in the customer's equity resulting from changes in market prices;

(2) Any security in an account ceasing to be margin or exempted; or

(3) Any change in the margin requirements prescribed under this part.

(d) *Guarantee of accounts.* No guarantee of a customer's account shall be given any effect for purposes of this part.

(e) *Receipt of funds or securities.* (1) A creditor, acting in good faith, may accept as immediate payment:

(i) Cash or any check, draft, or order payable on presentation; or

(ii) Any security with sight draft attached.

(2) A creditor may treat a security, check or draft as received upon written notification from another creditor that the specified security, check, or draft has been sent.

(3) Upon notification that a check, draft, or order has been dishonored or when securities have not been received within a reasonable time, the creditor shall take the action required by this part when payment or securities are not received on time.

(4) To temporarily finance a customer's receipt of securities pursuant to an employee benefit plan registered on SEC Form S–8 or the withholding taxes for an employee stock award plan, a creditor may accept, in lieu of the securities, a properly executed exercise notice, where applicable, and instructions to the issuer to deliver the stock to the creditor. Prior to acceptance, the creditor must verify that the issuer will deliver the securities promptly and the customer must designate the account into which the securities are to be deposited.

(f) *Exchange of securities.* (1) To enable a customer to participate in an offer to exchange securities which is made to all holders of an issue of securities, a creditor may submit for exchange any securities held in a margin account, without regard to the other provisions of this part, provided the consideration received is deposited into the account.

(2) If a nonmargin, nonexempted security is acquired in exchange for a margin security, its retention, withdrawal, or sale within 60 days following its acquisition shall be treated as if the security is a margin security.

(g) *Arranging for loans by others.* A creditor may arrange for the extension or maintenance of credit to or for any customer by any person, provided the creditor does not willfully arrange credit that violates parts 221 or 224 of this chapter.

(h) *Innocent mistakes.* If any failure to comply with this part results from a mistake made in good faith in executing a transaction or calculating the amount of margin, the creditor shall not be deemed in violation of this part if, promptly after the discovery of the mistake, the creditor takes appropriate corrective action.

(i) *Foreign currency.* (1) Freely convertible foreign currency may be treated at its U.S. dollar equivalent, provided the currency is marked-to-market daily.

(2) A creditor may extend credit denominated in any freely convertible foreign currency.

(j) *Exempted borrowers.* (1) A member of a national securities exchange or a registered broker or dealer that has been in existence for less than one year may meet the definition of exempted borrower based on a six-month period.

(2) Once a member of a national securities exchange or registered broker or dealer ceases to qualify as an exempted borrower, it shall notify its lender of this fact before obtaining additional credit. Any new extensions of credit to such a borrower, including rollovers, renewals, and additional draws on existing lines of credit, are subject to the provisions of this part.

[Reg. T, 63 FR 2822, Jan. 16, 1998]

### § 220.4 Margin account.

(a) *Margin transactions.* (1) All transactions not specifically authorized for inclusion in another account shall be recorded in the margin account.

(2) A creditor may establish separate margin accounts for the same person to:

(i) Clear transactions for other creditors where the transactions are introduced to the clearing creditor by separate creditors; or

(ii) Clear transactions through other creditors if the transactions are cleared by separate creditors; or

(iii) Provide one or more accounts over which the creditor or a third party investment adviser has investment discretion.

(b) *Required margin*—(1) *Applicability*. The required margin for each long or short position in securities is set forth in § 220.12 (the Supplement) and is subject to the following exceptions and special provisions.

(2) *Short sale against the box*. A short sale ''against the box'' shall be treated as a long sale for the purpose of computing the equity and the required margin.

(3) *When-issued securities*. The required margin on a net long or net short commitment in a when-issued security is the margin that would be required if the security were an issued margin security, plus any unrealized loss on the commitment or less any unrealized gain.

(4) *Stock used as cover*. (i) When a short position held in the account serves in lieu of the required margin for a short put, the amount prescribed by paragraph (b)(1) of this section as the amount to be added to the required margin in respect of short sales shall be increased by any unrealized loss on the position.

(ii) When a security held in the account serves in lieu of the required margin for a short call, the security shall be valued at no greater than the exercise price of the short call.

(5) *Accounts of partners*. If a partner of the creditor has a margin account with the creditor, the creditor shall disregard the partner's financial relations with the firm (as shown in the partner's capital and ordinary drawing accounts) in calculating the margin or equity of the partner's margin account.

(6) *Contribution to joint venture*. If a margin account is the account of a joint venture in which the creditor participates, any interest of the creditor in the joint account in excess of the interest which the creditor would have on the basis of its right to share in the profits shall be treated as an extension of credit to the joint account and shall be margined as such.

(7) *Transfer of accounts*. (i) A margin account that is transferred from one creditor to another may be treated as if it had been maintained by the transferee from the date of its origin, if the transferee accepts, in good faith, a signed statement of the transferor (or, if that is not practicable, of the customer), that any margin call issued under this part has been satisfied.

(ii) A margin account that is transferred from one customer to another as part of a transaction, not undertaken to avoid the requirements of this part, may be treated as if it had been maintained for the transferee from the date of its origin, if the creditor accepts in good faith and keeps with the transferee account a signed statement of the transferor describing the circumstances for the transfer.

(8) *Sound credit judgment*. In exercising sound credit judgment to determine the margin required in good faith pursuant to § 220.12 (the Supplement), the creditor shall make its determination for a specified security position without regard to the customer's other assets or securities positions held in connection with unrelated transactions.

(c) *When additional margin is required*—(1) *Computing deficiency*. All transactions on the same day shall be combined to determine whether additional margin is required by the creditor. For the purpose of computing equity in an account, security positions are established or eliminated and a credit or debit created on the trade date of a security transaction. Additional margin is required on any day when the day's transactions create or increase a margin deficiency in the account and shall be for the amount of the margin deficiency so created or increased.

(2) *Satisfaction of deficiency*. The additional required margin may be satisfied by a transfer from the special memorandum account or by a deposit of cash, margin securities, exempted securities, or any combination thereof.

(3) *Time limits*. (i) A margin call shall be satisfied within one payment period after the margin deficiency was created or increased.

(ii) The payment period may be extended for one or more limited periods upon application by the creditor to its examining authority unless the examining authority believes that the creditor is not acting in good faith or that

the creditor has not sufficiently determined that exceptional circumstances warrant such action. Applications shall be filed and acted upon prior to the end of the payment period or the expiration of any subsequent extension.

(4) *Satisfaction restriction.* Any transaction, position, or deposit that is used to satisfy one requirement under this part shall be unavailable to satisfy any other requirement.

(d) *Liquidation in lieu of deposit.* If any margin call is not met in full within the required time, the creditor shall liquidate securities sufficient to meet the margin call or to eliminate any margin deficiency existing on the day such liquidation is required, whichever is less. If the margin deficiency created or increased is $1000 or less, no action need be taken by the creditor.

(e) *Withdrawals of cash or securities.* (1) Cash or securities may be withdrawn from an account, except if:

(i) Additional cash or securities are required to be deposited into the account for a transaction on the same or a previous day; or

(ii) The withdrawal, together with other transactions, deposits, and withdrawals on the same day, would create or increase a margin deficiency.

(2) Margin excess may be withdrawn or may be transferred to the special memorandum account (§ 220.5) by making a single entry to that account which will represent a debit to the margin account and a credit to the special memorandum account.

(3) If a creditor does not receive a distribution of cash or securities which is payable with respect to any security in a margin account on the day it is payable and withdrawal would not be permitted under this paragraph (e), a withdrawal transaction shall be deemed to have occurred on the day the distribution is payable.

(f) *Interest, service charges, etc.* (1) Without regard to the other provisions of this section, the creditor, in its usual practice, may debit the following items to a margin account if they are considered in calculating the balance of such account:

(i) Interest charged on credit maintained in the margin account;

(ii) Premiums on securities borrowed in connection with short sales or to effect delivery;

(iii) Dividends, interest, or other distributions due on borrowed securities;

(iv) Communication or shipping charges with respect to transactions in the margin account; and

(v) Any other service charges which the creditor may impose.

(2) A creditor may permit interest, dividends, or other distributions credited to a margin account to be withdrawn from the account if:

(i) The withdrawal does not create or increase a margin deficiency in the account; or

(ii) The current market value of any securities withdrawn does not exceed 10 percent of the current market value of the security with respect to which they were distributed.

[Reg. T, 63 FR 2823, Jan. 16, 1998]

### § 220.5 Special memorandum account.

(a) A special memorandum account (SMA) may be maintained in conjunction with a margin account. A single entry amount may be used to represent both a credit to the SMA and a debit to the margin account. A transfer between the two accounts may be effected by an increase or reduction in the entry. When computing the equity in a margin account, the single entry amount shall be considered as a debit in the margin account. A payment to the customer or on the customer's behalf or a transfer to any of the customer's other accounts from the SMA reduces the single entry amount.

(b) The SMA may contain the following entries:

(1) Dividend and interest payments;

(2) Cash not required by this part, including cash deposited to meet a maintenance margin call or to meet any requirement of a self-regulatory organization that is not imposed by this part;

(3) Proceeds of a sale of securities or cash no longer required on any expired or liquidated security position that may be withdrawn under § 220.4(e); and

(4) Margin excess transferred from the margin account under § 220.4(e)(2).

[Reg. T, 63 FR 2824, Jan. 16, 1998]

**§ 220.6 Good faith account.**

In a good faith account, a creditor may effect or finance customer transactions in accordance with the following provisions:

(a) *Securities entitled to good faith margin*—(1) *Permissible transactions.* A creditor may effect and finance transactions involving the buying, carrying, or trading of any security entitled to ''good faith'' margin as set forth in § 220.12 (the Supplement).

(2) *Required margin.* The required margin is set forth in § 220.12 (the Supplement).

(3) *Satisfaction of margin.* Required margin may be satisfied by a transfer from the special memorandum account or by a deposit of cash, securities entitled to ''good faith'' margin as set forth in § 220.12 (the Supplement), any other asset that is not a security, or any combination thereof. An asset that is not a security shall have a margin value determined by the creditor in good faith.

(b) *Arbitrage.* A creditor may effect and finance for any customer bona fide arbitrage transactions. For the purpose of this section, the term ''bona fide arbitrage'' means:

(1) A purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable for the purpose of taking advantage of a difference in prices in the two markets; or

(2) A purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the prices of the two securities.

(c) *''Prime broker'' transactions.* A creditor may effect transactions for a customer as part of a ''prime broker'' arrangement in conformity with SEC guidelines.

(d) *Credit to ESOPs.* A creditor may extend and maintain credit to employee stock ownership plans without regard to the other provisions of this part.

(e) *Nonpurpose credit.* (1) A creditor may:

(i) Effect and carry transactions in commodities;

(ii) Effect and carry transactions in foreign exchange;

(iii) Extend and maintain secured or unsecured nonpurpose credit, subject to the requirements of paragraph (e)(2) of this section.

(2) Every extension of credit, except as provided in paragraphs (e)(1)(i) and (e)(1)(ii) of this section, shall be deemed to be purpose credit unless, prior to extending the credit, the creditor accepts in good faith from the customer a written statement that it is not purpose credit. The statement shall conform to the requirements established by the Board.

[Reg. T, 63 FR 2824, Jan. 16, 1998]

**§ 220.7 Broker-dealer credit account.**

(a) *Requirements.* In a broker-dealer credit account, a creditor may effect or finance transactions in accordance with the following provisions.

(b) *Purchase or sale of security against full payment.* A creditor may purchase any security from or sell any security to another creditor or person regulated by a foreign securities authority under a good faith agreement to promptly deliver the security against full payment of the purchase price.

(c) *Joint back office.* A creditor may effect or finance transactions of any of its owners if the creditor is a clearing and servicing broker or dealer owned jointly or individually by other creditors.

(d) *Capital contribution.* A creditor may extend and maintain credit to any partner or stockholder of the creditor for the purpose of making a capital contribution to, or purchasing stock of, the creditor, affiliated corporation or another creditor.

(e) *Emergency and subordinated credit.* A creditor may extend and maintain, with the approval of the appropriate examining authority:

(1) Credit to meet the emergency needs of any creditor; or

(2) Subordinated credit to another creditor for capital purposes, if the other creditor:

(i) Is an affiliated corporation or would not be considered a customer of

the lender apart from the subordinated loan; or

(ii) Will not use the proceeds of the loan to increase the amount of dealing in securities for the account of the creditor, its firm or corporation or an affiliated corporation.

(f) *Omnibus credit* (1) A creditor may effect and finance transactions for a broker or dealer who is registered with the SEC under section 15 of the Act and who gives the creditor written notice that:

(i) All securities will be for the account of customers of the broker or dealer; and

(ii) Any short sales effected will be short sales made on behalf of the customers of the broker or dealer other than partners.

(2) The written notice required by paragraph (f)(1) of this section shall conform to any SEC rule on the hypothecation of customers' securities by brokers or dealers.

(g) *Special purpose credit*. A creditor may extend the following types of credit with good faith margin:

(1) Credit to finance the purchase or sale of securities for prompt delivery, if the credit is to be repaid upon completion of the transaction.

(2) Credit to finance securities in transit or surrendered for transfer, if the credit is to be repaid upon completion of the transaction.

(3) Credit to enable a broker or dealer to pay for securities, if the credit is to be repaid on the same day it is extended.

(4) Credit to an exempted borrower.

(5) Credit to a member of a national securities exchange or registered broker or dealer to finance its activities as a market maker or specialist.

(6) Credit to a member of a national securities exchange or registered broker or dealer to finance its activities as an underwriter.

[Reg. T, 63 FR 2824, Jan. 16, 1998]

### § 220.8 Cash account.

(a) *Permissible transactions*. In a cash account, a creditor, may:

(1) Buy for or sell to any customer any security or other asset if:

(i) There are sufficient funds in the account; or

(ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment;

(2) Buy from or sell for any customer any security or other asset if:

(i) The security is held in the account; or

(ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account;

(3) Issue, endorse, or guarantee, or sell an option for any customer as part of a covered option transaction; and

(4) Use an escrow agreement in lieu of the cash, cash equivalents or underlying asset position if:

(i) In the case of a short call or a short put, the creditor is advised by the customer that the required securities, assets or cash are held by a person authorized to issue an escrow agreement and the creditor independently verifies that the appropriate escrow agreement will be delivered by the person promptly; or

(ii) In the case of a call issued, endorsed, guaranteed, or sold on the same day the underlying asset is purchased in the account and the underlying asset is to be delivered to a person authorized to issue an escrow agreement, the creditor verifies that the appropriate escrow agreement will be delivered by the person promptly.

(b) *Time periods for payment; cancellation or liquidation*—(1) *Full cash payment*. A creditor shall obtain full cash payment for customer purchases:

(i) Within one payment period of the date:

(A) Any nonexempted security was purchased;

(B) Any when-issued security was made available by the issuer for delivery to purchasers;

(C) Any ''when distributed'' security was distributed under a published plan;

(D) A security owned by the customer has matured or has been redeemed and a new refunding security of the same issuer has been purchased by the customer, provided:

(*1*) The customer purchased the new security no more than 35 calendar days prior to the date of maturity or redemption of the old security;

(*2*) The customer is entitled to the proceeds of the redemption; and

(*3*) The delayed payment does not exceed 103 percent of the proceeds of the old security.

(ii) In the case of the purchase of a foreign security, within one payment period of the trade date or within one day after the date on which settlement is required to occur by the rules of the foreign securities market, provided this period does not exceed the maximum time permitted by this part for delivery against payment transactions.

(2) *Delivery against payment.* If a creditor purchases for or sells to a customer a security in a delivery against payment transaction, the creditor shall have up to 35 calendar days to obtain payment if delivery of the security is delayed due to the mechanics of the transaction and is not related to the customer's willingness or ability to pay.

(3) *Shipment of securities, extension.* If any shipment of securities is incidental to consummation of a transaction, a creditor may extend the payment period by the number of days required for shipment, but not by more than one additional payment period.

(4) *Cancellation; liquidation; minimum amount.* A creditor shall promptly cancel or otherwise liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time. A creditor may, at its option, disregard any sum due from the customer not exceeding $1000.

(c) *90 day freeze.* (1) If a nonexempted security in the account is sold or delivered to another broker or dealer without having been previously paid for in full by the customer, the privilege of delaying payment beyond the trade date shall be withdrawn for 90 calendar days following the date of sale of the security. Cancellation of the transaction other than to correct an error shall constitute a sale.

(2) The 90 day freeze shall not apply if:

(i) Within the period specified in paragraph (b)(1) of this section, full payment is received or any check or draft in payment has cleared and the proceeds from the sale are not withdrawn prior to such payment or check clearance; or

(ii) The purchased security was delivered to another broker or dealer for deposit in a cash account which holds sufficient funds to pay for the security. The creditor may rely on a written statement accepted in good faith from the other broker or dealer that sufficient funds are held in the other cash account.

(d) *Extension of time periods; transfers.* (1) Unless the creditor's examining authority believes that the creditor is not acting in good faith or that the creditor has not sufficiently determined that exceptional circumstances warrant such action, it may upon application by the creditor:

(i) Extend any period specified in paragraph (b) of this section;

(ii) Authorize transfer to another account of any transaction involving the purchase of a margin or exempted security; or

(iii) Grant a waiver from the 90 day freeze.

(2) Applications shall be filed and acted upon prior to the end of the payment period, or in the case of the purchase of a foreign security within the period specified in paragraph (b)(1)(ii) of this section, or the expiration of any subsequent extension.

[Reg. T, 63 FR 2825, Jan. 16, 1998]

### § 220.9 Clearance of securities, options, and futures.

(a) *Credit for clearance of securities.* The provisions of this part shall not apply to the extension or maintenance of any credit that is not for more than one day if it is incidental to the clearance of transactions in securities directly between members of a national securities exchange or association or through any clearing agency registered with the SEC.

(b) *Deposit of securities with a clearing agency.* The provisions of this part shall not apply to the deposit of securities with an option or futures clearing agency for the purpose of meeting the deposit requirements of the agency if:

(1) The clearing agency:

(i) Issues, guarantees performance on, or clears transactions in, any security (including options on any security, certificate of deposit, securities index or foreign currency); or

(ii) Guarantees performance of contracts for the purchase or sale of a commodity for future delivery or options on such contracts;

(2) The clearing agency is registered with the Securities and Exchange Commission or is the clearing agency for a contract market regulated by the Commodity Futures Trading Commission; and

(3) The deposit consists of any margin security and complies with the rules of the clearing agency that have been approved by the Securities and Exchange Commission or the Commodity Futures Trading Commission.

[Reg. T, 63 FR 2826, Jan. 16, 1998]

### § 220.10 Borrowing and lending securities.

(a) Without regard to the other provisions of this part, a creditor may borrow or lend securities for the purpose of making delivery of the securities in the case of short sales, failure to receive securities required to be delivered, or other similar situations. If a creditor reasonably anticipates a short sale or fail transaction, such borrowing may be made up to one standard settlement cycle in advance of trade date.

(b) A creditor may lend foreign securities to a foreign person (or borrow such securities for the purpose of relending them to a foreign person) for any purpose lawful in the country in which they are to be used.

(c) A creditor that is an exempted borrower may lend securities without regard to the other provisions of this part and a creditor may borrow securities from an exempted borrower without regard to the other provisions of this part.

[Reg. T, 63 FR 2826, Jan. 16, 1998]

### § 220.11 Requirements for the list of marginable OTC stocks and the list of foreign margin stocks.

(a) *Requirements for inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) of this section, OTC margin stock shall meet the following requirements:

(1) Four or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stock, as determined by the Board, is at least $5 per share;

(3) The stock is registered under section 12 of the Act, is issued by an insurance company subject to section 12(g)(2)(G) of the Act, is issued by a closed-end investment management company subject to registration pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), is an American Depository Receipt (ADR) of a foreign issuer whose securities are registered under section 12 of the Act, or is a stock of an issuer required to file reports under section 15(d) of the Act;

(4) Daily quotations for both bid and asked prices for the stock are continously available to the general public;

(5) The stock has been publicly traded for at least six months;

(6) The issuer has at least $4 million of capital, surplus, and undivided profits;

(7) There are 400,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors or beneficial owners of more than 10 percent of the stock;

(8) There are 1,200 or more holders of record, as defined in SEC Rule 12g5–1 (17 CFR 240.12g5–1), of the stock who are not officers, directors or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock as determined by the Board, is at least 500 shares; and

(9) The issuer or a predecessor in interest has been in existence for at least three years.

(b) *Requirements for continued inclusion on the list of marginable OTC stocks.* Except as provided in paragraph (f) of this section, OTC margin stock shall meet the following requirements:

(1) Three or more dealers stand willing to, and do in fact, make a market in such stock and regularly submit

bona fide bids and offers to an automated quotations system for their own accounts;

(2) The minimum average bid price of such stocks, as determined by the Board, is at least $2 per share;

(3) The stock is registered as specified in paragraph (a)(3) of this section;

(4) Daily quotations for both bid and asked prices for the stock are continuously available to the general public; ;

(5) The issuer has at least $1 million of capital, surplus, and undivided profits;

(6) There are 300,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 percent of the stock; and

(7) There continue to be 800 or more holders of record, as defined in SEC Rule 12g5–1 (17 CFR 240.12g5–1), of the stock who are not officers, directors, or beneficial owners of 10 percent or more of the stock, or the average daily trading volume of such stock, as determined by the Board, is at least 300 shares.

(c) *Requirements for inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign security shall meet the following requirements before being placed on the *List of Foreign Margin Stocks:*

(1) The security is an equity security that is listed for trading on or through the facilities of a foreign securities exchange or a recognized foreign securities market and has been trading on such exchange or market for at least six months;

(2) Daily quotations for both bid and asked or last sale prices for the security provided by the foreign securities exchange or foreign securities market on which the security is traded are continuously available to creditors in the United States pursuant to an electronic quotation system;

(3) The aggregate market value of shares, the ownership of which is unrestricted, is not less than $1 billion;

(4) The average weekly trading volume of such security during the preceding six months is either at least 200,000 shares or $1 million; and

(5) The issuer or a predecessor in interest has been in existence for at least five years.

(d) *Requirements for continued inclusion on the list of foreign margin stocks.* Except as provided in paragraph (f) of this section, a foreign security shall meet the following requirements to remain on the *List of Foreign Margin Stocks:*

(1) The security continues to meet the requirements specified in paragraphs (c) (1) and (2) of this section;

(2) The aggregate market value of shares, the ownership of which is unrestricted, is not less than $500 million; and

(3) The average weekly trading volume of such security during the preceding six months is either at least 100,000 shares or $500,000.

(e) *Removal from the list.* The Board shall periodically remove from the lists any stock that:

(1) Ceases to exist or of which the issuer ceases to exist; or

(2) No longer substantially meets the provisions of paragraphs (b) or (d) of this section or the definition of OTC margin stock.

(f) *Discretionary authority of Board.* Without regard to other paragraphs of this section, the Board may add to, or omit or remove from the list of marginable OTC stocks and the list of foreign margin stocks an equity security, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(g) *Unlawful representations.* It shall be unlawful for any creditor to make, or cause to be made, any representation to the effect that the inclusion of a security on the list of marginable OTC stocks or the list of foreign margin stocks is evidence that the Board or the SEC has in any way passed upon the merits of, or given approval to, such security or any transactions therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with the lists or stocks on those lists shall be an unlawful representation.

[Reg. T, 63 FR 2826, Jan. 16, 1998]

### § 220.12 Supplement: margin requirements.

The required margin for each security position held in a margin account shall be as follows:

(a) Margin equity security, except for an exempted security, money market mutual fund or exempted securities mutual fund, warrant on a securities index or foreign currency or a long position in an option: 50 percent of the current market value of the security or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(b) Exempted security, non-equity security, money market mutual fund or exempted securities mutual fund: The margin required by the creditor in good faith or the percentage set by the regulatory authority where the trade occurs, whichever is greater.

(c) Short sale of a nonexempted security, except for a non-equity security:

(1) 150 percent of the current market value of the security; or

(2) 100 percent of the current market value if a security exchangeable or convertible within 90 calendar days without restriction other than the payment of money into the security sold short is held in the account, provided that any long call to be used as margin in connection with a short sale of the underlying security is an American-style option issued by a registered clearing corporation and listed or traded on a registered national securities exchange with an exercise price that does not exceed the price at which the underlying security was sold short.

(d) Short sale of an exempted security or non-equity security: 100 percent of the current market value of the security plus the margin required by the creditor in good faith.

(e) Nonmargin, nonexempted equity security: 100 percent of the current market value.

(f) Put or call on a security, certificate of deposit, securities index or foreign currency or a warrant on a securities index or foreign currency:

(1) In the case of puts and calls issued by a registered clearing corporation and listed or traded on a registered national securities exchange or a registered securities association and registered warrants on a securities index or foreign currency, the amount, or other position specified by the rules of the registered national securities exchange or the registered securities association authorized to trade the option or warrant, provided that all such rules have been approved or amended by the SEC; or

(2) In the case of all other puts and calls, the amount, or other position, specified by the maintenance rules of the creditor's examining authority.

[Reg. T, 63 FR 2827, Jan. 16, 1998]

INTERPRETATIONS

### § 220.101 Transactions of customers who are brokers or dealers.

The Board has recently considered certain questions regarding transactions of customers who are brokers or dealers.

(a) The first question was whether delivery and payment under § 220.4(f)(3) must be exactly simultaneous (such as in sight draft shipments), or whether it is sufficient if the broker-dealer customer, ''as promptly as practicable in accordance with the ordinary usage of the trade,'' mails or otherwise delivers to the creditor a check in settlement of the transaction, the check being accompanied by instructions for transfer or delivery of the security. The Board ruled that the latter method of setting the transaction is permissible.

(b) The second question was, in effect, whether the limitations of § 220.4(c)(8) apply to the account of a customer who is himself a broker or dealer. The answer is that the provision applies to any ''special cash account,'' regardless of the type of customer.

(c) The third question was, in effect, whether a purchase and a sale of an unissued security under § 220.4(f)(3) may be offset against each other, or whether each must be settled separately by what would amount to delivery of the security to settle one transaction and its redelivery to settle the other. The answer is that it is permissible to offset the transactions against each other without physical delivery and redelivery of the security.

[11 FR 14155, Dec. 7, 1946]

**§ 220.102 [Reserved]**

**§ 220.103 Borrowing of securities.**

(a) The Board of Governors has been asked for a ruling as to whether § 220.6(h), which deals with borrowing and lending of securities, applies to a borrower of securities if the lender is a private individual, as contrasted with a member of a national securities exchange or a broker or dealer.

(b) Section 220.6(h) does not require that the lender of the securities in such a case be a member of a national securities exchange or a broker or dealer. Therefore, a borrowing of securities may be able to qualify under the provision even though the lender is a private individual, and this is true whether the security is registered on a national securities exchange or is unregistered. In borrowing securities from a private individual under § 220.6(h), however, it becomes especially important to bear in mind two limitations that are contained in the section.

(c) The first limitation is that the section applies only if the broker borrows the securities for the purpose specified in the provision, that is, ''for the purpose of making delivery of such securities in the case of short sales, failure to receive securities he is required to deliver, or other similar cases''. The present language of the provision does not require that the delivery for which the securities are borrowed must be on a transaction which the borrower has himself made, either as agent or as principal; he may borrow under the provision in order to relend to someone else for the latter person to make such a delivery. However, the borrowing must be related to an actual delivery of the type specified—a delivery in connection with a specific transaction that has already occurred or is in immediate prospect. The provision does not authorize a broker to borrow securities (or make the related deposit) merely in order that he or some other broker may have the securities ''on hand'' or may anticipate some need that may or may not arise in the future.

(d) The ruling in the 1940 Federal Reserve Bulletin, at page 647, is an example of a borrowing which, on the facts as given, did not meet the requirement. There, the broker wished to borrow stocks with the understanding that he ''would offer to lend this stock in the 'loan crowd' on a national securities exchange.'' There was no assurance that the stocks would be used for the purpose specified in § 220.6(h); they might be, or they might merely be held idle while the person lending the stocks had the use of the funds deposited against them. The ruling held in effect that since the borrowing could not qualify under § 220.6(h) it must comply with other applicable provisions of the regulation.

(e) The second requirement is that the deposit of cash against the borrowed securities must be ''bona fide.'' This requirement naturally cannot be spelled out in detail, but it requires at least that the purpose of the broker in making the deposit should be to obtain the securities for the specified purpose, and that he should not use the arrangement as a means of accommodating a customer who is seeking to obtain more funds than he could get in a general account.

(f) The Board recognizes that even with these requirements there is still some possibility that the provision may be misapplied. The Board is reluctant to impose additional burdens on legitimate transactions by tightening the provision. If there should be evidence of abuses developing under the provision, however, it would become necessary to consider making it more restricted.

[12 FR 5278, Aug. 2, 1947]

**§ 220.104 [Reserved]**

**§ 220.105 Ninety-day rule in special cash account.**

(a) Section 220.4(c)(8) places a limitation on a special cash account if a security other than an exempted security has been purchased in the account and ''without having been previously paid for in full by the customer * * * has been * * * delivered out to any broker or dealer.'' The limitation is that during the succeeding 90 days the customer may not purchase a security in the account other than an exempted security unless funds sufficient for the purpose are held in the account. In other words, the privilege of delayed

payment in such an account is withdrawn during the 90-day period.

(b) The Board recently considered a question as to whether the following situation makes an account subject to the 90-day disqualification: A customer purchases registered security ABC in a special cash account. The broker executes the order in good faith as a bona fide cash transaction, expecting to obtain full cash payment promptly. The next day, the customer sells registered security XYZ in the account, promising to deposit it promptly in the account. The proceeds of the sale are equal to or greater than the cost of security ABC. After both sale and purchase have been made, the customer requests the broker to deliver security ABC to a different broker, to receive security XYZ from that broker at about the same time, and to settle with the other broker—such settlement to be made either by paying the cost of security XYZ to the other broker and receiving from him the cost of security ABC, or by merely settling any difference between these amounts.

(c) The Board expressed the view that the account becomes subject to the 90-day disqualification in § 220.4(c)(8). In the instant case, unlike that described at 1940 Federal Reserve Bulletin 772, the security sold is not held in the account and is not to be deposited in it unconditionally. It is to be obtained only against the delivery to the other broker of the security which had been purchased. Hence payment can not be said to have been made prior to such delivery; the purchased security has been delivered out to a broker without previously having been paid for in full, and the account becomes subject to the 90-day disqualification.

[13 FR 2368, May 1, 1948]

### §§ 220.106–220.107 [Reserved]

### § 220.108 International Bank Securities.

(a) Section 2 of the Act of June 29, 1949 (Pub. L. 142—81st Congress), amended the Bretton Woods Agreements Act by adding a new section numbered 15 providing, in part, that—

Any securities issued by International Bank for Reconstruction and Development (including any guaranty by the bank, whether or not limited in scope), and any securities guaranteed by the bank as to both principal and interest, shall be deemed to be exempted securities within the meaning of * * * paragraph (a)(12) of section 3 of the [Securities Exchange] Act of June 6, 1934, as amended (15 U.S.C. 78c). * * *.

(b) In response to inquiries with respect to the applicability of the margin requirements of this part to securities issued or guaranteed by the International Bank for Reconstruction and Development, the Board has replied that, as a result of this enactment, securities issued by the Bank are now classified as exempted securities under § 220.2(e). Such securities are now in the same category under this part as are United States Government, State and municipal bonds. Accordingly, the specific percentage limitations prescribed by this part with respect to maximum loan value and margin requirements are no longer applicable thereto.

[14 FR 5505, Sept. 7, 1949]

### § 220.109 [Reserved]

### § 220.110 Assistance by Federal credit union to its members.

(a) An inquiry was presented recently concerning the application of this part or part 221 of this subchapter, to a plan proposed by a Federal credit union to aid its members in purchasing stock of a corporation whose subsidiary apparently was the employer of all the credit union's members.

(b) From the information submitted, the plan appeared to contemplate that the Federal credit union would accept orders from its members for registered common stock of the parent corporation in multiples of 5 shares; that whenever orders had been so received for a total of 100 shares, the credit union, as agent for such members, would execute the orders through a brokerage firm with membership on a national securities exchange; that the brokerage firm would deliver certificates for the stock, registered in the names of the individual purchasers, to the credit union against payment by the credit union; that the credit union would prorate the total amount so paid, including the brokerage fee,

among the individual purchasers according to the number of shares purchased by them; and that a savings in brokerage fee resulting from the 100-lot purchases would be passed on by the credit union to the individual purchasers of the stock. However, amounts of the stock less than 100 shares would be purchased by the credit union through the brokerage firm for any members willing to forego such savings.

(c) It appeared further that the Federal credit union members for whom stock was so purchased would reimburse the credit union (1) by cash payment, (2) by the proceeds of withdrawn shares of the credit union, (3) by the proceeds of an installment loan from the credit union collateraled by the stock purchased, or by (4) by a combination of two or more of the above methods. To assist the collection of any such loan, the employer of the credit union members would provide payroll deductions. Apparently, sales by the credit union of any of the stock purchased by one of its members would occur only in satisfaction of a delinquent loan balance. In no case did it appear that the credit union would make a charge for arranging the execution of transactions in the stock for its members.

(d) The Board was of the view that, from the facts as presented, it did not appear that the Federal credit union should be regarded as the type of institution to which part 221 of this subchapter, in its present form, applied.

(e) With respect to this part, the question was whether the activities of the Federal credit union under the proposal, or otherwise, might be such as to bring it within the meaning of the terms ''broker'' or ''dealer'' as used in the part and the Securities Exchange Act of 1934. The Board observed that this, of course, was a question of fact that necessarily depended upon the circumstances of the particular case, including the manner in which the arrangement in question might be carried out in practice.

(f) On the basis of the information submitted, however, it did not appear to the Board that the Federal credit union should be regarded as being subject to this part as a ''broker or dealer who transacts a business in securities through the medium of'' a member firm solely because of its activities as contemplated by the proposal in question. The Board stated that the part rather clearly would not apply if there appeared to be nothing other than loans by the credit union to its members to finance purchases made directly by them of stock of the parent corporation of the employer of the member-borrowers. The additional fact that the credit union, as agent, would purchase such stock for its members (even though all such purchases might not be financed by credit union loans) was not viewed by the Board as sufficient to make the regulation applicable where, as from the facts presented, it did not appear that the credit union in any case was to make any charge or receive any compensation for assisting in such purchases or that the credit union otherwise was engaged in securities activities. However, the Board stated that matters of this kind must be examined closely for any variations that might suggest the inapplicability of the foregoing.

[18 FR 4592, Aug. 5, 1953]

### § 220.111 Arranging for extensions of credit to be made by a bank.

(a) The Board has recently had occasion to express opinions regarding the requirements which apply when a person subject to this part (for convenience, called here simply a broker) arranges for a bank to extend credit.

(b) The matter is treated generally in § 220.7(a) and is also subject to the general rule of law that any person who aids or abets a violation of law by another is himself guilty of a violation. It may be stated as a general principle that any person who arranges for credit to be extended by someone else has a responsibility so to conduct his activities as not to be a participant in a violation of this part, which applies to brokers, or part 221 of this subchapter, which applies to banks.

(c) More specifically, in arranging an extension of credit that may be subject to part 221 of this subchapter, a broker must act in good faith and, therefore, must question the accuracy of any non-purpose statement (i.e., a statement that the loan is not for the purpose of

purchasing or carrying registered stocks) given in connection with the loan where the circumstances are such that the broker from any source knows or has reason to know that the statement is incomplete or otherwise inaccurate as to the true purpose of the credit. The requirement of ''good faith'' is of vital importance. While the application of the requirement will necessarily vary with the facts of the particular case, the broker, like the bank for whom the loan is arranged to be made, must be alert to the circumstances surrounding the loan. Thus, for example, if a broker or dealer is to deliver registered stocks to secure the loan or is to receive the proceeds of the loan, the broker arranging the loan and the bank making it would be put on notice that the loan would probably be subject to part 221 of this subchapter. In any such circumstances they could not in good faith accept or rely upon a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation. The foregoing, of course, applies the principles contained in § 221.101 of this subchapter.

(d) In addition, when a broker is approached by another broker to arrange extensions of credit for customers of the approaching broker, the broker approached has a responsibility not to arrange any extension of credit which the approaching broker could not himself arrange. Accordingly, in such cases the statutes and regulations forbid the approached broker to arrange extensions of credit on unregistered securities for the purpose of purchasing or carrying either registered or unregistered securities. The approaching broker would also be violating the applicable requirements if he initiated or otherwise participated in any such forbidden transactions.

(e) The expression of views, set forth in this section, to the effect that certain specific transactions are forbidden, of course, should not in any way be understood to indicate approval of any other transactions which are not mentioned.

[18 FR 5505, Sept. 15, 1953]

**§ 220.112 [Reserved]**

**§ 220.113 Necessity for prompt payment and delivery in special cash accounts.**

(a) The Board of Governors recently received an inquiry concerning whether purchases of securities by certain municipal employees' retirement or pension systems on the basis of arrangements for delayed delivery and payment, might properly be effected by a creditor subject to this part in a special cash account under § 220.4(c).

(b) It appears that in a typical case the supervisors of the retirement system meet only once or twice each month, at which times decisions are made to purchase any securities wished to be acquired for the system. Although the securities are available for prompt delivery by the broker-dealer firm selected to effect the system's purchase, it is arranged in advance with the firm that the system will not accept delivery and pay for the securities before some date more than seven business days after the date on which the securities are purchased. Apparently, such an arrangement is occasioned by the monthly or semimonthly meetings of the system's supervisors. It was indicated that a retirement system of this kind may be supervised by officials who administer it as an incidental part of their regular duties, and that meetings requiring joint action by two or more supervisors may be necessary under the system's rules and procedures to authorize issuance of checks in payment for the securities purchased. It was indicated also that the purchases do not involve exempted securities, securities of the kind covered by § 220.4(c)(3), or any shipment of securities as described in § 220.4(c).

(c) This part provides that a creditor subject thereto may not effect for a customer a purchase in a special cash account under § 220.4(c) unless the use of the account meets the limitations of § 220.4(a) and the purchase constitutes a ''bona fide cash transaction'' which complies with the eligibility requirements of § 220.4(c)(1)(i). One such requirement is that the purchase be made ''in reliance upon an agreement accepted by the creditor (broker-dealer) in good faith'' that the customer

will ''promptly make full cash payment for the security, if funds sufficient for the purpose are not already in the account; and, subject to certain exceptions, § 220.4(c)(2) provides that the creditor shall promptly cancel or liquidate the transaction if payment is not made by the customer within seven business days after the date of purchase. As indicated in the Board's interpretation at 1940 Federal Reserve Bulletin 1172, a necessary part of the customer's undertaking pursuant to § 220.4(c)(1)(i) is that he ''should have the necessary means of payment readily available when he purchases a security in the special cash account. He should expect to pay for it immediately or in any event within the period (of not more than a very few days) that is as long as is usually required to carry through the ordinary securities transaction.''

(d) The arrangements for delayed delivery and payment in the case presented to the Board and outlined above clearly would be inconsistent with the requirement of § 220.4(c)(1)(i) that the purchase be made in reliance upon an agreement accepted by the creditor in good faith that the customer will ''promptly'' make full cash payment for the security. Accordingly, the Board said that transactions of the kind in question would not qualify as a ''bona fide cash transaction'' and, therefore, could not properly be effected in a special cash account, unless a contrary conclusion would be justified by the exception in § 220.4(c)(5).

(e) Section 220.4(c)(5) provides that if the creditor, ''acting in good faith in accordance with'' § 220.4(c)(1), purchases a security for a customer ''with the understanding that he is to deliver the security promptly to the customer, and the full cash payment is to be made promptly by the customer is to be made against such delivery'', the creditor may at his option treat the transaction as one to which the period applicable under § 220.4(c)(2) is not the seven days therein specified but 35 days after the date of such purchase. It will be observed that the application of § 220.4 (c)(5) is specifically conditioned on the creditor acting in good faith in accordance with § 220.4(c)(1). As noted above, the existence of the arrangements for delayed delivery and payment in the case presented would prevent this condition from being met, since the customer could not be regarded as having agreed to make full cash payment ''promptly''. Furthermore, such arrangements clearly would be inconsistent with the requirement of § 220.4(c)(5) that the creditor ''deliver the security promptly to the customer''.

(f) Section 220.4(c)(5) was discussed in the Board's published interpretation, referred to above, which states that ''it is not the purpose of (§ 220.4 (c)(5)) to allow additional time to customers for making payment. The 'prompt delivery' described in (§ 220.4 (c)(5)) is delivery which is to be made as soon as the broker or dealer can reasonably make it in view of the mechanics of the securities business and the bona fide usages of the trade. The provision merely recognizes the fact that in certain circumstances it is an established bona fide practice in the trade to obtain payment against delivery of the security to the customer, and the further fact that the mechanics of the trade, unrelated to the customer's readiness to pay, may sometimes delay such delivery to the customer''.

(g) In the case presented, it appears that the only reason for the delay is related solely to the customer's readiness to pay and is in no way attributable to the mechanics of the securities business. Accordingly, it is the Board's view that the exception in § 220.4(c)(5) should not be regarded as permitting the transactions in question to be effected in a special cash account.

[22 FR 5954, July 27, 1957]

### §§ 220.114–220.116 [Reserved]

### § 220.117 Exception to 90-day rule in special cash account.

(a) The Board of Governors has recently interpreted certain of the provisions of § 220.4(c)(8), with respect to the withdrawal of proceeds of a sale of stock in a ''special cash account'' when the stock has been sold out of the account prior to payment for its purchase.

(b) The specific factual situation presented may be summarized as follows:

Customer purchased stock in a special cash account with a member firm on Day 1. On Day 3 customer sold the same stock at a profit. On Day 8 customer delivered his check for the cost of the purchase to the creditor (member firm). On Day 9 the creditor mailed to the customer a check for the proceeds of the sale.

(c) Section 220.4(c)(8) prohibits a creditor, as a general rule, from effecting a purchase of a security in a customer's special cash account if any security has been purchased in that account during the preceding 90 days and has then been sold in the account or delivered out to any broker or dealer without having been previously paid for in full by the customer. One exception to this general rule reads as follows:

* * * The creditor may disregard for the purposes of this subparagraph (§ 220.4(c) (8)) a sale without prior payment provided full cash payment is received within the period described by subparagraph (2) of this paragraph (seven days after the date of purchase) and the customer has not withdrawn the proceeds of sale on or before the day on which such payment (and also final payment of any check received in that connection) is received. * * *

(d) Final payment of customer's check: (1) The first question is: When is the creditor to be regarded as having received ''final payment of any check received'' in connection with the purchase?

(2) The clear purpose of § 220.4(c) (8) is to prevent the use of the proceeds of sale of a stock by a customer to pay for its purchase—i.e., to prevent him from trading on the creditor's funds by being able to deposit the sale proceeds prior to presentment of his own check to the drawee bank. Thus, when a customer undertakes to pay for a purchase by check, that check does not constitute payment for the purchase, within the language and intent of the above-quoted exception in § 220.4(c)(8), until it has been honored by the drawee bank, indicating the sufficiency of his account to pay the check.

(3) The phrase ''final payment of any check'' is interpreted as above notwithstanding § 220.6(f), which provides that:

For the purposes of this part (Regulation T), a creditor may, at his option (1) treat the receipt in good faith of any check or draft drawn on a bank which in the ordinary course of business is payable on presentation, * * * as receipt of payment of the amount of such check, draft or order; * * *

This is a general provision substantially the same as language found in section 4(f) of Regulation T as originally promulgated in 1934. The language of the subject exception to the 90-day rule of § 220.4(c)(8), i.e., the exception based expressly on final ''payment of any check,'' was added to the regulation in 1949 by an amendment directed at a specific type of situation. Because the exception is a special, more recent provision, and because § 220.6(f), if controlling, would permit the exception to undermine, to some extent, the effectiveness of the 90-day rule, sound principles of construction require that the phrase ''final payment of any check'' be given its literal and intended effect.

(4) There is no fixed period of time from the moment of receipt by the payee, or of deposit, within which it is certain that any check will be paid by the drawee bank. Therefore, in the rare case where the operation of the subject exception to § 220.4(c)(8) is necessary to avoid application of the 90-day rule, a creditor should ascertain (from his bank of deposit or otherwise) the fact of payment of a customer's check given for the purchase. Having so determined the day of final payment, the creditor can permit withdrawal on any subsequent day.

(e) Mailing as ''withdrawal'': (1) Also presented is the question whether the mailing to the customer of the creditor's check for the sale proceeds constitutes a withdrawal of such proceeds by the customer at the time of mailing so that, if the check for the sale proceeds is mailed on or before the day on which the customer's check for the purchase is finally paid, the 90-day rule applies. It may be that a check mailed one day will not ordinarily be received by the customer until the next. The Board is of the view, however, that when the check for sale proceeds is issued and released into the mails, the proceeds are to be regarded as withdrawn by the customer; a more liberal interpretation would open a way for circumvention. Accordingly, the creditor's check should not be mailed nor the sale proceeds otherwise released to

the customer ''on or before the day'' on which payment for the purchase, including final payment of any check given for such payment, is received by the creditor, as determined in accordance with the principles stated herein.

(2) Applying the above principles to the schedule of transactions described in the second paragraph of this interpretation, the mailing of the creditor's check on ''Day 9'' would be consistent with the subject exception to § 220.4(c)(8), as interpreted herein, only if the customer's check was paid by the drawee bank on ''Day 8''.

[27 FR 3511, Apr. 12, 1962]

### § 220.118 Time of payment for mutual fund shares purchased in a special cash account.

(a) The Board has recently considered the question whether, in connection with the purchase of mutual fund shares in a ''special cash account'' under the provisions of this part 220, the 7-day period with respect to liquidation for nonpayment is that described in § 220.4(c)(2) or that described in § 220.4(c)(3).

(b) Section 220.4(c)(2) provides as follows:

> In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in subparagraphs (3)–(7) of this paragraph, promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof.

Section 220.4(c)(3), one of the exceptions referred to, provides in relevant part as follows:

> If the security when so purchased is an unissued security, the period applicable to the transaction under subparagraph (2) of this paragraph shall be 7 days after the date on which the security is made available by the issuer for delivery to purchasers.

(c) In the case presented, the shares of the mutual fund (open-end investment company) are technically not issued at the time they are sold by the underwriter and distributor. Several days may elapse from the date of sale before a certificate can be delivered by the transfer agent. The specific inquiry to the Board was, in effect, whether the 7-day period after which a purchase transaction must be liquidated or cancelled for nonpayment should run, in the case of mutual fund shares, from the time when a certificate for the purchased shares is available for delivery to the purchaser, instead of from the date of the purchase.

(d) Under the general rule of § 220.4 (c)(2) that is applicable to purchases of outstanding securities, the 7-day period runs from the date of purchase without regard to the time required for the mechanical acts of transfer of ownership and delivery of a certificate. This rule is based on the principles governing the use of special cash accounts in accordance with which, in the absence of special circumstances, payment is to be made promptly upon the purchase of securities.

(e) The purpose of § 220.4(c)(3) is to recognize the fact that, when an issue of securities is to be issued at some fixed future date, a security that is a part of such issue can be purchased on a ''when-issued'' basis and that payment may reasonably be delayed until after such date of issue, subject to other basic conditions for transactions in a special cash account. Thus, unissued securities should be regarded as ''made available for delivery to purchasers'' on the date when they are substantially as available as outstanding securities are available upon purchase, and this would ordinarily be the designated date of issuance or, in the case of a stock dividend, the ''payment date''. In any case, the time required for the mechanics of transfer and delivery of a certificate is not material under § 220.4(c)(3) any more than it is under § 220.4(c)(2).

(f) Mutual fund shares are essentially available upon purchase to the same extent as outstanding securities. The mechanics of their issuance and of the delivery of certificates are not significantly different from the mechanics of transfer and delivery of certificates for shares of outstanding securities, and the issuance of mutual fund shares is not a future event in a sense that would warrant the extension of the time for payment beyond that afforded in the case of outstanding securities. Consequently, the Board has concluded that a purchase of mutual fund shares

is not a purchase of an ''unissued security'' to which § 220.4(c)(3) applies, but is a transaction to which § 220.4(c)(2) applies.

[27 FR 10885, Nov. 8, 1962]

**§ 220.119 Applicability of margin requirements to credit extended to corporation in connection with retirement of stock.**

(a) The Board of Governors has been asked whether part 220 was violated when a dealer in securities transferred to a corporation 4,161 shares of the stock of such corporation for a consideration of $33,288, of which only 10 percent was paid in cash.

(b) If the transaction was of a kind that must be included in the corporation's ''general account'' with the dealer (§ 220.3), it would involve an excessive extension of credit in violation of § 220.3 (b)(1). However, the transaction would be permissible if the transaction came within the scope of § 220.4(f)(8), which permits a ''creditor'' (such as the dealer) to ''Extend and maintain credit to or for any customer without collateral or on any collateral whatever for any purpose other than purchasing or carrying or trading in securities.'' Accordingly, the crucial question is whether the corporation, in this transaction, was ''purchasing'' the 4,161 shares of its stock, within the meaning of that term as used in this part.

(c) Upon first examination, it might seem apparent that the transaction was a purchase by the corporation. From the viewpoint of the dealer the transaction was a sale, and ordinarily, at least a sale by one party connotes a purchase by the other. Furthermore, other indicia of a sale/purchase transaction were present, such as a transfer of property for a pecuniary consideration. However, when the underlying objectives of the margin regulations are considered, it appears that they do not encompass a transaction of this nature, where securities are transferred on credit to the issuer thereof for the purpose of retirement.

(d) Section 7(a) of the Securities Exchange Act of 1934 requires the Board of Governors to prescribe margin regulations ''For the purpose of preventing the excessive use of credit for the purchase or carrying of securities.'' Accordingly, the provisions of this part are not intended to prevent the use of credit where the transaction will not have the effect of increasing the volume of credit in the securities markets.

(e) It appears that the instant transaction would have no such effect. When the transaction was completed, the equity interest of the dealer was transmuted into a dollar-obligation interest; in lieu of its status as a stockholder of the corporation, the dealer became a creditor of that corporation. The corporation did not become the owner of any securities acquired through the use of credit; its outstanding stock was simply reduced by 4,161 shares.

(f) The meaning of ''sale'' and ''purchase'' in the Securities Exchange Act has been considered by the Federal courts in a series of decisions dealing with corporate ''insiders'' profits under section 16(b) of that Act. Although the statutory purpose sought to be effectuated in those cases is quite different from the purpose of the margin regulations, the decisions in question support the propriety of not regarding a transaction as a ''purchase'' where this accords with the probable legislative intent, even though, literally, the statutory definition seems to include the particular transaction. See Roberts v. Eaton (CA 2 1954) 212 F. 2d 82, and cases and other authorities there cited. The governing principle, of course, is to effectuate the purpose embodied in the statutory or regulatory provision being interpreted, even where that purpose may conflict with the literal words. U.S. v. Amer. Trucking Ass'ns, 310 U.S. 534, 543 (1940); 2 Sutherland, Statutory Construction (3d ed. 1943) ch. 45.

(g) There can be little doubt that an extension of credit to a corporation to enable it to retire debt securities would not be for the purpose of ''purchasing * * * securities'' and therefore would come within § 220.4(f)(8), regardless of whether the retirement was obligatory (e.g., at maturity) or was a voluntary ''call'' by the issuer. This is true, it is difficult to see any valid distinction, for this purpose, between (1) voluntary retirement of an indebtedness security and (2) voluntary retirement of an equity security.

(h) For the reasons indicated above, it is the opinion of the Board of Governors that the extension of credit here involved is not of the kind which the margin requirements are intended to regulate and that the transaction described does not involve an unlawful extension of credit as far as this part is concerned.

(i) The foregoing interpretation relates, of course, only to cases of the type described. It should not be regarded as governing any other situations; for example, the interpretation does not deal with cases where securities are being transferred to someone other than the issuer, or to the issuer for a purpose other than immediate retirement. Whether the margin requirements are inapplicable to any such situations would depend upon the relevant facts of actual cases presented.

[27 FR 12346, Dec. 13, 1962]

**§ 220.120 [Reserved]**

**§ 220.121 Applicability of margin requirements to joint account between two creditors.**

(a) The Board has recently been asked whether extensions of credit in a joint account between two brokerage firms, a member of a national securities exchange (''Firm X'') and a member of the National Association of Securities Dealers (''Firm Y'') are subject to the margin requirements of this part (Regulation T). It is understood that similar joint accounts are not uncommon, and it appears that the margin requirements of the regulation are not consistently applied to extensions of credit in the accounts.

(b) When the account in question was opened, Firm Y deposited $5,000 with Firm X and has made no further deposit in the account, except for the monthly settlement described below. Both firms have the privilege of buying and selling specified securities in the account, but it appears that Firm X initiates most of the transactions therein. Trading volume may run from half a million to a million dollars a month. Firm X carries the ''official'' ledger of the account and sends Firm Y a monthly statement with a complete record of all transactions effected during the month. Settlement is then made in accordance with the agreement between the two firms, which provides that profits and losses shall be shared equally on a fifty-fifty basis. However, all transactions are confirmed and reconfirmed between the two on a daily basis.

(c) Section 220.3(a) provides that

> All financial relations between a creditor and a customer, whether recorded in one record or in more than one record, shall be included in and be deemed to be part of the customer's general account with the creditor, * * *.

and § 220.2(c) defines the term ''customer'' to include

> * * * any person, or any group of persons acting jointly, * * * to or for whom a creditor is extending or maintaining any credit * * *

In the course of a normal month's operations, both Firm X and Firm Y are at one time or another extending credit to the joint account, since both make purchases for the account that are not ''settled'' until the month's end. Consequently, the account would be a ''customer'' within the above definition.

(d) Section 220.6(b) provides, with respect to the account of a joint adventure in which a creditor participates, that

> * * * the adjusted debit balance of the account shall include, in addition to the items specified in § 220.3(d), any amount by which the creditor's contribution to the joint adventure exceeds the contribution which he would have made if he had contributed merely in proportion to his right to share in the profits of the joint adventure.

In addition, the final paragraph of § 220.2(c) states that the definition of ''customer''

> * * * includes any joint adventure in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

(e) The above provisions clearly evince the Board's intent that the regulation shall cover trading accounts in which a creditor participates. If additional confirmation were needed, it is supplied by the fact that the Board found it needful specifically to exempt from ordinary margin requirements

credit extended to certain joint accounts in which a creditor participates. These include the account in which transactions of odd-lot dealers may be financed under § 220.4(f) (4), and the specialist's account under § 220.4(g). Accordingly, the Board concluded that the joint account between Firm X and Firm Y is a ''customer'' within the meaning of the regulation, and that extensions of credit in the account are subject to margin requirements.

[31 FR 7169, May 17, 1966]

### § 220.122 "Deep in the money put and call options" as extensions of credit.

(a) The Board of Governors has been asked to determine whether the business of selling instruments described as ''deep in the money put and call options'' would involve an extension of credit for the purposes of the Board's regulations governing margin requirements for securities transactions. Most of such options would be of the ''call'' type, such as the following proposal that was presented to the Board for its consideration:

> If X stock is selling at $100 per share, the customer would pay about $3,250 for a contract to purchase 100 shares of X at $70 per share within a 30-day period. The contract would be guaranteed by an exchange member, as are standard ''puts'' and ''calls''. When the contract is made with the customer, the seller, who will also be the writer of the contract, will immediately purchase 100 shares of X at $100 per share through the guarantor member firm in a margin account. If the customer exercises the option, the shares will be delivered to him; if the option is not exercised, the writer will sell the shares in the margin account to close out the transaction. As a practical matter, it is anticipated that the customer will exercise the option in almost every case.

(b) An ordinary ''put'' is an option given to a person to sell to the writer of the put a specified amount of securities at a stated price within a certain time. A ''call'' is an option given to a person to buy from the writer a specified amount of securities at a stated price within a certain time. To be freely saleable, options must be indorsed, or guaranteed, by a member firm of the exchange on which the security is registered. The guarantor charges a fee for this service.

(c) The option embodied in the normal put or call is exercisable either at the market price of the security at the time the option is written, or some ''points away'' from the market. The price of a normal option is modest by comparison with the margin required to take a position. Writers of normal options are persons who are satisfied with the current price of a security, and are prepared to purchase or sell at that price, with the small profit provided by the fee. Moreover, since a large proportion of all options are never exercised, a person who customarily writes normal options can anticipate that the fee would be clear profit in many cases, and he will not be obligated to buy or sell the stock in question.

(d) The stock exchanges require that the writer of an option deposit and maintain in his margin account with the indorser 30 percent of the current market price in the case of a call (unless he has a long position in the stock) and 25 percent in the case of a put (unless he has a short position in the stock). Many indorsing firms in fact require larger deposits. Under § 220.3(a) of Regulation T, all financial relations between a broker and his customer must be included in the customer's general account, unless specifically eligible for one of the special accounts authorized by § 220.4. Accordingly, the writer, as a customer of the member firm, must make a deposit, which is included in his general account.

(e) In order to prevent the deposit from being available against other margin purchases, and in effect counted twice, § 220.3(d)(5) requires that in computing the customer's adjusted debit balance, there shall be included ''the amount of any margin customarily required by the creditor in connection with his endorsement or guarantee of any put, call, or other option''. No other margin deposit is required in connection with a normal put or call option under Regulation T.

(f) Turning to the ''deep in the money'' proposed option contract described above, the price paid by the buyer can be divided into (1) a deposit of 30 percent of the current market

value of the stock, and (2) an additional fixed charge, or fee. To the extent that the price of the stock rose during the 30 ensuing days the proposed instrument would produce results similar to those in the case of an ordinary profitable call, and the contract right would be exercised. But even if the price fell, unlike the situation with a normal option, the buyer would still be virtually certain to exercise his right to purchase before it expired, in order to minimize his loss. The result would be that the buyer would not have a genuine choice whether or not to buy. Rather, the instrument would have made it possible for him, in effect, to purchase stock as of the time the contract was written by depositing 30 percent of the stock's current market price.

(g) It was suggested that the proposed contract is not unusual, since there are examples of ordinary options selling at up to 28 percent of current market value. However, such examples are of options running for 12 months, and reflect expectations of changes in the price of the stock over that period. The 30-day contracts discussed above are not comparable to such 12-month options, because instances of true expectations of price changes of this magnitude over a 30-day period would be exceedingly rare. And a contract that does not reflect such true expectations of price change, plus a reasonable fee for the services of the writer, is not an option in the accepted meaning of the term.

(h) Because of the virtual certainty that the contract right would be exercised under the proposal described above, the writer would buy the stock in a margin account with an indorsing firm immediately on writing the contract. The indorsing firm would extend credit in the amount of 20 percent of the current market price of the stock, the maximum permitted by the current § 220.8 (supplement to Regulation T). The writer would deposit the 30 percent supplied by the buyer, and furnish the remaining 50 percent out of his own working capital. His account with the indorsing firm would thus be appropriately margined.

(i) As to the buyer, however, the writer would function as a broker. In effect, he would purchase the stock for the account, or use, of the buyer, on what might be described as a deferred payment arrangement. Like an ordinary broker, the writer of the contract described above would put up funds to pay for the difference between the price of securities the customer wished to purchase and the customer's own contribution. His only risk would be that the price of the securities would decline in excess of the customer's contribution. True, he would be locked in, and could not liquidate the customer's collateral for 30 days even if the market price should fall in excess of 30 percent, but the risk of such a decline is extremely slight.

(j) Like any other broker who extends credit in a margin account, the writer who was in the business of writing and selling such a contract would be satisfied with a fixed predetermined amount of return on his venture, since he would realize only the fee charged. Unlike a writer of ordinary puts and calls, he would not receive a substantial part of his income from fees on unexercised contract rights. The similarity of his activities to those of a broker, and the dissimilarity to a writer of ordinary options, would be underscored by the fact that his fee would be a fixed predetermined amount of return similar to an interest charge, rather than a fee arrived at individually for each transaction according to the volatility of the stock and other individual considerations.

(k) The buyer's general account with the writer would in effect reflect a debit for the purchase price of the stock and, on the credit side, a deposit of cash in the amount of 30 percent of that price, plus an extension of credit for the remaining 70 percent, rather than the maximum permissible 20 percent.

(l) For the reasons stated above, the Board concluded that the proposed contracts would involve extensions of credit by the writer as broker in an amount exceeding that permitted by the current supplement to Regulation T. Accordingly, the writing of such contracts by a brokerage firm is presently prohibited by such regulation, and any brokerage firm that endorses such a contract would be arranging for

credit in an amount greater than the firm itself could extend, a practice that is prohibited by § 220.7(a).

[35 FR 3280, Feb. 21, 1970]

### § 220.123 Partial delayed issue contracts covering nonconvertible bonds.

(a) During recent years, it has become customary for portions of new issues of nonconvertible bonds and preferred stocks to be sold subject to partial delayed issue contracts, which have customarily been referred to in the industry as ''delayed delivery'' contracts, and the Board of Governors has been asked for its views as to whether such transactions involve any violations of the Board's margin regulations.

(b) The practice of issuing a portion of a debt (or equivalent) security issue at a date subsequent to the main underwriting has arisen where market conditions made it difficult or impossible, in a number of instances, to place an entire issue simultaneously. In instances of this kind, institutional investors (e.g., insurance companies or pension funds) whose cash flow is such that they expect to have funds available some months in the future, have been willing to subscribe to a portion, to be issued to them at a future date. The issuer has been willing to agree to issue the securities in two or more stages because it did not immediately need the proceeds to be realized from the deferred portion, because it could not raise funds on better terms, or because it preferred to have a certain portion of the issue taken down by an investor of this type.

(c) In the case of such a delayed issue contract, the underwriter is authorized to solicit from institutional customers offers to purchase from the issuer, pursuant to contracts of the kind described above, and the agreement becomes binding at the underwriters' closing, subject to specified conditions. When securities are issued pursuant to the agreement, the purchase price includes accrued interest or dividends, and until they are issued to it, the purchaser does not, in the case of bonds, have rights under the trust indenture, or, in the case of preferred stocks, voting rights.

(d) Securities sold pursuant to such arrangements are high quality debt issues (or their equivalent). The purchasers buy with a view to investment and do not resell or otherwise dispose of the contract prior to its completion. Delayed issue arrangements are not acceptable to issuers unless a substantial portion of an issue, not less than 10 percent, is involved.

(e) Sections 3(a) (13) and (14) of the Securities Exchange Act of 1934 provide that an agreement to purchase is equivalent to a purchase, and an agreement to sell to a sale. The Board has hitherto expressed the view that credit is extended at the time when there is a firm agreement to extend such credit (1968 Federal Reserve Bulletin 328; 12 CFR 207.101; ¶6800 Published Interpretations of the Board of Governors). Accordingly, in instances of the kind described above, the issuer may be regarded as extending credit to the institutional purchaser at the time of the underwriters' closing, when the obligations of both become fixed.

(f) Section 220.7(a) of the Board's Regulation T (12 CFR 220.7(a)), with an exception not applicable here, forbids a creditor subject to that regulation to arrange for credit on terms on which the creditor could not itself extend the credit. Sections 220.4(c) (1) and (2) (12 CFR 220.4(c) (1) and (2)) provide that a creditor may not sell securities to a customer except in good faith reliance upon an agreement that the customer will promptly, and in no event in more than 7 full business days, make full cash payment for the securities. Since the underwriters in question are creditors subject to the regulation, unless some specific exception applies, they are forbidden to arrange for the credit described above. This result follows because payment is not made until more than 7 full business days have passed from the time the credit is extended.

(g) However, § 220.4(c)(3) provides that:

> If the security when so purchased is an unissued security, the period applicable to the transaction under subparagraph (2) of this paragraph shall be 7 days after the date on which the security is made available by the issuer for delivery to purchasers.

(h) In interpreting § 220.4(c)(3), the Board has stated that the purpose of the provision:

> * * * is to recognize the fact that, when an issue of securities is to be issued at some future fixed date, a security that is part of such issue can be purchased on a ''when-issued'' basis and that payment may reasonably be delayed until after such date of issue, subject to other basic conditions for transactions in a special cash account. (1962 Federal Reserve Bulletin 1427; 12 CFR 220.118; ¶ 5996, Published Interpretations of the Board of Governors.)

In that situation, the Board distinguished the case of mutual fund shares, which technically are not issued until the certificate can be delivered by the transfer agent. The Board held that mutual fund shares must be regarded as issued at the time of purchase because they are:

> * * * essentially available upon purchase to the same extent as outstanding securities. The mechanics of their issuance and of the delivery of certificates are not significantly different from the mechanics of transfer and delivery of certificates for shares of outstanding securities, and the issuance of mutual fund shares is not a future event in the sense that would warrant the extension of the time for payment beyond that afforded in the case of outstanding securities. (ibid.)

The issuance of debt securities subject to delayed issue contracts, by contrast with that of mutual fund shares, which are in a status of continual underwriting, is a specific single event taking place at a future date fixed by the issuer with a view to its need for funds and the availability of those funds under current market conditions.

(i) For the reasons stated above the Board concluded that the nonconvertible debt and preferred stock subject to delayed issue contracts of the kind described above should not be regarded as having been issued until delivered, pursuant to the agreement, to the institutional purchaser. This interpretation does not apply, of course, to fact situations different from that described in this section.

[36 FR 2777, Feb. 10, 1971]

### § 220.124 Installment sale of tax-shelter programs as "arranging" for credit.

(a) The Board has been asked whether the sale by brokers and dealers of tax-shelter programs containing a provision that payment for the program may be made in installments would constitute ''arranging'' for credit in violation of this part 220. For the purposes of this interpretation, the term ''tax-shelter program'' means a program which is required to be registered pursuant to section 5 of the Securities Act of 1933 (15 U.S.C. section 77e), in which tax benefits, such as the ability to deduct substantial amounts of depreciation or oil exploration expenses, are made available to a person investing in the program. The programs may take various legal forms and can relate to a variety of industries including, but not limited to, oil and gas exploration programs, real estate syndications (except real estate investment trusts), citrus grove developments and cattle programs.

(b) The most common type of tax-shelter program takes the form of a limited partnership. In the case of the programs under consideration, the investor would commit himself to purchase and the partnership would commit itself to sell the interests. The investor would be entitled to the benefits, and become subject to the risks of ownership at the time the contract is made, although the full purchase price is not then required to be paid. The balance of the purchase price after the downpayment usually is payable in installments which range from 1 to 10 years depending on the program. Thus, the partnership would be extending credit to the purchaser until the time when the latter's contractual obligation has been fulfilled and the final payment made.

(c) With an exception not applicable here, § 220.7(a) of Regulation T provides that:

> A creditor [broker or dealer] may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only such terms and conditions * * *

(d) In the case of credit for the purpose of purchasing or carrying securities (purpose credit), § 220.8 of the regulation (the Supplement to Regulation T) does not permit any loan value to be given securities that are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(e) The courts have consistently held investment programs such as those described above to be ''securities'' for purpose of both the Securities Act of 1933 and the Securities Exchange Act of 1934. The courts have also held that the two statutes are to be construed together. Tax-shelter programs, accordingly, are securities for purposes of Regulation T. They also are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(f) Accordingly, the Board concludes that the sale by a broker/dealer of tax-shelter programs containing a provision that payment for the program may be made in installments would constitute ''arranging'' for the extension of credit to purchase or carry securities in violation of the prohibitions of §§ 220.7(a) and 220.8 of Regulation T.

[37 FR 6568, Mar. 31, 1972]

### § 220.125–220.126 [Reserved]

### § 220.127 Independent broker/dealers arranging credit in connection with the sale of insurance premium funding programs.

(a) The Board's September 5, 1972, clarifying amendment to § 220.4(k) set forth that creditors who arrange credit for the acquisition of mutual fund shares and insurance are also permitted to sell mutual fund shares without insurance under the provisions of the special cash account. It should be understood, of course, that such account provides a relatively short credit period of up to 7 business days even with so-called cash transactions. This amendment was in accordance with the Board's understanding in 1969, when the insurance premium funding provisions were adopted in § 220.4(k), that firms engaged in a general securities business would not also be engaged in the sale and arranging of credit in connection with such insurance premium funding programs.

(b) The 1972 amendment eliminated from § 220.4(k) the requirement that, to be eligible for the provisions of the section, a creditor had to be the issuer, or a subsidiary or affiliate of the issuer, of programs which combine the acquisition of both mutual fund shares and insurance. Thus the amendment permits an independent broker/dealer to sell such a program and to arrange for financing in that connection. In reaching such decision, the Board again relied upon the earlier understanding that independent broker/dealers who would sell such programs would not be engaged in transacting a general securities business.

(c) In response to a specific view recently expressed, the Board agrees that under Regulation T:

> * * * a broker/dealer dealing in special insurance premium funding products can only extend credit in connection with such products or in connection with the sale of shares of registered investment companies under the cash accounts * * * (and) cannot engage in the general securities business or sell any securities other than shares * * * (in) registered investment companies through a cash account or any other manner involving the extension of credit.

(d) There is a way, of course, as has been indicated, that an independent broker/dealer might be able to sell other than shares of registered investment companies without creating any conflict with the regulation. Such sales could be executed on a ''funds on hand'' basis and in the case of payment by check, would have to include the collection of such check. It is understood from industry sources, however, that few if any independent broker/dealers engage solely in a ''fund on hand'' type of operation.

[38 FR 11066, May 4, 1973]

### § 220.128 Treatment of simultaneous long and short positions in the same margin account when put or call options or combinations thereof on such stock are also outstanding in the account.

(a) The Board was recently asked whether under Regulation T, ''Credit by Brokers and Dealers'' (12 CFR part

220), if there are simultaneous long and short positions in the same security in the same margin account (often referred to as a short sale ''against the box''), such positions may be used to supply the place of the deposit of margin ordinarily required in connection with the guarantee by a creditor of a put or call option or combination thereof on such stock.

(b) The applicable provisions of regulation T are § 220.3(d)(3) and (5) and § 220.3(g)(4) and (5) which provide as follows:

(d) * * * the adjusted debit balance of a general account * * * shall be calculated by taking the sum of the following items:

* * * * *

(3) The current market value of any securities (other than unissued securities) sold short in the general account plus, for each security (other than an exempted security), such amount as the board shall prescribe from time to time in § 220.8(d) (the supplement to regulation T) as the margin required for such short sales, except that such amount so prescribed in such § 220.8(d) need not be included when there are held in the general account * * * the same securities or securities exchangeable or convertible within 90 calendar days, without restriction other than the payment of money, into such securities sold short;

* * * * *

(5) The amount of any margin customarily required by the creditor in connection with his endorsement or guarantee of any put, call, or other option;

* * * * *

(g) * * * (4) Any transaction which serves to meet the requirements of paragraph (e) of this section or otherwise serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.

(5) For the purposes of this part (regulation T), if a security has maximum loan value under paragraph (c)(1) of this section in a general account, or under § 220.4(j) in a special convertible debt security account, a sale of the same security (even though not the same certificate) in such account shall be deemed to be a long sale and shall not be deemed to be or treated as a short sale.

(c) Rule 431 of the New York Stock Exchange requires that a creditor obtain a minimum deposit of 25 percent of the current market value of the optioned stock in connection with his issuance or guarantee of a put, and at least 30 percent in the case of a call (and that such position be ''marked to the market''), but permits a short position in the stock to serve in lieu of the required deposit in the case of a put and a long position to serve in the case of a call. Thus, where the appropriate position is held in an account, that position may serve as the margin required by § 220.3(d)(5).

(d) In a short sale ''against the box,'' however, the customer is both long and short the same security. He may have established either position, properly margined, prior to taking the other, or he may have deposited fully paid securities in his margin account on the same day he makes a short sale of such securities. In either case, he will have directed his broker to borrow securities elsewhere in order to make delivery on the short sale rather than using his long position for this purpose (see also 17 CFR 240.3b–3).

(e) Generally speaking, a customer makes a short sale ''against the box'' for tax reasons. Regulation T, however, provides in § 220.3(g) that the two positions must be ''netted out'' for the purposes of the calculations required by the regulation. Thus, the board concludes that neither position would be available to serve as the deposit of margin required in connection with the endorsement by the creditor of an option.

(f) A similar conclusion obtains under § 220.3(d)(3). That section provides, in essence, that the margin otherwise required in connection with a short sale need not be included in the account if the customer has in the account a long position in the same security. In § 220.3(g) (4), however, it is provided that ''[A]ny transaction which * * * serves to permit any offsetting transaction in an account shall, to that extent, be unavailable to permit any other transaction in such account.'' Thus, if a customer has, for example, a long position in a security and that long position has been used to supply the margin required in connection with

a short sale of the same security, then the long position is unavailable to serve as the margin required in connection with the creditor's endorsement of a call option on such security.

(g) A situation was also described in which a customer has purported to establish simultaneous offsetting long and short positions by executing a ''cross'' or wash sale of the security on the same day. In this situation, no change in the beneficial ownership of stock has taken place. Since there is no actual ''*contra*'' party to either transaction, and no stock has been borrowed or delivered to accomplish the short sale, such fictitious positions would have no value for purposes of the Board's margin regulations. Indeed, the adoption of such a scheme in connection with an overall strategy involving the issuance, endorsement, or guarantee of put or call options or combinations thereof appears to be manipulative and may have been employed for the purpose of circumventing the requirements of the regulations.

[38 FR 12098, May 9, 1973]

### §§ 220.129–220.130 [Reserved]

### § 220.131 Application of the arranging section to broker-dealer activities under SEC Rule 144A.

(a) The Board has been asked whether the purchase by a broker-dealer of debt securities for resale in reliance on Rule 144A of the Securities and Exchange Commission (17 CFR 230.144A)[1] may be considered an arranging of credit permitted as an ''investment banking service'' under § 220.13(a) of Regulation T.

(b) SEC Rule 144A provides a safe harbor exemption from the registration requirements of the Securities Act of 1933 for resales of restricted securities to *qualified institutional buyers*, as defined in the rule. In general, a *qualified institutional buyer* is an institutional investor that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the buyer. Registered broker-dealers need only own and invest on a discretionary basis at least $10 million of securities in order to purchase as principal under the rule. Section 4(2) of the Securities Act of 1933 provides an exemption from the registration requirements for ''transactions by an issuer not involving any public offering.'' Securities acquired in a transaction under section 4(2) cannot be resold without registration under the Act or an exemption therefrom. Rule 144A provides a safe harbor exemption for resales of such securities. Accordingly, broker-dealers that previously acted only as agents in intermediating between issuers and purchasers of privately-placed securities, due to the lack of such a safe harbor, now may purchase privately-placed securities from issuers as principal and resell such securities to ''qualified institutional buyers'' under Rule 144A.

(c) The Board has consistently treated the purchase of a privately-placed debt security as an extension of credit subject to the margin regulations. If the issuer uses the proceeds to buy securities, the purchase of the privately-placed debt security by a creditor represents an extension of ''purpose credit'' to the issuer. Section 7(c) of the Securities Exchange Act of 1934 prohibits the extension of purpose credit by a creditor if the credit is unsecured, secured by collateral other than securities, or secured by any security (other than an exempted security) in contravention of Federal Reserve regulations. If a debt security sold pursuant to Rule 144A represents purpose credit and is not properly collateralized by securities, the statute and Regulation T can be viewed as preventing the broker-dealer from taking the security into inventory in spite of the fact that the broker-dealer intends to immediately resell the debt security.

(d) Under § 220.13 of Regulation T, a creditor may arrange credit it cannot itself extend if the arrangement is an ''investment banking service'' and the credit does not violate Regulations G and U. Investment banking services are defined to include, but not be limited to, ''underwritings, private placements, and advice and other services in connection with exchange offers, mergers, or acquisitions, except for

[1] Rule 144A, 17 CFR 230.144A, was originally published in the FEDERAL REGISTER at 55 FR 17933, April 30, 1990.

underwritings that involve the public distribution of an equity security with installment or other deferred-payment provisions.'' To comply with Regulations G and U where the proceeds of debt securities sold under Rule 144A may be used to purchase or carry margin stock and the debt securities are secured in whole or in part, directly or indirectly by margin stock (see 12 CFR 207.2(f), 207.112, and 221.2(g)), the margin requirements of the regulations must be met.

(e) The SEC's objective in adopting Rule 144A is to achieve ''a more liquid and efficient institutional resale market for unregistered securities.'' To further this objective, the Board believes it is appropriate for Regulation T purposes to characterize the participation of broker-dealers in this unique and limited market as an ''investment banking service.'' The Board is therefore of the view that the purchase by a creditor of debt securities for resale pursuant to SEC Rule 144A may be considered an investment banking service under the arranging section of Regulation T. The market-making activities of broker-dealers who hold themselves out to other institutions as willing to buy and sell Rule 144A securities on a regular and continuous basis may also be considered an arranging of credit permissible under § 220.13(a) of Regulation T.

[Reg. T, 55 FR 29566, July 20, 1990]

### § 220.132 Credit to brokers and dealers.

For text of this interpretation, see § 221.125 of this subchapter.

[Reg. T, 61 FR 60167, Nov. 26, 1996, as amended at 72 FR 70486, Dec. 12, 2007]

## PART 221—CREDIT BY BANKS AND PERSONS OTHER THAN BROKERS OR DEALERS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCK (REGULATION U)

Sec.

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AUTHORITY: 15 U.S.C. 78c, 78g, 78q, and 78w.

SOURCE: Reg. U, 63 FR 2827, Jan. 16, 1998, unless otherwise noted.

### § 221.1 Authority, purpose, and scope.

(a) *Authority*. Regulation U (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Securities Exchange Act of 1934 (the Act) (15 U.S.C. 78a *et seq.*).

(b) *Purpose and scope*. (1) This part imposes credit restrictions upon persons other than brokers or dealers (hereinafter lenders) that extend credit for the purpose of buying or carrying margin stock if the credit is secured directly or indirectly by margin stock. Lenders include ''banks'' (as defined in § 221.2) and other persons who are required to register with the Board under § 221.3(b). Lenders may not extend more than the maximum loan value of the collateral securing such credit, as set by the Board in § 221.7 (the Supplement).

(2) This part does not apply to clearing agencies regulated by the Securities and Exchange Commission or the Commodity Futures Trading Commission that accept deposits of margin stock in connection with:

(i) The issuance of, or guarantee of, or the clearance of transactions in, any security (including options on any security, certificate of deposit, securities index or foreign currency); or

(ii) The guarantee of contracts for the purchase or sale of a commodity for future delivery or options on such contracts.

(3) This part does not apply to credit extended to an exempted borrower.

(c) *Availability of forms*. The forms referenced in this part are available from the Federal Reserve Banks.

### § 221.2 Definitions.

The terms used in this part have the meanings given them in section 3(a) of the Act or as defined in this section as follows:

*Affiliate* means:

(1) For banks:

(i) Any bank holding company of which a bank is a subsidiary within the meaning of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(d));

(ii) Any other subsidiary of such bank holding company; and

(iii) Any other corporation, business trust, association, or other similar organization that is an affiliate as defined in section 2(b) of the Banking Act of 1933 (12 U.S.C. 221a(c));

(2) For nonbank lenders, *affiliate* means any person who, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with the lender.

*Bank*—(1) *Bank*. Has the meaning given to it in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)) and includes:

(i) Any subsidiary of a bank;

(ii) Any corporation organized under section 25(a) of the Federal Reserve Act (12 U.S.C. 611); and

(iii) Any agency or branch of a foreign bank located within the United States.

(2) *Bank* does not include:

(i) Any savings and loan association;

(ii) Any credit union;

(iii) Any lending institution that is an instrumentality or agency of the United States; or

(iv) Any member of a national securities exchange.

*Carrying* credit is credit that enables a customer to maintain, reduce, or retire indebtedness originally incurred to purchase a security that is currently a margin stock.

*Current market value* of:

(1) A security means:

(i) If quotations are available, the closing sale price of the security on the preceding business day, as appearing on any regularly published reporting or quotation service; or

(ii) If there is no closing sale price, the lender may use any reasonable estimate of the market value of the security as of the close of business on the preceding business day; or

(iii) If the credit is used to finance the purchase of the security, the total cost of purchase, which may include any commissions charged.

(2) Any other collateral means a value determined by any reasonable method.

*Customer* excludes an exempted borrower and includes any person or persons acting jointly, to or for whom a lender extends or maintains credit.

*Examining authority* means:

(1) The national securities exchange or national securities association of which a broker or dealer is a member; or

(2) If a member of more than one self-regulatory organization, the organization designated by the Securities and Exchange Commission as the examining authority for the broker or dealer.

*Exempted borrower* means a member of a national securities exchange or a registered broker or dealer, a substantial portion of whose business consists of transactions with persons other than brokers or dealers, and includes a borrower who:

(1) Maintains at least 1000 active accounts on an annual basis for persons other than brokers, dealers, and persons associated with a broker or dealer;

(2) Earns at least $10 million in gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker or dealer; or

(3) Earns at least 10 percent of its gross revenues on an annual basis from transactions with persons other than brokers, dealers, and persons associated with a broker-dealer.

*Good faith* with respect to:

(1) The loan value of collateral means that amount (not exceeding 100 per cent of the current market value of the collateral) which a lender, exercising sound credit judgment, would lend, without regard to the customer's other assets held as collateral in connection with unrelated transactions.

(2) Making a determination or accepting a statement concerning a borrower means that the lender or its duly authorized representative is alert to the circumstances surrounding the credit, and if in possession of information that would cause a prudent person not to make the determination or accept the notice or certification without inquiry, investigates and is satisfied that it is correct;

*In the ordinary course of business* means occurring or reasonably expected to occur in carrying out or furthering any business purpose, or in the case of an individual, in the course of any activity for profit or the management or preservation of property.

*Indirectly secured.* (1) Includes any arrangement with the customer under which:

(i) The customer's right or ability to sell, pledge, or otherwise dispose of margin stock owned by the customer is in any way restricted while the credit remains outstanding; or

(ii) The exercise of such right is or may be cause for accelerating the maturity of the credit.

(2) Does not include such an arrangement if:

(i) After applying the proceeds of the credit, not more than 25 percent of the value (as determined by any reasonable method) of the assets subject to the arrangement is represented by margin stock;

(ii) It is a lending arrangement that permits accelerating the maturity of the credit as a result of a default or renegotiation of another credit to the customer by another lender that is not an affiliate of the lender;

(iii) The lender holds the margin stock only in the capacity of custodian, depositary, or trustee, or under similar circumstances, and, in good faith, has not relied upon the margin stock as collateral; or

(iv) The lender, in good faith, has not relied upon the margin stock as collateral in extending or maintaining the particular credit.

*Lender* means:

(1) Any bank; or

(2) Any person subject to the registration requirements of this part.

*Margin stock* means:

(1) Any equity security registered or having unlisted trading privileges on a national securities exchange;

(2) Any OTC security designated as qualified for trading in the National Market System under a designation plan approved by the Securities and Exchange Commission (NMS security);

(3) Any debt security convertible into a margin stock or carrying a warrant or right to subscribe to or purchase a margin stock;

(4) Any warrant or right to subscribe to or purchase a margin stock; or

(5) Any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), other than:

(i) A company licensed under the Small Business Investment Company Act of 1958, as amended (15 U.S.C. 661); or

(ii) A company which has at least 95 percent of its assets continuously invested in exempted securities (as defined in 15 U.S.C. 78c(a)(12)); or

(iii) A company which issues face-amount certificates as defined in 15 U.S.C. 80a–2(a)(15), but only with respect of such securities; or

(iv) A company which is considered a money market fund under SEC Rule 2a–7 (17 CFR 270.2a–7).

*Maximum loan value* is the percentage of current market value assigned by the Board under § 221.7 (the Supplement) to specified types of collateral. The maximum loan value of margin stock is stated as a percentage of its current market value. Puts, calls and combinations thereof that do not qualify as margin stock have no loan value. All other collateral has good faith loan value.

*Nonbank lender* means any person subject to the registration requirements of this part.

*Purpose credit* is any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock.

### § 221.3 General requirements.

(a) *Extending, maintaining, and arranging credit*—(1) *Extending credit*. No lender, except a plan-lender, as defined in § 221.4(a), shall extend any purpose credit, secured directly or indirectly by margin stock, in an amount that exceeds the maximum loan value of the collateral securing the credit.

(2) *Maintaining credit*. A lender may continue to maintain any credit initially extended in compliance with this part, regardless of:

(i) Reduction in the customer's equity resulting from change in market prices;

(ii) Change in the maximum loan value prescribed by this part; or

(iii) Change in the status of the security (from nonmargin to margin) securing an existing purpose credit.

(3) *Arranging credit*. No lender may arrange for the extension or maintenance of any purpose credit, except upon the same terms and conditions under which the lender itself may extend or maintain purpose credit under this part.

(b) *Registration of nonbank lenders; termination of registration; annual report*—(1) *Registration*. Every person other than a person subject to part 220 of this chapter or a bank who, in the ordinary course of business, extends or maintains credit secured, directly or indirectly, by any margin stock shall register on Federal Reserve Form FR G–1 (OMB control number 7100–0011) within 30 days after the end of any calendar quarter during which:

(i) The amount of credit extended equals $200,000 or more; or

(ii) The amount of credit outstanding at any time during that calendar quarter equals $500,000 or more.

(2) *Deregistration*. A registered nonbank lender may apply to terminate its registration, by filing Federal Reserve Form FR G–2 (OMB control number 7100–0011), if the lender has not, during the preceding six calendar months, had more than $200,000 of such credit outstanding. Registration shall be deemed terminated when the application is approved by the Board.

(3) *Annual report*. Every registered nonbank lender shall, within 30 days following June 30 of every year, file Form FR G–4 (OMB control number 7100–0011).

(4) *Where to register and file applications and reports*. Registration statements, applications to terminate registration, and annual reports shall be filed with the Federal Reserve Bank of the district in which the principal office of the lender is located.

(c) *Purpose statement*—(1) *General rule*—(i) *Banks*. Except for credit extended under paragraph (c)(2) of this section, whenever a bank extends credit secured directly or indirectly by any margin stock, in an amount exceeding $100,000, the bank shall require its customer to execute Form FR U–1 (OMB No. 7100–0115), which shall be signed and accepted by a duly authorized officer of the bank acting in good faith.

(ii) *Nonbank lenders*. Except for credit extended under paragraph (c)(2) of this section or § 221.4, whenever a nonbank lender extends credit secured directly or indirectly by any margin stock, the

nonbank lender shall require its customer to execute Form FR G–3 (OMB control number 7100–0018), which shall be signed and accepted by a duly authorized representative of the nonbank lender acting in good faith.

(2) *Purpose statement for revolving-credit or multiple-draw agreements or financing of securities purchases on a payment-against-delivery basis*—(i) *Banks.* If a bank extends credit, secured directly or indirectly by any margin stock, in an amount exceeding $100,000, under a revolving-credit or other multiple-draw agreement, Form FR U–1 must be executed at the time the credit arrangement is originally established and must be amended as described in paragraph (c)(2)(iv) of this section for each disbursement if all of the collateral for the agreement is not pledged at the time the agreement is originally established.

(ii) *Nonbank lenders.* If a nonbank lender extends credit, secured directly or indirectly by any margin stock, under a revolving-credit or other multiple-draw agreement, Form FR G–3 must be executed at the time the credit arrangement is originally established and must be amended as described in paragraph (c)(2)(iv) of this section for each disbursement if all of the collateral for the agreement is not pledged at the time the agreement is originally established.

(iii) *Collateral.* If a purpose statement executed at the time the credit arrangement is initially made indicates that the purpose is to purchase or carry margin stock, the credit will be deemed in compliance with this part if:

(A) The maximum loan value of the collateral at least equals the aggregate amount of funds actually disbursed; or

(B) At the end of any day on which credit is extended under the agreement, the lender calls for additional collateral sufficient to bring the credit into compliance with § 221.7 (the Supplement).

(iv) *Amendment of purpose statement.* For any purpose credit disbursed under the agreement, the lender shall obtain and attach to the executed Form FR U–1 or FR G–3 a current list of collateral which adequately supports all credit extended under the agreement.

(d) *Single credit rule.* (1) All purpose credit extended to a customer shall be treated as a single credit, and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this part, except that syndicated loans need not be aggregated with other unrelated purpose credit extended by the same lender.

(2) A lender that has extended purpose credit secured by margin stock may not subsequently extend unsecured purpose credit to the same customer unless the combined credit does not exceed the maximum loan value of the collateral securing the prior credit.

(3) If a lender extended unsecured purpose credit to a customer prior to the extension of purpose credit secured by margin stock, the credits shall be combined and treated as a single credit solely for the purposes of the withdrawal and substitution provision of paragraph (f) of this section.

(4) If a lender extends purpose credit secured by any margin stock and nonpurpose credit to the same customer, the lender shall treat the credits as two separate loans and may not rely upon the required collateral securing the purpose credit for the nonpurpose credit.

(e) *Exempted borrowers.* (1) An exempted borrower that has been in existence for less than one year may meet the definition of exempted borrower based on a six-month period.

(2) Once a member of a national securities exchange or registered broker or dealer ceases to qualify as an exempted borrower, it shall notify its lenders of this fact. Any new extensions of credit to such a borrower, including rollovers, renewals, and additional draws on existing lines of credit, are subject to the provisions of this part.

(f) *Withdrawals and substitutions.* (1) A lender may permit any withdrawal or substitution of cash or collateral by the customer if the withdrawal or substitution would not:

(i) Cause the credit to exceed the maximum loan value of the collateral; or

(ii) Increase the amount by which the credit exceeds the maximum loan value of the collateral.

(2) For purposes of this section, the maximum loan value of the collateral on the day of the withdrawal or substitution shall be used.

(g) *Exchange offers.* To enable a customer to participate in a reorganization, recapitalization or exchange offer that is made to holders of an issue of margin stock, a lender may permit substitution of the securities received. A nonmargin, nonexempted security acquired in exchange for a margin stock shall be treated as if it is margin stock for a period of 60 days following the exchange.

(h) *Renewals and extensions of maturity.* A renewal or extension of maturity of a credit need not be considered a new extension of credit if the amount of the credit is increased only by the addition of interest, service charges, or taxes with respect to the credit.

(i) *Transfers of credit.* (1) A transfer of a credit between customers or between lenders shall not be considered a new extension of credit if:

(i) The original credit was extended by a lender in compliance with this part or by a lender subject to part 207 of this chapter in effect prior to April 1, 1998, (See part 207 appearing in the 12 CFR parts 200 to 219 edition revised as of January 1, 1997), in a manner that would have complied with this part;

(ii) The transfer is not made to evade this part;

(iii) The amount of credit is not increased; and

(iv) The collateral for the credit is not changed.

(2) Any transfer between customers at the same lender shall be accompanied by a statement by the transferor customer describing the circumstances giving rise to the transfer and shall be accepted and signed by a representative of the lender acting in good faith. The lender shall keep such statement with its records of the transferee account.

(3) When a transfer is made between lenders, the transferee shall obtain a copy of the Form FR U–1 or Form FR G–3 originally filed with the transferor and retain the copy with its records of the transferee account. If no form was originally filed with the transferor, the transferee may accept in good faith a statement from the transferor describing the purpose of the loan and the collateral securing it.

(j) *Action for lender's protection.* Nothing in this part shall require a bank to waive or forego any lien or prevent a bank from taking any action it deems necessary in good faith for its protection.

(k) *Mistakes in good faith.* A mistake in good faith in connection with the extension or maintenance of credit shall not be a violation of this part.

### § 221.4 Employee stock option, purchase, and ownership plans.

(a) *Plan-lender; eligible plan.* (1) Plan-lender means any corporation, (including a wholly-owned subsidiary, or a lender that is a thrift organization whose membership is limited to employees and former employees of the corporation, its subsidiaries or affiliates) that extends or maintains credit to finance the acquisition of margin stock of the corporation, its subsidiaries or affiliates under an eligible plan.

(2) *Eligible plan.* An eligible plan means any employee stock option, purchase, or ownership plan adopted by a corporation and approved by its stockholders that provides for the purchase of margin stock of the corporation, its subsidiaries, or affiliates.

(b) *Credit to exercise rights under or finance an eligible plan.* (1) If a plan-lender extends or maintains credit under an eligible plan, any margin stock that directly or indirectly secured that credit shall have good faith loan value.

(2) Credit extended under this section shall be treated separately from credit extended under any other section of this part except § 221.3(b)(1) and (b)(3).

(c) *Credit to ESOPs.* A nonbank lender may extend and maintain purpose credit without regard to the provisions of this part, except for § 221.3(b)(1) and (b)(3), if such credit is extended to an employee stock ownership plan (ESOP) qualified under section 401 of the Internal Revenue Code, as amended (26 U.S.C. 401).

**§ 221.5 Special purpose loans to brokers and dealers.**

(a) *Special purpose loans.* A lender may extend and maintain purpose credit to brokers and dealers without regard to the limitations set forth in §§ 221.3 and 221.7, if the credit is for any of the specific purposes and meets the conditions set forth in paragraph (c) of this section.

(b) *Written notice.* Prior to extending credit for more than a day under this section, the lender shall obtain and accept in good faith a written notice or certification from the borrower as to the purposes of the loan. The written notice or certification shall be evidence of continued eligibility for the special credit provisions until the borrower notifies the lender that it is no longer eligible or the lender has information that would cause a reasonable person to question whether the credit is being used for the purpose specified.

(c) *Types of special purpose credit.* The types of credit that may be extended and maintained on a good faith basis are as follows:

(1) *Hypothecation loans.* Credit secured by hypothecated customer securities that, according to written notice received from the broker or dealer, may be hypothecated by the broker or dealer under Securities and Exchange Commission (SEC) rules.

(2) *Temporary advances in payment-against-delivery transactions.* Credit to finance the purchase or sale of securities for prompt delivery, if the credit is to be repaid upon completion of the transaction.

(3) *Loans for securities in transit or transfer.* Credit to finance securities in transit or surrendered for transfer, if the credit is to be repaid upon completion of the transaction.

(4) *Intra-day loans.* Credit to enable a broker or dealer to pay for securities, if the credit is to be repaid on the same day it is extended.

(5) *Arbitrage loans.* Credit to finance proprietary or customer bona fide arbitrage transactions. For the purpose of this section bona fide arbitrage means:

(i) Purchase or sale of a security in one market, together with an offsetting sale or purchase of the same security in a different market at nearly the same time as practicable, for the purpose of taking advantage of a difference in prices in the two markets; or

(ii) Purchase of a security that is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days of the purchase into a second security, together with an offsetting sale of the second security at or about the same time, for the purpose of taking advantage of a concurrent disparity in the price of the two securities.

(6) *Market maker and specialist loans.* Credit to a member of a national securities exchange or registered broker or dealer to finance its activities as a market maker or specialist.

(7) *Underwriter loans.* Credit to a member of a national securities exchange or registered broker or dealer to finance its activities as an underwriter.

(8) *Emergency loans.* Credit that is essential to meet emergency needs of the broker-dealer business arising from exceptional circumstances.

(9) *Capital contribution loans.* Capital contribution loans include:

(i) Credit that Board has exempted by order upon a finding that the exemption is necessary or appropriate in the public interest or for the protection of investors, provided the Securities Investor Protection Corporation certifies to the Board that the exemption is appropriate; or

(ii) Credit to a customer for the purpose of making a subordinated loan or capital contribution to a broker or dealer in conformity with the SEC's net capital rules and the rules of the broker's or dealer's examining authority, provided:

(A) The customer reduces the credit by the amount of any reduction in the loan or contribution to the broker or dealer; and

(B) The credit is not used to purchase securities issued by the broker or dealer in a public distribution.

(10) Credit to clearing brokers or dealers. Credit to a member of a national securities exchange or registered broker or dealer whose nonproprietary business is limited to financing and carrying the accounts of registered market makers.

**§ 221.6 Exempted transactions.**

A bank may extend and maintain purpose credit without regard to the provisions of this part if such credit is extended:

(a) To any bank;

(b) To any foreign banking institution;

(c) Outside the United States;

(d) To an employee stock ownership plan (ESOP) qualified under section 401 of the Internal Revenue Code (26 U.S.C. 401);

(e) To any plan lender as defined in § 221.4(a) to finance an eligible plan as defined in § 221.4(b), provided the bank has no recourse to any securities purchased pursuant to the plan;

(f) To any customer, other than a broker or dealer, to temporarily finance the purchase or sale of securities for prompt delivery, if the credit is to be repaid in the ordinary course of business upon completion of the transaction and is not extended to enable the customer to pay for securities purchased in an account subject to part 220 of this chapter;

(g) Against securities in transit, if the credit is not extended to enable the customer to pay for securities purchased in an account subject to part 220 of this chapter; or

(h) To enable a customer to meet emergency expenses not reasonably foreseeable, and if the extension of credit is supported by a statement executed by the customer and accepted and signed by an officer of the bank acting in good faith. For this purpose, emergency expenses include expenses arising from circumstances such as the death or disability of the customer, or some other change in circumstances involving extreme hardship, not reasonably foreseeable at the time the credit was extended. The opportunity to realize monetary gain or to avoid loss is not a ''change in circumstances'' for this purpose.

**§ 221.7 Supplement: Maximum loan value of margin stock and other collateral.**

(a) *Maximum loan value of margin stock.* The maximum loan value of any margin stock is fifty per cent of its current market value.

(b) *Maximum loan value of nonmargin stock and all other collateral.* The maximum loan value of nonmargin stock and all other collateral except puts, calls, or combinations thereof is their good faith loan value.

(c) *Maximum loan value of options.* Except for options that qualify as margin stock, puts, calls, and combinations thereof have no loan value.

INTERPRETATIONS

**§ 221.101 Determination and effect of purpose of loan.**

(a) Under this part the original purpose of a loan is controlling. In other words, if a loan originally is not for the purpose of purchasing or carrying margin stock, changes in the collateral for the loan do not change its exempted character.

(b) However, a so-called increase in the loan is necessarily on an entirely different basis. So far as the purpose of the credit is concerned, it is a new loan, and the question of whether or not it is subject to this part must be determined accordingly.

(c) Certain facts should also be mentioned regarding the determination of the purpose of a loan. Section 221.3(c) provides in that whenever a lender is required to have its customer execute a ''Statement of Purpose for an Extension of Credit Secured by Margin Stock,'' the statement must be accepted by the lender ''acting in good faith.'' The requirement of ''good faith'' is of vital importance here. Its application will necessarily vary with the facts of the particular case, but it is clear that the bank must be alert to the circumstances surrounding the loan. For example, if the loan is to be made to a customer who is not a broker or dealer in securities, but such a broker or dealer is to deliver margin stock to secure the loan or is to receive the proceeds of the loan, the bank would be put on notice that the loan would probably be subject to this part. It could not accept in good faith a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation.

(d) Furthermore, the purpose of a loan means just that. It cannot be altered by some temporary application of

the proceeds. For example, if a borrower is to purchase Government securities with the proceeds of a loan, but is soon thereafter to sell such securities and replace them with margin stock, the loan is clearly for the purpose of purchasing or carrying margin stock.

### § 221.102 Application to committed credit where funds are disbursed thereafter.

The Board has concluded that the date a commitment to extend credit becomes binding should be regarded as the date when the credit is extended, since:

(a) On that date the parties should be aware of law and facts surrounding the transaction; and

(b) Generally, the date of contract is controlling for purposes of margin regulations and Federal securities law, regardless of the delivery of cash or securities.

### § 221.103 Loans to brokers or dealers.

Questions have arisen as to the adequacy of statements received by lending banks under § 221.3(c), ''Purpose Statement,'' in the case of loans to brokers or dealers secured by margin stock where the proceeds of the loans are to be used to finance customer transactions involving the purchasing or carrying of margin stock. While some such loans may qualify for exemption under §§ 221.1(b)(2), 221.4, 221.5 or 221.6, unless they do qualify for such an exemption they are subject to this part. For example, if a loan so secured is made to a broker to furnish cash working capital for the conduct of his brokerage business (i.e., for purchasing and carrying securities for the account of customers), the maximum loan value prescribed in § 221.7 (the Supplement) would be applicable unless the loan should be of a kind exempted under this part. This result would not be affected by the fact that the margin stock given as security for the loan was or included margin stock owned by the brokerage firm. In view of the foregoing, the statement referred to in § 221.3(c) which the lending bank must accept in good faith in determining the purpose of the loan would be inadequate if the form of statement accepted or used by the bank failed to call for answers which would indicate whether or not the loan was of the kind discussed elsewhere in this section.

### § 221.104 Federal credit unions.

For text of the interpretation on Federal credit unions, see 12 CFR 220.110.

### § 221.105 Arranging for extensions of credit to be made by a bank.

For text of the interpretation on Arranging for extensions of credit to be made by a bank, see 12 CFR 220.111.

### § 221.106 Reliance in "good faith" on statement of purpose of loan.

(a) Certain situations have arisen from time to time under this part wherein it appeared doubtful that, in the circumstances, the lending banks may have been entitled to rely upon the statements accepted by them in determining whether the purposes of certain loans were such as to cause the loans to be not subject to the part.

(b) The use by a lending bank of a statement in determining the purpose of a particular loan is, of course, provided for by § 221.3(c). However, under that paragraph a lending bank may accept such statement only if it is ''acting in good faith.'' As the Board stated in the interpretation contained in § 221.101, the ''requirement of 'good faith' is of vital importance''; and, to fulfill such requirement, ''it is clear that the bank must be alert to the circumstances surrounding the loan.''

(c) Obviously, such a statement would not be accepted by the bank in ''good faith'' if at the time the loan was made the bank had knowledge, from any source, of facts or circumstances which were contrary to the natural purport of the statement, or which were sufficient reasonably to put the bank on notice of the questionable reliability or completeness of the statement.

(d) Furthermore, the same requirement of ''good faith'' is to be applied whether the statement accepted by the bank is signed by the borrower or by an officer of the bank. In either case, ''good faith'' requires the exercise of special diligence in any instance in which the borrower is not personally

known to the bank or to the officer who processes the loan.

(e) The interpretation set forth in § 221.101 contains an example of the application of the ''good faith'' test. There it was stated that ''if the loan is to be made to a customer who is not a broker or dealer in securities, but such a broker or dealer is to deliver margin stock to secure the loan or is to receive the proceeds of the loan, the bank would be put on notice that the loan would probably be subject to this part. It could not accept in good faith a statement to the contrary without obtaining a reliable and satisfactory explanation of the situation''.

(f) Moreover, and as also stated by the interpretation contained in § 221.101, the purpose of a loan, of course, ''cannot be altered by some temporary application of the proceeds. For example, if a borrower is to purchase Government securities with the proceeds of a loan, but is soon thereafter to sell such securities and replace them with margin stock, the loan is clearly for the purpose of purchasing or carrying margin stock''. The purpose of a loan therefore, should not be determined upon a narrow analysis of the immediate use to which the proceeds of the loan are put. Accordingly, a bank acting in ''good faith'' should carefully scrutinize cases in which there is any indication that the borrower is concealing the true purpose of the loan, and there would be reason for special vigilance if margin stock is substituted for bonds or nonmargin stock soon after the loan is made, or on more than one occasion.

(g) Similarly, the fact that a loan made on the borrower's signature only, for example, becomes secured by margin stock shortly after the disbursement of the loan usually would afford reasonable grounds for questioning the bank's apparent reliance upon merely a statement that the purpose of the loan was not to purchase or carry margin stock.

(h) The examples in this section are, of course, by no means exhaustive. They simply illustrate the fundamental fact that no statement accepted by a lender is of any value for the purposes of this part unless the lender accepting the statement is ''acting in good faith'', and that ''good faith'' requires, among other things, reasonable diligence to learn the truth.

### § 221.107 Arranging loan to purchase open-end investment company shares.

For text of the interpretation on Arranging loan to purchase open-end investment company shares, see 12 CFR 220.112.

### § 221.108 Effect of registration of stock subsequent to making of loan.

(a) The Board recently was asked whether a loan by a bank to enable the borrower to purchase a newly issued nonmargin stock during the initial over-the-counter trading period prior to the stock becoming registered (listed) on a national securities exchange would be subject to this part. The Board replied that, until such stock qualifies as margin stock, this would not be applicable to such a loan.

(b) The Board has now been asked what the position of the lending bank would be under this part if, after the date on which the stock should become registered, such bank continued to hold a loan of the kind just described. It is assumed that the loan was in an amount greater than the maximum loan value for the collateral specified in this part.

(c) If the stock should become registered, the loan would then be for the purpose of purchasing or carrying a margin stock, and, if secured directly or indirectly by any margin stock, would be subject to this part as from the date the stock was registered. Under this part, this does not mean that the bank would have to obtain reduction of the loan in order to reduce it to an amount no more than the specified maximum loan value. It does mean, however, that so long as the loan balance exceeded the specified maximum loan value, the bank could not permit any withdrawals or substitutions of collateral that would increase such excess; nor could the bank increase the amount of the loan balance unless there was provided additional collateral having a maximum loan value at least equal to the amount of the increase. In other words, as from the date the stock should become a

margin stock, the loan would be subject to this part in exactly the same way, for example, as a loan subject to this part that became under-margined because of a decline in the current market value of the loan collateral or because of a decrease by the Board in the maximum loan value of the loan collateral.

### § 221.109 Loan to open-end investment company.

In response to a question regarding a possible loan by a bank to an open-end investment company that customarily purchases stocks registered on a national securities exchange, the Board stated that in view of the general nature and operations of such a company, any loan by a bank to such a company should be presumed to be subject to this part as a loan for the purpose of purchasing or carrying margin stock. This would not be altered by the fact that the open-end company had used, or proposed to use, its own funds or proceeds of the loan to redeem some of its own shares, since mere application of the proceeds of a loan to some other use cannot prevent the ultimate purpose of a loan from being to purchase or carry registered stocks.

### § 221.110 Questions arising under this part.

(a) This part governs ''any purpose credit'' extended by a lender ''secured directly or indirectly by margin stock'' and defines ''purpose credit'' as ''any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock, '' with certain exceptions, and provides that the maximum loan value of such margin stock shall be a fixed percentage ''of its current market value.''

(b) The Board of Governors has had occasion to consider the application of the language in paragraph (a) of this section to the two following questions:

(1) *Loan secured by stock.* First, is a loan to purchase or carry margin stock subject to this part where made in unsecured form, if margin stock is subsequently deposited as security with the lender, and surrounding circumstances indicate that the parties originally contemplated that the loan should be so secured? The Board answered that in a case of this kind, the loan would be subject to this part, for the following reasons:

(i) The Board has long held, in the closely related purpose area, that the original purpose of a loan should not be determined upon a narrow analysis of the technical circumstances under which a loan is made. Instead, the fundamental purpose of the loan is considered to be controlling. Indeed, ''the fact that a loan made on the borrower's signature only, for example, becomes secured by registered stock shortly after the disbursement of the loan'' affords reasonable grounds for questioning whether the bank was entitled to rely upon the borrower's statement as to the purpose of the loan. 1953 Fed. Res. Bull. 951 (*See*, § 221.106).

(ii) Where security is involved, standards of interpretation should be equally searching. If, for example, the original agreement between borrower and lender contemplated that the loan should be secured by margin stock, and such stock is in fact delivered to the bank when available, the transaction must be regarded as fundamentally a secured loan. This view is strengthened by the fact that this part applies to a loan ''secured directly or indirectly by margin stock.''

(2) *Loan to acquire controlling shares.* (i) The second question is whether this part governs a margin stock-secured loan made for the business purpose of purchasing a controlling interest in a corporation, or whether such a loan would be exempt on the ground that this part is directed solely toward purchases of stock for speculative or investment purposes. The Board answered that a margin stock-secured loan for the purpose of purchasing or carrying margin stock is subject to this part, regardless of the reason for which the purchase is made.

(ii) The answer is required, in the Board's view, since the language of this part is explicitly inclusive, covering ''any purpose credit, secured directly or indirectly by margin stock.'' Moreover, the withdrawal in 1945 of the original section 2(e) of this part, which exempted ''any loan for the purpose of purchasing a stock from or through a person who is not a member of a national securities exchange . . .'' plainly

implies that transactions of the sort described are now subject to the general prohibition of § 221.3(a).

**§ 221.111 Contribution to joint venture as extension of credit when the contribution is disproportionate to the contributor's share in the venture's profits or losses.**

(a) The Board considered the question whether a joint venture, structured so that the amount of capital contribution to the venture would be disproportionate to the right of participation in profits or losses, constitutes an ''extension of credit'' for the purpose of this part.

(b) An individual and a corporation plan to establish a joint venture to engage in the business of buying and selling securities, including margin stock. The individual would contribute 20 percent of the capital and receive 80 percent of the profits or losses; the corporate share would be the reverse. In computing profits or losses, each participant would first receive interest at the rate of 8 percent on his respective capital contribution. Although purchases and sales would be mutually agreed upon, the corporation could liquidate the joint portfolio if the individual's share of the losses equaled or exceeded his 20 percent contribution to the venture. The corporation would hold the securities, and upon termination of the venture, the assets would first be applied to repayment of capital contributions.

(c) In general, the relationship of joint venture is created when two or more persons combine their money, property, or time in the conduct of some particular line of trade or some particular business and agree to share jointly, or in proportion to capital contributed, the profits and losses of the undertaking.

(d) The incidents of the joint venture described in paragraph (b) of this section, however, closely parallel those of an extension of margin credit, with the corporation as lender and the individual as borrower. The corporation supplies 80 percent of the purchase price of securities in exchange for a net return of 8 percent of the amount advanced plus 20 percent of any gain. Like a lender of securities credit, the corporation is insulated against loss by retaining the right to liquidate the collateral before the securities decline in price below the amount of its contribution. Conversely, the individual—like a customer who borrows to purchase securities—puts up only 20 percent of their cost, is entitled to the principal portion of any appreciation in their value, bears the principal risk of loss should that value decline, and does not stand to gain or lose except through a change in value of the securities purchased.

(e) The Board is of the opinion that where the right of an individual to share in profits and losses of such a joint venture is disproportionate to his contribution to the venture:

(1) The joint venture involves an extension of credit by the corporation to the individual;

(2) The extension of credit is to purchase or carry margin stock, and is collateralized by such margin stock; and

(3) If the corporation is not a broker or dealer subject to Regulation T (12 CFR part 220), the credit is of the kind described by § 221.3(a).

**§ 221.112 Loans by bank in capacity as trustee.**

(a) The Board's advice has been requested whether a bank's activities in connection with the administration of an employees' savings plan are subject to this part.

(b) Under the plan, any regular, full-time employee may participate by authorizing the sponsoring company to deduct a percentage of his salary and wages and transmit the same to the bank as trustee. Voluntary contributions by the company are allocated among the participants. A participant may direct that funds held for him be invested by the trustee in insurance, annuity contracts, Series E Bonds, or in one or more of three specified securities which are listed on a stock exchange. Loans to purchase the stocks may be made to participants from funds of the trust, subject to approval of the administrative committee, which is composed of five participants, and of the trustee. The bank's right to approve is said to be restricted to the

mechanics of making the loan, the purpose being to avoid cumbersome procedures.

(c) Loans are secured by the credit balance of the borrowing participants in the savings fund, including stock, but excluding (in practice) insurance and annuity contracts and government securities. Additional stocks may be, but, in practice, have not been pledged as collateral for loans. Loans are not made, under the plan, from bank funds, and participants do not borrow from the bank upon assignment of the participants' accounts in the trust.

(d) It is urged that loans under the plan are not subject to this part because a loan should not be considered as having been made by a bank where the bank acts solely in its capacity of trustee, without exercise of any discretion.

(e) The Board reviewed this question upon at least one other occasion, and full consideration has again been given to the matter. After considering the arguments on both sides, the Board has reaffirmed its earlier view that, in conformity with an interpretation not published in the Code of Federal Regulations which was published at page 874 of the 1946 Federal Reserve Bulletin (*See* 12 CFR 261.10(f) for information on how to obtain Board publications.), this part applies to the activities of a bank when it is acting in its capacity as trustee. Although the bank in that case had at best a limited discretion with respect to loans made by it in its capacity as trustee, the Board concluded that this fact did not affect the application of the regulation to such loans.

### § 221.113 Loan which is secured indirectly by stock.

(a) A question has been presented to the Board as to whether a loan by a bank to a mutual investment fund is ''secured * * * indirectly by margin stock'' within the meaning of § 221.(3)(a), so that the loan should be treated as subject to this part.

(b) Briefly, the facts are as follows. Fund X, an open-end investment company, entered into a loan agreement with Bank Y, which was (and still is) custodian of the securities which comprise the portfolio of Fund X. The agreement includes the following terms, which are material to the question before the Board:

(1) Fund X agrees to have an ''asset coverage'' (as defined in the agreements) of 400 percent of all its borrowings, including the proposed borrowing, at the time when it takes down any part of the loan.

(2) Fund X agrees to maintain an ''asset coverage'' of at least 300 percent of its borrowings at all times.

(3) Fund X agrees not to amend its custody agreement with Bank Y, or to substitute another custodian without Bank Y's consent.

(4) Fund X agrees not to mortgage, pledge, or otherwise encumber any of its assets elsewhere than with Bank Y.

(c) In § 221.109 the Board stated that because of ''the general nature and operations of such a company'', any ''loan by a bank to an open-end investment company that customarily purchases margin stock * * * should be presumed to be subject to this part as a loan for the purpose of purchasing or carrying margin stock'' (purpose credit). The Board's interpretation went on to say that: ''this would not be altered by the fact that the open-end company had used, or proposed to use, its own funds or proceeds of the loan to redeem some of its own shares * * *.''

(d) Accordingly, the loan by Bank Y to Fund X was and is a ''purpose credit''. However, a loan by a bank is not subject to this part unless: it is a purpose credit; and it is ''secured directly or indirectly by margin stock''. In the present case, the loan is not ''secured directly'' by stock in the ordinary sense, since the portfolio of Fund X is not pledged to secure the credit from Bank Y. But the word ''indirectly'' must signify some form of security arrangement other than the ''direct'' security which arises from the ordinary ''transaction that gives recourse against a particular chattel or land or against a third party on an obligation'' described in the American Law Institute's Restatement of the Law of Security, page 1. Otherwise the word ''indirectly'' would be superfluous, and a regulation, like a statute, must be construed if possible to give meaning to every word.

(e) The Board has indicated its view that any arrangement under which margin stock is more readily available as security to the lending bank than to other creditors of the borrower may amount to indirect security within the meaning of this part. In an interpretation published at § 221.110 it stated: ''The Board has long held, in the * * * purpose area, that the original purpose of a loan should not be determined upon a narrow analysis of the technical circumstances under which a loan is made * * * . Where security is involved, standards of interpretation should be equally searching.'' In its pamphlet issued for the benefit and guidance of banks and bank examiners, entitled ''Questions and Answers Illustrating Application of Regulation U'', the Board said: ''In determining whether a loan is ''indirectly'' secured, it should be borne in mind that the reason the Board has thus far refrained * * * from regulating loans not secured by stock has been to simplify operations under the regulation. This objective of simplifying operations does not apply to loans in which arrangements are made to retain the substance of stock collateral while sacrificing only the form''.

(f) A wide variety of arrangements as to collateral can be made between bank and borrower which will serve, to some extent, to protect the interest of the bank in seeing that the loan is repaid, without giving the bank a conventional direct ''security'' interest in the collateral. Among such arrangements which have come to the Board's attention are the following:

(1) The borrower may deposit margin stock in the custody of the bank. An arrangement of this kind may not, it is true, place the bank in the position of a secured creditor in case of bankruptcy, or even of conflicting claims, but it is likely effectively to strengthen the bank's position. The definition of *indirectly secured* in § 221.2, which provides that a loan is not indirectly secured if the lender ''holds the margin stock only in the capacity of custodian, depositary or trustee, or under similar circumstances, and, in good faith has not relied upon the margin stock as collateral,'' does not exempt a deposit of this kind from the impact of the regulation unless it is clear that the bank ''has not relied'' upon the margin stock deposited with it.

(2) A borrower may not deposit his margin stock with the bank, but agree not to pledge or encumber his assets elsewhere while the loan is outstanding. Such an agreement may be difficult to police, yet it serves to some extent to protect the interest of the bank if only because the future credit standing and business reputation of the borrower will depend upon his keeping his word. If the assets covered by such an agreement include margin stock, then, the credit is ''indirectly secured'' by the margin stock within the meaning of this part.

(3) The borrower may deposit margin stock with a third party who agrees to hold the stock until the loan has been paid off. Here, even though the parties may purport to provide that the stock is not ''security'' for the loan (for example, by agreeing that the stock may not be sold and the proceeds applied to the debt if the borrower fails to pay), the mere fact that the stock is out of the borrower's control for the duration of the loan serves to some extent to protect the bank.

(g) The three instances described in paragraph (f) of this section are merely illustrative. Other methods, or combinations of methods, may serve a similar purpose. The conclusion that any given arrangement makes a credit ''indirectly secured'' by margin stock may, but need not, be reinforced by facts such as that the stock in question was purchased with proceeds of the loan, that the lender suggests or insists upon the arrangement, or that the loan would probably be subject to criticism by supervisory authorities were it not for the protective arrangement.

(h) Accordingly, the Board concludes that the loan by Bank Y to Fund X is indirectly secured by the portfolio of the fund and must be treated by the bank as a regulated loan.

### § 221.114 Bank loans to purchase stock of American Telephone and Telegraph Company under Employees' Stock Plan.

(a) The Board of Governors interpreted this part in connection with proposed loans by a bank to persons who are purchasing shares of stock of

American Telephone and Telegraph Company pursuant to its Employees' Stock Plan.

(b) According to the current offering under the Plan, an employee of the AT&T system may purchase shares through regular deductions from his pay over a period of 24 months. At the end of that period, a certificate for the appropriate number of shares will be issued to the participating employee by AT&T. Each employee is entitled to purchase, as a maximum, shares that will cost him approximately three-fourths of his annual base pay. Since the program extends over two years, it follows that the payroll deductions for this purpose may be in the neighborhood of 38 percent of base pay and a larger percentage of ''take-home pay.'' Deductions of this magnitude are in excess of the saving rate of many employees.

(c) Certain AT&T employees, who wish to take advantage of the current offering under the Plan, are the owners of shares of AT&T stock that they purchased under previous offerings. A bank proposed to receive such stock as collateral for a ''living expenses'' loan that will be advanced to the employee in monthly installments over the 24-month period, each installment being in the amount of the employee's monthly payroll deduction under the Plan. The aggregate amount of the advances over the 24-month period would be substantially greater than the maximum loan value of the collateral as prescribed in § 221.7 (the Supplement).

(d) In the opinion of the Board of Governors, a loan of the kind described would violate this part if it exceeded the maximum loan value of the collateral. The regulation applies to any margin stock-secured loan for the purpose of purchasing or carrying margin stock (§ 221.3(a)). Although the proposed loan would purport to be for living expenses, it seems quite clear, in view of the relationship of the loan to the Employees' Stock Plan, that its actual purpose would be to enable the borrower to purchase AT&T stock, which is margin stock. At the end of the 24-month period the borrower would acquire a certain number of shares of that stock and would be indebted to the lending bank in an amount approximately equal to the amount he would pay for such shares. In these circumstances, the loan by the bank must be regarded as a loan ''for the purpose of purchasing'' the stock, and therefore it is subject to the limitations prescribed by this part. This conclusion follows from the provisions of this part, and it may also be observed that a contrary conclusion could largely defeat the basic purpose of the margin regulations.

(e) Accordingly, the Board concluded that a loan of the kind described may not be made in an amount exceeding the maximum loan value of the collateral, as prescribed by the current § 221.7 (the Supplement).

### § 221.115 Accepting a purpose statement through the mail without benefit of face-to-face interview.

(a) The Board has been asked whether the acceptance of a purpose statement submitted through the mail by a lender subject to the provisions of this part will meet the good faith requirement of § 221.3(c). Section 221.3(c) states that in connection with any credit secured by collateral which includes any margin stock, a nonbank lender must obtain a purpose statement executed by the borrower and accepted by the lender in good faith. Such acceptance requires that the lender be alert to the circumstances surrounding the credit and if further information suggests inquiry, he must investigate and be satisfied that the statement is truthful.

(b) The lender is a subsidiary of a holding company which also has another subsidiary which serves as underwriter and investment advisor to various mutual funds. The sole business of the lender will be to make ''non-purpose'' consumer loans to shareholders of the mutual funds, such loans to be collateralized by the fund shares. Most mutual funds shares are margin stock for purposes of this part. Solicitation and acceptance of these consumer loans will be done principally through the mail and the lender wishes to obtain the required purpose statement by mail rather than by a face-to-face interview. Personal interviews are not practicable for the lender because shareholders of the funds are scattered throughout the country. In order to

provide the same safeguards inherent in face-to-face interviews, the lender has developed certain procedures designed to satisfy the good faith acceptance requirement of this part.

(c) The purpose statement will be supplemented with several additional questions relevant to the prospective borrower's investment activities such as purchases of any security within the last 6 months, dollar amount, and obligations to purchase or pay for previous purchases; present plans to purchase securities in the near future, participations in securities purchase plans, list of unpaid debts, and present income level. Some questions have been modified to facilitate understanding but no questions have been deleted. If additional inquiry is indicated by the answers on the form, a loan officer of the lender will interview the borrower by telephone to make sure the loan is ''non-purpose''. Whenever the loan exceeds the ''maximum loan value'' of the collateral for a regulated loan, a telephone interview will be done as a matter of course.

(d) One of the stated purposes of Regulation X (12 CFR part 224) was to prevent the infusion of unregulated credit into the securities markets by borrowers falsely certifying the purpose of a loan. The Board is of the view that the existence of Regulation X (12 CFR part 224), which makes the borrower liable for willful violations of the margin regulations, will allow a lender subject to this part to meet the good faith acceptance requirement of § 221.3(c) without a face-to-face interview if the lender adopts a program, such as the one described in paragraph (c) of this section, which requires additional detailed information from the borrower and proper procedures are instituted to verify the truth of the information received. Lenders intending to embark on a similar program should discuss proposed plans with their district Federal Reserve Bank. Lenders may have existing or future loans with the prospective customers which could complicate the efforts to determine the true purpose of the loan.

**§ 221.116 Bank loans to replenish working capital used to purchase mutual fund shares.**

(a) In a situation considered by the Board of Governors, a business concern (X) proposed to purchase mutual fund shares, from time to time, with proceeds from its accounts receivable, then pledge the shares with a bank in order to secure working capital. The bank was prepared to lend amounts equal to 70 percent of the current value of the shares as they were purchased by X. If the loans were subject to this part, only 50 percent of the current market value of the shares could be lent.

(b) The immediate purpose of the loans would be to replenish X's working capital. However, as time went on, X would be acquiring mutual fund shares at a cost that would exceed the net earnings it would normally have accumulated, and would become indebted to the lending bank in an amount approximately 70 percent of the prices of said shares.

(c) The Board held that the loans were for the purpose of purchasing the shares, and therefore subject to the limitations prescribed by this part. As pointed out in § 221.114 with respect to a similar program for putting a high proportion of cash income into stock, the borrowing against the margin stock to meet needs for which the cash would otherwise have been required, a contrary conclusion could largely defeat the basic purpose of the margin regulations.

(d) Also considered was an alternative proposal under which X would deposit proceeds from accounts receivable in a time account for 1 year, before using those funds to purchase mutual fund shares. The Board held that this procedure would not change the situation in any significant way. Once the arrangement was established, the proceeds would be flowing into the time account at the same time that similar amounts were released to purchase the shares, and over any extended period of time the result would be the same. Accordingly, the Board concluded that bank loans made under the alternative proposal would similarly be subject to this part.

**§ 221.117 When bank in "good faith" has not relied on stock as collateral.**

(a) The Board has received questions regarding the circumstances in which an extension or maintenance of credit will not be deemed to be ''indirectly secured'' by stock as indicated by the phrase, ''if the lender, in good faith, has not relied upon the margin stock as collateral,'' contained in paragraph (2)(iv) of the definition of *indirectly secured* in § 221.2.

(b) In response, the Board noted that in amending this portion of the regulation in 1968 it was indicated that one of the purposes of the change was to make clear that the definition of *indirectly secured* does not apply to certain routine negative covenants in loan agreements. Also, while the question of whether or not a bank has relied upon particular stock as collateral is necessarily a question of fact to be determined in each case in the light of all relevant circumstances, some indication that the bank had not relied upon stock as collateral would seem to be afforded by such circumstances as the fact that:

(1) The bank had obtained a reasonably current financial statement of the borrower and this statement could reasonably support the loan; and

(2) The loan was not payable on demand or because of fluctuations in market value of the stock, but instead was payable on one or more fixed maturities which were typical of maturities applied by the bank to loans otherwise similar except for not involving any possible question of stock collateral.

**§ 221.118 Bank arranging for extension of credit by corporation.**

(a) The Board considered the questions whether:

(1) The guaranty by a corporation of an ''unsecured'' bank loan to exercise an option to purchase stock of the corporation is an ''extension of credit'' for the purpose of this part;

(2) Such a guaranty is given ''in the ordinary course of business'' of the corporation, as defined in § 221.2; and

(3) The bank involved took part in arranging for such credit on better terms than it could extend under the provisions of this part.

(b) The Board understood that any officer or employee included under the corporation's stock option plan who wished to exercise his option could obtain a loan for the purchase price of the stock by executing an unsecured note to the bank. The corporation would issue to the bank a guaranty of the loan and hold the purchased shares as collateral to secure it against loss on the guaranty. Stock of the corporation is registered on a national securities exchange and therefore qualifies as ''margin stock'' under this part.

(c) A nonbank lender is subject to the registration and other requirements of this part if, in the ordinary course of his business, he extends credit on collateral that includes any margin stock in the amount of $200,000 or more in any calendar quarter, or has such credit outstanding in any calendar quarter in the amount of $500,000 or more. The Board understood that the corporation in question had sufficient guaranties outstanding during the applicable calendar quarter to meet the dollar thresholds for registration.

(d) In the Board's judgment a person who guarantees a loan, and thereby becomes liable for the amount of the loan in the event the borrower should default, is lending his credit to the borrower. In the circumstances described, such a lending of credit must be considered an ''extension of credit'' under this part in order to prevent circumvention of the regulation's limitation on the amount of credit that can be extended on the security of margin stock.

(e) Under § 221.2, the term *in the ordinary course of business means* ''occurring or reasonably expected to occur in carrying out or furthering any business purpose. * * *'' In general, stock option plans are designed to provide a company's employees with a proprietary interest in the company in the form of ownership of the company's stock. Such plans increase the company's ability to attract and retain able personnel and, accordingly, promote the interest of the company and its stockholders, while at the same time providing the company's employees with additional incentive to work toward

the company's future success. An arrangement whereby participating employees may finance the exercise of their options through an unsecured bank loan guaranteed by the company, thereby facilitating the employees' acquisition of company stock, is likewise designed to promote the company's interest and is, therefore, in furtherance of a business purpose.

(f) For the reasons indicated, the Board concluded that under the circumstances described a guaranty by the corporation constitutes credit extended in the ordinary course of business under this part, that the corporation is required to register pursuant to § 221.3(b), and that such guaranties may not be given in excess of the maximum loan value of the collateral pledged to secure the guaranty.

(g) Section 221.3(a)(3) provides that ''no lender may arrange for the extension or maintenance of any purpose credit, except upon the same terms and conditions on which the lender itself may extend or maintain purpose credit under this part''. Since the Board concluded that the giving of a guaranty by the corporation to secure the loan described above constitutes an extension of credit, and since the use of a guaranty in the manner described could not be effectuated without the concurrence of the bank involved, the Board further concluded that the bank took part in ''arranging'' for the extension of credit in excess of the maximum loan value of the margin stock pledged to secure the guaranties.

### § 221.119 Applicability of plan-lender provisions to financing of stock options and stock purchase rights qualified or restricted under Internal Revenue Code.

(a) The Board has been asked whether the plan-lender provisions of § 221.4(a) and (b) were intended to apply to the financing of stock options restricted or qualified under the Internal Revenue Code where such options or the option plan do not provide for such financing.

(b) It is the Board's experience that in some nonqualified plans, particularly stock purchase plans, the credit arrangement is distinct from the plan. So long as the credit extended, and particularly, the character of the plan-lender, conforms with the requirements of the regulation, the fact that option and credit are provided for in separate documents is immaterial. It should be emphasized that the Board does not express any view on the preferability of qualified as opposed to nonqualified options; its role is merely to prevent excessive credit in this area.

(c) Section 221.4(a) provides that a plan-lender may include a wholly-owned subsidiary of the issuer of the collateral (taking as a whole, corporate groups including subsidiaries and affiliates). This clarifies the Board's intent that, to qualify for special treatment under that section, the lender must stand in a special employer-employee relationship with the borrower, and a special relationship of issuer with regard to the collateral. The fact that the Board, for convenience and practical reasons, permitted the employing corporation to act through a subsidiary or other entity should not be interpreted to mean the Board intended the lender to be other than an entity whose overriding interests were coextensive with the issuer. An independent corporation, with independent interests was never intended, regardless of form, to be at the base of exempt stock-plan lending.

### § 221.120 Allocation of stock collateral to purpose and nonpurpose credits to same customer.

(a) A bank proposes to extend two credits (Credits A and B) to its customer. Although the two credits are proposed to be extended at the same time, each would be evidenced by a separate agreement. Credit A would be extended for the purpose of providing the customer with working capital (nonpurpose credit), collateralized by margin stock. Credit B would be extended for the purpose of purchasing or carrying margin stock (purpose credit), without collateral or on collateral other than stock.

(b) This part allows a bank to extend purpose and nonpurpose credits simultaneously or successively to the same customer. This rule is expressed in § 221.3(d)(4) which provides in substance that for any nonpurpose credit to the same customer, the lender shall in good faith require as much collateral

not already identified to the customer's purpose credit as the lender would require if it held neither the purpose loan nor the identified collateral. This rule in § 221.3(d)(4) also takes into account that the lender would not necessarily be required to hold collateral for the nonpurpose credit if, consistent with good faith banking practices, it would normally make this kind of nonpurpose loan without collateral.

(c) The Board views § 221.3(d)(4), when read in conjunction with § 221.3(c) and (f), as requiring that whenever a lender extends two credits to the same customer, one a purpose credit and the other nonpurpose, any margin stock collateral must first be identified with and attributed to the purpose loan by taking into account the maximum loan value of such collateral as prescribed in § 221.7 (the Supplement).

(d) The Board is further of the opinion that under the foregoing circumstances Credit B would be indirectly secured by stock, despite the fact that there would be separate loan agreements for both credits. This conclusion flows from the circumstance that the lender would hold in its possession stock collateral to which it would have access with respect to Credit B, despite any ostensible allocation of such collateral to Credit A.

### § 221.121 Extension of credit in certain stock option and stock purchase plans.

Questions have been raised as to whether certain stock option and stock purchase plans involve extensions of credit subject to this part when the participant is free to cancel his participation at any time prior to full payment, but in the event of cancellation the participant remains liable for damages. It thus appears that the participant has the opportunity to gain and bears the risk of loss from the time the transaction is executed and payment is deferred. In some cases brought to the Board's attention damages are related to the market price of the stock, but in others, there may be no such relationship. In either of these circumstances, it is the Board's view that such plans involve extensions of credit. Accordingly, where the security being purchased is a margin security and the credit is secured, directly or indirectly, by any margin security, the creditor must register and the credit must conform with either the regular margin requirements of § 221.3(a) or the special ''plan-lender'' provisions set forth in § 221.4, whichever is applicable. This assumes, of course, that the amount of credit extended is such that the creditor is subject to the registration requirements of § 221.3(b).

### § 221.122 Applicability of margin requirements to credit in connection with Insurance Premium Funding Programs.

(a) The Board has been asked numerous questions regarding purpose credit in connection with insurance premium funding programs. The inquiries are included in a set of guidelines in the format of questions and answers. (The guidelines are available pursuant to the Board's Rules Regarding Availability of Information, 12 CFR part 261.) A glossary of terms customarily used in connection with insurance premium funding credit activities is included in the guidelines. Under a typical insurance premium funding program, a borrower acquires mutual fund shares for cash, or takes fund shares which he already owns, and then uses the loan value (currently 50 percent as set by the Board) to buy insurance. Usually, a funding company (the issuer) will sell both the fund shares and the insurance through either independent broker/dealers or subsidiaries or affiliates of the issuer. A typical plan may run for 10 or 15 years with annual insurance premiums due. To illustrate, assuming an annual insurance premium of $300, the participant is required to put up mutual fund shares equivalent to 250 percent of the premium or $600 ($600 × 50 percent loan value equals $300 the amount of the insurance premium which is also the amount of the credit extended).

(b) The guidelines referenced in paragraph (a) of this section also:

(1) Clarify an earlier 1969 Board interpretation to show that the public offering price of mutual fund shares (which includes the front load, or sales commission) may be used as a measure of their current market value when the shares serve as collateral on a purpose

credit throughout the day of the purchase of the fund shares; and

(2) Relax a 1965 Board position in connection with accepting purpose statements by mail.

(c) It is the Board's view that when it is clearly established that a purpose statement supports a purpose credit then such statement executed by the borrower may be accepted by mail, provided it is received and also executed by the lender before the credit is extended.

### § 221.123 Combined credit for exercising employee stock options and paying income taxes incurred as a result of such exercise.

(a) Section 221.4(a) and (b), which provides special treatment for credit extended under employee stock option plans, was designed to encourage their use in recognition of their value in giving an employee a proprietary interest in the business. Taking a position that might discourage the exercise of options because of tax complications would conflict with the purpose of § 221.4(a) and (b).

(b) Accordingly, the Board has concluded that the combined loans for the exercise of the option and the payment of the taxes in connection therewith under plans complying with § 221.4(a)(2) may be regarded as *purpose credit* within the meaning of § 221.2.

### § 221.124 Purchase of debt securities to finance corporate takeovers.

(a) Petitions have been filed with the Board raising questions as to whether the margin requirements in this part apply to two types of corporate acquisitions in which debt securities are issued to finance the acquisition of margin stock of a target company.

(b) In the first situation, the acquiring company, Company A, controls a shell corporation that would make a tender offer for the stock of Company B, which is margin stock (as defined in § 221.2). The shell corporation has virtually no operations, has no significant business function other than to acquire and hold the stock of Company B, and has substantially no assets other than the margin stock to be acquired. To finance the tender offer, the shell corporation would issue debt securities which, by their terms, would be unsecured. If the tender offer is successful, the shell corporation would seek to merge with Company B. However, the tender offer seeks to acquire fewer shares of Company B than is necessary under state law to effect a short form merger with Company B, which could be consummated without the approval of shareholders or the board of directors of Company B.

(c) The purchase of the debt securities issued by the shell corporation to finance the acquisition clearly involves purpose credit (as defined in § 221.2). In addition, such debt securities would be purchased only by sophisticated investors in very large minimum denominations, so that the purchasers may be lenders for purposes of this part. *See* § 221.3(b). Since the debt securities contain no direct security agreement involving the margin stock, applicability of the lending restrictions of this part turns on whether the arrangement constitutes an extension of credit that is secured indirectly by margin stock.

(d) As the Board has recognized, indirect security can encompass a wide variety of arrangements between lenders and borrowers with respect to margin stock collateral that serve to protect the lenders' interest in assuring that a credit is repaid where the lenders do not have a conventional direct security interest in the collateral. *See* § 221.124. However, credit is not ''indirectly secured'' by margin stock if the lender in good faith has not relied on the margin stock as collateral extending or maintaining credit. *See* § 221.2.

(e) The Board is of the view that, in the situation described in paragraph (b) of this section, the debt securities would be presumed to be indirectly secured by the margin stock to be acquired by the shell acquisition vehicle. The staff has previously expressed the view that nominally unsecured credit extended to an investment company, a substantial portion of whose assets consist of margin stock, is indirectly secured by the margin stock. *See* Federal Reserve Regulatory Service 5–917.12. (*See* 12 CFR 261.10(f) for information on how to obtain Board publications.) This opinion notes that the investment company has substantially no assets other than margin stock to

support indebtedness and thus credit could not be extended to such a company in good faith without reliance on the margin stock as collateral.

(f) The Board believes that this rationale applies to the debt securities issued by the shell corporation described in paragraph (b) of this section. At the time the debt securities are issued, the shell corporation has substantially no assets to support the credit other than the margin stock that it has acquired or intends to acquire and has no significant business function other than to hold the stock of the target company in order to facilitate the acquisition. Moreover, it is possible that the shell may hold the margin stock for a significant and indefinite period of time, if defensive measures by the target prevent consummation of the acquisition. Because of the difficulty in predicting the outcome of a contested takeover at the time that credit is committed to the shell corporation, the Board believes that the purchasers of the debt securities could not, in good faith, lend without reliance on the margin stock as collateral. The presumption that the debt securities are indirectly secured by margin stock would not apply if there is specific evidence that lenders could in good faith rely on assets other than margin stock as collateral, such as a guaranty of the debt securities by the shell corporation's parent company or another company that has substantial non-margin stock assets or cash flow. This presumption would also not apply if there is a merger agreement between the acquiring and target companies entered into at the time the commitment is made to purchase the debt securities or in any event before loan funds are advanced. In addition, the presumption would not apply if the obligation of the purchasers of the debt securities to advance funds to the shell corporation is contingent on the shell's acquisition of the minimum number of shares necessary under applicable state law to effect a merger between the acquiring and target companies without the approval of either the shareholders or directors of the target company. In these two situations where the merger will take place promptly, the Board believes the lenders could reasonably be presumed to be relying on the assets of the target for repayment.

(g) In addition, the Board is of the view that the debt securities described in paragraph (b) of this section are indirectly secured by margin stock because there is a practical restriction on the ability of the shell corporation to dispose of the margin stock of the target company. Indirectly secured is defined in § 221.2 to include any arrangement under which the customer's right or ability to sell, pledge, or otherwise dispose of margin stock owned by the customer is in any way restricted while the credit remains outstanding. The purchasers of the debt securities issued by a shell corporation to finance a takeover attempt clearly understand that the shell corporation intends to acquire the margin stock of the target company in order to effect the acquisition of that company. This understanding represents a practical restriction on the ability of the shell corporation to dispose of the target's margin stock and to acquire other assets with the proceeds of the credit.

(h) In the second situation, Company C, an operating company with substantial assets or cash flow, seeks to acquire Company D, which is significantly larger than Company C. Company C establishes a shell corporation that together with Company C makes a tender offer for the shares of Company D, which is margin stock. To finance the tender offer, the shell corporation would obtain a bank loan that complies with the margin lending restrictions of this part and Company C would issue debt securities that would not be directly secured by any margin stock. The Board is of the opinion that these debt securities should not be presumed to be indirectly secured by the margin stock of Company D, since, as an operating business, Company C has substantial assets or cash flow without regard to the margin stock of Company D. Any presumption would not be appropriate because the purchasers of the debt securities may be relying on assets other than margin stock of Company D for repayment of the credit.

### § 221.125 Credit to brokers and dealers.

(a) The National Securities Markets Improvement Act of 1996 (Pub. L. 104–290, 110 Stat. 3416) restricts the Board's margin authority by repealing section 8(a) of the Securities Exchange Act of 1934 (the Exchange Act) and amending section 7 of the Exchange Act (15 U.S.C. 78g) to exclude the borrowing by a member of a national securities exchange or a registered broker or dealer ''a substantial portion of whose business consists of transactions with persons other than brokers or dealers'' and borrowing by a member of a national securities exchange or a registered broker or dealer to finance its activities as a market maker or an underwriter. Notwithstanding this exclusion, the Board may impose such rules and regulations if it determines they are ''necessary or appropriate in the public interest or for the protection of investors.''

(b) The Board has not found that it is necessary or appropriate in the public interest or for the protection of investors to impose rules and regulations regarding loans to brokers and dealers covered by the National Securities Markets Improvement Act of 1996.

# PART 222—FAIR CREDIT REPORTING (REGULATION V)

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AUTHORITY: 15 U.S.C. 1681a, 1681b, 1681c, 1681m, 1681s, 1681s-2, 1681s-3, 1681t, and 1681w; Secs. 3 and 214, Pub. L. 108–159, 117 Stat. 1952.

SOURCE: Reg. V, 68 FR 74469, Dec. 24, 2003, unless otherwise noted.

## Subpart A—General Provisions

### § 222.1 Purpose, scope, and effective dates.

(a) *Purpose.* The purpose of this part is to implement the Fair Credit Reporting Act. This part generally applies to persons that obtain and use information about consumers to determine the consumer's eligibility for products, services, or employment, share such information among affiliates, and furnish information to consumer reporting agencies.

(b) *Scope.* (1) [Reserved]

(2) *Institutions covered.* (i) Except as otherwise provided in this part, the regulations in this part apply to banks that are members of the Federal Reserve System (other than national banks) and their respective operating

subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)), branches and Agencies of foreign banks (other than Federal branches, Federal Agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*), and bank holding companies and affiliates of such holding companies, but do not apply to affiliates of bank holding companies that are depository institutions regulated by another federal banking agency or to consumer reporting agencies.

(ii) For purposes of appendix B to this part, financial institutions as defined in section 509 of the Gramm-Leach-Bliley Act (12 U.S.C. 6809), may use the model notices in appendix B to this part to comply with the notice requirement in section 623(a)(7) of the Fair Credit Reporting Act (15 U.S.C. 1681s–2(a)(7)).

(c) *Effective dates*. The applicable provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), Pub. L. 108–159, 117 Stat. 1952, shall be effective in accordance with the following schedule:

(1) *Provisions effective December 31, 2003*—(i) Sections 151(a)(2), 212(e), 214(c), 311(b), and 711, concerning the relation to state laws; and

(ii) Each of the provisions of the FACT Act that authorizes an agency to issue a regulation or to take other action to implement the applicable provision of the FACT Act or the applicable provision of the Fair Credit Reporting Act, as amended by the FACT Act, but only with respect to that agency's authority to propose and adopt the implementing regulation or to take such other action.

(2) *Provisions effective March 31, 2004*—(i) Section 111, concerning the definitions;

(ii) Section 156, concerning the statute of limitations;

(iii) Sections 312(d), (e), and (f), concerning the furnisher liability exception, liability and enforcement, and rule of construction, respectively;

(iv) Section 313(a), concerning action regarding complaints;

(v) Section 611, concerning communications for certain employee investigations; and

(vi) Section 811, concerning clerical amendments.

(3) *Provisions effective December 1, 2004*—(i) Section 112, concerning fraud alerts and active duty alerts;

(ii) Section 114, concerning procedures for the identification of possible instances of identity theft;

(iii) Section 115, concerning truncation of the social security number in a consumer report;

(iv) Section 151(a)(1), concerning the summary of rights of identity theft victims;

(v) Section 152, concerning blocking of information resulting from identity theft;

(vi) Section 153, concerning the coordination of identity theft complaint investigations;

(vii) Section 154, concerning the prevention of repollution of consumer reports;

(viii) Section 155, concerning notice by debt collectors with respect to fraudulent information;

(ix) Section 211(c), concerning a summary of rights of consumers;

(x) Section 212(a)–(d), concerning the disclosure of credit scores;

(xi) Section 213(c), concerning enhanced disclosure of the means available to opt out of prescreened lists;

(xii) Section 217(a), concerning the duty to provide notice to a consumer;

(xiii) Section 311(a), concerning the risk-based pricing notice;

(xiv) Section 312(a)–(c), concerning procedures to enhance the accuracy and integrity of information furnished to consumer reporting agencies;

(xv) Section 314, concerning improved disclosure of the results of reinvestigation;

(xvi) Section 315, concerning reconciling addresses;

(xvii) Section 316, concerning notice of dispute through reseller; and

(xviii) Section 317, concerning the duty to conduct a reasonable reinvestigation.

[68 FR 74469, Dec. 24, 2003, as amended at 69 FR 6530, Feb. 11, 2004; 69 FR 33284, June 15, 2004; 69 FR 77618, Dec. 28, 2004; 72 FR 62954, Nov. 7, 2007]

### § 222.2 Examples.

The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part. Examples in a paragraph illustrate only the issue described in the paragraph and do not illustrate any other issue that may arise in this part.

[70 FR 70678, Nov. 22, 2005]

### § 222.3 Definitions.

For purposes of this part, unless explicitly stated otherwise:

(a) *Act* means the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*).

(b) *Affiliate* means any company that is related by common ownership or common corporate control with another company.

(c) [Reserved]

(d) *Company* means any corporation, limited liability company, business trust, general or limited partnership, association, or similar organization.

(e) *Consumer* means an individual.

(f)–(h) [Reserved]

(i) *Common ownership or common corporate control* means a relationship between two companies under which:

(1) One company has, with respect to the other company:

(i) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting security of a company, directly or indirectly, or acting through one or more other persons;

(ii) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of a company; or

(iii) The power to exercise, directly or indirectly, a controlling influence over the management or policies of a company, as the Board determines; or

(2) Any other person has, with respect to both companies, a relationship described in paragraphs (i)(1)(i) through (i)(1)(iii) of this section.

(j) [Reserved]

(k) *Medical information* means:

(1) Information or data, whether oral or recorded, in any form or medium, created by or derived from a health care provider or the consumer, that relates to:

(i) The past, present, or future physical, mental, or behavioral health or condition of an individual;

(ii) The provision of health care to an individual; or

(iii) The payment for the provision of health care to an individual.

(2) The term does not include:

(i) The age or gender of a consumer;

(ii) Demographic information about the consumer, including a consumer's residence address or e-mail address;

(iii) Any other information about a consumer that does not relate to the physical, mental, or behavioral health or condition of a consumer, including the existence or value of any insurance policy; or

(iv) Information that does not identify a specific consumer.

(l) *Person* means any individual, partnership, corporation, trust, estate cooperative, association, government or governmental subdivision or agency, or other entity.

[Reg. V, 70 FR 70678, Nov. 22, 2005, as amended at 72 FR 63756, Nov. 9, 2007]

## Subpart B [Reserved]

## Subpart C—Affiliate Marketing

SOURCE: Reg. V, 72 FR 62955, Nov. 7, 2007, unless otherwise noted.

### § 222.20 Coverage and definitions.

(a) *Coverage.* Subpart C of this part applies to member banks of the Federal Reserve System (other than national banks) and their respective operating subsidiaries that are not functionally regulated within the meaning of section 5(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)(5)), branches and Agencies of foreign banks (other than Federal branches, Federal Agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25

or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*).

(b) *Definitions.* For purposes of this subpart:

(1) *Clear and conspicuous.* The term ''clear and conspicuous'' means reasonably understandable and designed to call attention to the nature and significance of the information presented.

(2) *Concise*—(i) *In general.* The term ''concise'' means a reasonably brief expression or statement.

(ii) *Combination with other required disclosures.* A notice required by this subpart may be concise even if it is combined with other disclosures required or authorized by federal or state law.

(3) *Eligibility information.* The term ''eligibility information'' means any information the communication of which would be a consumer report if the exclusions from the definition of ''consumer report'' in section 603(d)(2)(A) of the Act did not apply. Eligibility information does not include aggregate or blind data that does not contain personal identifiers such as account numbers, names, or addresses.

(4) *Pre-existing business relationship*—(i) *In general.* The term ''pre-existing business relationship'' means a relationship between a person, or a person's licensed agent, and a consumer based on—

(A) A financial contract between the person and the consumer which is in force on the date on which the consumer is sent a solicitation covered by this subpart;

(B) The purchase, rental, or lease by the consumer of the person's goods or services, or a financial transaction (including holding an active account or a policy in force or having another continuing relationship) between the consumer and the person, during the 18-month period immediately preceding the date on which the consumer is sent a solicitation covered by this subpart; or

(C) An inquiry or application by the consumer regarding a product or service offered by that person during the three-month period immediately preceding the date on which the consumer is sent a solicitation covered by this subpart.

(ii) *Examples of pre-existing business relationships.* (A) If a consumer has a time deposit account, such as a certificate of deposit, at a depository institution that is currently in force, the depository institution has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services.

(B) If a consumer obtained a certificate of deposit from a depository institution, but did not renew the certificate at maturity, the depository institution has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services for 18 months after the date of maturity of the certificate of deposit.

(C) If a consumer obtains a mortgage, the mortgage lender has a pre-existing business relationship with the consumer. If the mortgage lender sells the consumer's entire loan to an investor, the mortgage lender has a pre-existing business relationship with the consumer and can use eligibility information it receives from its affiliates to make solicitations to the consumer about its products or services for 18 months after the date it sells the loan, and the investor has a pre-existing business relationship with the consumer upon purchasing the loan. If, however, the mortgage lender sells a fractional interest in the consumer's loan to an investor but also retains an ownership interest in the loan, the mortgage lender continues to have a pre-existing business relationship with the consumer, but the investor does not have a pre-existing business relationship with the consumer. If the mortgage lender retains ownership of the loan, but sells ownership of the servicing rights to the consumer's loan, the mortgage lender continues to have a pre-existing business relationship with the consumer. The purchaser of the servicing rights also has a pre-existing business relationship with the consumer as of the date it purchases ownership of the servicing rights, but only if it collects payments from or

otherwise deals directly with the consumer on a continuing basis.

(D) If a consumer applies to a depository institution for a product or service that it offers, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the application.

(E) If a consumer makes a telephone inquiry to a depository institution about its products or services and provides contact information to the institution, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(F) If a consumer makes an inquiry to a depository institution by e-mail about its products or services, but does not obtain a product or service from or enter into a financial contract or transaction with the institution, the depository institution has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(G) If a consumer has an existing relationship with a depository institution that is part of a group of affiliated companies, makes a telephone call to the centralized call center for the group of affiliated companies to inquire about products or services offered by the insurance affiliate, and provides contact information to the call center, the call constitutes an inquiry to the insurance affiliate that offers those products or services. The insurance affiliate has a pre-existing business relationship with the consumer and can therefore use eligibility information it receives from its affiliated depository institution to make solicitations to the consumer about its products or services for three months after the date of the inquiry.

(iii) *Examples where no pre-existing business relationship is created.* (A) If a consumer makes a telephone call to a centralized call center for a group of affiliated companies to inquire about the consumer's existing account at a depository institution, the call does not constitute an inquiry to any affiliate other than the depository institution that holds the consumer's account and does not establish a pre-existing business relationship between the consumer and any affiliate of the account-holding depository institution.

(B) If a consumer who has a deposit account with a depository institution makes a telephone call to an affiliate of the institution to ask about the affiliate's retail locations and hours, but does not make an inquiry about the affiliate's products or services, the call does not constitute an inquiry and does not establish a pre-existing business relationship between the consumer and the affiliate. Also, the affiliate's capture of the consumer's telephone number does not constitute an inquiry and does not establish a pre-existing business relationship between the consumer and the affiliate.

(C) If a consumer makes a telephone call to a depository institution in response to an advertisement that offers a free promotional item to consumers who call a toll-free number, but the advertisement does not indicate that the depository institution's products or services will be marketed to consumers who call in response, the call does not create a pre-existing business relationship between the consumer and the depository institution because the consumer has not made an inquiry about a product or service offered by the institution, but has merely responded to an offer for a free promotional item.

(5) *Solicitation*—(i) *In general.* The term ''solicitation'' means the marketing of a product or service initiated by a person to a particular consumer that is—

(A) Based on eligibility information communicated to that person by its affiliate as described in this subpart; and

(B) Intended to encourage the consumer to purchase or obtain such product or service.

(ii) *Exclusion of marketing directed at the general public.* A solicitation does not include marketing communications that are directed at the general public. For example, television, general circulation magazine, and billboard advertisements do not constitute solicitations, even if those communications are intended to encourage consumers to purchase products and services from the person initiating the communications.

(iii) *Examples of solicitations.* A solicitation would include, for example, a telemarketing call, direct mail, e-mail, or other form of marketing communication directed to a particular consumer that is based on eligibility information received from an affiliate.

(6) *You* means a person described in paragraph (a) of this section.

**§ 222.21 Affiliate marketing opt-out and exceptions.**

(a) *Initial notice and opt-out requirement*—(1) *In general.* You may not use eligibility information about a consumer that you receive from an affiliate to make a solicitation for marketing purposes to the consumer, unless—

(i) It is clearly and conspicuously disclosed to the consumer in writing or, if the consumer agrees, electronically, in a concise notice that you may use eligibility information about that consumer received from an affiliate to make solicitations for marketing purposes to the consumer;

(ii) The consumer is provided a reasonable opportunity and a reasonable and simple method to ''opt out,'' or prohibit you from using eligibility information to make solicitations for marketing purposes to the consumer; and

(iii) The consumer has not opted out.

(2) *Example.* A consumer has a homeowner's insurance policy with an insurance company. The insurance company furnishes eligibility information about the consumer to its affiliated depository institution. Based on that eligibility information, the depository institution wants to make a solicitation to the consumer about its home equity loan products. The depository institution does not have a pre-existing business relationship with the consumer and none of the other exceptions apply. The depository institution is prohibited from using eligibility information received from its insurance affiliate to make solicitations to the consumer about its home equity loan products unless the consumer is given a notice and opportunity to opt out and the consumer does not opt out.

(3) *Affiliates who may provide the notice.* The notice required by this paragraph must be provided:

(i) By an affiliate that has or has previously had a pre-existing business relationship with the consumer; or

(ii) As part of a joint notice from two or more members of an affiliated group of companies, provided that at least one of the affiliates on the joint notice has or has previously had a pre-existing business relationship with the consumer.

(b) *Making solicitations*—(1) *In general.* For purposes of this subpart, you make a solicitation for marketing purposes if—

(i) You receive eligibility information from an affiliate;

(ii) You use that eligibility information to do one or more of the following:

(A) Identify the consumer or type of consumer to receive a solicitation;

(B) Establish criteria used to select the consumer to receive a solicitation; or

(C) Decide which of your products or services to market to the consumer or tailor your solicitation to that consumer; and

(iii) As a result of your use of the eligibility information, the consumer is provided a solicitation.

(2) *Receiving eligibility information from an affiliate, including through a common database.* You may receive eligibility information from an affiliate in various ways, including when the affiliate places that information into a common database that you may access.

(3) *Receipt or use of eligibility information by your service provider.* Except as provided in paragraph (b)(5) of this section, you receive or use an affiliate's eligibility information if a service provider acting on your behalf (whether an affiliate or a nonaffiliated third party)

receives or uses that information in the manner described in paragraphs (b)(1)(i) or (b)(1)(ii) of this section. All relevant facts and circumstances will determine whether a person is acting as your service provider when it receives or uses an affiliate's eligibility information in connection with marketing your products and services.

(4) *Use by an affiliate of its own eligibility information*. Unless you have used eligibility information that you receive from an affiliate in the manner described in paragraph (b)(1)(ii) of this section, you do not make a solicitation subject to this subpart if your affiliate:

(i) Uses its own eligibility information that it obtained in connection with a pre-existing business relationship it has or had with the consumer to market your products or services to the consumer; or

(ii) Directs its service provider to use the affiliate's own eligibility information that it obtained in connection with a pre-existing business relationship it has or had with the consumer to market your products or services to the consumer, and you do not communicate directly with the service provider regarding that use.

(5) *Use of eligibility information by a service provider*—(i) *In general*. You do not make a solicitation subject to Subpart C of this part if a service provider (including an affiliated or third-party service provider that maintains or accesses a common database that you may access) receives eligibility information from your affiliate that your affiliate obtained in connection with a pre-existing business relationship it has or had with the consumer and uses that eligibility information to market your products or services to the consumer, so long as—

(A) Your affiliate controls access to and use of its eligibility information by the service provider (including the right to establish the specific terms and conditions under which the service provider may use such information to market your products or services);

(B) Your affiliate establishes specific terms and conditions under which the service provider may access and use the affiliate's eligibility information to market your products and services (or those of affiliates generally) to the consumer, such as the identity of the affiliated companies whose products or services may be marketed to the consumer by the service provider, the types of products or services of affiliated companies that may be marketed, and the number of times the consumer may receive marketing materials, and periodically evaluates the service provider's compliance with those terms and conditions;

(C) Your affiliate requires the service provider to implement reasonable policies and procedures designed to ensure that the service provider uses the affiliate's eligibility information in accordance with the terms and conditions established by the affiliate relating to the marketing of your products or services;

(D) Your affiliate is identified on or with the marketing materials provided to the consumer; and

(E) You do not directly use your affiliate's eligibility information in the manner described in paragraph (b)(1)(ii) of this section.

(ii) *Writing requirements*. (A) The requirements of paragraphs (b)(5)(i)(A) and (C) of this section must be set forth in a written agreement between your affiliate and the service provider; and

(B) The specific terms and conditions established by your affiliate as provided in paragraph (b)(5)(i)(B) of this section must be set forth in writing.

(6) *Examples of making solicitations*. (i) A consumer has a deposit account with a depository institution, which is affiliated with an insurance company. The insurance company receives eligibility information about the consumer from the depository institution. The insurance company uses that eligibility information to identify the consumer to receive a solicitation about insurance products, and, as a result, the insurance company provides a solicitation to the consumer about its insurance products. Pursuant to paragraph (b)(1) of this section, the insurance company has made a solicitation to the consumer.

(ii) The same facts as in the example in paragraph (b)(6)(i) of this section, except that after using the eligibility information to identify the consumer

to receive a solicitation about insurance products, the insurance company asks the depository institution to send the solicitation to the consumer and the depository institution does so. Pursuant to paragraph (b)(1) of this section, the insurance company has made a solicitation to the consumer because it used eligibility information about the consumer that it received from an affiliate to identify the consumer to receive a solicitation about its products or services, and, as a result, a solicitation was provided to the consumer about the insurance company's products.

(iii) The same facts as in the example in paragraph (b)(6)(i) of this section, except that eligibility information about consumers that have deposit accounts with the depository institution is placed into a common database that all members of the affiliated group of companies may independently access and use. Without using the depository institution's eligibility information, the insurance company develops selection criteria and provides those criteria, marketing materials, and related instructions to the depository institution. The depository institution reviews eligibility information about its own consumers using the selection criteria provided by the insurance company to determine which consumers should receive the insurance company's marketing materials and sends marketing materials about the insurance company's products to those consumers. Even though the insurance company has received eligibility information through the common database as provided in paragraph (b)(2) of this section, it did not use that information to identify consumers or establish selection criteria; instead, the depository institution used its own eligibility information. Therefore, pursuant to paragraph (b)(4)(i) of this section, the insurance company has not made a solicitation to the consumer.

(iv) The same facts as in the example in paragraph (b)(6)(iii) of this section, except that the depository institution provides the insurance company's criteria to the depository institution's service provider and directs the service provider to use the depository institution's eligibility information to identify depository institution consumers who meet the criteria and to send the insurance company's marketing materials to those consumers. The insurance company does not communicate directly with the service provider regarding the use of the depository institution's information to market its products to the depository institution's consumers. Pursuant to paragraph (b)(4)(ii) of this section, the insurance company has not made a solicitation to the consumer.

(v) An affiliated group of companies includes a depository institution, an insurance company, and a service provider. Each affiliate in the group places information about its consumers into a common database. The service provider has access to all information in the common database. The depository institution controls access to and use of its eligibility information by the service provider. This control is set forth in a written agreement between the depository institution and the service provider. The written agreement also requires the service provider to establish reasonable policies and procedures designed to ensure that the service provider uses the depository institution's eligibility information in accordance with specific terms and conditions established by the depository institution relating to the marketing of the products and services of all affiliates, including the insurance company. In a separate written communication, the depository institution specifies the terms and conditions under which the service provider may use the depository institution's eligibility information to market the insurance company's products and services to the depository institution's consumers. The specific terms and conditions are: A list of affiliated companies (including the insurance company) whose products or services may be marketed to the depository institution's consumers by the service provider; the specific products or types of products that may be marketed to the depository institution's consumers by the service provider; the categories of eligibility information that may be used by the service provider in marketing products

or services to the depository institution's consumers; the types or categories of the depository institution's consumers to whom the service provider may market products or services of depository institution affiliates; the number and/or types of marketing communications that the service provider may send to the depository institution's consumers; and the length of time during which the service provider may market the products or services of the depository institution's affiliates to its consumers. The depository institution periodically evaluates the service provider's compliance with these terms and conditions. The insurance company asks the service provider to market insurance products to certain consumers who have deposit accounts with the depository institution. Without using the depository institution's eligibility information, the insurance company develops selection criteria and provides those criteria, marketing materials, and related instructions to the service provider. The service provider uses the depository institution's eligibility information from the common database to identify the depository institution's consumers to whom insurance products will be marketed. When the insurance company's marketing materials are provided to the identified consumers, the name of the depository institution is displayed on the insurance marketing materials, an introductory letter that accompanies the marketing materials, an account statement that accompanies the marketing materials, or the envelope containing the marketing materials. The requirements of paragraph (b)(5) of this section have been satisfied, and the insurance company has not made a solicitation to the consumer.

(vi) The same facts as in the example in paragraph (b)(6)(v) of this section, except that the terms and conditions permit the service provider to use the depository institution's eligibility information to market the products and services of other affiliates to the depository institution's consumers whenever the service provider deems it appropriate to do so. The service provider uses the depository institution's eligibility information in accordance with the discretion afforded to it by the terms and conditions. Because the terms and conditions are not specific, the requirements of paragraph (b)(5) of this section have not been satisfied.

(c) *Exceptions.* The provisions of this subpart do not apply to you if you use eligibility information that you receive from an affiliate:

(1) To make a solicitation for marketing purposes to a consumer with whom you have a pre-existing business relationship;

(2) To facilitate communications to an individual for whose benefit you provide employee benefit or other services pursuant to a contract with an employer related to and arising out of the current employment relationship or status of the individual as a participant or beneficiary of an employee benefit plan;

(3) To perform services on behalf of an affiliate, except that this subparagraph shall not be construed as permitting you to send solicitations on behalf of an affiliate if the affiliate would not be permitted to send the solicitation as a result of the election of the consumer to opt out under this subpart;

(4) In response to a communication about your products or services initiated by the consumer;

(5) In response to an authorization or request by the consumer to receive solicitations; or

(6) If your compliance with this subpart would prevent you from complying with any provision of State insurance laws pertaining to unfair discrimination in any State in which you are lawfully doing business.

(d) *Examples of exceptions*—(1) *Example of the pre-existing business relationship exception.* A consumer has a deposit account with a depository institution. The consumer also has a relationship with the depository institution's securities affiliate for management of the consumer's securities portfolio. The depository institution receives eligibility information about the consumer from its securities affiliate and uses that information to make a solicitation to the consumer about the depository institution's wealth management services. The depository institution may make this solicitation even if the consumer

has not been given a notice and opportunity to opt out because the depository institution has a pre-existing business relationship with the consumer.

(2) *Examples of service provider exception.* (i) A consumer has an insurance policy issued by an insurance company. The insurance company furnishes eligibility information about the consumer to its affiliated depository institution. Based on that eligibility information, the depository institution wants to make a solicitation to the consumer about its deposit products. The depository institution does not have a pre-existing business relationship with the consumer and none of the other exceptions in paragraph (c) of this section apply. The consumer has been given an opt-out notice and has elected to opt out of receiving such solicitations. The depository institution asks a service provider to send the solicitation to the consumer on its behalf. The service provider may not send the solicitation on behalf of the depository institution because, as a result of the consumer's opt-out election, the depository institution is not permitted to make the solicitation.

(ii) The same facts as in paragraph (d)(2)(i) of this section, except the consumer has been given an opt-out notice, but has not elected to opt out. The depository institution asks a service provider to send the solicitation to the consumer on its behalf. The service provider may send the solicitation on behalf of the depository institution because, as a result of the consumer's not opting out, the depository institution is permitted to make the solicitation.

(3) *Examples of consumer-initiated communications.* (i) A consumer who has a deposit account with a depository institution initiates a communication with the depository institution's credit card affiliate to request information about a credit card. The credit card affiliate may use eligibility information about the consumer it obtains from the depository institution or any other affiliate to make solicitations regarding credit card products in response to the consumer-initiated communication.

(ii) A consumer who has a deposit account with a depository institution contacts the institution to request information about how to save and invest for a child's college education without specifying the type of product in which the consumer may be interested. Information about a range of different products or services offered by the depository institution and one or more affiliates of the institution may be responsive to that communication. Such products or services may include the following: Mutual funds offered by the institution's mutual fund affiliate; section 529 plans offered by the institution, its mutual fund affiliate, or another securities affiliate; or trust services offered by a different financial institution in the affiliated group. Any affiliate offering investment products or services that would be responsive to the consumer's request for information about saving and investing for a child's college education may use eligibility information to make solicitations to the consumer in response to this communication.

(iii) A credit card issuer makes a marketing call to the consumer without using eligibility information received from an affiliate. The issuer leaves a voice-mail message that invites the consumer to call a toll-free number to apply for the issuer's credit card. If the consumer calls the toll-free number to inquire about the credit card, the call is a consumer-initiated communication about a product or service and the credit card issuer may now use eligibility information it receives from its affiliates to make solicitations to the consumer.

(iv) A consumer calls a depository institution to ask about retail locations and hours, but does not request information about products or services. The institution may not use eligibility information it receives from an affiliate to make solicitations to the consumer about its products or services because the consumer-initiated communication does not relate to the depository institution's products or services. Thus, the use of eligibility information received from an affiliate would not be responsive to the communication and the exception does not apply.

(v) A consumer calls a depository institution to ask about retail locations and hours. The customer service representative asks the consumer if there

is a particular product or service about which the consumer is seeking information. The consumer responds that the consumer wants to stop in and find out about certificates of deposit. The customer service representative offers to provide that information by telephone and mail additional information and application materials to the consumer. The consumer agrees and provides or confirms contact information for receipt of the materials to be mailed. The depository institution may use eligibility information it receives from an affiliate to make solicitations to the consumer about certificates of deposit because such solicitations would respond to the consumer-initiated communication about products or services.

(4) *Examples of consumer authorization or request for solicitations.* (i) A consumer who obtains a mortgage from a mortgage lender authorizes or requests information about homeowner's insurance offered by the mortgage lender's insurance affiliate. Such authorization or request, whether given to the mortgage lender or to the insurance affiliate, would permit the insurance affiliate to use eligibility information about the consumer it obtains from the mortgage lender or any other affiliate to make solicitations to the consumer about homeowner's insurance.

(ii) A consumer completes an online application to apply for a credit card from a credit card issuer. The issuer's online application contains a blank check box that the consumer may check to authorize or request information from the credit card issuer's affiliates. The consumer checks the box. The consumer has authorized or requested solicitations from the card issuer's affiliates.

(iii) A consumer completes an online application to apply for a credit card from a credit card issuer. The issuer's online application contains a pre-selected check box indicating that the consumer authorizes or requests information from the issuer's affiliates. The consumer does not deselect the check box. The consumer has not authorized or requested solicitations from the card issuer's affiliates.

(iv) The terms and conditions of a credit card account agreement contain preprinted boilerplate language stating that by applying to open an account the consumer authorizes or requests to receive solicitations from the credit card issuer's affiliates. The consumer has not authorized or requested solicitations from the card issuer's affiliates.

(e) *Relation to affiliate-sharing notice and opt-out.* Nothing in this subpart limits the responsibility of a person to comply with the notice and opt-out provisions of section 603(d)(2)(A)(iii) of the Act where applicable.

### § 222.22 Scope and duration of opt-out.

(a) *Scope of opt-out*—(1) *In general.* Except as otherwise provided in this section, the consumer's election to opt out prohibits any affiliate covered by the opt-out notice from using eligibility information received from another affiliate as described in the notice to make solicitations to the consumer.

(2) *Continuing relationship*—(i) *In general.* If the consumer establishes a continuing relationship with you or your affiliate, an opt-out notice may apply to eligibility information obtained in connection with—

(A) A single continuing relationship or multiple continuing relationships that the consumer establishes with you or your affiliates, including continuing relationships established subsequent to delivery of the opt-out notice, so long as the notice adequately describes the continuing relationships covered by the opt-out; or

(B) Any other transaction between the consumer and you or your affiliates as described in the notice.

(ii) Examples of continuing relationships. A consumer has a continuing relationship with you or your affiliate if the consumer—

(A) Opens a deposit or investment account with you or your affiliate;

(B) Obtains a loan for which you or your affiliate owns the servicing rights;

(C) Purchases an insurance product from you or your affiliate;

(D) Holds an investment product through you or your affiliate, such as when you act or your affiliate acts as a custodian for securities or for assets in an individual retirement arrangement;

(E) Enters into an agreement or understanding with you or your affiliate whereby you or your affiliate undertakes to arrange or broker a home mortgage loan for the consumer;

(F) Enters into a lease of personal property with you or your affiliate; or

(G) Obtains financial, investment, or economic advisory services from you or your affiliate for a fee.

(3) *No continuing relationship*—(i) *In general*. If there is no continuing relationship between a consumer and you or your affiliate, and you or your affiliate obtain eligibility information about a consumer in connection with a transaction with the consumer, such as an isolated transaction or a credit application that is denied, an opt-out notice provided to the consumer only applies to eligibility information obtained in connection with that transaction.

(ii) *Examples of isolated transactions*. An isolated transaction occurs if–

(A) The consumer uses your or your affiliate's ATM to withdraw cash from an account at another financial institution; or

(B) You or your affiliate sells the consumer a cashier's check or money order, airline tickets, travel insurance, or traveler's checks in isolated transactions.

(4) *Menu of alternatives*. A consumer may be given the opportunity to choose from a menu of alternatives when electing to prohibit solicitations, such as by electing to prohibit solicitations from certain types of affiliates covered by the opt-out notice but not other types of affiliates covered by the notice, electing to prohibit solicitations based on certain types of eligibility information but not other types of eligibility information, or electing to prohibit solicitations by certain methods of delivery but not other methods of delivery. However, one of the alternatives must allow the consumer to prohibit all solicitations from all of the affiliates that are covered by the notice.

(5) *Special rule for a notice following termination of all continuing relationships*—(i) *In general*. A consumer must be given a new opt-out notice if, after all continuing relationships with you or your affiliate(s) are terminated, the consumer subsequently establishes another continuing relationship with you or your affiliate(s) and the consumer's eligibility information is to be used to make a solicitation. The new opt-out notice must apply, at a minimum, to eligibility information obtained in connection with the new continuing relationship. Consistent with paragraph (b) of this section, the consumer's decision not to opt out after receiving the new opt-out notice would not override a prior opt-out election by the consumer that applies to eligibility information obtained in connection with a terminated relationship, regardless of whether the new opt-out notice applies to eligibility information obtained in connection with the terminated relationship.

(ii) *Example*. A consumer has a checking account with a depository institution that is part of an affiliated group. The consumer closes the checking account. One year after closing the checking account, the consumer opens a savings account with the same depository institution. The consumer must be given a new notice and opportunity to opt out before the depository institution's affiliates may make solicitations to the consumer using eligibility information obtained by the depository institution in connection with the new savings account relationship, regardless of whether the consumer opted out in connection with the checking account.

(b) *Duration of opt-out*. The election of a consumer to opt out must be effective for a period of at least five years (the ''opt-out period'') beginning when the consumer's opt-out election is received and implemented, unless the consumer subsequently revokes the opt-out in writing or, if the consumer agrees, electronically. An opt-out period of more than five years may be established, including an opt-out period that does not expire unless revoked by the consumer.

(c) *Time of opt-out*. A consumer may opt out at any time.

**§ 222.23 Contents of opt-out notice; consolidated and equivalent notices.**

(a) *Contents of opt-out notice*—(1) *In general.* A notice must be clear, conspicuous, and concise, and must accurately disclose:

(i) The name of the affiliate(s) providing the notice. If the notice is provided jointly by multiple affiliates and each affiliate shares a common name, such as ''ABC,'' then the notice may indicate that it is being provided by multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by ''all of the ABC companies,'' ''the ABC banking, credit card, insurance, and securities companies,'' or by listing the name of each affiliate providing the notice. But if the affiliates providing the joint notice do not all share a common name, then the notice must either separately identify each affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice is provided by ''all of the ABC and XYZ companies'' or by ''the ABC banking and credit card companies and the XYZ insurance companies'';

(ii) A list of the affiliates or types of affiliates whose use of eligibility information is covered by the notice, which may include companies that become affiliates after the notice is provided to the consumer. If each affiliate covered by the notice shares a common name, such as ''ABC,'' then the notice may indicate that it applies to multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by ''all of the ABC companies,'' ''the ABC banking, credit card, insurance, and securities companies,'' or by listing the name of each affiliate providing the notice. But if the affiliates covered by the notice do not all share a common name, then the notice must either separately identify each covered affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice applies to ''all of the ABC and XYZ companies'' or to ''the ABC banking and credit card companies and the XYZ insurance companies'';

(iii) A general description of the types of eligibility information that may be used to make solicitations to the consumer;

(iv) That the consumer may elect to limit the use of eligibility information to make solicitations to the consumer;

(v) That the consumer's election will apply for the specified period of time stated in the notice and, if applicable, that the consumer will be allowed to renew the election once that period expires;

(vi) If the notice is provided to consumers who may have previously opted out, such as if a notice is provided to consumers annually, that the consumer who has chosen to limit solicitations does not need to act again until the consumer receives a renewal notice; and

(vii) A reasonable and simple method for the consumer to opt out.

(2) *Joint relationships.* (i) If two or more consumers jointly obtain a product or service, a single opt-out notice may be provided to the joint consumers. Any of the joint consumers may exercise the right to opt out.

(ii) The opt-out notice must explain how an opt-out direction by a joint consumer will be treated. An opt-out direction by a joint consumer may be treated as applying to all of the associated joint consumers, or each joint consumer may be permitted to opt out separately. If each joint consumer is permitted to opt out separately, one of the joint consumers must be permitted to opt out on behalf of all of the joint consumers and the joint consumers must be permitted to exercise their separate rights to opt out in a single response.

(iii) It is impermissible to require *all* joint consumers to opt out before implementing *any* opt-out direction.

(3) *Alternative contents.* If the consumer is afforded a broader right to opt out of receiving marketing than is required by this subpart, the requirements of this section may be satisfied by providing the consumer with a clear, conspicuous, and concise notice that accurately discloses the consumer's opt-out rights.

(4) *Model notices.* Model notices are provided in appendix C of this part.

(b) *Coordinated and consolidated notices.* A notice required by this subpart may be coordinated and consolidated with any other notice or disclosure required to be issued under any other provision of law by the entity providing the notice, including but not limited to the notice described in section 603(d)(2)(A)(iii) of the Act and the Gramm-Leach-Bliley Act privacy notice.

(c) *Equivalent notices.* A notice or other disclosure that is equivalent to the notice required by this subpart, and that is provided to a consumer together with disclosures required by any other provision of law, satisfies the requirements of this section.

### § 222.24 Reasonable opportunity to opt out.

(a) *In general.* You must not use eligibility information about a consumer that you receive from an affiliate to make a solicitation to the consumer about your products or services, unless the consumer is provided a reasonable opportunity to opt out, as required by § 222.21(a)(1)(ii) of this part.

(b) *Examples of a reasonable opportunity to opt out.* The consumer is given a reasonable opportunity to opt out if:

(1) *By mail.* The opt-out notice is mailed to the consumer. The consumer is given 30 days from the date the notice is mailed to elect to opt out by any reasonable means.

(2) *By electronic means.* (i) The opt-out notice is provided electronically to the consumer, such as by posting the notice at an Internet Web site at which the consumer has obtained a product or service. The consumer acknowledges receipt of the electronic notice. The consumer is given 30 days after the date the consumer acknowledges receipt to elect to opt out by any reasonable means.

(ii) The opt-out notice is provided to the consumer by e-mail where the consumer has agreed to receive disclosures by e-mail from the person sending the notice. The consumer is given 30 days after the e-mail is sent to elect to opt out by any reasonable means.

(3) *At the time of an electronic transaction.* The opt-out notice is provided to the consumer at the time of an electronic transaction, such as a transaction conducted on an Internet Web site. The consumer is required to decide, as a necessary part of proceeding with the transaction, whether to opt out before completing the transaction. There is a simple process that the consumer may use to opt out at that time using the same mechanism through which the transaction is conducted.

(4) *At the time of an in-person transaction.* The opt-out notice is provided to the consumer in writing at the time of an in-person transaction. The consumer is required to decide, as a necessary part of proceeding with the transaction, whether to opt out before completing the transaction, and is not permitted to complete the transaction without making a choice. There is a simple process that the consumer may use during the course of the in-person transaction to opt out, such as completing a form that requires consumers to write a ''yes'' or ''no'' to indicate their opt-out preference or that requires the consumer to check one of two blank check boxes—one that allows consumers to indicate that they want to opt out and one that allows consumers to indicate that they do not want to opt out.

(5) *By including in a privacy notice.* The opt-out notice is included in a Gramm-Leach-Bliley Act privacy notice. The consumer is allowed to exercise the opt-out within a reasonable period of time and in the same manner as the opt-out under that privacy notice.

### § 222.25 Reasonable and simple methods of opting out.

(a) *In general.* You must not use eligibility information about a consumer that you receive from an affiliate to make a solicitation to the consumer about your products or services, unless the consumer is provided a reasonable and simple method to opt out, as required by § 222.21(a)(1)(ii) of this part.

(b) *Examples*—(1) *Reasonable and simple opt-out methods.* Reasonable and simple methods for exercising the opt-out right include—

(i) Designating a check-off box in a prominent position on the opt-out form;

(ii) Including a reply form and a self-addressed envelope together with the opt-out notice;

(iii) Providing an electronic means to opt out, such as a form that can be electronically mailed or processed at an Internet Web site, if the consumer agrees to the electronic delivery of information;

(iv) Providing a toll-free telephone number that consumers may call to opt out; or

(v) Allowing consumers to exercise all of their opt-out rights described in a consolidated opt-out notice that includes the privacy opt-out under the Gramm-Leach-Bliley Act, 15 U.S.C. 6801 *et seq.*, the affiliate sharing opt-out under the Act, and the affiliate marketing opt-out under the Act, by a single method, such as by calling a single toll-free telephone number.

(2) *Opt-out methods that are not reasonable and simple.* Reasonable and simple methods for exercising an opt-out right *do not* include—

(i) Requiring the consumer to write his or her own letter;

(ii) Requiring the consumer to call or write to obtain a form for opting out, rather than including the form with the opt-out notice;

(iii) Requiring the consumer who receives the opt-out notice in electronic form only, such as through posting at an Internet Web site, to opt out solely by paper mail or by visiting a different Web site without providing a link to that site.

(c) *Specific opt-out means.* Each consumer may be required to opt out through a specific means, as long as that means is reasonable and simple for that consumer.

**§ 222.26 Delivery of opt-out notices.**

(a) *In general.* The opt-out notice must be provided so that each consumer can reasonably be expected to receive actual notice. For opt-out notices provided electronically, the notice may be provided in compliance with either the electronic disclosure provisions in this subpart or the provisions in section 101 of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001 *et seq.*

(b) *Examples of reasonable expectation of actual notice.* A consumer may reasonably be expected to receive actual notice if the affiliate providing the notice:

(1) Hand-delivers a printed copy of the notice to the consumer;

(2) Mails a printed copy of the notice to the last known mailing address of the consumer;

(3) Provides a notice by e-mail to a consumer who has agreed to receive electronic disclosures by e-mail from the affiliate providing the notice; or

(4) Posts the notice on the Internet Web site at which the consumer obtained a product or service electronically and requires the consumer to acknowledge receipt of the notice.

(c) *Examples of no reasonable expectation of actual notice.* A consumer may *not* reasonably be expected to receive actual notice if the affiliate providing the notice:

(1) Only posts the notice on a sign in a branch or office or generally publishes the notice in a newspaper;

(2) Sends the notice via e-mail to a consumer who has not agreed to receive electronic disclosures by e-mail from the affiliate providing the notice; or

(3) Posts the notice on an Internet Web site without requiring the consumer to acknowledge receipt of the notice.

**§ 222.27 Renewal of opt-out.**

(a) *Renewal notice and opt-out requirement*—(1) *In general.* After the opt-out period expires, you may not make solicitations based on eligibility information you receive from an affiliate to a consumer who previously opted out, unless:

(i) The consumer has been given a renewal notice that complies with the requirements of this section and §§ 222.24 through 222.26 of this part, and a reasonable opportunity and a reasonable and simple method to renew the opt-out, and the consumer does not renew the opt-out; or

(ii) An exception in § 222.21(c) of this part applies.

(2) *Renewal period.* Each opt-out renewal must be effective for a period of at least five years as provided in § 222.22(b) of this part.

(3) *Affiliates who may provide the notice.* The notice required by this paragraph must be provided:

(i) By the affiliate that provided the previous opt-out notice, or its successor; or

(ii) As part of a joint renewal notice from two or more members of an affiliated group of companies, or their successors, that jointly provided the previous opt-out notice.

(b) *Contents of renewal notice.* The renewal notice must be clear, conspicuous, and concise, and must accurately disclose:

(1) The name of the affiliate(s) providing the notice. If the notice is provided jointly by multiple affiliates and each affiliate shares a common name, such as ''ABC,'' then the notice may indicate that it is being provided by multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by ''all of the ABC companies,'' ''the ABC banking, credit card, insurance, and securities companies,'' or by listing the name of each affiliate providing the notice. But if the affiliates providing the joint notice do not all share a common name, then the notice must either separately identify each affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice is provided by ''all of the ABC and XYZ companies'' or by ''the ABC banking and credit card companies and the XYZ insurance companies'';

(2) A list of the affiliates or types of affiliates whose use of eligibility information is covered by the notice, which may include companies that become affiliates after the notice is provided to the consumer. If each affiliate covered by the notice shares a common name, such as ''ABC,'' then the notice may indicate that it applies to multiple companies with the ABC name or multiple companies in the ABC group or family of companies, for example, by stating that the notice is provided by ''all of the ABC companies,'' ''the ABC banking, credit card, insurance, and securities companies,'' or by listing the name of each affiliate providing the notice. But if the affiliates covered by the notice do not all share a common name, then the notice must either separately identify each covered affiliate by name or identify each of the common names used by those affiliates, for example, by stating that the notice applies to ''all of the ABC and XYZ companies'' or to ''the ABC banking and credit card companies and the XYZ insurance companies'';

(3) A general description of the types of eligibility information that may be used to make solicitations to the consumer;

(4) That the consumer previously elected to limit the use of certain information to make solicitations to the consumer;

(5) That the consumer's election has expired or is about to expire;

(6) That the consumer may elect to renew the consumer's previous election;

(7) If applicable, that the consumer's election to renew will apply for the specified period of time stated in the notice and that the consumer will be allowed to renew the election once that period expires; and

(8) A reasonable and simple method for the consumer to opt out.

(c) *Timing of the renewal notice.*—(1) *In general.* A renewal notice may be provided to the consumer either—

(i) A reasonable period of time before the expiration of the opt-out period; or

(ii) Any time after the expiration of the opt-out period but before solicitations that would have been prohibited by the expired opt-out are made to the consumer.

(2) *Combination with annual privacy notice.* If you provide an annual privacy notice under the Gramm-Leach-Bliley Act, 15 U.S.C. 6801 *et seq.*, providing a renewal notice with the last annual privacy notice provided to the consumer before expiration of the opt-out period is a reasonable period of time before expiration of the opt-out in all cases.

(d) *No effect on opt-out period.* An opt-out period may not be shortened by sending a renewal notice to the consumer before expiration of the opt-out period, even if the consumer does not renew the opt out.

### § 222.28 Effective date, compliance date, and prospective application.

(a) *Effective date.* This subpart is effective January 1, 2008.

(b) *Mandatory compliance date.* Compliance with this subpart is required not later than October 1, 2008.

(c) *Prospective application.* The provisions of this subpart shall not prohibit you from using eligibility information that you receive from an affiliate to make solicitations to a consumer if you receive such information prior to October 1, 2008. For purposes of this section, you are deemed to receive eligibility information when such information is placed into a common database and is accessible by you.

## Subpart D—Medical Information

SOURCE: 70 FR 70679, Nov. 22, 2005, unless otherwise noted.

### § 222.30 Obtaining or using medical information in connection with a determination of eligibility for credit.

(a) *Scope.* This section applies to

(1) Any of the following that participates as a creditor in a transaction—

(i) A bank that is a member of the Federal Reserve System (other than national banks) and its subsidiaries;

(ii) A branch or Agency of a foreign bank (other than Federal branches, Federal Agencies, and insured State branches of foreign banks) and its subsidiaries;

(iii) A commercial lending company owned or controlled by foreign banks;

(iv) An organization operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*);

(v) A bank holding company and an affiliate of such holding company (other than depository institutions and consumer reporting agencies); or

(2) Any other person that participates as a creditor in a transaction involving a person described in paragraph (a)(1) of this section.

(b) *General prohibition on obtaining or using medical information. (1) In general.* A creditor may not obtain or use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, except as provided in this section.

(2) *Definitions.* (i) *Credit* has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(ii) *Creditor* has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(iii) *Eligibility, or continued eligibility, for credit* means the consumer's qualification or fitness to receive, or continue to receive, credit, including the terms on which credit is offered. The term does not include:

(A) Any determination of the consumer's qualification or fitness for employment, insurance (other than a credit insurance product), or other non-credit products or services;

(B) Authorizing, processing, or documenting a payment or transaction on behalf of the consumer in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit; or

(C) Maintaining or servicing the consumer's account in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit.

(c) *Rule of construction for obtaining and using unsolicited medical information*—(1) *In general.* A creditor does not obtain medical information in violation of the prohibition if it receives medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit without specifically requesting medical information.

(2) *Use of unsolicited medical information.* A creditor that receives unsolicited medical information in the manner described in paragraph (c)(1) of this section may use that information in connection with any determination of the consumer's eligibility, or continued eligibility, for credit to the extent the creditor can rely on at least one of the exceptions in § 222.30(d) or (e).

(3) *Examples.* A creditor does not obtain medical information in violation of the prohibition if, for example:

(i) In response to a general question regarding a consumer's debts or expenses, the creditor receives information that the consumer owes a debt to a hospital.

(ii) In a conversation with the creditor's loan officer, the consumer informs the creditor that the consumer has a particular medical condition.

(iii) In connection with a consumer's application for an extension of credit, the creditor requests a consumer report from a consumer reporting agency and receives medical information in the consumer report furnished by the agency even though the creditor did not specifically request medical information from the consumer reporting agency.

(d) *Financial information exception for obtaining and using medical information*—(1) *In general.* A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit so long as:

(i) The information is the type of information routinely used in making credit eligibility determinations, such as information relating to debts, expenses, income, benefits, assets, collateral, or the purpose of the loan, including the use of proceeds;

(ii) The creditor uses the medical information in a manner and to an extent that is no less favorable than it would use comparable information that is not medical information in a credit transaction; and

(iii) The creditor does not take the consumer's physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any such determination.

(2) *Examples.* (i) *Examples of the types of information routinely used in making credit eligibility determinations.* Paragraph (d)(1)(i) of this section permits a creditor, for example, to obtain and use information about:

(A) The dollar amount, repayment terms, repayment history, and similar information regarding medical debts to calculate, measure, or verify the repayment ability of the consumer, the use of proceeds, or the terms for granting credit;

(B) The value, condition, and lien status of a medical device that may serve as collateral to secure a loan;

(C) The dollar amount and continued eligibility for disability income, workers' compensation income, or other benefits related to health or a medical condition that is relied on as a source of repayment; or

(D) The identity of creditors to whom outstanding medical debts are owed in connection with an application for credit, including but not limited to, a transaction involving the consolidation of medical debts.

(ii) *Examples of uses of medical information consistent with the exception.* (A) A consumer includes on an application for credit information about two $20,000 debts. One debt is to a hospital; the other debt is to a retailer. The creditor contacts the hospital and the retailer to verify the amount and payment status of the debts. The creditor learns that both debts are more than 90 days past due. Any two debts of this size that are more than 90 days past due would disqualify the consumer under the creditor's established underwriting criteria. The creditor denies the application on the basis that the consumer has a poor repayment history on outstanding debts. The creditor has used medical information in a manner and to an extent no less favorable than it would use comparable non-medical information.

(B) A consumer indicates on an application for a $200,000 mortgage loan that she receives $15,000 in long-term disability income each year from her former employer and has no other income. Annual income of $15,000, regardless of source, would not be sufficient to support the requested amount of credit. The creditor denies the application on the basis that the projected debt-to-income ratio of the consumer does not meet the creditor's underwriting criteria. The creditor has used medical information in a manner and to an extent that is no less favorable than it would use comparable non-medical information.

(C) A consumer includes on an application for a $10,000 home equity loan that he has a $50,000 debt to a medical facility that specializes in treating a potentially terminal disease. The creditor contacts the medical facility to verify the debt and obtain the repayment history and current status of the loan. The creditor learns that the debt is current. The applicant meets the income and other requirements of the

creditor's underwriting guidelines. The creditor grants the application. The creditor has used medical information in accordance with the exception.

(iii) *Examples of uses of medical information inconsistent with the exception.* (A) A consumer applies for $25,000 of credit and includes on the application information about a $50,000 debt to a hospital. The creditor contacts the hospital to verify the amount and payment status of the debt, and learns that the debt is current and that the consumer has no delinquencies in her repayment history. If the existing debt were instead owed to a retail department store, the creditor would approve the application and extend credit based on the amount and repayment history of the outstanding debt. The creditor, however, denies the application because the consumer is indebted to a hospital. The creditor has used medical information, here the identity of the medical creditor, in a manner and to an extent that is less favorable than it would use comparable non-medical information.

(B) A consumer meets with a loan officer of a creditor to apply for a mortgage loan. While filling out the loan application, the consumer informs the loan officer orally that she has a potentially terminal disease. The consumer meets the creditor's established requirements for the requested mortgage loan. The loan officer recommends to the credit committee that the consumer be denied credit because the consumer has that disease. The credit committee follows the loan officer's recommendation and denies the application because the consumer has a potentially terminal disease. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis as part of a determination of eligibility or continued eligibility for credit.

(C) A consumer who has an apparent medical condition, such as a consumer who uses a wheelchair or an oxygen tank, meets with a loan officer to apply for a home equity loan. The consumer meets the creditor's established requirements for the requested home equity loan and the creditor typically does not require consumers to obtain a debt cancellation contract, debt suspension agreement, or credit insurance product in connection with such loans. However, based on the consumer's apparent medical condition, the loan officer recommends to the credit committee that credit be extended to the consumer only if the consumer obtains a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third party. The credit committee agrees with the loan officer's recommendation. The loan officer informs the consumer that the consumer must obtain a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third party to qualify for the loan. The consumer obtains one of these products and the creditor approves the loan. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis in setting conditions on the consumer's eligibility for credit.

(e) *Specific exceptions for obtaining and using medical information*—(1) *In general.* A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit—

(i) To determine whether the use of a power of attorney or legal representative that is triggered by a medical condition or event is necessary and appropriate or whether the consumer has the legal capacity to contract when a person seeks to exercise a power of attorney or act as legal representative for a consumer based on an asserted medical condition or event;

(ii) To comply with applicable requirements of local, state, or Federal laws;

(iii) To determine, at the consumer's request, whether the consumer qualifies for a legally permissible special credit program or credit-related assistance program that is—

(A) Designed to meet the special needs of consumers with medical conditions; and

(B) Established and administered pursuant to a written plan that—

(*1*) Identifies the class of persons that the program is designed to benefit; and

(*2*) Sets forth the procedures and standards for extending credit or providing other credit-related assistance under the program;

(iv) To the extent necessary for purposes of fraud prevention or detection;

(v) In the case of credit for the purpose of financing medical products or services, to determine and verify the medical purpose of a loan and the use of proceeds;

(vi) Consistent with safe and sound practices, if the consumer or the consumer's legal representative specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit, to accommodate the consumer's particular circumstances, and such request is documented by the creditor;

(vii) Consistent with safe and sound practices, to determine whether the provisions of a forbearance practice or program that is triggered by a medical condition or event apply to a consumer;

(viii) To determine the consumer's eligibility for, the triggering of, or the reactivation of a debt cancellation contract or debt suspension agreement if a medical condition or event is a triggering event for the provision of benefits under the contract or agreement; or

(ix) To determine the consumer's eligibility for, the triggering of, or the reactivation of a credit insurance product if a medical condition or event is a triggering event for the provision of benefits under the product.

(2) *Example of determining eligibility for a special credit program or credit assistance program.* A not-for-profit organization establishes a credit assistance program pursuant to a written plan that is designed to assist disabled veterans in purchasing homes by subsidizing the down payment for the home purchase mortgage loans of qualifying veterans. The organization works through mortgage lenders and requires mortgage lenders to obtain medical information about the disability of any consumer that seeks to qualify for the program, use that information to verify the consumer's eligibility for the program, and forward that information to the organization. A consumer who is a veteran applies to a creditor for a home purchase mortgage loan. The creditor informs the consumer about the credit assistance program for disabled veterans and the consumer seeks to qualify for the program. Assuming that the program complies with all applicable law, including applicable fair lending laws, the creditor may obtain and use medical information about the medical condition and disability, if any, of the consumer to determine whether the consumer qualifies for the credit assistance program.

(3) *Examples of verifying the medical purpose of the loan or the use of proceeds.* (i) If a consumer applies for $10,000 of credit for the purpose of financing vision correction surgery, the creditor may verify with the surgeon that the procedure will be performed. If the surgeon reports that surgery will not be performed on the consumer, the creditor may use that medical information to deny the consumer's application for credit, because the loan would not be used for the stated purpose.

(ii) If a consumer applies for $10,000 of credit for the purpose of financing cosmetic surgery, the creditor may confirm the cost of the procedure with the surgeon. If the surgeon reports that the cost of the procedure is $5,000, the creditor may use that medical information to offer the consumer only $5,000 of credit.

(iii) A creditor has an established medical loan program for financing particular elective surgical procedures. The creditor receives a loan application from a consumer requesting $10,000 of credit under the established loan program for an elective surgical procedure. The consumer indicates on the application that the purpose of the loan is to finance an elective surgical procedure not eligible for funding under the guidelines of the established loan program. The creditor may deny the consumer's application because the purpose of the loan is not for a particular procedure funded by the established loan program.

(4) *Examples of obtaining and using medical information at the request of the*

*consumer*. (i) If a consumer applies for a loan and specifically requests that the creditor consider the consumer's medical disability at the relevant time as an explanation for adverse payment history information in his credit report, the creditor may consider such medical information in evaluating the consumer's willingness and ability to repay the requested loan to accommodate the consumer's particular circumstances, consistent with safe and sound practices. The creditor may also decline to consider such medical information to accommodate the consumer, but may evaluate the consumer's application in accordance with its otherwise applicable underwriting criteria. The creditor may not deny the consumer's application or otherwise treat the consumer less favorably because the consumer specifically requested a medical accommodation, if the creditor would have extended the credit or treated the consumer more favorably under the creditor's otherwise applicable underwriting criteria.

(ii) If a consumer applies for a loan by telephone and explains that his income has been and will continue to be interrupted on account of a medical condition and that he expects to repay the loan by liquidating assets, the creditor may, but is not required to, evaluate the application using the sale of assets as the primary source of repayment, consistent with safe and sound practices, provided that the creditor documents the consumer's request by recording the oral conversation or making a notation of the request in the consumer's file.

(iii) If a consumer applies for a loan and the application form provides a space where the consumer may provide any other information or special circumstances, whether medical or nonmedical, that the consumer would like the creditor to consider in evaluating the consumer's application, the creditor may use medical information provided by the consumer in that space on that application to accommodate the consumer's application for credit, consistent with safe and sound practices, or may disregard that information.

(iv) If a consumer specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit and provides the creditor with medical information for that purpose, and the creditor determines that it needs additional information regarding the consumer's circumstances, the creditor may request, obtain, and use additional medical information about the consumer as necessary to verify the information provided by the consumer or to determine whether to make an accommodation for the consumer. The consumer may decline to provide additional information, withdraw the request for an accommodation, and have the application considered under the creditor's otherwise applicable underwriting criteria.

(v) If a consumer completes and signs a credit application that is not for medical purpose credit and the application contains boilerplate language that routinely requests medical information from the consumer or that indicates that by applying for credit the consumer authorizes or consents to the creditor obtaining and using medical information in connection with a determination of the consumer's eligibility, or continued eligibility, for credit, the consumer has not specifically requested that the creditor obtain and use medical information to accommodate the consumer's particular circumstances.

(5) *Example of a forbearance practice or program.* After an appropriate safety and soundness review, a creditor institutes a program that allows consumers who are or will be hospitalized to defer payments as needed for up to three months, without penalty, if the credit account has been open for more than one year and has not previously been in default, and the consumer provides confirming documentation at an appropriate time. A consumer is hospitalized and does not pay her bill for a particular month. This consumer has had a credit account with the creditor for more than one year and has not previously been in default. The creditor attempts to contact the consumer and speaks with the consumer's adult child, who is not the consumer's legal representative. The adult child informs the creditor that the consumer is hospitalized and is unable to pay the bill

at that time. The creditor defers payments for up to three months, without penalty, for the hospitalized consumer and sends the consumer a letter confirming this practice and the date on which the next payment will be due. The creditor has obtained and used medical information to determine whether the provisions of a medically-triggered forbearance practice or program apply to a consumer.

### § 222.31 Limits on redisclosure of information.

(a) *Scope*. This section applies to banks that are members of the Federal Reserve System (other than national banks) and their respective operating subsidiaries, branches and agencies of foreign banks (other than Federal branches, Federal Agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*), and bank holding companies and affiliates of such holding companies (other than depository institutions and consumer reporting agencies).

(b) *Limits on redisclosure*. If a person described in paragraph (a) of this section receives medical information about a consumer from a consumer reporting agency or its affiliate, the person must not disclose that information to any other person, except as necessary to carry out the purpose for which the information was initially disclosed, or as otherwise permitted by statute, regulation, or order.

### § 222.32 Sharing medical information with affiliates.

(a) *Scope*. This section applies to banks that are members of the Federal Reserve System (other than national banks) and their respective operating subsidiaries, branches and agencies of foreign banks (other than Federal branches, Federal Agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*).

(b) *In general*. The exclusions from the term ''consumer report'' in section 603(d)(2) of the Act that allow the sharing of information with affiliates do not apply to a person described in paragraph (a) of this section if that person communicates to an affiliate:

(1) Medical information;

(2) An individualized list or description based on the payment transactions of the consumer for medical products or services; or

(3) An aggregate list of identified consumers based on payment transactions for medical products or services.

(c) *Exceptions*. A person described in paragraph (a) of this section may rely on the exclusions from the term ''consumer report'' in section 603(d)(2) of the Act to communicate the information in paragraph (b) of this section to an affiliate:

(1) In connection with the business of insurance or annuities (including the activities described in section 18B of the model Privacy of Consumer Financial and Health Information Regulation issued by the National Association of Insurance Commissioners, as in effect on January 1, 2003);

(2) For any purpose permitted without authorization under the regulations promulgated by the Department of Health and Human Services pursuant to the Health Insurance Portability and Accountability Act of 1996 (HIPAA);

(3) For any purpose referred to in section 1179 of HIPAA;

(4) For any purpose described in section 502(e) of the Gramm-Leach-Bliley Act;

(5) In connection with a determination of the consumer's eligibility, or continued eligibility, for credit consistent with § 222.30 of this part; or

(6) As otherwise permitted by order of the Board.

## Subparts E–H [Reserved]

## Subpart I—Duties of Users of Consumer Reports Regarding Identity Theft

SOURCE: 69 FR 77618, Dec. 28, 2004, unless otherwise noted.

**§ 222.80–222.81 [Reserved]**

**§ 222.82 Duties of users regarding address discrepancies.**

(a) *Scope*. This section applies to a user of consumer reports (user) that receives a notice of address discrepancy from a consumer reporting agency, and that is a member bank of the Federal Reserve System (other than a national bank) and its respective operating subsidiaries, a branch or agency of a foreign bank (other than a Federal branch, Federal agency, or insured State branch of a foreign bank), commercial lending company owned or controlled by a foreign bank, and an organization operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*).

(b) *Definition*. For purposes of this section, a *notice of address discrepancy* means a notice sent to a user by a consumer reporting agency pursuant to 15 U.S.C. 1681c(h)(1), that informs the user of a substantial difference between the address for the consumer that the user provided to request the consumer report and the address(es) in the agency's file for the consumer.

(c) *Reasonable belief*—(1) *Requirement to form a reasonable belief*. A user must develop and implement reasonable policies and procedures designed to enable the user to form a reasonable belief that a consumer report relates to the consumer about whom it has requested the report, when the user receives a notice of address discrepancy.

(2) *Examples of reasonable policies and procedures*. (i) Comparing the information in the consumer report provided by the consumer reporting agency with information the user:

(A) Obtains and uses to verify the consumer's identity in accordance with the requirements of the Customer Information Program (CIP) rules implementing 31 U.S.C. 5318(l) (31 CFR 103.121);

(B) Maintains in its own records, such as applications, change of address notifications, other customer account records, or retained CIP documentation; or

(C) Obtains from third-party sources; or

(ii) Verifying the information in the consumer report provided by the consumer reporting agency with the consumer.

(d) *Consumer's address*.—(1) *Requirement to furnish consumer's address to a consumer reporting agency*. A user must develop and implement reasonable policies and procedures for furnishing an address for the consumer that the user has reasonably confirmed is accurate to the consumer reporting agency from whom it received the notice of address discrepancy when the user:

(i) Can form a reasonable belief that the consumer report relates to the consumer about whom the user requested the report;

(ii) Establishes a continuing relationship with the consumer; and

(iii) Regularly and in the ordinary course of business furnishes information to the consumer reporting agency from which the notice of address discrepancy relating to the consumer was obtained.

(2) *Examples of confirmation methods*. The user may reasonably confirm an address is accurate by:

(i) Verifying the address with the consumer about whom it has requested the report;

(ii) Reviewing its own records to verify the address of the consumer;

(iii) Verifying the address through third-party sources; or

(iv) Using other reasonable means.

(3) *Timing*. The policies and procedures developed in accordance with paragraph (d)(1) of this section must provide that the user will furnish the consumer's address that the user has reasonably confirmed is accurate to the consumer reporting agency as part of the information it regularly furnishes for the reporting period in which it establishes a relationship with the consumer.

[Reg. V, 72 FR 63756, Nov. 9, 2007]

**§ 222.83 Disposal of consumer information.**

(a) *Definitions as used in this section*. (1) *You* means member banks of the Federal Reserve System (other than national banks) and their respective operating subsidiaries, branches and agencies of foreign banks (other than Federal branches, Federal agencies and insured State branches of foreign banks), commercial lending companies

owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, 611 *et seq.*).

(b) *In general.* You must properly dispose of any consumer information that you maintain or otherwise possess in accordance with the Interagency Guidelines Establishing Information Security Standards, as required under sections 208.3(d) (Regulation H), 211.5(l) and 211.24(i) (Regulation K) of this chapter, to the extent that you are covered by the scope of the Guidelines.

(c) *Rule of construction.* Nothing in this section shall be construed to:

(1) Require you to maintain or destroy any record pertaining to a consumer that is not imposed under any other law; or

(2) Alter or affect any requirement imposed under any other provision of law to maintain or destroy such a record.

## Subpart J—Identity Theft Red Flags

SOURCE: Reg. V, 72 FR 63758, Nov. 9, 2007, unless otherwise noted.

### § 222.90 Duties regarding the detection, prevention, and mitigation of identity theft.

(a) *Scope.* This section applies to financial institutions and creditors that are member banks of the Federal Reserve System (other than national banks) and their respective operating subsidiaries, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*, and 611 *et seq.*).

(b) *Definitions.* For purposes of this section and appendix J, the following definitions apply:

(1) *Account* means a continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes. Account includes:

(i) An extension of credit, such as the purchase of property or services involving a deferred payment; and

(ii) A deposit account.

(2) The term *board of directors* includes:

(i) In the case of a branch or agency of a foreign bank, the managing official in charge of the branch or agency; and

(ii) In the case of any other creditor that does not have a board of directors, a designated employee at the level of senior management.

(3) *Covered account* means:

(i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a credit card account, mortgage loan, automobile loan, margin account, cell phone account, utility account, checking account, or savings account; and

(ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

(4) *Credit* has the same meaning as in 15 U.S.C. 1681a(r)(5).

(5) *Creditor* has the same meaning as in 15 U.S.C. 1681a(r)(5), and includes lenders such as banks, finance companies, automobile dealers, mortgage brokers, utility companies, and telecommunications companies.

(6) *Customer* means a person that has a covered account with a financial institution or creditor.

(7) *Financial institution* has the same meaning as in 15 U.S.C. 1681a(t).

(8) *Identity theft* has the same meaning as in 16 CFR 603.2(a).

(9) *Red Flag* means a pattern, practice, or specific activity that indicates the possible existence of identity theft.

(10) *Service provider* means a person that provides a service directly to the financial institution or creditor.

(c) *Periodic Identification of Covered Accounts.* Each financial institution or creditor must periodically determine whether it offers or maintains covered accounts. As a part of this determination, a financial institution or creditor

must conduct a risk assessment to determine whether it offers or maintains covered accounts described in paragraph (b)(3)(ii) of this section, taking into consideration:

(1) The methods it provides to open its accounts;

(2) The methods it provides to access its accounts; and

(3) Its previous experiences with identity theft.

(d) *Establishment of an Identity Theft Prevention Program*—(1) *Program requirement.* Each financial institution or creditor that offers or maintains one or more covered accounts must develop and implement a written Identity Theft Prevention Program (Program) that is designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. The Program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities.

(2) *Elements of the Program.* The Program must include reasonable policies and procedures to:

(i) Identify relevant Red Flags for the covered accounts that the financial institution or creditor offers or maintains, and incorporate those Red Flags into its Program;

(ii) Detect Red Flags that have been incorporated into the Program of the financial institution or creditor;

(iii) Respond appropriately to any Red Flags that are detected pursuant to paragraph (d)(2)(ii) of this section to prevent and mitigate identity theft; and

(iv) Ensure the Program (including the Red Flags determined to be relevant) is updated periodically, to reflect changes in risks to customers and to the safety and soundness of the financial institution or creditor from identity theft.

(e) *Administration of the Program.* Each financial institution or creditor that is required to implement a Program must provide for the continued administration of the Program and must:

(1) Obtain approval of the initial written Program from either its board of directors or an appropriate committee of the board of directors;

(2) Involve the board of directors, an appropriate committee thereof, or a designated employee at the level of senior management in the oversight, development, implementation and administration of the Program;

(3) Train staff, as necessary, to effectively implement the Program; and

(4) Exercise appropriate and effective oversight of service provider arrangements.

(f) *Guidelines.* Each financial institution or creditor that is required to implement a Program must consider the guidelines in appendix J of this part and include in its Program those guidelines that are appropriate.

### § 222.91 Duties of card issuers regarding changes of address.

(a) *Scope.* This section applies to a person described in § 222.90(a) that issues a debit or credit card (card issuer).

(b) *Definitions.* For purposes of this section:

(1) *Cardholder* means a consumer who has been issued a credit or debit card.

(2) *Clear and conspicuous* means reasonably understandable and designed to call attention to the nature and significance of the information presented.

(c) *Address validation requirements.* A card issuer must establish and implement reasonable policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a consumer's debit or credit card account and, within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account. Under these circumstances, the card issuer may not issue an additional or replacement card, until, in accordance with its reasonable policies and procedures and for the purpose of assessing the validity of the change of address, the card issuer:

(1)(i) Notifies the cardholder of the request:

(A) At the cardholder's former address; or

(B) By any other means of communication that the card issuer and the cardholder have previously agreed to use; and

(ii) Provides to the cardholder a reasonable means of promptly reporting incorrect address changes; or

(2) Otherwise assesses the validity of the change of address in accordance with the policies and procedures the card issuer has established pursuant to § 222.90 of this part.

(d) *Alternative timing of address validation.* A card issuer may satisfy the requirements of paragraph (c) of this section if it validates an address pursuant to the methods in paragraph (c)(1) or (c)(2) of this section when it receives an address change notification, before it receives a request for an additional or replacement card.

(e) *Form of notice.* Any written or electronic notice that the card issuer provides under this paragraph must be clear and conspicuous and provided separately from its regular correspondence with the cardholder.

## APPENDIX A TO PART 222 [RESERVED]

## APPENDIX B TO PART 222—MODEL NOTICES OF FURNISHING NEGATIVE INFORMATION

a. Although use of the model notices is not required, a financial institution that is subject to section 623(a)(7) of the FCRA shall be deemed to be in compliance with the notice requirement in section 623(a)(7) of the FCRA if the institution properly uses the model notices in this appendix (as applicable).

b. A financial institution may use Model Notice B–1 if the institution provides the notice prior to furnishing negative information to a nationwide consumer reporting agency.

c. A financial institution may use Model Notice B–2 if the institution provides the notice after furnishing negative information to a nationwide consumer reporting agency.

d. Financial institutions may make certain changes to the language or format of the model notices without losing the safe harbor from liability provided by the model notices. The changes to the model notices may not be so extensive as to affect the substance, clarity, or meaningful sequence of the language in the model notices. Financial institutions making such extensive revisions will lose the safe harbor from liability that this appendix provides. Acceptable changes include, for example,

1. Rearranging the order of the references to ''late payment(s),'' or ''missed payment(s)''

2. Pluralizing the terms ''credit bureau,'' ''credit report,'' and ''account''

3. Specifying the particular type of account on which information may be furnished, such as ''credit card account''

4. Rearranging in Model Notice B–1 the phrases ''information about your account'' and ''to credit bureaus'' such that it would read ''We may report to credit bureaus information about your account.''

*Model Notice B–1*

We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report.

*Model Notice B–2*

We have told a credit bureau about a late payment, missed payment or other default on your account. This information may be reflected in your credit report.

[69 FR 33285, June 15, 2004]

## APPENDIX C TO PART 222—MODEL FORMS FOR OPT-OUT NOTICES

a. Although use of the model forms is not required, use of the model forms in this appendix (as applicable) complies with the requirement in section 624 of the Act for clear, conspicuous, and concise notices.

b. Certain changes may be made to the language or format of the model forms without losing the protection from liability afforded by use of the model forms. These changes may not be so extensive as to affect the substance, clarity, or meaningful sequence of the language in the model forms. Persons making such extensive revisions will lose the safe harbor that this appendix provides. Acceptable changes include, for example:

1. Rearranging the order of the references to ''your income,'' ''your account history,'' and ''your credit score.''

2. Substituting other types of information for ''income,'' ''account history,'' or ''credit score'' for accuracy, such as ''payment history,'' ''credit history,'' ''payoff status,'' or ''claims history.''

3. Substituting a clearer and more accurate description of the affiliates providing or covered by the notice for phrases such as ''the [ABC] group of companies,'' including without limitation a statement that the entity providing the notice recently purchased the consumer's account.

4. Substituting other types of affiliates covered by the notice for ''credit card,'' ''insurance,'' or ''securities'' affiliates.

5. Omitting items that are not accurate or applicable. For example, if a person does not limit the duration of the opt-out period, the notice may omit information about the renewal notice.

6. Adding a statement informing consumers how much time they have to opt out

before shared eligibility information may be used to make solicitations to them.

7. Adding a statement that the consumer may exercise the right to opt out at any time.

8. Adding the following statement, if accurate: ''If you previously opted out, you do not need to do so again.''

9. Providing a place on the form for the consumer to fill in identifying information, such as his or her name and address

C–1 Model Form for Initial Opt-out Notice (Single-Affiliate Notice)

C–2 Model Form for Initial Opt-out Notice (Joint Notice)

C–3 Model Form for Renewal Notice (Single-Affiliate Notice)

C–4 Model Form for Renewal Notice (Joint Notice)

C–5 Model Form for Voluntary ''No Marketing'' Notice

*C–1—Model Form for Initial Opt-out Notice (Single-Affiliate Notice)—[Your Choice To Limit Marketing]/[Marketing Opt-out]*

• [Name of Affiliate] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from our affiliates. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from our affiliates.]

• You may limit our affiliates in the [ABC] group of companies, such as our [credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that we collect and share with them. This information includes your [income], your [account history with us], and your [credit score].

• Your choice to limit marketing offers from our affiliates will apply [until you tell us to change your choice]/[for x years from when you tell us your choice]/[for at least 5 years from when you tell us your choice]. [Include if the opt-out period expires.] Once that period expires, you will receive a renewal notice that will allow you to continue to limit marketing offers from our affiliates for [another x years]/[at least another 5 years].

• [Include, if applicable, in a subsequent notice, including an annual notice, for consumers who may have previously opted out.] If you have already made a choice to limit marketing offers from our affiliates, you do not need to act again until you receive the renewal notice.

To limit marketing offers, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

__Do not allow your affiliates to use my personal information to market to me.

*C–2—Model Form for Initial Opt-out Notice (Joint Notice)—[Your Choice To Limit Marketing]/[Marketing Opt-out]*

• The [ABC group of companies] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from the [ABC] companies. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from the [ABC] companies.]

• You may limit the [ABC] companies, such as the [ABC credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that they receive from other [ABC] companies. This information includes your [income], your [account history], and your [credit score].

• Your choice to limit marketing offers from the [ABC] companies will apply [until you tell us to change your choice]/[for x years from when you tell us your choice]/[for at least 5 years from when you tell us your choice]. [Include if the opt-out period expires.] Once that period expires, you will receive a renewal notice that will allow you to continue to limit marketing offers from the [ABC] companies for [another x years]/[at least another 5 years].

• [Include, if applicable, in a subsequent notice, including an annual notice, for consumers who may have previously opted out.] If you have already made a choice to limit marketing offers from the [ABC] companies, you do not need to act again until you receive the renewal notice.

To limit marketing offers, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

__Do not allow any company [in the ABC group of companies] to use my personal information to market to me.

*C–3—Model Form for Renewal Notice (Single-Affiliate Notice)—[Renewing Your Choice To Limit Marketing]/[Renewing Your Marketing Opt-Out]*

• [Name of Affiliate] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from our affiliates. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from our affiliates.]

• You previously chose to limit our affiliates in the [ABC] group of companies, such as our [credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that we share with them. This information includes your [income], your [account history with us], and your [credit score].

• Your choice has expired or is about to expire.

To renew your choice to limit marketing for [x] more years, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

__Renew my choice to limit marketing for [x] more years.

*C–4—Model Form for Renewal Notice (Joint Notice)—[Renewing Your Choice To Limit Marketing]/[Renewing Your Marketing Opt-Out]*

• The [ABC group of companies] is providing this notice.

• [Optional: Federal law gives you the right to limit some but not all marketing from the [ABC] companies. Federal law also requires us to give you this notice to tell you about your choice to limit marketing from the [ABC] companies.]

• You previously chose to limit the [ABC] companies, such as the [ABC credit card, insurance, and securities] affiliates, from marketing their products or services to you based on your personal information that they receive from other ABC companies. This information includes your [income], your [account history], and your [credit score].

• Your choice has expired or is about to expire.

To renew your choice to limit marketing for [x] more years, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: *www.---.com*

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

__Renew my choice to limit marketing for [x] more years.

*C–5—Model Form for Voluntary ''No Marketing'' Notice—Your Choice To Stop Marketing*

• [Name of Affiliate] is providing this notice.

• You may choose to stop all marketing from us and our affiliates.

To stop all marketing, contact us [include all that apply]:

• By telephone: 1–877–###–####

• On the Web: www.---.com

• By mail: Check the box and complete the form below, and send the form to:

[Company name]

[Company address]

__Do not market to me.

[72 FR 62962, Nov. 7, 2007]

## APPENDICES D–I TO PART 222 [RESERVED]

## APPENDIX J TO PART 222—INTERAGENCY GUIDELINES ON IDENTITY THEFT DETECTION, PREVENTION, AND MITIGATION

Section 222.90 of this part requires each financial institution and creditor that offers or maintains one or more covered accounts, as defined in §222.90(b)(3) of this part, to develop and provide for the continued administration of a written Program to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. These guidelines are intended to assist financial institutions and creditors in the formulation and maintenance of a Program that satisfies the requirements of §222.90 of this part.

### I. The Program

In designing its Program, a financial institution or creditor may incorporate, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

### II. Identifying Relevant Red Flags

(a) *Risk Factors.* A financial institution or creditor should consider the following factors in identifying relevant Red Flags for covered accounts, as appropriate:

(1) The types of covered accounts it offers or maintains;

(2) The methods it provides to open its covered accounts;

(3) The methods it provides to access its covered accounts; and

(4) Its previous experiences with identity theft.

(b) *Sources of Red Flags.* Financial institutions and creditors should incorporate relevant Red Flags from sources such as:

(1) Incidents of identity theft that the financial institution or creditor has experienced;

(2) Methods of identity theft that the financial institution or creditor has identified that reflect changes in identity theft risks; and

(3) Applicable supervisory guidance.

(c) *Categories of Red Flags.* The Program should include relevant Red Flags from the following categories, as appropriate. Examples of Red Flags from each of these categories are appended as Supplement A to this appendix J.

(1) Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services;

(2) The presentation of suspicious documents;

(3) The presentation of suspicious personal identifying information, such as a suspicious address change;

(4) The unusual use of, or other suspicious activity related to, a covered account; and

(5) Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor.

III. Detecting Red Flags

The Program's policies and procedures should address the detection of Red Flags in connection with the opening of covered accounts and existing covered accounts, such as by:

(a) Obtaining identifying information about, and verifying the identity of, a person opening a covered account, for example, using the policies and procedures regarding identification and verification set forth in the Customer Identification Program rules implementing 31 U.S.C. 5318(l) (31 CFR 103.121); and

(b) Authenticating customers, monitoring transactions, and verifying the validity of change of address requests, in the case of existing covered accounts.

IV. Preventing and Mitigating Identity Theft

The Program's policies and procedures should provide for appropriate responses to the Red Flags the financial institution or creditor has detected that are commensurate with the degree of risk posed. In determining an appropriate response, a financial institution or creditor should consider aggravating factors that may heighten the risk of identity theft, such as a data security incident that results in unauthorized access to a customer's account records held by the financial institution, creditor, or third party, or notice that a customer has provided information related to a covered account held by the financial institution or creditor to someone fraudulently claiming to represent the financial institution or creditor or to a fraudulent website. Appropriate responses may include the following:

(a) Monitoring a covered account for evidence of identity theft;

(b) Contacting the customer;

(c) Changing any passwords, security codes, or other security devices that permit access to a covered account;

(d) Reopening a covered account with a new account number;

(e) Not opening a new covered account;

(f) Closing an existing covered account;

(g) Not attempting to collect on a covered account or not selling a covered account to a debt collector;

(h) Notifying law enforcement; or

(i) Determining that no response is warranted under the particular circumstances.

V. Updating the Program

Financial institutions and creditors should update the Program (including the Red Flags determined to be relevant) periodically, to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft, based on factors such as:

(a) The experiences of the financial institution or creditor with identity theft;

(b) Changes in methods of identity theft;

(c) Changes in methods to detect, prevent, and mitigate identity theft;

(d) Changes in the types of accounts that the financial institution or creditor offers or maintains; and

(e) Changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

VI. Methods for Administering the Program

(a) *Oversight of Program.* Oversight by the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management should include:

(1) Assigning specific responsibility for the Program's implementation;

(2) Reviewing reports prepared by staff regarding compliance by the financial institution or creditor with §222.90 of this part; and

(3) Approving material changes to the Program as necessary to address changing identity theft risks.

(b) *Reports.* (1) *In general.* Staff of the financial institution or creditor responsible for development, implementation, and administration of its Program should report to the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management, at least annually, on compliance by the financial institution or creditor with §222.90 of this part.

(2) *Contents of report.* The report should address material matters related to the Program and evaluate issues such as: the effectiveness of the policies and procedures of the financial institution or creditor in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts;

service provider arrangements; significant incidents involving identity theft and management's response; and recommendations for material changes to the Program.

(c) *Oversight of service provider arrangements.* Whenever a financial institution or creditor engages a service provider to perform an activity in connection with one or more covered accounts the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft. For example, a financial institution or creditor could require the service provider by contract to have policies and procedures to detect relevant Red Flags that may arise in the performance of the service provider's activities, and either report the Red Flags to the financial institution or creditor, or to take appropriate steps to prevent or mitigate identity theft.

VII. Other Applicable Legal Requirements

Financial institutions and creditors should be mindful of other related legal requirements that may be applicable, such as:

(a) For financial institutions and creditors that are subject to 31 U.S.C. 5318(g), filing a Suspicious Activity Report in accordance with applicable law and regulation;

(b) Implementing any requirements under 15 U.S.C. 1681c–1(h) regarding the circumstances under which credit may be extended when the financial institution or creditor detects a fraud or active duty alert;

(c) Implementing any requirements for furnishers of information to consumer reporting agencies under 15 U.S.C. 1681s–2, for example, to correct or update inaccurate or incomplete information, and to not report information that the furnisher has reasonable cause to believe is inaccurate; and

(d) Complying with the prohibitions in 15 U.S.C. 1681m on the sale, transfer, and placement for collection of certain debts resulting from identity theft.

*Supplement A to Appendix J*

In addition to incorporating Red Flags from the sources recommended in section II.b. of the Guidelines in appendix J of this part, each financial institution or creditor may consider incorporating into its Program, whether singly or in combination, Red Flags from the following illustrative examples in connection with covered accounts:

*Alerts, Notifications or Warnings from a Consumer Reporting Agency*

1. A fraud or active duty alert is included with a consumer report.

2. A consumer reporting agency provides a notice of credit freeze in response to a request for a consumer report.

3. A consumer reporting agency provides a notice of address discrepancy, as defined in §222.82(b) of this part.

4. A consumer report indicates a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer, such as:

a. A recent and significant increase in the volume of inquiries;

b. An unusual number of recently established credit relationships;

c. A material change in the use of credit, especially with respect to recently established credit relationships; or

d. An account that was closed for cause or identified for abuse of account privileges by a financial institution or creditor.

*Suspicious Documents*

5. Documents provided for identification appear to have been altered or forged.

6. The photograph or physical description on the identification is not consistent with the appearance of the applicant or customer presenting the identification.

7. Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.

8. Other information on the identification is not consistent with readily accessible information that is on file with the financial institution or creditor, such as a signature card or a recent check.

9. An application appears to have been altered or forged, or gives the appearance of having been destroyed and reassembled.

*Suspicious Personal Identifying Information*

10. Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or creditor. For example:

a. The address does not match any address in the consumer report; or

b. The Social Security Number (SSN) has not been issued, or is listed on the Social Security Administration's Death Master File.

11. Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example, there is a lack of correlation between the SSN range and date of birth.

12. Personal identifying information provided is associated with known fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is the same as the address provided on a fraudulent application; or

b. The phone number on an application is the same as the number provided on a fraudulent application.

13. Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is fictitious, a mail drop, or a prison; or

b. The phone number is invalid, or is associated with a pager or answering service.

14. The SSN provided is the same as that submitted by other persons opening an account or other customers.

15. The address or telephone number provided is the same as or similar to the account number or telephone number submitted by an unusually large number of other persons opening accounts or other customers.

16. The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

17. Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.

18. For financial institutions and creditors that use challenge questions, the person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.

*Unusual Use of, or Suspicious Activity Related to, the Covered Account*

19. Shortly following the notice of a change of address for a covered account, the institution or creditor receives a request for a new, additional, or replacement card or a cell phone, or for the addition of authorized users on the account.

20. A new revolving credit account is used in a manner commonly associated with known patterns of fraud patterns. For example:

a. The majority of available credit is used for cash advances or merchandise that is easily convertible to cash (e.g., electronics equipment or jewelry); or

b. The customer fails to make the first payment or makes an initial payment but no subsequent payments.

21. A covered account is used in a manner that is not consistent with established patterns of activity on the account. There is, for example:

a. Nonpayment when there is no history of late or missed payments;

b. A material increase in the use of available credit;

c. A material change in purchasing or spending patterns;

d. A material change in electronic fund transfer patterns in connection with a deposit account; or

e. A material change in telephone call patterns in connection with a cellular phone account.

22. A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).

23. Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.

24. The financial institution or creditor is notified that the customer is not receiving paper account statements.

25. The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

*Notice from Customers, Victims of Identity Theft, Law Enforcement Authorities, or Other Persons Regarding Possible Identity Theft in Connection with Covered Accounts Held by the Financial Institution or Creditor*

26. The financial institution or creditor is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

[Reg. V, 72 FR 63758, Nov. 9, 2007]

# PART 223—TRANSACTIONS BETWEEN MEMBER BANKS AND THEIR AFFILIATES (REGULATION W)

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AUTHORITY: 12 U.S.C. 371c(b)(1)(E), (b)(2)(A), and (f), 371c–1(e), 1828(j), and 1468(a).

SOURCE: 67 FR 76604, Dec. 12, 2002, unless otherwise noted.

## Subpart A—Introduction and Definitions

### § 223.1 Authority, purpose, and scope.

(a) *Authority*. The Board of Governors of the Federal Reserve System (Board) has issued this part (Regulation W) under the authority of sections 23A(f) and 23B(e) of the Federal Reserve Act (12 U.S.C. 371c(f), 371c–1(e)).

(b) *Purpose*. Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c–1) establish certain quantitative limits and other prudential requirements for loans, purchases of assets, and certain other transactions between a member bank and its affiliates. This regulation implements sections 23A and 23B by defining terms used in the statute, explaining the statute's requirements, and exempting certain transactions.

(c) *Scope*. Sections 23A and 23B and this regulation apply by their terms to ''member banks''—that is, any national bank, State bank, trust company, or other institution that is a member of the Federal Reserve System. In addition, the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) applies sections 23A and 23B to insured State nonmember banks in the same manner and to the same extent as if they were member banks. The Home Owners' Loan Act (12 U.S.C. 1468(a)) also applies sections 23A and 23B to insured savings associations in the same manner and to

the same extent as if they were member banks (and imposes two additional restrictions).

### § 223.2 What is an "affiliate" for purposes of sections 23A and 23B and this part?

(a) For purposes of this part and except as provided in paragraphs (b) and (c) of this section, ''affiliate'' with respect to a member bank means:

(1) *Parent companies.* Any company that controls the member bank;

(2) *Companies under common control by a parent company.* Any company, including any subsidiary of the member bank, that is controlled by a company that controls the member bank;

(3) *Companies under other common control.* Any company, including any subsidiary of the member bank, that is controlled, directly or indirectly, by trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the member bank or any company that controls the member bank;

(4) *Companies with interlocking directorates.* Any company in which a majority of its directors, trustees, or general partners (or individuals exercising similar functions) constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank;

(5) *Sponsored and advised companies.* Any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the member bank or an affiliate of the member bank;

(6) *Investment companies.* (i) Any investment company for which the member bank or any affiliate of the member bank serves as an investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(20)); and

(ii) Any other investment fund for which the member bank or any affiliate of the member bank serves as an investment advisor, if the member bank and its affiliates own or control in the aggregate more than 5 percent of any class of voting securities or of the equity capital of the fund;

(7) *Depository institution subsidiaries.* A depository institution that is a subsidiary of the member bank;

(8) *Financial subsidiaries.* A financial subsidiary of the member bank;

(9) *Companies held under merchant banking or insurance company investment authority*—(i) *In general.* Any company in which a holding company of the member bank owns or controls, directly or indirectly, or acting through one or more other persons, 15 percent or more of the equity capital pursuant to section 4(k)(4)(H) or (I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H) or (I)).

(ii) *General exemption.* A company will not be an affiliate under paragraph (a)(9)(i) of this section if the holding company presents information to the Board that demonstrates, to the Board's satisfaction, that the holding company does not control the company.

(iii) *Specific exemptions.* A company also will not be an affiliate under paragraph (a)(9)(i) of this section if:

(A) No director, officer, or employee of the holding company serves as a director, trustee, or general partner (or individual exercising similar functions) of the company;

(B) A person that is not affiliated or associated with the holding company owns or controls a greater percentage of the equity capital of the company than is owned or controlled by the holding company, and no more than one officer or employee of the holding company serves as a director or trustee (or individual exercising similar functions) of the company; or

(C) A person that is not affiliated or associated with the holding company owns or controls more than 50 percent of the voting shares of the company, and officers and employees of the holding company do not constitute a majority of the directors or trustees (or individuals exercising similar functions) of the company.

(iv) *Application of rule to private equity funds.* A holding company will not be deemed to own or control the equity capital of a company for purposes of paragraph (a)(9)(i) of this section solely by virtue of an investment made by the holding company in a private equity

fund (as defined in the merchant banking subpart of the Board's Regulation Y (12 CFR 225.173(a))) that owns or controls the equity capital of the company unless the holding company controls the private equity fund under 12 CFR 225.173(d)(4).

(v) *Definition.* For purposes of this paragraph (a)(9), ''*holding company*'' with respect to a member bank means a company that controls the member bank, or a company that is controlled by shareholders that control the member bank, and all subsidiaries of the company (including any depository institution that is a subsidiary of the company).

(10) *Partnerships associated with the member bank or an affiliate.* Any partnership for which the member bank or any affiliate of the member bank serves as a general partner or for which the member bank or any affiliate of the member bank causes any director, officer, or employee of the member bank or affiliate to serve as a general partner;

(11) *Subsidiaries of affiliates.* Any subsidiary of a company described in paragraphs (a)(1) through (10) of this section; and

(12) *Other companies.* Any company that the Board determines by regulation or order, or that the appropriate Federal banking agency for the member bank determines by order, to have a relationship with the member bank, or any affiliate of the member bank, such that covered transactions by the member bank with that company may be affected by the relationship to the detriment of the member bank.

(b) ''*Affiliate*'' with respect to a member bank does *not* include:

(1) *Subsidiaries.* Any company that is a subsidiary of the member bank, unless the company is:

(i) A depository institution;

(ii) A financial subsidiary;

(iii) Directly controlled by:

(A) One or more affiliates (other than depository institution affiliates) of the member bank; or

(B) A shareholder that controls the member bank or a group of shareholders that together control the member bank;

(iv) An employee stock option plan, trust, or similar organization that exists for the benefit of the shareholders, partners, members, or employees of the member bank or any of its affiliates; or

(v) Any other company determined to be an affiliate under paragraph (a)(12) of this section;

(2) *Bank premises.* Any company engaged solely in holding the premises of the member bank;

(3) *Safe deposit.* Any company engaged solely in conducting a safe deposit business;

(4) *Government securities.* Any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and

(5) *Companies held DPC.* Any company where control results from the exercise of rights arising out of a bona fide debt previously contracted. This exclusion from the definition of ''affiliate'' applies only for the period of time specifically authorized under applicable State or Federal law or regulation or, in the absence of such law or regulation, for a period of two years from the date of the exercise of such rights. The Board may authorize, upon application and for good cause shown, extensions of time for not more than one year at a time, but such extensions in the aggregate will not exceed three years.

(c) For purposes of subpart F (implementing section 23B), ''affiliate'' with respect to a member bank also does *not* include any depository institution.

### § 223.3 What are the meanings of the other terms used in sections 23A and 23B and this part?

For purposes of this part:

(a) *Aggregate amount of covered transactions* means the amount of the covered transaction about to be engaged in added to the current amount of all outstanding covered transactions.

(b) *Appropriate Federal banking agency* with respect to a member bank or other depository institution has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(c) ''*Bank holding company*'' has the same meaning as in 12 CFR 225.2.

(d) ''*Capital stock and surplus*'' means the sum of:

(1) A member bank's tier 1 and tier 2 capital under the risk-based capital guidelines of the appropriate Federal banking agency, based on the member bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3);

(2) The balance of a member bank's allowance for loan and lease losses not included in its tier 2 capital under the risk-based capital guidelines of the appropriate Federal banking agency, based on the member bank's most recent consolidated Report of Condition and Income filed under 12 U.S.C. 1817(a)(3); and

(3) The amount of any investment by a member bank in a financial subsidiary that counts as a covered transaction and is required to be deducted from the member bank's capital for regulatory capital purposes.

(e) *Carrying value* with respect to a security means (unless otherwise provided) the value of the security on the financial statements of the member bank, determined in accordance with GAAP.

(f) *Company* means a corporation, partnership, limited liability company, business trust, association, or similar organization and, unless specifically excluded, includes a member bank and a depository institution.

(g) *Control*—(1) *In general.* ''*Control*'' by a company or shareholder over another company means that:

(i) The company or shareholder, directly or indirectly, or acting through one or more other persons, owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other company;

(ii) The company or shareholder controls in any manner the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the other company; or

(iii) The Board determines, after notice and opportunity for hearing, that the company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company.

(2) *Ownership or control of shares as fiduciary.* Notwithstanding any other provision of this regulation, no company will be deemed to control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in paragraph (a)(3) of § 223.2 or if the company owning or controlling the shares is a business trust.

(3) *Ownership or control of securities by subsidiary.* A company controls securities, assets, or other ownership interests owned or controlled, directly or indirectly, by any subsidiary (including a subsidiary depository institution) of the company.

(4) *Ownership or control of convertible instruments.* A company or shareholder that owns or controls instruments (including options or warrants) that are convertible or exercisable, at the option of the holder or owner, into securities, controls the securities, unless the company or shareholder presents information to the Board that demonstrates, to the Board's satisfaction, that the company or shareholder should not be deemed to control the securities.

(5) *Ownership or control of nonvoting securities.* A company or shareholder that owns or controls 25 percent or more of the equity capital of another company controls the other company, unless the company or shareholder presents information to the Board that demonstrates, to the Board's satisfaction, that the company or shareholder does not control the other company.

(h) *Covered transaction* with respect to an affiliate means:

(1) An extension of credit to the affiliate;

(2) A purchase of, or an investment in, a security issued by the affiliate;

(3) A purchase of an asset from the affiliate, including an asset subject to recourse or an agreement to repurchase, except such purchases of real and personal property as may be specifically exempted by the Board by order or regulation;

(4) The acceptance of a security issued by the affiliate as collateral for an extension of credit to any person or company; and

(5) The issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of the affiliate, a confirmation of a letter of credit issued by

the affiliate, and a cross-affiliate netting arrangement.

(i) *Credit transaction* with an affiliate means:

(1) An extension of credit to the affiliate;

(2) An issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of the affiliate and a confirmation of a letter of credit issued by the affiliate; and

(3) A cross-affiliate netting arrangement.

(j) *Cross-affiliate netting arrangement* means an arrangement among a member bank, one or more affiliates of the member bank, and one or more nonaffiliates of the member bank in which:

(1) A nonaffiliate is permitted to deduct any obligations of an affiliate of the member bank to the nonaffiliate when settling the nonaffiliate's obligations to the member bank; or

(2) The member bank is permitted or required to add any obligations of its affiliate to a nonaffiliate when determining the member bank's obligations to the nonaffiliate.

(k) ''*Depository institution*'' means, unless otherwise noted, an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), but does not include any branch of a foreign bank. For purposes of this definition, an operating subsidiary of a depository institution is treated as part of the depository institution.

(l) ''*Derivative transaction*'' means any derivative contract listed in sections III.E.1.a. through d. of appendix A to 12 CFR part 225 and any similar derivative contract, including a credit derivative contract.

(m) ''*Eligible affiliated mutual fund securities*'' has the meaning specified in paragraph (c)(2) of § 223.24.

(n) ''*Equity capital*'' means:

(1) With respect to a corporation, preferred stock, common stock, capital surplus, retained earnings, and accumulated other comprehensive income, less treasury stock, plus any other account that constitutes equity of the corporation; and

(2) With respect to a partnership, limited liability company, or other company, equity accounts similar to those described in paragraph (n)(1) of this section.

(o) ''*Extension of credit*'' to an affiliate means the making or renewal of a loan, the granting of a line of credit, or the extending of credit in any manner whatsoever, including on an intraday basis, to an affiliate. An extension of credit to an affiliate includes, without limitation:

(1) An advance to an affiliate by means of an overdraft, cash item, or otherwise;

(2) A sale of Federal funds to an affiliate;

(3) A lease that is the functional equivalent of an extension of credit to an affiliate;

(4) An acquisition by purchase, discount, exchange, or otherwise of a note or other obligation, including commercial paper or other debt securities, of an affiliate;

(5) Any increase in the amount of, extension of the maturity of, or adjustment to the interest rate term or other material term of, an extension of credit to an affiliate; and

(6) Any other similar transaction as a result of which an affiliate becomes obligated to pay money (or its equivalent).

(p) ''*Financial subsidiary*''

(1) *In general.* Except as provided in paragraph (p)(2) of this section, the term ''*financial subsidiary*'' means any subsidiary of a member bank that:

(i) Engages, directly or indirectly, in any activity that national banks are not permitted to engage in directly or that is conducted under terms and conditions that differ from those that govern the conduct of such activity by national banks; and

(ii) Is not a subsidiary that a national bank is specifically authorized to own or control by the express terms of a Federal statute (other than 12 U.S.C. 24a), and not by implication or interpretation.

(2) *Exceptions.* ''*Financial subsidiary*'' does not include:

(i) A subsidiary of a member bank that is considered a financial subsidiary under paragraph (p)(1) of this section solely because the subsidiary engages in the sale of insurance as agent or broker in a manner that is not permitted for national banks; and

(ii) A subsidiary of a State bank (other than a subsidiary described in section 46(a) of the Federal Deposit Insurance Act (12 U.S.C. 1831w(a))) that is considered a financial subsidiary under paragraph (p)(1) of this section solely because the subsidiary engages in one or more of the following activities:

(A) An activity that the State bank may engage in directly under applicable Federal and State law and that is conducted under the same terms and conditions that govern the conduct of the activity by the State bank; and

(B) An activity that the subsidiary was authorized by applicable Federal and State law to engage in prior to December 12, 2002, and that was lawfully engaged in by the subsidiary on that date.

(3) *Subsidiaries of financial subsidiaries*. If a company is a financial subsidiary under paragraphs (p)(1) and (p)(2) of this section, any subsidiary of such a company is also a financial subsidiary.

(q) ''*Foreign bank*'' and an ''*agency*,'' ''*branch*,'' or ''*commercial lending company*'' of a foreign bank have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(r) ''*GAAP*'' means U.S. generally accepted accounting principles.

(s) ''*General purpose credit card*'' has the meaning specified in paragraph (c)(4)(ii) of § 223.16.

(t) *In contemplation*. A transaction between a member bank and a nonaffiliate is presumed to be ''*in contemplation*'' of the nonaffiliate becoming an affiliate of the member bank if the member bank enters into the transaction with the nonaffiliate after the execution of, or commencement of negotiations designed to result in, an agreement under the terms of which the nonaffiliate would become an affiliate.

(u) ''*Intraday extension of credit*'' has the meaning specified in paragraph (l)(2) of § 223.42.

(v) ''*Low-quality asset*'' means:

(1) An asset (including a security) classified as ''substandard,'' ''doubtful,'' or ''loss,'' or treated as ''special mention'' or ''other transfer risk problems,'' either in the most recent report of examination or inspection of an affiliate prepared by either a Federal or State supervisory agency or in any internal classification system used by the member bank or the affiliate (including an asset that receives a rating that is substantially equivalent to ''classified'' or ''special mention'' in the internal system of the member bank or affiliate);

(2) An asset in a nonaccrual status;

(3) An asset on which principal or interest payments are more than thirty days past due;

(4) An asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor; and

(5) An asset acquired through foreclosure, repossession, or otherwise in satisfaction of a debt previously contracted, if the asset has not yet been reviewed in an examination or inspection.

(w) ''*Member bank*'' means any national bank, State bank, banking association, or trust company that is a member of the Federal Reserve System. For purposes of this definition, an operating subsidiary of a member bank is treated as part of the member bank.

(x) ''*Municipal securities*'' has the same meaning as in section 3(a)(29) of the Securities Exchange Act of 1934 (17 U.S.C. 78c(a)(29)).

(y) ''*Nonaffiliate*'' with respect to a member bank means any person that is not an affiliate of the member bank.

(z) ''*Obligations of, or fully guaranteed as to principal and interest by, the United States or its agencies*'' includes those obligations listed in 12 CFR 201.108(b) and any additional obligations as determined by the Board. The term does not include Federal Housing Administration or Veterans Administration loans.

(aa) ''*Operating subsidiary*'' with respect to a member bank or other depository institution means any subsidiary of the member bank or depository institution other than a subsidiary described in paragraphs (b)(1)(i) through (v) of § 223.2.

(bb) ''*Person*'' means an individual, company, trust, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

(cc) ''*Principal underwriter*'' has the meaning specified in paragraph (c)(1) of § 223.53.

(dd) ''*Purchase of an asset*'' by a member bank from an affiliate means the acquisition by a member bank of an asset from an affiliate in exchange for cash or any other consideration, including an assumption of liabilities. The merger of an affiliate into a member bank is a purchase of assets by the member bank from an affiliate if the member bank assumes any liabilities of the affiliate or pays any other form of consideration in the transaction.

(ee) *Riskless principal.* A company is ''*acting exclusively as a riskless principal*'' if, after receiving an order to buy (or sell) a security from a customer, the company purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(ff) ''*Securities*'' means stocks, bonds, debentures, notes, or similar obligations (including commercial paper).

(gg) ''*Securities affiliate*'' with respect to a member bank means:

(1) An affiliate of the member bank that is registered with the Securities and Exchange Commission as a broker or dealer; or

(2) Any other securities broker or dealer affiliate of a member bank that is approved by the Board.

(hh) ''*State bank*'' has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(ii) ''*Subsidiary*'' with respect to a specified company means a company that is controlled by the specified company.

(jj) ''*Voting securities*'' has the same meaning as in 12 CFR 225.2.

(kk) ''*Well capitalized*'' has the same meaning as in 12 CFR 225.2 and, in the case of any holding company that is not a bank holding company, ''*well capitalized*'' means that the holding company has and maintains at least the capital levels required for a bank holding company to be well capitalized under 12 CFR 225.2.

(ll) ''*Well managed*'' has the same meaning as in 12 CFR 225.2.

## Subpart B—General Provisions of Section 23A

### § 223.11 What is the maximum amount of covered transactions that a member bank may enter into with any single affiliate?

A member bank may not engage in a covered transaction with an affiliate (other than a financial subsidiary of the member bank) if the aggregate amount of the member bank's covered transactions with such affiliate would exceed 10 percent of the capital stock and surplus of the member bank.

### § 223.12 What is the maximum amount of covered transactions that a member bank may enter into with all affiliates?

A member bank may not engage in a covered transaction with any affiliate if the aggregate amount of the member bank's covered transactions with all affiliates would exceed 20 percent of the capital stock and surplus of the member bank.

### § 223.13 What safety and soundness requirement applies to covered transactions?

A member bank may not engage in any covered transaction, including any transaction exempt under this regulation, unless the transaction is on terms and conditions that are consistent with safe and sound banking practices.

### § 223.14 What are the collateral requirements for a credit transaction with an affiliate?

(a) *Collateral required for extensions of credit and certain other covered transactions.* A member bank must ensure that each of its credit transactions with an affiliate is secured by the amount of collateral required by paragraph (b) of this section at the time of the transaction.

(b) *Amount of collateral required*—(1) *The rule.* A credit transaction described in paragraph (a) of this section must be secured by collateral having a market value equal to at least:

(i) 100 percent of the amount of the transaction, if the collateral is:

(A) Obligations of the United States or its agencies;

(B) Obligations fully guaranteed by the United States or its agencies as to principal and interest;

(C) Notes, drafts, bills of exchange, or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(D) A segregated, earmarked deposit account with the member bank that is for the sole purpose of securing credit transactions between the member bank and its affiliates and is identified as such;

(ii) 110 percent of the amount of the transaction, if the collateral is obligations of any State or political subdivision of any State;

(iii) 120 percent of the amount of the transaction, if the collateral is other debt instruments, including loans and other receivables; or

(iv) 130 percent of the amount of the transaction, if the collateral is stock, leases, or other real or personal property.

(2) *Example*. A member bank makes a $1,000 loan to an affiliate. The affiliate posts as collateral for the loan $500 in U.S. Treasury securities, $480 in corporate debt securities, and $130 in real estate. The loan satisfies the collateral requirements of this section because $500 of the loan is 100 percent secured by obligations of the United States, $400 of the loan is 120 percent secured by debt instruments, and $100 of the loan is 130 percent secured by real estate.

(c) *Ineligible collateral*. The following items are not eligible collateral for purposes of this section:

(1) Low-quality assets;

(2) Securities issued by any affiliate;

(3) Equity securities issued by the member bank, and debt securities issued by the member bank that represent regulatory capital of the member bank;

(4) Intangible assets (including servicing assets), unless specifically approved by the Board; and

(5) Guarantees, letters of credit, and other similar instruments.

(d) *Perfection and priority requirements for collateral*—(1) *Perfection*. A member bank must maintain a security interest in collateral required by this section that is perfected and enforceable under applicable law, including in the event of default resulting from bankruptcy, insolvency, liquidation, or similar circumstances.

(2) *Priority*. A member bank either must obtain a first priority security interest in collateral required by this section or must deduct from the value of collateral obtained by the member bank the lesser of:

(i) The amount of any security interest in the collateral that is senior to that of the member bank; or

(ii) The amount of any credit secured by the collateral that is senior to that of the member bank.

(3) *Example*. A member bank makes a $2,000 loan to an affiliate. The affiliate grants the member bank a second priority security interest in a piece of real estate valued at $3,000. Another institution that previously lent $1,000 to the affiliate has a first priority security interest in the entire parcel of real estate. This transaction is not in compliance with the collateral requirements of this section. Due to the existence of the prior third-party lien on the real estate, the effective value of the real estate collateral for the member bank for purposes of this section is only $2,000—$600 less than the amount of real estate collateral required by this section for the transaction ($2,000 × 130 percent = $2,600).

(e) *Replacement requirement for retired or amortized collateral*. A member bank must ensure that any required collateral that subsequently is retired or amortized is replaced with additional eligible collateral as needed to keep the percentage of the collateral value relative to the amount of the outstanding credit transaction equal to the minimum percentage required at the inception of the transaction.

(f) *Inapplicability of the collateral requirements to certain transactions*. The collateral requirements of this section do not apply to the following transactions.

(1) *Acceptances*. An acceptance that already is fully secured either by attached documents or by other property that is involved in the transaction and has an ascertainable market value.

(2) *The unused portion of certain extensions of credit*. The unused portion of an extension of credit to an affiliate as long as the member bank does not have

any legal obligation to advance additional funds under the extension of credit until the affiliate provides the amount of collateral required by paragraph (b) of this section with respect to the entire used portion (including the amount of the requested advance) of the extension of credit.

(3) *Purchases of affiliate debt securities in the secondary market.* The purchase of a debt security issued by an affiliate as long as the member bank purchases the debt security from a nonaffiliate in a bona fide secondary market transaction.

### § 223.15 May a member bank purchase a low-quality asset from an affiliate?

(a) *In general.* A member bank may not purchase a low-quality asset from an affiliate unless, pursuant to an independent credit evaluation, the member bank had committed itself to purchase the asset before the time the asset was acquired by the affiliate.

(b) *Exemption for renewals of loan participations involving problem loans.* The prohibition contained in paragraph (a) of this section does not apply to the renewal of, or extension of additional credit with respect to, a member bank's participation in a loan to a nonaffiliate that was originated by an affiliate if:

(1) The loan was not a low-quality asset at the time the member bank purchased its participation;

(2) The renewal or extension of additional credit is approved, as necessary to protect the participating member bank's investment by enhancing the ultimate collection of the original indebtedness, by the board of directors of the participating member bank or, if the originating affiliate is a depository institution, by:

(i) An executive committee of the board of directors of the participating member bank; or

(ii) One or more senior management officials of the participating member bank, if:

(A) The board of directors of the member bank approves standards for the member bank's renewals or extensions of additional credit described in this paragraph (b), based on the determination set forth in paragraph (b)(2) of this section;

(B) Each renewal or extension of additional credit described in this paragraph (b) meets the standards; and

(C) The board of directors of the member bank periodically reviews renewals and extensions of additional credit described in this paragraph (b) to ensure that they meet the standards and periodically reviews the standards to ensure that they continue to meet the criterion set forth in paragraph (b)(2) of this section;

(3) The participating member bank's share of the renewal or extension of additional credit does not exceed its proportional share of the original transaction by more than 5 percent, unless the member bank obtains the prior written approval of its appropriate Federal banking agency; and

(4) The participating member bank provides its appropriate Federal banking agency with written notice of the renewal or extension of additional credit not later than 20 days after consummation.

### § 223.16 What transactions by a member bank with any person are treated as transactions with an affiliate?

(a) *In general.* A member bank must treat any of its transactions with any person as a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

(b) *Certain agency transactions.* (1) Except to the extent described in paragraph (b)(2) of this section, an extension of credit by a member bank to a nonaffiliate is not treated as an extension of credit to an affiliate under paragraph (a) of this section if:

(i) The proceeds of the extension of credit are used to purchase an asset through an affiliate of the member bank, and the affiliate is acting exclusively as an agent or broker in the transaction; and

(ii) The asset purchased by the nonaffiliate is not issued, underwritten, or sold as principal by any affiliate of the member bank.

(2) The interpretation set forth in paragraph (b)(1) of this section does not apply to the extent of any agency fee,

brokerage commission, or other compensation received by an affiliate from the proceeds of the extension of credit. The receipt of such compensation may qualify, however, for the exemption contained in paragraph (c)(2) of this section.

(c) *Exemptions*. Notwithstanding paragraph (a) of this section, the following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12 or the collateral requirements of § 223.14. The transactions are, however, subject to the safety and soundness requirement of § 223.13 and the market terms requirement and other provisions of subpart F (implementing section 23B).

(1) *Certain riskless principal transactions*. An extension of credit by a member bank to a nonaffiliate, if:

(i) The proceeds of the extension of credit are used to purchase a security through a securities affiliate of the member bank, and the securities affiliate is acting exclusively as a riskless principal in the transaction;

(ii) The security purchased by the nonaffiliate is not issued, underwritten, or sold as principal (other than as riskless principal) by any affiliate of the member bank; and

(iii) Any riskless principal mark-up or other compensation received by the securities affiliate from the proceeds of the extension of credit meets the market terms standard set forth in paragraph (c)(2) of this section.

(2) *Brokerage commissions, agency fees, and riskless principal mark-ups*. An affiliate's retention of a portion of the proceeds of an extension of credit described in paragraph (b) or (c)(1) of this section as a brokerage commission, agency fee, or riskless principal mark-up, if that commission, fee, or mark-up is substantially the same as, or lower than, those prevailing at the same time for comparable transactions with or involving other nonaffiliates, in accordance with the market terms requirement of § 223.51.

(3) *Preexisting lines of credit*. An extension of credit by a member bank to a nonaffiliate, if:

(i) The proceeds of the extension of credit are used to purchase a security from or through a securities affiliate of the member bank; and

(ii) The extension of credit is made pursuant to, and consistent with any conditions imposed in, a preexisting line of credit that was not established in contemplation of the purchase of securities from or through an affiliate of the member bank.

(4) *General purpose credit card transactions*.

(i) *In general*. An extension of credit by a member bank to a nonaffiliate, if:

(A) The proceeds of the extension of credit are used by the nonaffiliate to purchase a product or service from an affiliate of the member bank; and

(B) The extension of credit is made pursuant to, and consistent with any conditions imposed in, a general purpose credit card issued by the member bank to the nonaffiliate.

(ii) *Definition*. ''*General purpose credit card*'' means a credit card issued by a member bank that is widely accepted by merchants that are not affiliates of the member bank for the purchase of products or services, if:

(A) Less than 25 percent of the total value of products and services purchased with the card by all cardholders are purchases of products and services from one or more affiliates of the member bank;

(B) All affiliates of the member bank would be permissible for a financial holding company (as defined in 12 U.S.C. 1841) under section 4 of the Bank Holding Company Act (12 U.S.C. 1843), and the member bank has no reason to believe that 25 percent or more of the total value of products and services purchased with the card by all cardholders are or would be purchases of products and services from one or more affiliates of the member bank; or

(C) The member bank presents information to the Board that demonstrates, to the Board's satisfaction, that less than 25 percent of the total value of products and services purchased with the card by all cardholders are and would be purchases of products and services from one or more affiliates of the member bank.

(iii) *Calculating compliance*. To determine whether a credit card qualifies as a general purpose credit card under the standard set forth in paragraph (c)(4)(ii)(A) of this section, a member bank must compute compliance on a

monthly basis, based on cardholder purchases that were financed by the credit card during the preceding 12 calendar months. If a credit card has qualified as a general purpose credit card for 3 consecutive months but then ceases to qualify in the following month, the member bank may continue to treat the credit card as a general purpose credit card for such month and three additional months (or such longer period as may be permitted by the Board).

(iv) *Example of calculating compliance with the 25 percent test.* A member bank seeks to qualify a credit card as a general purpose credit card under paragraph (c)(4)(ii)(A) of this section. The member bank assesses its compliance under paragraph (c)(4)(iii) of this section on the 15th day of every month (for the preceding 12 calendar months). The credit card qualifies as a general purpose credit card for at least three consecutive months. On June 15, 2005, however, the member bank determines that, for the 12-calendar-month period from June 1, 2004, through May 31, 2005, 27 percent of the total value of products and services purchased with the card by all cardholders were purchases of products and services from an affiliate of the member bank. Unless the credit card returns to compliance with the 25 percent limit by the 12-calendar-month period ending August 31, 2005, the card will cease to qualify as a general purpose credit card as of September 1, 2005. Any outstanding extensions of credit under the credit card that were used to purchase products or services from an affiliate of the member bank would become covered transactions at such time.

## Subpart C—Valuation and Timing Principles Under Section 23A

### § 223.21 What valuation and timing principles apply to credit transactions?

(a) *Valuation*—(1) *Initial valuation.* Except as provided in paragraph (a)(2) or (3) of this section, a credit transaction with an affiliate initially must be valued at the greater of:

(i) The principal amount of the transaction;

(ii) The amount owed by the affiliate to the member bank under the transaction; or

(iii) The sum of:

(A) The amount provided to, or on behalf of, the affiliate in the transaction; and

(B) Any additional amount that the member bank could be required to provide to, or on behalf of, the affiliate under the terms of the transaction.

(2) *Initial valuation of certain acquisitions of a credit transaction.* If a member bank acquires from a nonaffiliate a credit transaction with an affiliate, the covered transaction initially must be valued at the sum of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the credit transaction; and

(ii) Any additional amount that the member bank could be required to provide to, or on behalf of, the affiliate under the terms of the transaction.

(3) *Debt securities.* The valuation principles of paragraphs (a)(1) and (2) of this section do not apply to a member bank's purchase of or investment in a debt security issued by an affiliate, which is governed by § 223.23.

(4) *Examples.* The following are examples of how to value a member bank's credit transactions with an affiliate.

(i) *Term loan.* A member bank makes a loan to an affiliate that has a principal amount of $100. The affiliate pays $2 in up-front fees to the member bank, and the affiliate receives net loan proceeds of $98. The member bank must initially value the covered transaction at $100.

(ii) *Revolving credit.* A member bank establishes a $300 revolving credit facility for an affiliate. The affiliate has drawn down $100 under the facility. The member bank must value the covered transaction at $300 throughout the life of the facility.

(iii) *Guarantee.* A member bank has issued a guarantee to a nonaffiliate on behalf of an affiliate under which the member bank would be obligated to pay the nonaffiliate $500 if the affiliate defaults on an issuance of debt securities. The member bank must value the guarantee at $500 throughout the life of the guarantee.

(iv) *Acquisition of a loan to an affiliate.* A member bank purchases from a nonaffiliate a fixed-rate loan to an affiliate. The loan has an outstanding principal amount of $100 but, due to movements in the general level of interest rates since the time of the loan's origination, the member bank is able to purchase the loan for $90. The member bank initially must value the credit transaction at $90 (and must ensure that the credit transaction complies with the collateral requirements of § 223.14 at the time of its acquisition of the loan).

(b) *Timing*—(1) *In general.* A member bank engages in a credit transaction with an affiliate at the time during the day that:

(i) The member bank becomes legally obligated to make an extension of credit to, issue a guarantee, acceptance, or letter of credit on behalf of, or confirm a letter of credit issued by, an affiliate;

(ii) The member bank enters into a cross-affiliate netting arrangement; or

(iii) The member bank acquires an extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate.

(2) *Credit transactions by a member bank with a nonaffiliate that becomes an affiliate of the member bank.*

(i) *In general.* A credit transaction with a nonaffiliate becomes a covered transaction at the time that the nonaffiliate becomes an affiliate of the member bank. The member bank must treat the amount of any such credit transaction as part of the aggregate amount of the member bank's covered transactions for purposes of determining compliance with the quantitative limits of §§ 223.11 and 223.12 in connection with any future covered transactions. Except as described in paragraph (b)(2)(ii) of this section, the member bank is not required to reduce the amount of its covered transactions with any affiliate because the nonaffiliate has become an affiliate. If the nonaffiliate becomes an affiliate less than one year after the member bank enters into the credit transaction with the nonaffiliate, the member bank also must ensure that the credit transaction complies with the collateral requirements of § 223.14 promptly after the nonaffiliate becomes an affiliate.

(ii) *Credit transactions by a member bank with a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank.* Notwithstanding the provisions of paragraph (b)(2)(i) of this section, if a member bank engages in a credit transaction with a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank, the member bank must ensure that:

(A) The aggregate amount of the member bank's covered transactions (including any such credit transaction with the nonaffiliate) would not exceed the quantitative limits of § 223.11 or 223.12 at the time the nonaffiliate becomes an affiliate; and

(B) The credit transaction complies with the collateral requirements of § 223.14 at the time the nonaffiliate becomes an affiliate.

(iii) *Example.* A member bank with capital stock and surplus of $1,000 and no outstanding covered transactions makes a $120 unsecured loan to a nonaffiliate. The member bank does not make the loan in contemplation of the nonaffiliate becoming an affiliate. Nine months later, the member bank's holding company purchases all the stock of the nonaffiliate, thereby making the nonaffiliate an affiliate of the member bank. The member bank is not in violation of the quantitative limits of § 223.11 or 223.12 at the time of the stock acquisition. The member bank is, however, prohibited from engaging in any additional covered transactions with the new affiliate at least until such time as the value of the loan transaction falls below 10 percent of the member bank's capital stock and surplus. In addition, the member bank must bring the loan into compliance with the collateral requirements of § 223.14 promptly after the stock acquisition.

### § 223.22 What valuation and timing principles apply to asset purchases?

(a) *Valuation*—(1) *In general.* Except as provided in paragraph (a)(2) of this section, a purchase of an asset by a member bank from an affiliate must be valued initially at the total amount of consideration given (including liabilities assumed) by the member bank in exchange for the asset. The value of

the covered transaction after the purchase may be reduced to reflect amortization or depreciation of the asset, to the extent that such reductions are consistent with GAAP.

(2) *Exceptions.* (i) *Purchase of an extension of credit to an affiliate.* A purchase from an affiliate of an extension of credit to an affiliate must be valued in accordance with § 223.21, unless the note or obligation evidencing the extension of credit is a security issued by an affiliate (in which case the transaction must be valued in accordance with § 223.23).

(ii) *Purchase of a security issued by an affiliate.* A purchase from an affiliate of a security issued by an affiliate must be valued in accordance with § 223.23.

(iii) *Transfer of a subsidiary.* A transfer to a member bank of securities issued by an affiliate that is treated as a purchase of assets from an affiliate under § 223.31 must be valued in accordance with paragraph (b) of § 223.31.

(iv) *Purchase of a line of credit.* A purchase from an affiliate of a line of credit, revolving credit facility, or other similar credit arrangement for a nonaffiliate must be valued initially at the total amount of consideration given by the member bank in exchange for the asset plus any additional amount that the member bank could be required to provide to the borrower under the terms of the credit arrangement.

(b) *Timing*—(1) *In general.* A purchase of an asset from an affiliate remains a covered transaction for a member bank for as long as the member bank holds the asset.

(2) *Asset purchases by a member bank from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank.* If a member bank purchases an asset from a nonaffiliate in contemplation of the nonaffiliate becoming an affiliate of the member bank, the asset purchase becomes a covered transaction at the time that the nonaffiliate becomes an affiliate of the member bank. In addition, the member bank must ensure that the aggregate amount of the member bank's covered transactions (including any such transaction with the nonaffiliate) would not exceed the quantitative limits of § 223.11 or 223.12 at the time the nonaffiliate becomes an affiliate.

(c) *Examples.* The following are examples of how to value a member bank's purchase of an asset from an affiliate.

(1) *Cash purchase of assets.* A member bank purchases a pool of loans from an affiliate for $10 million. The member bank initially must value the covered transaction at $10 million. Going forward, if the borrowers repay $6 million of the principal amount of the loans, the member bank may value the covered transaction at $4 million.

(2) *Purchase of assets through an assumption of liabilities.* An affiliate of a member bank contributes real property with a fair market value of $200,000 to the member bank. The member bank pays the affiliate no cash for the property, but assumes a $50,000 mortgage on the property. The member bank has engaged in a covered transaction with the affiliate and initially must value the transaction at $50,000. Going forward, if the member bank retains the real property but pays off the mortgage, the member bank must continue to value the covered transaction at $50,000. If the member bank, however, sells the real property, the transaction ceases to be a covered transaction at the time of the sale (regardless of the status of the mortgage).

### § 223.23 What valuation and timing principles apply to purchases of and investments in securities issued by an affiliate?

(a) *Valuation*—(1) *In general.* Except as provided in paragraph (b) of § 223.32 with respect to financial subsidiaries, a member bank's purchase of or investment in a security issued by an affiliate must be valued at the greater of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; or

(ii) The carrying value of the security.

(2) *Examples.* The following are examples of how to value a member bank's purchase of or investment in securities issued by an affiliate (other than a financial subsidiary of the member bank).

(i) *Purchase of the debt securities of an affiliate.* The parent holding company

of a member bank owns 100 percent of the shares of a mortgage company. The member bank purchases debt securities issued by the mortgage company for $600. The initial carrying value of the securities is $600. The member bank initially must value the investment at $600.

(ii) *Purchase of the shares of an affiliate.* The parent holding company of a member bank owns 51 percent of the shares of a mortgage company. The member bank purchases an additional 30 percent of the shares of the mortgage company from a third party for $100. The initial carrying value of the shares is $100. The member bank initially must value the investment at $100. Going forward, if the member bank's carrying value of the shares declines to $40, the member bank must continue to value the investment at $100.

(iii) *Contribution of the shares of an affiliate.* The parent holding company of a member bank owns 100 percent of the shares of a mortgage company and contributes 30 percent of the shares to the member bank. The member bank gives no consideration in exchange for the shares. If the initial carrying value of the shares is $300, then the member bank initially must value the investment at $300. Going forward, if the member bank's carrying value of the shares increases to $500, the member bank must value the investment at $500.

(b) *Timing*—(1) *In general.* A purchase of or investment in a security issued by an affiliate remains a covered transaction for a member bank for as long as the member bank holds the security.

(2) *A member bank's purchase of or investment in a security issued by a nonaffiliate that becomes an affiliate of the member bank.* A member bank's purchase of or investment in a security issued by a nonaffiliate that becomes an affiliate of the member bank must be treated according to the same transition rules that apply to credit transactions described in paragraph (b)(2) of § 223.21.

**§ 223.24 What valuation principles apply to extensions of credit secured by affiliate securities?**

(a) *Valuation of extensions of credit secured exclusively by affiliate securities.* An extension of credit by a member bank to a nonaffiliate secured exclusively by securities issued by an affiliate of the member bank must be valued at the lesser of:

(1) The total value of the extension of credit; or

(2) The fair market value of the securities issued by an affiliate that are pledged as collateral, if the member bank verifies that such securities meet the market quotation standard contained in paragraph (e) of § 223.42 or the standards set forth in paragraphs (f)(1) and (5) of § 223.42.

(b) *Valuation of extensions of credit secured by affiliate securities and other collateral.* An extension of credit by a member bank to a nonaffiliate secured in part by securities issued by an affiliate of the member bank and in part by nonaffiliate collateral must be valued at the lesser of:

(1) The total value of the extension of credit less the fair market value of the nonaffiliate collateral; or

(2) The fair market value of the securities issued by an affiliate that are pledged as collateral, if the member bank verifies that such securities meet the market quotation standard contained in paragraph (e) of § 223.42 or the standards set forth in paragraphs (f)(1) and (5) of § 223.42.

(c) *Exclusion of eligible affiliated mutual fund securities*—(1) *The exclusion.* Eligible affiliated mutual fund securities are not considered to be securities issued by an affiliate, and are instead considered to be nonaffiliate collateral, for purposes of paragraphs (a) and (b) of this section, unless the member bank knows or has reason to know that the proceeds of the extension of credit will be used to purchase the eligible affiliated mutual fund securities collateral or will otherwise be used for the benefit of or transferred to an affiliate of the member bank.

(2) *Definition.* ''*Eligible affiliated mutual fund securities*'' with respect to a member bank are securities issued by an affiliate of the member bank that is

an open-end investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), if:

(i) The securities issued by the investment company:

(A) Meet the market quotation standard contained in paragraph (e) of § 223.42;

(B) Meet the standards set forth in paragraphs (f)(1) and (5) of § 223.42; or

(C) Have closing prices that are made public through a mutual fund ''supermarket'' website maintained by an unaffiliated securities broker-dealer or mutual fund distributor; and

(ii) The member bank and its affiliates do not own or control in the aggregate more than 5 percent of any class of voting securities or of the equity capital of the investment company (excluding securities held by the member bank or an affiliate in good faith in a fiduciary capacity, unless the member bank or affiliate holds the securities for the benefit of the member bank or affiliate, or the shareholders, employees, or subsidiaries of the member bank or affiliate).

(3) *Example.* A member bank proposes to lend $100 to a nonaffiliate secured exclusively by eligible affiliated mutual fund securities. The member bank knows that the nonaffiliate intends to use all the loan proceeds to purchase the eligible affiliated mutual fund securities that would serve as collateral for the loan. Under the attribution rule in § 223.16, the member bank must treat the loan to the nonaffiliate as a loan to an affiliate, and, because securities issued by an affiliate are ineligible collateral under § 223.14, the loan would not be in compliance with § 223.14.

## Subpart D—Other Requirements Under Section 23A

### § 223.31 How does section 23A apply to a member bank's acquisition of an affiliate that becomes an operating subsidiary of the member bank after the acquisition?

(a) *Certain acquisitions by a member bank of securities issued by an affiliate are treated as a purchase of assets from an affiliate.* A member bank's acquisition of a security issued by a company that was an affiliate of the member bank before the acquisition is treated as a purchase of assets from an affiliate, if:

(1) As a result of the transaction, the company becomes an operating subsidiary of the member bank; and

(2) The company has liabilities, or the member bank gives cash or any other consideration in exchange for the security.

(b) *Valuation*—(1) *Initial valuation.* A transaction described in paragraph (a) of this section must be valued initially at the greater of:

(i) The sum of:

(A) The total amount of consideration given by the member bank in exchange for the security; and

(B) The total liabilities of the company whose security has been acquired by the member bank, as of the time of the acquisition; or

(ii) The total value of all covered transactions (as computed under this part) acquired by the member bank as a result of the security acquisition.

(2) *Ongoing valuation.* The value of a transaction described in paragraph (a) of this section may be reduced after the initial transfer to reflect:

(i) Amortization or depreciation of the assets of the transferred company, to the extent that such reductions are consistent with GAAP; and

(ii) Sales of the assets of the transferred company.

(c) *Valuation example.* The parent holding company of a member bank contributes between 25 and 100 percent of the voting shares of a mortgage company to the member bank. The parent holding company retains no shares of the mortgage company. The member bank gives no consideration in exchange for the transferred shares. The mortgage company has total assets of $300,000 and total liabilities of $100,000. The mortgage company's assets do not include any loans to an affiliate of the member bank or any other asset that would represent a separate covered transaction for the member bank upon consummation of the share transfer. As a result of the transaction, the mortgage company becomes an operating subsidiary of the member bank. The transaction is treated as a purchase of the assets of the mortgage company by

the member bank from an affiliate under paragraph (a) of this section. The member bank initially must value the transaction at $100,000, the total amount of the liabilities of the mortgage company. Going forward, if the member bank pays off the liabilities, the member bank must continue to value the covered transaction at $100,000. If the member bank, however, sells $15,000 of the transferred assets of the mortgage company or if $15,000 of the transferred assets amortize, the member bank may value the covered transaction at $85,000.

(d) *Exemption for step transactions.* A transaction described in paragraph (a) of this section is exempt from the requirements of this regulation (other than the safety and soundness requirement of § 223.13 and the market terms requirement of § 223.51) if:

(1) The member bank acquires the securities issued by the transferred company within one business day (or such longer period, up to three months, as may be permitted by the member bank's appropriate Federal banking agency) after the company becomes an affiliate of the member bank;

(2) The member bank acquires all the securities of the transferred company that were transferred in connection with the transaction that made the company an affiliate of the member bank;

(3) The business and financial condition (including the asset quality and liabilities) of the transferred company does not materially change from the time the company becomes an affiliate of the member bank and the time the member bank acquires the securities issued by the company; and

(4) At or before the time that the transferred company becomes an affiliate of the member bank, the member bank notifies its appropriate Federal banking agency and the Board of the member bank's intent to acquire the company.

(e) *Example of step transaction.* A bank holding company acquires 100 percent of the shares of an unaffiliated leasing company. At that time, the subsidiary member bank of the holding company notifies its appropriate Federal banking agency and the Board of its intent to acquire the leasing company from its holding company. On the day after consummation of the acquisition, the holding company transfers all of the shares of the leasing company to the member bank. No material change in the business or financial condition of the leasing company occurs between the time of the holding company's acquisition and the member bank's acquisition. The leasing company has liabilities. The leasing company becomes an operating subsidiary of the member bank at the time of the transfer. This transfer by the holding company to the member bank, although deemed an asset purchase by the member bank from an affiliate under paragraph (a) of this section, would qualify for the exemption in paragraph (d) of this section.

### § 223.32 What rules apply to financial subsidiaries of a member bank?

(a) *Exemption from the 10 percent limit for covered transactions between a member bank and a single financial subsidiary.* The 10 percent quantitative limit contained in § 223.11 does not apply with respect to covered transactions between a member bank and a financial subsidiary of the member bank. The 20 percent quantitative limit contained in § 223.12 does apply to such transactions.

(b) *Valuation of purchases of or investments in the securities of a financial subsidiary*—(1) *General rule.* A member bank's purchase of or investment in a security issued by a financial subsidiary of the member bank must be valued at the greater of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; and

(ii) The carrying value of the security (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the security).

(2) *Carrying value of an investment in a consolidated financial subsidiary.* If a financial subsidiary is consolidated with its parent member bank under GAAP, the carrying value of the member bank's investment in securities issued

by the financial subsidiary shall be equal to the carrying value of the securities on parent-only financial statements of the member bank, determined in accordance with GAAP (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the securities).

(3) *Examples of the valuation of purchases of and investments in the securities of a financial subsidiary*. The following are examples of how a member bank must value its purchase of or investment in securities issued by a financial subsidiary of the member bank. Each example involves a securities underwriter that becomes a financial subsidiary of the member bank after the transactions described below.

(i) *Initial valuation*. (A) *Direct acquisition by a member bank*. A member bank pays $500 to acquire 100 percent of the shares of a securities underwriter. The initial carrying value of the shares on the member bank's parent-only GAAP financial statements is $500. The member bank initially must value the investment at $500.

(B) *Contribution of a financial subsidiary to a member bank*. The parent holding company of a member bank acquires 100 percent of the shares of a securities underwriter in a transaction valued at $500, and immediately contributes the shares to the member bank. The member bank gives no consideration in exchange for the shares. The member bank initially must value the investment at the carrying value of the shares on the member bank's parent-only GAAP financial statements. Under GAAP, the member bank's initial carrying value of the shares would be $500.

(ii) *Carrying value not adjusted for earnings and losses of the financial subsidiary*. A member bank and its parent holding company engage in the transaction described in paragraph (b)(3)(i)(B) of this section, and the member bank initially values the investment at $500. In the following year, the securities underwriter earns $25 in profit, which is added to its retained earnings. The member bank's carrying value of the shares of the underwriter is not adjusted for purposes of this part, and the member bank must continue to value the investment at $500. If, however, the member bank contributes $100 of additional capital to the securities underwriter, the member bank must value the aggregate investment at $600.

(c) *Treatment of an affiliate's investments in, and extensions of credit to, a financial subsidiary of a member bank*—(1) *Investments*. Any purchase of, or investment in, the securities of a financial subsidiary of a member bank by an affiliate of the member bank is treated as a purchase of or investment in such securities by the member bank.

(2) *Extensions of credit that are treated as regulatory capital of the financial subsidiary*. Any extension of credit to a financial subsidiary of a member bank by an affiliate of the member bank is treated as an extension of credit by the member bank to the financial subsidiary if the extension of credit is treated as capital of the financial subsidiary under any Federal or State law, regulation, or interpretation applicable to the subsidiary.

(3) *Other extensions of credit*. Any other extension of credit to a financial subsidiary of a member bank by an affiliate of the member bank will be treated as an extension of credit by the member bank to the financial subsidiary, if the Board determines, by regulation or order, that such treatment is necessary or appropriate to prevent evasions of the Federal Reserve Act or the Gramm-Leach-Bliley Act.

### § 223.33 What rules apply to derivative transactions?

(a) *Market terms requirement*. Derivative transactions between a member bank and its affiliates (other than depository institutions) are subject to the market terms requirement of § 223.51.

(b) *Policies and procedures*. A member bank must establish and maintain policies and procedures reasonably designed to manage the credit exposure arising from its derivative transactions with affiliates in a safe and sound manner. The policies and procedures must at a minimum provide for:

(1) Monitoring and controlling the credit exposure arising at any one time

from the member bank's derivative transactions with each affiliate and all affiliates in the aggregate (through, among other things, imposing appropriate credit limits, mark-to-market requirements, and collateral requirements); and

(2) Ensuring that the member bank's derivative transactions with affiliates comply with the market terms requirement of § 223.51.

(c) *Credit derivatives*. A credit derivative between a member bank and a nonaffiliate in which the member bank provides credit protection to the nonaffiliate with respect to an obligation of an affiliate of the member bank is a guarantee by a member bank on behalf of an affiliate for purposes of this regulation. Such derivatives would include:

(1) An agreement under which the member bank, in exchange for a fee, agrees to compensate the nonaffiliate for any default of the underlying obligation of the affiliate; and

(2) An agreement under which the member bank, in exchange for payments based on the total return of the underlying obligation of the affiliate, agrees to pay the nonaffiliate a spread over funding costs plus any depreciation in the value of the underlying obligation of the affiliate.

## Subpart E—Exemptions from the Provisions of Section 23A

### § 223.41 What covered transactions are exempt from the quantitative limits and collateral requirements?

The following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12 or the collateral requirements of § 223.14. The transactions are, however, subject to the safety and soundness requirement of § 223.13 and the prohibition on the purchase of a low-quality asset of § 223.15.

(a) *Parent institution/subsidiary institution transactions*. Transactions with a depository institution if the member bank controls 80 percent or more of the voting securities of the depository institution or the depository institution controls 80 percent or more of the voting securities of the member bank.

(b) *Transactions between a member bank and a depository institution owned by the same holding company*. Transactions with a depository institution if the same company controls 80 percent or more of the voting securities of the member bank and the depository institution.

(c) *Certain loan purchases from an affiliated depository institution*. Purchasing a loan on a nonrecourse basis from an affiliated depository institution.

(d) *Internal corporate reorganization transactions*. Purchasing assets from an affiliate (including in connection with a transfer of securities issued by an affiliate to a member bank described in paragraph (a) of § 223.31), if:

(1) The asset purchase is part of an internal corporate reorganization of a holding company and involves the transfer of all or substantially all of the shares or assets of an affiliate or of a division or department of an affiliate;

(2) The member bank provides its appropriate Federal banking agency and the Board with written notice of the transaction before consummation, including a description of the primary business activities of the affiliate and an indication of the proposed date of the asset purchase;

(3) The member bank's top-tier holding company commits to its appropriate Federal banking agency and the Board before consummation either:

(i) To make quarterly cash contributions to the member bank, for a two-year period following the member bank's purchase, equal to the book value plus any write-downs taken by the member bank, of any transferred assets that have become low-quality assets during the quarter; or

(ii) To repurchase, on a quarterly basis for a two-year period following the member bank's purchase, at a price equal to the book value plus any write-downs taken by the member bank, any transferred assets that have become low-quality assets during the quarter;

(4) The member bank's top-tier holding company complies with the commitment made under paragraph (d)(3) of this section;

(5) A majority of the member bank's directors reviews and approves the transaction before consummation;

(6) The value of the covered transaction (as computed under this part), when aggregated with the value of any

other covered transactions (as computed under this part) engaged in by the member bank under this exemption during the preceding 12 calendar months, represents less than 10 percent of the member bank's capital stock and surplus (or such higher amount, up to 25 percent of the member bank's capital stock and surplus, as may be permitted by the member bank's appropriate Federal banking agency after conducting a review of the member bank's financial condition and the quality of the assets transferred to the member bank); and

(7) The holding company and all its subsidiary member banks and other subsidiary depository institutions are well capitalized and well managed and would remain well capitalized upon consummation of the transaction.

### § 223.42 What covered transactions are exempt from the quantitative limits, collateral requirements, and low-quality asset prohibition?

The following transactions are not subject to the quantitative limits of §§ 223.11 and 223.12, the collateral requirements of § 223.14, or the prohibition on the purchase of a low-quality asset of § 223.15. The transactions are, however, subject to the safety and soundness requirement of § 223.13.

(a) *Making correspondent banking deposits*. Making a deposit in an affiliated depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) or affiliated foreign bank that represents an ongoing, working balance maintained in the ordinary course of correspondent business.

(b) *Giving credit for uncollected items*. Giving immediate credit to an affiliate for uncollected items received in the ordinary course of business.

(c) *Transactions secured by cash or U.S. government securities*.

(1) *In general*. Engaging in a credit transaction with an affiliate to the extent that the transaction is and remains secured by:

(i) Obligations of the United States or its agencies;

(ii) Obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(iii) A segregated, earmarked deposit account with the member bank that is for the sole purpose of securing credit transactions between the member bank and its affiliates and is identified as such.

(2) *Example*. A member bank makes a $100 non-amortizing term loan to an affiliate secured by U.S. Treasury securities with a market value of $50 and real estate with a market value of $75. The value of the covered transaction is $50. If the market value of the U.S. Treasury securities falls to $45 during the life of the loan, the value of the covered transaction would increase to $55.

(d) *Purchasing securities of a servicing affiliate*. Purchasing a security issued by any company engaged solely in providing services described in section 4(c)(1) of the Bank Holding Company Act (12 U.S.C. 1843(c)(1)).

(e) *Purchasing certain liquid assets*. Purchasing an asset having a readily identifiable and publicly available market quotation and purchased at or below the asset's current market quotation. An asset has a readily identifiable and publicly available market quotation if the asset's price is quoted routinely in a widely disseminated publication that is readily available to the general public.

(f) *Purchasing certain marketable securities*. Purchasing a security from a securities affiliate, if:

(1) The security has a ''ready market,'' as defined in 17 CFR 240.15c3–1(c)(11)(i);

(2) The security is eligible for a State member bank to purchase directly, subject to the same terms and conditions that govern the investment activities of a State member bank, and the member bank records the transaction as a purchase of a security for purposes of its Call Report, consistent with the requirements for a State member bank;

(3) The security is not a low-quality asset;

(4) The member bank does not purchase the security during an underwriting, or within 30 days of an underwriting, if an affiliate is an underwriter of the security, unless the security is purchased as part of an issue of obligations of, or obligations fully

guaranteed as to principal and interest by, the United States or its agencies;

(5) The security's price is quoted routinely on an unaffiliated electronic service that provides indicative data from real-time financial networks, provided that:

(i) The price paid by the member bank is at or below the current market quotation for the security; and

(ii) The size of the transaction executed by the member bank does not cast material doubt on the appropriateness of relying on the current market quotation for the security; and

(6) The member bank maintains, for a period of two years, records and supporting information that are sufficient to enable the appropriate Federal banking agency to ensure the member bank's compliance with the terms of this exemption.

(g) *Purchasing municipal securities.* Purchasing a municipal security from a securities affiliate if:

(1) The security is rated by a nationally recognized statistical rating organization or is part of an issue of securities that does not exceed $25 million;

(2) The security is eligible for purchase by a State member bank, subject to the same terms and conditions that govern the investment activities of a State member bank, and the member bank records the transaction as a purchase of a security for purposes of its Call Report, consistent with the requirements for a State member bank; and

(3)(i) The security's price is quoted routinely on an unaffiliated electronic service that provides indicative data from real-time financial networks, provided that:

(A) The price paid by the member bank is at or below the current market quotation for the security; and

(B) The size of the transaction executed by the member bank does not cast material doubt on the appropriateness of relying on the current market quotation for the security; or

(ii) The price paid for the security can be verified by reference to two or more actual, current price quotes from unaffiliated broker-dealers on the exact security to be purchased or a security comparable to the security to be purchased, where:

(A) The price quotes obtained from the unaffiliated broker-dealers are based on a transaction similar in size to the transaction that is actually executed; and

(B) The price paid is no higher than the average of the price quotes; or

(iii) The price paid for the security can be verified by reference to the written summary provided by the syndicate manager to syndicate members that discloses the aggregate par values and prices of all bonds sold from the syndicate account, if the member bank:

(A) Purchases the municipal security during the underwriting period at a price that is at or below that indicated in the summary; and

(B) Obtains a copy of the summary from its securities affiliate and retains the summary for three years.

(h) *Purchasing an extension of credit subject to a repurchase agreement.* Purchasing from an affiliate an extension of credit that was originated by the member bank and sold to the affiliate subject to a repurchase agreement or with recourse.

(i) *Asset purchases by a newly formed member bank.* The purchase of an asset from an affiliate by a newly formed member bank, if the appropriate Federal banking agency for the member bank has approved the asset purchase in writing in connection with its review of the formation of the member bank.

(j) *Transactions approved under the Bank Merger Act.* Any merger or consolidation between a member bank and an affiliated depository institution or U.S. branch or agency of a foreign bank, or any acquisition of assets or assumption of deposit liabilities by a member bank from an affiliated depository institution or U.S. branch or agency of a foreign bank, if the transaction has been approved by the responsible Federal banking agency pursuant to the Bank Merger Act (12 U.S.C. 1828(c)).

(k) *Purchasing an extension of credit from an affiliate.* Purchasing from an affiliate, on a nonrecourse basis, an extension of credit, if:

(1) The extension of credit was originated by the affiliate;

(2) The member bank makes an independent evaluation of the creditworthiness of the borrower before the affiliate

makes or commits to make the extension of credit;

(3) The member bank commits to purchase the extension of credit before the affiliate makes or commits to make the extension of credit;

(4) The member bank does not make a blanket advance commitment to purchase extensions of credit from the affiliate; and

(5) The dollar amount of the extension of credit, when aggregated with the dollar amount of all other extensions of credit purchased from the affiliate during the preceding 12 calendar months by the member bank and its depository institution affiliates, does not represent more than 50 percent (or such lower percent as is imposed by the member bank's appropriate Federal banking agency) of the dollar amount of extensions of credit originated by the affiliate during the preceding 12 calendar months.

(l) *Intraday extensions of credit*—(1) *In general*. An intraday extension of credit to an affiliate, if the member bank:

(i) Has established and maintains policies and procedures reasonably designed to manage the credit exposure arising from the member bank's intraday extensions of credit to affiliates in a safe and sound manner, including policies and procedures for:

(A) Monitoring and controlling the credit exposure arising at any one time from the member bank's intraday extensions of credit to each affiliate and all affiliates in the aggregate; and

(B) Ensuring that any intraday extension of credit by the member bank to an affiliate complies with the market terms requirement of § 223.51;

(ii) Has no reason to believe that the affiliate will have difficulty repaying the extension of credit in accordance with its terms; and

(iii) Ceases to treat any such extension of credit (regardless of jurisdiction) as an intraday extension of credit at the end of the member bank's business day in the United States.

(2) *Definition*. *Intraday extension of credit* by a member bank to an affiliate means an extension of credit by a member bank to an affiliate that the member bank expects to be repaid, sold, or terminated, or to qualify for a complete exemption under this regulation, by the end of its business day in the United States.

(m) *Riskless principal transactions*. Purchasing a security from a securities affiliate of the member bank if:

(1) The member bank or the securities affiliate is acting exclusively as a riskless principal in the transaction; and

(2) The security purchased is not issued, underwritten, or sold as principal (other than as riskless principal) by any affiliate of the member bank.

(n) *Securities financing transactions*. (1) From September 15, 2008, until January 30, 2009 (unless further extended by the Board), securities financing transactions with an affiliate, if:

(i) The security or other asset financed by the member bank in the transaction is of a type that the affiliate financed in the U.S. tri-party repurchase agreement market at any time during the week of September 8–12, 2008;

(ii) The transaction is marked to market daily and subject to daily margin-maintenance requirements, and the member bank is at least as overcollateralized in the transaction as the affiliate's clearing bank was overcollateralized in comparable transactions with the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iii) The aggregate risk profile of the securities financing transactions under this exemption is no greater than the aggregate risk profile of the securities financing transactions of the affiliate in the U.S. tri-party repurchase agreement market on September 12, 2008;

(iv) The member bank's top-tier holding company guarantees the obligations of the affiliate under the securities financing transactions (or provides other security to the bank that is acceptable to the Board); and

(v) The member bank has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

(2) For purposes of this exemption:

(i) *Securities financing transaction means:*

(A) A purchase by a member bank from an affiliate of a security or other

asset, subject to an agreement by the affiliate to repurchase the asset from the member bank;

(B) A borrowing of a security by a member bank from an affiliate on a collateralized basis; or

(C) A secured extension of credit by a member bank to an affiliate.

(ii) *U.S. tri-party repurchase agreement market* means the U.S. market for securities financing transactions in which the counterparties use custodial arrangements provided by JPMorgan Chase Bank or Bank of New York or another financial institution approved by the Board.

(o) *Purchases of certain asset-backed commercial paper*. Purchases of asset-backed commercial paper from an affiliated SEC-registered open-end investment company that holds itself out as a money market mutual fund under SEC Rule 2a–7 (17 CFR 270.2a–7), if the member bank:

(1) Purchases the asset-backed commercial paper between September 19, 2008, and January 30, 2009 (unless extended by the Board), pursuant to the asset-backed commercial paper lending facility established by the Board on September 19, 2008; and

(2) Has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

[67 FR 76604, Dec. 12, 2002, as amended at 73 FR 54308, Sept. 19, 2008; 73 FR 55709, Sept. 26, 2008]

### § 223.43 What are the standards under which the Board may grant additional exemptions from the requirements of section 23A?

(a) *The standards*. The Board may, at its discretion, by regulation or order, exempt transactions or relationships from the requirements of section 23A and subparts B, C, and D of this part if it finds such exemptions to be in the public interest and consistent with the purposes of section 23A.

(b) *Procedure*. A member bank may request an exemption from the requirements of section 23A and subparts B, C, and D of this part by submitting a written request to the General Counsel of the Board. Such a request must:

(1) Describe in detail the transaction or relationship for which the member bank seeks exemption;

(2) Explain why the Board should exempt the transaction or relationship; and

(3) Explain how the exemption would be in the public interest and consistent with the purposes of section 23A.

## Subpart F—General Provisions of Section 23B

### § 223.51 What is the market terms requirement of section 23B?

A member bank may not engage in a transaction described in § 223.52 unless the transaction is:

(a) On terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the member bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates; or

(b) In the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliates.

### § 223.52 What transactions with affiliates or others must comply with section 23B's market terms requirement?

(a) The market terms requirement of § 223.51 applies to the following transactions:

(1) Any covered transaction with an affiliate, unless the transaction is exempt under paragraphs (a) through (c) of § 223.41 or paragraphs (a) through (e) or (h) through (j) of § 223.42;

(2) The sale of a security or other asset to an affiliate, including an asset subject to an agreement to repurchase;

(3) The payment of money or the furnishing of a service to an affiliate under contract, lease, or otherwise;

(4) Any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the member bank or to any other person; and

(5) Any transaction or series of transactions with a nonaffiliate, if an affiliate:

(i) Has a financial interest in the nonaffiliate; or

(ii) Is a participant in the transaction or series of transactions.

(b) For the purpose of this section, any transaction by a member bank with any person will be deemed to be a transaction with an affiliate of the member bank if any of the proceeds of the transaction are used for the benefit of, or transferred to, the affiliate.

### § 223.53 What asset purchases are prohibited by section 23B?

(a) *Fiduciary purchases of assets from an affiliate.* A member bank may not purchase as fiduciary any security or other asset from any affiliate unless the purchase is permitted:

(1) Under the instrument creating the fiduciary relationship;

(2) By court order; or

(3) By law of the jurisdiction governing the fiduciary relationship.

(b) *Purchase of a security underwritten by an affiliate.* (1) A member bank, whether acting as principal or fiduciary, may not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security if a principal underwriter of that security is an affiliate of the member bank.

(2) Paragraph (b)(1) of this section does not apply if the purchase or acquisition of the security has been approved, before the security is initially offered for sale to the public, by a majority of the directors of the member bank based on a determination that the purchase is a sound investment for the member bank, or for the person on whose behalf the member bank is acting as fiduciary, as the case may be, irrespective of the fact that an affiliate of the member bank is a principal underwriter of the security.

(3) The approval requirement of paragraph (b)(2) of this section may be met if:

(i) A majority of the directors of the member bank approves standards for the member bank's acquisitions of securities described in paragraph (b)(1) of this section, based on the determination set forth in paragraph (b)(2) of this section;

(ii) Each acquisition described in paragraph (b)(1) of this section meets the standards; and

(iii) A majority of the directors of the member bank periodically reviews acquisitions described in paragraph (b)(1) of this section to ensure that they meet the standards and periodically reviews the standards to ensure that they continue to meet the criterion set forth in paragraph (b)(2) of this section.

(4) A U.S. branch, agency, or commercial lending company of a foreign bank may comply with paragraphs (b)(2) and (b)(3) of this section by obtaining the approvals and reviews required by paragraphs (b)(2) and (b)(3) from either:

(i) A majority of the directors of the foreign bank; or

(ii) A majority of the senior executive officers of the foreign bank.

(c) *Special definitions.* For purposes of this section:

(1) *''Principal underwriter''* means any underwriter who, in connection with a primary distribution of securities:

(i) Is in privity of contract with the issuer or an affiliated person of the issuer;

(ii) Acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or

(iii) Is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

(2) *''Security''* has the same meaning as in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)).

### § 223.54 What advertisements and statements are prohibited by section 23B?

(a) *In general.* A member bank and its affiliates may not publish any advertisement or enter into any agreement stating or suggesting that the member bank will in any way be responsible for the obligations of its affiliates.

(b) *Guarantees, acceptances, letters of credit, and cross-affiliate netting arrangements subject to section 23A.* Paragraph (a) of this section does not prohibit a member bank from:

(1) Issuing a guarantee, acceptance, or letter of credit on behalf of an affiliate, confirming a letter of credit

issued by an affiliate, or entering into a cross-affiliate netting arrangement, to the extent such transaction satisfies the quantitative limits of §§ 223.11 and 223.12 and the collateral requirements of § 223.14, and is otherwise permitted under this regulation; or

(2) Making reference to such a guarantee, acceptance, letter of credit, or cross-affiliate netting arrangement if otherwise required by law.

### § 223.55 What are the standards under which the Board may grant exemptions from the requirements of section 23B?

The Board may prescribe regulations to exempt transactions or relationships from the requirements of section 23B and subpart F of this part if it finds such exemptions to be in the public interest and consistent with the purposes of section 23B.

### § 223.56 What transactions are exempt from the market-terms requirement of section 23B?

The following transactions are exempt from the market-terms requirement of § 223.51.

(a) *Purchases of certain asset-backed commercial paper*. Purchases of asset-backed commercial paper from an affiliated SEC-registered open-end investment company that holds itself out as a money market mutual fund under SEC Rule 2a–7 (17 CFR 270.2a–7), if the member bank:

(1) Purchases the asset-backed commercial paper between September 19, 2008, and January 30, 2009 (unless extended by the Board), pursuant to the asset-backed commercial paper lending facility established by the Board on September 19, 2008; and

(2) Has not been specifically informed by the Board, after consultation with the member bank's appropriate Federal banking agency, that the member bank may not use this exemption.

(b) [Reserved]

[73 FR 55709, Sept. 26, 2008]

## Subpart G—Application of Sections 23A and 23B to U.S. Branches and Agencies of Foreign Banks

### § 223.61 How do sections 23A and 23B apply to U.S. branches and agencies of foreign banks?

(a) *Applicability of sections 23A and 23B to foreign banks engaged in underwriting insurance, underwriting or dealing in securities, merchant banking, or insurance company investment in the United States*. Except as provided in this subpart, sections 23A and 23B of the Federal Reserve Act and the provisions of this regulation apply to each U.S. branch, agency, or commercial lending company of a foreign bank in the same manner and to the same extent as if the branch, agency, or commercial lending company were a member bank.

(b) *Affiliate defined*. For purposes of this subpart, any company that would be an affiliate of a U.S. branch, agency, or commercial lending company of a foreign bank if such branch, agency, or commercial lending company were a member bank is an affiliate of the branch, agency, or commercial lending company if the company also is:

(1) Directly engaged in the United States in any of the following activities:

(i) Insurance underwriting pursuant to section 4(k)(4)(B) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(B));

(ii) Securities underwriting, dealing, or market making pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(E));

(iii) Merchant banking activities pursuant to section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) (but only to the extent that the proceeds of the transaction are used for the purpose of funding the affiliate's merchant banking activities);

(iv) Insurance company investment activities pursuant to section 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(I)); or

(v) Any other activity designated by the Board;

(2) A portfolio company (as defined in the merchant banking subpart of Regulation Y (12 CFR 225.177(c))) controlled by the foreign bank or an affiliate of the foreign bank or a company that would be an affiliate of the branch, agency, or commercial lending company of the foreign bank under paragraph (a)(9) of § 223.2 if such branch, agency, or commercial lending company were a member bank; or

(3) A subsidiary of an affiliate described in paragraph (b)(1) or (2) of this section.

(c) *Capital stock and surplus.* For purposes of this subpart, the ''*capital stock and surplus*'' of a U.S. branch, agency, or commercial lending company of a foreign bank will be determined by reference to the capital of the foreign bank as calculated under its home country capital standards.

## Subpart H—Miscellaneous Interpretations

### § 223.71 How do sections 23A and 23B apply to transactions in which a member bank purchases from one affiliate an asset relating to another affiliate?

(a) *In general.* In some situations in which a member bank purchases an asset from an affiliate, the asset purchase qualifies for an exemption under this regulation, but the member bank's resulting ownership of the purchased asset also represents a covered transaction (which may or may not qualify for an exemption under this part). In these situations, the transaction engaged in by the member bank would qualify as two different types of covered transaction. Although an asset purchase exemption may suffice to exempt the member bank's asset purchase from the first affiliate, the asset purchase exemption does not exempt the member bank's resulting covered transaction with the second affiliate. The exemptions subject to this interpretation include §§ 223.31(e), 223.41(a) through (d), and 223.42(e), (f), (i), (j), (k), and (m).

(b) *Examples*—(1) *The (d)(6) exemption.* A member bank purchases from Affiliate A securities issued by Affiliate B in a purchase that qualifies for the (d)(6) exemption in section 23A. The member bank's asset purchase from Affiliate A would be an exempt covered transaction under § 223.42(e); but the member bank also would have acquired an investment in securities issued by Affiliate B, which would be a covered transaction between the member bank and Affiliate B under § 223.3(h)(2) that does not qualify for the (d)(6) exemption. The (d)(6) exemption, by its terms, only exempts asset purchases by a member bank from an affiliate; hence, the (d)(6) exemption cannot exempt a member bank's investment in securities issued by an affiliate (even if the securities would qualify for the (d)(6) exemption).

(2) T*he sister-bank exemption.* A member bank purchases from Sister-Bank Affiliate A a loan to Affiliate B in a purchase that qualifies for the sister-bank exemption in section 23A. The member bank's asset purchase from Sister-Bank Affiliate A would be an exempt covered transaction under § 223.41(b); but the member bank also would have acquired an extension of credit to Affiliate B, which would be a covered transaction between the member bank and Affiliate B under § 223.3(h)(1) that does not qualify for the sister-bank exemption. The sister-bank exemption, by its terms, only exempts transactions by a member bank with a sister-bank affiliate; hence, the sister-bank exemption cannot exempt a member bank's extension of credit to an affiliate that is not a sister bank (even if the extension of credit was purchased from a sister bank).

# PART 224—BORROWERS OF SECURITIES CREDIT (REGULATION X)

Sec.

224.1 Authority, purpose, and scope.
224.2 Definitions.
224.3 Margin regulations to be applied by nonexempted borrowers.

AUTHORITY: 15 U.S.C. 78g.

SOURCE: Reg. X, 48 FR 56572, Dec. 22, 1983, unless otherwise noted.

EDITORIAL NOTE: See the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access, for FR citations to Part 224 OTC Margin Stocks changes.

### § 224.1 Authority, purpose, and scope.

(a) *Authority and purpose*. Regulation X (this part) is issued by the Board of Governors of the Federal Reserve System (the Board) under the Securities Exchange Act of 1934, as amended (the Act) (15 U.S.C. 78a et seq.). This part implements section 7(f) of the Act (15 U.S.C. 78g(f)), the purpose of which is to require that credit obtained within or outside the United States complies with the limitations of the Board's Margin Regulations T and U (12 CFR parts 220 and 221, respectively).

(b) *Scope and exemptions*. The Act and this part apply the Board's margin regulations to United States persons and foreign persons controlled by or acting on behalf of or in conjunction with United States persons (hereinafter borrowers), who obtain credit outside the United States to purchase or carry United States securities, or within the United States to purchase or carry any securities (both types of credit are hereinafter referred to as purpose credit). The following borrowers are exempt from the Act and this part:

(1) Any borrower who obtains purpose credit within the United States, unless the borrower willfully causes the credit to be extended in contravention of Regulations T or U.

(2) Any borrower whose permanent residence is outside the United States and who does not obtain or have outstanding, during any calendar year, a total of more than $100,000 in purpose credit obtained outside the United States; and

(3) Any borrower who is exempt by Order upon terms and conditions set by the Board.

[Reg. X, 48 FR 56572, Dec. 22, 1983, as amended by Reg. X, 63 FR 2839, Jan. 16, 1998]

### § 224.2 Definitions.

The terms used in this part have the meanings given to them in sections 3(a) and 7(f) of the Act, and in Regulations T and U. Section 7(f) of the Act contains the following definitions:

(a) *United States person* includes a person which is organized or exists under the laws of any State or, in the case of a natural person, a citizen or resident of the United States; a domestic estate; or a trust in which one or more of the foregoing persons has a cumulative direct or indirect beneficial interest in excess of 50 per centum of the valve of the trust.

(b) *United States security* means a security (other than an exempted security) issued by a person incorporated under the laws of any State, or whose principal place of business is within a State.

(c) *Foreign person controlled by a United States person* includes any noncorporate entity in which United States persons directly or indirectly have more than a 50 per centum beneficial interest, and any corporation in which one or more United States persons, directly or indirectly, own stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock.

[Reg. X, 48 FR 56572, Dec. 22, 1983, as amended by Reg. X, 63 FR 2839, Jan. 16, 1998]

### § 224.3 Margin regulations to be applied by nonexempted borrowers.

(a) *Credit transactions outside the United States*. No borrower shall obtain purpose credit from outside the United States unless it conforms to the following margin regulations:

(1) Regulation T (12 CFR part 220) if the credit is obtained from a foreign branch of a broker-dealer;

(2) Regulation U (12 CFR part 221), as it applies to banks, if the credit is obtained from a foreign branch of a bank, except for the requirement of a purpose statement (12 CFR 221.3(c)(1)(i) and (c)(2)(i)); and

(3) Regulation U (12 CFR part 221), as it applies to nonbank lenders, if the credit is obtained from any other lender outside the United States, except for the requirement of a purpose statement (12 CFR 221.3(c)(1)(ii) and (c)(2)(ii)).

(b) *Credit transactions within the United States*. Any borrower who willfully causes credit to be extended in contravention of Regulations T and U (12 CFR parts 220 and 221), and who, therefore, is not exempted by § 224.1(b)(1), must conform the credit to

the margin regulation that applies to the lender.

[Reg. X, 63 FR 2839, Jan. 16, 1998]

# PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

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APPENDIX G TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: INTERNAL-RATINGS-BASED AND ADVANCED MEASUREMENT APPROACHES

AUTHORITY: 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p–1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331–3351, 3906, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

SOURCE: Reg. Y, 49 FR 818, Jan. 5, 1984, unless otherwise noted.

EDITORIAL NOTE: Nomenclature changes for part 225 appear at 69 FR 77618, Dec. 28, 2004.

REGULATIONS

## Subpart A—General Provisions

SOURCE: Reg. Y, 62 FR 9319, Feb. 28, 1997, unless otherwise noted.

### § 225.1 Authority, purpose, and scope.

(a) *Authority*. This part[1] (Regulation Y) is issued by the Board of Governors of the Federal Reserve System (*Board*) under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) (*BHC Act*); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13)) (*Bank Control Act*); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)); section 914 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 1831i); section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972); and the International Lending Supervision Act of 1983 (Pub. L. 98–181, title IX). The BHC Act is codified at 12 U.S.C. 1841, *et seq*.

(b) *Purpose*. The principal purposes of this part are to:

(1) Regulate the acquisition of control of banks by companies and individuals;

(2) Define and regulate the nonbanking activities in which bank holding companies and foreign banking organizations with United States operations may engage; and

(3) Set forth the procedures for securing approval for these transactions and activities.

(c) *Scope*—(1) *Subpart A* contains general provisions and definitions of terms used in this regulation.

(2) *Subpart B* governs acquisitions of bank or bank holding company securities and assets by bank holding companies or by any company that will become a bank holding company as a result of the acquisition.

(3) *Subpart C* defines and regulates the nonbanking activities in which bank holding companies and foreign banking organizations may engage directly or through a subsidiary. The Board's Regulation K governs certain nonbanking activities conducted by foreign banking organizations and certain foreign activities conducted by bank holding companies (12 CFR part 211, International Banking Operations).

(4) *Subpart D* specifies situations in which a company is presumed to control voting securities or to have the power to exercise a controlling influence over the management or policies of a bank or other company; sets forth the procedures for making a control determination; and provides rules governing the effectiveness of divestitures by bank holding companies.

(5) *Subpart E* governs changes in bank control resulting from the acquisition by individuals or companies (other than bank holding companies) of voting securities of a bank holding company or state member bank of the Federal Reserve System.

(6) *Subpart F* specifies the limitations that govern companies that control so-

[1] Code of Federal Regulations, title 12, chapter II, part 225.

called nonbank banks and the activities of nonbank banks.

(7) *Subpart G* prescribes minimum standards that apply to the performance of real estate appraisals and identifies transactions that require state certified appraisers.

(8) *Subpart H* identifies the circumstances when written notice must be provided to the Board prior to the appointment of a director or senior officer of a bank holding company and establishes procedures for obtaining the required Board approval.

(9) Subpart I establishes the procedure by which a bank holding company may elect to become a financial holding company, enumerates the consequences if a financial holding company ceases to meet a requirement applicable to a financial holding company, lists the activities in which a financial holding company may engage, establishes the procedure by which a person may request the Board to authorize additional activities as financial in nature or incidental thereto, and establishes the procedure by which a financial holding company may seek approval to engage in an activity that is complementary to a financial activity.

(10) *Subpart J* governs the conduct of merchant banking investment activities by financial holding companies as permitted under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)).

(11) *Appendix A* to the regulation contains the Board's Risk-Based Capital Adequacy Guidelines for bank holding companies.

(12) *Appendix B* contains the Board's Capital Adequacy Guidelines for measuring leverage for bank holding companies and state member banks.

(13) *Appendix C* contains the Board's policy statement governing small bank holding companies.

(14) *Appendix D* contains the Board's Capital Adequacy Guidelines for measuring tier 1 leverage for bank holding companies.

(15) *Appendix E* contains the Board's Capital Adequacy Guidelines for measuring market risk of bank holding companies.

(16) *Appendix F* contains the Interagency Guidelines Establishing Information Security Standards.

[Reg. Y, 62 FR 9319, Feb. 28, 1997, as amended at 65 FR 16472, Mar. 28, 2000; 66 FR 414, Jan. 3, 2001; 66 FR 8484, Jan. 31, 2001; 66 FR 8636, Feb. 1, 2001]

### § 225.2 Definitions.

Except as modified in this regulation or unless the context otherwise requires, the terms used in this regulation have the same meaning as set forth in the relevant statutes.

(a) *Affiliate* means any company that controls, is controlled by, or is under common control with, another company.

(b)(1) *Bank* means:

(i) An insured bank as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); or

(ii) An institution organized under the laws of the United States which both:

(A) Accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and

(B) Is engaged in the business of making commercial loans.

(2) *Bank* does not include those institutions qualifying under the exceptions listed in section 2(c)(2) of the BHC Act (12 U.S.C. 1841(c)(2)).

(c)(1) *Bank holding company* means any company (including a bank) that has direct or indirect control of a bank, other than control that results from the ownership or control of:

(i) Voting securities held in good faith in a fiduciary capacity (other than as provided in paragraphs (e)(2)(ii) and (iii) of this section) without sole discretionary voting authority, or as otherwise exempted under section 2(a)(5)(A) of the BHC Act;

(ii) Voting securities acquired and held only for a reasonable period of time in connection with the underwriting of securities, as provided in section 2(a)(5)(B) of the BHC Act;

(iii) Voting rights to voting securities acquired for the sole purpose and in the course of participating in a proxy solicitation, as provided in section 2(a)(5)(C) of the BHC Act;

(iv) Voting securities acquired in satisfaction of debts previously contracted in good faith, as provided in section 2(a)(5)(D) of the BHC Act, if the securities are divested within two years of acquisition (or such later period as the Board may permit by order); or

(v) Voting securities of certain institutions owned by a thrift institution or a trust company, as provided in sections 2(a)(5)(E) and (F) of the BHC Act.

(2) Except for the purposes of § 225.4(b) of this subpart and subpart E of this part, or as otherwise provided in this regulation, *bank holding company* includes a foreign banking organization. For the purposes of subpart B of this part, *bank holding company* includes a foreign banking organization only if it owns or controls a bank in the United States.

(d)(1) *Company* includes any bank, corporation, general or limited partnership, association or similar organization, business trust, or any other trust unless by its terms it must terminate either within 25 years, or within 21 years and 10 months after the death of individuals living on the effective date of the trust.

(2) *Company* does not include any organization, the majority of the voting securities of which are owned by the United States or any state.

(3) *Testamentary trusts exempt*. Unless the Board finds that the trust is being operated as a business trust or company, a trust is presumed not to be a company if the trust:

(i) Terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effective date of the trust or within 25 years;

(ii) Is a testamentary or *inter vivos* trust established by an individual or individuals for the benefit of natural persons (or trusts for the benefit of natural persons) who are related by blood, marriage or adoption;

(iii) Contains only assets previously owned by the individual or individuals who established the trust;

(iv) Is not a Massachusetts business trust; and

(v) Does not issue shares, certificates, or any other evidence of ownership.

(4) *Qualified limited partnerships exempt*. Company does not include a qualified limited partnership, as defined in section 2(o)(10) of the BHC Act.

(e)(1) *Control* of a bank or other company means (except for the purposes of subpart E of this part):

(i) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting securities of the bank or other company, directly or indirectly or acting through one or more other persons;

(ii) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the bank or other company;

(iii) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the bank or other company, as determined by the Board after notice and opportunity for hearing in accordance with § 225.31 of subpart D of this part; or

(iv) Conditioning in any manner the transfer of 25 percent or more of the outstanding shares of any class of voting securities of a bank or other company upon the transfer of 25 percent or more of the outstanding shares of any class of voting securities of another bank or other company.

(2) A bank or other company is deemed to control voting securities or assets owned, controlled, or held, directly or indirectly:

(i) By any subsidiary of the bank or other company;

(ii) In a fiduciary capacity (including by pension and profit-sharing trusts) for the benefit of the shareholders, members, or employees (or individuals serving in similar capacities) of the bank or other company or any of its subsidiaries; or

(iii) In a fiduciary capacity for the benefit of the bank or other company or any of its subsidiaries.

(f) *Foreign banking organization* and *qualifying foreign banking organization* have the same meanings as provided in § 211.21(n) and § 211.23 of the Board's Regulation K (12 CFR 211.21(n) and 211.23).

(g) *Insured depository institution* includes an insured bank as defined in

section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)) and a savings association.

(h) *Lead insured depository institution* means the largest insured depository institution controlled by the bank holding company as of the quarter ending immediately prior to the proposed filing, based on a comparison of the average total risk-weighted assets controlled during the previous 12-month period by each insured depository institution subsidiary of the holding company.

(i) *Management official* means any officer, director (including honorary or advisory directors), partner, or trustee of a bank or other company, or any employee of the bank or other company with policy-making functions.

(j) *Nonbank bank* means any institution that:

(1) Became a bank as a result of enactment of the Competitive Equality Amendments of 1987 (Pub. L. 100–86), on the date of enactment (August 10, 1987); and

(2) Was not controlled by a bank holding company on the day before the enactment of the Competitive Equality Amendments of 1987 (August 9, 1987).

(k) *Outstanding shares* means any voting securities, but does not include securities owned by the United States or by a company wholly owned by the United States.

(l) Person includes an individual, bank, corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity.

(m) *Savings association* means:

(1) Any federal savings association or federal savings bank;

(2) Any building and loan association, savings and loan association, homestead association, or cooperative bank if such association or cooperative bank is a member of the Savings Association Insurance Fund; and

(3) Any savings bank or cooperative that is deemed by the director of the Office of Thrift Supervision to be a savings association under section 10(l) of the Home Owners Loan Act.

(n) *Shareholder*—(1) *Controlling shareholder* means a person that owns or controls, directly or indirectly, 25 percent or more of any class of voting securities of a bank or other company.

(2) *Principal shareholder* means a person that owns or controls, directly or indirectly, 10 percent or more of any class of voting securities of a bank or other company, or any person that the Board determines has the power, directly or indirectly, to exercise a controlling influence over the management or policies of a bank or other company.

(o) *Subsidiary* means a bank or other company that is controlled by another company, and refers to a direct or indirect subsidiary of a bank holding company. An indirect subsidiary is a bank or other company that is controlled by a subsidiary of the bank holding company.

(p) *United States* means the United States and includes any state of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

(q)(1) *Voting securities* means shares of common or preferred stock, general or limited partnership shares or interests, or similar interests if the shares or interest, by statute, charter, or in any manner, entitle the holder:

(i) To vote for or to select directors, trustees, or partners (or persons exercising similar functions of the issuing company); or

(ii) To vote on or to direct the conduct of the operations or other significant policies of the issuing company.

(2) *Nonvoting shares.* Preferred shares, limited partnership shares or interests, or similar interests are not *voting securities* if:

(i) Any voting rights associated with the shares or interest are limited solely to the type customarily provided by statute with regard to matters that would significantly and adversely affect the rights or preference of the security or other interest, such as the issuance of additional amounts or classes of senior securities, the modification of the terms of the security or interest, the dissolution of the issuing company, or the payment of dividends by the issuing company when preferred dividends are in arrears;

(ii) The shares or interest represent an essentially passive investment or financing device and do not otherwise provide the holder with control over the issuing company; and

(iii) The shares or interest do not entitle the holder, by statute, charter, or in any manner, to select or to vote for the selection of directors, trustees, or partners (or persons exercising similar functions) of the issuing company.

(3) *Class of voting shares.* Shares of stock issued by a single issuer are deemed to be the same class of voting shares, regardless of differences in dividend rights or liquidation preference, if the shares are voted together as a single class on all matters for which the shares have voting rights other than matters described in paragraph (o)(2)(i) of this section that affect solely the rights or preferences of the shares.

(r) *Well-capitalized*—(1) *Bank holding company.* In the case of a bank holding company,[2] *well-capitalized* means that:

(i) On a consolidated basis, the bank holding company maintains a total risk-based capital ratio of 10.0 percent or greater, as defined in appendix A of this part;

(ii) On a consolidated basis, the bank holding company maintains a Tier 1 risk-based capital ratio of 6.0 percent or greater, as defined in appendix A of this part; and

(iii) The bank holding company is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board to meet and maintain a specific capital level for any capital measure.

(2) *Insured and uninsured depository institution*—(i) *Insured depository institution.* In the case of an insured depository institution, ''well capitalized'' means that the institution has and maintains at least the capital levels required to be well capitalized under the capital adequacy regulations or guidelines applicable to the institution that have been adopted by the appropriate Federal banking agency for the institution under section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o).

(ii) *Uninsured depository institution.* In the case of a depository institution the deposits of which are not insured by the Federal Deposit Insurance Corporation, ''well capitalized'' means that the institution has and maintains at least the capital levels required for an insured depository institution to be well capitalized.

(3) *Foreign banks*—(i) *Standards applied.* For purposes of determining whether a foreign banking organization qualifies under paragraph (r)(1) of this section:

(A) A foreign banking organization whose home country supervisor, as defined in § 211.21 of the Board's Regulation K (12 CFR 211.21), has adopted capital standards consistent in all respects with the Capital Accord of the Basle Committee on Banking Supervision (Basle Accord) may calculate its capital ratios under the home country standard; and

(B) A foreign banking organization whose home country supervisor has not adopted capital standards consistent in all respects with the Basle Accord shall obtain a determination from the Board that its capital is equivalent to the capital that would be required of a U.S. banking organization under paragraph (r)(1) of this section.

(ii) *Branches and agencies.* For purposes of determining, under paragraph (r)(1) of this section, whether a branch or agency of a foreign banking organization is well-capitalized, the branch or agency shall be deemed to have the same capital ratios as the foreign banking organization.

(s) *Well managed*—(1) *In general.* Except as otherwise provided in this part, a company or depository institution is well managed if:

(i) At its most recent inspection or examination or subsequent review by the appropriate Federal banking agency for the company or institution (or the appropriate state banking agency in an examination described in section 10(d) of the Federal Deposit Insurance Act (12 U.S.C. 1820(d)), the company or institution received:

[2] For purposes of this subpart and subparts B and C of this part, a bank holding company with consolidated assets of less than $500 million that is subject to the Small Bank Holding Company Policy Statement in appendix C of this part will be deemed to be ''well-capitalized'' if the bank holding company meets the requirements for expedited/waived processing in appendix C.

(A) At least a satisfactory composite rating; and

(B) At least a satisfactory rating for management, if such rating is given.

(ii) In the case of a company or depository institution that has not received an inspection or examination rating, the Board has determined, after a review of the managerial and other resources of the company or depository institution and after consulting with the appropriate Federal and state banking agencies, as applicable, for the company or institution, that the company or institution is well managed.

(2) *Merged depository institutions*—(i) *Merger involving well managed institutions.* A depository institution that results from the merger of two or more depository institutions that are well managed shall be considered to be well managed unless the Board determines otherwise after consulting with the appropriate Federal and state banking agencies, as applicable, for each depository institution involved in the merger.

(ii) *Merger involving a poorly rated institution.* A depository institution that results from the merger of a depository institution that is well managed with one or more depository institutions that are not well managed or have not been examined shall be considered to be well managed if the Board determines, after a review of the managerial and other resources of the resulting depository institution and after consulting with the appropriate Federal and state banking agencies for the institutions involved in the merger, as applicable, that the resulting institution is well managed.

(3) *Foreign banking organizations.* Except as otherwise provided in this part, a foreign banking organization is considered well managed if the combined operations of the foreign banking organization in the United States have received at least a satisfactory composite rating at the most recent annual assessment.

(t) *Depository institution.* For purposes of this part, the term ''depository institution'' has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

[Reg. Y, 62 FR 9319, Feb. 28, 1997, as amended at 65 FR 3791, Jan. 25, 2000; 65 FR 15055, Mar. 21, 2000; 66 FR 414, Jan. 3, 2001; 71 FR 9901, Feb. 28, 2006]

### § 225.3 Administration.

(a) *Delegation of authority.* Designated Board members and officers and the Federal Reserve Banks are authorized by the Board to exercise various functions prescribed in this regulation and in the Board's Rules Regarding Delegation of Authority (12 CFR part 265) and the Board's Rules of Procedure (12 CFR part 262).

(b) *Appropriate Federal Reserve Bank.* In administering this regulation, unless a different Federal Reserve Bank is designated by the Board, the appropriate Federal Reserve Bank is as follows:

(1) For a bank holding company (or a company applying to become a bank holding company): the Reserve Bank of the Federal Reserve district in which the company's banking operations are principally conducted, as measured by total domestic deposits in its subsidiary banks on the date it became (or will become) a bank holding company;

(2) For a foreign banking organization that has no subsidiary bank and is not subject to paragraph (b)(1) of this section: the Reserve Bank of the Federal Reserve district in which the total assets of the organization's United States branches, agencies, and commercial lending companies are the largest as of the later of January 1, 1980, or the date it becomes a foreign banking organization;

(3) For an individual or company submitting a notice under subpart E of this part: The Reserve Bank of the Federal Reserve district in which the banking operations of the bank holding company or state member bank to be acquired are principally conducted, as measured by total domestic deposits on the date the notice is filed.

### § 225.4 Corporate practices.

(a) *Bank holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary

banks and shall not conduct its operations in an unsafe or unsound manner.

(2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*), the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

(b) *Purchase or redemption by bank holding company of its own securities*—(1) *Filing notice.* Except as provided in paragraph (b)(6) of this section, a bank holding company shall give the Board prior written notice before purchasing or redeeming its equity securities if the gross consideration for the purchase or redemption, when aggregated with the net consideration paid by the company for all such purchases or redemptions during the preceding 12 months, is equal to 10 percent or more of the company's consolidated net worth. For the purposes of this section, ''net consideration'' is the gross consideration paid by the company for all of its equity securities purchased or redeemed during the period minus the gross consideration received for all of its equity securities sold during the period.

(2) *Contents of notice.* Any notice under this section shall be filed with the appropriate Reserve Bank and shall contain the following information:

(i) The purpose of the transaction, a description of the securities to be purchased or redeemed, the total number of each class outstanding, the gross consideration to be paid, and the terms and sources of funding for the transaction;

(ii) A description of all equity securities redeemed within the preceding 12 months, the net consideration paid, and the terms of any debt incurred in connection with those transactions; and

(iii) (A) If the bank holding company has consolidated assets of $500 million or more, consolidated *pro forma* risk-based capital and leverage ratio calculations for the bank holding company as of the most recent quarter, and, if the redemption is to be debt funded, a parent-only *pro forma* balance sheet as of the most recent quarter; or

(B) If the bank holding company has consolidated assets of less than $500 million, a *pro forma* parent-only balance sheet as of the most recent quarter, and, if the redemption is to be debt funded, one-year income statement and cash flow projections.

(3) *Acting on notice.* Within 15 calendar days of receipt of a notice under this section, the appropriate Reserve Bank shall either approve the transaction proposed in the notice or refer the notice to the Board for decision. If the notice is referred to the Board for decision, the Board shall act on the notice within 30 calendar days after the Reserve Bank receives the notice.

(4) *Factors considered in acting on notice.* (i) The Board may disapprove a proposed purchase or redemption if it finds that the proposal would constitute an unsafe or unsound practice, or would violate any law, regulation, Board order, directive, or any condition imposed by, or written agreement with, the Board.

(ii) In determining whether a proposal constitutes an unsafe or unsound practice, the Board shall consider whether the bank holding company's financial condition, after giving effect to the proposed purchase or redemption, meets the financial standards applied by the Board under section 3 of the BHC Act, including the Board's Capital Adequacy Guidelines (appendix A of this part) and the Board's Policy Statement for Small Bank Holding Companies (appendix C of this part).

(5) *Disapproval and hearing.* (i) The Board shall notify the bank holding company in writing of the reasons for a decision to disapprove any proposed purchase or redemption. Within 10 calendar days of receipt of a notice of disapproval by the Board, the bank holding company may submit a written request for a hearing.

(ii) The Board shall order a hearing within 10 calendar days of receipt of

the request if it finds that material facts are in dispute, or if it otherwise appears appropriate. Any hearing conducted under this paragraph shall be held in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR part 263).

(iii) At the conclusion of the hearing, the Board shall by order approve or disapprove the proposed purchase or redemption on the basis of the record of the hearing.

(6) *Exception for well-capitalized bank holding companies.* A bank holding company is not required to obtain prior Board approval for the redemption or purchase of its equity securities under this section provided:

(i) Both before and immediately after the redemption, the bank holding company is well-capitalized;

(ii) The bank holding company is well-managed; and

(iii) The bank holding company is not the subject of any unresolved supervisory issues.

(c) *Deposit insurance.* Every bank that is a bank holding company or a subsidiary of a bank holding company shall obtain Federal Deposit Insurance and shall remain an *insured bank* as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)).

(d) *Acting as transfer agent or clearing agent.* A bank holding company or any nonbanking subsidiary that is a ''bank,'' as defined in section 3(a)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(6)), and that is a transfer agent of securities, a clearing agency, or a participant in a clearing agency (as those terms are defined in section 3(a) of the Securities Exchange Act (15 U.S.C. 78c(a)), shall be subject to §§ 208.31–208.33 of the Board's Regulation H (12 CFR 208.31–208.33) as if it were a state member bank.

(e) *Reporting requirement for credit secured by certain bank holding company stock.* Each executive officer or director of a bank holding company the shares of which are not publicly traded shall report annually to the board of directors of the bank holding company the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the bank holding company. For purposes of this paragraph, the terms ''executive officer'' and ''director'' shall have the meaning given in § 215.2 of Regulation O (12 CFR 215.2).

(f) *Suspicious activity report.* A bank holding company or any nonbank subsidiary thereof, or a foreign bank that is subject to the BHC Act or any nonbank subsidiary of such foreign bank operating in the United States, shall file a suspicious activity report in accordance with the provisions of § 208.62 of the Board's Regulation H (12 CFR 208.62).

(g) *Requirements for financial holding companies engaged in securities underwriting, dealing, or market-making activities.* (1) Any intra-day extension of credit by a bank or thrift, or U.S. branch or agency of a foreign bank to an affiliated company engaged in underwriting, dealing in, or making a market in securities pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(E)) must be on market terms consistent with section 23B of the Federal Reserve Act. (12 U.S.C. 371c–1).

(2) A foreign bank that is or is treated as a financial holding company under this part shall ensure that:

(i) Any extension of credit by any U.S. branch or agency of such foreign bank to an affiliated company engaged in underwriting, dealing in, or making a market in securities pursuant to section 4(k)(4)(E) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(E)), conforms to sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1) as if the branch or agency were a member bank;

(ii) Any purchase by any U.S. branch or agency of such foreign bank, as principal or fiduciary, of securities for which a securities affiliate described in paragraph (g)(2)(i) of this section is a principal underwriter conforms to sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1) as if the branch or agency were a member bank; and

(iii) Its U.S. branches and agencies not advertise or suggest that they are responsible for the obligations of a securities affiliate described in paragraph (g)(2)(i) of this section, consistent with section 23B(c) of the Federal Reserve Act (12 U.S.C. 371c–1(c)) as

if the branches or agencies were member banks.

(h) *Protection of customer information and consumer information.* A bank holding company shall comply with the Interagency Guidelines Establishing Information Security Standards, as set forth in appendix F of this part, prescribed pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805). A bank holding company shall properly dispose of consumer information in accordance with the rules set forth at 16 CFR part 682.

[Reg. Y, 62 FR 9319, Feb. 28, 1997, as amended at 63 FR 58621, Nov. 2, 1998; 65 FR 14442, Mar. 17, 2000; 66 FR 8636, Feb. 1, 2001; 69 FR 77618, Dec. 28, 2004; 71 FR 9901, Feb. 28, 2006]

### § 225.5 Registration, reports, and inspections.

(a) *Registration of bank holding companies.* Each company shall register within 180 days after becoming a bank holding company by furnishing information in the manner and form prescribed by the Board. A company that receives the Board's prior approval under subpart B of this part to become a bank holding company may complete this registration requirement through submission of its first annual report to the Board as required by paragraph (b) of this section.

(b) *Reports of bank holding companies.* Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.

(c) *Examinations and inspections.* The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operations and activities. The Board shall rely, as far as possible, on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of the bank holding company or of the branch or agency of the foreign bank.

### § 225.6 Penalties for violations.

(a) *Criminal and civil penalties.* (1) Section 8 of the BHC Act provides criminal penalties for willful violation, and civil penalties for violation, by any company or individual, of the BHC Act or any regulation or order issued under it, or for making a false entry in any book, report, or statement of a bank holding company.

(2) Civil money penalty assessments for violations of the BHC Act shall be made in accordance with subpart C of the Board's Rules of Practice for Hearings (12 CFR part 263, subpart C). For any willful violation of the Bank Control Act or any regulation or order issued under it, the Board may assess a civil penalty as provided in 12 U.S.C. 1817(j)(15).

(b) *Cease-and-desist proceedings.* For any violation of the BHC Act, the Bank Control Act, this regulation, or any order or notice issued thereunder, the Board may institute a cease-and-desist proceeding in accordance with the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*).

### § 225.7 Exceptions to tying restrictions.

(a) *Purpose.* This section establishes exceptions to the anti-tying restrictions of section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)). These exceptions are in addition to those in section 106. The section also restricts tying of electronic benefit transfer services by bank holding companies and their nonbank subsidiaries.

(b) *Exceptions to statute.* Subject to the limitations of paragraph (c) of this section, a bank may:

(1) *Extension to affiliates of statutory exceptions preserving traditional banking relationships.* Extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition or requirement that a customer:

(i) Obtain a loan, discount, deposit, or trust service from an affiliate of the bank; or

(ii) Provide to an affiliate of the bank some additional credit, property, or service that the bank could require to be provided to itself pursuant to section 106(b)(1)(C) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(1)(C)).

(2) *Safe harbor for combined-balance discounts.* Vary the consideration for any product or package of products based on a customer's maintaining a combined minimum balance in certain products specified by the bank (eligible products), if:

(i) The bank offers deposits, and all such deposits are eligible products; and

(ii) Balances in deposits count at least as much as nondeposit products toward the minimum balance.

(3) *Safe harbor for foreign transactions.* Engage in any transaction with a customer if that customer is:

(i) A corporation, business, or other person (other than an individual) that:

(A) Is incorporated, chartered, or otherwise organized outside the United States; and

(B) Has its principal place of business outside the United States; or

(ii) An individual who is a citizen of a foreign country and is not resident in the United States.

(c) *Limitations on exceptions.* Any exception granted pursuant to this section shall terminate upon a finding by the Board that the arrangement is resulting in anti-competitive practices. The eligibility of a bank to operate under any exception granted pursuant to this section shall terminate upon a finding by the Board that its exercise of this authority is resulting in anti-competitive practices.

(d) *Extension of statute to electronic benefit transfer services.* A bank holding company or nonbank subsidiary of a bank holding company that provides electronic benefit transfer services shall be subject to the anti-tying restrictions applicable to such services set forth in section 7(i)(11) of the Food Stamp Act of 1977 (7 U.S.C. 2016(i)(11)).

(e) For purposes of this section, *bank* has the meaning given that term in section 106(a) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971), but shall also include a United States branch, agency, or commercial lending company subsidiary of a foreign bank that is subject to section 106 pursuant to section 8(d) of the International Banking Act of 1978 (12 U.S.C. 3106(d)), and any company made subject to section 106 by section 4(f)(9) or 4(h) of the BHC Act.

## Subpart B—Acquisition of Bank Securities or Assets

SOURCE: Reg. Y, 62 FR 9324, Feb. 28, 1997, unless otherwise noted.

### § 225.11 Transactions requiring Board approval.

The following transactions require the Board's prior approval under section 3 of the Bank Holding Company Act except as exempted under § 225.12 or as otherwise covered by § 225.17 of this subpart:

(a) *Formation of bank holding company.* Any action that causes a bank or other company to become a bank holding company.

(b) *Acquisition of subsidiary bank.* Any action that causes a bank to become a subsidiary of a bank holding company.

(c) *Acquisition of control of bank or bank holding company securities.* (1) The acquisition by a bank holding company of direct or indirect ownership or control of any voting securities of a bank or bank holding company, if the acquisition results in the company's control of more than 5 percent of the outstanding shares of any class of voting securities of the bank or bank holding company.

(2) An acquisition includes the purchase of additional securities through the exercise of preemptive rights, but does not include securities received in a stock dividend or stock split that does not alter the bank holding company's proportional share of any class of voting securities.

(d) *Acquisition of bank assets.* The acquisition by a bank holding company or by a subsidiary thereof (other than a bank) of all or substantially all of the assets of a bank.

(e) *Merger of bank holding companies.* The merger or consolidation of bank holding companies, including a merger

through the purchase of assets and assumption of liabilities.

(f) *Transactions by foreign banking organization.* Any transaction described in paragraphs (a) through (e) of this section by a foreign banking organization that involves the acquisition of an interest in a U.S. bank or in a bank holding company for which application would be required if the foreign banking organization were a bank holding company.

**§ 225.12 Transactions not requiring Board approval.**

The following transactions do *not* require the Board's approval under § 225.11 of this subpart:

(a) *Acquisition of securities in fiduciary capacity.* The acquisition by a bank or other company (other than a trust that is a company) of control of voting securities of a bank or bank holding company in good faith in a fiduciary capacity, unless:

(1) The acquiring bank or other company has sole discretionary authority to vote the securities and retains this authority for more than two years; or

(2) The acquisition is for the benefit of the acquiring bank or other company, or its shareholders, employees, or subsidiaries.

(b) *Acquisition of securities in satisfaction of debts previously contracted.* The acquisition by a bank or other company of control of voting securities of a bank or bank holding company in the regular course of securing or collecting a debt previously contracted in good faith, if the acquiring bank or other company divests the securities within two years of acquisition. The Board or Reserve Bank may grant requests for up to three one-year extensions.

(c) *Acquisition of securities by bank holding company with majority control.* The acquisition by a bank holding company of additional voting securities of a bank or bank holding company if more than 50 percent of the outstanding voting securities of the bank or bank holding company is lawfully controlled by the acquiring bank holding company prior to the acquisition.

(d) *Acquisitions involving bank mergers and internal corporate reorganizations*—(1) *Transactions subject to Bank Merger Act.* The merger or consolidation of a subsidiary bank of a bank holding company with another bank, or the purchase of assets by the subsidiary bank, or a similar transaction involving subsidiary banks of a bank holding company, if the transaction requires the prior approval of a federal supervisory agency under the Bank Merger Act (12 U.S.C. 1828(c)) and does not involve the acquisition of shares of a bank. This exception does not include:

(i) The merger of a nonsubsidiary bank and a nonoperating subsidiary bank formed by a company for the purpose of acquiring the nonsubsidiary bank; or

(ii) Any transaction requiring the Board's prior approval under § 225.11(e) of this subpart.

The Board may require an application under this subpart if it determines that the merger or consolidation would have a significant adverse impact on the financial condition of the bank holding company, or otherwise requires approval under section 3 of the BHC Act.

(2) *Certain acquisitions subject to Bank Merger Act.* The acquisition by a bank holding company of shares of a bank or company controlling a bank or the merger of a company controlling a bank with the bank holding company, if the transaction is part of the merger or consolidation of the bank with a subsidiary bank (other than a nonoperating subsidiary bank) of the acquiring bank holding company, or is part of the purchase of substantially all of the assets of the bank by a subsidiary bank (other than a nonoperating subsidiary bank) of the acquiring bank holding company, and if:

(i) The bank merger, consolidation, or asset purchase occurs simultaneously with the acquisition of the shares of the bank or bank holding company or the merger of holding companies, and the bank is not operated by the acquiring bank holding company as a separate entity other than as the survivor of the merger, consolidation, or asset purchase;

(ii) The transaction requires the prior approval of a federal supervisory agency under the Bank Merger Act (12 U.S.C. 1828(c));

(iii) The transaction does not involve the acquisition of any nonbank company that would require prior approval under section 4 of the BHC Act (12 U.S.C. 1843);

(iv) Both before and after the transaction, the acquiring bank holding company meets the Board's Capital Adequacy Guidelines (appendices A, B, C, D, and E of this part);

(v) At least 10 days prior to the transaction, the acquiring bank holding company has provided to the Reserve Bank written notice of the transaction that contains:

(A) A copy of the filing made to the appropriate federal banking agency under the Bank Merger Act; and

(B) A description of the holding company's involvement in the transaction, the purchase price, and the source of funding for the purchase price; and

(vi) Prior to expiration of the period provided in paragraph (d)(2)(v) of this section, the Reserve Bank has not informed the bank holding company that an application under § 225.11 is required.

(3) *Internal corporate reorganizations.* (i) Subject to paragraph (d)(3)(ii) of this section, any of the following transactions performed in the United States by a bank holding company:

(A) The merger of holding companies that are subsidiaries of the bank holding company;

(B) The formation of a subsidiary holding company;[1]

(C) The transfer of control or ownership of a subsidiary bank or a subsidiary holding company between one subsidiary holding company and another subsidiary holding company or the bank holding company.

(ii) A transaction described in paragraph (d)(3)(i) of this section qualifies for this exception if:

(A) The transaction represents solely a corporate reorganization involving companies and insured depository institutions that, both preceding and following the transaction, are lawfully controlled and operated by the bank holding company;

(B) The transaction does not involve the acquisition of additional voting shares of an insured depository institution that, prior to the transaction, was less than majority owned by the bank holding company;

(C) The bank holding company is not organized in mutual form; and

(D) Both before and after the transaction, the bank holding company meets the Board's Capital Adequacy Guidelines (appendices A, B, C, D, and E of this part).

(e) *Holding securities in escrow.* The holding of any voting securities of a bank or bank holding company in an escrow arrangement for the benefit of an applicant pending the Board's action on an application for approval of the proposed acquisition, if title to the securities and the voting rights remain with the seller and payment for the securities has not been made to the seller.

(f) *Acquisition of foreign banking organization.* The acquisition of a foreign banking organization where the foreign banking organization does not directly or indirectly own or control a bank in the United States, unless the acquisition is also by a foreign banking organization and otherwise subject to § 225.11(f) of this subpart.

### § 225.13 Factors considered in acting on bank acquisition proposals.

(a) *Factors requiring denial.* As specified in section 3(c) of the BHC Act, the Board may not approve any application under this subpart if:

(1) The transaction would result in a monopoly or would further any combination or conspiracy to monopolize, or to attempt to monopolize, the business of banking in any part of the United States;

(2) The effect of the transaction may be substantially to lessen competition in any section of the country, tend to create a monopoly, or in any other manner be in restraint of trade, unless the Board finds that the transaction's anti-competitive effects are clearly outweighed by its probable effect in meeting the convenience and needs of the community;

(3) The applicant has failed to provide the Board with adequate assurances that it will make available such

[1] In the case of a transaction that results in the formation or designation of a new bank holding company, the new bank holding company must complete the registration requirements described in § 225.5.

information on its operations or activities, and the operations or activities of any affiliate of the applicant, that the Board deems appropriate to determine and enforce compliance with the BHC Act and other applicable federal banking statutes, and any regulations thereunder; or

(4) In the case of an application involving a foreign banking organization, the foreign banking organization is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country, as provided in § 211.24(c)(1)(ii) of the Board's Regulation K (12 CFR 211.24(c)(1)(ii)).

(b) *Other factors.* In deciding applications under this subpart, the Board also considers the following factors with respect to the applicant, its subsidiaries, any banks related to the applicant through common ownership or management, and the bank or banks to be acquired:

(1) *Financial condition.* Their financial condition and future prospects, including whether current and projected capital positions and levels of indebtedness conform to standards and policies established by the Board.

(2) *Managerial resources.* The competence, experience, and integrity of the officers, directors, and principal shareholders of the applicant, its subsidiaries, and the banks and bank holding companies concerned; their record of compliance with laws and regulations; and the record of the applicant and its affiliates of fulfilling any commitments to, and any conditions imposed by, the Board in connection with prior applications.

(3) *Convenience and needs of community.* The convenience and needs of the communities to be served, including the record of performance under the Community Reinvestment Act of 1977 (12 U.S.C. 2901 *et seq.*) and regulations issued thereunder, including the Board's Regulation BB (12 CFR part 228).

(c) *Interstate transactions.* The Board may approve any application or notice under this subpart by a bank holding company to acquire control of all or substantially all of the assets of a bank located in a state other than the home state of the bank holding company, without regard to whether the transaction is prohibited under the law of any state, if the transaction complies with the requirements of section 3(d) of the BHC Act (12 U.S.C. 1842(d)).

(d) *Conditional approvals.* The Board may impose conditions on any approval, including conditions to address competitive, financial, managerial, safety and soundness, convenience and needs, compliance or other concerns, to ensure that approval is consistent with the relevant statutory factors and other provisions of the BHC Act.

### § 225.14 Expedited action for certain bank acquisitions by well-run bank holding companies.

(a) *Filing of notice*—(1) *Information required and public notice.* As an alternative to the procedure provided in § 225.15, a bank holding company that meets the requirements of paragraph (c) of this section may satisfy the prior approval requirements of § 225.11 in connection with the acquisition of shares, assets or control of a bank, or a merger or consolidation between bank holding companies, by providing the appropriate Reserve Bank with a written notice containing the following:

(i) A certification that all of the criteria in paragraph (c) of this section are met;

(ii) A description of the transaction that includes identification of the companies and insured depository institutions involved in the transaction[2] and identification of each banking market affected by the transaction;

(iii) A description of the effect of the transaction on the convenience and needs of the communities to be served and of the actions being taken by the bank holding company to improve the

[2] If, in connection with a transaction under this subpart, any person or group of persons proposes to acquire control of the acquiring bank holding company for purposes of the Bank Control Act or § 225.41, the person or group of persons may fulfill the notice requirements of the Bank Control Act and § 225.43 by providing, as part of the submission by the acquiring bank holding company under this subpart, identifying and biographical information required in paragraph (6)(A) of the Bank Control Act (12 U.S.C. 1817(j)(6)(A)), as well as any financial or other information requested by the Reserve Bank under § 225.43.

CRA performance of any insured depository institution subsidiary that does not have at least a satisfactory CRA performance rating at the time of the transaction;

(iv) Evidence that notice of the proposal has been published in accordance with § 225.16(b)(1);

(v)(A) If the bank holding company has consolidated assets of $500 million or more, an abbreviated consolidated *pro forma* balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* risk-based capital ratios for the acquiring bank holding company as of the most recent quarter, and a description of the purchase price and the terms and sources of funding for the transaction;

(B) If the bank holding company has consolidated assets of less than $500 million, a *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, and a description of the purchase price, the terms and sources of funding for the transaction, and the sources and schedule for retiring any debt incurred in the transaction;

(vi) If the bank holding company has consolidated assets of less than $300 million, a list of and biographical information regarding any directors or senior executive officers of the resulting bank holding company that are not directors or senior executive officers of the acquiring bank holding company or of a company or institution to be acquired;

(vii) For each insured depository institution whose Tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, Tier 1 capital and total capital of the institution on a *pro forma* basis; and

(viii) The market indexes for each relevant banking market reflecting the *pro forma* effect of the transaction.

(2) *Waiver of unnecessary information.* The Reserve Bank may reduce the information requirements in paragraph (a)(1)(v) through (viii) of this section as appropriate.

(b)(1) *Action on proposals under this section.* The Board or the appropriate Reserve Bank shall act on a proposal submitted under this section or notify the bank holding company that the transaction is subject to the procedure in § 225.15 within 5 business days after the close of the public comment period. The Board and the Reserve Bank shall not approve any proposal under this section prior to the third business day following the close of the public comment period, unless an emergency exists that requires expedited or immediate action. The Board may extend the period for action under this section for up to 5 business days.

(2) *Acceptance of notice in event expedited procedure not available.* In the event that the Board or the Reserve Bank determines after the filing of a notice under this section that a bank holding company may not use the procedure in this section and must file an application under § 225.15, the application shall be deemed accepted for purposes of § 225.15 as of the date that the notice was filed under this section.

(c) *Criteria for use of expedited procedure.* The procedure in this section is available only if:

(1) *Well-capitalized organization*—(i) *Bank holding company.* Both at the time of and immediately after the proposed transaction, the acquiring bank holding company is well-capitalized;

(ii) *Insured depository institutions.* Both at the time of and immediately after the proposed transaction:

(A) The lead insured depository institution of the acquiring bank holding company is well-capitalized;

(B) Well-capitalized insured depository institutions control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the acquiring bank holding company; and

(C) No insured depository institution controlled by the acquiring bank holding company is undercapitalized;

(2) *Well managed organization*—(i) *Satisfactory examination ratings.* At the time of the transaction, the acquiring bank holding company, its lead insured depository institution, and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the holding company are well managed and have

received at least a satisfactory rating for compliance at their most recent examination if such rating was given;

(ii) *No poorly managed institutions.* No insured depository institution controlled by the acquiring bank holding company has received 1 of the 2 lowest composite ratings at the later of the institution's most recent examination or subsequent review by the appropriate federal banking agency for the institution;

(iii) *Recently acquired institutions excluded.* Any insured depository institution that has been acquired by the bank holding company during the 12-month period preceding the date on which written notice is filed under paragraph (a) of this section may be excluded for purposes of paragraph (c)(2)(ii) of this section if :

(A) The bank holding company has developed a plan acceptable to the appropriate federal banking agency for the institution to restore the capital and management of the institution; and

(B) All insured depository institutions excluded under this paragraph represent, in the aggregate, less than 10 percent of the aggregate total risk-weighted assets of all insured depository institutions controlled by the bank holding company;

(3) *Convenience and needs criteria*—(i) *Effect on the community.* The record indicates that the proposed transaction would meet the convenience and needs of the community standard in the BHC Act; and

(ii) *Established CRA performance record.* At the time of the transaction, the lead insured depository institution of the acquiring bank holding company and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured institutions controlled by the holding company have received a satisfactory or better composite rating at the most recent examination under the Community Reinvestment Act;

(4) *Public comment.* No comment that is timely and substantive as provided in § 225.16 is received by the Board or the appropriate Reserve Bank other than a comment that supports approval of the proposal;

(5) *Competitive criteria*—(i) *Competitive screen.* Without regard to any divestitures proposed by the acquiring bank holding company, the acquisition does not cause:

(A) Insured depository institutions controlled by the acquiring bank holding company to control in excess of 35 percent of market deposits in any relevant banking market; or

(B) The Herfindahl-Hirschman index to increase by more than 200 points in any relevant banking market with a post-acquisition index of at least 1800; and

(ii) *Department of Justice.* The Department of Justice has not indicated to the Board that consummation of the transaction is likely to have a significantly adverse effect on competition in any relevant banking market;

(6) *Size of acquisition*—(i) *In general*—(A) *Limited Growth.* Except as provided in paragraph (c)(6)(ii) of this section, the sum of the aggregate risk-weighted assets to be acquired in the proposal and the aggregate risk- weighted assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the consolidated risk-weighted assets of the acquiring bank holding company. For purposes of this paragraph *other qualifying transactions* means any transaction approved under this section or § 225.23 during the 12 months prior to filing the notice under this section; and

(B) *Individual size limitation.* The total risk-weighted assets to be acquired do not exceed $7.5 billion;

(ii) *Small bank holding companies.* Paragraph (c)(6)(i)(A) of this section shall not apply if, immediately following consummation of the proposed transaction, the consolidated risk-weighted assets of the acquiring bank holding company are less than $300 million;

(7) *Supervisory actions.* During the 12-month period ending on the date on which the bank holding company proposes to consummate the proposed transaction, no formal administrative order, including a written agreement, cease and desist order, capital directive, prompt corrective action directive, asset maintenance agreement, or other formal enforcement action, is or

was outstanding against the bank holding company or any insured depository institution subsidiary of the holding company, and no formal administrative enforcement proceeding involving any such enforcement action, order, or directive is or was pending;

(8) *Interstate acquisitions.* Board-approval of the transaction is not prohibited under section 3(d) of the BHC Act;

(9) *Other supervisory considerations.* Board approval of the transaction is not prohibited under the informational sufficiency or comprehensive home country supervision standards set forth in section 3(c)(3) of the BHC Act; and

(10) *Notification.* The acquiring bank holding company has not been notified by the Board, in its discretion, prior to the expiration of the period in paragraph (b)(1) of this section that an application under § 225.15 is required in order to permit closer review of any financial, managerial, competitive, convenience and needs or other matter related to the factors that must be considered under this part.

(d) *Comment by primary banking supervisor*—(1) *Notice.* Upon receipt of a notice under this section, the appropriate Reserve Bank shall promptly furnish notice of the proposal and a copy of the information filed pursuant to paragraph (a) of this section to the primary banking supervisor of the insured depository institutions to be acquired.

(2) *Comment period.* The primary banking supervisor shall have 30 calendar days (or such shorter time as agreed to by the primary banking supervisor) from the date of the letter giving notice in which to submit its views and recommendations to the Board.

(3) *Action subject to supervisor's comment.* Action by the Board or the Reserve Bank on a proposal under this section is subject to the condition that the primary banking supervisor not recommend in writing to the Board disapproval of the proposal prior to the expiration of the comment period described in paragraph (d)(2) of this section. In such event, any approval given under this section shall be revoked and, if required by section 3(b) of the BHC Act, the Board shall order a hearing on the proposal.

(4) *Emergencies.* Notwithstanding paragraphs (d)(2) and (d)(3) of this section, the Board may provide the primary banking supervisor with 10 calendar days' notice of a proposal under this section if the Board finds that an emergency exists requiring expeditious action, and may act during the notice period or without providing notice to the primary banking supervisor if the Board finds that it must act immediately to prevent probable failure.

(5) *Primary banking supervisor.* For purposes of this section and § 225.15(b), *the primary banking supervisor* for an institution is:

(i) The Office of the Comptroller of the Currency, in the case of a national banking association or District bank;

(ii) The appropriate supervisory authority for the State in which the bank is chartered, in the case of a State bank;

(iii) The Director of the Office of Thrift Supervision, in the case of a savings association.

(e) *Branches and agencies of foreign banking organizations.* For purposes of this section, a U.S. branch or agency of a foreign banking organization shall be considered to be an insured depository institution. A U.S. branch or agency of a foreign banking organization shall be subject to paragraph (c)(3)(ii) of this section only to the extent it is insured by the Federal Deposit Insurance Corporation in accordance with section 6 of the International Banking Act of 1978 (12 U.S.C. 3104).

[Reg. Y, 62 FR 9324, Feb. 28, 1997, as amended at 66 FR 415, Jan. 3, 2001; 71 FR 9901, Feb. 28, 2006]

### § 225.15 Procedures for other bank acquisition proposals.

(a) *Filing application.* Except as provided in § 225.14, an application for the Board's prior approval under this subpart shall be governed by the provisions of this section and shall be filed with the appropriate Reserve Bank on the designated form.

(b) *Notice to primary banking supervisor.* Upon receipt of an application under this subpart, the Reserve Bank shall promptly furnish notice and a copy of the application to the primary banking supervisor of each bank to be acquired. The primary supervisor shall

have 30 calendar days from the date of the letter giving notice in which to submit its views and recommendations to the Board.

(c) *Accepting application for processing.* Within 7 calendar days after the Reserve Bank receives an application under this section, the Reserve Bank shall accept it for processing as of the date the application was filed or return the application if it is substantially incomplete. Upon accepting an application, the Reserve Bank shall immediately send copies to the Board. The Reserve Bank or the Board may request additional information necessary to complete the record of an application at any time after accepting the application for processing.

(d) *Action on applications*—(1) *Action under delegated authority.* The Reserve Bank shall approve an application under this section within 30 calendar days after the acceptance date for the application, unless the Reserve Bank, upon notice to the applicant, refers the application to the Board for decision because action under delegated authority is not appropriate.

(2) *Board action.* The Board shall act on an application under this subpart that is referred to it for decision within 60 calendar days after the acceptance date for the application, unless the Board notifies the applicant that the 60-day period is being extended for a specified period and states the reasons for the extension. In no event may the extension exceed the 91-day period provided in § 225.16(f). The Board may, at any time, request additional information that it believes is necessary for its decision.

### § 225.16 Public notice, comments, hearings, and other provisions governing applications and notices.

(a) *In general.* The provisions of this section apply to all notices and applications filed under § 225.14 and § 225.15.

(b) *Public notice*—(1) *Newspaper publication*—(i) *Location of publication.* In the case of each notice or application submitted under § 225.14 or § 225.15, the applicant shall publish a notice in a newspaper of general circulation, in the form and at the locations specified in § 262.3 of the Rules of Procedure (12 CFR 262.3);

(ii) *Contents of notice.* A newspaper notice under this paragraph shall provide an opportunity for interested persons to comment on the proposal for a period of at least 30 calendar days;

(iii) *Timing of publication.* Each newspaper notice published in connection with a proposal under this paragraph shall be published no more than 15 calendar days before and no later than 7 calendar days following the date that a notice or application is filed with the appropriate Reserve Bank.

(2) FEDERAL REGISTER *notice.* (i) *Publication by Board.* Upon receipt of a notice or application under § 225.14 or § 225.15, the Board shall promptly publish notice of the proposal in the FEDERAL REGISTER and shall provide an opportunity for interested persons to comment on the proposal for a period of no more than 30 days;

(ii) *Request for advance publication.* A bank holding company may request that, during the 15-day period prior to filing a notice or application under § 225.14 or § 225.15, the Board publish notice of a proposal in the FEDERAL REGISTER. A request for advance FEDERAL REGISTER publication shall be made in writing to the appropriate Reserve Bank and shall contain the identifying information prescribed by the Board for FEDERAL REGISTER publication;

(3) *Waiver or shortening of notice.* The Board may waive or shorten the required notice periods under this section if the Board determines that an emergency exists requiring expeditious action on the proposal, or if the Board finds that immediate action is necessary to prevent the probable failure of an insured depository institution.

(c) *Public comment*—(1) *Timely comments.* Interested persons may submit information and comments regarding a proposal filed under this subpart. A comment shall be considered timely for purposes of this subpart if the comment, together with all supplemental information, is submitted in writing in accordance with the Board's Rules of Procedure and received by the Board or the appropriate Reserve Bank prior to the expiration of the latest public comment period provided in paragraph (b) of this section.

(2) *Extension of comment period*—(i) *In general*. The Board may, in its discretion, extend the public comment period regarding any proposal submitted under this subpart.

(ii) *Requests in connection with obtaining application or notice*. In the event that an interested person has requested a copy of a notice or application submitted under this subpart, the Board may, in its discretion and based on the facts and circumstances, grant such person an extension of the comment period for up to 15 calendar days.

(iii) *Joint requests by interested person and acquiring company*. The Board will grant a joint request by an interested person and the acquiring bank holding company for an extension of the comment period for a reasonable period for a purpose related to the statutory factors the Board must consider under this subpart.

(3) *Substantive comment*. A comment will be considered substantive for purposes of this subpart unless it involves individual complaints, or raises frivolous, previously-considered or wholly unsubstantiated claims or irrelevant issues.

(d) *Notice to Attorney General*. The Board or Reserve Bank shall immediately notify the United States Attorney General of approval of any notice or application under § 225.14 or § 225.15.

(e) *Hearings*. As provided in section 3(b) of the BHC Act, the Board shall order a hearing on any application or notice under § 225.15 if the Board receives from the primary supervisor of the bank to be acquired, within the 30-day period specified in § 225.15(b), a written recommendation of disapproval of an application. The Board may order a formal or informal hearing or other proceeding on the application or notice, as provided in § 262.3(i)(2) of the Board's Rules of Procedure. Any request for a hearing (other than from the primary supervisor) shall comply with § 262.3(e) of the Rules of Procedure (12 CFR 262.3(e)).

(f) *Approval through failure to act*—(1) *Ninety-one day rule*. An application or notice under § 225.14 or § 225.15 shall be deemed approved if the Board fails to act on the application or notice within 91 calendar days after the date of submission to the Board of the complete record on the application. For this purpose, the Board acts when it issues an order stating that the Board has approved or denied the application or notice, reflecting the votes of the members of the Board, and indicating that a statement of the reasons for the decision will follow promptly.

(2) *Complete record*. For the purpose of computing the commencement of the 91-day period, the record is complete on the latest of:

(i) The date of receipt by the Board of an application or notice that has been accepted by the Reserve Bank;

(ii) The last day provided in any notice for receipt of comments and hearing requests on the application or notice;

(iii) The date of receipt by the Board of the last relevant material regarding the application or notice that is needed for the Board's decision, if the material is received from a source outside of the Federal Reserve System; or

(iv) The date of completion of any hearing or other proceeding.

(g) *Exceptions to notice and hearing requirements*—(1) *Probable bank failure*. If the Board finds it must act immediately on an application or notice in order to prevent the probable failure of a bank or bank holding company, the Board may modify or dispense with the notice and hearing requirements of this section.

(2) *Emergency*. If the Board finds that, although immediate action on an application or notice is not necessary, an emergency exists requiring expeditious action, the Board shall provide the primary supervisor 10 days to submit its recommendation. The Board may act on such an application or notice without a hearing and may modify or dispense with the other notice and hearing requirements of this section.

(h) *Waiting period*. A transaction approved under § 225.14 or § 225.15 shall not be consummated until 30 days after the date of approval of the application, except that a transaction may be consummated:

(1) Immediately upon approval, if the Board has determined under paragraph (g) of this section that the application or notice involves a probable bank failure;

(2) On or after the 5th calendar day following the date of approval, if the Board has determined under paragraph (g) of this section that an emergency exists requiring expeditious action; or

(3) On or after the 15th calendar day following the date of approval, if the Board has not received any adverse comments from the United States Attorney General relating to the competitive factors and the Attorney General has consented to the shorter waiting period.

### § 225.17 Notice procedure for one-bank holding company formations.

(a) *Transactions that qualify under this section.* An acquisition by a company of control of a bank may be consummated 30 days after providing notice to the appropriate Reserve Bank in accordance with paragraph (b) of this section, provided that all of the following conditions are met:

(1) The shareholder or shareholders who control at least 67 percent of the shares of the bank will control, immediately after the reorganization, at least 67 percent of the shares of the holding company in substantially the same proportion, except for changes in shareholders' interests resulting from the exercise of dissenting shareholders' rights under state or federal law;[3]

(2) No shareholder, or group of shareholders acting in concert, will, following the reorganization, own or control 10 percent or more of any class of voting shares of the bank holding company, unless that shareholder or group of shareholders was authorized, after review under the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)) by the appropriate federal banking agency for the bank, to own or control 10 percent or more of any class of voting shares of the bank;[4]

(3) The bank is adequately capitalized (as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o));

(4) The bank received at least a composite ''satisfactory'' rating at its most recent examination, in the event that the bank was examined;

(5) At the time of the reorganization, neither the bank nor any of its officers, directors, or principal shareholders is involved in any unresolved supervisory or enforcement matters with any appropriate federal banking agency;

(6) The company demonstrates that any debt that it incurs at the time of the reorganization, and the proposed means of retiring this debt, will not place undue burden on the holding company or its subsidiary on a *pro forma* basis;[5]

(7) The holding company will not, as a result of the reorganization, acquire control of any additional bank or engage in any activities other than those of managing and controlling banks; and

(8) During this period, neither the appropriate Reserve Bank nor the Board objected to the proposal or required the filing of an application under § 225.15 of this subpart.

(b) *Contents of notice.* A notice filed under this paragraph shall include:

(1) Certification by the notificant's board of directors that the requirements of 12 U.S.C. 1842(a)(C) and this section are met by the proposal;

(2) A list identifying all principal shareholders of the bank prior to the reorganization and of the holding company following the reorganization, and specifying the percentage of shares held by each principal shareholder in the bank and proposed to be held in the new holding company;

[3] A shareholder of a bank in reorganization will be considered to have the same proportional interest in the holding company if the shareholder interest increases, on a *pro rata* basis, as a result of either the redemption of shares from dissenting shareholders by the bank or bank holding company, or the acquisition of shares of dissenting shareholders by the remaining shareholders.

[4] This procedure is not available in cases in which the exercise of dissenting shareholders' rights would cause a company that is not a bank holding company (other than the company in formation) to be required to register as a bank holding company. This procedure also is not available for the formation of a bank holding company organized in mutual form.

[5] For a banking organization with consolidated assets, on a *pro forma* basis, of less than $500 million (other than a banking organization that will control a de novo bank), this requirement is satisfied if the proposal complies with the Board's Small Bank Holding Company Policy Statement (appendix C of this part).

(3) A description of the resulting management of the proposed bank holding company and its subsidiary bank, including:

(i) Biographical information regarding any senior officers and directors of the resulting bank holding company who were not senior officers or directors of the bank prior to the reorganization; and

(ii) A detailed history of the involvement of any officer, director, or principal shareholder of the resulting bank holding company in any administrative or criminal proceeding; and

(4) *Pro forma* financial statements for the holding company, and a description of the amount, source, and terms of debt, if any, that the bank holding company proposes to incur, and information regarding the sources and timing for debt service and retirement.

(c) *Acknowledgment of notice.* Within 7 calendar days following receipt of a notice under this section, the Reserve Bank shall provide the notificant with a written acknowledgment of receipt of the notice. This written acknowledgment shall indicate that the transaction described in the notice may be consummated on the 30th calendar day after the date of receipt of the notice if the Reserve Bank or the Board has not objected to the proposal during that time.

(d) *Application required upon objection.* The Reserve Bank or the Board may object to a proposal during the notice period by providing the bank holding company with a written explanation of the reasons for the objection. In such case, the bank holding company may file an application for prior approval of the proposal pursuant to § 225.15 of this subpart.

[Reg. Y, 62 FR 9319, Feb. 28, 1997, as amended at 71 FR 9902, Feb. 28, 2006]

## Subpart C—Nonbanking Activities and Acquisitions by Bank Holding Companies

SOURCE: Reg. Y, 62 FR 9329, Feb. 28, 1997, unless otherwise noted.

### § 225.21 Prohibited nonbanking activities and acquisitions; exempt bank holding companies.

(a) *Prohibited nonbanking activities and acquisitions.* Except as provided in § 225.22 of this subpart, a bank holding company or a subsidiary may not engage in, or acquire or control, directly or indirectly, voting securities or assets of a company engaged in, any activity other than:

(1) Banking or managing or controlling banks and other subsidiaries authorized under the BHC Act; and

(2) An activity that the Board determines to be so closely related to banking, or managing or controlling banks as to be a proper incident thereto, including any incidental activities that are necessary to carry on such an activity, if the bank holding company has obtained the prior approval of the Board for that activity in accordance with the requirements of this regulation.

(b) *Exempt bank holding companies.* The following bank holding companies are exempt from the provisions of this subpart:

(1) *Family-owned companies.* Any company that is a ''company covered in 1970'' (as defined in section 2(b) of the BHC Act), more than 85 percent of the voting securities of which was collectively owned on June 30, 1968, and continuously thereafter, by members of the same family (or their spouses) who are lineal descendants of common ancestors.

(2) *Labor, agricultural, and horticultural organizations.* Any company that was on January 4, 1977, both a bank holding company and a labor, agricultural, or horticultural organization exempt from taxation under section 501 of the Internal Revenue Code (26 U.S.C. 501(c)).

(3) *Companies granted hardship exemption.* Any bank holding company that has controlled only one bank since before July 1, 1968, and that has been granted an exemption by the Board under section 4(d) of the BHC Act, subject to any conditions imposed by the Board.

(4) *Companies granted exemption on other grounds.* Any company that acquired control of a bank before December 10, 1982, without the Board's prior

approval under section 3 of the BHC Act, on the basis of a narrow interpretation of the term *demand deposit* or *commercial loan*, if the Board has determined that:

(i) Coverage of the company as a bank holding company under this subpart would be unfair or represent an unreasonable hardship; and

(ii) Exclusion of the company from coverage under this part is consistent with the purposes of the BHC Act and section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971, 1972(1)). The provisions of § 225.4 of subpart A of this part do not apply to a company exempt under this paragraph.

### § 225.22 Exempt nonbanking activities and acquisitions.

(a) *Certain de novo activities.* A bank holding company may, either directly or indirectly, engage *de novo* in any nonbanking activity listed in § 225.28(b) (other than operation of an insured depository institution) without obtaining the Board's prior approval if the bank holding company:

(1) Meets the requirements of paragraphs (c) (1), (2), and (6) of § 225.23;

(2) Conducts the activity in compliance with all Board orders and regulations governing the activity; and

(3) Within 10 business days after commencing the activity, provides written notice to the appropriate Reserve Bank describing the activity, identifying the company or companies engaged in the activity, and certifying that the activity will be conducted in accordance with the Board's orders and regulations and that the bank holding company meets the requirements of paragraphs (c) (1), (2), and (6) of § 225.23.

(b) *Servicing activities.* A bank holding company may, without the Board's prior approval under this subpart, furnish services to or perform services for, or establish or acquire a company that engages solely in servicing activities for:

(1) The bank holding company or its subsidiaries in connection with their activities as authorized by law, including services that are necessary to fulfill commitments entered into by the subsidiaries with third parties, if the bank holding company or servicing company complies with the Board's published interpretations and does not act as principal in dealing with third parties; and

(2) The internal operations of the bank holding company or its subsidiaries. Services for the internal operations of the bank holding company or its subsidiaries include, but are not limited to:

(i) Accounting, auditing, and appraising;

(ii) Advertising and public relations;

(iii) Data processing and data transmission services, data bases, or facilities;

(iv) Personnel services;

(v) Courier services;

(vi) Holding or operating property used wholly or substantially by a subsidiary in its operations or for its future use;

(vii) Liquidating property acquired from a subsidiary;

(viii) Liquidating property acquired from any sources either prior to May 9, 1956, or the date on which the company became a bank holding company, whichever is later; and

(ix) Selling, purchasing, or underwriting insurance, such as blanket bond insurance, group insurance for employees, and property and casualty insurance.

(c) *Safe deposit business.* A bank holding company or nonbank subsidiary may, without the Board's prior approval, conduct a safe deposit business, or acquire voting securities of a company that conducts such a business.

(d) *Nonbanking acquisitions not requiring prior Board approval.* The Board's prior approval is not required under this subpart for the following acquisitions:

(1) *DPC acquisitions.* (i) Voting securities or assets, acquired by foreclosure or otherwise, in the ordinary course of collecting a debt previously contracted (DPC property) in good faith, if the DPC property is divested within two years of acquisition.

(ii) The Board may, upon request, extend this two-year period for up to three additional years. The Board may permit additional extensions for up to 5 years (for a total of 10 years), for shares, real estate or other assets

where the holding company demonstrates that each extension would not be detrimental to the public interest and either the bank holding company has made good faith attempts to dispose of such shares, real estate or other assets or disposal of the shares, real estate or other assets during the initial period would have been detrimental to the company.

(iii) Transfers of DPC property within the bank holding company system do not extend any period for divestiture of the property.

(2) *Securities or assets required to be divested by subsidiary.* Voting securities or assets required to be divested by a subsidiary at the request of an examining federal or state authority (except by the Board under the BHC Act or this regulation), if the bank holding company divests the securities or assets within two years from the date acquired from the subsidiary.

(3) *Fiduciary investments.* Voting securities or assets acquired by a bank or other company (other than a trust that is a company) in good faith in a fiduciary capacity, if the voting securities or assets are:

(i) Held in the ordinary course of business; and

(ii) Not acquired for the benefit of the company or its shareholders, employees, or subsidiaries.

(4) *Securities eligible for investment by national bank.* Voting securities of the kinds and amounts explicitly eligible by federal statute (other than section 4 of the Bank Service Corporation Act, 12 U.S.C. 1864) for investment by a national bank, and voting securities acquired prior to June 30, 1971, in reliance on section 4(c)(5) of the BHC Act and interpretations of the Comptroller of the Currency under section 5136 of the Revised Statutes (12 U.S.C. 24(7)).

(5) *Securities or property representing 5 percent or less of a company.* Voting securities of a company or property that, in the aggregate, represent 5 percent or less of the outstanding shares of any class of voting securities of a company, or that represent a 5 percent interest or less in the property, subject to the provisions of 12 CFR 225.137.

(6) *Securities of investment company.* Voting securities of an investment company that is solely engaged in investing in securities and that does not own or control more than 5 percent of the outstanding shares of any class of voting securities of any company.

(7) *Assets acquired in ordinary course of business.* Assets of a company acquired in the ordinary course of business, subject to the provisions of 12 CFR 225.132, if the assets relate to activities in which the acquiring company has previously received Board approval under this regulation to engage.

(8) *Asset acquisitions by lending company or industrial bank.* Assets of an office(s) of a company, all or substantially all of which relate to making, acquiring, or servicing loans if:

(i) The acquiring company has previously received Board approval under this regulation or is not required to obtain prior Board approval under this regulation to engage in lending activities or industrial banking activities;

(ii) The assets acquired during any 12-month period do not represent more than 50 percent of the risk-weighted assets (on a consolidated basis) of the acquiring lending company or industrial bank, or more than $100 million, whichever amount is less;

(iii) The assets acquired do not represent more than 50 percent of the selling company's consolidated assets that are devoted to lending activities or industrial banking business;

(iv) The acquiring company notifies the Reserve Bank of the acquisition within 30 days after the acquisition; and

(v) The acquiring company, after giving effect to the transaction, meets the Board's Capital Adequacy Guidelines (appendix A of this part), and the Board has not previously notified the acquiring company that it may not acquire assets under the exemption in this paragraph.

(e) *Acquisition of securities by subsidiary banks*—(1) *National bank.* A national bank or its subsidiary may, without the Board's approval under this subpart, acquire or retain securities on the basis of section 4(c)(5) of the BHC Act in accordance with the regulations of the Comptroller of the Currency.

(2) *State bank.* A state-chartered bank or its subsidiary may, insofar as federal law is concerned, and without the

Board's prior approval under this subpart:

(i) Acquire or retain securities, on the basis of section 4(c)(5) of the BHC Act, of the kinds and amounts explicitly eligible by federal statute for investment by a national bank; or

(ii) Acquire or retain all (but, except for directors' qualifying shares, not less than all) of the securities of a company that engages solely in activities in which the parent bank may engage, at locations at which the bank may engage in the activity, and subject to the same limitations as if the bank were engaging in the activity directly.

(f) *Activities and securities of new bank holding companies.* A company that becomes a bank holding company may, for a period of two years, engage in nonbanking activities and control voting securities or assets of a nonbank subsidiary, if the bank holding company engaged in such activities or controlled such voting securities or assets on the date it became a bank holding company. The Board may grant requests for up to three one-year extensions of the two-year period.

(g) *Grandfathered activities and securities.* Unless the Board orders divestiture or termination under section 4(a)(2) of the BHC Act, a ''company covered in 1970,'' as defined in section 2(b) of the BHC Act, may:

(1) Retain voting securities or assets and engage in activities that it has lawfully held or engaged in continuously since June 30, 1968; and

(2) Acquire voting securities of any newly formed company to engage in such activities.

(h) *Securities or activities exempt under Regulation K.* A bank holding company may acquire voting securities or assets and engage in activities as authorized in Regulation K (12 CFR part 211).

### § 225.23 Expedited action for certain nonbanking proposals by well-run bank holding companies.

(a) *Filing of notice*—(1) *Information required.* A bank holding company that meets the requirements of paragraph (c) of this section may satisfy the notice requirement of this subpart in connection with the acquisition of voting securities or assets of a company engaged in nonbanking activities that the Board has permitted by order or regulation (other than an insured depository institution),[1] or a proposal to engage *de novo,* either directly or indirectly, in a nonbanking activity that the Board has permitted by order or by regulation, by providing the appropriate Reserve Bank with a written notice containing the following:

(i) A certification that all of the criteria in paragraph (c) of this section are met;

(ii) A description of the transaction that includes identification of the companies involved in the transaction, the activities to be conducted, and a commitment to conduct the proposed activities in conformity with the Board's regulations and orders governing the conduct of the proposed activity;

(iii) If the proposal involves an acquisition of a going concern:

(A) If the bank holding company has consolidated assets of $500 million or more, an abbreviated consolidated *pro forma* balance sheet for the acquiring bank holding company as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, consolidated *pro forma* risk-based capital ratios for the acquiring bank holding company as of the most recent quarter, a description of the purchase price and the terms and sources of funding for the transaction, and the total revenue and net income of the company to be acquired;

(B) If the bank holding company has consolidated assets of less than $500 million, a *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction, a description of the purchase price and the terms and sources of funding for the transaction and the sources and schedule for retiring any debt incurred in the transaction, and the total assets, off-balance sheet

[1] A bank holding company may acquire voting securities or assets of a savings association or other insured depository institution that is not a bank by using the procedures in § 225.14 of subpart B if the bank holding company and the proposal qualify under that section as if the savings association or other institution were a bank for purposes of that section.

items, revenue and net income of the company to be acquired;

(C) For each insured depository institution whose Tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, Tier 1 capital and total capital of the institution on a *pro forma* basis;

(iv) Identification of the geographic markets in which competition would be affected by the proposal, a description of the effect of the proposal on competition in the relevant markets, a list of the major competitors in that market in the proposed activity if the affected market is local in nature, and, if requested, the market indexes for the relevant market; and

(v) A description of the public benefits that can reasonably be expected to result from the transaction.

(2) *Waiver of unnecessary information.* The Reserve Bank may reduce the information requirements in paragraphs (a)(1) (iii) and (iv) of this section as appropriate.

(b)(1) *Action on proposals under this section.* The Board or the appropriate Reserve Bank shall act on a proposal submitted under this section, or notify the bank holding company that the transaction is subject to the procedure in § 225.24, within 12 business days following the filing of all of the information required in paragraph (a) of this section.

(2) *Acceptance of notice if expedited procedure not available.* If the Board or the Reserve Bank determines, after the filing of a notice under this section, that a bank holding company may not use the procedure in this section and must file a notice under § 225.24, the notice shall be deemed accepted for purposes of § 225.24 as of the date that the notice was filed under this section.

(c) *Criteria for use of expedited procedure.* The procedure in this section is available only if:

(1) *Well-capitalized organization*—(i) *Bank holding company.* Both at the time of and immediately after the proposed transaction, the acquiring bank holding company is well-capitalized;

(ii) *Insured depository institutions.* Both at the time of and immediately after the transaction:

(A) The lead insured depository institution of the acquiring bank holding company is well-capitalized;

(B) Well-capitalized insured depository institutions control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the acquiring bank holding company; and

(C) No insured depository institution controlled by the acquiring bank holding company is undercapitalized;

(2) *Well managed organization*—(i) *Satisfactory examination ratings.* At the time of the transaction, the acquiring bank holding company, its lead insured depository institution, and insured depository institutions that control at least 80 percent of the total risk-weighted assets of insured depository institutions controlled by the holding company are well managed and have received at least a satisfactory rating for compliance at their most recent examination if such rating was given;

(ii) *No poorly managed institutions.* No insured depository institution controlled by the acquiring bank holding company has received 1 of the 2 lowest composite ratings at the later of the institution's most recent examination or subsequent review by the appropriate federal banking agency for the institution.

(iii) *Recently acquired institutions excluded.* Any insured depository institution that has been acquired by the bank holding company during the 12-month period preceding the date on which written notice is filed under paragraph (a) of this section may be excluded for purposes of paragraph (c)(2)(ii) of this section if:

(A) The bank holding company has developed a plan acceptable to the appropriate federal banking agency for the institution to restore the capital and management of the institution; and

(B) All insured depository institutions excluded under this paragraph represent, in the aggregate, less than 10 percent of the aggregate total risk-weighted assets of all insured depository institutions controlled by the bank holding company;

(3) *Permissible activity.* (i) The Board has determined by regulation or order

that each activity proposed to be conducted is so closely related to banking, or managing or controlling banks, as to be a proper incident thereto; and

(ii) The Board has not indicated that proposals to engage in the activity are subject to the notice procedure provided in § 225.24;

(4) *Competitive criteria*—(i) *Competitive screen*. In the case of the acquisition of a going concern, the acquisition, without regard to any divestitures proposed by the acquiring bank holding company, does not cause:

(A) The acquiring bank holding company to control in excess of 35 percent of the market share in any relevant market; or

(B) The Herfindahl-Hirschman index to increase by more than 200 points in any relevant market with a post-acquisition index of at least 1800; and

(ii) *Other competitive factors*. The Board has not indicated that the transaction is subject to close scrutiny on competitive grounds;

(5) *Size of acquisition*—(i) *In general*—(A) *Limited growth*. Except as provided in paragraph (c)(5)(ii) of this section, the sum of aggregate risk-weighted assets to be acquired in the proposal and the aggregate risk-weighted assets acquired by the acquiring bank holding company in all other qualifying transactions does not exceed 35 percent of the consolidated risk-weighted assets of the acquiring bank holding company. For purposes of this paragraph, ''other qualifying transactions'' means any transaction approved under this section or § 225.14 during the 12 months prior to filing the notice under this section;

(B) *Consideration paid*. The gross consideration to be paid by the acquiring bank holding company in the proposal does not exceed 15 percent of the consolidated Tier 1 capital of the acquiring bank holding company; and

(C) *Individual size limitation*. The total risk-weighted assets to be acquired do not exceed $7.5 billion;

(ii) *Small bank holding companies*. Paragraph (c)(5)(i)(A) of this section shall not apply if, immediately following consummation of the proposed transaction, the consolidated risk-weighted assets of the acquiring bank holding company are less than $300 million;

(6) *Supervisory actions*. During the 12-month period ending on the date on which the bank holding company proposes to consummate the proposed transaction, no formal administrative order, including a written agreement, cease and desist order, capital directive, prompt corrective action directive, asset maintenance agreement, or other formal enforcement order is or was outstanding against the bank holding company or any insured depository institution subsidiary of the holding company, and no formal administrative enforcement proceeding involving any such enforcement action, order, or directive is or was pending; and

(7) *Notification*. The bank holding company has not been notified by the Board, in its discretion, prior to the expiration of the period in paragraph (b) of this section that a notice under § 225.24 is required in order to permit closer review of any potential adverse effect or other matter related to the factors that must be considered under this part.

(d) *Branches and agencies of foreign banking organizations*. For purposes of this section, a U.S. branch or agency of a foreign banking organization shall be considered to be an insured depository institution.

[Reg. Y, 62 FR 9329, Feb. 28, 1997, as amended at 66 FR 415, Jan. 3, 2001; 71 FR 9902, Feb. 28, 2006]

### § 225.24 Procedures for other nonbanking proposals.

(a) *Notice required for nonbanking activities*. Except as provided in § 225.22 and § 225.23, a notice for the Board's prior approval under § 225.21(a) to engage in or acquire a company engaged in a nonbanking activity shall be filed by a bank holding company (including a company seeking to become a bank holding company) with the appropriate Reserve Bank in accordance with this section and the Board's Rules of Procedure (12 CFR 262.3).

(1) *Engaging de novo in listed activities*. A bank holding company seeking to commence or to engage *de novo*, either directly or through a subsidiary, in a nonbanking activity listed in § 225.28

shall file a notice containing a description of the activities to be conducted and the identity of the company that will conduct the activity.

(2) *Acquiring company engaged in listed activities.* A bank holding company seeking to acquire or control voting securities or assets of a company engaged in a nonbanking activity listed in § 225.28 shall file a notice containing the following:

(i) A description of the proposal, including a description of each proposed activity, and the effect of the proposal on competition among entities engaging in each proposed activity in each relevant market with relevant market indexes;

(ii) The identity of any entity involved in the proposal, and, if the notificant proposes to conduct the activity through an existing subsidiary, a description of the existing activities of the subsidiary;

(iii) A statement of the public benefits that can reasonably be expected to result from the proposal;

(iv) If the bank holding company has consolidated assets of $150 million or more:

(A) Parent company and consolidated *pro forma* balance sheets for the acquiring bank holding company as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction;

(B) Consolidated *pro forma* risk-based capital and leverage ratio calculations for the acquiring bank holding company as of the most recent quarter; and

(C) A description of the purchase price and the terms and sources of funding for the transaction;

(v) If the bank holding company has consolidated assets of less than $150 million:

(A) A *pro forma* parent-only balance sheet as of the most recent quarter showing credit and debit adjustments that reflect the proposed transaction; and

(B) A description of the purchase price and the terms and sources of funding for the transaction and, if the transaction is debt funded, one-year income statement and cash flow projections for the parent company, and the sources and schedule for retiring any debt incurred in the transaction;

(vi) For each insured depository institution whose Tier 1 capital, total capital, total assets or risk-weighted assets change as a result of the transaction, the total risk-weighted assets, total assets, Tier 1 capital and total capital of the institution on a *pro forma* basis; and

(vii) A description of the management expertise, internal controls and risk management systems that will be utilized in the conduct of the proposed activities; and

(viii) A copy of the purchase agreements, and balance sheet and income statements for the most recent quarter and year-end for any company to be acquired.

(b) *Notice provided to Board.* The Reserve Bank shall immediately send to the Board a copy of any notice received under paragraphs (a)(2) or (a)(3) of this section.

(c) *Notice to public*—(1) *Listed activities and activities approved by order*—(i) In a case involving an activity listed in § 225.28 or previously approved by the Board by order, the Reserve Bank shall notify the Board for publication in the FEDERAL REGISTER immediately upon receipt by the Reserve Bank of:

(A) A notice under this section; or

(B) A written request that notice of a proposal under this section or § 225.23 be published in the FEDERAL REGISTER. Such a request may request that FEDERAL REGISTER publication occur up to 15 calendar days prior to submission of a notice under this subpart.

(ii) The FEDERAL REGISTER notice published under this paragraph shall invite public comment on the proposal, generally for a period of 15 days.

(2) *New activities*—(i) *In general.* In the case of a notice under this subpart involving an activity that is not listed in § 225.28 and that has not been previously approved by the Board by order, the Board shall send notice of the proposal to the FEDERAL REGISTER for publication, unless the Board determines that the notificant has not demonstrated that the activity is so closely related to banking or to managing or controlling banks as to be a proper incident thereto. The FEDERAL REGISTER notice shall invite public comment on the proposal for a reasonable period of time, generally for 30 days.

(ii) *Time for publication*. The Board shall send the notice required under this paragraph to the FEDERAL REGISTER within 10 business days of acceptance by the Reserve Bank. The Board may extend the 10-day period for an additional 30 calendar days upon notice to the notificant. In the event notice of a proposal is not published for comment, the Board shall inform the notificant of the reasons for the decision.

(d) *Action on notices*—(1) *Reserve Bank action*—(i) *In general*. Within 30 calendar days after receipt by the Reserve Bank of a notice filed pursuant to paragraphs (a)(1) or (a)(2) of this section, the Reserve Banks shall:

(A) Approve the notice; or

(B) Refer the notice to the Board for decision because action under delegated authority is not appropriate.

(ii) *Return of incomplete notice*. Within 7 calendar days of receipt, the Reserve Bank may return any notice as informationally incomplete that does not contain all of the information required by this subpart. The return of such a notice shall be deemed action on the notice.

(iii) *Notice of action*. The Reserve Bank shall promptly notify the bank holding company of any action or referral under this paragraph.

(iv) *Close of public comment period*. The Reserve Bank shall not approve any notice under this paragraph (d)(1) of this section prior to the third business day after the close of the public comment period, unless an emergency exists that requires expedited or immediate action.

(2) *Board action; internal schedule*. The Board seeks to act on every notice referred to it for decision within 60 days of the date that the notice is filed with the Reserve Bank. If the Board is unable to act within this period, the Board shall notify the notificant and explain the reasons and the date by which the Board expects to act.

(3)(i) *Required time limit for System action*. The Board or the Reserve Bank shall act on any notice under this section within 60 days after the submission of a complete notice.

(ii) *Extension of required period for action* (A) *In general*.—The Board may extend the 60-day period required for Board action under paragraph (d)(3)(i) of this section for an additional 30 days upon notice to the notificant.

(B) *Unlisted activities*. If a notice involves a proposal to engage in an activity that is not listed in § 225.28, the Board may extend the period required for Board action under paragraph (d)(3)(i) of this section for an additional 90 days. This 90-day extension is in addition to the 30-day extension period provided in paragraph (d)(3)(ii)(A) of this section. The Board shall notify the notificant that the notice period has been extended and explain the reasons for the extension.

(4) *Requests for additional information*. The Board or the Reserve Bank may modify the information requirements under this section or at any time request any additional information that either believes is needed for a decision on any notice under this section.

(5) *Tolling of period*. The Board or the Reserve Bank may at any time extend or toll the time period for action on a notice for any period with the consent of the notificant.

[Reg. Y, 62 FR 9332, Feb. 28, 1997, as amended at 62 FR 60640, Nov. 12, 1997; 65 FR 14438, Mar. 17, 2000]

### § 225.25 Hearings, alteration of activities, and other matters.

(a) *Hearings*—(1) *Procedure to request hearing*. Any request for a hearing on a notice under this subpart shall comply with the provisions of 12 CFR 262.3(e).

(2) *Determination to hold hearing*. The Board may order a formal or informal hearing or other proceeding on a notice as provided in 12 CFR 262.3(i)(2). The Board shall order a hearing only if there are disputed issues of material fact that cannot be resolved in some other manner.

(3) *Extension of period for hearing*. The Board may extend the time for action on any notice for such time as is reasonably necessary to conduct a hearing and evaluate the hearing record. Such extension shall not exceed 91 calendar days after the date of submission to the Board of the complete record on the notice. The procedures for computation of the 91-day rule as set forth in § 225.16(f) apply to notices under this subpart that involve hearings.

(b) *Approval through failure to act.* (1) Except as provided in paragraph (a) of this section or § 225.24(d)(5), a notice under this subpart shall be deemed to be approved at the conclusion of the period that begins on the date the complete notice is received by the Reserve Bank or the Board and that ends 60 calendar days plus any applicable extension and tolling period thereafter.

(2) *Complete notice.* For purposes of paragraph (b)(1) of this section, a notice shall be deemed complete at such time as it contains all information required by this subpart and all other information requested by the Board or the Reserve Bank.

(c) *Notice to expand or alter nonbanking activities*—(1) *De novo expansion.* A notice under this subpart is required to open a new office or to form a subsidiary to engage in, or to relocate an existing office engaged in, a nonbanking activity that the Board has previously approved for the bank holding company under this regulation, only if:

(i) The Board's prior approval was limited geographically;

(ii) The activity is to be conducted in a country outside of the United States and the bank holding company has not previously received prior Board approval under this regulation to engage in the activity in that country; or

(iii) The Board or appropriate Reserve Bank has notified the company that a notice under this subpart is required.

(2) *Activities outside United States.* With respect to activities to be engaged in outside the United States that require approval under this subpart, the procedures of this section apply only to activities to be engaged in directly by a bank holding company that is not a qualifying foreign banking organization, or by a nonbank subsidiary of a bank holding company approved under this subpart. Regulation K (12 CFR part 211) governs other international operations of bank holding companies.

(3) *Alteration of nonbanking activity.* Unless otherwise permitted by the Board, a notice under this subpart is required to alter a nonbanking activity in any material respect from that considered by the Board in acting on the application or notice to engage in the activity.

(d) *Emergency savings association acquisitions.* In the case of a notice to acquire a savings association, the Board may modify or dispense with the public notice and hearing requirements of this subpart if the Board finds that an emergency exists that requires the Board to act immediately and the primary federal regulator of the institution concurs.

[Reg. Y, 62 FR 9333, Feb. 28, 1997, as amended by Reg. Y, 62 FR 60640, Nov. 12, 1997]

### § 225.26 Factors considered in acting on nonbanking proposals.

(a) *In general.* In evaluating a notice under § 225.23 or § 225.24, the Board shall consider whether the notificant's performance of the activities can reasonably be expected to produce benefits to the public (such as greater convenience, increased competition, and gains in efficiency) that outweigh possible adverse effects (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices).

(b) *Financial and managerial resources.* Consideration of the factors in paragraph (a) of this section includes an evaluation of the financial and managerial resources of the notificant, including its subsidiaries and any company to be acquired, the effect of the proposed transaction on those resources, and the management expertise, internal control and risk-management systems, and capital of the entity conducting the activity.

(c) *Competitive effect of de novo proposals.* Unless the record demonstrates otherwise, the commencement or expansion of a nonbanking activity *de novo* is presumed to result in benefits to the public through increased competition.

(d) *Denial for lack of information.* The Board may deny any notice submitted under this subpart if the notificant neglects, fails, or refuses to furnish all information required by the Board.

(e) *Conditional approvals.* The Board may impose conditions on any approval, including conditions to address permissibility, financial, managerial, safety and soundness, competitive, compliance, conflicts of interest, or

other concerns to ensure that approval is consistent with the relevant statutory factors and other provisions of the BHC Act.

### § 225.27 Procedures for determining scope of nonbanking activities.

(a) *Advisory opinions regarding scope of previously approved nonbanking activities*—(1) *Request for advisory opinion.* Any person may submit a request to the Board for an advisory opinion regarding the scope of any permissible nonbanking activity. The request shall be submitted in writing to the Board and shall identify the proposed parameters of the activity, or describe the service or product that will be provided, and contain an explanation supporting an interpretation regarding the scope of the permissible nonbanking activity.

(2) *Response to request.* The Board shall provide an advisory opinion within 45 days of receiving a written request under this paragraph.

(b) *Procedure for consideration of new activities*—(1) *Initiation of proceeding.* The Board may, at any time, on its own initiative or in response to a written request from any person, initiate a proceeding to determine whether any activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

(2) *Requests for determination.* Any request for a Board determination that an activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto, shall be submitted to the Board in writing, and shall contain evidence that the proposed activity is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

(3) *Publication.* The Board shall publish in the FEDERAL REGISTER notice that it is considering the permissibility of a new activity and invite public comment for a period of at least 30 calendar days. In the case of a request submitted under paragraph (b) of this section, the Board may determine not to publish notice of the request if the Board determines that the requester has provided no reasonable basis for a determination that the activity is so closely related to banking, or managing or controlling banks as to be a proper incident thereto, and notifies the requester of the determination.

(4) *Comments and hearing requests.* Any comment and any request for a hearing regarding a proposal under this section shall comply with the provisions of § 262.3(e) of the Board's Rules of Procedure (12 CFR 262.3(e)).

### § 225.28 List of permissible nonbanking activities.

(a) *Closely related nonbanking activities.* The activities listed in paragraph (b) of this section are so closely related to banking or managing or controlling banks as to be a proper incident thereto, and may be engaged in by a bank holding company or its subsidiary in accordance with the requirements of this regulation.

(b) *Activities determined by regulation to be permissible*—(1) *Extending credit and servicing loans.* Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company's account or for the account of others.

(2) *Activities related to extending credit.* Any activity usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit, as determined by the Board. The Board has determined that the following activities are usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit:

(i) *Real estate and personal property appraising.* Performing appraisals of real estate and tangible and intangible personal property, including securities.

(ii) *Arranging commercial real estate equity financing.* Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control, and risk of such a real estate project to one or more investors, if the bank holding company and its affiliates do not have an interest in, or participate in managing or developing, a real estate project for which it arranges equity financing, and do not promote or sponsor the development of the property.

(iii) *Check-guaranty services.* Authorizing a subscribing merchant to accept

personal checks tendered by the merchant's customers in payment for goods and services, and purchasing from the merchant validly authorized checks that are subsequently dishonored.

(iv) *Collection agency services*. Collecting overdue accounts receivable, either retail or commercial.

(v) *Credit bureau services*. Maintaining information related to the credit history of consumers and providing the information to a credit grantor who is considering a borrower's application for credit or who has extended credit to the borrower.

(vi) *Asset management, servicing, and collection activities*. Engaging under contract with a third party in asset management, servicing, and collection[2] of assets of a type that an insured depository institution may originate and own, if the company does not engage in real property management or real estate brokerage services as part of these services.

(vii) *Acquiring debt in default*. Acquiring debt that is in default at the time of acquisition, if the company:

(A) Divests shares or assets securing debt in default that are not permissible investments for bank holding companies, within the time period required for divestiture of property acquired in satisfaction of a debt previously contracted under § 225.12(b);[3]

(B) Stands only in the position of a creditor and does not purchase equity of obligors of debt in default (other than equity that may be collateral for such debt); and

(C) Does not acquire debt in default secured by shares of a bank or bank holding company.

(viii) *Real estate settlement servicing*. Providing real estate settlement services.[4]

(3) *Leasing personal or real property*. Leasing personal or real property or acting as agent, broker, or adviser in leasing such property if:

(i) The lease is on a nonoperating basis;[5]

(ii) The initial term of the lease is at least 90 days;

(iii) In the case of leases involving real property:

(A) At the inception of the initial lease, the effect of the transaction will yield a return that will compensate the lessor for not less than the lessor's full investment in the property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial lease; and

(B) The estimated residual value of property for purposes of paragraph (b)(3)(iii)(A) of this section shall not exceed 25 percent of the acquisition cost of the property to the lessor.

(4) *Operating nonbank depository institutions*—(i) *Industrial banking*. Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company, so long as the institution is not a bank.

(ii) *Operating savings association*. Owning, controlling, or operating a savings association, if the savings association engages only in deposit-taking activities, lending, and other activities that

[2] Asset management services include acting as agent in the liquidation or sale of loans and collateral for loans, including real estate and other assets acquired through foreclosure or in satisfaction of debts previously contracted.

[3] For this purpose, the divestiture period for property begins on the date that the debt is acquired, regardless of when legal title to the property is acquired.

[4] For purposes of this section, real estate settlement services do not include providing title insurance as principal, agent, or broker.

[5] The requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly, engage in operating, servicing, maintaining, or repairing leased property during the lease term. For purposes of the leasing of automobiles, the requirement that the lease be on a nonoperating basis means that the bank holding company may not, directly or indirectly: (1) Provide servicing, repair, or maintenance of the leased vehicle during the lease term; (2) purchase parts and accessories in bulk or for an individual vehicle after the lessee has taken delivery of the vehicle; (3) provide the loan of an automobile during servicing of the leased vehicle; (4) purchase insurance for the lessee; or (5) provide for the renewal of the vehicle's license merely as a service to the lessee where the lessee could renew the license without authorization from the lessor. The bank holding company may arrange for a third party to provide these services or products.

are permissible for bank holding companies under this subpart C.

(5) *Trust company functions.* Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law, so long as the company is not a bank for purposes of section 2(c) of the Bank Holding Company Act.

(6) *Financial and investment advisory activities.* Acting as investment or financial advisor to any person, including (without, in any way, limiting the foregoing):

(i) Serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a–2(a)(20)), to an investment company registered under that act, including sponsoring, organizing, and managing a closed-end investment company;

(ii) Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies;

(iii) Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions, and conducting financial feasibility studies;[6]

(iv) Providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments;

(v) Providing educational courses, and instructional materials to consumers on individual financial management matters; and

(vi) Providing tax-planning and tax-preparation services to any person.

(7) *Agency transactional services for customer investments*—(i) *Securities brokerage.* Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services), if the securities brokerage services are restricted to buying and selling securities solely as agent for the account of customers and do not include securities underwriting or dealing.

(ii) *Riskless principal transactions.* Buying and selling in the secondary market all types of securities on the order of customers as a ''riskless principal'' to the extent of engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer. This does not include:

(A) Selling bank-ineligible securities[7] at the order of a customer that is the issuer of the securities, or selling bank-ineligible securities in any transaction where the company has a contractual agreement to place the securities as agent of the issuer; or

(B) Acting as a riskless principal in any transaction involving a bank-ineligible security for which the company or any of its affiliates acts as underwriter (during the period of the underwriting or for 30 days thereafter) or dealer.[8]

(iii) *Private placement services.* Acting as agent for the private placement of securities in accordance with the requirements of the Securities Act of 1933 (1933 Act) and the rules of the Securities and Exchange Commission, if the company engaged in the activity does not purchase or repurchase for its own account the securities being placed, or

[6] Feasibility studies do not include assisting management with the planning or marketing for a given project or providing general operational or management advice.

[7] A bank-ineligible security is any security that a State member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

[8] A company or its affiliates may not enter quotes for specific bank-ineligible securities in any dealer quotation system in connection with the company's riskless principal transactions; except that the company or its affiliates may enter ''bid'' or ''ask'' quotations, or publish ''offering wanted'' or ''bid wanted'' notices on trading systems other than NASDAQ or an exchange, if the company or its affiliate does not enter price quotations on different sides of the market for a particular security during any two-day period.

hold in inventory unsold portions of issues of these securities.

(iv) *Futures commission merchant.* Acting as a futures commission merchant (FCM) for unaffiliated persons in the execution, clearance, or execution and clearance of any futures contract and option on a futures contract traded on an exchange in the United States or abroad if:

(A) The activity is conducted through a separately incorporated subsidiary of the bank holding company, which may engage in activities other than FCM activities (including, but not limited to, permissible advisory and trading activities); and

(B) The parent bank holding company does not provide a guarantee or otherwise become liable to the exchange or clearing association other than for those trades conducted by the subsidiary for its own account or for the account of any affiliate.

(v) *Other transactional services.* Providing to customers as agent transactional services with respect to swaps and similar transactions, any transaction described in paragraph (b)(8) of this section, any transaction that is permissible for a state member bank, and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange.

(8) *Investment transactions as principal*—(i) *Underwriting and dealing in government obligations and money market instruments.* Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including banker's acceptances and certificates of deposit, under the same limitations as would be applicable if the activity were performed by the bank holding company's subsidiary member banks or its subsidiary nonmember banks as if they were member banks.

(ii) *Investing and trading activities.* Engaging as principal in:

(A) Foreign exchange;

(B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal approved by the Board), nonfinancial asset, or group of assets, other than a bank-ineligible security,[9] if:

(*1*) A state member bank is authorized to invest in the asset underlying the contract;

(*2*) The contract requires cash settlement;

(*3*) The contract allows for assignment, termination, or offset prior to delivery or expiration, and the company—

(*i*) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(*ii*) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or

(*4*) The contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company—

(*i*) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(*ii*) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

(C) Forward contracts, options,[10] futures, options on futures, swaps, and

[9] A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

[10] This reference does not include acting as a dealer in options based on indices of bank-ineligible securities when the options are traded on securities exchanges. These options are securities for purposes of the federal securities laws and bank-ineligible securities for purposes of section 20 of the Glass-Steagall Act, 12 U.S.C. 337. Similarly, this reference does not include acting as a dealer

*Continued*

similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires cash settlement.

(iii) *Buying and selling bullion, and related activities.* Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, copper, and any other metal approved by the Board, for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

(9) *Management consulting and counseling activities*—(i) *Management consulting.* (A) Providing management consulting advice:[11]

(*1*) On any matter to unaffiliated depository institutions, including commercial banks, savings and loan associations, savings banks, credit unions, industrial banks, Morris Plan banks, cooperative banks, industrial loan companies, trust companies, and branches or agencies of foreign banks;

(*2*) On any financial, economic, accounting, or audit matter to any other company.

(B) A company conducting management consulting activities under this subparagraph and any affiliate of such company may not:

(*1*) Own or control, directly or indirectly, more than 5 percent of the voting securities of the client institution; and

(*2*) Allow a management official, as defined in 12 CFR 212.2(h), of the company or any of its affiliates to serve as a management official of the client institution, except where such interlocking relationship is permitted pursuant to an exemption granted under 12 CFR 212.4(b) or otherwise permitted by the Board.

(C) A company conducting management consulting activities may provide management consulting services to customers not described in paragraph (b)(9)(i)(A)(*1*) of this section or regarding matters not described in paragraph (b)(9)(i)(A)(*2*) of this section, if the total annual revenue derived from those management consulting services does not exceed 30 percent of the company's total annual revenue derived from management consulting activities.

(ii) *Employee benefits consulting services.* Providing consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans.

(iii) *Career counseling services.* Providing career counseling services to:

(A) A financial organization[12] and individuals currently employed by, or recently displaced from, a financial organization;

(B) Individuals who are seeking employment at a financial organization; and

(C) Individuals who are currently employed in or who seek positions in the finance, accounting, and audit departments of any company.

(10) *Support services*—(i) *Courier services.* Providing courier services for:

(A) Checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

(B) Audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.[13]

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in any other instrument that is a bank-ineligible security for purposes of section 20. A bank holding company may deal in these instruments in accordance with the Board's orders on dealing in bank-ineligible securities.

[11] In performing this activity, bank holding companies are not authorized to perform tasks or operations or provide services to client institutions either on a daily or continuing basis, except as necessary to instruct the client institution on how to perform such services for itself. See also the Board's interpretation of bank management consulting advice (12 CFR 225.131).

[12] *Financial organization* refers to insured depository institution holding companies and their subsidiaries, other than nonbanking affiliates of diversified savings and loan holding companies that engage in activities not permissible under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1842(c)(8)).

[13] See also the Board's interpretation on courier activities (12 CFR 225.129), which sets

(ii) *Printing and selling MICR-encoded items*. Printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition (MICR) encoding.

(11) *Insurance agency and underwriting*—(i) *Credit insurance*. Acting as principal, agent, or broker for insurance (including home mortgage redemption insurance) that is:

(A) Directly related to an extension of credit by the bank holding company or any of its subsidiaries; and

(B) Limited to ensuring the repayment of the outstanding balance due on the extension of credit[14] in the event of the death, disability, or involuntary unemployment of the debtor.

(ii) *Finance company subsidiary*. Acting as agent or broker for insurance directly related to an extension of credit by a finance company[15] that is a subsidiary of a bank holding company, if:

(A) The insurance is limited to ensuring repayment of the outstanding balance on such extension of credit in the event of loss or damage to any property used as collateral for the extension of credit; and

(B) The extension of credit is not more than $10,000, or $25,000 if it is to finance the purchase of a residential manufactured home[16] and the credit is secured by the home; and

(C) The applicant commits to notify borrowers in writing that:

(*1*) They are not required to purchase such insurance from the applicant;

(*2*) Such insurance does not insure any interest of the borrower in the collateral; and

(*3*) The applicant will accept more comprehensive property insurance in place of such single-interest insurance.

(iii) *Insurance in small towns*. Engaging in any insurance agency activity in a place where the bank holding company or a subsidiary of the bank holding company has a lending office and that:

(A) Has a population not exceeding 5,000 (as shown in the preceding decennial census); or

(B) Has inadequate insurance agency facilities, as determined by the Board, after notice and opportunity for hearing.

(iv) *Insurance-agency activities conducted on May 1, 1982*. Engaging in any specific insurance-agency activity[17] if the bank holding company, or subsidiary conducting the specific activity, conducted such activity on May 1, 1982, or received Board approval to conduct such activity on or before May 1, 1982.[18] A bank holding company or subsidiary engaging in a specific insurance agency activity under this clause may:

(A) Engage in such specific insurance agency activity only at locations:

(*1*) In the state in which the bank holding company has its principal place of business (as defined in 12 U.S.C. 1842(d));

(*2*) In any state or states immediately adjacent to such state; and

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forth conditions for bank holding company entry into the activity.

[14] *Extension of credit* includes direct loans to borrowers, loans purchased from other lenders, and leases of real or personal property so long as the leases are nonoperating and full-payout leases that meet the requirements of paragraph (b)(3) of this section.

[15] *Finance company* includes all non-deposit-taking financial institutions that engage in a significant degree of consumer lending (excluding lending secured by first mortgages) and all financial institutions specifically defined by individual states as finance companies and that engage in a significant degree of consumer lending.

[16] These limitations increase at the end of each calendar year, beginning with 1982, by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published by the Bureau of Labor Statistics.

[17] Nothing contained in this provision shall preclude a bank holding company subsidiary that is authorized to engage in a specific insurance-agency activity under this clause from continuing to engage in the particular activity after merger with an affiliate, if the merger is for legitimate business purposes and prior notice has been provided to the Board.

[18] For the purposes of this paragraph, activities engaged in on May 1, 1982, include activities carried on subsequently as the result of an application to engage in such activities pending before the Board on May 1, 1982, and approved subsequently by the Board or as the result of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition.

(*3*) In any state in which the specific insurance-agency activity was conducted (or was approved to be conducted) by such bank holding company or subsidiary thereof or by any other subsidiary of such bank holding company on May 1, 1982; and

(B) Provide other insurance coverages that may become available after May 1, 1982, so long as those coverages insure against the types of risks as (or are otherwise functionally equivalent to) coverages sold or approved to be sold on May 1, 1982, by the bank holding company or subsidiary.

(v) *Supervision of retail insurance agents.* Supervising on behalf of insurance underwriters the activities of retail insurance agents who sell:

(A) Fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or its subsidiaries; and

(B) Group insurance that protects the employees of the bank holding company or its subsidiaries.

(vi) *Small bank holding companies.* Engaging in any insurance-agency activity if the bank holding company has total consolidated assets of $50 million or less. A bank holding company performing insurance-agency activities under this paragraph may not engage in the sale of life insurance or annuities except as provided in paragraphs (b)(11) (i) and (iii) of this section, and it may not continue to engage in insurance-agency activities pursuant to this provision more than 90 days after the end of the quarterly reporting period in which total assets of the holding company and its subsidiaries exceed $50 million.

(vii) *Insurance-agency activities conducted before 1971.* Engaging in any insurance-agency activity performed at any location in the United States directly or indirectly by a bank holding company that was engaged in insurance-agency activities prior to January 1, 1971, as a consequence of approval by the Board prior to January 1, 1971.

(12) *Community development activities*—(i) *Financing and investment activities.* Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

(ii) *Advisory activities.* Providing advisory and related services for programs designed primarily to promote community welfare.

(13) *Money orders, savings bonds, and traveler's checks.* The issuance and sale at retail of money orders and similar consumer-type payment instruments; the sale of U.S. savings bonds; and the issuance and sale of traveler's checks.

(14) *Data processing.* (i) Providing data processing, data storage and data transmission services, facilities (including data processing, data storage and data transmission hardware, software, documentation, or operating personnel), databases, advice, and access to such services, facilities, or databases by any technological means, if:

(A) The data to be processed, stored or furnished are financial, banking or economic; and

(B) The hardware provided in connection therewith is offered only in conjunction with software designed and marketed for the processing, storage and transmission of financial, banking, or economic data, and where the general purpose hardware does not constitute more than 30 percent of the cost of any packaged offering.

(ii) A company conducting data processing, data storage, and data transmission activities may conduct data processing, data storage, and data transmission activities not described in paragraph (b)(14)(i) of this section if the total annual revenue derived from those activities does not exceed 49 percent of the company's total annual revenues derived from data processing, data storage and data transmission activities.

[Reg. Y, 62 FR 9329, Feb. 28, 1997, as amended at 68 FR 39810, July 3, 2003; 68 FR 41901, July 16, 2003; 68 FR 68499, Dec. 9, 2003]

## Subpart D—Control and Divestiture Proceedings

### § 225.31 Control proceedings.

(a) *Preliminary determination of control.* (1) The Board may issue a preliminary determination of control under the procedures set forth in this section in any case in which:

(i) Any of the presumptions of control set forth in paragraph (d) of this section is present; or

(ii) It otherwise appears that a company has the power to exercise a controlling influence over the management or policies of a bank or other company.

(2) If the Board makes a preliminary determination of control under this section, the Board shall send notice to the controlling company containing a statement of the facts upon which the preliminary determination is based.

(b) *Response to preliminary determination of control.* Within 30 calendar days of issuance by the Board of a preliminary determination of control or such longer period permitted by the Board, the company against whom the determination has been made shall:

(1) Submit for the Board's approval a specific plan for the prompt termination of the control relationship;

(2) File an application under subpart B or C of this regulation to retain the control relationship; or

(3) Contest the preliminary determination by filing a response, setting forth the facts and circumstances in support of its position that no control exists, and, if desired, requesting a hearing or other proceeding.

(c) *Hearing and final determination.* (1) The Board shall order a formal hearing or other appropriate proceeding upon the request of a company that contests a preliminary determination that the company has the power to exercise a controlling influence over the management or policies of a bank or other company, if the Board finds that material facts are in dispute. The Board may also in its discretion order a formal hearing or other proceeding with respect to a preliminary determination that the company controls voting securities of the bank or other company under the presumptions in paragraph (d)(1) of this section.

(2) At a hearing or other proceeding, any applicable presumptions established by paragraph (d) of this section shall be considered in accordance with the Federal Rules of Evidence and the Board's Rules of Practice for Formal Hearings (12 CFR part 263).

(3) After considering the submissions of the company and other evidence, including the record of any hearing or other proceeding, the Board shall issue a final order determining whether the company controls voting securities, or has the power to exercise a controlling influence over the management or policies, of the bank or other company. If a control relationship is found, the Board may direct the company to terminate the control relationship or to file an application for the Board's approval to retain the control relationship under subpart B or C of this regulation.

(d) *Rebuttable presumptions of control.* The following rebuttable presumptions shall be used in any proceeding under this section:

(1) *Control of voting securities*—(i) *Securities convertible into voting securities.* A company that owns, controls, or holds securities that are immediately convertible, at the option of the holder or owner, into voting securities of a bank or other company, controls the voting securities.

(ii) *Option or restriction on voting securities.* A company that enters into an agreement or understanding under which the rights of a holder of voting securities of a bank or other company are restricted in any manner controls the securities. This presumption does not apply where the agreement or understanding:

(A) Is a mutual agreement among shareholders granting to each other a right of first refusal with respect to their shares;

(B) Is incident to a *bona fide* loan transaction; or

(C) Relates to restrictions on transferability and continues only for the time necessary to obtain approval from the appropriate Federal supervisory authority with respect to acquisition by the company of the securities.

(2) *Control over company*—(i) *Management agreement.* A company that enters into any agreement or understanding with a bank or other company (other than an investment advisory agreement), such as a management contract, under which the first company or any of its subsidiaries directs or exercises significant influence over the general management or overall operations of the bank or other company controls the bank or other company.

(ii) *Shares controlled by company and associated individuals.* A company that, together with its management officials or controlling shareholders (including members of the immediate families of either), owns, controls, or holds with power to vote 25 percent or more of the outstanding shares of any class of voting securities of a bank or other company controls the bank or other company, if the first company owns, controls, or holds with power to vote more than 5 percent of the outstanding shares of any class of voting securities of the bank or other company.

(iii) *Common management officials.* A company that has one or more management officials in common with a bank or other company controls the bank or other company, if the first company owns, controls or holds with power to vote more than 5 percent of the outstanding shares of any class of voting securities of the bank or other company, and no other person controls as much as 5 percent of the outstanding shares of any class of voting securities of the bank or other company.

(iv) *Shares held as fiduciary.* The presumptions in paragraphs (d)(2) (ii) and (iii) of this section do not apply if the securities are held by the company in a fiduciary capacity without sole discretionary authority to exercise the voting rights.

(e) *Presumption of non-control*—(1) In any proceeding under this section, there is a presumption that any company that directly or indirectly owns, controls, or has power to vote less than 5 percent of the outstanding shares of any class of voting securities of a bank or other company does not have control over that bank or other company.

(2) In any proceeding under this section, or judicial proceeding under the BHC Act, other than a proceeding in which the Board has made a preliminary determination that a company has the power to exercise a controlling influence over the management or policies of the bank or other company, a company may not be held to have had control over the bank or other company at any given time, unless that company, at the time in question, directly or indirectly owned, controlled, or had power to vote 5 percent or more of the outstanding shares of any class of voting securities of the bank or other company, or had already been found to have control on the basis of the existence of a controlling influence relationship.

[Reg. Y, 49 FR 818, Jan. 5, 1984, as amended at 58 FR 474, Jan. 6, 1993; Reg. Y, 62 FR 9338, Feb. 28, 1997]

## Subpart E—Change in Bank Control

SOURCE: Reg. Y, 62 FR 9338, Feb. 28, 1997, unless otherwise noted.

### § 225.41 Transactions requiring prior notice.

(a) *Prior notice requirement.* Any person acting directly or indirectly, or through or in concert with one or more persons, shall give the Board 60 days' written notice, as specified in § 225.43 of this subpart, before acquiring control of a state member bank or bank holding company, unless the acquisition is exempt under § 225.42.

(b) *Definitions.* For purposes of this subpart:

(1) *Acquisition* includes a purchase, assignment, transfer, or pledge of voting securities, or an increase in percentage ownership of a state member bank or a bank holding company resulting from a redemption of voting securities.

(2) *Acting in concert* includes knowing participation in a joint activity or parallel action towards a common goal of acquiring control of a state member bank or bank holding company whether or not pursuant to an express agreement.

(3) *Immediate family* includes a person's father, mother, stepfather, stepmother, brother, sister, stepbrother, stepsister, son, daughter, stepson, stepdaughter, grandparent, grandson, granddaughter, father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, the spouse of any of the foregoing, and the person's spouse.

(c) *Acquisitions requiring prior notice*—(1) *Acquisition of control.* The acquisition of voting securities of a state member bank or bank holding company constitutes the acquisition of control under the Bank Control Act, requiring

prior notice to the Board, if, immediately after the transaction, the acquiring person (or persons acting in concert) will own, control, or hold with power to vote 25 percent or more of any class of voting securities of the institution.

(2) *Rebuttable presumption of control.* The Board presumes that an acquisition of voting securities of a state member bank or bank holding company constitutes the acquisition of control under the Bank Control Act, requiring prior notice to the Board, if, immediately after the transaction, the acquiring person (or persons acting in concert) will own, control, or hold with power to vote 10 percent or more of any class of voting securities of the institution, and if:

(i) The institution has registered securities under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l); or

(ii) No other person will own, control, or hold the power to vote a greater percentage of that class of voting securities immediately after the transaction.[1]

(d) *Rebuttable presumption of concerted action.* The following persons shall be presumed to be acting in concert for purposes of this subpart:

(1) A company and any controlling shareholder, partner, trustee, or management official of the company, if both the company and the person own voting securities of the state member bank or bank holding company;

(2) An individual and the individual's immediate family;

(3) Companies under common control;

(4) Persons that are parties to any agreement, contract, understanding, relationship, or other arrangement, whether written or otherwise, regarding the acquisition, voting, or transfer of control of voting securities of a state member bank or bank holding company, other than through a revocable proxy as described in § 225.42(a)(5) of this subpart;

(5) Persons that have made, or propose to make, a joint filing under sections 13 or 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78n), and the rules promulgated thereunder by the Securities and Exchange Commission; and

(6) A person and any trust for which the person serves as trustee.

(e) *Acquisitions of loans in default.* The Board presumes an acquisition of a loan in default that is secured by voting securities of a state member bank or bank holding company to be an acquisition of the underlying securities for purposes of this section.

(f) *Other transactions.* Transactions other than those set forth in paragraph (c) of this section resulting in a person's control of less than 25 percent of a class of voting securities of a state member bank or bank holding company are not deemed by the Board to constitute control for purposes of the Bank Control Act.

(g) *Rebuttal of presumptions.* Prior notice to the Board is not required for any acquisition of voting securities under the presumption of control set forth in this section, if the Board finds that the acquisition will not result in control. The Board shall afford any person seeking to rebut a presumption in this section an opportunity to present views in writing or, if appropriate, orally before its designated representatives at an informal conference.

### § 225.42 Transactions not requiring prior notice.

(a) *Exempt transactions.* The following transactions do not require notice to the Board under this subpart:

(1) *Existing control relationships.* The acquisition of additional voting securities of a state member bank or bank holding company by a person who:

(i) Continuously since March 9, 1979 (or since the institution commenced business, if later), held power to vote 25 percent or more of any class of voting securities of the institution; or

(ii) Is presumed, under § 225.41(c)(2) of this subpart, to have controlled the institution continuously since March 9, 1979, if the aggregate amount of voting securities held does not exceed 25 percent or more of any class of voting securities of the institution or, in other

[1] If two or more persons, not acting in concert, each propose to acquire simultaneously equal percentages of 10 percent or more of a class of voting securities of the state member bank or bank holding company, each person must file prior notice to the Board.

cases, where the Board determines that the person has controlled the bank continuously since March 9, 1979;

(2) *Increase of previously authorized acquisitions.* Unless the Board or the Reserve Bank otherwise provides in writing, the acquisition of additional shares of a class of voting securities of a state member bank or bank holding company by any person (or persons acting in concert) who has lawfully acquired and maintained control of the institution (for purposes of § 225.41(c) of this subpart), after complying with the procedures and receiving approval to acquire voting securities of the institution under this subpart, or in connection with an application approved under section 3 of the BHC Act (12 U.S.C. 1842; § 225.11 of subpart B of this part) or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 U.S.C. 1828(c));

(3) *Acquisitions subject to approval under BHC Act or Bank Merger Act.* Any acquisition of voting securities subject to approval under section 3 of the BHC Act (12 U.S.C. 1842; § 225.11 of subpart B of this part), or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 U.S.C. 1828(c));

(4) *Transactions exempt under BHC Act.* Any transaction described in sections 2(a)(5), 3(a)(A), or 3(a)(B) of the BHC Act (12 U.S.C. 1841(a)(5), 1842(a)(A), and 1842(a)(B)), by a person described in those provisions;

(5) *Proxy solicitation.* The acquisition of the power to vote securities of a state member bank or bank holding company through receipt of a revocable proxy in connection with a proxy solicitation for the purposes of conducting business at a regular or special meeting of the institution, if the proxy terminates within a reasonable period after the meeting;

(6) *Stock dividends.* The receipt of voting securities of a state member bank or bank holding company through a stock dividend or stock split if the proportional interest of the recipient in the institution remains substantially the same; and

(7) *Acquisition of foreign banking organization.* The acquisition of voting securities of a qualifying foreign banking organization. (This exemption does not extend to the reports and information required under paragraphs 9, 10, and 12 of the Bank Control Act (12 U.S.C. 1817(j) (9), (10), and (12)) and § 225.44 of this subpart.)

(b) *Prior notice exemption.* (1) The following acquisitions of voting securities of a state member bank or bank holding company, which would otherwise require prior notice under this subpart, are not subject to the prior notice requirements if the acquiring person notifies the appropriate Reserve Bank within 90 calendar days after the acquisition and provides any relevant information requested by the Reserve Bank:

(i) Acquisition of voting securities through inheritance;

(ii) Acquisition of voting securities as a *bona fide* gift; and

(iii) Acquisition of voting securities in satisfaction of a debt previously contracted (DPC) in good faith.

(2) The following acquisitions of voting securities of a state member bank or bank holding company, which would otherwise require prior notice under this subpart, are not subject to the prior notice requirements if the acquiring person does not reasonably have advance knowledge of the transaction, and provides the written notice required under section 225.43 to the appropriate Reserve Bank within 90 calendar days after the transaction occurs:

(i) Acquisition of voting securities resulting from a redemption of voting securities by the issuing bank or bank holding company; and

(ii) Acquisition of voting securities as a result of actions (including the sale of securities) by any third party that is not within the control of the acquiror.

(3) Nothing in paragraphs (b)(1) or (b)(2) of this section limits the authority of the Board to disapprove a notice pursuant to § 225.43(h) of this subpart.

### § 225.43 Procedures for filing, processing, publishing, and acting on notices.

(a) *Filing notice.* (1) A notice required under this subpart shall be filed with the appropriate Reserve Bank and shall contain all the information required by paragraph 6 of the Bank Control Act (12 U.S.C. 1817(j)(6)), or prescribed in the designated Board form.

(2) The Board may waive any of the informational requirements of the notice if the Board determines that it is in the public interest.

(3) A notificant shall notify the appropriate Reserve Bank or the Board immediately of any material changes in a notice submitted to the Reserve Bank, including changes in financial or other conditions.

(4) When the acquiring person is an individual, or group of individuals acting in concert, the requirement to provide personal financial data may be satisfied by a current statement of assets and liabilities and an income summary, as required in the designated Board form, together with a statement of any material changes since the date of the statement or summary. The Reserve Bank or the Board, nevertheless, may request additional information, if appropriate.

(b) *Acceptance of notice.* The 60-day notice period specified in § 225.41 of this subpart begins on the date of receipt of a complete notice. The Reserve Bank shall notify the person or persons submitting a notice under this subpart in writing of the date the notice is or was complete and thereby accepted for processing. The Reserve Bank or the Board may request additional relevant information at any time after the date of acceptance.

(c) *Publication*—(1) *Newspaper Announcement.* Any person(s) filing a notice under this subpart shall publish, in a form prescribed by the Board, an announcement soliciting public comment on the proposed acquisition. The announcement shall be published in a newspaper of general circulation in the community in which the head office of the state member bank to be acquired is located or, in the case of a proposed acquisition of a bank holding company, in the community in which its head office is located and in the community in which the head office of each of its subsidiary banks is located. The announcement shall be published no earlier than 15 calendar days before the filing of the notice with the appropriate Reserve Bank and no later than 10 calendar days after the filing date; and the publisher's affidavit of a publication shall be provided to the appropriate Reserve Bank.

(2) *Contents of newspaper announcement.* The newspaper announcement shall state:

(i) The name of each person identified in the notice as a proposed acquiror of the bank or bank holding company;

(ii) The name of the bank or bank holding company to be acquired, including the name of each of the bank holding company's subsidiary banks; and

(iii) A statement that interested persons may submit comments on the notice to the Board or the appropriate Reserve Bank for a period of 20 days, or such shorter period as may be provided, pursuant to paragraph (c)(5) of this section.

(3) FEDERAL REGISTER *announcement.* The Board shall, upon filing of a notice under this subpart, publish announcement in the FEDERAL REGISTER of receipt of the notice. The FEDERAL REGISTER announcement shall contain the information required under paragraphs (c)(2)(i) and (c)(2)(ii) of this section and a statement that interested persons may submit comments on the proposed acquisition for a period of 15 calendar days, or such shorter period as may be provided, pursuant to paragraph (c)(5) of this section. The Board may waive publication in the FEDERAL REGISTER, if the Board determines that such action is appropriate.

(4) *Delay of publication.* The Board may permit delay in the publication required under paragraphs (c)(1) and (c)(3) of this section if the Board determines, for good cause shown, that it is in the public interest to grant such delay. Requests for delay of publication may be submitted to the appropriate Reserve Bank.

(5) *Shortening or waiving notice.* The Board may shorten or waive the public comment or newspaper publication requirements of this paragraph, or act on a notice before the expiration of a public comment period, if it determines in writing that an emergency exists, or that disclosure of the notice, solicitation of public comment, or delay until expiration of the public comment period would seriously threaten the safety or soundness of the bank or bank holding company to be acquired.

(6) *Consideration of public comments.* In acting upon a notice filed under this subpart, the Board shall consider all public comments received in writing within the period specified in the newspaper or FEDERAL REGISTER announcement, whichever is later. At the Board's option, comments received after this period may, but need not, be considered.

(7) *Standing.* No person (other than the acquiring person) who submits comments or information on a notice filed under this subpart shall thereby become a party to the proceeding or acquire any standing or right to participate in the Board's consideration of the notice or to appeal or otherwise contest the notice or the Board's action regarding the notice.

(d) *Time period for Board action*—(1) *Consummation of acquisition*—(i) The notificant(s) may consummate the proposed acquisition 60 days after submission to the Reserve Bank of a complete notice under paragraph (a) of this section, unless within that period the Board disapproves the proposed acquisition or extends the 60-day period, as provided under paragraph (d)(2) of this section.

(ii) The notificant(s) may consummate the proposed transaction before the expiration of the 60-day period if the Board notifies the notificant(s) in writing of the Board's intention not to disapprove the acquisition.

(2) *Extensions of time period.* (i) The Board may extend the 60-day period in paragraph (d)(1) of this section for an additional 30 days by notifying the acquiring person(s).

(ii) The Board may further extend the period during which it may disapprove a notice for two additional periods of not more than 45 days each, if the Board determines that:

(A) Any acquiring person has not furnished all the information required under paragraph (a) of this section;

(B) Any material information submitted is substantially inaccurate;

(C) The Board is unable to complete the investigation of an acquiring person because of inadequate cooperation or delay by that person; or

(D) Additional time is needed to investigate and determine that no acquiring person has a record of failing to comply with the requirements of the Bank Secrecy Act, subchapter II of Chapter 53 of Title 31, United States Code.

(iii) If the Board extends the time period under this paragraph, it shall notify the acquiring person(s) of the reasons therefor and shall include a statement of the information, if any, deemed incomplete or inaccurate.

(e) *Advice to bank supervisory agencies.* (1) Upon accepting a notice relating to acquisition of securities of a state member bank, the Reserve Bank shall send a copy of the notice to the appropriate state bank supervisor, which shall have 30 calendar days from the date the notice is sent in which to submit its views and recommendations to the Board. The Reserve Bank also shall send a copy of any notice to the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

(2) If the Board finds that it must act immediately in order to prevent the probable failure of the bank or bank holding company involved, the Board may dispense with or modify the requirements for notice to the state supervisor.

(f) *Investigation and report.* (1) After receiving a notice under this subpart, the Board or the appropriate Reserve Bank shall conduct an investigation of the competence, experience, integrity, and financial ability of each person by and for whom an acquisition is to be made. The Board shall also make an independent determination of the accuracy and completeness of any information required to be contained in a notice under paragraph (a) of this section. In investigating any notice accepted under this subpart, the Board or Reserve Bank may solicit information or views from any person, including any bank or bank holding company involved in the notice, and any appropriate state, federal, or foreign governmental authority.

(2) The Board or the appropriate Reserve Bank shall prepare a written report of its investigation, which shall contain, at a minimum, a summary of the results of the investigation.

(g) *Factors considered in acting on notices.* In reviewing a notice filed under this subpart, the Board shall consider

the information in the record, the views and recommendations of the appropriate bank supervisor, and any other relevant information obtained during any investigation of the notice.

(h) *Disapproval and hearing*—(1) *Disapproval of notice.* The Board may disapprove an acquisition if it finds adverse effects with respect to any of the factors set forth in paragraph 7 of the Bank Control Act (12 U.S.C. 1817(j)(7)) (*i.e.*, competitive, financial, managerial, banking, or incompleteness of information).

(2) *Disapproval notification.* Within three days after its decision to issue a notice of intent to disapprove any proposed acquisition, the Board shall notify the acquiring person in writing of the reasons for the action.

(3) *Hearing.* Within 10 calendar days of receipt of the notice of the Board's intent to disapprove, the acquiring person may submit a written request for a hearing. Any hearing conducted under this paragraph shall be in accordance with the Rules of Practice for Formal Hearings (12 CFR part 263). At the conclusion of the hearing, the Board shall, by order, approve or disapprove the proposed acquisition on the basis of the record of the hearing. If the acquiring person does not request a hearing, the notice of intent to disapprove becomes final and unappealable.

### § 225.44 Reporting of stock loans.

(a) *Requirements.* (1) Any foreign bank or affiliate of a foreign bank that has credit outstanding to any person or group of persons, in the aggregate, which is secured, directly or indirectly, by 25 percent or more of any class of voting securities of a state member bank, shall file a consolidated report with the appropriate Reserve Bank for the state member bank.

(2) The foreign bank or its affiliate also shall file a copy of the report with its appropriate Federal banking agency.

(3) Any shares of the state member bank held by the foreign bank or any affiliate of the foreign bank as principal must be included in the calculation of the number of shares in which the foreign bank or its affiliate has a security interest for purposes of paragraph (a) of this section.

(b) *Definitions.* For purposes of paragraph (a) of this section:

(1) *Foreign bank* shall have the same meaning as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(2) *Credit outstanding* includes any loan or extension of credit; the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit; and any other type of transaction that extends credit or financing to the person or group of persons.

(3) *Group of persons* includes any number of persons that the foreign bank or any affiliate of a foreign bank has reason to believe:

(i) Are acting together, in concert, or with one another to acquire or control shares of the same insured depository institution, including an acquisition of shares of the same depository institution at approximately the same time under substantially the same terms; or

(ii) Have made, or propose to make, a joint filing under section 13 or 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78n), and the rules promulgated thereunder by the Securities and Exchange Commission regarding ownership of the shares of the same insured depository institution.

(c) *Exceptions.* Compliance with paragraph (a) of this section is not required if:

(1) The person or group of persons referred to in that paragraph has disclosed the amount borrowed and the security interest therein to the Board or appropriate Reserve Bank in connection with a notice filed under § 225.41 of this subpart, or another application filed with the Board or Reserve Bank as a substitute for a notice under § 225.41 of this subpart, including an application filed under section 3 of the BHC Act (12 U.S.C. 1842) or section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act, 12 U.S.C. 1828(c)), or an application for membership in the Federal Reserve System; or

(2) The transaction involves a person or group of persons that has been the owner or owners of record of the stock for a period of one year or more; or, if the transaction involves stock issued by a newly chartered bank, before the bank is opened for business.

(d) *Report requirements.* (1) The consolidated report shall indicate the number and percentage of shares securing each applicable extension of credit, the identity of the borrower, and the number of shares held as principal by the foreign bank and any affiliate thereof.

(2) A foreign bank, or any affiliate of a foreign bank, shall file the consolidated report in writing within 30 days of the date on which the foreign bank or affiliate first believes that the security for any outstanding credit consists of 25 percent or more of any class of voting securities of a state member bank.

(e) *Other reporting requirements.* A foreign bank, or any affiliate thereof, that is supervised by the System and is required to report credit outstanding that is secured by the shares of an insured depository institution to another Federal banking agency also shall file a copy of the report with the appropriate Reserve Bank.

## Subpart F—Limitations on Nonbank Banks

### § 225.52 Limitation on overdrafts.

(a) *Definitions.* For purposes of this section—

(1) *Account* means a reserve account, clearing account, or deposit account as defined in the Board's Regulation D (12 CFR 204.2(a)(1)(i)), that is maintained at a Federal Reserve Bank or nonbank bank.

(2) *Cash item* means (i) a check other than a check classified as a noncash item; or (ii) any other item payable on demand and collectible at par that the Federal Reserve Bank of the district in which the item is payable is willing to accept as a cash item.

(3) *Discount window loan* means any credit extended by a Federal Reserve Bank to a nonbank bank or industrial bank pursuant to the provisions of the Board's Regulation A (12 CFR part 201).

(4) *Industrial bank* means an institution as defined in section 2(c)(2)(H) of the BHC Act (12 U.S.C. 1841(c)(2)(H)).

(5) *Noncash item* means an item handled by a Reserve Bank as a noncash item under the Reserve Bank's ''Collection of Noncash Items Operating Circular'' (*e.g.*, a maturing bankers' acceptance or a maturing security, or a demand item, such as a check, with special instructions or an item that has not been preprinted or post-encoded).

(6) *Other nonelectronic transactions* include all other transactions not included as funds transfers, book-entry securities transfers, cash items, noncash items, automated clearing house transactions, net settlement entries, and discount window loans (*e.g.*, original issue of securities or redemption of securities).

(7) An *overdraft* in an account occurs whenever the Federal Reserve Bank, nonbank bank, or industrial bank holding an account posts a transaction to the account of the nonbank bank, industrial bank, or affiliate that exceeds the aggregate balance of the accounts of the nonbank bank, industrial bank, or affiliate, as determined by the posting rules set forth in paragraphs (d) and (e) of this section and continues until the aggregate balance of the account is zero or greater.

(8) *Transfer item* means an item as defined in subpart B of Regulation J (12 CFR 210.25 *et seq*).

(b) *Restriction on overdrafts*—(1) *Affiliates.* Neither a nonbank bank nor an industrial bank shall permit any affiliate to incur any overdraft in its account with the nonbank bank or industrial bank.

(2) *Nonbank banks or industrial banks.* (i) No nonbank bank or industrial bank shall incur any overdraft in its account at a Federal Reserve Bank on behalf of an affiliate.

(ii) An overdraft by a nonbank bank or industrial bank in its account at a Federal Reserve Bank shall be deemed to be on behalf of an affiliate whenever:

(A) A nonbank bank or industrial bank holds an account for an affiliate from which third-party payments can be made; and

(B) When the posting of an affiliate's transaction to the nonbank bank's or industrial bank's account at a Reserve Bank creates an overdraft in its account at a Federal Reserve Bank or increases the amount of an existing overdraft in its account at a Federal Reserve Bank.

(c) *Permissible overdrafts*. The following are permissible overdrafts not subject to paragraph (b) of this section:

(1) *Inadvertent error*. An overdraft in its account by a nonbank bank or its affiliate, or an industrial bank or its affiliate, that results from an inadvertent computer error or inadvertent accounting error, that was not reasonably forseeable or could not have been prevented through the maintenance of procedures reasonably adopted by the nonbank bank or affiliate to avoid such overdraft; and

(2) *Fully secured primary dealer affiliate overdrafts*. (i) An overdraft incurred by an affiliate of a nonbank bank, which affiliate is recognized as a primary dealer by the Federal Reserve Bank of New York, in the affiliate's account at the nonbank bank, or an overdraft incurred by a nonbank bank on behalf of its primary dealer affiliate in the nonbank bank's account at a Federal Reserve Bank; *provided:* the overdraft is fully secured by bonds, notes, or other obligations which are direct obligations of the United States or on which the principal and interest are fully guaranteed by the United States or by securities and obligations eligible for settlement on the Federal Reserve book-entry system.

(ii) An overdraft by a nonbank bank in its account at a Federal Reserve Bank that is on behalf of a primary dealer affiliate is fully secured when that portion of its overdraft at the Federal Reserve Bank that corresponds to the transaction posted for an affiliate that caused or increased the nonbank bank's overdraft is fully secured in accordance with paragraph (c)(2)(iii) of this section.

(iii) An overdraft is fully secured under paragraph (c)(2)(i) when the nonbank bank can demonstrate that the overdraft is secured, at all times, by a perfected security interest in specific, identified obligations described in paragraph (c)(2)(i) with a market value that, in the judgment of the Reserve Bank holding the nonbank bank's account, is sufficiently in excess of the amount of the overdraft to provide a margin of protection in a volatile market or in the event the securities need to be liquidated quickly.

(d) *Posting by Federal Reserve Banks*. For purposes of determining the balance of an account under this section, payments and transfers by nonbank banks and industrial banks processed by the Federal Reserve Banks shall be considered posted to their accounts at Federal Reserve Banks as follows:

(1) *Funds transfers*. Transfer items shall be posted:

(i) To the transferor's account at the time the transfer is actually made by the transferor's Federal Reserve Bank; and

(ii) To the transferee's account at the time the transferee's Reserve Bank sends the transfer item or sends or telephones the advice of credit for the item to the transferee, whichever occurs first.

(2) *Book-entry securities transfers against payment*. A book-entry securities transfer against payment shall be posted: (i) to the transferor's account at the time the entry is made by the transferor's Reserve Bank; and (ii) to the transferee's account at the time the entry is made by the transferee's Reserve Bank.

(3) *Discount window loans*. Credit for a discount window loan shall be posted to the account of a nonbank bank or industrial bank at the close of business on the day that it is made or such earlier time as may be specifically agreed to by the Federal Reserve Bank and the nonbank bank under the terms of the loan. Debit for repayment of a discount window loan shall be posted to the account of the nonbank bank or industrial bank as of the close of business on the day of maturity of the loan or such earlier time as may be agreed to by the Federal Reserve Bank and the nonbank bank or required by the Federal Reserve Bank under the terms of the loan.

(4) *Other transactions*. Total aggregate credits for automated clearing house transfers, cash items, noncash items, net settlement entries, and other nonelectronic transactions shall be posted to the account of a nonbank bank or industrial bank as of the opening of business on settlement day. Total aggregate debits for these transactions and entries shall be posted to the account of a nonbank bank or industrial

bank as of the close of business on settlement day.

(e) *Posting by nonbank banks and industrial banks.* For purposes of determining the balance of an affiliate's account under this section, payments and transfers through an affiliate's account at a nonbank bank or industrial bank shall be posted as follows:

(1) *Funds transfers.* (i) Fedwire transfer items shall be posted:

(A) To the transferor affiliate's account no later than the time the transfer is actually made by the transferor's Federal Reserve Bank; and

(B) To the transferee affiliate's account no earlier than the time the transferee's Reserve Bank sends the transfer item, or sends or telephones the advice of credit for the item to the transferee, whichever occurs first.

(ii) For funds transfers not sent or received through Federal Reserve Banks, debits shall be posted to the transferor affiliate's account not later than the time the nonbank bank or industrial bank becomes obligated on the transfer. Credits shall not be posted to the transferee affiliate's account before the nonbank bank or industrial bank has received actually and finally collected funds for the transfer.

(2) *Book-entry securities transfers against payment.* (i) A book-entry securities transfer against payment shall be posted:

(A) To the transferor affiliate's account not earlier than the time the entry is made by the transferor's Reserve Bank; and

(B) To the transferee affiliate's account not later than the time the entry is made by the transferee's Reserve Bank.

(ii) For book-entry securities transfers against payment that are not sent or received through Federal Reserve Banks, entries shall be posted:

(A) To the buyer-affiliate's account not later than the time the nonbank bank or industrial bank becomes obligated on the transfer; and

(B) To the seller-affiliate's account not before the nonbank bank or industrial bank has received actually and finally collected funds for the transfer.

(3) *Other transactions*—(i) *Credits.* Except as otherwise provided in this paragraph, credits for cash items, noncash items, ACH transfers, net settlement entries, and all other nonelectronic transactions shall be posted to an affiliate's account on the day of the transaction (*i.e.*, settlement day for ACH transactions or the day of credit for check transactions), but no earlier than the Federal Reserve Bank's opening of business on that day. Credit for cash items that are required by federal or state statute or regulation to be made available to the depositor for withdrawal prior to the posting time set forth in the preceding paragraph shall be posted as of the required availability time.

(ii) *Debits.* Debits for cash items, noncash items, ACH transfers, net settlement entries, and all other nonelectronic transactions shall be posted to an affiliate's account on the day of the transaction (*e.g.*, settlement day for ACH transactions or the day of presentment for check transactions), but no later than the Federal Reserve Bank's close of business on that day. If a check drawn on an affiliate's account or an ACH debit transfer received by an affiliate is returned timely by the nonbank bank or industrial bank in accordance with applicable law and agreements, no entry need to be posted to the affiliate's account for such item.

[Reg. Y, 53 FR 37744, Sept. 28, 1988]

## Subpart G—Appraisal Standards for Federally Related Transactions

SOURCE: Reg. Y, 55 FR 27771, July 5, 1990, unless otherwise noted.

### § 225.61 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Board of Governors of the Federal Reserve System (the *Board*) under title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (*FIRREA*) (Pub. L. No. 101–73, 103 Stat. 183 (1989)), 12 U.S.C. 3310, 3331–3351, and section 5(b) of the Bank Holding Company Act, 12 U.S.C. 1844(b).

(b) *Purpose and scope.* (1) Title XI provides protection for federal financial and public policy interests in real estate related transactions by requiring real estate appraisals used in connection with federally related transactions

to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This subpart implements the requirements of title XI, and applies to all federally related transactions entered into by the Board or by institutions regulated by the Board (*regulated institutions*).

(2) This subpart:

(i) Identifies which real estate-related financial transactions require the services of an appraiser;

(ii) Prescribes which categories of federally related transactions shall be appraised by a State certified appraiser and which by a State licensed appraiser; and

(iii) Prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the Board.

**§ 225.62 Definitions.**

(a) *Appraisal* means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(b) *Appraisal Foundation* means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) *Appraisal Subcommittee* means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(d) *Business loan* means a loan or extension of credit to any corporation, general or limited partnership, business trust, joint venture, pool, syndicate, sole proprietorship, or other business entity.

(e) *Complex 1-to-4 family residential property appraisal* means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

(f) *Federally related transaction* means any real estate-related financial transaction entered into on or after August 9, 1990, that:

(1) The Board or any regulated institution engages in or contracts for; and

(2) Requires the services of an appraiser.

(g) *Market value* means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(1) Buyer and seller are typically motivated;

(2) Both parties are well informed or well advised, and acting in what they consider their own best interests;

(3) A reasonable time is allowed for exposure in the open market;

(4) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(5) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(h) *Real estate* or *real property* means an identified parcel or tract of land, with improvements, and includes easements, rights of way, undivided or future interests, or similar rights in a tract of land, but does not include mineral rights, timber rights, growing crops, water rights, or similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

(i) *Real estate-related financial transaction* means any transaction involving:

(1) The sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof; or

(2) The refinancing of real property or interests in real property; or

(3) The use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

(j) *State certified appraiser* means any individual who has satisfied the requirements for certification in a State

or territory whose criteria for certification as a real estate appraiser currently meet or exceed the minimum criteria for certification issued by the Appraiser Qualifications Board of the Appraisal Foundation. No individual shall be a State certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a State or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualifications Board of the Appraisal Foundation. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI of FIRREA. The Board may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(k) *State licensed appraiser* means any individual who has satisfied the requirements for licensing in a State or territory where the licensing procedures comply with title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the State or territory are inconsistent with title XI. The Board may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within the Board's jurisdiction.

(l) *Tract development* means a project of five units or more that is constructed or is to be constructed as a single development.

(m) *Transaction value* means:

(1) For loans or other extensions of credit, the amount of the loan or extension of credit;

(2) For sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) For the pooling of loans or interests in real property for resale or purchase, the amount of the loan or the market value of the real property calculated with respect to each such loan or interest in real property.

[Reg. Y, 55 FR 27771, July 5, 1990, as amended at 59 FR 29500, June 7, 1994]

### § 225.63 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $250,000 or less;

(2) A lien on real estate has been taken as collateral in an abundance of caution;

(3) The transaction is not secured by real estate;

(4) A lien on real estate has been taken for purposes other than the real estate's value;

(5) The transaction is a business loan that:

(i) Has a transaction value of $1 million or less; and

(ii) Is not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment;

(6) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(7) The transaction involves an existing extension of credit at the lending institution, provided that:

(i) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or

(ii) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs;

(8) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgaged-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met Board regulatory requirements for appraisals at the time of origination;

(9) The transaction is wholly or partially insured or guaranteed by a

United States government agency or United States government sponsored agency;

(10) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate;

(11) The regulated institution is acting in a fiduciary capacity and is not required to obtain an appraisal under other law;

(12) The transaction involves underwriting or dealing in mortgage-backed securities; or

(13) The Board determines that the services of an appraiser are not necessary in order to protect Federal financial and public policy interests in real estate-related financial transactions or to protect the safety and soundness of the institution.

(b) *Evaluations required.* For a transaction that does not require the services of a State certified or licensed appraiser under paragraph (a)(1), (a)(5) or (a)(7) of this section, the institution shall obtain an appropriate evaluation of real property collateral that is consistent with safe and sound banking practices.

(c) *Appraisals to address safety and soundness concerns.* The Board reserves the right to require an appraisal under this subpart whenever the agency believes it is necessary to address safety and soundness concerns.

(d) *Transactions requiring a State certified appraiser*—(1) *All transactions of $1,000,000 or more.* All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a State certified appraiser.

(2) *Nonresidential transactions of $250,000 or more.* All federally related transactions having a transaction value of $250,000 or more, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a State certified appraiser.

(3) *Complex residential transactions of $250,000 or more.* All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a State certified appraiser if the transaction value is $250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex, unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If during the course of the appraisal a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) The regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and co-sign the appraisal; or

(ii) The institution may engage a certified appraiser to complete the appraisal.

(e) *Transactions requiring either a State certified or licensed appraiser.* All appraisals for federally related transactions not requiring the services of a State certified appraiser shall be prepared by either a State certified appraiser or a State licensed appraiser.

[Reg. Y, 55 FR 27771, July 5, 1990, as amended at 58 FR 15077, Mar. 19, 1993; 59 FR 29500, June 7, 1994; 63 FR 65532, Nov. 27, 1998]

### § 225.64 Minimum appraisal standards.

For federally related transactions, all appraisals shall, at a minimum:

(a) Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation, 1029 Vermont Ave., NW., Washington, DC 20005, unless principles of safe and sound banking require compliance with stricter standards;

(b) Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;

(c) Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially

leased buildings, non-market lease terms, and tract developments with unsold units;

(d) Be based upon the definition of market value as set forth in this subpart; and

(e) Be performed by State licensed or certified appraisers in accordance with requirements set forth in this subpart.

[Reg. Y, 59 FR 29501, June 7, 1994]

### § 225.65 Appraiser independence.

(a) *Staff appraisers.* If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to ensure that the appraisers exercise independent judgment and that the appraisal is adequate. Such steps include, but are not limited to, prohibiting an individual from performing appraisals in connection with federally related transactions in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any vote or approval involving assets on which they performed an appraisal.

(b) *Fee appraisers.* (1) If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or the transaction.

(2) A regulated institution also may accept an appraisal that was prepared by an appraiser engaged directly by another financial services institution, if:

(i) The appraiser has no direct or indirect interest, financial or otherwise, in the property or the transaction; and

(ii) The regulated institution determines that the appraisal conforms to the requirements of this subpart and is otherwise acceptable.

[Reg. Y, 55 FR 27771, July 5, 1990, as amended at 59 FR 29501, June 7, 1994]

### § 225.66 Professional association membership; competency.

(a) *Membership in appraisal organizations.* A State certified appraiser or a State licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be State certified or licensed, as appropriate. However, a State certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

### § 225.67 Enforcement.

Institutions and institution-affiliated parties, including staff appraisers and fee appraisers, may be subject to removal and/or prohibition orders, cease and desist orders, and the imposition of civil money penalties pursuant to the Federal Deposit Insurance Act, 12 U.S.C 1811 *et seq.*, as amended, or other applicable law.

## Subpart H—Notice of Addition or Change of Directors and Senior Executive Officers

SOURCE: Reg. Y, 62 FR 9341, Feb. 28, 1997, unless otherwise noted.

### § 225.71 Definitions.

(a) *Director* means a person who serves on the board of directors of a regulated institution, except that this term does not include an advisory director who:

(1) Is not elected by the shareholders of the regulated institution;

(2) Is not authorized to vote on any matters before the board of directors or any committee thereof;

(3) Solely provides general policy advice to the board of directors and any committee thereof; and

(4) Has not been identified by the Board or Reserve Bank as a person who performs the functions of a director for purposes of this subpart.

(b) *Regulated institution* means a state member bank or a bank holding company.

(c) *Senior executive officer* means a person who holds the title or, without regard to title, salary, or compensation, performs the function of one or more of the following positions: president, chief executive officer, chief operating officer, chief financial officer, chief lending officer, or chief investment officer. *Senior executive officer* also includes any other person identified by the Board or Reserve Bank, whether or not hired as an employee, with significant influence over, or who participates in, major policymaking decisions of the regulated institution.

(d) *Troubled condition* for a regulated institution means an institution that:

(1) Has a composite rating, as determined in its most recent report of examination or inspection, of 4 or 5 under the Uniform Financial Institutions Rating System or under the Federal Reserve Bank Holding Company Rating System;

(2) Is subject to a cease-and-desist order or formal written agreement that requires action to improve the financial condition of the institution, unless otherwise informed in writing by the Board or Reserve Bank; or

(3) Is informed in writing by the Board or Reserve Bank that it is in troubled condition for purposes of the requirements of this subpart on the basis of the institution's most recent report of condition or report of examination or inspection, or other information available to the Board or Reserve Bank.

### § 225.72 Director and officer appointments; prior notice requirement.

(a) *Prior notice by regulated institution.* A regulated institution shall give the Board 30 days' written notice, as specified in § 225.73, before adding or replacing any member of its board of directors, employing any person as a senior executive officer of the institution, or changing the responsibilities of any senior executive officer so that the person would assume a different senior executive officer position, if:

(1) The regulated institution is not in compliance with all minimum capital requirements applicable to the institution as determined on the basis of the institution's most recent report of condition or report of examination or inspection;

(2) The regulated institution is in troubled condition; or

(3) The Board determines, in connection with its review of a capital restoration plan required under section 38 of the Federal Deposit Insurance Act or subpart B of the Board's Regulation H, or otherwise, that such notice is appropriate.

(b) *Prior notice by individual.* The prior notice required by paragraph (a) of this section may be provided by an individual seeking election to the board of directors of a regulated institution.

### § 225.73 Procedures for filing, processing, and acting on notices; standards for disapproval; waiver of notice.

(a) *Filing notice*—(1) *Content.* The notice required in § 225.72 shall be filed with the appropriate Reserve Bank and shall contain:

(i) The information required by paragraph 6(A) of the Change in Bank Control Act (12 U.S.C. 1817(j)(6)(A)) as may be prescribed in the designated Board form;

(ii) Additional information consistent with the Federal Financial Institutions Examination Council's Joint Statement of Guidelines on Conducting Background Checks and Change in Control Investigations, as set forth in the designated Board form; and

(iii) Such other information as may be required by the Board or Reserve Bank.

(2) *Modification.* The Reserve Bank may modify or accept other information in place of the requirements of § 225.73(a)(1) for a notice filed under this subpart.

(3) *Acceptance and processing of notice.* The 30-day notice period specified in § 225.72 shall begin on the date all information required to be submitted by the notificant pursuant to § 225.73(a)(1) is received by the appropriate Reserve

Bank. The Reserve Bank shall notify the regulated institution or individual submitting the notice of the date on which all required information is received and the notice is accepted for processing, and of the date on which the 30-day notice period will expire. The Board or Reserve Bank may extend the 30-day notice period for an additional period of not more than 60 days by notifying the regulated institution or individual filing the notice that the period has been extended and stating the reason for not processing the notice within the 30-day notice period.

(b) *Commencement of service*—(1) *At expiration of period.* A proposed director or senior executive officer may begin service after the end of the 30-day period and any extension as provided under paragraph (a)(3) of this section, unless the Board or Reserve Bank disapproves the notice before the end of the period.

(2) *Prior to expiration of period.* A proposed director or senior executive officer may begin service before the end of the 30-day period and any extension as provided under paragraph (a)(3) of this section, if the Board or the Reserve Bank notifies in writing the regulated institution or individual submitting the notice of the Board's or Reserve Bank's intention not to disapprove the notice.

(c) *Notice of disapproval.* The Board or Reserve Bank shall disapprove a notice under § 225.72 if the Board or Reserve Bank finds that the competence, experience, character, or integrity of the individual with respect to whom the notice is submitted indicates that it would not be in the best interests of the depositors of the regulated institution or in the best interests of the public to permit the individual to be employed by, or associated with, the regulated institution. The notice of disapproval shall contain a statement of the basis for disapproval and shall be sent to the regulated institution and the disapproved individual.

(d) *Appeal of a notice of disapproval.* (1) A disapproved individual or a regulated institution that has submitted a notice that is disapproved under this section may appeal the disapproval to the Board within 15 days of the effective date of the notice of disapproval. An appeal shall be in writing and explain the reasons for the appeal and include all facts, documents, and arguments that the appealing party wishes to be considered in the appeal, and state whether the appealing party is requesting an informal hearing.

(2) Written notice of the final decision of the Board shall be sent to the appealing party within 60 days of the receipt of an appeal, unless the appealing party's request for an informal hearing is granted.

(3) The disapproved individual may not serve as a director or senior executive officer of the state member bank or bank holding company while the appeal is pending.

(e) *Informal hearing.* (1) An individual or regulated institution whose notice under this section has been disapproved may request an informal hearing on the notice. A request for an informal hearing shall be in writing and shall be submitted within 15 days of a notice of disapproval. The Board may, in its sole discretion, order an informal hearing if the Board finds that oral argument is appropriate or necessary to resolve disputes regarding material issues of fact.

(2) An informal hearing shall be held within 30 days of a request, if granted, unless the requesting party agrees to a later date.

(3) Written notice of the final decision of the Board shall be given to the individual and the regulated institution within 60 days of the conclusion of any informal hearing ordered by the Board, unless the requesting party agrees to a later date.

(f) *Waiver of notice*—(1) *Waiver requests.* The Board or Reserve Bank may permit an individual to serve as a senior executive officer or director before the notice required under this subpart is provided, if the Board or Reserve Bank finds that:

(i) Delay would threaten the safety or soundness of the regulated institution or a bank controlled by a bank holding company;

(ii) Delay would not be in the public interest; or

(iii) Other extraordinary circumstances exist that justify waiver of prior notice.

(2) *Automatic waiver.* An individual may serve as a director upon election

to the board of directors of a regulated institution before the notice required under this subpart is provided if the individual:

(i) Is not proposed by the management of the regulated institution;

(ii) Is elected as a new member of the board of directors at a meeting of the regulated institution; and

(iii) Provides to the appropriate Reserve Bank all the information required in § 225.73(a) within two (2) business days after the individual's election.

(3) *Effect on disapproval authority*. A waiver shall not affect the authority of the Board or Reserve Bank to disapprove a notice within 30 days after a waiver is granted under paragraph (f)(1) of this section or the election of an individual who has filed a notice and is serving pursuant to an automatic waiver under paragraph (f)(2) of this section.

## Subpart I—Financial Holding Companies

SOURCE: Reg. Y, 66 FR 415, Jan. 3, 2001, unless otherwise noted.

### § 225.81 What is a financial holding company?

(a) *Definition*. A financial holding company is a bank holding company that meets the requirements of this section.

(b) *Requirements to be a financial holding company*. In order to be a financial holding company:

(1) All depository institutions controlled by the bank holding company must be and remain well capitalized;

(2) All depository institutions controlled by the bank holding company must be and remain well managed; and

(3) The bank holding company must have made an effective election to become a financial holding company.

(c) *Requirements for foreign banks that are or are owned by bank holding companies*—(1) *Foreign banks with U.S. branches or agencies that also own U.S. banks*. A foreign bank that is a bank holding company and that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section, § 225.82, and §§ 225.90 through 225.92 in order to be a financial holding company. After it becomes a financial holding company, a foreign bank described in this paragraph will be subject to the provisions of §§ 225.83, 225.84, 225.93, and 225.94.

(2) *Bank holding companies that own foreign banks with U.S. branches or agencies*. A bank holding company that owns a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States must comply with the requirements of this section, § 225.82, and §§ 225.90 through 225.92 in order to be a financial holding company. After it becomes a financial holding company, a bank holding company described in this paragraph will be subject to the provisions of §§ 225.83, 225.84, 225.93, and 225.94.

### § 225.82 How does a bank holding company elect to become a financial holding company?

(a) *Filing requirement*. A bank holding company may elect to become a financial holding company by filing a written declaration with the appropriate Reserve Bank. A declaration by a bank holding company is considered to be filed on the date that all information required by paragraph (b) of this section is received by the appropriate Reserve Bank.

(b) *Contents of declaration*. To be deemed complete, a declaration must:

(1) State that the bank holding company elects to be a financial holding company;

(2) Provide the name and head office address of the bank holding company and of each depository institution controlled by the bank holding company;

(3) Certify that each depository institution controlled by the bank holding company is well capitalized as of the date the bank holding company submits its declaration;

(4) Provide the capital ratios as of the close of the previous quarter for all relevant capital measures, as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o), for each depository institution controlled by the company on the date the company submits its declaration; and

(5) Certify that each depository institution controlled by the company is well managed as of the date the company submits its declaration.

(c) *Effectiveness of election.* An election by a bank holding company to become a financial holding company shall not be effective if, during the period provided in paragraph (e) of this section, the Board finds that, as of the date the declaration was filed with the appropriate Reserve Bank:

(1) Any insured depository institution controlled by the bank holding company (except an institution excluded under paragraph (d) of this section) has not achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the institution's most recent examination; or

(2) Any depository institution controlled by the bank holding company is not both well capitalized and well managed.

(d) *Consideration of the CRA performance of a recently acquired insured depository institution.* Except as provided in paragraph (f) of this section, an insured depository institution will be excluded for purposes of the review of the Community Reinvestment Act rating provisions of paragraph (c)(1) of this section if:

(1) The bank holding company acquired the insured depository institution during the 12-month period preceding the filing of an election under paragraph (a) of this section;

(2) The bank holding company has submitted an affirmative plan to the appropriate Federal banking agency for the institution to take actions necessary for the institution to achieve at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the next examination of the institution; and

(3) The appropriate Federal banking agency for the institution has accepted the plan described in paragraph (d)(2) of this section.

(e) *Effective date of election*—(1) *In general.* An election filed by a bank holding company under paragraph (a) of this section is effective on the 31st calendar day after the date that a complete declaration was filed with the appropriate Reserve Bank, unless the Board notifies the bank holding company prior to that time that the election is ineffective.

(2) *Earlier notification that an election is effective.* The Board or the appropriate Reserve Bank may notify a bank holding company that its election to become a financial holding company is effective prior to the 31st day after the date that a complete declaration was filed with the appropriate Reserve Bank. Such a notification must be in writing.

(f) *Requests to become a financial holding company submitted as part of an application to become a bank holding company*—(1) *In general.* A company that is not a bank holding company and has applied for the Board's approval to become a bank holding company under section 3(a)(1) of the BHC Act (12 U.S.C. 1842(a)(1)) may as part of that application submit a request to become a financial holding company.

(2) *Contents of request.* A request to become a financial holding company submitted as part of an application to become a bank holding company must:

(i) State that the company seeks to become a financial holding company on consummation of its proposal to become a bank holding company; and

(ii) Certify that each depository institution that would be controlled by the company on consummation of its proposal to become a bank holding company will be both well capitalized and well managed as of the date the company consummates the proposal.

(3) *Request becomes a declaration and an effective election on date of consummation of bank holding company proposal.* A complete request submitted by a company under this paragraph (f) becomes a complete declaration by a bank holding company for purposes of section 4(l) of the BHC Act (12 U.S.C. 1843(l)) and becomes an effective election for purposes of § 225.81(b) on the date that the company lawfully consummates its proposal under section 3 of the BHC Act (12 U.S.C. 1842), unless the Board notifies the company at any time prior to consummation of the proposal and that:

(i) Any depository institution that would be controlled by the company on consummation of the proposal will not

be both well capitalized and well managed on the date of consummation; or

(ii) Any insured depository institution that would be controlled by the company on consummation of the proposal has not achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the institution's most recent examination.

(4) *Limited exclusion for recently acquired institutions not available.* Unless the Board determines otherwise, an insured depository institution that is controlled or would be controlled by the company as part of its proposal to become a bank holding company may not be excluded for purposes of evaluating the Community Reinvestment Act criterion described in this paragraph or in paragraph (d) of this section.

(g) *Board's authority to exercise supervisory authority over a financial holding company.* An effective election to become a financial holding company does not in any way limit the Board's statutory authority under the BHC Act, the Federal Deposit Insurance Act, or any other relevant Federal statute to take appropriate action, including imposing supervisory limitations, restrictions, or prohibitions on the activities and acquisitions of a bank holding company that has elected to become a financial holding company, or enforcing compliance with applicable law.

### § 225.83 What are the consequences of failing to continue to meet applicable capital and management requirements?

(a) *Notice by the Board.* If the Board finds that a financial holding company controls any depository institution that is not well capitalized or well managed, the Board will notify the company in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the area(s) of noncompliance. The Board may provide this notice at any time before or after receiving notice from the financial holding company under paragraph (b) of this section.

(b) *Notification by a financial holding company required*—(1) *Notice to Board.* A financial holding company must notify the Board in writing within 15 calendar days of becoming aware that any depository institution controlled by the company has ceased to be well capitalized or well managed. This notification must identify the depository institution involved and the area(s) of noncompliance.

(2) *Triggering events for notice to the Board*—(i) *Well capitalized.* A company becomes aware that a depository institution it controls is no longer well capitalized upon the occurrence of any material event that would change the category assigned to the institution for purposes of section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o). *See* 12 CFR 6.3(b)–(c), 208.42(b)–(c), and 325.102(b)–(c).

(ii) *Well managed.* A company becomes aware that a depository institution it controls is no longer well managed at the time the depository institution receives written notice from the appropriate Federal or state banking agency that either its composite rating or its rating for management is not at least satisfactory.

(c) *Execution of agreement acceptable to the Board*—(1) *Agreement required; time period.* Within 45 days after receiving a notice from the Board under paragraph (a) of this section, the company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) *Extension of time for executing agreement.* Upon request by a company, the Board may extend the 45-day period under paragraph (c)(1) of this section if the Board determines that granting additional time is appropriate under the circumstances. A request by a company for additional time must include an explanation of why an extension is necessary.

(3) *Agreement requirements.* An agreement required by paragraph (c)(1) of this section to correct a capital or management deficiency must:

(i) Explain the specific actions that the company will take to correct all areas of noncompliance;

(ii) Provide a schedule within which each action will be taken;

(iii) Provide any other information that the Board may require; and

(iv) Be acceptable to the Board.

(d) *Limitations during period of noncompliance*—Until the Board determines that a company has corrected the conditions described in a notice under paragraph (a) of this section:

(1) The Board may impose any limitations or conditions on the conduct or activities of the company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the BHC Act; and

(2) The company and its affiliates may not commence any additional activity or acquire control or shares of any company under section 4(k) of the BHC Act without prior approval from the Board.

(e) *Consequences of failure to correct conditions within 180 days*—(1) *Divestiture of depository institutions.* If a company does not correct the conditions described in a notice under paragraph (a) of this section within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the company to divest ownership or control of any depository institution owned or controlled by the company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) *Alternative method of complying with a divestiture order.* A company may comply with an order issued under paragraph (e)(1) of this section by ceasing to engage (both directly and through any subsidiary that is not a depository institution or a subsidiary of a depository institution) in any activity that may be conducted only under section 4(k), (n), or (o) of the BHC Act (12 U.S.C. 1843(k), (n), or (o)). The termination of activities must be completed within the time period referred to in paragraph (e)(1) of this section and in accordance with the terms and conditions acceptable to the Board.

(f) *Consultation with other agencies.* In taking any action under this section, the Board will consult with the relevant Federal and state regulatory authorities.

### § 225.84 What are the consequences of failing to maintain a satisfactory or better rating under the Community Reinvestment Act at all insured depository institution subsidiaries?

(a) *Limitations on activities*—(1) *In general.* Upon receiving a notice regarding performance under the Community Reinvestment Act in accordance with paragraph (a)(2) of this section, a financial holding company may not:

(i) Commence any additional activity under section 4(k) or 4(n) of the BHC Act (12 U.S.C. 1843(k) or (n)); or

(ii) Directly or indirectly acquire control, including all or substantially all of the assets, of a company engaged in any activity under section 4(k) or 4(n) of the BHC Act (12 U.S.C. 1843(k) or (n)).

(2) *Notification.* A financial holding company receives notice for purposes of this paragraph at the time that the appropriate Federal banking agency for any insured depository institution controlled by the company or the Board provides notice to the institution or company that the institution has received a rating of ''needs to improve record of meeting community credit needs'' or ''substantial noncompliance in meeting community credit needs'' in the institution's most recent examination under the Community Reinvestment Act.

(b) *Exceptions for certain activities*—(1) *Continuation of investment activities.* The prohibition in paragraph (a) of this section does not prevent a financial holding company from continuing to make investments in the ordinary course of conducting merchant banking activities under section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)) or insurance company investment activities under section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I))if:

(i) The financial holding company lawfully was a financial holding company and commenced the merchant banking activity under section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)) or the insurance company investment activity under section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I)) prior to the time that an insured depository institution controlled by the financial holding company received a rating below ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act; and

(ii) The Board has not, in the exercise of its supervisory authority, advised the financial holding company that these activities must be restricted.

(2) *Activities that are closely related to banking.* The prohibition in paragraph (a) of this section does not prevent a financial holding company from commencing any additional activity or acquiring control of a company engaged in any activity under section 4(c) of the BHC Act (12 U.S.C. 1843(c)), if the company complies with the notice, approval, and other requirements of that section and section 4(j) of the BHC Act (12 U.S.C. 1843(j)).

(c) *Duration of prohibitions.* The prohibitions described in paragraph (a) of this section shall continue in effect until such time as each insured depository institution controlled by the financial holding company has achieved at least a rating of ''satisfactory record of meeting community credit needs'' under the Community Reinvestment Act at the most recent examination of the institution.

### § 225.85 Is notice to or approval from the Board required prior to engaging in a financial activity?

(a) *No prior approval required generally*—(1) *In general.* A financial holding company and any subsidiary (other than a depository institution or subsidiary of a depository institution) of the financial holding company may engage in any activity listed in § 225.86, or acquire shares or control of a company engaged exclusively in activities listed in § 225.86, without providing prior notice to or obtaining prior approval from the Board unless required under paragraph (c) of this section.

(2) *Acquisitions by a financial holding company of a company engaged in other permissible activities.* In addition to the activities listed in § 225.86, a company acquired or to be acquired by a financial holding company under paragraph (a)(1) of this section may engage in activities otherwise permissible for a financial holding company under this part in accordance with any applicable notice, approval, or other requirement.

(3) *Acquisition by a financial holding company of a company engaged in limited nonfinancial activities*—(i) *Mixed acquisitions generally permitted.* A financial holding company may under this subpart acquire more than 5 percent of the outstanding shares of any class of voting securities or control of a company that is not engaged exclusively in activities that are financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) of the BHC Act (12 U.S.C. 1843(c)) if:

(A) The company to be acquired is substantially engaged in activities that are financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) of the BHC Act (12 U.S.C. 1843(c));

(B) The financial holding company complies with the notice requirements of § 225.87, if applicable; and

(C) The company conforms, terminates, or divests, within 2 years of the date the financial holding company acquires shares or control of the company, all activities that are not financial in nature, incidental to a financial activity, or otherwise permissible for the financial holding company under section 4(c) (12 U.S.C. 1843(c))of the BHC Act.

(ii) *Definition of ''substantially engaged.''* Unless the Board determines otherwise, a company will be considered to be ''substantially engaged'' in activities permissible for a financial holding company for purposes of paragraph (a)(3)(A) of this section if at least 85 percent of the company's consolidated total annual gross revenues is derived from and at least 85 percent of the company's consolidated total assets is attributable to the conduct of activities that are financial in nature, incidental to a financial activity, or otherwise permissible for a financial holding company under section 4(c) of the BHC Act (12 U.S.C. 1843(c)).

(b) *Locations in which a financial holding company may conduct financial activities.* A financial holding company may conduct any activity listed in § 225.86 at any location in the United States or at any location outside of the United States subject to the laws of the jurisdiction in which the activity is conducted.

(c) *Circumstances under which prior notice to the Board is required*—(1) *Acquisition of more than 5 percent of the shares of a savings association.* A financial holding company must obtain Board approval in accordance with section 4(j) of the BHC Act (12 U.S.C. 1843(j))

and either § 225.14 or § 225.24, as appropriate, prior to acquiring control or more than 5 percent of the outstanding shares of any class of voting securities of a savings association or of a company that owns, operates, or controls a savings association.

(2) *Supervisory actions.* The Board may, if appropriate in the exercise of its supervisory or other authority, including under § 225.82(g) or § 225.83(d) or other relevant authority, require a financial holding company to provide notice to or obtain approval from the Board prior to engaging in any activity or acquiring shares or control of any company.

### § 225.86 What activities are permissible for any financial holding company?

The following activities are financial in nature or incidental to a financial activity:

(a) *Activities determined to be closely related to banking.* (1) Any activity that the Board had determined by regulation prior to November 12, 1999, to be so closely related to banking as to be a proper incident thereto, subject to the terms and conditions contained in this part, unless modified by the Board. These activities are listed in § 225.28.

(2) Any activity that the Board had determined by an order that was in effect on November 12, 1999, to be so closely related to banking as to be a proper incident thereto, subject to the terms and conditions contained in this part and those in the authorizing orders. These activities are:

(i) Providing administrative and other services to mutual funds (*Societe Generale*, 84 Federal Reserve Bulletin 680 (1998));

(ii) Owning shares of a securities exchange (*J.P. Morgan & Co, Inc., and UBS AG*, 86 Federal Reserve Bulletin 61 (2000));

(iii) Acting as a certification authority for digital signatures and authenticating the identity of persons conducting financial and nonfinancial transactions (*Bayerische Hypo- und Vereinsbank AG, et al.*, 86 Federal Reserve Bulletin 56 (2000));

(iv) Providing employment histories to third parties for use in making credit decisions and to depository institutions and their affiliates for use in the ordinary course of business (*Norwest Corporation*, 81 Federal Reserve Bulletin 732 (1995));

(v) Check cashing and wire transmission services (*Midland Bank, PLC*, 76 Federal Reserve Bulletin 860 (1990) (check cashing); *Norwest Corporation*, 81 Federal Reserve Bulletin 1130 (1995) (money transmission));

(vi) In connection with offering banking services, providing notary public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, and selling public transportation tickets and tokens (*Popular, Inc.*, 84 Federal Reserve Bulletin 481 (1998)); and

(vii) Real estate title abstracting (*The First National Company*, 81 Federal Reserve Bulletin 805 (1995)).

(b) *Activities determined to be usual in connection with the transaction of banking abroad.* Any activity that the Board had determined by regulation in effect on November 11, 1999, to be usual in connection with the transaction of banking or other financial operations abroad (*see* § 211.5(d) of this chapter), subject to the terms and conditions in part 211 and Board interpretations in effect on that date regarding the scope and conduct of the activity. In addition to the activities listed in paragraphs (a) and (c) of this section, these activities are:

(1) Providing management consulting services, including to any person with respect to nonfinancial matters, so long as the management consulting services are advisory and do not allow the financial holding company to control the person to which the services are provided;

(2) Operating a travel agency in connection with financial services offered by the financial holding company or others; and

(3) Organizing, sponsoring, and managing a mutual fund, so long as:

(i) The fund does not exercise managerial control over the entities in which the fund invests; and

(ii) The financial holding company reduces its ownership in the fund, if any, to less than 25 percent of the equity of the fund within one year of sponsoring the fund or such additional period as the Board permits.

(c) *Activities permitted under section 4(k)(4) of the BHC Act* (12 U.S.C. 1843(k)(4)). Any activity defined to be financial in nature under sections 4(k)(4)(A) through (E), (H) and (I) of the BHC Act (12 U.S.C. 1843(k)(4)(A) through (E), (H) and (I)).

(d) *Activities determined to be financial in nature or incidental to financial activities by the Board*—(1) *Acting as a finder*—Acting as a finder in bringing together one or more buyers and sellers of any product or service for transactions that the parties themselves negotiate and consummate.

(i) *What is the scope of finder activities?* Acting as a finder includes providing any or all of the following services through any means—

(A) Identifying potential parties, making inquiries as to interest, introducing and referring potential parties to each other, and arranging contacts between and meetings of interested parties;

(B) Conveying between interested parties expressions of interest, bids, offers, orders and confirmations relating to a transaction; and

(C) Transmitting information concerning products and services to potential parties in connection with the activities described in paragraphs (d)(1)(i)(A) and (B) of this section.

(ii) *What are some examples of finder services?* The following are examples of the services that may be provided by a finder when done in accordance with paragraphs (d)(1)(iii) and (iv) of this section. These examples are not exclusive.

(A) Hosting an electronic marketplace on the financial holding company's Internet web site by providing hypertext or similar links to the web sites of third party buyers or sellers.

(B) Hosting on the financial holding company's servers the Internet web site of—

(*1*) A buyer (or seller) that provides information concerning the buyer (or seller) and the products or services it seeks to buy (or sell) and allows sellers (or buyers) to submit expressions of interest, bids, offers, orders and confirmations relating to such products or services; or

(*2*) A government or government agency that provides information concerning the services or benefits made available by the government or government agency, assists persons in completing applications to receive such services or benefits from the government or agency, and allows persons to transmit their applications for services or benefits to the government or agency.

(C) Operating an Internet web site that allows multiple buyers and sellers to exchange information concerning the products and services that they are willing to purchase or sell, locate potential counterparties for transactions, aggregate orders for goods or services with those made by other parties, and enter into transactions between themselves.

(D) Operating a telephone call center that provides permissible finder services.

(iii) *What limitations are applicable to a financial holding company acting as a finder?* (A) A finder may act only as an intermediary between a buyer and a seller.

(B) A finder may not bind any buyer or seller to the terms of a specific transaction or negotiate the terms of a specific transaction on behalf of a buyer or seller, except that a finder may—

(*1*) Arrange for buyers to receive preferred terms from sellers so long as the terms are not negotiated as part of any individual transaction, are provided generally to customers or broad categories of customers, and are made available by the seller (and not by the financial holding company); and

(*2*) Establish rules of general applicability governing the use and operation of the finder service, including rules that—

(*i*) Govern the submission of bids and offers by buyers and sellers that use the finder service and the circumstances under which the finder service will match bids and offers submitted by buyers and sellers; and

(*ii*) Govern the manner in which buyers and sellers may bind themselves to the terms of a specific transaction.

(C) A finder may not—

(*1*) Take title to or acquire or hold an ownership interest in any product or service offered or sold through the finder service;

(*2*) Provide distribution services for physical products or services offered or sold through the finder service;

(*3*) Own or operate any real or personal property that is used for the purpose of manufacturing, storing, transporting, or assembling physical products offered or sold by third parties; or

(*4*) Own or operate any real or personal property that serves as a physical location for the physical purchase, sale or distribution of products or services offered or sold by third parties.

(D) A finder may not engage in any activity that would require the company to register or obtain a license as a real estate agent or broker under applicable law.

(iv) *What disclosures are required?* A finder must distinguish the products and services offered by the financial holding company from those offered by a third party through the finder service.

(2) [Reserved]

(e) *Activities permitted under section 4(k)(5) of the Bank Holding Company Act (12 U.S.C. 1843(k)(5)).* (1) The following types of activities are financial in nature or incidental to a financial activity when conducted pursuant to a determination by the Board under paragraph (e)(2) of this section:

(i) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

(ii) Providing any device or other instrumentality for transferring money or other financial assets; and

(iii) Arranging, effecting, or facilitating financial transactions for the account of third parties.

(2) *Review of specific activities*—(i) *Is a specific request required?* A financial holding company that wishes to engage on the basis of paragraph (e)(1) of this section in an activity that is not otherwise permissible for a financial holding company must obtain a determination from the Board that the activity is permitted under paragraph (e)(1).

(ii) *Consultation with the Secretary of the Treasury*. After receiving a request under this section, the Board will provide the Secretary of the Treasury with a copy of the request and consult with the Secretary in accordance with section 4(k)(2)(A) of the Bank Holding Company Act (12 U.S.C. 1843(k)(2)(A)).

(iii) *Board action on requests*. After consultation with the Secretary, the Board will promptly make a written determination regarding whether the specific activity described in the request is included in an activity category listed in paragraph (e)(1) of this section and is therefore either financial in nature or incidental to a financial activity.

(3) *What factors will the Board consider?* In evaluating a request made under this section, the Board will take into account the factors listed in section 4(k)(3) of the BHC Act (12 U.S.C. 1843(k)(3)) that it must consider when determining whether an activity is financial in nature or incidental to a financial activity.

(4) *What information must the request contain?* Any request by a financial holding company under this section must be in writing and must:

(i) Identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted; and

(ii) Provide information supporting the requested determination, including information regarding how the proposed activity falls into one of the categories listed in paragraph (e)(1) of this section, and any other information required by the Board concerning the proposed activity.

[Reg. Y, 66 FR 415, Jan. 3, 2001, as amended at 66 FR 19081, Apr. 13, 2001]

### § 225.87 Is notice to the Board required after engaging in a financial activity?

(a) *Post-transaction notice generally required to engage in a financial activity*. A financial holding company that commences an activity or acquires shares of a company engaged in an activity listed in § 225.86 must notify the appropriate Reserve Bank in writing within 30 calendar days after commencing the activity or consummating the acquisition by using the appropriate form.

(b) *Cases in which notice to the Board is not required*—(1) *Acquisitions that do not involve control of a company*. A notice under paragraph (a) of this section is not required in connection with the

acquisition of shares of a company if, following the acquisition, the financial holding company does not control the company.

(2) *No additional notice required to engage* de novo *in an activity for which a financial holding company already has provided notice.* After a financial holding company provides the appropriate Reserve Bank with notice that the company is engaged in an activity listed in § 225.86, a financial holding company may, unless otherwise notified by the Board, commence the activity *de novo* through any subsidiary that the financial holding company is authorized to control without providing additional notice under paragraph (a) of this section.

(3) *Conduct of certain investment activities.* Unless required by paragraph (b)(4) of this section, a financial holding company is not required to provide notice under paragraph (a) of this section of any individual acquisition of shares of a company as part of the conduct by a financial holding company of securities underwriting, dealing, or market making activities as described in section 4(k)(4)(E) of the BHC Act (12 U.S.C. 1843(k)(4)(E)), merchant banking activities conducted pursuant to section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)), or insurance company investment activities conducted pursuant to section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I)), if the financial holding company previously has notified the Board under paragraph (a) of this section that the company has commenced the relevant securities, merchant banking, or insurance company investment activities, as relevant.

(4) *Notice of large merchant banking or insurance company investments.* Notwithstanding paragraph (b)(1) or (b)(3) of this section, a financial holding company must provide notice under paragraph (a) of the section if:

(i) As part of a merchant banking activity conducted under section 4(k)(4)(H) of the BHC Act (12 U.S.C. 1843(k)(4)(H)), the financial holding company acquires more than 5 percent of the shares, assets, or ownership interests of any company at a total cost that exceeds the lesser of 5 percent of the financial holding company's Tier 1 capital or $200 million;

(ii) As part of an insurance company investment activity conducted under section 4(k)(4)(I) of the BHC Act (12 U.S.C. 1843(k)(4)(I)), the financial holding company acquires more than 5 percent of the shares, assets, or ownership interests of any company at a total cost that exceeds the lesser of 5 percent of the financial holding company's Tier 1 capital or $200 million; or

(iii) The Board in the exercise of its supervisory authority notifies the financial holding company that a notice is necessary.

### § 225.88 How to request the Board to determine that an activity is financial in nature or incidental to a financial activity?

(a) *Requests regarding activities that may be financial in nature or incidental to a financial activity.* A financial holding company or other interested party may request a determination from the Board that an activity not listed in § 225.86 is financial in nature or incidental to a financial activity.

(b) *Required information.* A request submitted under this section must be in writing and must:

(1) Identify and define the activity for which the determination is sought, specifically describing what the activity would involve and how the activity would be conducted;

(2) Explain in detail why the activity should be considered financial in nature or incidental to a financial activity; and

(3) Provide information supporting the requested determination and any other information required by the Board concerning the proposed activity.

(c) *Board procedures for reviewing requests*—(1) *Consultation with the Secretary of the Treasury.* Upon receipt of the request, the Board will provide the Secretary of the Treasury a copy of the request and consult with the Secretary in accordance with section 4(k)(2)(A) of the BHC Act (12 U.S.C. 1843(k)(2)(A)).

(2) *Public notice.* The Board may, as appropriate and after consultation with the Secretary, publish a description of the proposal in the FEDERAL

REGISTER with a request for public comment.

(d) *Board action.* The Board will endeavor to make a decision on any request filed under paragraph (a) of this section within 60 calendar days following the completion of both the consultative process described in paragraph (c)(1) of this section and the public comment period, if any.

(e) *Advisory opinions regarding scope of financial activities*—(1) *Written request.* A financial holding company or other interested party may request an advisory opinion from the Board about whether a specific proposed activity falls within the scope of an activity listed in § 225.86 as financial in nature or incidental to a financial activity. The request must be submitted in writing and must contain:

(i) A detailed description of the particular activity in which the company proposes to engage or the product or service the company proposes to provide;

(ii) An explanation supporting an interpretation regarding the scope of the permissible financial activity; and

(iii) Any additional information requested by the Board regarding the activity.

(2) *Board response.* The Board will provide an advisory opinion within 45 calendar days of receiving a complete written request under paragraph (e)(1) of this section.

### § 225.89 How to request approval to engage in an activity that is complementary to a financial activity?

(a) *Prior Board approval is required.* A financial holding company that seeks to engage in or acquire more than 5 percent of the outstanding shares of any class of voting securities of a company engaged in an activity that the financial holding company believes is complementary to a financial activity must obtain prior approval from the Board in accordance with section 4(j) of the BHC Act (12 U.S.C. 1843(j)). The notice must be in writing and must:

(1) Identify and define the proposed complementary activity, specifically describing what the activity would involve and how the activity would be conducted;

(2) Identify the financial activity for which the proposed activity would be complementary and provide detailed information sufficient to support a finding that the proposed activity should be considered complementary to the identified financial activity;

(3) Describe the scope and relative size of the proposed activity, as measured by the percentage of the projected financial holding company revenues expected to be derived from and assets associated with conducting the activity;

(4) Discuss the risks that conducting the activity may reasonably be expected to pose to the safety and soundness of the subsidiary depository institutions of the financial holding company and to the financial system generally;

(5) Describe the potential adverse effects, including potential conflicts of interest, decreased or unfair competition, or other risks, that conducting the activity could raise, and explain the measures the financial holding company proposes to take to address those potential effects;

(6) Describe the potential benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that the proposal reasonably can be expected to produce; and

(7) Provide any information about the financial and managerial resources of the financial holding company and any other information requested by the Board.

(b) *Factors for consideration by the Board.* In evaluating a notice to engage in a complementary activity, the Board must consider whether:

(1) The proposed activity is complementary to a financial activity;

(2) The proposed activity would pose a substantial risk to the safety or soundness of depository institutions or the financial system generally; and

(3) The proposal could be expected to produce benefits to the public that outweigh possible adverse effects.

(c) *Board action.* The Board will inform the financial holding company in writing of the Board's determination regarding the proposed activity within the period described in section 4(j) of the BHC Act (12 U.S.C. 1843(j)).

**§ 225.90 What are the requirements for a foreign bank to be treated as a financial holding company?**

(a) *Foreign banks as financial holding companies.* A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, and any company that owns or controls such a foreign bank, will be treated as a financial holding company if:

(1) The foreign bank, any other foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, and any U.S. depository institution subsidiary that is owned or controlled by the foreign bank or company, is and remains well capitalized and well managed; and

(2) The foreign bank, and any company that owns or controls the foreign bank, has made an effective election to be treated as a financial holding company under this subpart.

(b) *Standards for ''well capitalized.''* A foreign bank will be considered ''well capitalized'' if either:

(1)(i) Its home country supervisor, as defined in § 211.21 of the Board's Regulation K (12 CFR 211.21), has adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord);

(ii) The foreign bank maintains a Tier 1 capital to total risk-based assets ratio of 6 percent and a total capital to total risk-based assets ratio of 10 percent, as calculated under its home country standard; and

(iii) The foreign bank's capital is comparable to the capital required for a U.S. bank owned by a financial holding company; or

(2) The foreign bank has obtained a determination from the Board under § 225.91(c) that the foreign bank's capital is otherwise comparable to the capital that would be required of a U.S. bank owned by a financial holding company.

(c) *Standards for ''well managed.''* A foreign bank will be considered ''well managed'' if:

(1) The foreign bank has received at least a satisfactory composite rating of its U.S. branch, agency, and commercial lending company operations at its most recent assessment;

(2) The home country supervisor of the foreign bank consents to the foreign bank expanding its activities in the United States to include activities permissible for a financial holding company; and

(3) The management of the foreign bank meets standards comparable to those required of a U.S. bank owned by a financial holding company.

**§ 225.91 How may a foreign bank elect to be treated as a financial holding company?**

(a) *Filing requirement.* A foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, or a company that owns or controls such a foreign bank, may elect to be treated as a financial holding company by filing a written declaration with the appropriate Reserve Bank.

(b) *Contents of declaration.* The declaration must:

(1) State that the foreign bank or the company elects to be treated as a financial holding company;

(2) Provide the risk-based capital ratios and amount of Tier 1 capital and total assets of the foreign bank, and of each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, as of the close of the most recent quarter and as of the close of the most recent audited reporting period;

(3) Certify that the foreign bank, and each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, meets the standards of well capitalized set out in § 225.90(b)(1)(i) and (ii) or § 225.90(b)(2) as of the date the foreign bank or company files its election;

(4) Certify that the foreign bank, and each foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, is well managed as defined in § 225.90(c)(1) as of the date the foreign bank or company files its election;

(5) Certify that all U.S. depository institution subsidiaries of the foreign

bank or company are well capitalized and well managed as of the date the foreign bank or company files its election; and

(6) Provide the capital ratios for all relevant capital measures (as defined in section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831(o))) as of the close of the previous quarter for each U.S. depository institution subsidiary of the foreign bank or company.

(c) *Pre-clearance process.* Before filing an election to be treated as a financial holding company, a foreign bank or company may file a request for review of its qualifications to be treated as a financial holding company. The Board will endeavor to make a determination on such requests within 30 days of receipt. A foreign bank that has not been found, or that is chartered in a country where no bank from that country has been found, by the Board under the Bank Holding Company Act or the International Banking Act to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor is required to use this process.

### § 225.92 How does an election by a foreign bank become effective?

(a) *In general.* An election described in § 225.91 is effective on the 31st day after the date that an election was received by the appropriate Federal Reserve Bank, unless the Board notifies the foreign bank or company prior to that time that:

(1) The election is ineffective; or

(2) The period is extended with the consent of the foreign bank or company making the election.

(b) *Earlier notification that an election is effective.* The Board or the appropriate Federal Reserve Bank may notify a foreign bank or company that its election to be treated as a financial holding company is effective prior to the 31st day after the election was filed with the appropriate Federal Reserve Bank. Such notification must be in writing.

(c) *Under what circumstances will the Board find an election to be ineffective?* An election to be treated as a financial holding company shall not be effective if, during the period provided in paragraph (a) of this section, the Board finds that:

(1) The foreign bank certificant, or any foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States and is controlled by a foreign bank or company certificant, is not both well capitalized and well managed;

(2) Any U.S. insured depository institution subsidiary of the foreign bank or company (except an institution excluded under paragraph (d) of this section) or any U.S. branch of a foreign bank that is insured by the Federal Deposit Insurance Corporation has not achieved at least a rating of ''satisfactory record of meeting community needs'' under the Community Reinvestment Act at the institution's most recent examination;

(3) Any U.S. depository institution subsidiary of the foreign bank or company is not both well capitalized and well managed; or

(4) The Board does not have sufficient information to assess whether the foreign bank or company making the election meets the requirements of this subpart.

(d) *How is CRA performance of recently acquired insured depository institutions considered?* An insured depository institution will be excluded for purposes of the review of CRA ratings described in paragraph (c)(2) of this section consistent with the provisions of § 225.82(d).

(e) *Factors used in the Board's determination regarding comparability of capital and management*—(1) *In general.* In determining whether a foreign bank is well capitalized and well managed in accordance with comparable capital and management standards, the Board will give due regard to national treatment and equality of competitive opportunity. In this regard, the Board may take into account the foreign bank's composition of capital, Tier 1 capital to total assets leverage ratio, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements, the foreign bank's anti-money laundering procedures, whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis,

and other factors that may affect analysis of capital and management. The Board will consult with the home country supervisor for the foreign bank as appropriate.

(2) *Assessment of consolidated supervision.* A foreign bank that is not subject to comprehensive supervision on a consolidated basis by its home country authorities may not be considered well capitalized and well managed unless:

(i) The home country has made significant progress in establishing arrangements for comprehensive supervision on a consolidated basis; and

(ii) The foreign bank is in strong financial condition as demonstrated, for example, by capital levels that significantly exceed the minimum levels that are required for a well capitalized determination and strong asset quality.

### § 225.93 What are the consequences of a foreign bank failing to continue to meet applicable capital and management requirements?

(a) *Notice by the Board.* If a foreign bank or company has made an effective election to be treated as a financial holding company under this subpart and the Board finds that the foreign bank, any foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, or any U.S. depository institution subsidiary controlled by the foreign bank or company, ceases to be well capitalized or well managed, the Board will notify the foreign bank and company, if any, in writing that it is not in compliance with the applicable requirement(s) for a financial holding company and identify the areas of noncompliance.

(b) *Notification by a financial holding company required*—(1) *Notice to Board.* Promptly upon becoming aware that the foreign bank, any foreign bank that maintains a U.S. branch, agency, or commercial lending company and is controlled by the foreign bank or company, or any U.S. depository institution subsidiary of the foreign bank or company, has ceased to be well capitalized or well managed, the foreign bank and company, if any, must notify the Board and identify the area of noncompliance.

(2) *Triggering events for notice to the Board*—(i) *Well capitalized.* A foreign bank becomes aware that it is no longer well capitalized at the time that the foreign bank or company is required to file a report of condition (or similar supervisory report) with its home country supervisor or the appropriate Federal Reserve Bank that indicates that the foreign bank no longer meets the well capitalized standards.

(ii) *Well managed.* A foreign bank becomes aware that it is no longer well managed at the time that the foreign bank receives written notice from the appropriate Federal Reserve Bank that the composite rating of its U.S. branch, agency, and commercial lending company operations is not at least satisfactory.

(c) *Execution of agreement acceptable to the Board*—(1) *Agreement required; time period.* Within 45 days after receiving a notice under paragraph (a) of this section, the foreign bank or company must execute an agreement acceptable to the Board to comply with all applicable capital and management requirements.

(2) *Extension of time for executing agreement.* Upon request by the foreign bank or company, the Board may extend the 45-day period under paragraph (c)(1) of this section if the Board determines that granting additional time is appropriate under the circumstances. A request by a foreign bank or company for additional time must include an explanation of why an extension is necessary.

(3) *Agreement requirements.* An agreement required by paragraph (c)(1) of this section to correct a capital or management deficiency must:

(i) Explain the specific actions that the foreign bank or company will take to correct all areas of noncompliance;

(ii) Provide a schedule within which each action will be taken;

(iii) Provide any other information that the Board may require; and

(iv) Be acceptable to the Board.

(d) *Limitations during period of noncompliance*—Until the Board determines that a foreign bank or company has corrected the conditions described in a notice under paragraph (a) of this section:

(1) The Board may impose any limitations or conditions on the conduct or the U.S. activities of the foreign bank or company or any of its affiliates as the Board finds to be appropriate and consistent with the purposes of the Bank Holding Company Act; and

(2) The foreign bank or company and its affiliates may not commence any additional activity in the United States or acquire control or shares of any company under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1843(k)) without prior approval from the Board.

(e) *Consequences of failure to correct conditions within 180 days*—(1) *Termination of Offices and Divestiture*. If a foreign bank or company does not correct the conditions described in a notice under paragraph (a) of this section within 180 days of receipt of the notice or such additional time as the Board may permit, the Board may order the foreign bank or company to terminate the foreign bank's U.S. branches and agencies and divest any commercial lending companies owned or controlled by the foreign bank or company. Such divestiture must be done in accordance with the terms and conditions established by the Board.

(2) *Alternative method of complying with a divestiture order*. A foreign bank or company may comply with an order issued under paragraph (e)(1) of this section by ceasing to engage (both directly and through any subsidiary that is not a depository institution or a subsidiary of a depository institution) in any activity that may be conducted only under section 4(k), (n), or (o) of the BHC Act (12 U.S.C. 1843(k), (n) and (o)). The termination of activities must be completed within the time period referred to in paragraph (e)(1) of this section and subject to terms and conditions acceptable to the Board.

(f) *Consultation with Other Agencies*. In taking any action under this section, the Board will consult with the relevant Federal and state regulatory authorities and the appropriate home country supervisor(s) of the foreign bank.

### § 225.94 What are the consequences of an insured branch or depository institution failing to maintain a satisfactory or better rating under the Community Reinvestment Act?

(a) *Insured branch as an ''insured depository institution.''* A U.S. branch of a foreign bank that is insured by the Federal Deposit Insurance Corporation shall be treated as an ''insured depository institution'' for purposes of § 225.84.

(b) *Applicability*. The provisions of § 225.84, with the modifications contained in this section, shall apply to a foreign bank that operates an insured branch referred to in paragraph (a) of this section or an insured depository institution in the United States, and any company that owns or controls such a foreign bank, that has made an effective election under § 225.92 in the same manner and to the same extent as they apply to a financial holding company.

INTERPRETATIONS

### § 225.101 Bank holding company's subsidiary banks owning shares of nonbanking companies.

(a) The Board's opinion has been requested on the following related matters under the Bank Holding Company Act of 1956.

(b) The question is raised as to whether shares in a nonbanking company which were acquired by a banking subsidiary of the bank holding company many years ago when their acquisition was lawful and are now held as investments, and which do not include more than 5 percent of the outstanding voting securities of such nonbanking company and do not have a value greater than 5 percent of the value of the bank holding company's total assets, are exempted from the divestment requirements of the Act by the provisions of section 4(c)(5) of the Act.

(c) In the Board's opinion, this exemption is as applicable to such shares when held by a banking subsidiary of a bank holding company as when held directly by the bank holding company itself. While the exemption specifically refers only to shares held or acquired by the bank holding company, the prohibition of the Act against retention of

nonbanking interests applies to indirect as well as direct ownership of shares of a nonbanking company, and, in the absence of a clear mandate to the contrary, any exception to this prohibition should be given equal breadth with the prohibition. Any other interpretation would lead to unwarranted results.

(d) Although certain of the other exemptions in section 4(c) of the Act specifically refer to shares held or acquired by banking subsidiaries, an analysis of those exemptions suggests that such specific reference to banking subsidiaries was for the purpose of excluding nonbanking subsidiaries from such exemptions, rather than for the purpose of providing an inclusionary emphasis on banking subsidiaries.

(e) It should be noted that the Board's view as to this question should not be interpreted as meaning that each banking subsidiary could own up to 5 percent of the stock of the same nonbanking organization. In the Board's opinion the limitations set forth in section 4(c)(5) apply to the aggregate amount of stock held in a particular organization by the bank holding company itself and by all of its subsidiaries.

(f) Secondly, question is raised as to whether shares in a nonbanking company acquired in satisfaction of debts previously contracted (d.p.c.) by a banking subsidiary of the bank holding company may be retained if such shares meet the conditions contained in section 4(c)(5) as to value and amount, notwithstanding the requirement of section 4(c)(2) that shares acquired d.p.c. be disposed of within two years after the date of their acquisition or the date of the Act, whichever is later. In the Board's opinion, the 5 percent exemption provided by section 4(c)(5) covers any shares, including shares acquired d.p.c., that meet the conditions set forth in that exemption, and, consequently, d.p.c. shares held by a banking subsidiary of a bank holding company which meet such conditions are not subject to the two-year disposition requirement prescribed by section 4(c)(2), although any such shares would, of course, continue to be subject to such requirement for disposition as may be prescribed by provisions of any applicable banking laws or by the appropriate bank supervisory authorities.

(g) Finally, question is raised as to whether shares held by banking subsidiaries of the bank holding company in companies holding bank premises of such subsidiaries are exempted from the divestment requirements by section 4(c)(1) of the Act. It is the Board's view that section 4(c)(1), exempting shares owned or acquired by a bank holding company in any company engaged solely in holding or operating properties used wholly or substantially by any subsidiary bank, is to be read and interpreted, like section 4(c)(5), as applying to shares owned indirectly by a bank holding company through a banking subsidiary as well as to shares held directly by the bank holding company. A contrary interpretation would impair the right that member banks controlled by bank holding companies would otherwise have to invest, subject to the limitations of section 24A of the Federal Reserve Act, in stock of companies holding their bank premises; and such a result was not, in the Board's opinion, intended by the Bank Holding Company Act.

[21 FR 10472, Dec. 29, 1956. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.102 Bank holding company indirectly owning nonbanking company through subsidiaries.

(a) The Board of Governors has been requested for an opinion regarding the exemptions contained in section 4(c)(5) of the Bank Holding Company Act of 1956. It is stated that Y Company is an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting securities of any company and do not include any asset having a value greater than 5 per centum of the value of the total assets of X Corporation, a bank holding company. It is stated that direct ownership by X Corporation of voting shares of Y Company would be exempt by reason of section 4(c)(5) from the prohibition of section 4 of the Act against ownership by bank holding companies of nonbanking assets.

(b) It was asked whether it makes any difference that the shares of Y Company are not owned directly by X Corporation but instead are owned through Subsidiaries A and B. X Corporation owns all the voting shares of Subsidiary A, which owns one-half of the voting shares of Subsidiary B. Subsidiaries A and B each own one-third of the voting shares of Y Company.

(c) Section 4(c)(5) is divided into two parts. The first part exempts the ownership of securities of nonbanking companies when the securities do not include more than 5 percent of the voting securities of the nonbanking company and do not have a value greater than 5 percent of the value of the total assets of the bank holding company. The second part exempts the ownership of securities of an investment company which is not a bank holding company and is not engaged in any business other than investing in securities, provided the securities held by the investment company meet the 5 percent tests mentioned above.

(d) In § 225.101, the Board expressed the opinion that the first exemption in section 4(c)(5):

> * * * is as applicable to such shares when held by a banking subsidiary of a bank holding company as when held directly by the bank holding company itself. While the exemption specifically refers only to shares held or acquired by the bank holding company, the prohibition of the Act against retention of nonbanking interests applies to indirect as well as direct ownership of shares of a nonbanking company, and, in the absence of a clear mandate to the contrary, any exception to this prohibition should be given equal breadth with the prohibition. Any other interpretation would lead to unwarranted results.

(e) The Board is of the view that the principles stated in that opinion are also applicable to the second exemption in section 4(c)(5), and that they apply whether or not the subsidiary owning the shares is a banking subsidiary. Accordingly, on the basis of the facts presented, the Board is of the opinion that the second exemption in section 4(c)(5) applies to the indirect ownership by X Corporation of shares of Y Company through Subsidiaries A and B.

[22 FR 2533, Apr. 13, 1957. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.103 Bank holding company acquiring stock by dividends, stock splits or exercise of rights.

(a) The Board of Governors has been asked whether a bank holding company may receive bank stock dividends or participate in bank stock splits without the Board's prior approval, and whether such a company may exercise, without the Board's prior approval, rights to subscribe to new stock issued by banks in which the holding company already owns stock.

(b) Neither a stock dividend nor a stock split results in any change in a stockholder's proportional interest in the issuing company or any increase in the assets of that company. Such a transaction would have no effect upon the extent of a holding company's control of the bank involved; and none of the five factors required by the Bank Holding Company Act to be considered by the Board in approving a stock acquisition would seem to have any application. In view of the objectives and purposes of the act, the word ''acquire'' would not seem reasonably to include transactions of this kind.

(c) On the other hand, the exercise by a bank holding company of the right to subscribe to an issue of additional stock of a bank could result in an increase in the holding company's proportional interest in the bank. The holding company would voluntarily pay additional funds for the extra shares and would ''acquire'' the additional stock even under a narrow meaning of that term. Moreover, the exercise of such rights would cause the assets of the issuing company to be increased and in a sense, therefore, the ''size or extent'' of the bank holding company system would be expanded.

(d) In the circumstances, it is the Board's opinion that receipt of bank stock by means of a stock dividend or stock split, assuming no change in the class of stock, does not require the Board's prior approval under the act, but that purchase of bank stock by a bank holding company through the exercise of rights does require the Board's prior approval, unless one of the exceptions set forth in section 3(a) is applicable.

[22 FR 7461, Sept. 19, 1957. Redesignated at 36 FR 21666, Nov. 12, 1971]

**§ 225.104 "Services" under section 4(c)(1) of Bank Holding Company Act.**

(a) Section 4(c)(1) of the Bank Holding Company Act, among other things, exempts from the nonbanking divestment requirements of section 4(a) of the Act shares of a company engaged ''solely in the business of furnishing services to or performing services for'' its bank holding company or subsidiary banks thereof.

(b) The Board of Governors has had occasion to express opinions as to whether this section of law applies to the following two sets of facts:

(1) In the first case, Corporation X, a nonbanking subsidiary of a bank holding company (Holding Company A), was engaged in the business of purchasing installment paper suitable for investment by banking subsidiaries of Holding Company A. All installment paper purchased by Corporation X was sold by it to a bank which is a subsidiary of Holding Company A, without recourse, at a price equal to the cost of the installment paper to Corporation X, and with compensation to the latter based on the earnings from such paper remaining after certain reserves, expenses and charges. The subsidiary bank sold participations in such installment paper to the other affiliated banks of Holding Company A which desired to participate. Purchases by Corporation X consisted mainly of paper insured under Title I of the National Housing Act and, in addition, Corporation X purchased time payment contracts covering sales of appliances by dealers under contractual arrangements with utilities, as well as paper covering home improvements which was not insured. Pursuant to certain service agreements, Corporation X made all collections, enforced guaranties, filed claims under Title I insurance and performed other services for the affiliated banks. Also Corporation X rendered to banking subsidiaries of Holding Company A various accounting, statistical and advisory services such as payroll, life insurance and budget loan installment account.

(2) In the second case, Corporation Y, a nonbanking subsidiary of a bank holding company (Holding Company B, which was also a bank), solicited business on behalf of Holding Company B from dealers, throughout several adjoining or contiguous States, who made time sales and desired to convert their time sales paper into cash; but Corporation Y made no loans or purchases of sales contracts and did not discount or advance money for time sales obligations. Corporation Y investigated credit standings of purchasers obligated on time sale contracts to be acquired by Holding Company B, Corporation Y received from dealers the papers offered by them and inspected such papers to see that they were in order, and transmitted to Holding Company B for its determination to purchase, including, in some cases, issuance of drafts in favor of dealers in order to facilitate their prompt receipt of payment for installment paper purchased by Holding Company B. Corporation Y made collections of delinquent paper or delinquent installments, which sometimes involved repossession and resale of the automobile or other property which secured the paper. Also, upon request of purchasers obligated on paper held by Holding Company B, Corporation Y transmitted installment payments to Holding Company B. Holding Company B reimbursed Corporation Y for its actual costs and expenses in performing the services mentioned above, including the salaries and wages of all Corporation Y officers and employees.

(c) While the term ''services'' is sometimes used in a broad and general sense, the legislative history of the Bank Holding Company Act indicates that in section 4(c)(1) the word was meant to be somewhat more limited in its application. An early version of the bill specifically exempted companies engaged in serving the bank holding company and its subsidiary banks in ''auditing, appraising, investment counseling''. The statute as finally enacted does not expressly mention any specific type of servicing activity for exemption. In recommending the change, the Senate Banking and Currency Committee stated that the types of services contemplated are ''in the fields of advertising, public relations, developing new business, organizations,

operations, preparing tax returns, personnel, and many others'', which indicates that latitude should be given to the range of activities contemplated by this section beyond those specifically set forth in the early draft of the bill. (84th Cong., 2d Sess., Senate Report 1095, Part 2, p. 3.) It nevertheless seems evident that Congress intended such services to be types of activities generally comparable to those mentioned above from the early bill (''auditing, appraising, investment counseling'') and in the excerpt from the Committee Report on the later bill (''advertising, public relations, developing new business, organization, operations, preparing tax returns, personnel, and many others''). This legislative history and the context in which the term ''services'' is used in section 4(c)(1) seem to suggest that the term was in general intended to refer to servicing operations which a bank could carry on itself, but which the bank or its holding company chooses to have done through another organization. Moreover, the report of the Senate Banking and Currency Committee indicated that the types of servicing permitted under section 4(c)(1) are to be distinguished from activities of a ''financial, fiduciary, or insurance nature'', such as those which might be considered for possible exemption under section 4(c)(6) of the Act.

(d) With respect to the first set of facts, the Board expressed the opinion that certain of the activities of Corporation X, such as the accounting, statistical and advisory services referred to above, may be within the range of servicing activities contemplated by section 4(c)(1), but that this would not appear to be the case with the main activity of Corporation X, which was the purchase of installment paper and the resale of such paper at cost, without recourse, to banking subsidiaries of Holding Company A. This latter and basic activity of Corporation X appeared to involve essentially a financial relationship between it and the banking subsidiaries of Holding Company A and appeared beyond the category of servicing exemptions contemplated by section 4(c)(1) of the Act. Accordingly, it was the Board's view that Corporation X could not be regarded as qualifying under section 4 (c)(1) as a company engaged ''solely in the business of furnishing services to or performing services for'' Holding Company A or subsidiary banks thereof.

(e) With respect to the second set of facts, the Board expressed the opinion that some of the activities engaged in by Corporation Y were clearly within the range of servicing activities contemplated by section 4(c)(1). There was some question as to whether or not some of the other activities of Corporation Y mentioned above could meet the test, but on balance, it seemed that all such activities probably were activities in which Holding Company B, which as already indicated was a bank, could itself engage, at the present locations of Corporation Y, without being engaged in the operation of bank branches at those locations. In the circumstances, while the question was not free from doubt, the Board expressed the opinion that the activities of Corporation Y were those of a company engaged ''solely in the business of furnishing services to or performing services for'' Holding Company B within the meaning of section 4(c)(1) of the Act, and that, accordingly, the control by Holding Company B of shares in Corporation Y was exempted under that section.

[23 FR 2675, May 23, 1958. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.107 Acquisition of stock in small business investment company.

(a) A registered bank holding company requested an opinion by the Board of Governors with respect to whether that company and its banking subsidiaries may acquire stock in a small business investment company organized pursuant to the Small Business Investment Act of 1958.

(b) It is understood that the bank holding company and its subsidiary banks propose to organize and subscribe for stock in a small business investment company which would be chartered pursuant to the Small Business Investment Act of 1958 which provides for long-term credit and equity financing for small business concerns.

(c) Section 302(b) of the Small Business Investment Act authorizes national banks, as well as other member banks and nonmember insured banks to the extent permitted by applicable State law, to invest capital in small business investment companies not exceeding one percent of the capital and surplus of such banks. Section 4(c)(4) of the Bank Holding Company Act exempts from the prohibitions of section 4 of the Act ''shares which are of the kinds and amounts eligible for investment by National banking associations under the provisions of section 5136 of the Revised Statutes''. Section 5136 of the Revised Statutes (paragraph ''Seventh'') in turn provides, in part, as follows:

> Except as hereinafter provided or otherwise permitted by law nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation.

Since the shares of a small business investment company are of a kind and amount expressly made eligible for investment by a national bank under the Small Business Investment Act of 1958, it follows, therefore, that the ownership or control of such shares by a bank holding company would be exempt from the prohibitions of section 4 of the Bank Holding Company Act by virtue of the provisions of section 4(c)(4) of that Act. Accordingly, the ownership or control of such shares by the bank holding company would be exempt from the prohibitions of section 4 of the Bank Holding Company Act.

(d) An additional question is presented, however, as to whether section 6 of the Bank Holding Company Act prohibits banking subsidiaries of the bank holding company from purchasing stock in a small business investment company where the latter is a ''subsidiary'' under that Act.

(e) Section 6(a)(1) of the Act makes it unlawful for a bank to invest any of its funds in the capital stock of any other subsidiary of the bank holding company. However, section 6(a)(1) was, in effect, amended by section 302(b) of the Small Business Investment Act (15 U.S.C. 682) as amended by the Act of June 11, 1960 (Pub. L. 86–502) so as to nullify this prohibition when the ''subsidiary'' is a small business investment company.

(f) Accordingly, section 6 of the Bank Holding Company Act does not prohibit banking subsidiaries of the bank holding company from purchasing stock in a small business investment company organized pursuant to the Small Business Investment Act of 1958, where that company is or will be a subsidiary of the bank holding company.

[25 FR 7485, Aug. 9, 1960. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.109 "Services" under section 4(c)(1) of Bank Holding Company Act.

(a) The Board of Governors has been requested by a bank holding company for an interpretation under section 4(c)(1) of the Bank Holding Company Act which, among other things, exempts from the nonbanking divestment requirements of section 4(a) of the Act, shares of a company engaged ''solely in the business of furnishing services to or performing services for'' its bank holding company or subsidiary banks thereof.

(b) It is understood that a nonbanking subsidiary of the holding company engages in writing comprehensive automobile insurance (fire, theft, and collision) which is sold only to customers of a subsidiary bank of the holding company in connection with the bank's retail installment loans; that when payment is made on a loan secured by a lien on a motor vehicle, renewal policies are not issued by the insurance company; and that the insurance company receives the usual agency commissions on all comprehensive automobile insurance written for customers of the bank.

(c) It is also understood that the insurance company writes credit life insurance for the benefit of the bank and its installment-loan customers; that each insured debtor is covered for an amount equal to the unpaid balance of his note to the bank, not to exceed $5,000; that as the note is reduced by regular monthly payments, the amount of insurance is correspondingly reduced so that at all times the debtor is insured for the unpaid balance of his note; that each insurance contract provides for payment in full of the entire

loan balance upon the death or permanent disability of the insured borrower; and that this credit life insurance is written only at the request of, and solely for, the bank's borrowing customers. It is further understood that the insurance company engages in no other activity.

(d) As indicated in § 225.104 (23 FR 2675), the term ''services,'' while sometimes used in a broad and general sense, appears to be somewhat more limited in its application in section 4(c)(1) of the Bank Holding Company Act. Unlike an early version of the Senate bill (S. 2577, before amendment), the act as finally enacted does not expressly mention any type of servicing activity for exemption. The legislative history of the Act, however, as indicated in the relevant portion of the record of the Senate Banking and Currency Committee on amended S. 2577 (84th Cong., 2d Sess., Senate Report 1095, Part 2, p. 3) makes it evident that Congress had in mind the exemption of services comparable to the types of activities mentioned expressly in the early Senate bill (''auditing, appraising, investment counseling'') and in the Committee Report on the later bill (''advertising, public relations, developing new business, organization, operations, preparing tax returns, personnel, and many others''). Furthermore, this Committee Report expressly stated that the provision of section 4(c)(1) with respect to ''furnishing services to or performing services for'' was not intended to supplant the exemption contained under section 4 (c)(6) of the Act.

(e) The only activity of the insurance company (writing comprehensive automobile insurance and credit life insurance) appears to involve an insurance relationship between it and a banking subsidiary of the holding company which the legislative history clearly indicates does not come within the meaning of the phrase ''furnishing services to or performing services for'' a bank holding company or its banking subsidiaries.

(f) Accordingly, it is the Board's view that the insurance company could not be regarded as qualifying as a company engaged ''solely in the business of furnishing services to or performing services for'' the bank holding company or banks with respect to which the latter is a bank holding company.

[23 FR 9017, Nov. 20, 1958. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.111 Limit on investment by bank holding company system in stock of small business investment companies.

(a) Under the provisions of section 4(c)(5) of the Bank Holding Company Act, as amended (12 U.S.C. 1843), a bank holding company may acquire shares of nonbank companies ''which are of the kinds and amounts eligible for investment'' by national banks. Pursuant to section 302(b) of the Small Business Investment Act of 1958 (15 U.S.C. 682(b)), as amended by Title II of the Small Business Act Amendments of 1967 (Pub. L. 90–104, 81 Stat. 268, 270), a national bank may invest in stock of small business investment companies (SBICs) subject to certain restrictions.

(b) On the basis of the foregoing statutory provisions, it is the position of the Board that a bank holding company may acquire direct or indirect ownership or control of stock of an SBIC subject to the following limits:

(1) The total direct and indirect investments of a bank holding company in stock of SBICs may not exceed:

(i) With respect to all stock of SBICs owned or controlled directly or indirectly by a subsidiary bank, 5 percent of that bank's capital and surplus;

(ii) With respect to all stock of SBICs owned directly by a bank holding company that is a bank, 5 percent of that bank's capital and surplus; and

(iii) With respect to all stock of SBICs otherwise owned or controlled directly or indirectly by a bank holding company, 5 percent of its proportionate interest in the capital and surplus of each subsidiary bank (that is, the holding company's percentage of that bank's stock times that bank's capital and surplus) less that bank's investment in stock of SBICs; and

(2) A bank holding company may not acquire direct or indirect ownership or control of 50 percent or more of the shares of any class of equity securities of an SBIC that have actual or potential voting rights.

(c) A bank holding company or a bank subsidiary that acquired direct or indirect ownership or control of 50 percent or more of any such class of equity securities prior to January 9, 1968, is not required to divest to a level below 50 percent. A bank that acquired 50 percent or more prior to January 9, 1968, may become a subsidiary in a holding company system without any necessity for divesting to a level below 50 percent: *Provided*, That such action does not result in the bank holding company acquiring control of a percentage greater than that controlled by such bank.

(12 U.S.C. 248. Interprets 12 U.S.C. 1843, 15 U.S.C. 682)

[33 FR 6967, May 9, 1968. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.112 Indirect control of small business concern through convertible debentures held by small business investment company.

(a) A question has been raised concerning the applicability of provisions of the Bank Holding Company Act of 1956 to the acquisition by a bank holding company of stock of a small business investment company (''SBIC'') organized pursuant to the Small Business Investment Act of 1958 (''SBI Act'').

(b) As indicated in the interpretation of the Board (§ 225.107) published at 23 FR 7813, it is the Board's opinion that, since stock of an SBIC is eligible for purchase by national banks and since section 4(c)(4) of the Holding Company Act exempts stock eligible for investment by national banks from the prohibitions of section 4 of that Act, a bank holding company may lawfully acquire stock in such an SBIC.

(c) However, section 304 of the SBI Act provides that debentures of a small business concern purchased by a small business investment company may be converted at the option of such company into stock of the small business concern. The question therefore arises as to whether, in the event of such conversion, the parent bank holding company would be regarded as having acquired ''direct or indirect ownership or control'' of stock of the small business concern in violation of section 4(a) of the Holding Company Act.

(d) The Small Business Investment Act clearly contemplates that one of the primary purposes of that Act was to enable SBICs to provide needed equity capital to small business concerns through the purchase of debentures convertible into stock. Thus, to the extent that a stockholder in an SBIC might acquire indirect control of stock of a small business concern, such control appears to be a natural and contemplated incident of ownership of stock of the SBIC. The Office of the Comptroller of the Currency has informally indicated concurrence with this interpretation insofar as it affects investments by national banks in stock of an SBIC.

(e) Since the exception as to stock eligible for investment by national banks contained in section 4(c)(4) of the Holding Company Act was apparently intended to permit a bank holding company to acquire any stock that would be eligible for purchase by a national bank, it is the Board's view that section 4(a)(1) of the Act does not prohibit a bank holding company from acquiring stock of an SBIC, even though ownership of such stock may result in the acquisition of indirect ownership or control of stock of a small business concern which would not itself be eligible for purchase directly by a national bank or a bank holding company.

[24 FR 1584, Mar. 4, 1959. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.113 Services under section 4(a) of Bank Holding Company Act.

(a) The Board of Governors has been requested for an opinion as to whether the performance of certain functions by a bank holding company for four banks of which it owns less than 25 percent of the voting shares is in violation of section 4(a) of the Bank Holding Company Act.

(b) It is claimed that the holding company is engaged in ''managing'' four nonsubsidiary banks, for which services it receives ''management fees.'' Specifically, the company engages in the following activities for the four nonsubsidiary banks: (1) Establishment and supervision of loaning policies; (2) direction of the purchase and sale of investment securities; (3)

selection and training of officer personnel; (4) establishment and enforcement of operating policies; and (5) general supervision over all policies and practices.

(c) The question raised is whether these activities are prohibited by section 4(a)(2) of the Bank Holding Company Act, which permits a bank holding company to engage in only three categories of business: (1) Banking; (2) managing or controlling banks; and (3) furnishing services to or performing services for any bank of which the holding company owns or controls 25 percent or more of the voting shares.

(d) Clearly, the activities of the company with respect to the four nonsubsidiary banks do not constitute ''banking.'' With respect to the business of ''managing or controlling'' banks, it is the Board's view that such business, within the purview of section 4(a)(2), is essentially the exercise of a broad governing influence of the sort usually exercised by bank stockholders, as distinguished from direct or active participation in the establishment or carrying out of particular policies or operations. The latter kinds of activities fall within the third category of businesses in which a bank holding company is permitted to engage. In the Board's view, the activities enumerated above fall in substantial part within that third category.

(e) Section 4(a)(2), like all other sections of the Holding Company Act, must be interpreted in the light of all of its provisions, as well as in the light of other sections of the Act. The expression ''managing * * * banks,'' if it could be taken by itself, might appear to include activities of the sort enumerated. However, such an interpretation of those words would virtually nullify the last portion of section 4(a)(2), which permits a holding company to furnish services to or perform services for ''any bank of which it owns or controls 25 per centum or more of the voting shares.''

(f) Since Congress explicitly authorized the performance of services for banks that are at least 25 percent owned by a holding company, it obviously intended that the holding company should not perform services for banks in which it owns less than 25 percent of the voting shares. However, if the second category—''managing or controlling banks''—were interpreted to permit the holding company to perform services for any bank, including a bank in which it held less than 25 percent of the stock (or no stock whatsoever), the last clause of section 4(a)(2) would be meaningless.

(g) It is principally for this reason—that is, to give effective meaning to the final clause of section 4(a)(2)—that the Board interprets ''managing or controlling banks'' in that provision as referring to the exercise of a stockholder's management or control of banks, rather than direct and active participation in their operations. To repeat, such active participation in operations falls within the third category (''furnishing services to or performing services for any bank'') and consequently may be engaged in only with respect to banks in which the holding company ''owns or controls 25 per centum or more of the voting shares.''

(h) Accordingly, it is the Board's conclusion that, in performing the services enumerated, the bank holding company is ''furnishing services to or performing services for'' the four banks referred to. Under the Act such furnishing or performing of services is permissible only if the holding company owns or controls 25 percent of the voting shares of each bank receiving such services, and, since the company owns less than 25 percent of the voting shares of these banks, it follows that these activities are prohibited by section 4(a)(2).

(i) While this conclusion is required, in the Board's opinion, by the language of the statute, it may be noted further that any other conclusion would make it possible for bank holding company or any other corporation, through arrangements for the ''managing'' of banks in the manner here involved, to acquire effective control of banks without acquiring bank stocks and thus to evade the underlying objectives of section 3 of the Act.

[25 FR 281, Jan. 14, 1960. Redesignated at 36 FR 21666, Nov. 12, 1971]

**§ 225.115 Applicability of Bank Service Corporation Act in certain bank holding company situations.**

(a) Questions have been presented to the Board of Governors regarding the applicability of the recently enacted Bank Service Corporation Act (Pub. L. 87–856, approved October 23, 1962) in cases involving service corporations that are subsidiaries of bank holding companies under the Bank Holding Company Act of 1956. In addition to being charged with the administration of the latter Act, the Board is named in the Bank Service Corporation Act as the Federal supervisory agency with respect to the performance of bank services for State member banks.

(b) *Holding company-owned corporation serving only subsidiary banks.* (1) One question is whether the Bank Service Corporation Act is applicable in the case of a corporation, wholly owned by a bank holding company, which is engaged in performing ''bank services'', as defined in section 1(b) of the Act, exclusively for subsidiary banks of the holding company.

(2) Except as noted below with respect to section 5 thereof, the Bank Service Corporation Act is not applicable in this case. This is true because none of the stock of the corporation performing the services is owned by any bank and the corporation, therefore, is not a ''bank service corporation'' as defined in section 1(c) of the Act. A corporation cannot meet that definition unless part of its stock is owned by two or more banks. The situation clearly is unaffected by section 2(b) of the Act which permits a corporation that fell within the definition initially to continue to function as a bank service corporation although subsequently only one of the banks remains as a stockholder in the corporation.

(3) However, although it is not a bank service corporation, the corporation in question and each of the banks for which it performs bank services are subject to section 5 of the Bank Service Corporation Act. That section, which requires the furnishing of certain assurances to the appropriate Federal supervisory agency in connection with the performance of bank services for a bank, is applicable whether such services are performed by a bank service corporation or by others.

(4) Section 4(a)(1) of the Bank Holding Company Act prohibits the acquisition by a bank holding company of ''direct or indirect ownership or control'' of shares of a nonbanking company, subject to certain exceptions. Section 4(c)(1) of the Act exempts from section 4(a)(1) shares of a company engaged ''solely in the business of furnishing services to or performing services for'' its bank holding company or subsidiary banks thereof. Assuming that the bank services performed by the corporation in question are ''services'' of the kinds contemplated by section 4(c)(1) of the Bank Holding Company Act (as would be true, for example, of the electronic data processing of deposit accounts), the holding company's ownership of the corporation's shares in the situation described above clearly is permissible under that section of the Act.

(c) *Bank service corporation owned by holding company subsidiaries and serving also other banks.* (1) The other question concerns the applicability of the Bank Service Corporation Act and the Bank Holding Company Act in the case of a corporation, all the stock of which is owned either by a bank holding company and its subsidiary banks together or by the subsidiary banks alone, which is engaged in performing ''bank services'', as defined in section 1(b) of the Bank Service Corporation Act, for the subsidiary banks and for other banks, as well.

(2) In contrast to the situation under paragraph (b) of this section, the corporation in this case is a ''bank service corporation'' within the meaning of section 1(c) of the Bank Service Corporation Act because of the ownership by each of the subsidiary banks of a part of the corporation's stock. This stock ownership is one of the important facts differentiating this case from the first one. Being a bank service corporation, the corporation in question is subject to section 3 of the Act concerning applications to bank service corporations by competitive banks for bank services, and to section 4 forbidding a bank service corporation from engaging in any activity other than the performance of bank services

for banks. Section 5, mentioned previously and relating to ''assurances'', also is applicable in this case.

(3) The other important difference between this case and the situation in paragraph (b) of this section is that here the bank service corporation performs services for nonsubsidiary banks, as well as for subsidiary banks. This is permissible because section 2(a) of the Bank Service Corporation Act, which authorizes any two or more banks to invest limited amounts in a bank service corporation, removes all limitations and prohibitions of Federal law exclusively relating to banks that otherwise would prevent any such investment. From the legislative history of section 2(a), it is clear that section 6 of the Bank Holding Company Act is among the limitations and prohibitions so removed. But for such removal, section 6(a)(1) of that Act would make it unlawful for any of the subsidiary banks of the bank holding company in question to own stock in the bank service corporation subsidiary of the holding company, as the exemption in section 6(b)(1) would not apply because of the servicing by the bank service corporation of nonsubsidiary banks.

(4) Because the bank service corporation referred to in the question is serving banks other than the subsidiary banks, the bank holding company is not exempt under section 4(c)(1) of the Bank Holding Company Act from the prohibition of acquisition of nonbanking interests in section 4(a)(1) of that Act. The bank holding company, however, is entitled to the benefit of the exemption in section 4(c)(4) of the Act. That section exempts from section 4(a) ''shares which are of the kinds and amounts eligible for investment by National banking associations under the provisions of section 5136 of the Revised Statutes''. Section 5136 provides, in part, that: ''Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation.'' As the provisions of section 2(a) of the Bank Service Corporation Act and its legislative history make it clear that shares of a bank service corporation are of a kind eligible for investment by national banks under section 5136, it follows that the direct or indirect ownership on control of such shares by a bank holding company are permissible within the amount limitation discussed in paragraph (d) of this section.

(d) *Limit on investment by bank holding company system in stock of bank service corporation.* (1) In the situation presented by paragraph (c) the bank holding company clearly owns or controls, directly or indirectly, all of the stock of the bank service corporation. The remaining question, therefore, is whether the total direct and indirect investment of the bank holding company in the bank service corporation exceeds the amount permissible under the Bank Holding Company Act.

(2) The effect of sections 4(a)(1) and 4(c)(4) of the Bank Holding Company Act is to limit the amount of shares of a bank service corporation that a bank holding company may own or control, directly or indirectly, to the amount eligible for investment by a national bank, as previously indicated. Under section 2(a) of the Bank Service Corporation Act, the amount of shares of a bank service corporation eligible for investment by a national bank may not exceed ''10 per centum [of the bank's] * * * paid-in and unimpaired capital and unimpaired surplus''.

(3) The Board's view is that this aspect of the matter should be determined in accordance with the principles set forth in § 225.111, as revised (27 FR 12671), involving the application of sections 4(a)(1) and 4(c)(4) of the Bank Holding Company Act in the light of section 302(b) of the Small Business Investment Act limiting the amount eligible for investment by a national bank in the shares of a small business investment company to two percent of the bank's ''capital and surplus''.

(4) Except for the differences in the percentage figures, the investment limitation in section 302(b) of the Small Business Investment Act is essentially the same as the investment limitation in section 2(a) of the Bank Service Corporation Act since, as an accounting matter and for the purposes under consideration, ''capital and surplus'' may be regarded as equivalent in meaning to ''paid-in and unimpaired capital and

unimpaired surplus.'' Accordingly, the maximum permissible investment by a bank holding company system in the stock of a bank service corporation should be determined in accordance with the formula prescribed in § 222.111.

[27 FR 12918, Dec. 29, 1962. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.118 Computer services for customers of subsidiary banks.

(a) The question has been presented to the Board of Governors whether a wholly-owned nonbanking subsidiary (''service company'') of a bank holding company, which is now exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956 (''the Act'') because its sole business is the providing of services for the holding company and the latter's subsidiary banks, would lose its exempt status if it should provide data processing services for customers of the subsidiary banks.

(b) The Board understood from the facts presented that the service company owns a computer which it utilizes to furnish data processing services for the subsidiary banks of its parent holding company. Customers of these banks have requested that the banks provide for them computerized billing, accounting, and financial records maintenance services. The banks wish to utilize the computer services of the service company in providing these and other services of a similar nature. It is proposed that, in each instance where a subsidiary bank undertakes to provide such services, the bank will enter into a contract directly with the customer and then arrange to have the service company perform the services for it, the bank. In no case will the service company provide services for anyone other than its affiliated banks. Moreover, it will not hold itself out as, nor will its parent corporation or affiliated banks represent it to be, authorized or willing to provide services for others.

(c) Section 4(c)(1) of the Act permits a holding company to own shares in ''any company engaged solely * * * in the business of furnishing services to or performing services for such holding company and banks with respect to which it is a bank holding company * * *.'' The Board has ruled heretofore that the term ''services'' as used in section 4(c)(1) is to be read as relating to those services (excluding ''closely related'' activities of ''a financial, fiduciary, or insurance nature'' within the meaning of section 4(c)(6)) which a bank itself can provide for its customers (§ 225.104). A determination as to whether a particular service may legitimately be rendered or performed by a bank for its customers must be made in the light of applicable Federal or State statutory or regulatory provisions. In the case of a State-chartered bank, the laws of the State in which the bank operates, together with any interpretations thereunder rendered by appropriate bank authorities, would govern the right of the bank to provide a particular service. In the case of a national bank, a similar determination would require reference to provisions of Federal law relating to the establishment and operation of national banks, as well as to pertinent rulings or interpretations promulgated thereunder.

(d) Accordingly, on the assumption that all of the services to be performed are of the kinds that the holding company's subsidiary banks may render for their customers under applicable Federal or State law, the Board concluded that the rendition of such services by the service company for its affiliated banks would not adversely affect its exempt status under section 4(c)(1) of the Act.

(e) In arriving at the above conclusion, the Board emphasized that its views were premised explicitly upon the facts presented to it, and particularly its understanding that banks are permitted, under applicable Federal or State law to provide the proposed computer services. The Board emphasized also that in respect to the service company's operations, there continues in effect the requirement under section 4(c)(1) that the service company engage solely in the business of furnishing services to or performing services for the bank holding company and its subsidiary banks. The Board added that any substantial change in the facts that had been presented might require re-examination of the service company's status under section 4(c)(1).

[29 FR 12361, Aug. 28, 1964. Redesignated at 36 FR 21666, Nov. 12, 1971]

**§ 225.121 Acquisition of Edge corporation affiliate by State member banks of registered bank holding company.**

(a) The Board has been asked whether it is permissible for the commercial banking affiliates of a bank holding company registered under the Bank Holding Company Act of 1956, as amended, to acquire and hold the shares of the holding company's Edge corporation subsidiary organized under section 25(a) of the Federal Reserve Act.

(b) Section 9 of the Bank Holding Company Act amendments of 1966 (Pub. L. 89–485, approved July 1, 1966) repealed section 6 of the Bank Holding Company Act of 1956. That rendered obsolete the Board's interpretation of section 6 that was published in the March 1966 Federal Reserve Bulletin, page 339 (§ 225.120). Thus, so far as Federal Banking law applicable to State member banks is concerned, the answer to the foregoing question depends on the provisions of section 23A of the Federal Reserve Act, as amended by the 1966 amendments to the Bank Holding Company Act. By its specific terms, the provisions of section 23A do not apply to an affiliate organized under section 25(a) of the Federal Reserve Act.

(c) Accordingly, the Board concludes that, except for such restrictions as may exist under applicable State law, it would be legally permissible by virtue of paragraph 20 of section 9 of the Federal Reserve Act for any or all of the State member banks that are affiliates of a registered bank holding company to acquire and hold shares of the Edge corporation subsidiary of the bank holding company within the amount limitation in the last sentence of paragraph 12 of section 25(a) of the Federal Reserve Act.

(12 U.S.C. 24, 248, 335, 371c, 611, 618)

[31 FR 10263, July 29, 1966. Redesignated at 36 FR 21666, Nov. 12, 1971]

**§ 225.122 Bank holding company ownership of mortgage companies.**

(a) The Board of Governors recently considered whether a bank holding may acquire, either directly or through a subsidiary, the stock of a so-called ''mortgage company'' that would be operated on the following basis: The company would solicit mortgage loans on behalf of a bank in the holding company system, assemble credit information, make property inspections and appraisals, and secure title information. The company would also participate in the preparation of applications for mortgage loans, which it would submit, together with recommendations with respect to action thereon, to the bank, which alone would decide whether to make any or all of the loans requested. The company would in addition solicit investors to purchase mortgage loans from the bank and would seek to have such investors contract with the bank for the servicing of such loans.

(b) Under section 4 of the Bank Holding Company Act (12 U.S.C. 1843), a bank holding company is generally prohibited from acquiring ''direct or indirect ownership'' of stock of nonbanking corporations. The two exceptions principally involved in the question presented are with respect to (1) stock that is eligible for investment by a national bank (section 4(c)(5) of the Act) and (2) shares of a company ''furnishing services to or performing services for such bank holding company or its banking subsidiaries'' (section 4(c)(1)(C) of the Act).

(c) The Board has previously indicated its view that a national bank is forbidden by the so-called ''stock-purchase prohibition'' of paragraph ''Seventh'' of section 5136 of the Revised Statutes (12 U.S.C. 24) to purchase ''for its own account * * * any shares of stock of any corporation'' except (1) to the extent permitted by specific provisions of Federal law or (2) as comprised within the concept of ''such incidental powers as shall be necessary to carry on the business of banking'' referred to in the first sentence of said paragraph ''Seventh''. There is no specific statutory provision authorizing a national bank to purchase stock in a mortgage company, and in the Board's view such purchase may not properly be regarded as authorized under the ''incidental powers'' clause. (See 1966 Federal Reserve Bulletin 1151; 12 CFR 208.119.) Accordingly, a bank holding company may not acquire stock in a mortgage

company on the basis of the section 4(c)(5) exemption.

(d) However, the Board does not believe that such conclusion prejudices consideration of the question whether such a company is within the section 4(c)(1)(C) ''servicing exemption''. The basic purpose of section 4 of the Act is to confine a bank holding company's activities to the management and control of banks. In determining whether an activity in which a bank could itself engage is within the servicing exemption, the question is simply whether such activity may appropriately be considered as ''furnishing services to or performing services for'' a bank.

(e) As indicated in the Board's interpretation published in the 1958 Federal Reserve Bulletin at page 431 (12 CFR 225.104), the legislative history of the servicing exemption indicates that it includes the following activities: ''auditing, appraising, investment counseling'' and ''advertising, public relations, developing new business, organization, operations, preparing tax returns, and personnel''. The legislative history further indicates that some other activities also are within the scope of the exemption. However, the types of servicing permitted under such exemption must be distinguished from activities of a ''financial fiduciary, or insurance nature'', such as those that might be considered for possible exemption under section 4(c)(8) of the Act.

(f) In considering the interrelation of these exemptions in the light of the purpose of the prohibition against bank holding company interests in nonbanking organizations, the Board has concluded that the appropriate test for determining whether a mortgage company may be considered as within the servicing exemption is whether the company will perform as principal any banking activities—such as receiving deposits, paying checks, extending credit, conducting a trust department, and the like. In other words, if the mortgage company is to act merely as an adjunct to a bank for the purpose of facilitating the banks operations, the company may appropriately be considered as within the scope of the servicing exemption.[1]

(g) On this basis the Board concluded that, insofar as the Bank Holding Company Act is concerned, a bank holding company may acquire, either directly or through a subsidiary, the stock of a mortgage company whose functions are as described in the question presented. On the other hand, in the Board's view, a bank holding company may not acquire, on the basis of the servicing exemption, a mortgage company whose functions include such activities as extending credit for its own account, arranging interim financing, entering into mortgage service contracts on a fee basis, or otherwise performing functions other than solely on behalf of a bank.

(12 U.S.C. 248)

[32 FR 15004, Oct. 3, 1967, as amended at 35 FR 19662, Dec. 29, 1970. Redesignated at 36 FR 21666, Nov. 12, 1971]

### § 225.123 Activities closely related to banking.

(a) Effective June 15, 1971, the Board of Governors has amended § 225.4(a) of Regulation Y to implement its regulatory authority under section 4(c)(8) of the Bank Holding Company Act. In some respects activities determined by the Board to be closely related to banking are described in general terms that will require interpretation from time to time. The Board's views on some questions that have arisen are set forth below.

(b) Section 225.4(a) states that a company whose ownership by a bank holding company is authorized on the basis of that section may engage solely in specified activities. That limitation refers only to activities the authority for which depends on section 4(c)(8) of the Act. It does not prevent a holding company from establishing one subsidiary

[1] Insofar as the 1958 interpretation referred to above suggested that the branch banking laws are an appropriate general test for determining the scope of the servicing exemption, such interpretation is hereby modified. In view of the different purposes to be served by the branch banking laws and by section 4 of the Bank Holding Company Act, the Board has concluded that basing determinations under the latter solely on the basis of determinations under the former is inappropriate.

to engage, for example, in activities specified in § 225.4(a) and also in activities that fall within the scope of section 4(c)(1)(C) of the Act—the ''servicing'' exemption.

(c) The amendments to § 225.4(a) do not apply to restrict the activities of a company previously approved by the Board on the basis of section 4(c)(8) of the Act. Activities of a company authorized on the basis of section 4(c)(8) either before the 1970 Amendments or pursuant to the amended § 225.4(a) may be shifted in a corporate reorganization to another company within the holding company system without complying with the procedures of § 225.4(b), as long as all the activities of such company are permissible under one of the exemptions in section 4 of the Act.

(d) Under the procedures in § 225.4(a)(c), a holding company that wishes to change the location at which it engages in activities authorized pursuant to § 225.4(a) must publish notice in a newspaper of general circulation in the community to be served. The Board does not regard minor changes in location as within the coverage of that requirement. A move from one site to another within a 1-mile radius would constitute such a minor change if the new site is in the same State.

(e) Data processing. In providing packaged data processing and transmission services for banking, financial and economic data for installation on the premises of the customer, as authorized by § 225.4(a)(8)(ii), a bank holding company should limit its activities to providing facilities that perform banking functions, such as check collection, or other similar functions for customers that are depository or other similar institutions, such as mortgage companies. In addition, the Board regards the following as incidental activities necessary to carry on the permissible activities in this area:

(1) Providing excess capacity, not limited to the processing or transmission of banking, financial or economic data on data processing or transmission equipment or facilities used in connection with permissible data processing and data transmission activities, where:

(A) Equipment is not purchased solely for the purpose of creating excess capacity;

(B) Hardware is not offered in connection therewith; and

(C) Facilities for the use of the excess capacity do not include the provision of any software, other than systems software (including language), network communications support, and the operating personnel and documentation necessary for the maintenance and use of these facilities.

(2) Providing by-products of permissible data processing and data transmission activities, where not designed, or appreciably enhanced, for the purpose of marketability.

(3) Furnishing any data processing service upon request of a customer if such data processing service is not otherwise reasonably available in the relevant market area; and

In order to eliminate or reduce to an insignificant degree any possibility of unfair competition where services, facilities, by-products or excess capacity are provided by a bank holding company's nonbank subsidiary or related entity, the entity providing the services, facilities, by-products and/or excess capacity should have separate books and financial statements, and should provide these books and statements to any new or renewal customer requesting financial data. Consolidated or other financial statements of the bank holding company should not be provided unless specifically requested by the customer.

(Interprets and applies 12 U.S.C. 1843 (c)(8))

[36 FR 10778, June 3, 1971, as amended at 36 FR 11806, June 19, 1971. Redesignated at 36 FR 21666, Nov. 12, 1971 and amended at 40 FR 13477, Mar. 27, 1975; 47 FR 37372, Aug. 26, 1982; 52 FR 45161, Nov. 25, 1987]

### § 225.124 Foreign bank holding companies.

(a) Effective December 1, 1971, the Board of Governors has added a new § 225.4(g) to Regulation Y implementing its authority under section 4(c)(9) of the Bank Holding Company Act. The Board's views on some questions that have arisen in connection with the meaning of terms used in § 225.4(g) are set forth in paragraphs (b) through (g) of this section.

(b) The term ''activities'' refers to nonbanking activities and does not include the banking activities that foreign banks conduct in the United States through branches or agencies licensed under the banking laws of any State of the United States or the District of Columbia.

(c) A company (including a bank holding company) will not be deemed to be engaged in ''activities'' in the United States merely because it exports (or imports) products to (or from) the United States, or furnishes services or finances goods or services in the United States, from locations outside the United States. A company is engaged in ''activities'' in the United States if it owns, leases, maintains, operates, or controls any of the following types of facilities in the United States:

(1) A factory,

(2) A wholesale distributor or purchasing agency,

(3) A distribution center,

(4) A retail sales or service outlet,

(5) A network of franchised dealers,

(6) A financing agency, or

(7) Similar facility for the manufacture, distribution, purchasing, furnishing, or financing of goods or services locally in the United States.

A company will not be considered to be engaged in ''activities'' in the United States if its products are sold to independent importers, or are distributed through independent warehouses, that are not controlled or franchised by it.

(d) In the Board's opinion, section 4 (a)(1) of the Bank Holding Company Act applies to ownership or control of shares of stock as an investment and does not apply to ownership or control of shares of stock in the capacity of an underwriter or dealer in securities. Underwriting or dealing in shares of stock are nonbanking activities prohibited to bank holding companies by section 4(a)(2) of the Act, unless otherwise exempted. Under § 225.4(g) of Regulation Y, foreign bank holding companies are exempt from the prohibitions of section 4 of the Act with respect to their activities outside the United States; thus foreign bank holding companies may underwrite or deal in shares of stock (including shares of United States issuers) to be distributed outside the United States, provided that shares so acquired are disposed of within a reasonable time.

(e) A foreign bank holding company does not ''indirectly'' own voting shares by reason of the ownership or control of such voting shares by any company in which it has a noncontrolling interest. A foreign bank holding company may, however, ''indirectly'' control such voting shares if its noncontrolling interest in such company is accompanied by other arrangements that, in the Board's judgment, result in control of such shares by the bank holding company. The Board has made one exception to this general approach. A foreign bank holding company will be considered to indirectly own or control voting shares of a bank if that bank holding company acquires more than 5 percent of any class of voting shares of another bank holding company. A bank holding company may make such an acquisition only with prior approval of the Board.

(f) A company is ''indirectly'' engaged in activities in the United States if any of its subsidiaries (whether or not incorporated under the laws of this country) is engaged in such activities. A company is not ''indirectly'' engaged in activities in the United States by reason of a noncontrolling interest in a company engaged in such activities.

(g) Under the foregoing rules, a foreign bank holding company may have a noncontrolling interest in a foreign company that has a U.S. subsidiary (but is not engaged in the securities business in the United States) if more than half of the foreign company's consolidated assets and revenues are located and derived outside the United States. For the purpose of such determination, the assets and revenues of the United States subsidiary would be counted among the consolidated assets and revenues of the foreign company to the extent required or permitted by generally accepted accounting principles in the United States. The foreign bank holding company would not, however, be permitted to ''indirectly'' control voting shares of the said U.S. subsidiary, as might be the case if there are other arrangements accompanying its noncontrolling interest in the foreign parent company that, in the Board's judgment, result in control of

such shares by the bank holding company.

(Interprets and applies 12 U.S.C. 1843 (a) (1), (2), and (c)(9))

[36 FR 21808, Nov. 16, 1971]

### § 225.125 Investment adviser activities.

(a) Effective February 1, 1972, the Board of Governors amended § 225.4(a) of Regulation Y to add ''serving as investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act'' to the list of activities it has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. During the course of the Board's consideration of this amendment several questions arose as to the scope of such activity, particularly in view of certain restrictions imposed by sections 16, 20, 21, and 32 of the Banking Act of 1933 (12 U.S.C. 24, 377, 378, 78) (sometimes referred to hereinafter as the ''Glass-Steagall Act provisions'') and the U.S. Supreme Court's decision in Investment Company Institute v. Camp, 401 U.S. 617 (1971). The Board's views with respect to some of these questions are set forth below.

(b) It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment adviser. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of whether they have subsidiaries that are member banks.

(c) Under § 225.4(a)(5), as amended, bank holding companies (which term, as used herein, includes both their bank and nonbank subsidiaries) may, in accordance with the provisions of § 225.4 (b), act as investment advisers to various types of investment companies, such as ''open-end'' investment companies (commonly referred to as ''mutual funds'') and ''closed-end'' investment companies. Briefly, a mutual fund is an investment company which, typically, is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer; a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares.

(d) The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an ''investment adviser'' under the Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

(e) The Board recognizes that presently most mutual funds are organized, sponsored and managed by investment advisers with which they are affiliated and that their securities are distributed to the public by such affiliated investment advisers, or subsidiaries or affiliates thereof. However, the Board believes that (1) The Glass-Steagall Act provisions do not permit a bank holding company to perform all such functions, and (2) It is not necessary for a bank holding company to perform all such functions in order to engage effectively in the described activity.

(f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize, or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale, and distribution of securities. A bank holding company should not act as investment adviser to an investment company that has a name similar to the name of the holding company or any of its subsidiary banks, unless the prospectus of the investment company contains the disclosures required in paragraph (h) of this section. In no case should a bank holding company act as investment adviser to an investment company that has either the same

name as the name of the holding company or any of its subsidiary banks, or a name that contains the word ''bank.''

(g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not purchase in their sole discretion, in a fiduciary capacity (including as managing agent), securities of any investment company for which the bank holding company acts as investment adviser unless, the purchase is specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.

(h) Under section 20 of the Glass-Steagall Act, a member bank is prohibited from being affiliated with a company that directly, or through a subsidiary, engages principally in the issue, flotation, underwriting, public sale, or distribution of securities. A bank holding company or its nonbank subsidiary may not engage, directly or indirectly, in the underwriting, public sale or distribution of securities of any investment company for which the holding company or any nonbank subsidiary provides investment advice except in compliance with the terms of section 20, and only after obtaining the Board's approval under section 4 of the Bank Holding Company Act and subject to the limitations and disclosures required by the Board in those cases. The Board has determined, however, that the conduct of securities brokerage activities by a bank holding company or its nonbank subsidiaries, when conducted individually or in combination with investment advisory activities, is not deemed to be the underwriting, public sale, or distribution of securities prohibited by the Glass-Steagall Act, and the U.S. Supreme Court has upheld that determination. *See Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 207 (1984); *see also Securities Industry Ass'n* v. *Board of Governors*, 821 F.2d 810 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988). Accordingly, the Board believes that a bank holding company or any of its nonbank subsidiaries that has been authorized by the Board under the Bank Holding Company Act to conduct securities brokerage activities (either separately or in combination with investment advisory activities) may act as agent, upon the order and for the account of customers of the holding company or its nonbank subsidiary, to purchase or sell shares of an investment company for which the bank holding company or any of its subsidiaries acts as an investment adviser. In addition, a bank holding company or any of its nonbank subsidiaries that has been authorized by the Board under the Bank Holding Company Act to provide investment advice to third parties generally (either separately or in combination with securities brokerage services) may provide investment advice to customers with respect to the purchase or sale of shares of an investment company for which the holding company or any of its subsidiaries acts as an investment adviser. In the event that a bank holding company or any of its nonbank subsidiaries provides brokerage or investment advisory services (either separately or in combination) to customers in the situations described above, at the time the service is provided the bank holding company should instruct its officers and employees to caution customers to read the prospectus of the investment company before investing and must advise customers in writing that the investment company's shares are not insured by the Federal Deposit Insurance Corporation, and are not deposits, obligations of, or endorsed or guaranteed in any way by, any bank, unless that happens to be the case. The holding company or nonbank subsidiary must also disclose in writing to the customer the role of the company or affiliate as adviser to the investment company. These disclosures may be made orally so long as written disclosure is provided to the customer immediately thereafter. To the extent that a bank owned by a bank holding company engages in providing advisory or brokerage services to bank customers in connection with an investment company advised by the bank holding company or a nonbank affiliate, but is not required by the bank's primary regulator to make disclosures comparable to the disclosures required to be made by bank holding companies providing such services, the bank holding company should require

its subsidiary bank to make the disclosures required in this paragraph to be made by a bank holding company that provides such advisory or brokerage services.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

[37 FR 1464, Jan. 29, 1972, as amended by Reg. Y, 57 FR 30391, July 9, 1992; 61 FR 45875, Aug. 30, 1996; Reg. Y, 62 FR 9343, Feb. 28, 1997]

### § 225.126 Activities not closely related to banking.

Pursuant to section 4(c)(8) of the Bank Holding Company Act and § 225.4(a) of Regulation Y, the Board of Governors has determined that the following activities are not so closely related to banking or managing or controlling banks as to be a proper incident thereto:

(a) Insurance premium funding—that is, the combined sale of mutual funds and insurance.

(b) Underwriting life insurance that is not sold in connection with a credit transaction by a bank holding company, or a subsidiary thereof.

(c) Real estate brokerage (see 1972 Fed. Res. Bulletin 428).

(d) Land development (see 1972 Fed. Res. Bulletin 429).

(e) Real estate syndication.

(f) Management consulting (see 1972 Fed. Res. Bulletin 571).

(g) Property management (see 1972 Fed. Res. Bulletin 652).

[Reg. Y, 37 FR 20329, Sept. 29, 1972; 37 FR 21938, Oct. 17, 1972, as amended at 54 FR 37302, Sept. 8, 1989]

### § 225.127 Investment in corporations or projects designed primarily to promote community welfare.

(a) Under § 225.25(b)(6) of Regulation Y, a bank holding company may, in accordance with the provisions of § 225.23, engage in ''making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas.'' The Board included that activity among those the Board has determined to be so closely related to banking or managing or controlling banks as be a proper incident thereto, in order to permit bank holding companies to fulfill their civic responsibilities. As indicated hereinafter in this interpretation, the Board intends § 225.25(b)(6) to enable bank holding companies to take an active role in the quest for solutions to the Nation's social problems. Although the interpretation primarily focuses on low- and moderate-income housing, it is not intended to limit projects under § 225.25(b)(6) to that area. Other investments primarily designed to promote community welfare are considered permissible, but have not been defined in order to provide bank holding companies flexibility in approaching community problems. For example, bank holding companies may utilize this flexibility to provide new and creative approaches to the promotion of employment opportunities for low-income persons. Bank holding companies possess a unique combination of financial and managerial resources making them particularly suited for a meaningful and substantial role in remedying our social ills. Section 225.25(b)(6) is intended to provide an opportunity for them to assume such a role.

(b) Under the authority of § 225.25(b)(6), a bank holding company may invest in community development corporations established pursuant to Federal or State law. A bank holding company may also participate in other civic projects, such as a municipal parking facility sponsored by a local civic organization as a means to promote greater public use of the community's facilities.

(c) Within the category of permissible investments under § 225.25(b)(6)

are investments in projects to construct or rehabilitate multifamily low- or moderate-income housing with respect to which a mortgage is insured under section 221(d)(3), 221(d)(4), or 236 of the National Housing Act (12 U.S.C. 1701) and investments in projects to construct or rehabilitate low- or moderate-income housing which is financed or assisted by direct loan, tax abatement, or insurance under provisions of State or local law, similar to the aforementioned Federal programs, provided that, with respect to all such projects the owner is, by statute, regulation, or regulatory authority, limited as to the rate of return on his investment in the project, as to rentals or occupancy charges for units in the project, and in such other respects as would be a ''limited dividend corporation'' (as defined by the Secretary of Housing and Urban Development).

(d) Investments in other projects that may be considered to be designed primarily to promote community welfare include but are not limited to: (1) Projects for the construction or rehabilitation of housing for the benefit of persons of low- or moderate-income, (2) projects for the construction or rehabilitation of ancillary local commercial facilities necessary to provide goods or services principally to persons residing in low- or moderate-income housing, and (3) projects designed explicitly to create improved job opportunities for low- or moderate-income groups (for example, minority equity investments, on a temporary basis, in small or medium-sized locally-controlled businesses in low-income urban or other economically depressed areas). In the case of de novo projects, the copy of the notice with respect to such other projects which is to be furnished to Reserve Banks in accordance with the provisions of § 225.23 should be accompanied by a memorandum which demonstrates that such projects meet the objectives of § 225.25(b)(6).

(e) Investments in corporations or projects organized to build or rehabilitate high-income housing, or commercial, office, or industrial facilities that are not designed explicitly to create improved job opportunities for low-income persons shall be presumed not to be designed primarily to promote community welfare, unless there is substantial evidence to the contrary, even though to some extent the investment may benefit the community.

(f) Section 6 of the Depository Institutions Disaster Relief Act of 1992 permits state member banks (12 U.S.C. 338a) and national banks (12 U.S.C. 24 (Eleventh)) to invest in the stock of community development corporations that are designed primarily to promote the public welfare of low- and moderate-income communities and persons in the areas of housing, services and employment. The Board and the Office of the Comptroller of the Currency have adopted rules that permit state member banks and national banks to make certain investments without prior approval. The Board believes that these rules are consistent with the Board's interpretation of, and decisions regarding, the scope of community welfare activities permissible for bank holding companies. Accordingly, approval received by a bank holding company to conduct activities designed to promote the community welfare under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and § 225.25(b)(6) of the Board's Regulation Y (12 CFR 225.25(b)(6)) includes approval to engage, either directly or through a subsidiary, in the following activities, up to five percent of the bank holding company's total consolidated capital stock and surplus, without additional Board or Reserve Bank approval:

(1) Invest in and provide financing to a corporation or project or class of corporations or projects that the Board previously has determined is a public welfare project pursuant to paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a);

(2) Invest in and provide financing to a corporation or project that the Office of the Comptroller of the Currency previously has determined, by order or regulation, is a public welfare investment pursuant to section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh));

(3) Invest in and provide financing to a community development financial institution pursuant to section 103(5) of the Community Development Banking

and Financial Institutions Act of 1994 (12 U.S.C. 4702(5));

(4) Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent residential property if a majority of the units will be occupied by low- and moderate-income persons or if the property is a ''qualified low-income building'' as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));

(5) Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent nonresidential real property or other assets located in a low- or moderate-income area provided the property is used primarily for low- and moderate-income persons;

(6) Invest in and provide financing to one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(7) Invest in, provide financing to, develop, and otherwise assist job training or placement facilities or programs designed primarily for low- and moderate-income persons;

(8) Invest in and provide financing to an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which (based on full time equivalent positions) will be held by low- and moderate-income persons; and

(9) Provide technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development.

(g) For purposes of paragraph (f) of this section, low- and moderate-income persons or areas means individuals and communities whose incomes do not exceed 80 percent of the median income of the area involved, as determined by the U.S. Department of Housing and Urban Development. Small businesses are businesses that are smaller than the maximum size eligibility standards established by the Small Business Administration (SBA) for the Small Business Investment Company and Development Company Programs or the SBA section 7A loan program; and specifically include those businesses that are majority-owned by members of minority groups or by women.

(h) For purposes of paragraph (f) of this section, five percent of the total consolidated capital stock and surplus of a bank holding company includes its total investment in projects described in paragraph (f) of this section, when aggregated with similar types of investments made by depository institutions controlled by the bank holding company. The term total consolidated capital stock and surplus of the bank holding company means total equity capital and the allowance for loan and lease losses. For bank holding companies that file the FR Y–9C (Consolidated Financial Statements for Bank Holding Companies), these items are readily ascertained from Schedule HC—Consolidated Balance Sheet (total equity capital (line 27h) and allowance for loan and lease losses (line 4b)). For bank holding companies filing the FR Y-SP (Parent Company Only Financial Statements for Small Bank Holding Companies), an approximation of these items is ascertained from the Balance Sheet (total equity capital (line 16e)) and allowance for loan and lease losses (line 3b)) and from the Report of Condition for Insured Banks (Schedule RC—Balance Sheet (line 4b)).

[37 FR 11316, June 7, 1972; 37 FR 13336, July 7, 1972, as amended at Reg. Y, 59 FR 63713, Dec. 9, 1994]

### § 225.129 Activities closely related to banking.

*Courier activities*. The Board's amendment of § 225.4(a), which adds courier services to the list of closely related activities is intended to permit holding companies to transport time critical materials of limited intrinsic value of the types utilized by banks and bank-related firms in performing their business activities. Such transportation activities are of particular importance in the check clearing process of the banking system, but are also important to the performance of other activities, including the processing of financially-related economic data. The authority is not intended to permit holding companies to engage generally in the provision of transportation services.

During the course of the Board's proceedings pertaining to courier services,

objections were made that courier activities were not a proper incident to banking because of the possibility that holding companies would or had engaged in unfair competitive practices. The Board believes that adherence to the following principles will eliminate or reduce to an insignificant degree any possibility of unfair competition:

a. A holding company courier subsidiary established under section 4(c)(8) should be a separate, independent corporate entity, not merely a servicing arm of a bank.

b. As such, the subsidiary should exist as a separate, profit-oriented operation and should not be subsidized by the holding company system.

c. Services performed should be explicitly priced, and shall not be paid for indirectly, for example, on the basis of deposits maintained at or loan arrangements with affiliated banks.

Accordingly, entry of holding companies into courier activities on the basis of section 4(c)(8) will be conditioned as follows:

1. *The courier subsidiary shall perform services on an explicit fee basis and shall be structured as an individual profit center designed to be operated on a profitable basis*. The Board may regard operating losses sustained over an extended period as being inconsistent with continued authority to engage in courier activities.

2. *Courier services performed on behalf of an affiliate's customer* (*such as the carriage of incoming cash letters*) *shall be paid for by the customer. Such payments shall not be made indirectly, for example, on the basis of imputed earnings on deposits maintained at or of loan arrangements with subsidiaries of the holding company*. Concern has also been expressed that bank-affiliated courier services will be utilized to gain a competitive advantage over firms competing with other holding company affiliates. To reduce the possibility that courier affiliates might be so employed, the Board will impose the following third condition:

3. *The courier subsidiary shall, when requested by any bank or any data processing firm providing financially-related data processing services which firm competes with a banking or data processing* subsidiary of Applicant, furnish comparable service at comparable rates, unless compliance with such request would be beyond the courier subsidiary's practical capacity. In this regard, the courier subsidiary should make known to the public its minimum rate schedule for services and its general pricing policies thereto. The courier subsidiary is also expected to maintain for a reasonable period of time (not less than two years) each request denied with the reasons for such denial.

[38 FR 32126, Nov. 21, 1973, as amended at 40 FR 36309, Aug. 20, 1975]

### § 225.130 Issuance and sale of short-term debt obligations by bank holding companies.

For text of interpretation, see § 250.221 of this chapter.

[38 FR 35231, Dec. 26, 1973]

### § 225.131 Activities closely related to banking.

(a) *Bank management consulting advice*. The Board's amendment of § 225.4(a), which adds bank management consulting advice to the list of closely related activities, described in general terms the nature of such activity. This interpretation is intended to explain in greater detail certain of the terms in the amendment.

(b) It is expected that bank management consulting advice would include, but not be limited to, advice concerning: Bank operations, systems and procedures; computer operations and mechanization; implementation of electronic funds transfer systems; site planning and evaluation; bank mergers and the establishment of new branches; operation and management of a trust department; international banking; foreign exchange transactions; purchasing policies and practices; cost analysis, capital adequacy and planning; auditing; accounting procedures; tax planning; investment advice (as authorized in § 225.4(a)(5)); credit policies and administration, including credit documentation, evaluation, and debt collection; product development, including specialized lending provisions; marketing operations, including research, market development and advertising programs; personnel operations,

including recruiting, training, evaluation and compensation; and security measures and procedures.

(c) In permitting bank holding companies to provide management consulting advice to nonaffiliated ''banks'', the Board intends such advice to be given only to an institution that both accepts deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans. It is also intended that such management consulting advice may be provided to the ''operations subsidiaries'' of a bank, since such subsidiaries perform functions that a bank is empowered to perform directly at locations at which the bank is authorized to engage in business (§ 250.141 of this chapter).

(d) Although a bank holding company providing management consulting advice is prohibited by the regulation from owning or controlling, directly or indirectly, any equity securities in a client bank, this limitation does not apply to shares of a client bank acquired, directly or indirectly, as a result of a default on a debt previously contracted. This limitation is also inapplicable to shares of a client bank acquired by a bank holding company, directly or indirectly, in a fiduciary capacity: *Provided,* That the bank holding company or its subsidiary does not have sole discretionary authority to vote such shares or shares held with sole voting rights constitute not more than five percent of the outstanding voting shares of a client bank.

[39 FR 8318, Mar. 5, 1974; 39 FR 21120, June 19, 1974]

### § 225.132 Acquisition of assets.

(a) From time to time questions have arisen as to whether and under what circumstances a bank holding company engaged in nonbank activities, directly or indirectly through a subsidiary, pursuant to section 4(c)(8) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1843(c)(3)), may acquire the assets and employees of another company, without first obtaining Board approval pursuant to section 4(c)(8) and the Board's Regulation Y (12 CFR 225.4(b)).

(b) In determining whether Board approval is required in connection with the acquisition of assets, it is necessary to determine (a) whether the acquisition is made in the ordinary course of business[1] or (b) whether it constitutes the acquisition, in whole or in part, of a going concern.[2]

(c) The following examples illustrate transactions where prior Board approval will generally be required:

(1) The transaction involves the acquisition of all or substantially all of the assets of a company, or a subsidiary, division, department or office thereof.

(2) The transaction involves the acquisition of less than ''substantially all'' of the assets of a company, or a subsidiary, division, department or office thereof, the operations of which are being terminated or substantially discontinued by the seller, but such asset acquisition is significant in relation to the size of the same line of nonbank activity of the holding company (e.g., consumer finance mortgage banking, data processing). For purposes of this interpretation, an acquisition would generally be presumed to be significant if the book value of the nonbank assets being acquired exceeds 50 percent of the book value of the nonbank assets of the holding company or nonbank subsidiary comprising the same line of activity.

(3) The transaction involves the acquisition of assets for resale and the sale of such assets is not a normal business activity of the acquiring holding company.

(4) The transaction involves the acquisition of the assets of a company, or a subsidiary, division, department or office thereof, and a major purpose of the transaction is to hire some of the seller's principal employees who are expert, skilled and experienced in the

[1] Section 225.4(c)(3) of the Board's Regulation Y (12 CFR 225.4(c)(3)) generally prohibits a bank holding company or its subsidiary engaged in activities pursuant to authority of section 4(c)(8) of the Act from being a party to any merger ''or acquisition of assets other than in the ordinary course of business'' without prior Board approval.

[2] In accordance with the provisions of section 4(c)(8) of the Act and § 225.4(b) of Regulation Y, the acquisition of a going concern requires prior Board approval.

business of the company being acquired.

(d) In some cases it may be difficult, due to the wide variety of circumstances involving possible acquisition of assets, to determine whether such acquisitions require prior Board approval. Bank holding companies are encouraged to contact their local Reserve Bank for guidance where doubt exists as to whether such an acquisition is in the ordinary course of business or an acquisition, in whole or in part, of a going concern.

[39 FR 35128, Sept. 30, 1974, as amended at Reg. Y, 57 FR 28779, June 29, 1992]

### § 225.133 Computation of amount invested in foreign corporations under general consent procedures.

For text of this interpretation, see § 211.111 of this subchapter.

[40 FR 43199, Sept. 19, 1975]

### § 225.134 Escrow arrangements involving bank stock resulting in a violation of the Bank Holding Company Act.

(a) In connection with a recent application to become a bank holding company, the Board considered a situation in which shares of a bank were acquired and then placed in escrow by the applicant prior to the Board's approval of the application. The facts indicated that the applicant company had incurred debt for the purpose of acquiring bank shares and immediately after the purchase the shares were transferred to an unaffiliated escrow agent with instructions to retain possession of the shares pending Board action on the company's application to become a bank holding company. The escrow agreement provided that, if the application were approved by the Board, the escrow agent was to return the shares to the applicant company; and, if the application were denied, the escrow agent was to deliver the shares to the applicant company's shareholders upon their assumption of debt originally incurred by the applicant in the acquisition of the bank shares. In addition, the escrow agreement provided that, while the shares were held in escrow, the applicant could not exercise voting or any other ownership rights with respect to those shares.

(b) On the basis of the above facts, the Board concluded that the company had violated the prior approval provisions of section 3 of the Bank Holding Company Act (''Act'') at the time that it made the initial acquisition of bank shares and that, for purposes of the Act, the company continued to control those shares in violation of the Act. In view of these findings, individuals and bank holding companies should not enter into escrow arrangements of the type described herein, or any similar arrangement, without securing the prior approval of the Board, since such action could constitute a violation of the Act.

(c) While the above represents the Board's conclusion with respect to the particular escrow arrangement involved in the proposal presented, the Board does not believe that the use of an escrow arrangement would always result in a violation of the Act. For example, it appears that a transaction whereby bank shares are placed in escrow pending Board action on an application would not involve a violation of the Act so long as title to such shares remains with the seller during the pendency of the application; there are no other indicia that the applicant controls the shares held in escrow; and, in the event of a Board denial of the application, the escrow agreement provides that the shares would be returned to the seller.

[41 FR 9859, Mar. 8, 1976. Correctly designated at 41 FR 12009, Mar. 23, 1976]

### § 225.136 Utilization of foreign subsidiaries to sell long-term debt obligations in foreign markets and to transfer the proceeds to their United States parent(s) for domestic purposes.

For text of this interpretation, see § 211.112 of this subchapter.

[42 FR 752, Jan. 4, 1977]

### § 225.137 Acquisitions of shares pursuant to section 4(c)(6) of the Bank Holding Company Act.

(a) The Board has received a request for an interpretation of section 4(c)(6) of the Bank Holding Company Act

(''Act'')[1] in connection with a proposal under which a number of bank holding companies would purchase interests in an insurance company to be formed for the purpose of underwriting or reinsuring credit life and credit accident and health insurance sold in connection with extensions of credit by the stockholder bank holding companies and their affiliates.

(b) Each participating holding company would own no more than 5 percent of the outstanding voting shares of the company. However, the investment of each holding company would be represented by a separate class of voting security, so that each stockholder would own 100 percent of its respective class. The participating companies would execute a formal ''Agreement Among Stockholders'' under which each would agree to use its best efforts at all times to direct or recommend to customers and clients the placement of their life, accident and health insurance directly or indirectly with the company. Such credit-related insurance placed with the company would be identified in the records of the company as having been originated by the respective stockholder. A separate capital account would be maintained for each stockholder consisting of the original capital contribution increased or decreased from time to time by the net profit or loss resulting from the insurance business attributable to each stockholder. Thus, each stockholder would receive a return on its investment based upon the claims experience and profitability of the insurance business that it had itself generated. Dividends declared by the board of directors of the company would be payable to each stockholder only out of the earned surplus reflected in the respective stockholder's capital account.

(c) It has been requested that the Board issue an interpretation that section 4(c)(6) of the Act provides an exemption under which participating bank holding companies may acquire such interests in the company without prior approval of the Board.

(d) On the basis of a careful review of the documents submitted, in light of the purposes and provisions of the Act, the Board has concluded that section 4(c)(6) of the Act is inapplicable to this proposal and that a bank holding company must obtain the approval of the Board before participating in such a proposal in the manner described. The Board's conclusion is based upon the following considerations:

(1) Section 2(a)(2)(A) of the Act provides that a company is deemed to have control over a second company if it owns or controls ''25 per centum or more of any class of voting securities'' of the second company. In the case presented, the stock interest of each participant would be evidenced by a different class of stock and each would accordingly, own 100 percent of a class of voting securities of the company. Thus, each of the stockholders would be deemed to ''control'' the company and prior Board approval would be required for each stockholder's acquisition of stock in the company.

The Board believes that this application of section 2(a)(2)(A) of the Act is particularly appropriate on the facts presented here. The company is, in practical effect, a conglomeration of separate business ventures each owned 100 percent by a stockholder the value of whose economic interest in the company is determined by reference to the profits and losses attributable to its respective class of stock. Furthermore, it is the Board's opinion that this application of section 2(a)(2)(A) is not inconsistent with section 4(c)(6). Even assuming that section (4)(c)(6) is intended to refer to all outstanding voting shares, and not merely the outstanding shares of a particular class of securities, section 4(c)(6) must be viewed as permitting ownership of 5 percent of a company's voting stock only when that ownership does not

[1] It should be noted that every Board Order granting approval under section 4(c)(8) of the Act contains the following paragraph:

''This determination is subject . . . to the Board's authority to require such modification or termination of the activities of a holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder, or to prevent evasion thereof.''

The Board believes that, even apart from this Interpretation, this language preserves the authority of the Board to require the revisions contemplated in this Interpretation.

constitute ''control'' as otherwise defined in the Act. For example, it is entirely possible that a company could exercise a controlling influence over the management and policies of a second company, and thus ''control'' that company under the Act's definitions, even though it held less than 5 percent of the voting stock of the second company. To view section 4(c)(6) as an unqualified exemption for holdings of less than 5 percent would thus create a serious gap in the coverage of the Act.

(2) The Board believes that section 4(c)(6) should properly be interpreted as creating an exemption from the general prohibitions in section 4 on ownership of stock in nonbank companies only for passive investments amounting to not more than 5 percent of a company's outstanding stock, and that the exemption was not intended to allow a group of holding companies, through concerted action, to engage in an activity as entrepreneurs. Section 4 of the Act, of course, prohibits not only owning stock in nonbank companies, but engaging in activities other than banking or those activities permitted by the Board under section 4(c)(8) as being closely related to banking. Thus, if a holding company may be deemed to be engaging in an activity through the medium of a company in which it owns less than 5 percent of the voting stock it may nevertheless require Board approval, despite the section 4(c)(6) exemption.

(e) To accept the argument that section 4(c)(6) is an unqualified grant of permission to a bank holding company to own 5 percent of the shares of any nonbanking company irrespective of the nature or extent of the holding company's participation in the affairs of the nonbanking company would, in the Board's view, create the potential for serious and widespread evasion of the Act's controls over nonbanking activities. Such a construction would allow a group of 20 bank holding companies—or even a single bank holding company and one or more nonbank companies—to engage in entrepreneurial joint ventures in businesses prohibited to bank holding companies, a result the Board believes to be contrary to the intent of Congress.

(f) In this proposal, each of the participating stockholders must be viewed as engaging in the business of insurance underwriting. Each stockholder would agree to channel to the company the insurance business it generates, and the value of the interest of each stockholder would be determined by reference to the profitability of the business generated by that stockholder itself. There is no sharing or pooling among stockholders of underwriting risks assumed by the company, and profit or loss from investments is allocated on the basis of each bank holding company's allocable underwriting profit or loss. The interest of each stockholder is thus clearly that of an entrepreneur rather than that of an investor.

(g) Accordingly, on the basis of the factual situation before the Board, and for the reasons summarized above, the Board has concluded that section 4(c)(6) of the Act cannot be interpreted to exempt the ownership of 5 percent of the voting stock of a company under the circumstances described, and that a bank holding company wishing to become a stockholder in a company under this proposal would be required to obtain the Board's approval to do so.

[42 FR 1263, Jan. 6, 1977; 42 FR 2951, Jan. 14, 1977]

### § 225.138 Statement of policy concerning divestitures by bank holding companies.

(a) From time to time the Board of Governors receives requests from companies subject to the Bank Holding Company Act, or other laws administered by the Board, to extend time periods specified either by statute or by Board order for the divestiture of assets held or activities engaged in by such companies. Such divestiture requirements may arise in a number of ways. For example, divestiture may be ordered by the Board in connection with an acquisition found to have been made in violation of law. In other cases the divestiture may be pursuant to a statutory requirement imposed at the time and amendment to the Act was adopted, or it may be required as a result of a foreclosure upon collateral

held by the company or a bank subsidiary in connection with a debt previously contracted in good faith. Certain divestiture periods may be extended in the discretion of the Board, but in other cases the Board may be without statutory authority, or may have only limited authority, to extend a specified divestiture period.

(b) In the past, divestitures have taken many different forms, and the Board has followed a variety of procedures in enforcing divestiture requirements. Because divestitures may occur under widely disparate factual circumstances, and because such forced dispositions may have the potential for causing a serious adverse economic impact upon the divesting company, the Board believes it is important to maintain a large measure of flexibility in dealing with divestitures. For these reasons, there can be no fixed rule as to the type of divestiture that will be appropriate in all situations. For example, where divestiture has been ordered to terminate a control relationship created or maintained in violation of the Act, it may be necessary to impose conditions that will assure that the unlawful relationship has been fully terminated and that it will not arise in the future. In other circumstances, however, less stringent conditions may be appropriate.

(1) *Avoidance of delays in divestitures.* Where a specific time period has been fixed for accomplishing divestiture, the affected company should endeavor and should be encouraged to complete the divestiture as early as possible during the specific period. There will generally be substantial advantages to divesting companies in taking steps to plan for and accomplish divestitures well before the end of the divestiture period. For example, delays may impair the ability of the company to realize full value for the divested assets, for as the end of the divestiture period approaches the ''forced sale'' aspect of the divestiture may lead potential buyers to withhold firm offers and to bargain for lower prices. In addition, because some prospective purchasers may themselves require regulatory approval to acquire the divested property, delay by the divesting company may—by leaving insufficient time to obtain such approvals—have the effect of narrowing the range of prospective purchases. Thus, delay in planning for divestiture may increase the likelihood that the company will seek an extension of the time for divestiture if difficulty is encountered in securing a purchaser, and in certain situations, of course, the Board may be without statutory authority to grant extensions.

(2) *Submissions and approval of divestiture plans.* When a divestiture requirement is imposed, the company affected should generally be asked to submit a divestiture plan promptly for review and approval by the Reserve Bank or the Board. Such a requirement may be imposed pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act to issue such orders as may be necessary to enable the Board to administer and carry out the purposes of the Act and prevent evasions thereof. A divestiture plan should be as specific as possible, and should indicate the manner in which divestiture will be accomplished—for example, by a bulk sale of the assets to a third party, by ''spinoff'' or distribution of shares to the shareholders of the divesting company, or by termination of prohibited activities. In addition, the plan should specify the steps the company expects to take in effecting the divestiture and assuring its completeness, and should indicate the time schedule for taking such steps. In appropriate circumstances, the divestiture plan should make provision for assuring that ''controlling influence'' relationships, such as management or financial interlocks, will not continue to exist.

(3) *Periodic progress reports.* A company subject to a divestiture requirement should generally be required to submit regular periodic reports detailing the steps it has taken to effect divestiture. Such a requirement may be imposed pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act, referred to above, as well as its authority under section 5(c) of the Act to require reports for the purpose of keeping the Board informed as to whether the Act and Board regulations and order thereunder are being complied with. Reports should set forth in detail such matters

as the identities of potential buyers who have been approached by the company, the dates of discussions with potential buyers and the identities of the individuals involved in such discussions, the terms of any offers received, and the reasons for rejecting any offers. In addition, the reports should indicate whether the company has employed brokers, investment bankers or others to assist in the divestiture, or its reasons for not doing so, and should describe other efforts by the company to seek out possible purchasers. The purpose of requiring such reports is to insure that substantial and good faith efforts being made by the company to satisfy its divestiture obligations. The frequency of such reports may vary depending upon the nature of the divestiture and the period specified for divestiture. However, such reports should generally not be required less frequently than every three months, and may in appropriate cases be required on a monthly or even more frequent basis. Progress reports as well as divestiture plans should be afforded confidential treatment.

(4) *Extensions of divestiture periods.* Certain divestiture periods—such as December 31, 1980 deadline for divestitures required by the 1970 Amendments to the Bank Holding Company Act—are not extendable. In such cases it is imperative that divestiture be accomplished in a timely manner. In certain other cases, the Board may have discretion to extend a statutorily prescribed divestiture period within specified limits. For example, under section 4(c)(2) of the Act the Board may extend for three one-year periods the two-year period in which a bank subsidiary of a holding company is otherwise required to divest shares acquired in satisfaction of a debt previously contracted in good faith. In such cases, however, when the permissible extensions expire the Board no longer has discretion to grant further extensions. In still other cases, where a divestiture period is prescribed by the Board, in the exercise of its regulatory judgment, the Board may have broader discretion to grant extensions. Where extensions of specified divestiture periods are permitted by law, extensions should not be granted except under compelling circumstances. Neither unfavorable market conditions, nor the possibility that the company may incur some loss, should alone be viewed as constituting such circumstances—particularly if the company has failed to take earlier steps to accomplish a divestiture under more favorable circumstances. Normally, a request for an extension will not be considered unless the company has established that it has made substantial and continued good faith efforts to accomplish the divestiture within the prescribed period. Furthermore, requests for extensions of divestiture periods must be made sufficiently in advance of the expiration of the prescribed period both to enable the Board to consider the request in an orderly manner and to enable the company to effect a timely divestiture in the event the request for extension is denied. Companies subject to divestiture requirements should be aware that a failure to accomplish a divestiture within the prescribed period may in and of itself be viewed as a separate violation of the Act.

(5) *Use of trustees.* In appropriate cases a company subject to a divestiture requirement may be required to place the assets subject to divestiture with an independent trustee under instructions to accomplish a sale by a specified date, by public auction if necessary. Such a trustee may be given the responsibility for exercising the voting rights with respect to shares being divested. The use of such a trustee may be particularly appropriate where the divestiture is intended to terminate a control relationship established or maintained in violation of law, or where the divesting company has demonstrated an inability or unwillingness to take timely steps to effect a divestiture.

(6) *Presumptions of control.* Bank holding companies contemplating a divestiture should be mindful of section 2(g)(3) of the Bank Holding Company Act, which creates a presumption of continued control over the transferred assets where the transferee is indebted to the transferor, or where certain interlocks exist, as well as § 225.2 of Regulation Y, which sets forth certain additional control presumptions. Where one of these presumptions has

arisen with respect to divested assets, the divestiture will not be considered as complete until the presumption has been overcome. It should be understood that the inquiry into the termination of control relationships is not limited by the statutory and regulatory presumptions of control, and that the Board may conclude that a control relationship still exists even though the presumptions do not apply.

(7) *Role of the Reserve Banks.* The Reserve Banks have a responsibility for supervising and enforcing divestitures. Specifically, in coordination with Board staff they should review divestiture plans to assure that proposed divestitures will result in the termination of control relationships and will not create unsafe or unsound conditions in any bank or bank holding company; they should monitor periodic progress reports to assure that timely steps are being taken to effect divestitures; and they should prompt companies to take such steps when it appears that progress is not being made. Where Reserve Banks have delegated authority to extend divestiture periods, that authority should be exercised consistently with this policy statement.

[42 FR 10969, Feb. 25, 1977]

### § 225.139 Presumption of continued control under section 2(g)(3) of the Bank Holding Company Act.

(a) Section 2(g)(3) of the Bank Holding Company Act (the ''Act'') establishes a statutory presumption that where certain specified relationships exist between a transferor and transferee of shares, the transferor (if it is a bank holding company, or a company that would be such but for the transfer) continues to own or control indirectly the transferred shares.[1] This presumption arises by operation of law, as of the date of the transfer, without the need for any order or determination by the Board. Operation of the presumption may be terminated only by the issuance of a Board determination, after opportunity for hearing, ''that the transferor is not in fact capable of controlling the transferee.''[2]

(b) The purpose of section 2(g)(3) is to provide the Board an opportunity to assess the effectiveness of divestitures in certain situations in which there may be a risk that the divestiture will not result in the complete termination of a control relationship. By presuming control to continue as a matter of law, section 2(g)(3) operates to allow the effectiveness of the divestiture to be assessed before the divesting company is permitted to act on the assumption that the divestiture is complete. Thus, for example, if a holding company divests its banking interest under circumstances where the presumption of continued control arises, the divesting company must continue to consider itself bound by the Act until an appropriate order is entered by the Board dispelling the presumption. Section 2(g)(3) does not establish a substantive rule that invalidates transfers to which it applies, and in a great many cases the Board has acted favorably on applications to have the presumption dispelled. It merely provides a procedural opportunity for Board consideration of the effect of such transfers in advance of their being deemed effective. Whether or not the statutory presumption arises, the substantive test for assessing the effectiveness of a divestiture is the same—that is, the Board must be assured that all control relationships between the transferor and the transferred property have been terminated and will not be reestablished.[3]

[1] The presumption arises where the transferee ''is indebted to the transferor, or has one or more officers, directors, trustees, or beneficiaries in common with or subject to control by the transferor.''

[2] The Board has delegated to its General Counsel the authority to issue such determinations, 12 CFR 265.2(b)(1).

[3] It should be noted, however, that the Board will require termination of any interlocking management relationships between the divesting company and the transferee or the divested company as a precondition of finding that a divestiture is complete. Similarly, the retention of an economic interest in the divested company that would create an incentive for the divesting company to attempt to influence the management of the divested company will preclude a finding that the divestiture is complete. (See the Board's Order in the matter of ''International Bank'', 1977 Federal Reserve Bulletin 1106, 1113.)

(c) In the course of administering section 2(g)(3) the Board has had several occasions to consider the scope of that section. In addition, questions have been raised by and with the Board's staff as to coverage of the section. Accordingly, the Board believes it would be useful to set forth the following interpretations of section 2(g)(3):

(1) The terms *transferor* and *transferee*, as used in section 2(g)(3), include parents and subsidiaries of each. Thus, for example, where a transferee is indebted to a subsidiary of the transferor, or where a specified interlocking relationship exists between the transferor or transferee and a subsidiary of the other (or between subsidiaries of each), the presumption arises. Similarly, if a parent of the transferee is indebted to a parent of the transferor, the presumption arises. The presumption of continued control also arises where an interlock or debt relationship is retained between the divesting company and the company being divested, since the divested company will be or may be viewed as a *subsidiary* of the transferee or group of transferees.

(2) The terms *officers*, *directors*, and *trustees*, as used in section 2(g)(3), include persons performing functions normally associated with such positions (including general partners in a partnership and limited partners having a right to participate in the management of the affairs of the partnership) as well as persons holding such positions in an advisory or honorary capacity. The presumption arises not only where the transferee or transferred company has an officer, director or trustee *in common with* the transferor, but where the transferee himself holds such a position with the transferor.[4] It should be noted that where a transfer takes the form of a pro-rata distribution, or *spin-off*, of shares to a company's shareholders, officers and directors of the transferor company are likely to receive a portion of such shares. The presumption of continued control would, of course, attach to any shares transferred to officers and directors of the divesting company, whether by *spinoff* or outright sale. However, the presumption will be of legal significance—and will thus require an application under section 2(g)(3)—only where the total number of shares subject to the presumption exceeds one of the applicable thresholds in the Act. For example, where officers and directors of a one-bank holding company receive in the aggregate 25 percent or more of the stock of a bank subsidiary being divested by the holding company, the holding company would be presumed to continue to control the *divested* bank. In such a case it would be necessary for the divesting company to demonstrate that it no longer controls either the divested bank or the officer/director transferees. However, if officers and directors were to receive in the aggregate less than 25 percent of the bank's stock (and no other shares were subject to the presumption), section 2(g)(3) would not have the legal effect of presuming continued control of the bank.[5] In the case of a divestiture of nonbank shares, an application under section 2(g)(3) would be required whenever officers and directors of the divesting company received in the aggregate more than 5 percent of the shares of the company being divested.

(3) Although section 2(g)(3) refers to transfers of *shares* it is not, in the Board's view, limited to disposition of corporate stock. General or limited partnership interests, for example, are included within the term *shares*. Furthermore, the transfer of all or substantially all of the assets of a company, or the transfer of such a significant volume of assets that the transfer may in effect constitute the disposition

[4] It has been suggested that the words *in common with* in section 2(g)(3) evidence an intent to make the presumption applicable only where the transferee is a *company* having an interlock with the transferor. Such an interpretation would, in the Board's view, create an unwarranted gap in the coverage of section 2(g)(3). Furthermore, because the presumption clearly arises where the transferee is an individual who is indebted to the transferor such an interpretation would result in an illogical internal inconsistency in the statute.

[5] Of course, the fact that section 2(g)(3) would not operate to presume continued control would not necessarily mean that control had in fact been terminated if control could be exercised through other means.

of a separate activity of the company, is deemed by the Board to involve a transfer of *shares* of that company.

(4) The term *indebtedness* giving rise to the presumption of continued control under section 2(g)(3) of the Act is not limited to debt incurred in connection with the transfer; it includes any debt outstanding at the time of transfer from the transferee to the transferor or its subsidiaries. However, the Board believes that not every kind of indebtedness was within the contemplation of the Congress when section 2(g)(3) was adopted. Routine business credit of limited amounts and loans for personal or household purposes are generally not the kinds of indebtedness that, standing alone, support a presumption that the creditor is able to control the debtor. Accordingly, the Board does not regard the presumption of section 2(g)(3) as applicable to the following categories of credit, provided the extensions of credit are not secured by the transferred property and are made in the ordinary course of business of the transferor (or its subsidiary) that is regularly engaged in the business of extending credit:

(i) Consumer credit extended for personal or household use to an individual transferee; (ii) student loans made for the education of the individual transferee or a spouse or child of the transferee; (iii) a home mortgage loan made to an individual transferee for the purchase of a residence for the individual's personal use and secured by the residence; and (iv) loans made to companies (as defined in section 2(b) of the Act) in an aggregate amount not exceeding ten per cent of the total purchase price (or if not sold, the fair market value) of the transferred property. The amounts and terms of the preceding categories of credit should not differ substantially from similar credit extended in comparable circumstances to others who are not transferees. It should be understood that, while the statutory presumption in situations involving these categories of credit may not apply, the Board is not precluded in any case from examining the facts of a particular transfer and finding that the divestiture of control was ineffective based on the facts of record.

(d) Section 2(g)(3) provides that a Board determination that a transferor is not in fact capable of controlling a transferee shall be made after opportunity for hearing. It has been the Board's routine practice since 1966 to publish notice in the FEDERAL REGISTER of applications filed under section 2(g)(3) and to offer interested parties an opportunity for a hearing. Virtually without exception no comments have been submitted on such applications by parties other than the applicant and, with the exception of one case in which the request was later withdrawn, no hearings have been requested in such cases. Because the Board believes that the hearing provision in section 2(g)(3) was intended as a protection for applicants who are seeking to have the presumption overcome by a Board order, a hearing would not be of use where an application is to be granted. In light of the experience indicating that the publication of FEDERAL REGISTER notice of such applications has not served a useful purpose, the Board has decided to alter its procedures in such cases. In the future, FEDERAL REGISTER notice of section 2(g)(3) applications will be published only in cases in which the Board's General Counsel, acting under delegated authority, has determined not to grant such an application and has referred the matter to the Board for decision.[6]

(12 U.S.C. 1841, 1844)

[43 FR 6214, Feb. 14, 1978; 43 FR 15147, Apr. 11, 1978; 43 FR 15321, Apr. 12, 1978, as amended at 45 FR 8280, Feb. 7, 1980; 45 FR 11125, Feb. 20, 1980]

### § 225.140 Disposition of property acquired in satisfaction of debts previously contracted.

(a) The Board recently considered the permissibility, under section 4 of the

[6] It should be noted that in the event a third party should take exception to a Board order under section 2(g)(3) finding that control has been terminated, any rights such party might have would not be prejudiced by the order. If such party brought facts to the Board's attention indicating that control had not been terminated the Board would have ample authority to revoke its order and take necessary remedial action.

Orders issued under section 2(g)(3) are published in the Federal Reserve ''Bulletin.''

Bank Holding Company Act, of a subsidiary of a bank holding company acquiring and holding assets acquired in satisfaction of a debt previously contracted in good faith (a ''dpc'' acquisition). In the situation presented, a lending subsidiary of a bank holding company made a ''dpc'' acquisition of assets and transferred them to a wholly-owned subsidiary of the bank holding company for the purpose of effecting an orderly divestiture. The question presented was whether such ''dpc'' assets could be held indefinitely by a bank holding company subsidiary as incidental to its permissible lending activity.

(b) While the Board believes that ''dpc'' acquisitions may be regarded as normal, necessary and incidental to the business of lending, the Board does not believe that the holding of assets acquired ''dpc'' without any time restrictions is appropriate from the standpoint of prudent banking and in light of the prohibitions in section 4 of the Act against engaging in nonbank activities. If a nonbanking subsidiary of a bank holding company were permitted, either directly or through a subsidiary, to hold ''dpc'' assets of substantial amount over an extended period of time, the holding of such property could result in an unsafe or unsound banking practice or in the holding company engaging in an impermissible activity in connection with the assets, rather than liquidating them.

(c) The Board notes that section 4(c)(2) of the Bank Holding Company Act provides an exemption from the prohibitions of section 4 of the Act for bank holding company subsidiaries to acquire *shares* ''dpc''. It also provides that such ''dpc'' shares may be held for a period of two years, subject to the Board's authority to grant three one-year extensions up to a maximum of five years.[1] Viewed in light of the Congressional policy evidenced by section 4(c)(2), the Board believes that a lending subsidiary of a bank holding company or the holding company itself, should be permitted, as an incident to permissible lending activities, to make acquisitions of ''dpc'' *assets*. Consistent with the principles underlying the provisions of section 4(c)(2) of the Act and as a matter of prudent banking practice, such assets may be held for no longer than five years from the date of acquisition. Within the divestiture period it is expected that the company will make good faith efforts to dispose of ''dpc'' shares or assets at the earliest practicable date. While no specific authorization is necessary to hold such assets for the five-year period, after two years from the date of acquisition of such assets, the holding company should report annually on its efforts to accomplish divestiture to its Reserve Bank. The Reserve Bank will monitor the efforts of the company to effect an orderly divestiture, and may order divestiture before the end of the five-year period if supervisory concerns warrant such action.

(d) The Board recognizes that there are instances where a company may encounter particular difficulty in attempting to effect an orderly divestiture of ''dpc'' real estate holdings within the divestiture period, notwithstanding its persistent good faith efforts to dispose of such property. In the Depository Institutions Deregulation and Monetary Control Act of 1980, (Pub. L. 96–221) Congress, recognizing that real estate possesses unusual characteristics, amended the National Banking Act to permit national banks to hold real estate for five years and for an additional five-year period subject to certain conditions. Consistent with the policy underlying the recent Congressional enactment, and as a matter of supervisory policy, a bank holding company may be permitted to hold real estate acquired ''dpc'' beyond the initial five-year period provided that the value of the real estate on the books of the company has been written down to fair market value, the carrying costs are not significant in relation to the overall financial position of the company, and the company has made good faith efforts to effect divestiture. Companies holding real estate for this extended period are expected to make active efforts to dispose of it, and should keep the Reserve Bank advised

[1] The Board notes that where the dpc shares or other similar interests represent less than 5 percent of the total of such interests outstanding, they may be retained on the basis of section 4(c)(6), even if originally acquired dpc.

on a regular basis concerning their ongoing efforts. Fair market value should be derived from appraisals, comparable sales or some other reasonable method. In any case, ''dpc'' real estate would not be permitted to be held beyond 10 years from the date of its acquisition.

(e) With respect to the transfer by a subsidiary of other ''dpc'' shares or assets to another company in the holding company system, including a section 4(c)(1)(D) liquidating subsidiary, or to the holding company itself, such transfers would not alter the original divestiture period applicable to such shares or assets at the time of their acquisition. Moreover, to ensure that assets are not carried at inflated values for extended periods of time, the Board expects, in the case of all such intracompany transfers, that the shares or assets will be transferred at a value no greater than the fair market value at the time of transfer and that the transfer will be made in a normal arms-length transaction.

(f) With regard to ''dpc'' assets acquired by a banking subsidiary of a holding company, so long as the assets continue to be held by the bank itself, the Board will regard them as being solely within the regulatory authority of the primary supervisor of the bank.

(12 U.S.C. 1843 (c)(1)(d), (c)(2), (c)(8), and 1844 (b); 12 U.S.C. 1818)

[45 FR 49905, July 28, 1980]

### § 225.141 Operations subsidiaries of a bank holding company.

In orders approving the retention by a bank holding company of a 4(c)(8) subsidiary, the Board has stated that it would permit, without any specific regulatory approval, the formation of a wholly owned subsidiary of an approved 4(c)(8) company to engage in activities that such a company could itself engage in directly through a division or department. (*Northwestern Financial Corporation*, 65 Federal Reserve Bulletin 566 (1979).) Section 4(a)(2) of the Act provides generally that a bank holding company may engage directly in the business of managing and controlling banks and permissible nonbank activities, and in furnishing services directly to its subsidiaries. Even though section 4 of the Act generally prohibits the acquisition of shares of nonbanking organizations, the Board does not believe that such prohibition should apply to the formation by a holding company of a wholly-owned subsidiary to engage in activities that it could engage in directly. Accordingly, as a general matter, the Board will permit without any regulatory approval a bank holding company to form a wholly-owned subsidiary to perform servicing activities for subsidiaries that the holding company itself could perform directly or through a department or a division under section 4(a)(2) of the Act. The Board believes that permitting this type of subsidiary is not inconsistent with the nonbanking prohibitions of section 4 of the Act, and is consistent with the authority in section 4(c)(1)(C) of the Act, which permits a bank holding company, without regulatory approval, to form a subsidiary to perform services for its *banking* subsidiaries. The Board notes, however, that a servicing subsidiary established by a bank holding company in reliance on this interpretation will be an affiliate of the subsidiary bank of the holding company for the purposes of the lending restrictions of section 23A of the Federal Reserve Act. (12 U.S.C. 371c)

(12 U.S.C. 1843(a)(2) and 1844(b))

[45 FR 54326, July 15, 1980]

### § 225.142 Statement of policy concerning bank holding companies engaging in futures, forward and options contracts on U.S. Government and agency securities and money market instruments.

(a) *Purpose of financial contract positions.* In supervising the activities of bank holding companies, the Board has adopted and continues to follow the principle that bank holding companies should serve as a source of strength for their subsidiary banks. Accordingly, the Board believes that any positions that bank holding companies or their nonbank subsidiaries take in financial contracts should reduce risk exposure, that is, not be speculative.

(b) *Establishment of prudent written policies, appropriate limitations and internal controls and audit programs.* If the parent organization or nonbank subsidiary is taking or intends to take positions in financial contracts, that

company's board of directors should approve prudent written policies and establish appropriate limitations to insure that financial contract activities are performed in a safe and sound manner with levels of activity reasonably related to the organization's business needs and capacity to fulfill obligations. In addition, internal controls and internal audit programs to monitor such activity should be established. The board of directors, a duly authorized committee thereof or the internal auditors should review periodically (at least monthly) all financial contract positions to insure conformity with such policies and limits. In order to determine the company's exposure, all open positions should be reviewed and market values determined at least monthly, or more often, depending on volume and magnitude of positions.

(c) *Formulating policies and recording financial contracts.* In formulating its policies and procedures, the parent holding company may consider the interest rate exposure of its nonbank subsidiaries, but not that of its bank subsidiaries. As a matter of policy, the Board believes that any financial contracts executed to reduce the interest rate exposure of a bank affiliate of a holding company should be reflected on the books and records of the bank affiliate (to the extent required by the bank policy statements), rather than on the books and records of the parent company. If a bank has an interest rate exposure that management believes requires hedging with financial contracts, the bank should be the direct beneficiary of any effort to reduce that exposure. The Board also believes that final responsibility for financial contract transactions for the account of each affiliated bank should reside with the management of that bank.

(d) *Accounting.* The joint bank policy statements of March 12, 1980 include accounting guidelines for banks that engage in financial contract activities. Since the Financial Accounting Standards Board is presently considering accounting standards for contract activities, no specific accounting requirements for financial contracts entered into by parent bank holding companies and nonbank subsidiaries are being mandated at this time. The Board expects to review further developments in this area.

(e) *Board to monitor bank holding company transactions in financial contracts.* The Board intends to monitor closely bank holding company transactions in financial contracts to ensure that any such activity is consistent with maintaining a safe and sound banking system. In any cases where bank holding companies are found to be engaging in speculative practices, the Board is prepared to institute appropriate action under the Financial Institutions Supervisory Act of 1966, as amended.

(f) *Federal Reserve Bank notification.* Bank holding companies should furnish written notification to their District Federal Reserve Bank within 10 days after financial contract activities are begun by the parent or a nonbank subsidiary. Holding companies in which the parent or a nonbank subsidiary currently engage in financial contract activity should furnish notice by March 31, 1983.

(Secs. 5(b) and 8 of the Bank Holding Company Act (12 U.S.C. 1844 and 1847); sec. 8(b) of the Financial Institutions Supervisory Act (12 U.S.C. 1818(b))

[48 FR 7720, Feb. 24, 1983]

### § 225.143 Policy statement on nonvoting equity investments by bank holding companies.

(a) *Introduction.* (1) In recent months, a number of bank holding companies have made substantial equity investments in a bank or bank holding company (the ''acquiree'') located in states other than the home state of the investing company through acquisition of preferred stock or nonvoting common shares of the acquiree. Because of the evident interest in these types of investments and because they raise substantial questions under the Bank Holding Company Act (the ''Act''), the Board believes it is appropriate to provide guidance regarding the consistency of such arrangements with the Act.

(2) This statement sets out the Board's concerns with these investments, the considerations the Board will take into account in determining whether the investments are consistent with the Act, and the general scope of

arrangements to be avoided by bank holding companies. The Board recognizes that the complexity of legitimate business arrangements precludes rigid rules designed to cover all situations and that decisions regarding the existence or absence of control in any particular case must take into account the effect of the combination of provisions and covenants in the agreement as a whole and the particular facts and circumstances of each case. Nevertheless, the Board believes that the factors outlined in this statement provide a framework for guiding bank holding companies in complying with the requirements of the Act.

(b) *Statutory and regulatory provisions.* (1) Under section 3(a) of the Act, a bank holding company may not acquire direct or indirect ownership or control of more than 5 per cent of the voting shares of a bank without the Board's prior approval. (12 U.S.C. 1842(a)(3)). In addition, this section of the Act provides that a bank holding company may not, without the Board's prior approval, acquire control of a bank: That is, in the words of the statute, ''for any action to be taken that causes a bank to become a subsidiary of a bank holding company.'' (12 U.S.C. 1842(a)(2)). Under the Act, a bank is a subsidiary of a bank holding company if:

(i) The company directly or indirectly owns, controls, or holds with power to vote 25 per cent or more of the voting shares of the bank;

(ii) The company controls in any manner the election of a majority of the board of directors of the bank; or

(iii) The Board determines, after notice and opportunity for hearing, that the company has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the bank. (12 U.S.C. 1841(d)).

(2) In intrastate situations, the Board may approve bank holding company acquisitions of additional banking subsidiaries. However, where the acquiree is located outside the home state of the investing bank holding company, section 3(d) of the Act prevents the Board from approving any application that will permit a bank holding company to ''acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank.'' (12 U.S.C. 1842(d)(1)).

(c) *Review of agreements.* (1) In apparent expectation of statutory changes that might make interstate banking permissible, bank holding companies have sought to make substantial equity investments in other bank holding companies across state lines, but without obtaining more than 5 per cent of the voting shares or control of the acquiree. These investments involve a combination of the following arrangements:

(i) Options on, warrants for, or rights to convert nonvoting shares into substantial blocks of voting securities of the acquiree bank holding company or its subsidiary bank(s);

(ii) Merger or asset acquisition agreements with the out-of-state bank or bank holding company that are to be consummated in the event interstate banking is permitted;

(iii) Provisions that limit or restrict major policies, operations or decisions of the acquiree; and

(iv) Provisions that make acquisition of the acquiree or its subsidiary bank(s) by a third party either impossible or economically impracticable.

The various warrants, options, and rights are not exercisable by the investing bank holding company unless interstate banking is permitted, but may be transferred by the investor either immediately or after the passage of a period of time or upon the occurrence of certain events.

(2) After a careful review of a number of these agreements, the Board believes that investments in nonvoting stock, absent other arrangements, can be consistent with the Act. Some of the agreements reviewed appear consistent with the Act since they are limited to investments of relatively moderate size in nonvoting equity that may become voting equity only if interstate banking is authorized.

(3) However, other agreements reviewed by the Board raise substantial problems of consistency with the control provisions of the Act because the investors, uncertain whether or when interstate banking may be authorized, have evidently sought to assure the soundness of their investments, prevent takeovers by others, and allow for

sale of their options, warrants, or rights to a person of the investor's choice in the event a third party obtains control of the acquiree or the investor otherwise becomes dissatisfied with its investment. Since the Act precludes the investors from protecting their investments through ownership or use of voting shares or other exercise of control, the investors have substituted contractual agreements for rights normally achieved through voting shares.

(4) For example, various covenants in certain of the agreements seek to assure the continuing soundness of the investment by substantially limiting the discretion of the acquiree's management over major policies and decisions, including restrictions on entering into new banking activities without the investor's approval and requirements for extensive consultations with the investor on financial matters. By their terms, these covenants suggest control by the investing company over the management and policies of the acquiree.

(5) Similarly, certain of the agreements deprive the acquiree bank holding company, by covenant or because of an option, of the right to sell, transfer, or encumber a majority or all of the voting shares of its subsidiary bank(s) with the aim of maintaining the integrity of the investment and preventing takeovers by others. These long-term restrictions on voting shares fall within the presumption in the Board's Regulation Y that attributes control of shares to any company that enters into any agreement placing long-term restrictions on the rights of a holder of voting securities. (12 CFR 225.2(b)(4)).

(6) Finally, investors wish to reserve the right to sell their options, warrants or rights to a person of their choice to prevent being locked into what may become an unwanted investment. The Board has taken the position that the ability to control the ultimate disposition of voting shares to a person of the investor's choice and to secure the economic benefits therefrom indicates control of the shares under the Act.[1] Moreover, the ability to transfer rights to large blocks of voting shares, even if nonvoting in the hands of the investing company, may result in such a substantial position of leverage over the management of the acquiree as to involve a structure that inevitably results in control prohibited by the Act.

(d) *Provisions that avoid control.* (1) In the context of any particular agreement, provisions of the type described above may be acceptable if combined with other provisions that serve to preclude control. The Board believes that such agreements will not be consistent with the Act unless provisions are included that will preserve management's discretion over the policies and decisions of the acquiree and avoid control of voting shares.

(2) As a first step towards avoiding control, covenants in any agreement should leave management free to conduct banking and permissible nonbanking activities. Another step to avoid control is the right of the acquiree to ''call'' the equity investment and options or warrants to assure that covenants that may become inhibiting can be avoided by the acquiree. This right makes such investments or agreements more like a loan in which the borrower has a right to escape covenants and avoid the lender's influence by prepaying the loan.

(3) A measure to avoid problems of control arising through the investor's control over the ultimate disposition of rights to substantial amounts of voting shares of the acquiree would be a provision granting the acquiree a right of first refusal before warrants, options or other rights may be sold and requiring a public and dispersed distribution of these rights if the right of first refusal is not exercised.

(4) In this connection, the Board believes that agreements that involve rights to less than 25 percent of the voting shares, with a requirement for a dispersed public distribution in the event of sale, have a much greater prospect of achieving consistency with the Act than agreements involving a greater percentage. This guideline is drawn by analogy from the provision in the Act that ownership of 25 percent or more of the voting securities of a bank constitutes control of the bank.

[1] *See* Board letter dated March 18, 1982, to C. A. Cavendes, Sociedad Financiera.

(5) The Board expects that one effect of this guideline would be to hold down the size of the nonvoting equity investment by the investing company relative to the acquiree's total equity, thus avoiding the potential for control because the investor holds a very large proportion of the acquiree's total equity. Observance of the 25 percent guideline will also make provisions in agreements providing for a right of first refusal or a public and widely dispersed offering of rights to the acquiree's shares more practical and realistic.

(6) Finally, certain arrangements should clearly be avoided regardless of other provisions in the agreement that are designed to avoid control. These are:

(i) Agreements that enable the investing bank holding company (or its designee) to direct in any manner the voting of more than 5 per cent of the voting shares of the acquiree;

(ii) Agreements whereby the investing company has the right to direct the acquiree's use of the proceeds of an equity investment by the investing company to effect certain actions, such as the purchase and redemption of the acquiree's voting shares; and

(iii) The acquisition of more than 5 per cent of the voting shares of the acquiree that ''simultaneously'' with their acquisition by the investing company become nonvoting shares, remain nonvoting shares while held by the investor, and revert to voting shares when transferred to a third party.

(e) *Review by the Board.* This statement does not constitute the exclusive scope of the Board's concerns, nor are the considerations with respect to control outlined in this statement an exhaustive catalog of permissible or impermissible arrangements. The Board has instructed its staff to review agreements of the kind discussed in this statement and to bring to the Board's attention those that raise problems of consistency with the Act. In this regard, companies are requested to notify the Board of the terms of such proposed merger or asset acquisition agreements or nonvoting equity investments prior to their execution or consummation.

[47 FR 30966, July 16, 1982]

## § 225.145 Limitations established by the Competitive Equality Banking Act of 1987 on the activities and growth of nonbank banks.

(a) *Introduction.* Effective August 10, 1987, the Competitive Equality Banking Act of 1987 (''CEBA'') redefined the term ''bank'' in the Bank Holding Company Act (''BHC Act'' or ''Act'') to include any bank the deposits of which are insured by the Federal Deposit Insurance Corporation as well as any other institution that accepts demand or checkable deposit accounts and is engaged in the business of making commercial loans. 12 U.S.C. 1841(c). CEBA also contained a grandfather provision for certain companies affected by this redefinition. CEBA amended section 4 of the BHC Act to permit a company that on March 5, 1987, controlled a nonbank bank (an institution that became a bank as a result of enactment of CEBA) and that was not a bank holding company on August 9, 1987, to retain its nonbank bank and not be treated as a bank holding company for purposes of the BHC Act if the company and its subsidiary nonbank bank observe certain limitations imposed by CEBA.[1] Certain of these limitations are codified in section 4(f)(3) of the BHC Act and generally restrict nonbank banks from commencing new activities or certain cross-marketing activities with affiliates after March 5, 1987, or permitting overdrafts for affiliates or incurring overdrafts on behalf of affiliates at a Federal Reserve Bank. 12 U.S.C. 1843(f)(3).[2] The Board's views regarding

[1] 12 U.S.C. 1843(f). Such a company is treated as a bank holding company, however, for purposes of the anti-tying provisions in section 106 of the BHC Act Amendments of 1970 (12 U.S.C. 1971 *et seq.*) and the insider lending limitations of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b). The company is also subject to certain examination and enforcement provisions to assure compliance with CEBA.

[2] CEBA also prohibits, with certain limited exceptions, a company controlling a grandfathered nonbank bank from acquiring control of an additional bank or thrift institution or acquiring, directly or indirectly after March 5, 1987, more than 5 percent of the assets or shares of a bank or thrift institution. 12 U.S.C. 1843(f)(2).

the meaning and scope of these limitations are set forth below and in provisions of the Board's Regulation Y (12 CFR 225.52).

(b) *Congressional findings.* (1) At the outset, the Board notes that the scope and application of the Act's limitations on nonbank banks must be guided by the Congressional findings set out in section 4(f)(3) of the BHC Act. Congress was aware that these nonbank banks had been acquired by companies that engage in a wide range of nonbanking activities, such as retailing and general securities activities that are forbidden to bank holding companies under section 4 of the BHC Act. In section 4(f)(3), Congress found that nonbank banks controlled by grandfathered nonbanking companies may, because of their relationships with affiliates, be involved in conflicts of interest, concentration of resources, or other effects adverse to bank safety and soundness. Congress also found that nonbank banks may be able to compete unfairly against banks controlled by bank holding companies by combining banking services with financial services not permissible for bank holding companies. Section 4(f)(3) states that the purpose of the nonbank bank limitations is to minimize any such potential adverse effects or inequities by restricting the activities of nonbank banks until further Congressional action in the area of bank powers could be undertaken. Similarly, the Senate Report accompanying CEBA states that the restrictions CEBA places on nonbank banks ''will help prevent existing nonbank banks from changing their basic character * * * while Congress considers proposals for comprehensive legislation; from drastically eroding the separation of banking and commerce; and from increasing the potential for unfair competition, conflicts of interest, undue concentration of resources, and other adverse effects.'' S. Rep. No. 100–19, 100th Cong., 1st Sess. 12 (1987). *See also* H. Rep. No. 100–261, 100th Cong., 1st Sess. 124 (1987) (the ''Conference Report'').

(2) Thus, Congress explicitly recognized in the statute itself that nonbanking companies controlling grandfathered nonbank banks, which include the many of the nation's largest commercial and financial organizations, were being accorded a significant competitive advantage that could not be matched by bank holding companies because of the general prohibition against nonbanking activities in section 4 of the BHC Act. Congress recognized that this inequality in regulatory approach could inflict serious competitive harm on regulated bank holding companies as the grandfathered entities sought to exploit potential synergies between banking and commercial products and services. *See* Conference Report at 125–126. The basic and stated purpose of the restrictions on grandfathered nonbank banks is to minimize these potential anticompetitive effects.

(3) The Board believes that the specific CEBA limitations should be implemented in light of these Congressional findings and the legislative intent reflected in the plain meaning of the terms used in the statute. In those instances when the language of the statute did not provide clear guidance, legislative materials and the Congressional intent manifested in the overall statutory structure were considered. The Board also notes that prior precedent requires that grandfather exceptions in the BHC Act, such as the nonbank bank limitations and particularly the exceptions thereto, are to be interpreted narrowly in order to ensure the proper implementation of Congressional intent.[3]

(c) *Activity limitation*—(1) *Scope of activity.* (i) The first limitation established under section 4(f)(3) provides that a nonbank bank shall not ''engage in any activity in which such bank was not lawfully engaged as of March 5, 1987.'' The term *activity* as used in this provision of CEBA is not defined. The structure and placement of the CEBA activity restriction within section 4 of the BHC Act and its legislative history do, however, provide direction as to certain transactions that Congress intended to treat as separate activities, thereby providing guidance as to the meaning Congress intended to ascribe

[3] *E.g.*, *Maryland National Corporation*, 73 Federal Reserve Bulletin 310, 313–314 (1987). *Cf.*, *Spokane & Inland Empire Railroad Co.* v. *United States*, 241 U.S. 344, 350 (1915).

to the term generally. First, it is clear that the term *activity* was not meant to refer to banking as a single activity. To the contrary, the term must be viewed as distinguishing between deposit taking and lending activities and treating demand deposit-taking as a separate activity from general deposit-taking and commercial lending as separate from the general lending category.

(ii) Under the activity limitation, a nonbank bank may engage only in activities in which it was ''lawfully engaged'' as of March 5, 1987. As of that date, a nonbank bank could not have been engaged in both demand deposit-taking and commercial lending activity without placing it and its parent holding company in violation of the BHC Act. Thus, under the activity limitations, a nonbank bank could not after March 5, 1987, commence the demand deposit-taking or commercial lending activity that it did not conduct as of March 5, 1987. The debates and Senate and Conference Reports on CEBA confirm that Congress intended the activity limitation to prevent a grandfathered nonbank bank from converting itself into a full-service bank by both offering demand deposits and engaging in the business of making commercial loans.[4] Thus, these types of transactions provide a clear guide as to the type of banking transactions that would constitute activities under CEBA and the degree of specificity intended by Congress in interpreting that term.

(iii) It is also clear that the activity limitation was not intended simply to prevent a nonbank bank from both accepting demand deposits and making commercial loans; it has a broader scope and purpose. If Congress had meant the term to refer to just these two activities, it would have used the restriction it used in another section of CEBA dealing with nonbank banks owned by bank holding companies which has this result, *i.e.*, the nonbank bank could not engage in any activity that would have caused it to become a bank under the prior bank definition in the Act. *See* 12 U.S.C. 1843(g)(1)(A). Indeed, an earlier version of CEBA under consideration by the Senate Banking Committee contained such a provision for nonbank banks owned by commercial holding companies, which was deleted in favor of the broader activity limitation actually enacted. Committee Print No. 1, (Feb. 17, 1987). In this regard, both the Senate Report and Conference Report refer to demand deposit-taking and commercial lending as examples of activities that could be affected by the activity limitation, not as the sole activities to be limited by the provision.[5]

(iv) Finally, additional guidance as to the meaning of the term *activity* is provided by the statutory context in which the term appears. The activity limitation is contained in section 4 of the BHC Act, which regulates the investments and activities of bank holding companies and their nonbank subsidiaries. The Board believes it reasonable to conclude that by placing the CEBA activity limitation in section 4 of the BHC Act, Congress meant that Board and judicial decisions regarding the meaning of the term *activity* in that section be looked to for guidance. This is particularly appropriate given the fact that grandfathered nonbank banks, whether owned by bank holding companies or unregulated holding companies, were treated as nonbank companies and not banks before enactment of CEBA.

(v) This interpretation of the term activity draws support from comments by Senator Proxmire during the Senate's consideration of the provision that the term was not intended to apply ''on a product-by-product, customer-by-customer basis.'' 133 Cong. Rec. S4054–5 (daily ed. March 27, 1987). This is the same manner in which the Board has interpreted the term activity in the nonbanking provision of section 4 as referring to generic categories

[4] Conference Report at 124–25; S. Rep. No. 100–19 at 12, 32; H. Rep. No. 99–175, 99th Cong., 1st Sess. 3 (1985) (''the activities limitation is to prevent an institution engaged in a limited range of functions from expanding into new areas and becoming, in essence, a full-service bank''); 133 Cong. Rec. S4054 (daily ed. March 27, 1987); (Comments of Senator Proxmire).

[5] Conference Report at 124–125; S. Rep. No. 100–19 at 32.

of activities, not to discrete products and services.

(vi) Accordingly, consistent with the terms and purposes of the legislation and the Congressional intent to minimize unfair competition and the other adverse effects set out in the CEBA findings, the Board concludes that the term *activity* as used in section 4(f)(3) means any line of banking or nonbanking business. This definition does not, however, envision a product-by-product approach to the activity limitation. The Board believes it would be helpful to describe the application of the activity limitation in the context of the following major categories of activities: deposit-taking, lending, trust, and other activities engaged in by banks.

(2) *Deposit-taking activities.* (i) With respect to deposit-taking, the Board believes that the activity limitation in section 4(f)(3) generally refers to three types of activity: demand deposit-taking; non-demand deposit-taking with a third party payment capability; and time and savings deposit-taking without third party payment powers. As previously discussed, it is clear from the terms and intent of CEBA that the activity limitation would prevent, and was designed to prevent, nonbank banks that prior to the enactment of CEBA had refrained from accepting demand deposits in order to avoid coverage as a *bank* under the BHC Act, from starting to take these deposits after enactment of CEBA and thus becoming full-service banks. Accordingly, CEBA requires that the taking of demand deposits be treated as a separate activity.

(ii) The Board also considers nondemand deposits withdrawable by check or other similar means for payment to third parties or others to constitute a separate line of business for purposes of applying the activity limitation. In this regard, the Board has previously recognized that this line of businesss constitutes a permissible but separate activity under section 4 of the BHC Act. Furthermore, the offering of accounts with transaction capability requires different expertise and systems than non-transaction deposit-taking and represented a distinct new activity that traditionally separated banks from thrift and similar institutions.

(iii) Support for this view may also be found in the House Banking Committee report on proposed legislation prior to CEBA that contained a similar prohibition on new activities for nonbank banks. In discussing the activity limitation, the report recognized a distinction between demand deposits and accounts with transaction capability and those without transaction capability:

> With respect to deposits, the Committee recognizes that it is legitimate for an institution currently involved in offering demand deposits or other third party transaction accounts to make use of new technologies that are in the process of replacing the existing check-based, paper payment system. Again, however, the Committee does not believe that technology should be used as a lever for an institution that was only incidentally involved in the payment system to transform itself into a significant offeror of transaction account capability.[6]

(iv) Finally, this distinction between demand and nondemand checkable accounts and accounts not subject to withdrawal by check was specifically recognized by Congress in the redefinition of the term *bank* in CEBA to include an institution that takes demand deposits or ''deposits that the depositor may withdraw by check or other means for payment to third parties or others'' as well as in various exemptions from that definition for trust companies, credit card banks, and certain industrial banks.[7]

(v) Thus, an institution that as of March 5, 1987, offered only time and savings accounts that were not withdrawable by check for payment to third parties could not thereafter begin offering accounts with transaction capability, for example, NOW accounts or other types of transaction accounts.

(3) *Lending.* As noted, the CEBA activity limitation does not treat lending as a single activity; it clearly distinguishes between commercial and other types of lending. This distinction is also reflected in the definition of *bank* in the BHC Act in effect both prior to

[6] H. Rep. No. 99–175, 99th Cong., 1st Sess. 13 (1985).

[7] See 12 U.S.C. 1841(c)(2) (D), (F), (H), and (I).

and after enactment of CEBA as well as in various of the exceptions from this definition. In addition, commercial lending is a specialized form of lending involving different techniques and analysis from other types of lending. Based upon these factors, the Board would view commercial lending as a separate and distinct activity for purposes of the activity limitation in section 4(f)(3). The Board's decisions under section 4 of the BHC Act have not generally differentiated between types of commercial lending, and thus the Board would view commercial lending as a single activity for purposes of CEBA. Thus, a nonbank bank that made commercial loans as of March 5, 1987, could make any type of commercial loan thereafter.

(i) *Commercial lending.* For purposes of the activity limitation, a commercial loan is defined in accordance with the Supreme Court's decision in *Board of Governors* v. *Dimension Financial Corporation,* 474 U.S. 361 (1986), as a direct loan to a business customer for the purpose of providing funds for that customer's business. In this regard, the Board notes that whether a particular transaction is a commercial loan must be determined not from the face of the instrument, but from the application of the definition of commercial loan in the *Dimension* decision to that transaction. Thus, certain transactions of the type mentioned in the Board's ruling at issue in *Dimension* and in the Senate and Conference Reports in the CEBA legislation[8] would be commercial loans if they meet the test for commercial loans established in *Dimension.* Under this test, a commercial loan would not include, for example, an open-market investment in a commercial entity that does not involve a borrower-lender relationship or negotiation of credit terms, such as a money market transaction.

(ii) *Other lending.* Based upon the guidance in the Act as to the degree of specificity required in applying the activity limitation with respect to lending, the Board believes that, in addition to commercial lending, there are three other types of lending activities: consumer mortgage lending, consumer credit card lending, and other consumer lending. Mortgage lending and credit card lending are recognized, discrete lines of banking and business activity, involving techniques and processes that are different from and more specialized than those required for general consumer lending. For example, these activities are, in many cases, conducted by specialized institutions, such as mortgage companies and credit card institutions, or through separate organizational structures within an institution, particularly in the case of mortgage lending. Additionally, the Board's decisions under section 4 of the Act have recognized mortgage banking and credit card lending as separate activities for bank holding companies. The Board's Regulation Y reflects this specialization, noting as examples of permissible lending activity: consumer finance, credit card and mortgage lending. 12 CFR 225.25(b)(1). Finally, CEBA itself recognizes the specialized nature of credit card lending by exempting an institution specializing in that activity from the bank definition. For purpose of the activity limitation, a consumer mortgage loan will mean any loan to an individual that is secured by real estate and that is not a commercial loan. A credit card loan would be any loan made to an individual by means of a credit card that is not a commercial loan.

(4) *Trust activities.* Under section 4 of the Act, the Board has historically treated trust activities as a single activity and has not differentiated the function on the basis of whether the customer was an individual or a business. *See* 12 CFR 225.25(b)(3). Similarly, the trust company exemption from the bank definition in CEBA makes no distinction between various types of trust activities. Accordingly, the Board would view trust activities as a separate activity without additional differentiation for purposes of the activity limitation in section 4(f)(3).

(5) *Other activities.* With respect to activities other than the various traditional deposit-taking, lending or trust activities, the Board believes it appropriate, for the reasons discussed above,

[8] S. Rep. No. 100–19 at 31; Conference Report at 123.

to apply the activity limitation in section 4(f)(3) as the term *activity* generally applies in other provisions of section 4 of the BHC Act. Thus, a grandfathered nonbank bank could not, for example, commence after March 5, 1987, any of the following activities (unless it was engaged in such an activity as of that date): discount securities brokerage, full-service securities brokerage investment advisory services, underwriting or dealing in government securities as permissible for member banks, foreign exchange transaction services, real or personal property leasing, courier services, data processing for third parties, insurance agency activities,[9] real estate development, real estate brokerage, real estate syndication, insurance underwriting, management consulting, futures commission merchant, or activities of the general type listed in § 225.25(b) of Regulation Y.

(6) *Meaning of engaged in*. In order to be *engaged in* an activity, a nonbank bank must demonstrate that it had a program in place to provide a particular product or service included within the grandfathered activity to a customer and that it was in fact offering the product or service to customers as of March 5, 1987. Thus, a nonbank bank is not engaged in an activity as of March 5, 1987, if the product or service in question was in a planning state as of that date and had not been offered or delivered to a customer. Consistent with prior Board interpretations of the term activity in the grandfather provisions of section 4, the Board does not believe that a company may be engaged in an activity on the basis of a single isolated transaction that was not part of a program to offer the particular product or to conduct in the activity on an ongoing basis. For example, a nonbank bank that held an interest in a single real estate project would not thereby be engaged in real estate development for purposes of this provision, unless evidence was presented indicating the interest was held under a program to commence a real estate development business.

(7) *Meaning of as of* The Board believes that the grandfather date ''as of March 5, 1987'' as used throughout section 4(f)(3) should refer to activities engaged in on March 5, 1987, or a reasonably short period preceding this date not exceeding 13 months. 133 Cong. Rec. S3957 (daily ed. March 26, 1987). (Remarks of Senators Dodd and Proxmire). Activities that the institution had terminated prior to March 5, 1988, however, would not be considered to have been conducted or engaged in *as of* March 5. For example, if within 13 months of March 5, 1987, the nonbank bank had terminated its commercial lending activity in order to avoid the *bank* definition in the Act, the nonbank bank could not recommence that activity after enactment of CEBA.

(d) *Cross-marketing limitation*—(1) *In general*. Section 4(f)(3) also limits cross-marketing activities by nonbank banks and their affiliates. Under this provision, a nonbank bank may not offer or market a product or service of an affiliate unless the product or service may be offered by bank holding companies generally under section 4(c)(8) of the BHC Act. In addition, a nonbank bank may not permit any of its products or services to be offered or marketed by or through a nonbank affiliate unless the affiliate engages only in activities permissible for a bank holding company under section 4(c)(8). These limitations are subject to an exception for products or services that were being so offered or marketed as of March 5, 1987, but only in the same manner in which they were being offered or marketed as of that date.

(2) *Examples of impermissible cross-marketing*. The Conference Report illustrates the application of this limitation to the following two covered transactions: (i) products and services of an affiliate that bank holding companies may not offer under the BHC Act, and (ii) products and services of the nonbank bank. In the first case, the restrictions would prohibit, for example, a company from marketing life insurance or automotive supplies through its affiliate nonbank bank because these products are not generally

[9] In this area, section 4 of the Act does not treat all insurance agency activities as a single activity. Thus, for example, the Act treats the sale of credit-related life, accident and health insurance as a separate activity from general insurance agency activities. See 12 U.S.C. 1843(c)(8).

permissible under the BHC Act. Conference Report at 126. In the second case, a nonbank bank may not permit its products or services to be offered or marketed through a life insurance affiliate or automobile parts retailer because these affiliates engage in activities prohibited under the BHC Act. *Id.*

(3) *Permissible cross-marketing.* On the other hand, a nonbank bank could offer to its customers consumer loans from an affiliated mortgage banking or consumer finance company. These affiliates could likewise offer their customers the nonbank bank's products or services provided the affiliates engaged only in activities permitted for bank holding companies under the closely-related-to-banking standard of section 4(c)(8) of the BHC Act. If the affiliate is engaged in both permissible and impermissible activities within the meaning of section 4(c)(8) of the BHC Act, however, the affiliate could not offer or market the nonbank bank's products or services.

(4) *Product approach to cross-marketing restriction.* (i) Unlike the activity restrictions, the cross-marketing restrictions of CEBA apply by their terms to individual products and services. Thus, an affiliate of a nonbank bank that was engaged in activities that are not permissible for bank holding companies and that was marketing a particular product or service of a nonbank bank on the grandfather date could continue to market that product and, as discussed below, could change the terms and conditions of the loan. The nonbank affiliate could not, however, begin to offer or market another product or service of the nonbank bank.

(ii) The Board believes that the term *product or service* must be interpreted in light of its accepted ordinary commercial usage. In some instances, commercial usage has identified a group of products so closely related that they constitute a product line (*e.g.*, certificates of deposit) and differences in versions of the product (*e.g.*, a one-year certificate of deposit) simply represent a difference in the terms of the product.[10] This approach is consistent with the treatment in CEBA's legislative history of certificates of deposit as a product line rather than each particular type of CD as a separate product.[11]

(iii) In the area of consumer lending, the Board believes the following provide examples of different consumer loan products: mortgage loans to finance the purchase of the borrower's residence, unsecured consumer loans, consumer installment loans secured by the personal property to be purchased (*e.g.* automobile, boat or home appliance loans), or second mortgage loans.[12] Under this interpretation, a nonbank bank that offered automobile loans through a nonbank affiliate on the grandfather date could market boat loans, appliance loans or any type of secured consumer installment loan through that affiliate. It could not, however, market unsecured consumer loans, home mortgage loans or other types of consumer loans.

(iv) In other areas, the Board believes that the determination as to what constitutes a product or service should be made on a case-by-case basis consistent with the principles that the terms *product or service* must be interpreted in accordance with their ordinary commercial usage and must be narrower in scope than the definition of activity. Essentially, the concept applied in this analysis is one of permitting the continuation of the specific product marketing activity that was undertaken as

[10] American Bankers Association, *Banking Terminology* (1981).

[11] During the Senate debates on CEBA, Senator Proxmire in response to a statement from Senator Cranston that the joint-marketing restrictions do not lock into place the specific terms or conditions of the particular grandfathered product or service, stated:

That is correct. For example, if a nonbank bank was jointly marketing on March 5, 1987, a 3 year, $5,000 certificate of deposit, this bill would not prohibit offering in the same manner a 1 year, $2,000 certificate of deposit with a different interest rate. 133 Cong. Rec. S3959 (daily ed. March 26, 1987).

[12] In this regard, the Supreme Court in *United States* v. *Philadelphia National Bank,* noted that ''the principal banking products are of course various types of credit, for example: unsecured personal and business loans, mortgage loans, loans secured by securities or accounts receivable, automobile installment and consumer goods, installment loans, tuition financing, bank credit cards, revolving credit funds.'' 374 U.S. 321, 326 n.5 (1963).

of March 5, 1987. Thus, for example, while insurance underwriting may constitute a separate activity under CEBA, a nonbank bank could not market a life insurance policy issued by the affiliate if on the grandfather date it had only marketed homeowners' policies issued by the affiliate.

(5) *Change in terms and conditions permitted.* (i) The cross-marketing restrictions would not limit the ability of the institution to change the specific terms and conditions of a particular grandfathered product or service. The Conference Report indicates a legislative intent not to lock into place the specific terms or conditions of a grandfathered product or service. Conference Report at 126. For example, a nonbank bank marketing a three-year, $5,000 certificate of deposit through an affiliate under the exemption could offer a one-year $2,000 certificate of deposit with a different interest rate after the grandfather date. *See* footnote 11 above. Modifications that alter the type of product, however, are not permitted. Thus, a nonbank bank that marketed through affiliates on March 5, 1987, only certificates of deposit could not commence marketing MMDA's or NOW accounts after the grandfather date.

(ii) General changes in the character of the product or service as the result of market or technological innovation are similarly permitted to the extent that they do not transform a grandfathered product into a new product. Thus, an unsecured line of credit could not be modified to include a lien on the borrower's residence without becoming a new product.

(6) *Meaning of offer or market.* In the Board's opinion, the terms *offer or market* in the cross-marketing restrictions refer to the presentation to a customer of an institution's products or service through any type of program, including telemarketing, advertising brochures, direct mailing, personal solicitation, customer referrals, or joint-marketing agreements or presentations. An institution must have offered or actually marketed the product or service on March 5 or shortly before that date (as discussed above) to qualify for the grandfather privilege. Thus, if the cross-marketing program was in the planning stage on March 5, 1987, the program would not quality for grandfather treatment under CEBA.

(7) *Limitations on cross-marketing to in the same manner.* (i) The cross-marketing restriction in section 4(f)(3) contains a grandfather provision that permits products or services that would otherwise be prohibited from being offered or marketed under the provision to continue to be offered or marketed by a particular entity if the products or services were being so offered or marketed as of March 5, 1987, but ''only in the same manner in which they were being offered or marketed as of that date.'' Thus, to qualify for the grandfather provision, the manner of offering or marketing the otherwise prohibited product or service must remain the same as on the grandfather date.

(ii) In interpreting this provision, the Board notes that Congress designed the joint-marketing restrictions to prevent the significant risk to the public posed by the conduct of such activities by insured banks affiliated with companies engaged in general commerce, to ensure objectivity in the credit-granting process and to ''minimize the unfair competitive advantage that grandfathered commercial companies owning nonbank banks might otherwise engage over regulated bank holding companies and our competing commercial companies that have no subsidiary bank.'' Conference Report at 125–126. The Board believes that determinations regarding the manner of cross-marketing of a particular product or service may best be accomplished by applying the limitation to the particular facts in each case consistent with the stated purpose of this provision of CEBA and the general principle that grandfather restrictions and exceptions to general prohibitions must be narrowly construed in order to prevent the exception from nullifying the rule. Essentially, as in the scope of the term ''product or service'', the guiding principle of Congressional intent with respect to this term is to permit only the continuation of the specific types of cross-marketing activity that were undertaken as of March 5, 1987.

(8) *Eligibility for cross-marketing grandfather exemption.* The Conference Report also clarifies that entitlement to

an exemption to continue to cross-market products and services otherwise prohibited by the statute applies only to the specific company that was engaged in the activity as of March 5, 1987. Conference Report at 126. Thus, an affiliate that was not engaged in cross-marketing products or services as of the grandfather date may not commence these activities under the exemption even if such activities were being conducted by another affiliate. *Id.*; *see also* S. Rep. No. 100–19 at 33–34.

(e) *Eligibility for grandfathered nonbank bank status.* In reviewing the reports required by CEBA, the Board notes that a number of institutions that had not commenced business operations on August 10, 1987, the date of enactment of CEBA, claimed grandfather privileges under section 4(f)(3) of CEBA. To qualify for grandfather privileges under section 4(f)(3), the institution must have ''bec[o]me a bank as a result of the enactment of [CEBA]'' and must have been controlled by a nonbanking company on March 5, 1987. 12 U.S.C. 1843(f)(1)(A). An institution that did not have FDIC insurance on August 10, 1987, and that did not accept demand deposits or transaction accounts or engage in the business of commercial lending on that date, would not have become a *bank* as a result of enactment of CEBA. Thus, institutions that had not commenced operations on August 10, 1987, could not qualify for grandfather privileges under section 4(f)(3) of CEBA. This view is supported by the activity limitations of section 4(f)(3), which, as noted, limit the activities of grandfathered nonbank banks to those in which they were lawfully engaged as of March 5, 1987. A nonbank bank that had not commenced conducting business activities on March 5, 1987, could not after enactment of CEBA engage in any activities under this provision.

[Reg. Y, 53 FR 37746, Sept. 28, 1988, as amended by Reg. Y, 62 FR 9343, Feb. 28, 1997]

## Subpart J—Merchant Banking Investments

SOURCE: Reg. Y, 66 FR 8484, Jan. 31, 2001, unless otherwise noted.

### § 225.170 What type of investments are permitted by this subpart, and under what conditions may they be made?

(a) *What types of investments are permitted by this subpart?* Section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) and this subpart authorize a financial holding company, directly or indirectly and as principal or on behalf of one or more persons, to acquire or control any amount of shares, assets or ownership interests of a company or other entity that is engaged in any activity not otherwise authorized for the financial holding company under section 4 of the Bank Holding Company Act. For purposes of this subpart, shares, assets or ownership interests acquired or controlled under section 4(k)(4)(H) and this subpart are referred to as ''merchant banking investments.'' A financial holding company may not directly or indirectly acquire or control any merchant banking investment except in compliance with the requirements of this subpart.

(b) *Must the investment be a bona fide merchant banking investment?* The acquisition or control of shares, assets or ownership interests under this subpart is not permitted unless it is part of a bona fide underwriting or merchant or investment banking activity.

(c) *What types of ownership interests may be acquired?* Shares, assets or ownership interests of a company or other entity include any debt or equity security, warrant, option, partnership interest, trust certificate or other instrument representing an ownership interest in the company or entity, whether voting or nonvoting.

(d) *Where in a financial holding company may merchant banking investments be made?* A financial holding company and any subsidiary (other than a depository institution or subsidiary of a depository institution) may acquire or control merchant banking investments. A financial holding company and its subsidiaries may not acquire or control merchant banking investments on behalf of a depository institution or subsidiary of a depository institution.

(e) *May assets other than shares be held directly?* A financial holding company may not under this subpart acquire or

control assets, other than debt or equity securities or other ownership interests in a company, unless:

(1) The assets are held by or promptly transferred to a portfolio company;

(2) The portfolio company maintains policies, books and records, accounts, and other indicia of corporate, partnership or limited liability organization and operation that are separate from the financial holding company and limit the legal liability of the financial holding company for obligations of the portfolio company; and

(3) The portfolio company has management that is separate from the financial holding company to the extent required by § 225.171.

(f) *What type of affiliate is required for a financial holding company to make merchant banking investments?* A financial holding company may not acquire or control merchant banking investments under this subpart unless the financial holding company qualifies under at least one of the following paragraphs:

(1) *Securities affiliate*. The financial holding company is or has an affiliate that is registered under the Securities Exchange Act of 1934 (15 U.S.C. 78c, 78o, 78o–4) as:

(i) A broker or dealer; or

(ii) A municipal securities dealer, including a separately identifiable department or division of a bank that is registered as a municipal securities dealer.

(2) *Insurance affiliate with an investment adviser affiliate*. The financial holding company controls:

(i) An insurance company that is predominantly engaged in underwriting life, accident and health, or property and casualty insurance (other than credit-related insurance), or providing and issuing annuities; and

(ii) A company that:

(A) Is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*); and

(B) Provides investment advice to an insurance company.

## § 225.171 What are the limitations on managing or operating a portfolio company held as a merchant banking investment?

(a) *May a financial holding company routinely manage or operate a portfolio company?* Except as permitted in paragraph (e) of this section, a financial holding company may not routinely manage or operate any portfolio company.

(b) *When does a financial holding company routinely manage or operate a company?*

(1) *Examples of routine management or operation*—(i) *Executive officer interlocks at the portfolio company*. A financial holding company routinely manages or operates a portfolio company if any director, officer or employee of the financial holding company serves as or has the responsibilities of an executive officer of the portfolio company.

(ii) Interlocks by executive officers of the financial holding company. (A) *Prohibition*. A financial holding company routinely manages or operates a portfolio company if any executive officer of the financial holding company serves as or has the responsibilities of an officer or employee of the portfolio company.

(B) *Definition*. For purposes of paragraph (b)(1)(ii)(A) of this section, the term ''financial holding company'' includes the financial holding company and only the following subsidiaries of the financial holding company:

(*1*) A securities broker or dealer registered under the Securities Exchange Act of 1934;

(*2*) A depository institution;

(*3*) An affiliate that engages in merchant banking activities under this subpart or insurance company investment activities under section 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(I));

(*4*) A small business investment company (as defined in section 302(b) of the Small Business Investment Act of 1958 (15 U.S.C. 682(b)) controlled by the financial holding company or by any depository institution controlled by the financial holding company; and

(*5*) Any other affiliate that engages in significant equity investment activities that are subject to a special capital charge under the capital adequacy rules or guidelines of the Board.

(iii) *Covenants regarding ordinary course of business.* A financial holding company routinely manages or operates a portfolio company if any covenant or other contractual arrangement exists between the financial holding company and the portfolio company that would restrict the portfolio company's ability to make routine business decisions, such as entering into transactions in the ordinary course of business or hiring officers or employees other than executive officers.

(2) *Presumptions of routine management or operation.* A financial holding company is presumed to routinely manage or operate a portfolio company if:

(i) Any director, officer, or employee of the financial holding company serves as or has the responsibilities of an officer (other than an executive officer) or employee of the portfolio company; or

(ii) Any officer or employee of the portfolio company is supervised by any director, officer, or employee of the financial holding company (other than in that individual's capacity as a director of the portfolio company).

(c) *How may a financial holding company rebut a presumption that it is routinely managing or operating a portfolio company?* A financial holding company may rebut a presumption that it is routinely managing or operating a portfolio company under paragraph (b)(2) of this section by presenting information to the Board demonstrating to the Board's satisfaction that the financial holding company is not routinely managing or operating the portfolio company.

(d) *What arrangements do not involve routinely managing or operating a portfolio company?*—(1) *Director representation at portfolio companies.* A financial holding company may select any or all of the directors of a portfolio company or have one or more of its directors, officers, or employees serve as directors of a portfolio company if:

(i) The portfolio company employs officers and employees responsible for routinely managing and operating the company; and

(ii) The financial holding company does not routinely manage or operate the portfolio company, except as permitted in paragraph (e) of this section.

(2) *Covenants or other provisions regarding extraordinary events.* A financial holding company may, by virtue of covenants or other written agreements with a portfolio company, restrict the ability of the portfolio company, or require the portfolio company to consult with or obtain the approval of the financial holding company, to take actions outside of the ordinary course of the business of the portfolio company. Examples of the types of actions that may be subject to these types of covenants or agreements include, but are not limited to, the following:

(i) The acquisition of significant assets or control of another company by the portfolio company or any of its subsidiaries;

(ii) Removal or selection of an independent accountant or auditor or investment banker by the portfolio company;

(iii) Significant changes to the business plan or accounting methods or policies of the portfolio company;

(iv) Removal or replacement of any or all of the executive officers of the portfolio company;

(v) The redemption, authorization or issuance of any equity or debt securities (including options, warrants or convertible shares) of the portfolio company or any borrowing by the portfolio company outside of the ordinary course of business;

(vi) The amendment of the articles of incorporation or by-laws (or similar governing documents) of the portfolio company; and

(vii) The sale, merger, consolidation, spin-off, recapitalization, liquidation, dissolution or sale of substantially all of the assets of the portfolio company or any of its significant subsidiaries.

(3) *Providing advisory and underwriting services to, and having consultations with, a portfolio company.* A financial holding company may:

(i) Provide financial, investment and management consulting advice to a

portfolio company in a manner consistent with and subject to any restrictions on such activities contained in §§ 225.28(b)(6) or 225.86(b)(1) of this part (12 CFR 225.28(b)(6) and 225.86(b)(1));

(ii) Provide assistance to a portfolio company in connection with the underwriting or private placement of its securities, including acting as the underwriter or placement agent for such securities; and

(iii) Meet with the officers or employees of a portfolio company to monitor or provide advice with respect to the portfolio company's performance or activities.

(e) *When may a financial holding company routinely manage or operate a portfolio company?*—(1) *Special circumstances required.* A financial holding company may routinely manage or operate a portfolio company only when intervention by the financial holding company is necessary or required to obtain a reasonable return on the financial holding company's investment in the portfolio company upon resale or other disposition of the investment, such as to avoid or address a significant operating loss or in connection with a loss of senior management at the portfolio company.

(2) *Duration Limited.* A financial holding company may routinely manage or operate a portfolio company only for the period of time as may be necessary to address the cause of the financial holding company's involvement, to obtain suitable alternative management arrangements, to dispose of the investment, or to otherwise obtain a reasonable return upon the resale or disposition of the investment.

(3) *Notice required for extended involvement.* A financial holding company may not routinely manage or operate a portfolio company for a period greater than nine months without prior written notice to the Board.

(4) *Documentation required.* A financial holding company must maintain and make available to the Board upon request a written record describing its involvement in routinely managing or operating a portfolio company.

(f) *May a depository institution or its subsidiary routinely manage or operate a portfolio company?*—(1) *In general.* A depository institution and a subsidiary of a depository institution may not routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this subpart.

(2) *Definition applying provisions governing routine management or operation.* For purposes of this section other than paragraph (e) and for purposes of § 225.173(d), a financial holding company includes a depository institution controlled by the financial holding company and a subsidiary of such a depository institution.

(3) *Exception for certain subsidiaries of depository institutions.* For purposes of paragraph (e) of this section, a financial holding company includes a financial subsidiary held in accordance with section 5136A of the Revised Statutes (12 U.S.C. 24a) or section 46 of the Federal Deposit Insurance Act (12 U.S.C. 1831w), and a subsidiary that is a small business investment company and that is held in accordance with the Small Business Investment Act (15 U.S.C. 661 *et seq.*), and such a subsidiary may, in accordance with the limitations set forth in this section, routinely manage or operate a portfolio company in which an affiliated company owns or controls an interest under this subpart.

### § 225.172 What are the holding periods permitted for merchant banking investments?

(a) *Must investments be made for resale?* A financial holding company may own or control shares, assets and ownership interests pursuant to this subpart only for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the financial holding company's merchant banking investment activities.

(b) *What period of time is generally permitted for holding merchant banking investments?*—(1) *In general.* Except as provided in this section or § 225.173, a financial holding company may not, directly or indirectly, own, control or hold any share, asset or ownership interest pursuant to this subpart for a period that exceeds 10 years.

(2) *Ownership interests acquired from or transferred to companies held under this subpart.* For purposes of paragraph

(b)(1) of this section, shares, assets or ownership interests—

(i) Acquired by a financial holding company from a company in which the financial holding company held an interest under this subpart will be considered to have been acquired by the financial holding company on the date that the share, asset or ownership interest was acquired by the company; and

(ii) Acquired by a company from a financial holding company will be considered to have been acquired by the company on the date that the share, asset or ownership interest was acquired by the financial holding company if—

(A) The financial holding company held the share, asset, or ownership interest under this subpart; and

(B) The financial holding company holds an interest in the acquiring company under this subpart.

(3) *Interests previously held by a financial holding company under limited authority.* For purposes of paragraph (b)(1) of this section, any shares, assets, or ownership interests previously owned or controlled, directly or indirectly, by a financial holding company under any other provision of the Federal banking laws that imposes a limited holding period will if acquired under this subpart be considered to have been acquired by the financial holding company under this subpart on the date the financial holding company first acquired ownership or control of the shares, assets or ownership interests under such other provision of law. For purposes of this paragraph (b)(3), a financial holding company includes a depository institution controlled by the financial holding company and any subsidiary of such a depository institution.

(4) *Approval required to hold interests held in excess of time limit.* A financial holding company may seek Board approval to own, control or hold shares, assets or ownership interests of a company under this subpart for a period that exceeds the period specified in paragraph (b)(1) of this section. A request for approval must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for the request, including information that addresses the factors in paragraph (b)(5) of this section; and

(iii) Explain the financial holding company's plan for divesting the shares, assets or ownership interests.

(5) *Factors governing Board determinations.* In reviewing any proposal under paragraph (b)(4) of this section, the Board may consider all the facts and circumstances related to the investment, including:

(i) The cost to the financial holding company of disposing of the investment within the applicable period;

(ii) The total exposure of the financial holding company to the company and the risks that disposing of the investment may pose to the financial holding company;

(iii) Market conditions;

(iv) The nature of the portfolio company's business;

(v) The extent and history of involvement by the financial holding company in the management and operations of the company; and

(vi) The average holding period of the financial holding company's merchant banking investments.

(6) *Restrictions applicable to investments held beyond time period.* A financial holding company that directly or indirectly owns, controls or holds any share, asset or ownership interest of a company under this subpart for a total period that exceeds the period specified in paragraph (b)(1) of this section must—

(i) For purposes of determining the financial holding company's regulatory capital, apply to the financial holding company's adjusted carrying value of such shares, assets, or ownership interests a capital charge determined by the Board that must be:

(A) Higher than the maximum marginal Tier 1 capital charge applicable under the Board's capital adequacy rules or guidelines (*see* 12 CFR 225 appendix A) to merchant banking investments held by that financial holding company; and

(B) In no event less than 25 percent of the adjusted carrying value of the investment; and

(ii) Abide by any other restrictions that the Board may impose in connection with granting approval under paragraph (b)(4) of this section.

### § 225.173 How are investments in private equity funds treated under this subpart?

(a) *What is a private equity fund?* For purposes of this subpart, a ''private equity fund'' is any company that:

(1) Is formed for the purpose of and is engaged exclusively in the business of investing in shares, assets, and ownership interests of financial and nonfinancial companies for resale or other disposition;

(2) Is not an operating company;

(3) No more than 25 percent of the total equity of which is held, owned or controlled, directly or indirectly, by the financial holding company and its directors, officers, employees and principal shareholders;

(4) Has a maximum term of not more than 15 years; and

(5) Is not formed or operated for the purpose of making investments inconsistent with the authority granted under section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)) or evading the limitations governing merchant banking investments contained in this subpart.

(b) *What form may a private equity fund take?* A private equity fund may be a corporation, partnership, limited liability company or other type of company that issues ownership interests in any form.

(c) *What is the holding period permitted for interests in private equity funds?*—(1) *In general.* A financial holding company may own, control or hold any interest in a private equity fund under this subpart and any interest in a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this subpart for the duration of the fund, up to a maximum of 15 years.

(2) *Request to hold interest for longer period.* A financial holding company may seek Board approval to own, control or hold an interest in or held through a private equity fund for a period longer than the duration of the fund in accordance with § 225.172(b) of this subpart.

(3) *Application of rules.* The rules described in § 225.172(b)(2) and (3) governing holding periods of interests acquired, transferred or previously held by a financial holding company apply to interests in, held through, or acquired from a private equity fund.

(d) *How do the restrictions on routine management and operation apply to private equity funds and investments held through a private equity fund?*—(1) *Portfolio companies held through a private equity fund.* A financial holding company may not routinely manage or operate a portfolio company that is owned or controlled by a private equity fund in which the financial holding company owns or controls any interest under this subpart, except as permitted under § 225.171(e).

(2) *Private equity funds controlled by a financial holding company.* A private equity fund that is controlled by a financial holding company may not routinely manage or operate a portfolio company, except as permitted under § 225.171(e).

(3) *Private equity funds that are not controlled by a financial holding company.* A private equity fund may routinely manage or operate a portfolio company so long as no financial holding company controls the private equity fund or as permitted under § 225.171(e).

(4) *When does a financial holding company control a private equity fund?* A financial holding company controls a private equity fund for purposes of this subpart if the financial holding company, including any director, officer, employee or principal shareholder of the financial holding company:

(i) Serves as a general partner, managing member, or trustee of the private equity fund (or serves in a similar role with respect to the private equity fund);

(ii) Owns or controls 25 percent or more of any class of voting shares or similar interests in the private equity fund;

(iii) In any manner selects, controls or constitutes a majority of the directors, trustees or management of the private equity fund; or

(iv) Owns or controls more than 5 percent of any class of voting shares or similar interests in the private equity fund and is the investment adviser to the fund.

### § 225.174 What aggregate thresholds apply to merchant banking investments?

(a) *In general.* A financial holding company may not, without Board approval, directly or indirectly acquire any additional shares, assets or ownership interests under this subpart or make any additional capital contribution to any company the shares, assets or ownership interests of which are held by the financial holding company under this subpart if the aggregate carrying value of all merchant banking investments held by the financial holding company under this subpart exceeds:

(1) 30 percent of the Tier 1 capital of the financial holding company; or

(2) After excluding interests in private equity funds, 20 percent of the Tier 1 capital of the financial holding company.

(b) *How do these thresholds apply to a private equity fund?* Paragraph (a) of this section applies to the interest acquired or controlled by the financial holding company under this subpart in a private equity fund. Paragraph (a) of this section does not apply to any interest in a company held by a private equity fund or to any interest held by a person that is not affiliated with the financial holding company.

(c) *How long do these thresholds remain in effect?* This § 225.174 shall cease to be effective on the date that a final rule issued by the Board that specifically addresses the appropriate regulatory capital treatment of merchant banking investments becomes effective.

### § 225.175 What risk management, record keeping and reporting policies are required to make merchant banking investments?

(a) *What internal controls and records are necessary?*—(1) *General.* A financial holding company, including a private equity fund controlled by a financial holding company, that makes investments under this subpart must establish and maintain policies, procedures, records and systems reasonably designed to conduct, monitor and manage such investment activities and the risks associated with such investment activities in a safe and sound manner, including policies, procedures, records and systems reasonably designed to:

(i) Monitor and assess the carrying value, market value and performance of each investment and the aggregate portfolio;

(ii) Identify and manage the market, credit, concentration and other risks associated with such investments;

(iii) Identify, monitor and assess the terms, amounts and risks arising from transactions and relationships (including contingent fees or contingent interests) with each company in which the financial holding company holds an interest under this subpart;

(iv) Ensure the maintenance of corporate separateness between the financial holding company and each company in which the financial holding company holds an interest under this subpart and protect the financial holding company and its depository institution subsidiaries from legal liability for the operations conducted and financial obligations of each such company; and

(v) Ensure compliance with this part and any other provisions of law governing transactions and relationships with companies in which the financial holding company holds an interest under this subpart (*e.g.*, fiduciary principles or sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c–1), if applicable).

(2) *Availability of records.* A financial holding company must make the policies, procedures and records required by paragraph (a)(1) of this section available to the Board or the appropriate Reserve Bank upon request.

(b) *What periodic reports must be filed?* A financial holding company must provide reports to the appropriate Reserve Bank in such format and at such times as the Board may prescribe.

(c) *Is notice required for the acquisition of companies?*—(1) *Fulfillment of statutory notice requirement.* Except as required in paragraph (c)(2) of this section, no post-acquisition notice under section 4(k)(6) of the Bank Holding Company Act (12 U.S.C. 1843(k)(6)) is required by a financial holding company in connection with an investment

made under this subpart if the financial holding company has previously filed a notice under § 225.87 indicating that it had commenced merchant banking investment activities under this subpart.

(2) *Notice of large individual investments.* A financial holding company must provide written notice to the Board on the appropriate form within 30 days after acquiring more than 5 percent of the voting shares, assets or ownership interests of any company under this subpart, including an interest in a private equity fund, at a total cost to the financial holding company that exceeds the lesser of 5 percent of the Tier 1 capital of the financial holding company or $200 million.

### § 225.176 How do the statutory cross marketing and sections 23A and B limitations apply to merchant banking investments?

(a) *Are cross marketing activities prohibited?*—(1) *In general.* A depository institution, including a subsidiary of a depository institution, controlled by a financial holding company may not:

(i) Offer or market, directly or through any arrangement, any product or service of any company if more than 5 percent of the company's voting shares, assets or ownership interests are owned or controlled by the financial holding company pursuant to this subpart; or

(ii) Allow any product or service of the depository institution, including any product or service of a subsidiary of the depository institution, to be offered or marketed, directly or through any arrangement, by or through any company described in paragraph (a)(1)(i) of this section.

(2) *How are certain subsidiaries treated?* For purposes of paragraph (a)(1) of this section, a subsidiary of a depository institution does not include a financial subsidiary held in accordance with section 5136A of the Revised Statutes (12 U.S.C. 24a) or section 46 of the Federal Deposit Insurance Act. (12 U.S.C. 1831w), any company held by a company owned in accordance with section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.*; 12 U.S.C. 611 *et seq.*), or any company held by a small business investment company owned in accordance with the Small Business Investment Act of 1958 (15 U.S.C. 661 *et seq.*).

(3) *How do the cross marketing restrictions apply to private equity funds?* The restriction contained in paragraph (a)(1) of this section does not apply to:

(i) Portfolio companies held by a private equity fund that the financial holding company does not control; or

(ii) The sale, offer or marketing of any interest in a private equity fund, whether or not controlled by the financial holding company.

(b) *When are companies held under section 4(k)(4)(H) affiliates under sections 23A and B?*—(1) *Rebuttable presumption of control.* The following rebuttable presumption of control shall apply for purposes of sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c-1): if a financial holding company directly or indirectly owns or controls more than 15 percent of the total equity of a company pursuant to this subpart, the company shall be presumed to be an affiliate of any member bank that is affiliated with the financial holding company.

(2) *Request to rebut presumption.* A financial holding company may rebut this presumption by providing information acceptable to the Board demonstrating that the financial holding company does not control the company.

(3) *Presumptions that control does not exist.* Absent evidence to the contrary, the presumption in paragraph (b)(1) of this section will be considered to have been rebutted without Board approval under paragraph (b)(2) of this section if any one of the following requirements are met:

(i) No officer, director or employee of the financial holding company serves as a director, trustee, or general partner (or individual exercising similar functions) of the company;

(ii) A person that is not affiliated or associated with the financial holding company owns or controls a greater percentage of the equity capital of the portfolio company than the amount owned or controlled by the financial holding company, and no more than one officer or employee of the holding company serves as a director or trustee

(or individual exercising similar functions) of the company; or

(iii) A person that is not affiliated or associated with the financial holding company owns or controls more than 50 percent of the voting shares of the portfolio company, and officers and employees of the holding company do not constitute a majority of the directors or trustees (or individuals exercising similar functions) of the company.

(4) *Convertible instruments.* For purposes of paragraph (b)(1) of this section, equity capital includes options, warrants and any other instrument convertible into equity capital.

(5) *Application of presumption to private equity funds.* A financial holding company will not be presumed to own or control the equity capital of a company for purposes of paragraph (b)(1) of this section solely by virtue of an investment made by the financial holding company in a private equity fund that owns or controls the equity capital of the company unless the financial holding company controls the private equity fund as described in § 225.173(d)(4).

(6) *Application of sections 23A and B to U.S. branches and agencies of foreign banks.* Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c, 371c–1) shall apply to all covered transactions between each U.S. branch and agency of a foreign bank that acquires or controls, or that is affiliated with a company that acquires or controls, merchant banking investments and—

(i) Any portfolio company that the foreign bank or affiliated company controls or is presumed to control under paragraph (b)(1) of this section; and

(ii) Any company that the foreign bank or affiliated company controls or is presumed to control under paragraph (b)(1) of this section if the company is engaged in acquiring or controlling merchant banking investments and the proceeds of the covered transaction are used for the purpose of funding the company's merchant banking investment activities.

**§ 225.177 Definitions.**

(a) *What do references to a financial holding company include?*—(1) Except as otherwise expressly provided, the term ''financial holding company'' as used in this subpart means the financial holding company and all of its subsidiaries, including a private equity fund or other fund controlled by the financial holding company.

(2) Except as otherwise expressly provided, the term ''financial holding company'' does not include a depository institution or subsidiary of a depository institution or any portfolio company controlled directly or indirectly by the financial holding company.

(b) *What do references to a depository institution include?* For purposes of this subpart, the term ''depository institution'' includes a U.S. branch or agency of a foreign bank.

(c) *What is a portfolio company?* A portfolio company is any company or entity:

(1) That is engaged in any activity not authorized for the financial holding company under section 4 of the Bank Holding Company Act (12 U.S.C. 1843); and

(2) Any shares, assets or ownership interests of which are held, owned or controlled directly or indirectly by the financial holding company pursuant to this subpart, including through a private equity fund that the financial holding company controls.

(d) *Who are the executive officers of a company?*—(1) An executive officer of a company is any person who participates or has the authority to participate (other than in the capacity as a director) in major policymaking functions of the company, whether or not the officer has an official title, the title designates the officer as an assistant, or the officer serves without salary or other compensation.

(2) The term ''executive officer'' does not include—

(i) Any person, including a person with an official title, who may exercise a certain measure of discretion in the performance of his duties, including the discretion to make decisions in the ordinary course of the company's business, but who does not participate in the determination of major policies of the company and whose decisions are limited by policy standards fixed by senior management of the company; or

(ii) Any person who is excluded from participating (other than in the capacity of a director) in major policymaking functions of the company by resolution of the board of directors or by the bylaws of the company and who does not in fact participate in such policymaking functions.

CONDITIONS TO ORDERS

**§ 225.200 Conditions to Board's section 20 orders.**

(a) *Introduction*. Under section 20 of the Glass-Steagall Act (12 U.S.C. 377) and section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), a nonbank subsidiary of a bank holding company may to a limited extent underwrite and deal in securities for which underwriting and dealing by a member bank is prohibited. Pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, these so-called section 20 subsidiaries are required to register with the SEC as broker-dealers and are subject to all the financial reporting, anti-fraud and financial responsibility rules applicable to broker-dealers. In addition, transactions between insured depository institutions and their section 20 affiliates are restricted by sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c–1). The Board expects a section 20 subsidiary, like any other subsidiary of a bank holding company, to be operated prudently. Doing so would include observing corporate formalities (such as the maintenance of separate accounting and corporate records), and instituting appropriate risk management, including independent trading and exposure limits consistent with parent company guidelines.

(b) *Conditions*. As a condition of each order approving establishment of a section 20 subsidiary, a bank holding company shall comply with the following conditions.

(1) *Capital*. (i) A bank holding company shall maintain adequate capital on a fully consolidated basis. If operating a section 20 authorized to underwrite and deal in all types of debt and equity securities, a bank holding company shall maintain strong capital on a fully consolidated basis.

(ii) In the event that a bank or thrift affiliate of a section 20 subsidiary shall become less than well capitalized (as defined in section 38 of the Federal Deposit Insurance Act, 12 U.S.C. 1831o), and the bank holding company shall fail to restore it promptly to the well capitalized level, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1989 order allowing underwriting and dealing in bank-ineligible securities,[1] or order the bank holding company to divest the section 20 subsidiary.

(iii) A foreign bank that operates a branch or agency in the United States shall maintain strong capital on a fully consolidated basis at levels above the minimum levels required by the Basle Capital Accord. In the event that the Board determines that the foreign bank's capital has fallen below these levels and the foreign bank fails to restore its capital position promptly, the Board may, in its discretion, reimpose the funding, credit extension and credit enhancement firewalls contained in its 1990 order allowing foreign banks to underwrite and deal in bank-ineligible securities,[2] or order the foreign bank to divest the section 20 subsidiary.

(2) *Internal controls*. (i) Each bank holding company or foreign bank shall cause its subsidiary banks, thrifts, branches or agencies[3] to adopt policies and procedures, including appropriate limits on exposure, to govern their participation in transactions underwritten or arranged by a section 20 affiliate.

(ii) Each bank holding company or foreign bank shall ensure that an independent and thorough credit evaluation has been undertaken in connection with participation by a bank, thrift, or branch or agency in such transactions, and that adequate documentation of

[1] Firewalls 5–8, 19, 21 and 22 of *J.P. Morgan & Co., The Chase Manhattan Corp., Bankers Trust New York Corp., Citicorp, and Security Pacific Corp.*, 75 Federal Reserve Bulletin 192, 214–16 (1989).

[2] Firewalls 5–8, 19, 21 and 22 of *Canadian Imperial Bank of Commerce, The Royal Bank of Canada, Barclays PLC and Barclays Bank PLC*, 76 Federal Reserve Bulletin 158, (1990).

[3] The terms ''branch'' and ''agency'' refer to a U.S. branch and agency of a foreign bank.

that evaluation is maintained for review by examiners of the appropriate federal banking agency and the Federal Reserve.

(3) *Interlocks restriction.* (i) Directors, officers or employees of a bank or thrift subsidiary of a bank holding company, or a bank or thrift subsidiary or branch or agency of a foreign bank, shall not serve as a majority of the board of directors or the chief executive officer of an affiliated section 20 subsidiary.

(ii) Directors, officers or employees of a section 20 subsidiary shall not serve as a majority of the board of directors or the chief executive officer of an affiliated bank or thrift subsidiary or branch or agency, except that the manager of a branch or agency may act as a director of the underwriting subsidiary.

(iii) For purposes of this standard, the manager of a branch or agency of a foreign bank generally will be considered to be the chief executive officer of the branch or agency.

(4) *Customer disclosure*—(i) *Disclosure to section 20 customers.* A section 20 subsidiary shall provide, in writing, to each of its retail customers,[4] at the time an investment account is opened, the same minimum disclosures, and obtain the same customer acknowledgment, described in the Interagency Statement on Retail Sales of Nondeposit Investment Products (Statement) as applicable in such situations. These disclosures must be provided regardless of whether the section 20 subsidiary is itself engaged in activities through arrangements with a bank that is covered by the Statement.

(ii) *Disclosures accompanying investment advice.* A director, officer, or employee of a bank, thrift, branch or agency may not express an opinion on the value or the advisability of the purchase or the sale of a bank-ineligible security that he or she knows is being underwritten or dealt in by a section 20 affiliate unless he or she notifies the customer of the affiliate's role.

[4] For purposes of this operating standard, a retail customer is any customer that is not an ''accredited investor'' as defined in 17 CFR 230.501(a).

(5) *Intra-day credit.* Any intra-day extension of credit to a section 20 subsidiary by an affiliated bank, thrift, branch or agency shall be on market terms consistent with section 23B of the Federal Reserve Act.

(6) *Restriction on funding purchases of securities during underwriting period.* No bank, thrift, branch or agency shall knowingly extend credit to a customer secured by, or for the purpose of purchasing, any bank-ineligible security that a section 20 affiliate is underwriting or has underwritten within the past 30 days, unless:

(i) The extension of credit is made pursuant to, and consistent with any conditions imposed in a preexisting line of credit that was not established in contemplation of the underwriting; or

(ii) The extension of credit is made in connection with clearing transactions for the section 20 affiliate.

(7) *Reporting requirement.* (i) Each bank holding company or foreign bank shall submit quarterly to the appropriate Federal Reserve Bank any FOCUS report filed with the NASD or other self-regulatory organizations, and any information required by the Board to monitor compliance with these operating standards and section 20 of the Glass-Steagall Act, on forms provided by the Board.

(ii) In the event that a section 20 subsidiary is required to furnish notice concerning its capitalization to the Securities and Exchange Commission pursuant to 17 CFR 240.17a–11, a copy of the notice shall be filed concurrently with the appropriate Federal Reserve Bank.

(8) *Foreign banks.* A foreign bank shall ensure that any extension of credit by its branch or agency to a section 20 affiliate, and any purchase by such branch or agency, as principal or fiduciary, of securities for which a section 20 affiliate is a principal underwriter, conforms to sections 23A and 23B of the Federal Reserve Act, and that its branches and agencies not advertise or suggest that they are responsible for the obligations of a section 20 affiliate, consistent with section 23B(c) of the Federal Reserve Act.

[62 FR 45306, Aug. 27, 1997, as amended by Reg. Y, 63 FR 14804, Mar. 27, 1998]

# APPENDIX A TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: RISK-BASED MEASURE

AT 73 FR 79606, DEC. 30, 2008.

## I. OVERVIEW

The Board of Governors of the Federal Reserve System has adopted a risk-based capital measure to assist in the assessment of the capital adequacy of bank holding companies (*banking organizations*).[1] The principal objectives of this measure are to: (i) Make regulatory capital requirements more sensitive to differences in risk profiles among banking organizations; (ii) factor off-balance sheet exposures into the assessment of capital adequacy; (iii) minimize disincentives to holding liquid, low-risk assets; and (iv) achieve greater consistency in the evaluation of the capital adequacy of major banking organizations throughout the world.[2]

The risk-based capital guidelines include both a definition of capital and a framework for calculating weighted risk assets by assigning assets and off-balance sheet items to broad risk categories. An institution's risk-based capital ratio is calculated by dividing its qualifying capital (the numerator of the ratio) by its weighted risk assets (the denominator).[3] The definition of qualifying capital is outlined below in section II, and the procedures for calculating weighted risk assets are discussed in section III. Attachment I illustrates a sample calculation of weighted risk assets and the risk-based capital ratio.

In addition, when certain organizations that engage in trading activities calculate their risk-based capital ratio under this appendix A, they must also refer to appendix E of this part, which incorporates capital charges for certain market risks into the risk-based capital ratio. When calculating their risk-based capital ratio under this appendix A, such organizations are required to refer to appendix E of this part for supplemental rules to determine qualifying and excess capital, calculate risk-weighted assets, calculate market risk equivalent assets, and calculate risk-based capital ratios adjusted for market risk.

The risk-based capital guidelines also establish a schedule for achieving a minimum supervisory standard for the ratio of qualifying capital to weighted risk assets and provide for transitional arrangements during a phase-in period to facilitate adoption and implementation of the measure at the end of 1992. These interim standards and transitional arrangements are set forth in section IV.

The risk-based guidelines apply on a consolidated basis to any bank holding company with consolidated assets of $500 million or more. The risk-based guidelines also apply on a consolidated basis to any bank holding company with consolidated assets of less than $500 million if the holding company (i) is engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) conducts significant off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary; or (iii) has a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission (SEC). The Federal Reserve may apply the risk-based guidelines at its discretion to any bank holding company, regardless of asset size, if such action is warranted for supervisory purposes.[4]

The risk-based guidelines are to be used in the inspection and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. Thus, in considering an application filed by a bank holding company, the Federal Reserve will take into account the organization's risk-based capital ratio, the reasonableness of its capital plans, and the degree of progress it has demonstrated toward meeting the interim and final risk-based capital standards.

The risk-based capital ratio focuses principally on broad categories of credit risk, although the framework for assigning assets and off-balance sheet items to risk categories does incorporate elements of transfer risk, as well as limited instances of interest rate and market risk. The risk-based ratio does not, however, incorporate other factors

[1] Supervisory ratios that relate capital to total assets for bank holding companies are outlined in appendices B and D of this part.

[2] The risk-based capital measure is based upon a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Regulations and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten Central Bank Governors. The framework is described in a paper prepared by the BSC entitled ''International Convergence of Capital Measurement,'' July 1988.

[3] Banking organizations will initially be expected to utilize period-end amounts in calculating their risk-based capital ratios. When necessary and appropriate, ratios based on average balances may also be calculated on a case-by-case basis. Moreover, to the extent banking organizations have data on average balances that can be used to calculate risk-based ratios, the Federal Reserve will take such data into account.

[4] [Reserved]

that can affect an organization's financial condition. These factors include overall interest rate exposure; liquidity, funding and market risks; the quality and level of earnings; investment or loan portfolio concentrations; the quality of loans and investments; the effectiveness of loan and investment policies; and management's ability to monitor and control financial and operating risks.

In addition to evaluating capital ratios, an overall assessment of capital adequacy must take account of these other factors, including, in particular, the level and severity of problem and classified assets. For this reason, the final supervisory judgment on an organization's capital adequacy may differ significantly from conclusions that might be drawn solely from the level of the organization's risk-based capital ratio.

The risk-based capital guidelines establish *minimum* ratios of capital to weighted risk assets. In light of the considerations just discussed, banking organizations generally are expected to operate well above the minimum risk-based ratios. In particular, banking organizations contemplating significant expansion proposals are expected to maintain strong capital levels substantially above the minimum ratios and should not allow significant diminution of financial strength below these strong levels to fund their expansion plans. Institutions with high or inordinate levels of risk are also expected to operate above minimum capital standards. In all cases, institutions should hold capital commensurate with the level and nature of the risks to which they are exposed. Banking organizations that do not meet the minimum risk-based standard, or that are otherwise considered to be inadequately capitalized, are expected to develop and implement plans acceptable to the Federal Reserve for achieving adequate levels of capital within a reasonable period of time.

The Board will monitor the implementation and effect of these guidelines in relation to domestic and international developments in the banking industry. When necessary and appropriate, the Board will consider the need to modify the guidelines in light of any significant changes in the economy, financial markets, banking practices, or other relevant factors.

## II. Definition of Qualifying Capital for the Risk Based Capital Ratio

(i) A banking organization's qualifying total capital consists of two types of capital components: ''core capital elements'' (tier 1 capital elements) and ''supplementary capital elements'' (tier 2 capital elements). These capital elements and the various limits, restrictions, and deductions to which they are subject, are discussed below. To qualify as an element of tier 1 or tier 2 capital, an instrument must be fully paid up and effectively unsecured. Accordingly, if a banking organization has purchased, or has directly or indirectly funded the purchase of, its own capital instrument, that instrument generally is disqualified from inclusion in regulatory capital. A qualifying tier 1 or tier 2 capital instrument must be subordinated to all senior indebtedness of the organization. If issued by a bank, it also must be subordinated to claims of depositors. In addition, the instrument must not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

(ii) On a case-by-case basis, the Federal Reserve may determine whether, and to what extent, any instrument that does not fit wholly within the terms of a capital element set forth below, or that does not have the characteristics or the ability to absorb losses commensurate with the capital treatment specified below, will qualify as an element of tier 1 or tier 2 capital. In making such a determination, the Federal Reserve will consider the similarity of the instrument to instruments explicitly addressed in the guidelines; the ability of the instrument to absorb losses, particularly while the organization operates as a going concern; the maturity and redemption features of the instrument; and other relevant terms and factors.

(iii) The redemption of capital instruments before stated maturity could have a significant impact on an organization's overall capital structure. Consequently, an organization should consult with the Federal Reserve before redeeming any equity or other capital instrument included in tier 1 or tier 2 capital prior to stated maturity if such redemption could have a material effect on the level or composition of the organization's capital base. Such consultation generally would not be necessary when the instrument is to be redeemed with the proceeds of, or replaced by, a like amount of a capital instrument that is of equal or higher quality with regard to terms and maturity and the Federal Reserve considers the organization's capital position to be fully sufficient.

### *A. The Definition and Components of Qualifying Capital*

1. *Tier 1 capital.* Tier 1 capital generally is defined as the sum of core capital elements less any amounts of goodwill, other intangible assets, interest-only strips receivables, deferred tax assets, nonfinancial equity investments, and other items that are required to be deducted in accordance with section II.B. of this appendix. Tier 1 capital must represent at least 50 percent of qualifying total capital.

a. *Core capital elements (tier 1 capital elements).* The elements qualifying for inclusion in the tier 1 component of a banking organization's qualifying total capital are:

i. Qualifying common stockholders' equity;

ii. Qualifying noncumulative perpetual preferred stock, including related surplus, and senior perpetual preferred stock issued to the United States Department of the Treasury (Treasury) under the Troubled Asset Relief Program (TARP) established by the Emergency Economic Stabilization Act of 2008, Division A of Pub. L. No. 110–343 (which for purposes of this appendix shall be considered qualifying noncumulative perpetual preferred stock), including related surplus;

iii. Minority interest related to qualifying common or noncumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class A minority interest); and

iv. Restricted core capital elements. The aggregate of these items is limited within tier 1 capital as set forth in section II.A.1.b. of this appendix. These elements are defined to include:

(1) Qualifying cumulative perpetual preferred stock (including related surplus);

(2) Minority interest related to qualifying cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or foreign bank subsidiary (Class B minority interest);

(3) Minority interest related to qualifying common stockholders' equity or perpetual preferred stock issued by a consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank (Class C minority interest); and

(4) Qualifying trust preferred securities.

b. *Limits on restricted core capital elements*—

i. *Limits*. (1) The aggregate amount of restricted core capital elements that may be included in the tier 1 capital of a banking organization must not exceed 25 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Stated differently, the aggregate amount of restricted core capital elements is limited to one-third of the sum of core capital elements, excluding restricted core capital elements, net of goodwill less any associated deferred tax liability.

(2) In addition, the aggregate amount of restricted core capital elements (other than qualifying mandatory convertible preferred securities[5]) that may be included in the tier 1 capital of an internationally active banking organization[6] must not exceed 15 percent of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability.

(3) Amounts of restricted core capital elements in excess of this limit generally may be included in tier 2 capital. The excess amounts of restricted core capital elements that are in the form of Class C minority interest and qualifying trust preferred securities are subject to further limitation within tier 2 capital in accordance with section II.A.2.d.iv. of this appendix. A banking organization may attribute excess amounts of restricted core capital elements first to any qualifying cumulative perpetual preferred stock or to Class B minority interest, and second to qualifying trust preferred securities or to Class C minority interest, which are subject to a tier 2 sublimit.

ii. *Transition*.

(1) The quantitative limits for restricted core capital elements set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix become effective on March 31, 2009. Prior to that time, a banking organization with restricted core capital elements in amounts that cause it to exceed these limits must consult with the Federal Reserve on a plan for ensuring that the banking organization is not unduly relying on these elements in its capital base and, where appropriate, for reducing such reliance to ensure that the organization complies with these limits as of March 31, 2009.

(2) Until March 31, 2009, the aggregate amount of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities that a banking organization may include in tier 1 capital is limited to 25 percent of the sum of the following core capital elements: qualifying common stockholders' equity, Qualifying noncumulative and cumulative perpetual preferred stock (including related surplus), qualifying minority interest in the equity accounts of consolidated subsidiaries, and qualifying trust preferred securities. Amounts of qualifying cumulative perpetual

[5] Qualifying mandatory convertible preferred securities generally consist of the joint issuance by a bank holding company to investors of trust preferred securities and a forward purchase contract, which the investors fully collateralize with the securities, that obligates the investors to purchase a fixed amount of the bank holding company's common stock, generally in three years. A bank holding company wishing to issue mandatorily convertible preferred securities and include them in tier 1 capital must consult with the Federal Reserve prior to issuance to ensure that the securities' terms are consistent with tier 1 capital treatment.

[6] For this purpose, an internationally active banking organization is a banking organization that (1) as of its most recent year-end FR Y–9C reports total consolidated assets equal to $250 billion or more or (2) on a consolidated basis, reports total on-balance-sheet foreign exposure of $10 billion or more on its filings of the most recent year-end FFIEC 009 Country Exposure Report.

preferred stock (including related surplus) and qualifying trust preferred securities in excess of this limit may be included in tier 2 capital.

(3) Until March 31, 2009, internationally active banking organizations generally are expected to limit the amount of qualifying cumulative perpetual preferred stock (including related surplus) and qualifying trust preferred securities included in tier 1 capital to 15 percent of the sum of core capital elements set forth in section II.A.1.b.ii.2. of this appendix.

c. *Definitions and requirements for core capital elements*—i. *Qualifying common stockholders' equity*.

(1) *Definition*. Qualifying common stockholders' equity is limited to common stock; related surplus; and retained earnings, including capital reserves and adjustments for the cumulative effect of foreign currency translation, net of any treasury stock, less net unrealized holding losses on available-for-sale equity securities with readily determinable fair values. For this purpose, net unrealized holding gains on such equity securities and net unrealized holding gains (losses) on available-for-sale debt securities are not included in qualifying common stockholders' equity.

(2) *Restrictions on terms and features*. A capital instrument that has a stated maturity date or that has a preference with regard to liquidation or the payment of dividends is not deemed to be a component of qualifying common stockholders' equity, regardless of whether or not it is called common equity. Terms or features that grant other preferences also may call into question whether the capital instrument would be deemed to be qualifying common stockholders' equity. Features that require, or provide significant incentives for, the issuer to redeem the instrument for cash or cash equivalents will render the instrument ineligible as a component of qualifying common stockholders' equity.

(3) *Reliance on voting common stockholders' equity*. Although section II.A.1. of this appendix allows for the inclusion of elements other than common stockholders' equity within tier 1 capital, voting common stockholders' equity, which is the most desirable capital element from a supervisory standpoint, generally should be the dominant element within tier 1 capital. Thus, banking organizations should avoid over-reliance on preferred stock and nonvoting elements within tier 1 capital. Such nonvoting elements can include portions of common stockholders' equity where, for example, a banking organization has a class of nonvoting common equity, or a class of voting common equity that has substantially fewer voting rights per share than another class of voting common equity. Where a banking organization relies excessively on nonvoting elements within tier 1 capital, the Federal Reserve generally will require the banking organization to allocate a portion of the nonvoting elements to tier 2 capital.

ii. *Qualifying perpetual preferred stock*.

(1) *Qualifying requirements*. Perpetual preferred stock qualifying for inclusion in tier 1 capital has no maturity date and cannot be redeemed at the option of the holder. Perpetual preferred stock will qualify for inclusion in tier 1 capital only if it can absorb losses while the issuer operates as a going concern.

(2) *Restrictions on terms and features*. Perpetual preferred stock included in tier 1 capital may not have any provisions restricting the banking organization's ability or legal right to defer or waive dividends, other than provisions requiring prior or concurrent deferral or waiver of payments on more junior instruments, which the Federal Reserve generally expects in such instruments consistent with the notion that the most junior capital elements should absorb losses first. Dividend deferrals or waivers for preferred stock, which the Federal Reserve expects will occur either voluntarily or at its direction when an organization is in a weakened condition, must not be subject to arrangements that would diminish the ability of the deferral to shore up the banking organization's resources. Any perpetual preferred stock with a feature permitting redemption at the option of the issuer may qualify as tier 1 capital only if the redemption is subject to prior approval of the Federal Reserve. Features that require, or create significant incentives for the issuer to redeem the instrument for cash or cash equivalents will render the instrument ineligible for inclusion in tier 1 capital. For example, perpetual preferred stock that has a credit-sensitive dividend feature—that is, a dividend rate that is reset periodically based, in whole or in part, on the banking organization's current credit standing—generally does not qualify for inclusion in tier 1 capital.[7] Similarly, perpetual preferred stock that has a dividend rate step-up or a market value conversion feature—that is, a feature whereby the holder must or can convert the preferred stock into common stock at the market price prevailing at the time of conversion—generally does not qualify for inclusion in

[7] Traditional floating-rate or adjustable-rate perpetual preferred stock (that is, perpetual preferred stock in which the dividend rate is not affected by the issuer's credit standing or financial condition but is adjusted periodically in relation to an independent index based solely on general market interest rates), however, generally qualifies for inclusion in tier 1 capital provided all other requirements are met.

tier 1 capital.[8] Perpetual preferred stock that does not qualify for inclusion in tier 1 capitol generally will qualify for inclusion in tier 2 capital.

(3) *Noncumulative and cumulative features.* Perpetual preferred stock that is noncumulative generally may not permit the accumulation or payment of unpaid dividends in any form, including in the form of common stock. Perpetual preferred stock that provides for the accumulation or future payment of unpaid dividends is deemed to be cumulative, regardless of whether or not it is called noncumulative.

iii. *Qualifying minority interest.* Minority interest in the common and preferred stockholders' equity accounts of a consolidated subsidiary (minority interest) represents stockholders' equity associated with common or preferred equity instruments issued by a banking organization's consolidated subsidiary that are held by investors other than the banking organization. Minority interest is included in tier 1 capital because, as a general rule, it represents equity that is freely available to absorb losses in the issuing subsidiary. Nonetheless, minority interest typically is not available to absorb losses in the banking organization as a whole, a feature that is a particular concern when the minority interest is issued by a subsidiary that is neither a U.S. depository institution nor a foreign bank. For this reason, this appendix distinguishes among three types of qualifying minority interest. Class A minority interest is minority interest related to qualifying common and noncumulative perpetual preferred equity instruments issued directly (that is, not through a subsidiary) by a consolidated U.S. depository institution[9] or foreign bank[10] subsidiary of a banking organization. Class A minority interest is not subject to a formal limitation within tier 1 capital. Class B minority interest is minority interest related to qualifying cumulative perpetual preferred equity instruments issued directly by a consolidated U.S. depository institution or foreign bank subsidiary of a banking organization. Class B minority interest is a restricted core capital element subject to the limitations set forth in section II.A.1.b.i. of this appendix, but is not subject to a tier 2 sub-limit. Class C minority interest is minority interest related to qualifying common or perpetual preferred stock issued by a banking organization's consolidated subsidiary that is neither a U.S. depository institution nor a foreign bank. Class C minority interest is eligible for inclusion in tier 1 capital as a restricted core capital element and is subject to the limitations set forth in sections II.A.1.b.i. and II.A.2.d.iv. of this appendix. Minority interest in small business investment companies, investment funds that hold nonfinancial equity investments (as defined in section II.B.5.b. of this appendix), and subsidiaries engaged in nonfinancial activities are not included in the banking organization's tier 1 or total capital if the banking organization's interest in the company or fund is held under one of the legal authorities listed in section II.B.5.b. of this appendix. In addition, minority interest in consolidated asset-backed commercial paper programs (ABCP) (as defined in section III.B.6. of this appendix) that are sponsored by a banking organization are not included in the organization's tier 1 or total capital if the organization excludes the consolidated assets of such programs from risk-weighted assets pursuant to section III.B.6. of this appendix.

iv. *Qualifying trust preferred securities.*

(1) A banking organization that wishes to issue trust preferred securities and include them in tier 1 capital must first consult with the Federal Reserve. Trust preferred securities are defined as undated preferred securities issued by a trust or similar entity sponsored (but generally not consolidated) by a banking organization that is the sole common equity holder of the trust. Qualifying trust preferred securities must allow for dividends to be deferred for at least twenty consecutive quarters without an event of default, unless an event of default leading to

[8] Notwithstanding this provision, senior perpetual preferred stock issued to the Treasury under the TARP established by the Emergency Economic Stabilization Act of 2008, Division A of Pub. L. No. 110–343, may be included in tier 1 capital. In addition, traditional convertible perpetual preferred stock, which the holder must or can convert at a fixed number of common shares at a preset price, generally qualifies for inclusion in tier 1 capital provided all other requirements are met.

[9] U.S. depository institutions are defined to include branches (foreign and domestic) of federally insured banks and depository institutions chartered and headquartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and U.S. territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, and international banking facilities of domestic banks.

[10] For this purpose, a foreign bank is defined as an institution that engages in the business of banking; is recognized as a bank by the bank supervisory or monetary authorities of the country of its organization or principal banking operations; receives deposits to a substantial extent in the regular course of business; and has the power to accept demand deposits.

acceleration permitted under section II.A.1.c.iv.(2) has occurred. The required notification period for such deferral must be reasonably short, no more than 15 business days prior to the payment date. Qualifying trust preferred securities are otherwise subject to the same restrictions on terms and features as qualifying perpetual preferred stock under section II.A.1.c.ii.(2) of this appendix.

(2) The sole asset of the trust must be a junior subordinated note issued by the sponsoring banking organization that has a minimum maturity of thirty years, is subordinated with regard to both liquidation and priority of periodic payments to all senior and subordinated debt of the sponsoring banking organization (other than other junior subordinated notes underlying trust preferred securities). Otherwise the terms of a junior subordinated note must mirror those of the preferred securities issued by the trust.[11] The note must comply with section II.A.2.d. of this appendix and the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166[12] except that the note may provide for an event of default and the acceleration of principal and accrued interest upon (a) nonpayment of interest for 20 or more consecutive quarters or (b) termination of the trust without redemption of the trust preferred securities, distribution of the notes to investors, or assumption of the obligation by a successor to the banking organization.

(3) In the last five years before the maturity of the note, the outstanding amount of the associated trust preferred securities is excluded from tier 1 capital and included in tier 2 capital, where the trust preferred securities are subject to the amortization provisions and quantitative restrictions set forth in sections II.A.2.d.iii. and iv. of this appendix as if the trust preferred securities were limited-life preferred stock.

2. *Supplementary capital elements (tier 2 capital elements).* The tier 2 component of an institution's qualifying capital may consist of the following items that are defined as supplementary capital elements:

(i) Allowance for loan and lease losses (subject to limitations discussed below);

(ii) Perpetual preferred stock and related surplus (subject to conditions discussed below);

(iii) Hybrid capital instruments (as defined below), perpetual debt, and mandatory convertible debt securities;

(iv) Term subordinated debt and intermediate-term preferred stock, including related surplus (subject to limitations discussed below);

(v) Unrealized holding gains on equity securities (subject to limitations discussed in section II.A.2.e. of this appendix).

The maximum amount of tier 2 capital that may be included in an institution's qualifying total capital is limited to 100 percent of tier 1 capital (net of goodwill, other intangible assets, interest-only strips receivables and nonfinancial equity investments that are required to be deducted in accordance with section II.*B*. of this appendix A).

The elements of supplementary capital are discussed in greater detail below.

a. *Allowance for loan and lease losses.* Allowances for loan and lease losses are reserves that have been established through a charge against earnings to absorb future losses on

[11] Under generally accepted accounting principles, the trust issuing the preferred securities generally is not consolidated on the banking organization's balance sheet; rather the underlying subordinated note is recorded as a liability on the organization's balance sheet. Only the amount of the trust preferred securities issued, which generally is equal to the amount of the underlying subordinated note less the amount of the sponsoring banking organization's common equity investment in the trust (which is recorded as an asset on the banking organization's consolidated balance sheet), may be included in tier 1 capital. Because this calculation method effectively deducts the banking organization's common stock investment in the trust in computing the numerator of the capital ratio, the common equity investment in the trust should be excluded from the calculation of risk-weighted assets in accordance with footnote 17 of this appendix. Where a banking organization has issued trust preferred securities as part of a pooled issuance, the organization generally must not buy back a security issued from the pool. Where a banking organization does hold such a security (for example, as a result of an acquisition of another banking organization), the amount of the trust preferred securities includable in regulatory capital must, consistent with section II.(i) of this appendix, be reduced by the notional amount of the banking organization's investment in the security issued by the pooling entity.

[12] Trust preferred securities issued before April 15, 2005, generally would be includable in tier 1 capital despite noncompliance with sections II.A.1.c.iv. or II.A.2.d. of this appendix or 12 CFR 250.166 provided the non-complying terms of the instrument (i) have been commonly used by banking organizations, (ii) do not provide an unreasonably high degree of protection to the holder in circumstances other than bankruptcy of the banking organization, and (iii) do not effectively allow a holder in due course of the note to stand ahead of senior or subordinated debt holders in the event of bankruptcy of the banking organization.

loans or lease financing receivables. Allowances for loan and lease losses exclude ''allocated transfer risk reserves,''[13] and reserves created against identified losses.

During the transition period, the risk-based capital guidelines provide for reducing the amount of this allowance that may be included in an institution's total capital. Initially, it is unlimited. However, by year-end 1990, the amount of the allowance for loan and lease losses that will qualify as capital will be limited to 1.5 percent of an institution's weighted risk assets. By the end of the transition period, the amount of the allowance qualifying for inclusion in Tier 2 capital may not exceed 1.25 percent of weighted risk assets.[14]

b. *Perpetual preferred stock.* Perpetual preferred stock (and related surplus) that meets the requirements set forth in section II.A.1.c.ii.(1) of this appendix is eligible for inclusion in tier 2 capital without limit.[15]

c. *Hybrid capital instruments, perpetual debt, and mandatory convertible debt securities.* Hybrid capital instruments include instruments that are essentially permanent in nature and that have certain characteristics of both equity and debt. Such instruments may be included in Tier 2 without limit. The general criteria hybrid capital instruments must meet in order to qualify for inclusion in Tier 2 capital are listed below:

(1) The instrument must be unsecured; fully paid-up and subordinated to general creditors. If issued by a bank, it must also be subordinated to claims or depositors.

(2) The instrument must not be redeemable at the option of the holder prior to maturity, except with the prior approval of the Federal Reserve. (Consistent with the Board's criteria for perpetual debt and mandatory convertible securities, this requirement implies that holders of such instruments may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.)

(3) The instrument must be available to participate in losses while the issuer is operating as a going concern. (Term subordinated debt would not meet this requirement.) To satisfy this requirement, the instrument must convert to common or perpetual preferred stock in the event that the accumulated losses exceed the sum of the retained earnings and capital surplus accounts of the issuer.

(4) The instrument must provide the option for the issuer to defer interest payments if: a) the issuer does not report a profit in the preceding annual period (defined as combined profits for the most recent four quarters), *and* b) the issuer eliminates cash dividends on common and preferred stock.

Perpetual debt and mandatory convertible debt securities that meet the criteria set forth in 12 CFR part 225, appendix B, also qualify as unlimited elements of Tier 2 capital for bank holding companies.

d. *Subordinated debt and intermediate-term preferred stock*—i. *Five-year minimum maturity.* Subordinated debt and intermediate-term preferred stock must have an original weighted average maturity of at least five years to qualify as tier 2 capital. If the holder has the option to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined, for risk-based capital purposes, as the earliest possible date on which the holder can put the instrument back to the issuing banking organization.

ii. *Other restrictions on subordinated debt.* Subordinated debt included in tier 2 capital must comply with the Federal Reserve's subordinated debt policy statement set forth in 12 CFR 250.166.[16] Accordingly, such subordinated debt must meet the following requirements:

[13] Allocated transfer risk reserves are reserves that have been established in accordance with Section 905(a) of the International Lending Supervision Act of 1983, 12 U.S.C. 3904(a), against certain assets whose value U.S. supervisory authorities have found to be significantly impaired by protracted transfer risk problems.

[14] The amount of the allowance for loan and lease losses that may be included in Tier 2 capital is based on a percentage of gross weighted risk assets. A banking organization may deduct reserves for loan and lease losses in excess of the amount permitted to be included in Tier 2 capital, as well as allocated transfer risk reserves, from the sum of gross weighted risk assets and use the resulting net sum of weighted risk assets in computing the denominator of the risk-based capital ratio.

[15] Long-term preferred stock with an original maturity of 20 years or more (including related surplus) will also qualify in this category as an element of tier 2 capital. If the holder of such an instrument has the right to require the issuer to redeem, repay, or repurchase the instrument prior to the original stated maturity, maturity would be defined for risk-based capital purposes as the earliest possible date on which the holder can put the instrument back to the issuing banking organization. In the last five years before the maturity of the stock, it must be treated as limited-life preferred stock, subject to the amortization provisions and quantitative restrictions set forth in sections II.A.2.d.iii. and iv. of this appendix.

[16] The subordinated debt policy statement set forth in 12 CFR 250.166 notes that certain

*Continued*

(1) The subordinated debt must be unsecured.

(2) The subordinated debt must clearly state on its face that it is not a deposit and is not insured by a Federal agency.

(3) The subordinated debt must not have credit-sensitive features or other provisions that are inconsistent with safe and sound banking practice.

(4) Subordinated debt issued by a subsidiary U.S. depository institution or foreign bank of a bank holding company must be subordinated in right of payment to the claims of all the institution's general creditors and depositors, and generally must not contain provisions permitting debt holders to accelerate payment of principal or interest upon the occurrence of any event other than receivership of the institution. Subordinated debt issued by a bank holding company or its subsidiaries that are neither U.S. depository institutions nor foreign banks must be subordinated to all senior indebtedness of the issuer; that is, the debt must be subordinated at a minimum to all borrowed money, similar obligations arising from off-balance sheet guarantees and direct credit substitutes, and obligations associated with derivative products such as interest rate and foreign exchange contracts, commodity contracts, and similar arrangements. Subordinated debt issued by a bank holding company or any of its subsidiaries that is not a U.S. depository institution or foreign bank must not contain provisions permitting debt holders to accelerate the payment of principal or interest upon the occurrence of any event other than the bankruptcy of the bank holding company or the receivership of a major subsidiary depository institution. Thus, a provision permitting acceleration in the event that any other affiliate of the bank holding company issuer enters into bankruptcy or receivership makes the instrument ineligible for inclusion in tier 2 capital.

iii. *Discounting in last five years.* As a limited-life capital instrument approaches maturity, it begins to take on characteristics of a short-term obligation. For this reason, the outstanding amount of term subordinated debt and limited-life preferred stock eligible for inclusion in tier 2 capital is reduced, or discounted, as these instruments approach maturity: one-fifth of the outstanding amount is excluded each year during the instrument's last five years before maturity. When remaining maturity is less than one year, the instrument is excluded from tier 2 capital.

iv. *Limits.* The aggregate amount of term subordinated debt (excluding mandatory convertible debt) and limited-life preferred stock as well as, beginning March 31, 2009, qualifying trust preferred securities and Class C minority interest in excess of the limits set forth in section II.A.1.b.i. of this appendix that may be included in tier 2 capital is limited to 50 percent of tier 1 capital (net of goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix). Amounts of these instruments in excess of this limit, although not included in tier 2 capital, will be taken into account by the Federal Reserve in its overall assessment of a banking organization's funding and financial condition.

e. *Unrealized gains on equity securities and unrealized gains (losses) on other assets.* Up to 45 percent of pretax net unrealized holding gains (that is, the excess, if any, of the fair value over historical cost) on available-for-sale equity securities with readily determinable fair values may be included in supplementary capital. However, the Federal Reserve may exclude all or a portion of these unrealized gains from Tier 2 capital if the Federal Reserve determines that the equity securities are not prudently valued. Unrealized gains (losses) on other types of assets, such as bank premises and available-for-sale debt securities, are not included in supplementary capital, but the Federal Reserve may take these unrealized gains (losses) into account as additional factors when assessing an institution's overall capital adequacy.

f. *Revaluation reserves.* i. Such reserves reflect the formal balance sheet restatement or revaluation for capital purposes of asset carrying values to reflect current market values. The Federal Reserve generally has not included unrealized asset appreciation in capital ratio calculations, although it has long taken such values into account as a separate factor in assessing the overall financial strength of a banking organization.

ii. Consistent with long-standing supervisory practice, the excess of market values over book values for assets held by bank holding companies will generally not be recognized in supplementary capital or in the calculation of the risk-based capital ratio. However, all bank holding companies are encouraged to disclose their equivalent of premises (building) and security revaluation

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terms found in subordinated debt may provide protection to investors without adversely affecting the overall benefits of the instrument to the issuing banking organization and, thus, would be acceptable for subordinated debt included in capital. For example, a provision that prohibits a bank holding company from merging, consolidating, or selling substantially all of its assets unless the new entity redeems or assumes the subordinated debt or that designates the failure to pay principal and interest on a timely basis as an event of default would be acceptable, so long as the occurrence of such events does not allow the debt holders to accelerate the payment of principal or interest on the debt.

reserves. The Federal Reserve will consider any appreciation, as well as any depreciation, in specific asset values as additional considerations in assessing overall capital strength and financial condition.

*B. Deductions from Capital and Other Adjustments*

Certain assets are deducted from an organization's capital for the purpose of calculating the risk-based capital ratio.[17] These assets include:

(i)(a) Goodwill—deducted from the sum of core capital elements.

(b) Certain identifiable intangible assets, that is, intangible assets other than goodwill—deducted from the sum of core capital elements in accordance with section II.B.1.b. of this appendix.

(c) Certain credit-enhancing interest-only strips receivables—deducted from the sum of core capital elements in accordance with sections II.B.1.c. through e. of this appendix.

(ii) Investments in banking and finance subsidiaries that are not consolidated for accounting or supervisory purposes, and investments in other designated subsidiaries or associated companies at the discretion of the Federal Reserve—deducted from total capital components (as described in greater detail below).

(iii) Reciprocal holdings of capital instruments of banking organizations—deducted from total capital components.

(iv) Deferred tax assets—portions are deducted from the sum of core capital elements in accordance with section II.B.4. of this appendix A.

(v) Nonfinancial equity investments—portions are deducted from the sum of core capital elements in accordance with section II.*B*.5 of this appendix A.

1. *Goodwill and other intangible assets*—a. *Goodwill*. Goodwill is an intangible asset that represents the excess of the purchase price over the fair market value of identifiable assets acquired less liabilities assumed in acquisitions accounted for under the purchase method of accounting. Any goodwill carried on the balance sheet of a bank holding company after December 31, 1992, will be deducted from the sum of core capital elements in determining Tier 1 capital for ratio calculation purposes. Any goodwill in existence before March 12, 1988, is ''grandfathered'' during the transition period and is not deducted from core capital elements until after December 31, 1992. However, bank holding company goodwill acquired as a result of a merger or acquisition that was consummated on or after March 12, 1988, is deducted immediately.

b. *Other intangible assets*. i. All servicing assets, including servicing assets on assets other than mortgages (i.e., nonmortgage servicing assets), are included in this appendix as identifiable intangible assets. The only types of identifiable intangible assets that may be included in, that is, not deducted from, an organization's capital are readily marketable mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships. The total amount of these assets that may be included in capital is subject to the limitations described below in sections II.B.1.d. and e. of this appendix.

ii. The treatment of identifiable intangible assets set forth in this section generally will be used in the calculation of a bank holding company's capital ratios for supervisory and applications purposes. However, in making an overall assessment of a bank holding company's capital adequacy for applications purposes, the Board may, if it deems appropriate, take into account the quality and composition of an organization's capital, together with the quality and value of its tangible and intangible assets.

c. *Credit-enhancing interest-only strips receivables (I/Os)* i. Credit-enhancing I/Os are on-balance sheet assets that, in form or in substance, represent a contractual right to receive some or all of the interest due on transferred assets and expose the bank holding company to credit risk directly or indirectly associated with transferred assets that exceeds a *pro rata* share of the bank holding company's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Such I/Os, whether purchased or retained, including other similar ''spread'' assets, may be included in, that is, not deducted from, a bank holding company's capital subject to the limitations described below in sections II.B.1.d. and e. of this appendix.

ii. Both purchased and retained credit-enhancing I/Os, on a non-tax adjusted basis, are included in the total amount that is used for purposes of determining whether a bank holding company exceeds the tier 1 limitation described below in this section. In determining whether an I/O or other types of spread assets serve as a credit enhancement, the Federal Reserve will look to the economic substance of the transaction.

d. *Fair value limitation*. The amount of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that a bank holding company may include in capital shall be the lesser of 90 percent of their fair value, as determined in accordance with section II.B.1.f. of this appendix, or 100 percent of their book value,

[17] Any assets deducted from capital in computing the numerator of the ratio are not included in weighted risk assets in computing the denominator of the ratio.

as adjusted for capital purposes in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (FR Y–9C Report). The amount of credit-enhancing I/Os that a bank holding company may include in capital shall be its fair value. If both the application of the limits on mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships and the adjustment of the balance sheet amount for these assets would result in an amount being deducted from capital, the bank holding company would deduct only the greater of the two amounts from its core capital elements in determining tier 1 capital.

e. *Tier 1 capital limitation.* i. The total amount of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that may be included in capital, in the aggregate, cannot exceed 100 percent of tier 1 capital. Nonmortgage servicing assets and purchased credit card relationships are subject, in the aggregate, to a separate sublimit of 25 percent of tier 1 capital. In addition, the total amount of credit-enhancing I/Os (both purchased and retained) that may be included in capital cannot exceed 25 percent of tier 1 capital.[18]

ii. For purposes of calculating these limitations on mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, and credit-enhancing I/Os, tier 1 capital is defined as the sum of core capital elements, net of goodwill, and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships, but prior to the deduction of any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing I/Os (both purchased and retained), any disallowed deferred tax assets, and any nonfinancial equity investments.

iii. Bank holding companies may elect to deduct disallowed mortgage servicing assets, disallowed nonmortgage servicing assets, and disallowed credit-enhancing I/Os (both purchased and retained) on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred-tax assets when determining the amount of deferred-tax assets that are dependent upon future taxable income.

f. *Valuation.* Bank holding companies must review the book value of all intangible assets at least quarterly and make adjustments to these values as necessary. The fair value of mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, and credit-enhancing I/Os also must be determined at least quarterly. This determination shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or account attrition rates. Examiners will review both the book value and the fair value assigned to these assets, together with supporting documentation, during the inspection process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of a bank holding company's intangible assets or credit-enhancing I/Os.

g. *Growing organizations.* Consistent with long-standing Board policy, banking organizations experiencing substantial growth, whether internally or by acquisition, are expected to maintain strong capital positions substantially above minimum supervisory levels, without significant reliance on intangible assets or credit-enhancing I/Os.

2. *Investments in certain subsidiaries*— a. *Unconsolidated banking or finance subsidiaries.* The aggregate amount of investments in banking or finance subsidiaries[19] whose financial statements are not consolidated for accounting or regulatory reporting purposes, regardless of whether the investment is made by the parent bank holding company or its direct or indirect subsidiaries, will be deducted from the consolidated parent banking organization's total capital components.[20] Generally, investments for this purpose are defined as equity and debt capital

[18] Amounts of servicing assets, purchased credit card relationships, and credit-enhancing I/Os (both retained and purchased) in excess of these limitations, as well as all other identifiable intangible assets, including core deposit intangibles and favorable leaseholds, are to be deducted from a bank holding company's core capital elements in determining tier 1 capital. However, identifiable intangible assets (other than mortgage servicing assets and purchased credit card relationships) acquired on or before February 19, 1992, generally will not be deducted from capital for supervisory purposes, although they will continue to be deducted for applications purposes.

[19] For this purpose, a banking and finance subsidiary generally is defined as any company engaged in banking or finance in which the parent institution holds directly or indirectly more than 50 percent of the outstanding voting stock, or which is otherwise controlled or capable of being controlled by the parent institution. For purposes of this section, the definition of banking and finance subsidiary does not include a trust or other special purpose entity used to issue trust preferred securities.

[20] An exception to this deduction would be made in the case of shares acquired in the regular course of securing or collecting a debt previously contracted in good faith. The

investments and any other instruments that are deemed to be capital in the particular subsidiary.

Advances (that is, loans, extensions of credit, guarantees, commitments, or any other forms of credit exposure) to the subsidiary that are not deemed to be capital will generally not be deducted from an organization's capital. Rather, such advances generally will be included in the parent banking organization's consolidated assets and be assigned to the 100 percent risk category, unless such obligations are backed by recognized collateral or guarantees, in which case they will be assigned to the risk category appropriate to such collateral or guarantees. These advances may, however, also be deducted from the consolidated parent banking organization's capital if, in the judgment of the Federal Reserve, the risks stemming from such advances are comparable to the risks associated with capital investments or if the advances involve other risk factors that warrant such an adjustment to capital for supervisory purposes. These other factors could include, for example, the absence of collateral support.

Inasmuch as the assets of unconsolidated banking and finance subsidiaries are not fully reflected in a banking organization's consolidated total assets, such assets may be viewed as the equivalent of off-balance sheet exposures since the operations of an unconsolidated subsidiary could expose the parent organization and its affiliates to considerable risk. For this reason, it is generally appropriate to view the capital resources invested in these unconsolidated entities as primarily supporting the risks inherent in these off-balance sheet assets, and not generally available to support risks or absorb losses elsewhere in the organization.

b. *Other subsidiaries and investments.* The deduction of investments, regardless of whether they are made by the parent bank holding company or by its direct or indirect subsidiaries, from a consolidated banking organization's capital will also be applied in the case of any subsidiaries, that, while consolidated for accounting purposes, are not consolidated for certain specified supervisory or regulatory purposes, such as to facilitate functional regulation. For this purpose, aggregate capital investments (that is, the sum of any equity or debt instruments that are deemed to be capital) in these subsidiaries will be deducted from the consolidated parent banking organization's total capital components.[21]

Advances (that is, loans, extensions of credit, guarantees, commitments, or any other forms of credit exposure) to such subsidiaries that are not deemed to be capital will generally not be deducted from capital. Rather, such advances will normally be included in the parent banking organization's consolidated assets and assigned to the 100 percent risk category, unless such obligations are backed by recognized collateral or guarantees, in which case they will be assigned to the risk category appropriate to such collateral or guarantees. These advances may, however, be deducted from the consolidated parent banking organization's capital if, in the judgment of the Federal Reserve, the risks stemming from such advances are comparable to the risks associated with capital investments or if such advances involve other risk factors that warrant such an adjustment to capital for supervisory purposes. These other factors could include, for example, the absence of collateral support.[22]

In general, when investments in a consolidated subsidiary are deducted from a consolidated parent banking organization's capital, the subsidiary's assets will also be excluded from the consolidated assets of the parent banking organization in order to assess the latter's capital adequacy.[23]

The Federal Reserve may also deduct from a banking organization's capital, on a case-by-case basis, investments in certain other

requirements for consolidation are spelled out in the instructions to the FR Y–9C Report.

[21] Investments in unconsolidated subsidiaries will be deducted from both Tier 1 and Tier 2 capital. As a general rule, one-half (50 percent) of the aggregate amount of capital investments will be deducted from the bank holding company's Tier 1 capital and one-half (50 percent) from its Tier 2 capital. However, the Federal Reserve may, on a case-by-case basis, deduct a proportionately greater amount from Tier 1 if the risks associated with the subsidiary so warrant. If the amount deductible from Tier 2 capital exceeds actual Tier 2 capital, the excess would be deducted from Tier 1 capital. Bank holding companies' risk-based capital ratios, net of these deductions, must exceed the minimum standards set forth in section IV.

[22] In assessing the overall capital adequacy of a banking organization, the Federal Reserve may also consider the organization's fully consolidated capital position.

[23] If the subsidiary's assets are consolidated with the parent banking organization for financial reporting purposes, this adjustment will involve excluding the subsidiary's assets on a line-by-line basis from the consolidated parent organization's assets. The parent banking organization's capital ratio will then be calculated on a consolidated basis with the exception that the assets of the excluded subsidiary will not be consolidated with the remainder of the parent banking organization.

subsidiaries in order to determine if the consolidated banking organization meets minimum supervisory capital requirements without reliance on the resources invested in such subsidiaries.

The Federal Reserve will not automatically deduct investments in other unconsolidated subsidiaries or investments in joint ventures and associated companies.[24] Nonetheless, the resources invested in these entities, like investments in unconsolidated banking and finance subsidiaries, support assets not consolidated with the rest of the banking organization's activities and, therefore, may not be generally available to support additional leverage or absorb losses elsewhere in the banking organization. Moreover, experience has shown that banking organizations stand behind the losses of affiliated institutions, such as joint ventures and associated companies, in order to protect the reputation of the organization as a whole. In some cases, this has led to losses that have exceeded the investments in such organizations.

For this reason, the Federal Reserve will monitor the level and nature of such investments for individual banking organizations and may, on a case-by-case basis, deduct such investments from total capital components, apply an appropriate risk-weighted capital charge against the organization's proportionate share of the assets of its associated companies, require a line-by-line consolidation of the entity (in the event that the parent's control over the entity makes it the functional equivalent of a subsidiary), or otherwise require the organization to operate with a risk-based capital ratio above the minimum.

In considering the appropriateness of such adjustments or actions, the Federal Reserve will generally take into account whether:

(1) The parent banking organization has significant influence over the financial or managerial policies or operations of the subsidiary, joint venture, or associated company;

(2) The banking organization is the largest investor in the affiliated company; or

(3) Other circumstances prevail that appear to closely tie the activities of the affiliated company to the parent banking organization.

3. *Reciprocal holdings of banking organizations' capital instruments*. Reciprocal holdings of banking organizations' capital instruments (that is, instruments that qualify as Tier 1 or Tier 2 capital) will be deducted from an organization's total capital components for the purpose of determining the numerator of the risk-based capital ratio.

Reciprocal holdings are cross-holdings resulting from formal or informal arrangements in which two or more banking organizations swap, exchange, or otherwise agree to hold each other's capital instruments. Generally, deductions will be limited to intentional cross-holdings. At present, the Board does not intend to require banking organizations to deduct non-reciprocal holdings of such capital instruments.[25]

4. *Deferred-tax assets*. a. The amount of deferred-tax assets that is dependent upon future taxable income, net of the valuation allowance for deferred-tax assets, that may be included in, that is, not deducted from, a bank holding company's capital may not exceed the lesser of:

i. The amount of these deferred-tax assets that the bank holding company is expected to realize within one year of the calendar quarter-end date, based on its projections of future taxable income for that year,[26] or

[24] The definition of such entities is contained in the instructions to the Consolidated Financial Statements for Bank Holding Companies. Under regulatory reporting procedures, associated companies and joint ventures generally are defined as companies in which the banking organization owns 20 to 50 percent of the voting stock.

[25] Deductions of holdings of capital securities also would not be made in the case of interstate ''stake out'' investments that comply with the Board's Policy Statement on Nonvoting Equity Investments, 12 CFR 225.143 (Federal Reserve Regulatory Service 4–172.1; 68 Federal Reserve Bulletin 413 (1982)). In addition, holdings of capital instruments issued by other banking organizations but taken in satisfaction of debts previously contracted would be exempt from any deduction from capital. The Board intends to monitor nonreciprocal holdings of other banking organizations' capital instruments and to provide information on such holdings to the Basle Supervisors' Committee as called for under the Basle capital framework.

[26] To determine the amount of expected deferred-tax assets realizable in the next 12 months, an institution should assume that all existing temporary differences fully reverse as of the report date. Projected future taxable income should not include net operating loss carry-forwards to be used during that year or the amount of existing temporary differences a bank holding company expects to reverse within the year. Such projections should include the estimated effect of tax-planning strategies that the organization expects to implement to realize net operating losses or tax-credit carry-forwards that would otherwise expire during the year. Institutions do not have to prepare a new 12-month projection each quarter. Rather, on interim report dates, institutions may use the future-taxable income projections for their current fiscal year, adjusted for any

ii. 10 percent of tier 1 capital.

b. The reported amount of deferred-tax assets, net of any valuation allowance for deferred-tax assets, in excess of the lesser of these two amounts is to be deducted from a banking organization's core capital elements in determining tier 1 capital. For purposes of calculating the 10 percent limitation, tier 1 capital is defined as the sum of core capital elements, net of goodwill and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships, but prior to the deduction of any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit-enhancing I/Os, any disallowed deferred-tax assets, and any nonfinancial equity investments. There generally is no limit in tier 1 capital on the amount of deferred-tax assets that can be realized from taxes paid in prior carry-back years or from future reversals of existing taxable temporary differences.

5. *Nonfinancial equity investments*—a. *General*. A bank holding company must deduct from its core capital elements the sum of the appropriate percentages (as determined below) of the adjusted carrying value of all nonfinancial equity investments held by the parent bank holding company or by its direct or indirect subsidiaries. For purposes of this section II.B.5, investments held by a bank holding company include all investments held directly or indirectly by the bank holding company or any of its subsidiaries.

b. *Scope of nonfinancial equity investments*. A nonfinancial equity investment means any equity investment held by the bank holding company: under the merchant banking authority of section 4(k)(4)(H) of the BHC Act and subpart J of the Board's Regulation Y (12 CFR 225.175 et seq.); under section 4(c)(6) or 4(c)(7) of BHC Act in a nonfinancial company or in a company that makes investments in nonfinancial companies; in a nonfinancial company through a small business investment company (SBIC) under section 302(b) of the Small Business Investment Act of 1958;[27] in a nonfinancial company under the portfolio investment provisions of the Board's Regulation K (12 CFR 211.8(c)(3)); or in a nonfinancial company under section 24 of the Federal Deposit Insurance Act (other than section 24(f)).[28] A nonfinancial company is an entity that engages in any activity that has not been determined to be financial in nature or incidental to financial activities under section 4(k) of the Bank Holding Company Act (12 U.S.C. 1843(k)).

c. *Amount of deduction from core capital*. i. The bank holding company must deduct from its core capital elements the sum of the appropriate percentages, as set forth in Table 1, of the adjusted carrying value of all nonfinancial equity investments held by the bank holding company. The amount of the percentage deduction increases as the aggregate amount of nonfinancial equity investments held by the bank holding company increases as a percentage of the bank holding company's Tier 1 capital.

TABLE 1—DEDUCTION FOR NONFINANCIAL EQUITY INVESTMENTS

| Aggregate adjusted carrying value of all nonfinancial equity investments held directly or indirectly by the bank holding company (as a percentage of the Tier 1 capital of the parent banking organization)[1] | Deduction from Core Capital Elements (as a percentage of the adjusted carrying value of the investment) |
|---|---|
| Less than 15 percent | 8 percent. |
| 15 percent to 24.99 percent | 12 percent. |
| 25 percent and above | 25 percent. |

[1] For purposes of calculating the adjusted carrying value of nonfinancial equity investments as a percentage of Tier 1 capital, Tier 1 capital is defined as the sum of core capital elements net of goodwill and net of all identifiable intangible assets other than mortgage servicing assets, nonmortgage servicing assets and purchased credit card relationships, but prior to the deduction for any disallowed mortgage servicing assets, any disallowed nonmortgage servicing assets, any disallowed purchased credit card relationships, any disallowed credit enhancing I/Os (both purchased and retained), any disallowed deferred tax assets, and any nonfinancial equity investments.

ii. These deductions are applied on a marginal basis to the portions of the adjusted carrying value of nonfinancial equity investments that fall within the specified ranges of the parent holding company's Tier 1 capital. For example, if the adjusted carrying value of all nonfinancial equity investments held by a bank holding company equals 20 percent of the Tier 1 capital of the bank holding company, then the amount of the deduction

significant changes that have occurred or are expected to occur.

[27] An equity investment made under section 302(b) of the Small Business Investment Act of 1958 in an SBIC that is not consolidated with the parent banking organization is treated as a nonfinancial equity investment.

[28] *See* 12 U.S.C. 1843(c)(6), (c)(7) and (k)(4)(H); 15 U.S.C. 682(b); 12 CFR 211.5(b)(1)(iii); and 12 U.S.C. 1831a. In a case in which the Board of Directors of the FDIC, acting directly in exceptional cases and after a review of the proposed activity, has permitted a lesser capital deduction for an investment approved by the Board of Directors under section 24 of the Federal Deposit Insurance Act, such deduction shall also apply to the consolidated bank holding company capital calculation so long as the bank's investments under section 24 and SBIC investments represent, in the aggregate, less than 15 percent of the Tier 1 capital of the bank.

would be 8 percent of the adjusted carrying value of all investments up to 15 percent of the company's Tier 1 capital, and 12 percent of the adjusted carrying value of all investments in excess of 15 percent of the company's Tier 1 capital.

iii. The total adjusted carrying value of any nonfinancial equity investment that is subject to deduction under this paragraph is excluded from the bank holding company's risk-weighted assets for purposes of computing the denominator of the company's risk-based capital ratio.[29]

iv. As noted in section I, this appendix establishes *minimum* risk-based capital ratios and banking organizations are at all times expected to maintain capital commensurate with the level and nature of the risks to which they are exposed. The risk to a banking organization from nonfinancial equity investments increases with its concentration in such investments and strong capital levels above the minimum requirements are particularly important when a banking organization has a high degree of concentration in nonfinancial equity investments (*e.g.*, in excess of 50 percent of Tier 1 capital). The Federal Reserve intends to monitor banking organizations and apply heightened supervision to equity investment activities as appropriate, including where the banking organization has a high degree of concentration in nonfinancial equity investments, to ensure that each organization maintains capital levels that are appropriate in light of its equity investment activities. The Federal Reserve also reserves authority to impose a higher capital charge in any case where the circumstances, such as the level of risk of the particular investment or portfolio of investments, the risk management systems of the banking organization, or other information, indicate that a higher minimum capital requirement is appropriate.

d. *SBIC investments.* i. No deduction is required for nonfinancial equity investments that are held by a bank holding company through one or more SBICs that are consolidated with the bank holding company or in one or more SBICs that are not consolidated with the bank holding company to the extent that all such investments, in the aggregate, do not exceed 15 percent of the aggregate of the bank holding company's pro rata interests in the Tier 1 capital of its subsidiary banks. Any nonfinancial equity investment that is held through or in an SBIC and not required to be deducted from Tier 1 capital under this section II.B.5.d. will be assigned a 100 percent risk-weight and included in the parent holding company's consolidated risk-weighted assets.[30]

ii. To the extent the adjusted carrying value of all nonfinancial equity investments that a bank holding company holds through one or more SBICs that are consolidated with the bank holding company or in one or more SBICs that are not consolidated with the bank holding company exceeds, in the aggregate, 15 percent of the aggregate Tier 1 capital of the company's subsidiary banks, the appropriate percentage of such amounts (as set forth in Table 1) must be deducted from the bank holding company's core capital elements. In addition, the aggregate adjusted carrying value of *all* nonfinancial equity investments held through a consolidated SBIC and in a non-consolidated SBIC (including any investments for which no deduction is required) must be included in determining, for purposes of Table 1, the total amount of nonfinancial equity investments held by the bank holding company in relation to its Tier 1 capital.

e. *Transition provisions.* No deduction under this section II.*B*.5 is required to be made with respect to the adjusted carrying value of any nonfinancial equity investment (or portion of such an investment) that was made by the bank holding company prior to March 13, 2000, or that was made after such

[29] For example, if 8 percent of the adjusted carrying value of a nonfinancial equity investment is deducted from Tier 1 capital, the entire adjusted carrying value of the investment will be excluded from risk-weighted assets in calculating the denominator for the risk-based capital ratio.

[30] If a bank holding company has an investment in an SBIC that is consolidated for accounting purposes but that is not wholly owned by the bank holding company, the adjusted carrying value of the bank holding company's nonfinancial equity investments through the SBIC is equal to the holding company's proportionate share of the adjusted carrying value of the SBIC's equity investments in nonfinancial companies. The remainder of the SBIC's adjusted carrying value (*i.e.* the minority interest holders' proportionate share) is excluded from the risk-weighted assets of the bank holding company. If a bank holding company has an investment in a SBIC that is not consolidated for accounting purposes and has current information that identifies the percentage of the SBIC's assets that are equity investments in nonfinancial companies, the bank holding company may reduce the adjusted carrying value of its investment in the SBIC proportionately to reflect the percentage of the adjusted carrying value of the SBIC's assets that are not equity investments in nonfinancial companies. If a bank holding company reduces the adjusted carrying value of its investment in a non-consolidated SBIC to reflect financial investments of the SBIC, the amount of the adjustment will be risk weighted at 100 percent and included in the bank's risk-weighted assets.

date pursuant to a binding written commitment[31] entered into by the bank holding company prior to March 13, 2000, provided that in either case the bank holding company has continuously held the investment since the relevant investment date.[32] For purposes of this section II.B.5.e., a nonfinancial equity investment made prior to March 13, 2000, includes any shares or other interests received by the bank holding company through a stock split or stock dividend on an investment made prior to March 13, 2000, provided the bank holding company provides no consideration for the shares or interests received and the transaction does not materially increase the bank'' holding company's proportional interest in the company. The exercise on or after March 13, 2000, of options or warrants acquired prior to March 13, 2000, is *not* considered to be an investment made prior to March 13, 2000, if the bank holding company provides any consideration for the shares or interests received upon exercise of the options or warrants. Any nonfinancial equity investment (or portion thereof) that is not required to be deducted from Tier 1 capital under this section II.B.5.e. must be included in determining the total amount of nonfinancial equity investments held by the bank holding company in relation to its Tier 1 capital for purposes of Table 1. In addition, any nonfinancial equity investment (or portion thereof) that is not required to be deducted from Tier 1 capital under this section II.B.5.e. will be assigned a 100-percent risk weight and included in the bank holding company's consolidated risk-weighted assets.

f. *Adjusted carrying value.* i. For purposes of this section II.*B*.5., the ''adjusted carrying value'' of investments is the aggregate value at which the investments are carried on the balance sheet of the consolidated bank holding company reduced by any unrealized gains on those investments that are reflected in such carrying value but excluded from the bank holding company's Tier 1 capital and associated deferred tax liabilities. For example, for investments held as available-for-sale (AFS), the adjusted carrying value of the investments would be the aggregate carrying value of the investments (as reflected on the consolidated balance sheet of the bank holding company) *less* any unrealized gains on those investments that are included in other comprehensive income and not reflected in Tier 1 capital, and associated deferred tax liabilities.[33]

ii. As discussed above with respect to consolidated SBICs, some equity investments may be in companies that are consolidated for accounting purposes. For investments in a nonfinancial company that is consolidated for accounting purposes under generally accepted accounting principles, the parent banking organization's adjusted carrying value of the investment is determined under the equity method of accounting (net of any intangibles associated with the investment that are deducted from the consolidated bank holding company's core capital in accordance with section II.B.1 of this appendix). Even though the assets of the nonfinancial company are consolidated for accounting purposes, these assets (as well as the credit equivalent amounts of the company's off-balance sheet items) should be excluded from the banking organization's risk-weighted assets for regulatory capital purposes.

g. *Equity investments.* For purposes of this section II.*B*.5, an equity investment means any equity instrument (including common stock, preferred stock, partnership interests, interests in limited liability companies,

[31] A ''binding written commitment'' means a legally binding written agreement that requires the banking organization to acquire shares or other equity of the company, or make a capital contribution to the company, under terms and conditions set forth in the agreement. Options, warrants, and other agreements that give a banking organization the right to acquire equity or make an investment, but do not require the banking organization to take such actions, are not considered a binding written commitment for purposes of this section II.*B*.5.

[32] For example, if a bank holding company made an equity investment in 100 shares of a nonfinancial company prior to March 13, 2000, that investment would not be subject to a deduction under this section II.*B*.5. However, if the bank holding company made any additional equity investment in the company after March 13, 2000, such as by purchasing additional shares of the company (including through the exercise of options or warrants acquired before or after March 13, 2000) or by making a capital contribution to the company, and such investment was not made pursuant to a binding written commitment entered into before March 13, 2000, the adjusted carrying value of the additional investment would be subject to a deduction under this section II.*B*.5. In addition, if the bank holding company sold and repurchased shares of the company after March 13, 2000, the adjusted carrying value of the re-acquired shares would be subject to a deduction under this section II.*B*.5.

[33] Unrealized gains on AFS investments may be included in supplementary capital to the extent permitted under section II.A.2.e of this appendix A. In addition, the unrealized losses on AFS equity investments are deducted from Tier 1 capital in accordance with section II.A.1.a of this appendix A.

trust certificates and warrants and call options that give the holder the right to purchase an equity instrument), any equity feature of a debt instrument (such as a warrant or call option), and any debt instrument that is convertible into equity where the instrument or feature is held under one of the legal authorities listed in section II.*B*.5.b. of this appendix. An investment in any other instrument (including subordinated debt) may be treated as an equity investment if, in the judgment of the Federal Reserve, the instrument is the functional equivalent of equity or exposes the state member bank to essentially the same risks as an equity instrument.

ATTACHMENT II—SUMMARY OF DEFINITION OF QUALIFYING CAPITAL FOR BANK HOLDING COMPANIES*

[Using the Year-End 1992 Standard]

| Components | Minimum requirements |
|---|---|
| CORE CAPITAL (Tier 1) | Must equal or exceed 4% of weighted-risk assets. |
| Common stockholders' equity | No limit. |
| Qualifying noncumulative perpetual preferred stock | No limit; bank holding companies should avoid undue reliance on preferred stock in tier 1. |
| Qualifying cumulative perpetual preferred stock | Limited to 25% of the sum of common stock, qualifying perpetual stock, and minority interests. |
| Minority interest in equity accounts of consolidated subsidiaries. | Organizations should avoid using minority interests to introduce elements not otherwise qualifying for tier 1 capital. |
| Less: Goodwill, other intangible assets, credit-enhancing interest-only strips and nonfinancial equity investments required to be deducted from capital [1] | |
| SUPPLEMENTARY CAPITAL (Tier 2) | Total of tier 2 is limited to 100% of tier 1. [2] |
| Allowance for loan and lease losses | Limited to 1.25% of weighted-risk assets. [2] |
| Perpetual preferred stock | No limit within tier 2. |
| Hybrid capital instruments and equity contract notes | No limit within tier 2. |
| Subordinated debt and intermediate-term preferred stock (original weighted average maturity of 5 years or more). | Subordinated debt and intermediate-term preferred stock are limited to 50% of tier 1 [2]; amortized for capital purposes as they approach maturity. |
| Revaluation reserves (equity and building) | Not included; organizations encouraged to disclose; may be evaluated on a case-by-case basis for international comparisons; and taken into account in making an overall assessment of capital. |
| DEDUCTIONS (from sum of tier 1 and tier 2) | |
| Investments in unconsolidated subsidiaries | As a general rule, one-half of the aggregate investments will be deducted from tier 1 capital and one-half from tier 2 capital. [3] |
| Reciprocal holdings of banking organizations' capital securities | |
| Other deductions (such as other subsidiaries or joint ventures) as determined by supervisory authority. | On a case-by-case basis or as a matter of policy after a formal rulemaking. |
| TOTAL CAPITAL (tier 1 + tier 2 − deductions) | Must equal or exceed 8% of weighted-risk assets. |

[1] Requirements for the deduction of other intangible assets and residual interests are set forth in section II.B.1. of this appendix.

[2] Amounts in excess of limitations are permitted but do not qualify as capital.

[3] A proportionately greater amount may be deducted from tier 1 capital, if the risks associated with the subsidiary so warrant.

* See discussion in section II of the guidelines for a complete description of the requirements for, and the limitations on, the components of qualifying capital.

## III. PROCEDURES FOR COMPUTING WEIGHTED RISK ASSETS AND OFF-BALANCE SHEET ITEMS

### *A. Procedures*

Assets and credit equivalent amounts of off-balance sheet items of bank holding companies are assigned to one of several broad risk categories, according to the obligor, or, if relevant, the guarantor or the nature of the collateral. The aggregate dollar value of the amount in each category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are added together, and this sum is the banking organization's total weighted risk assets that comprise the denominator of the risk-based capital ratio. Attachment I provides a sample calculation.

Risk weights for all off-balance sheet items are determined by a two-step process. First, the ''credit equivalent amount'' of off-balance sheet items is determined, in most cases, by multiplying the off-balance sheet item by a credit conversion factor. Second, the credit equivalent amount is treated like any balance sheet asset and generally is assigned to the appropriate risk category according to the obligor, or, if relevant, the guarantor or the nature of the collateral.

In general, if a particular item qualifies for placement in more than one risk category, it is assigned to the category that has the lowest risk weight. A holding of a U.S. municipal revenue bond that is fully guaranteed by a U.S. bank, for example, would be assigned the 20 percent risk weight appropriate to claims guaranteed by U.S. banks, rather

than the 50 percent risk weight appropriate to U.S. municipal revenue bonds.[34]

The Federal Reserve will, on a case-by-case basis, determine the appropriate risk weight for any asset or credit equivalent amount of an off-balance sheet item that does not fit wholly within the terms of one of the risk weight categories set forth below or that imposes risks on a bank holding company that are incommensurate with the risk weight otherwise specified below for the asset or off-balance sheet item. In addition, the Federal Reserve will, on a case-by-case basis, determine the appropriate credit conversion factor for any off-balance sheet item that does not fit wholly within the terms of one of the credit conversion factors set forth below or that imposes risks on a banking organization that are incommensurate with the credit conversion factors otherwise specified below for the off-balance sheet item. In making such a determination, the Federal Reserve will consider the similarity of the asset or off-balance sheet item to assets or off-balance sheet items explicitly treated in the guidelines, as well as other relevant factors.

*B. Collateral, Guarantees, and Other Considerations*

1. *Collateral.* The only forms of collateral that are formally recognized by the risk-based capital framework are: Cash on deposit in a subsidiary lending institution; securities issued or guaranteed by the central governments of the OECD-based group of countries,[35] U.S. Government agencies, or U.S. Government-sponsored agencies; and securities issued by multilateral lending institutions or regional development banks. Claims fully secured by such collateral generally are assigned to the 20 percent risk-weight category. Collateralized transactions meeting all the conditions described in section III.C.1. may be assigned a zero percent risk weight.

With regard to collateralized claims that may be assigned to the 20 percent risk-weight category, the extent to which qualifying securities are recognized as collateral is determined by their current market value. If such a claim is only partially secured, that is, the market value of the pledged securities is less than the face amount of a balance-sheet asset or an off-balance-sheet item, the

[34] An investment in shares of a fund whose portfolio consists primarily of various securities or money market instruments that, if held separately, would be assigned to different risk categories, generally is assigned to the risk category appropriate to the highest risk-weighted asset that the fund is permitted to hold in accordance with the stated investment objectives set forth in the prospectus. An organization may, at its option, assign a fund investment on a pro rata basis to different risk categories according to the investment limits in the fund's prospectus. In no case will an investment in shares in any fund be assigned to a total risk weight of less than 20 percent. If an organization chooses to assign a fund investment on a pro rata basis, and the sum of the investment limits of assets in the fund's prospectus exceeds 100 percent, the organization must assign risk weights in descending order. If, in order to maintain a necessary degree of short-term liquidity, a fund is permitted to hold an insignificant amount of its assets in short-term, highly liquid securities of superior credit quality that do not qualify for a preferential risk weight, such securities generally will be disregarded when determining the risk category into which the organization's holding in the overall fund should be assigned. The prudent use of hedging instruments by a fund to reduce the risk of its assets will not increase the risk weighting of the fund investment. For example, the use of hedging instruments by a fund to reduce the interest rate risk of its government bond portfolio will not increase the risk weight of that fund above the 20 percent category. Nonetheless, if a fund engages in any activities that appear speculative in nature or has any other characteristics that are inconsistent with the preferential risk weighting assigned to the fund's assets, holdings in the fund will be assigned to the 100 percent risk category.

[35] The OECD-based group of countries comprises all full members of the Organization for Economic Cooperation and Development (OECD) regardless of entry date, as well as countries that have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the IMF's General Arrangements to Borrow, but excludes any country that has rescheduled its external sovereign debt within the previous five years. As of November 1995, the OECD included the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States; and Saudi Arabia had concluded special lending arrangements with the IMF associated with the IMF's General Arrangements to Borrow. A rescheduling of external sovereign debt generally would include any renegotiation of terms arising from a country's inability or unwillingness to meet its external debt service obligations, but generally would not include renegotiations of debt in the normal course of business, such as a renegotiation to allow the borrower to take advantage of a decline in interest rates or other change in market conditions.

portion that is covered by the market value of the qualifying collateral is assigned to the 20 percent risk category, and the portion of the claim that is not covered by collateral in the form of cash or a qualifying security is assigned to the risk category appropriate to the obligor or, if relevant, the guarantor. For example, to the extent that a claim on a private sector obligor is collateralized by the current market value of U.S. Government securities, it would be placed in the 20 percent risk category and the balance would be assigned to the 100 percent risk category.

2. *Guarantees*. Guarantees of the OECD and non-OECD central governments, U.S. Government agencies, U.S. Government-sponsored agencies, state and local governments of the OECD-based group of countries, multilateral lending institutions and regional development banks, U.S. depository institutions, and foreign banks are also recognized. If a claim is partially guaranteed, that is, coverage of the guarantee is less than the face amount of a balance sheet asset or an off-balance sheet item, the portion that is not fully covered by the guarantee is assigned to the risk category appropriate to the obligor or, if relevant, to any collateral. The face amount of a claim covered by two types of guarantees that have different risk weights, such as a U.S. Government guarantee and a state guarantee, is to be apportioned between the two risk categories appropriate to the guarantors.

The existence of other forms of collateral or guarantees that the risk-based capital framework does not formally recognize may be taken into consideration in evaluating the risks inherent in an organization's loan portfolio—which, in turn, would affect the overall supervisory assessment of the organization's capital adequacy.

3. *Recourse obligations, direct credit substitutes, residual interests, and asset- and mortgage-backed securities*. Direct credit substitutes, assets transferred with recourse, and securities issued in connection with asset securitizations and structured financings are treated as described below. The term ''asset securitizations'' or ''securitizations'' in this rule includes structured financings, as well as asset securitization transactions.

a. *Definitions*—i. *Credit derivative* means a contract that allows one party (the ''protection purchaser'') to transfer the credit risk of an asset or off-balance sheet credit exposure to another party (the ''protection provider''). The value of a credit derivative is dependent, at least in part, on the credit performance of the ''reference asset.''

ii. *Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of assets (including loan servicing assets) and that obligate the bank holding company to protect investors from losses arising from credit risk in the assets transferred or the loans serviced. Credit-enhancing representations and warranties include promises to protect a party from losses resulting from the default or nonperformance of another party or from an insufficiency in the value of the collateral. Credit-enhancing representations and warranties do not include:

*1.* Early default clauses and similar warranties that permit the return of, or premium refund clauses covering, 1–4 family residential first mortgage loans that qualify for a 50 percent risk weight for a period not to exceed 120 days from the date of transfer. These warranties may cover only those loans that were originated within 1 year of the date of transfer;

*2.* Premium refund clauses that cover assets guaranteed, in whole or in part, by the U.S. Government, a U.S. Government agency or a government-sponsored enterprise, provided the premium refund clauses are for a period not to exceed 120 days from the date of transfer; or

*3.* Warranties that permit the return of assets in instances of misrepresentation, fraud or incomplete documentation.

iii. *Direct credit substitute* means an arrangement in which a bank holding company assumes, in form or in substance, credit risk associated with an on- or off-balance sheet credit exposure that was not previously owned by the bank holding company (third-party asset) and the risk assumed by the bank holding company exceeds the pro rata share of the bank holding company's interest in the third-party asset. If the bank holding company has no claim on the third-party asset, then the bank holding company's assumption of any credit risk with respect to the third party asset is a direct credit substitute. Direct credit substitutes include, but are not limited to:

*1.* Financial standby letters of credit that support financial claims on a third party that exceed a bank holding company's pro rata share of losses in the financial claim;

*2.* Guarantees, surety arrangements, credit derivatives, and similar instruments backing financial claims that exceed a bank holding company's pro rata share in the financial claim;

*3.* Purchased subordinated interests or securities that absorb more than their pro rata share of losses from the underlying assets;

*4.* Credit derivative contracts under which the bank holding company assumes more than its pro rata share of credit risk on a third party exposure;

*5.* Loans or lines of credit that provide credit enhancement for the financial obligations of an account party;

*6.* Purchased loan servicing assets if the servicer is responsible for credit losses or if the servicer makes or assumes credit-enhancing representations and warranties with

respect to the loans serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.viii. of this appendix are not direct credit substitutes;

*7.* Clean-up calls on third party assets. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank holding company are not direct credit substitutes; and

*8.* Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

iv. *Eligible ABCP liquidity facility* means a liquidity facility supporting ABCP, in form or in substance, that is subject to an asset quality test at the time of draw that precludes funding against assets that are 90 days or more past due or in default. In addition, if the assets that an eligible ABCP liquidity facility is required to fund against are externally rated assets or exposures at the inception of the facility, the facility can be used to fund only those assets or exposures that are externally rated investment grade at the time of funding. Notwithstanding the eligibility requirements set forth in the two preceding sentences, a liquidity facility will be considered an eligible ABCP liquidity facility if the assets that are funded under the liquidity facility and which do not meet the eligibility requirements are guaranteed, either conditionally or unconditionally, by the U.S. government or its agencies, or by the central government of an OECD country.

v. *Externally rated* means that an instrument or obligation has received a credit rating from a nationally recognized statistical rating organization.

vi. *Face amount* means the notional principal, or face value, amount of an off-balance sheet item; the amortized cost of an asset not held for trading purposes; and the fair value of a trading asset.

vii. *Financial asset* means cash or other monetary instrument, evidence of debt, evidence of an ownership interest in an entity, or a contract that conveys a right to receive or exchange cash or another financial instrument from another party.

viii. *Financial standby letter of credit* means a letter of credit or similar arrangement that represents an irrevocable obligation to a third-party beneficiary:

*1.* To repay money borrowed by, or advanced to, or for the account of, a second party (the account party), or

*2.* To make payment on behalf of the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

ix. *Liquidity Facility* means a legally binding commitment to provide liquidity support to ABCP by lending to, or purchasing assets from, any structure, program, or conduit in the event that funds are required to repay maturing ABCP.

x. *Mortgage servicer cash advance* means funds that a residential mortgage loan servicer advances to ensure an uninterrupted flow of payments, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the loan. A mortgage servicer cash advance is not a recourse obligation or a direct credit substitute if:

*1.* The servicer is entitled to full reimbursement and this right is not subordinated to other claims on the cash flows from the underlying asset pool; or

*2.* For any one loan, the servicer's obligation to make nonreimbursable advances is contractually limited to an insignificant amount of the outstanding principal balance of that loan.

xi. *Nationally recognized statistical rating organization (NRSRO)* means an entity recognized by the Division of Market Regulation of the Securities and Exchange Commission (or any successor Division) (Commission) as a nationally recognized statistical rating organization for various purposes, including the Commission's uniform net capital requirements for brokers and dealers.

xii. *Recourse* means the retention, by a bank holding company, in form or in substance, of any credit risk directly or indirectly associated with an asset it has transferred and sold that exceeds a pro rata share of the banking organization's claim on the asset. If a banking organization has no claim on a transferred asset, then the retention of any risk of credit loss is recourse. A recourse obligation typically arises when a bank holding company transfers assets and retains an explicit obligation to repurchase the assets or absorb losses due to a default on the payment of principal or interest or any other deficiency in the performance of the underlying obligor or some other party. Recourse may also exist implicitly if a bank holding company provides credit enhancement beyond any contractual obligation to support assets it has sold. The following are examples of recourse arrangements:

*1.* Credit-enhancing representations and warranties made on the transferred assets;

*2.* Loan servicing assets retained pursuant to an agreement under which the bank holding company will be responsible for credit losses associated with the loans being serviced. Mortgage servicer cash advances that meet the conditions of section III.B.3.a.x. of this appendix are not recourse arrangements;

*3.* Retained subordinated interests that absorb more than their pro rata share of losses from the underlying assets;

*4.* Assets sold under an agreement to repurchase, if the assets are not already included on the balance sheet;

*5.* Loan strips sold without contractual recourse where the maturity of the transferred

loan is shorter than the maturity of the commitment under which the loan is drawn;

*6*. Credit derivatives issued that absorb more than the bank holding company's pro rata share of losses from the transferred assets;

*7*. Clean-up calls at inception that are greater than 10 percent of the balance of the original pool of transferred loans. Clean-up calls that are 10 percent or less of the original pool balance that are exercisable at the option of the bank holding company are not recourse arrangements; and

*8*. Liquidity facilities that provide liquidity support to ABCP (other than eligible ABCP liquidity facilities).

xiii. *Residual interest* means any on-balance sheet asset that represents an interest (including a beneficial interest) created by a transfer that qualifies as a sale (in accordance with generally accepted accounting principles) of financial assets, whether through a securitization or otherwise, and that exposes the bank holding company to credit risk directly or indirectly associated with the transferred assets that exceeds a pro rata share of the bank holding company's claim on the assets, whether through subordination provisions or other credit enhancement techniques. Residual interests generally include credit-enhancing I/Os, spread accounts, cash collateral accounts, retained subordinated interests, other forms of over-collateralization, and similar assets that function as a credit enhancement. Residual interests further include those exposures that, in substance, cause the bank holding company to retain the credit risk of an asset or exposure that had qualified as a residual interest before it was sold. Residual interests generally do not include interests purchased from a third party, except that purchased credit-enhancing I/Os are residual interests for purposes of this appendix.

xiv. *Risk participation* means a participation in which the originating party remains liable to the beneficiary for the full amount of an obligation (*e.g.*, a direct credit substitute) notwithstanding that another party has acquired a participation in that obligation.

xv. *Securitization* means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.

xvi. *Sponsor* means a bank holding company that establishes an ABCP program; approves the sellers permitted to participate in the program; approves the asset pools to be purchased by the program; or administers the program by monitoring the assets, arranging for debt placement, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

xvii. *Structured finance program* means a program where receivable interests and asset-backed securities issued by multiple participants are purchased by a special purpose entity that repackages those exposures into securities that can be sold to investors. Structured finance programs allocate credit risks, generally, between the participants and credit enhancement provided to the program.

xviii. *Traded position* means a position that is externally rated and is retained, assumed, or issued in connection with an asset securitization, where there is a reasonable expectation that, in the near future, the rating will be relied upon by unaffiliated investors to purchase the position; or an unaffiliated third party to enter into a transaction involving the position, such as a purchase, loan, or repurchase agreement.

b. *Credit equivalent amounts and risk weight of recourse obligations and direct credit substitutes*. i. *Credit equivalent amount*. Except as otherwise provided in sections III.B.3.c. through f. and III.B.5. of this appendix, the credit-equivalent amount for a recourse obligation or direct credit substitute is the full amount of the credit-enhanced assets for which the bank holding company directly or indirectly retains or assumes credit risk multiplied by a 100 percent conversion factor.

ii. *Risk-weight factor*. To determine the bank holding company's risk-weight factor for off-balance sheet recourse obligations and direct credit substitutes, the credit equivalent amount is assigned to the risk category appropriate to the obligor in the underlying transaction, after considering any associated guarantees or collateral. For a direct credit substitute that is an on-balance sheet asset (*e.g.*, a purchased subordinated security), a bank holding company must calculate risk-weighted assets using the amount of the direct credit substitute and the full amount of the assets it supports, *i.e.*, all the more senior positions in the structure. The treatment of direct credit substitutes that have been syndicated or in which risk participations have been conveyed or acquired is set forth in section III.D.1 of this appendix.

c. *Externally-rated positions: credit-equivalent amounts and risk weights of recourse obligations, direct credit substitutes, residual interests, and asset- and mortgage-backed securities (including asset-backed commercial paper)*—i. *Traded positions*. With respect to a recourse obligation, direct credit substitute, residual interest (other than a credit-enhancing I/Ostrip) or asset- and mortgage-backed security (including asset-backed commercial paper) that is a traded position and that has received an external rating on a long-term

position that is one grade below investment grade or better or a short-term rating that is investment grade, the bank holding company may multiply the face amount of the position by the appropriate risk weight, determined in accordance with the tables below. Stripped mortgage-backed securities and other similar instruments, such as interest-only or principal-only strips that are not credit enhancements, must be assigned to the 100 percent risk category. If a traded position has received more than one external rating, the lowest single rating will apply.

| Long-term rating category | Examples | Risk weight (In percent) |
|---|---|---|
| Highest or second highest investment grade | AAA, AA | 20 |
| Third highest investment grade | A | 50 |
| Lowest investment grade | BBB | 100 |
| One category below investment grade | BB | 200 |

| Short-term rating | Examples | Risk weight (In percent) |
|---|---|---|
| Highest investment grade | A–1, P–1 | 20 |
| Second highest investment grade | A–2, P–2 | 50 |
| Lowest investment grade | A–3, P–3 | 100 |

ii. *Non-traded positions.* A recourse obligation, direct credit substitute, or residual interest (but not a credit-enhancing I/O strip) extended in connection with a securitization that is not a traded position may be assigned a risk weight in accordance with section III.B.3.c.i. of this appendix if:

*1.* It has been externally rated by more than one NRSRO;

*2.* It has received an external rating on a long-term position that is one grade below investment grade or better or on a short-term position that is investment grade by all NRSROs providing a rating;

*3.* The ratings are publicly available; and

*4.* The ratings are based on the same criteria used to rate traded positions.

If the ratings are different, the lowest rating will determine the risk category to which the recourse obligation, direct credit substitute, or residual interest will be assigned.

d. *Senior positions not externally rated.* For a recourse obligation, direct credit substitute, residual interest, or asset-or mortgage-backed security that is not externally rated but is senior or preferred in all features to a traded position (including collateralization and maturity), a bank holding company may apply a risk weight to the face amount of the senior position in accordance with section III.B.3.c.i. of this appendix, based on the traded position, subject to any current or prospective supervisory guidance and the bank holding company satisfying the Federal Reserve that this treatment is appropriate. This section will apply only if the traded subordinated position provides substantive credit support to the unrated position until the unrated position matures.

e. *Capital requirement for residual interests*—i. *Capital requirement for credit-enhancing I/O strips.* After applying the concentration limit to credit-enhancing I/O strips (both purchased and retained) in accordance with sections II.B.2.c. through e. of this appendix, a bank holding company must maintain risk-based capital for a credit-enhancing I/O strip (both purchased and retained), regardless of the external rating on that position, equal to the remaining amount of the credit-enhancing I/O (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred credit-enhancing I/O strip will be treated as if the credit-enhancing I/O strip was retained by the bank holding company and not transferred.

ii. *Capital requirement for other residual interests. 1.* If a residual interest does not meet the requirements of sections III.B.3.c. or d. of this appendix, a bank holding must maintain risk-based capital equal to the remaining amount of the residual interest that is retained on the balance sheet (net of any existing associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred. Transactions that, in substance, result in the retention of credit risk associated with a transferred residual interest will be treated as if the residual interest was retained by the bank holding company and not transferred.

*2.* Where the aggregate capital requirement for residual interests and other recourse obligations in connection with the same transfer of assets exceed the full risk-based capital requirement for those assets, a bank holding company must maintain risk-based capital equal to the greater of the risk-based capital requirement for the residual interest as calculated under section III.B.3.e.ii.*1.* of

this appendix or the full risk-based capital requirement for the assets transferred.

f. *Positions that are not rated by an NRSRO.* A position (but not a residual interest) maintained in connection with a securitization and that is not rated by a NRSRO may be risk-weighted based on the bank holding company's determination of the credit rating of the position, as specified in the table below, multiplied by the face amount of the position. In order to obtain this treatment, the bank holding company's system for determining the credit rating of the position must meet one of the three alternative standards set out in sections III.B.3.f.i. through III.B.3.f.iii. of this appendix.

| Rating category | Examples | Risk weight (In percent) |
|---|---|---|
| Highest or second highest investment grade | AAA, AA | 100 |
| Third highest investment grade | A | 100 |
| Lowest investment grade | BBB | 100 |
| One category below investment grade | BB | 200 |

i. *Internal risk rating used for asset-backed programs.* A direct credit substitute (other than a purchased credit-enhancing I/O) is assumed in connection with an asset-backed commercial paper program sponsored by the bank holding company and the bank holding company is able to demonstrate to the satisfaction of the Federal Reserve, prior to relying upon its use, that the bank holding company's internal credit risk rating system is adequate. Adequate internal credit risk rating systems usually contain the following criteria:

*1.* The internal credit risk system is an integral part of the bank holding company's risk management system, which explicitly incorporates the full range of risks arising from a bank holding company's participation in securitization activities;

*2.* Internal credit ratings are linked to measurable outcomes, such as the probability that the position will experience any loss, the position's expected loss given default, and the degree of variance in losses given default on that position;

*3.* The bank holding company's internal credit risk system must separately consider the risk associated with the underlying loans or borrowers, and the risk associated with the structure of a particular securitization transaction;

*4.* The bank holding company's internal credit risk system must identify gradations of risk among ''pass'' assets and other risk positions;

*5.* The bank holding company must have clear, explicit criteria that are used to classify assets into each internal risk grade, including subjective factors;

*6.* The bank holding company must have independent credit risk management or loan review personnel assigning or reviewing the credit risk ratings;

*7.* The bank holding company must have an internal audit procedure that periodically verifies that the internal credit risk ratings are assigned in accordance with the established criteria;

*8.* The bank holding company must monitor the performance of the internal credit risk ratings assigned to nonrated, nontraded direct credit substitutes over time to determine the appropriateness of the initial credit risk rating assignment and adjust individual credit risk ratings, or the overall internal credit risk ratings system, as needed; and

*9.* The internal credit risk system must make credit risk rating assumptions that are consistent with, or more conservative than, the credit risk rating assumptions and methodologies of NRSROs.

ii. *Program Ratings.* A direct credit substitute or recourse obligation (other than a residual interest) is assumed or retained in connection with a structured finance program and a NRSRO has reviewed the terms of the program and stated a rating for positions associated with the program. If the program has options for different combinations of assets, standards, internal credit enhancements and other relevant factors, and the NRSRO specifies ranges of rating categories to them, the bank holding company may apply the rating category that corresponds to the bank holding company's position. In order to rely on a program rating, the bank holding company must demonstrate to the Federal Reserve's satisfaction that the credit risk rating assigned to the program meets the same standards generally used by NRSROs for rating traded positions. The bank holding company must also demonstrate to the Federal Reserve's satisfaction that the criteria underlying the NRSRO's assignment of ratings for the program are satisfied for the particular position. If a bank holding company participates in a securitization sponsored by another party, the Federal Reserve may authorize the bank holding company to use this approach based on a programmatic rating obtained by the sponsor of the program.

iii. *Computer Program.* The bank holding company is using an acceptable credit assessment computer program to determine the rating of a direct credit substitute or recourse obligation (but not residual interest)

issued in connection with a structured finance program. A NRSRO must have developed the computer program, and the bank holding company must demonstrate to the Federal Reserve's satisfaction that ratings under the program correspond credibly and reliably with the rating of traded positions.

g. *Limitations on risk-based capital requirements*—i. *Low-level exposure*. If the maximum contractual exposure to loss retained or assumed by a bank holding company in connection with a recourse obligation or a direct credit substitute is less than the effective risk-based capital requirement for the enhanced assets, the risk-based capital requirement is limited to the maximum contractual exposure, less any liability account established in accordance with generally accepted accounting principles. This limitation does not apply when a bank holding company provides credit enhancement beyond any contractual obligation to support assets it has sold.

ii. *Mortgage-related securities or participation certificates retained in a mortgage loan swap*. If a bank holding company holds a mortgage-related security or a participation certificate as a result of a mortgage loan swap with recourse, capital is required to support the recourse obligation plus the percentage of the mortgage-related security or participation certificate that is not covered by the recourse obligation. The total amount of capital required for the on-balance sheet asset and the recourse obligation, however, is limited to the capital requirement for the underlying loans, calculated as if the organization continued to hold these loans as on-balance sheet assets.

iii. *Related on-balance sheet assets*. If a recourse obligation or direct credit substitute subject to section III.B.3. of this appendix also appears as a balance sheet asset, the balance sheet asset is not included in an organization's risk-weighted assets to the extent the value of the balance sheet asset is already included in the off-balance sheet credit equivalent amount for the recourse obligation or direct credit substitute, except in the case of loan servicing assets and similar arrangements with embedded recourse obligations or direct credit substitutes. In that case, both the on-balance sheet assets and the related recourse obligations and direct credit substitutes are incorporated into the risk-based capital calculation.

4. *Maturity*. Maturity is generally not a factor in assigning items to risk categories with the exception of claims on non-OECD banks, commitments, and interest rate and foreign exchange rate contracts. Except for commitments, short-term is defined as one year or less *remaining* maturity and long-term is defined as over one year *remaining* maturity. In the case of commitments, short-term is defined as one year or less *original* maturity and long-term is defined as over one year *original* maturity.

5. *Small Business Loans and Leases on Personal Property Transferred with Recourse*. a. Notwithstanding other provisions of this appendix A, a qualifying banking organization that has transferred small business loans and leases on personal property (small business obligations) with recourse shall include in weighted-risk assets only the amount of retained recourse, provided two conditions are met. First, the transaction must be treated as a sale under GAAP and, second, the banking organization must establish pursuant to GAAP a non-capital reserve sufficient to meet the organization's reasonably estimated liability under the recourse arrangement. Only loans and leases to businesses that meet the criteria for a small business concern established by the Small Business Administration under section 3(a) of the Small Business Act are eligible for this capital treatment.

b. For purposes of this appendix A, a banking organization is qualifying if it meets the criteria for well capitalized or, by order of the Board, adequately capitalized, as those criteria are set forth in the Board's prompt corrective action regulation for state member banks (12 CFR 208.40). For purposes of determining whether an organization meets these criteria, its capital ratios must be calculated without regard to the capital treatment for transfers of small business obligations with recourse specified in section III.B.5.a. of this appendix A. The total outstanding amount of recourse retained by a qualifying banking organization on transfers of small business obligations receiving the preferential capital treatment cannot exceed 15 percent of the organization's total risk-based capital. By order, the Board may approve a higher limit.

c. If a bank holding company ceases to be qualifying or exceeds the 15 percent capital limitation, the preferential capital treatment will continue to apply to any transfers of small business obligations with recourse that were consummated during the time that the organization was qualifying and did not exceed the capital limit.

6. *Asset-backed commercial paper programs*. a. An asset-backed commercial paper (ABCP) program means a program that primarily issues externally rated commercial paper backed by assets or exposures held in a bankruptcy-remote, special purpose entity.

b. A bank holding company that qualifies as a primary beneficiary and must consolidate an ABCP program that is defined as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets provided that the bank holding company is the sponsor of the ABCP program. If a bank holding company excludes such consolidated ABCP program

assets, the bank holding company must assess the appropriate risk-based capital charge against any exposures of the organization arising in connection with such ABCP programs, including direct credit substitutes, recourse obligations, residual interests, liquidity facilities, and loans, in accordance with sections III.B.3., III.C., and III.D. of this appendix.

c. If a bank holding company has multiple overlapping exposures (such as a program-wide credit enhancement and multiple pool-specific liquidity facilities) to an ABCP program that is not consolidated for risk-based capital purposes, the bank holding company is not required to hold duplicative risk-based capital under this appendix against the overlapping position. Instead, the bank holding company should apply to the overlapping position the applicable risk-based capital treatment that results in the highest capital charge.

*C. Risk Weights*

Attachment III contains a listing of the risk categories, a summary of the types of assets assigned to each category and the risk weight associated with each category, that is, 0 percent, 20 percent, 50 percent, and 100 percent. A brief explanation of the components of each category follows.

1. *Category 1: zero percent.* This category includes cash (domestic and foreign) owned and held in all offices of subsidiary depository institutions or in transit and gold bullion held in either a subsidiary depository institution's own vaults or in another's vaults on an allocated basis, to the extent it is offset by gold bullion liabilities.[36] The category also includes all direct claims (including securities, loans, and leases) on, and the portions of claims that are directly and unconditionally guaranteed by, the central governments[37] of the OECD countries and U.S. Government agencies,[38] as well as all direct local currency claims on, and the portions of local currency claims that are directly and unconditionally guaranteed by, the central governments of non-OECD countries, to the extent that subsidiary depository institutions have liabilities booked in that currency. A claim is not considered to be unconditionally guaranteed by a central government if the validity of the guarantee is dependent upon some affirmative action by the holder or a third party. Generally, securities guaranteed by the U.S. Government or its agencies that are actively traded in financial markets, such as GNMA securities, are considered to be unconditionally guaranteed.

This category also includes claims collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the banking organization's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

This category also includes ABCP (i) purchased by a bank holding company between September 19, 2008, and January 30, 2009 (unless extended by the Board), from an SEC-registered open-end investment company that holds itself out as a money market mutual fund under SEC Rule 2a–7 (17 CFR 270.2a–7) and (ii) pledged by the bank holding company to a Federal Reserve Bank to secure financing from the ABCP lending facility established by the Board on September 19, 2008.

2. *Category 2: 20 percent.* a. This category includes cash items in the process of collection, both foreign and domestic; short-term claims (including demand deposits) on, and the portions of short-term claims that are

[36] All other holdings of bullion are assigned to the 100 percent risk category.

[37] A central government is defined to include departments and ministries, including the central bank, of the central government. The U.S. central bank includes the 12 Federal Reserve Banks, and stock held in these banks as a condition of membership is assigned to the zero percent risk category. The definition of central government does not include state, provincial, or local governments; or commercial enterprises owned by the central government. In addition, it does not include local government entities or commercial enterprises whose obligations are guaranteed by the central government, although any claims on such entities guaranteed by central governments are placed in the same general risk category as other claims guaranteed by central governments. OECD central governments are defined as central governments of the OECD-based group of countries; non-OECD central governments are defined as central governments of countries that do not belong to the OECD-based group of countries.

[38] A U.S. Governmnt agency is defined as an instrumentality of the U.S. Government whose obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. Such agencies include the Government National Mortgage Association (GNMA), the Veterans Administration (VA), the Federal Housing Administration (FHA), the Export-Import Bank (Exim Bank), the Overseas Private Investment Corporation (OPIC), the Commodity Credit Corporation (CCC), and the Small Business Administration (SBA).

guaranteed by,[39] U.S. depository institutions[40] and foreign banks[41]; and long-term claims on, and the portions of long-term claims that are guaranteed by, U.S. depository institutions and OECD banks.[42]

b. This category also includes the portions of claims that are conditionally guaranteed by OECD central governments and U.S. Government agencies, as well as the portions of local currency claims that are conditionally guaranteed by non-OECD central governments, to the extent that subsidiary depository institutions have liabilities booked in that currency. In addition, this category also includes claims on, and the portions of claims that are guaranteed by, U.S. government-sponsored[43] agencies and claims on, and the portions of claims guaranteed by, the International Bank for Reconstruction and Development (World Bank), the International Finance Corporation, the Interamerican Development Bank, the Asian Development Bank, the African Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank, and other multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member. General obligation claims on, or portions of claims guaranteed by the full faith and credit of, states or other political subdivisions of the U.S. or other countries of the OECD—based group are also assigned to this category.[44]

c. This category also includes the portions of claims (including repurchase transactions) collateralized by cash on deposit in the subsidiary lending institution or by securities issued or guaranteed by OECD central governments or U.S. government agencies that do not qualify for the zero percent risk-weight category; collateralized by securities issued or guaranteed by U.S. government-sponsored agencies; or collateralized by securities issued by multilateral lending institutions or regional development banks in which the U.S. government is a shareholder or contributing member.

d. This category also includes claims[45] on, or guaranteed by, a qualifying securities firm[46] incorporated in the United States or

[39] Claims guaranteed by U.S. depository institutions and foreign banks include risk participations in both bankers acceptances and standby letters of credit, as well as participations in commitments, that are conveyed to U.S. depository institutions or foreign banks.

[40] *See* footnote 9 of this appendix for the definition of a U.S. depository institution. For this purpose, the definition also includes U.S.-chartered depository institutions owned by foreigners. However, branches and agencies of foreign banks located in the U.S., as well as all bank holding companies, are excluded.

[41] *See* footnote 10 of this appendix for the definition of a foreign bank. Foreign banks are distinguished as either OECD banks or non-OECD banks. OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries (other than the United States) that belong to the OECD-based group of countries. Non-OECD banks include banks and their branches (foreign and domestic) organized under the laws of countries that do not belong to the OECD-based group of countries.

[42] Long-term claims on, or guaranteed by, non-OECD banks and all claims on bank holding companies are assigned to the 100 percent risk category, as are holdings of bank-issued securities that qualify as capital of the issuing banks.

[43] For this purpose, U.S. government-sponsored agencies are defined as agencies originally established or chartered by the Federal government to serve public purposes specified by the U.S. Congress but whose obligations are *not explicitly* guaranteed by the full faith and credit of the U.S. government. These agencies include the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), the Farm Credit System, the Federal Home Loan Bank System, and the Student Loan Marketing Association (SLMA). Claims on U.S. government-sponsored agencies include capital stock in a Federal Home Loan Bank that is held as a condition of membership in that Bank.

[44] Claims on, or guaranteed by, states or other political subdivisions of countries that do not belong to the OECD-based group of countries are placed in the 100 percent risk category.

[45] Claims on a qualifying securities firm that are instruments the firm, or its parent company, uses to satisfy its applicable capital requirement are not eligible for this risk weight.

[46] With regard to securities firms incorporated in the United States, qualifying securities firms are those securities firms that are broker-dealers registered with the Securities and Exchange Commission and are in compliance with the SEC's net capital rule, 17 CFR 240.15c3–1. With regard to securities firms incorporated in other countries in the OECD-based group of countries, qualifying securities firms are those securities firms that a banking organization is able to demonstrate are subject to consolidated supervision and regulation (covering their direct and indirect subsidiaries, but not necessarily their parent organizations) comparable to that imposed on banks in OECD countries.

*Continued*

other member of the OECD-based group of countries provided that: the qualifying securities firm has a long-term issuer credit rating, or a rating on at least one issue of long-term debt, in one of the three highest investment grade rating categories from a nationally recognized statistical rating organization; or the claim is guaranteed by the firm's parent company and the parent company has such a rating. If ratings are available from more than one rating agency, the lowest rating will be used to determine whether the rating requirement has been met. This category also includes a collateralized claim on a qualifying securities firm in such a country, without regard to satisfaction of the rating standard, provided the claim arises under a contract that:

(1) Is a reverse repurchase/repurchase agreement or securities lending/borrowing transaction executed under standard industry documentation;

(2) Is collateralized by debt or equity securities that are liquid and readily marketable;

(3) Is marked-to-market daily;

(4) Is subject to a daily margin maintenance requirement under the standard industry documentation; and

(5) Can be liquidated, terminated, or accelerated immediately in bankruptcy or similar proceeding, and the security or collateral agreement will not be stayed or avoided, under applicable law of the relevant jurisdiction.[47]

3. *Category 3: 50 percent*. This category includes loans fully secured by first liens[48] on 1- to 4-family residential properties, either owner-occupied or rented, or on multifamily residential properties,[49] that meet certain criteria.[50] Loans included in this category must have been made in accordance with prudent underwriting standards;[51] be performing in accordance with their original terms; and not be 90 days or more past due or carried in nonaccrual status. The following additional criteria must also be applied to a loan secured by a multifamily residential property that is included in this category: all principal and interest payments on the loan must have been made on time for at least the year preceding placement in this category, or in the case where the existing

Such regulation must include risk-based capital requirements comparable to those applied to banks under the Accord on International Convergence of Capital Measurement and Capital Standards (1988, as amended in 1998) (Basel Accord).

[47] For example, a claim is exempt from the automatic stay in bankruptcy in the United States if it arises under a securities contract or repurchase agreement subject to section 555 or 559 of the Bankruptcy Code, respectively (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407), or the Board's Regulation EE (12 CFR Part 231).

[48] If a banking organization holds the first and junior lien(s) on a residential property and no other party holds an intervening lien, the transaction is treated as a single loan secured by a first lien for the purposes of determining the loan-to-value ratio and assigning a risk weight.

[49] Loans that qualify as loans secured by 1- to 4-family residential properties or multifamily residential properties are listed in the instructions to the FR Y–9C Report. In addition, for risk-based capital purposes, loans secured by 1- to 4-family residential properties include loans to builders with substantial project equity for the construction of 1- to 4-family residences that have been presold under firm contracts to purchasers who have obtained firm commitments for permanent qualifying mortgage loans and have made substantial earnest money deposits. Such loans to builders will be considered prudently underwritten only if the bank holding company has obtained sufficient documentation that the buyer of the home intends to purchase the home (i.e., has a legally binding written sales contract) and has the ability to obtain a mortgage loan sufficient to purchase the home (i.e., has a firm written commitment for permanent financing of the home upon completion).

[50] Residential property loans that do not meet all the specified criteria or that are made for the purpose of speculative property development are placed in the 100 percent risk category.

[51] Prudent underwriting standards include a conservative ratio of the current loan balance to the value of the property. In the case of a loan secured by multifamily residential property, the loan-to-value ratio is not conservative if it exceeds 80 percent (75 percent if the loan is based on a floating interest rate). Prudent underwriting standards also dictate that a loan-to-value ratio used in the case of originating a loan to acquire a property would not be deemed conservative unless the value is based on the lower of the acquisition cost of the property or appraised (or if appropriate, evaluated) value. Otherwise, the loan-to-value ratio generally would be based upon the value of the property as determined by the most current appraisal, or if appropriate, the most current evaluation. All appraisals must be made in a manner consistent with the Federal banking agencies' real estate appraisal regulations and guidelines and with the banking organization's own appraisal guidelines.

property owner is refinancing a loan on that property, all principal and interest payments on the loan being refinanced must have been made on time for at least the year preceding placement in this category; amortization of the principal and interest must occur over a period of not more than 30 years and the minimum original maturity for repayment of principal must not be less than 7 years; and the annual net operating income (before debt service) generated by the property during its most recent fiscal year must not be less than 120 percent of the loan's current annual debt service (115 percent if the loan is based on a floating interest rate) or, in the case of a cooperative or other not-for-profit housing project, the property must generate sufficient cash flow to provide comparable protection to the institution. Also included in this category are privately-issued mortgage-backed securities provided that:

(1) The structure of the security meets the criteria described in section III(B)(3) above;

(2) if the security is backed by a pool of conventional mortgages, on 1- to 4-family residential or multifamily residential properties, each underlying mortgage meets the criteria described above in this section for eligibility for the 50 percent risk category at the time the pool is originated;

(3) If the security is backed by privately-issued mortgage-backed securities, each underlying security qualifies for the 50 percent risk category; and

(4) If the security is backed by a pool of multifamily residential mortgages, principal and interest payments on the security are not 30 days or more past due. Privately-issued mortgage-backed securities that do not meet these criteria or that do not qualify for a lower risk weight are generally assigned to the 100 percent risk category.

Also assigned to this category are *revenue* (non-general obligation) bonds or similar obligations, including loans and leases, that are obligations of states or other political subdivisions of the U.S. (for example, municipal revenue bonds) or other countries of the OECD-based group, but for which the government entity is committed to repay the debt with revenues from the specific projects financed, rather than from general tax funds.

Credit equivalent amounts of derivative contracts involving standard risk obligors (that is, obligors whose loans or debt securities would be assigned to the 100 percent risk category) are included in the 50 percent category, unless they are backed by collateral or guarantees that allow them to be placed in a lower risk category.

4. *Category 4: 100 percent*. a. All assets not included in the categories above are assigned to this category, which comprises standard risk assets. The bulk of the assets typically found in a loan portfolio would be assigned to the 100 percent category.

b. This category includes long-term claims on, and the portions of long-term claims that are guaranteed by, non-OECD banks, and all claims on non-OECD central governments that entail some degree of transfer risk.[52] This category includes all claims on foreign and domestic private-sector obligors not included in the categories above (including loans to nondepository financial institutions and bank holding companies); claims on commercial firms owned by the public sector; customer liabilities to the organization on acceptances outstanding involving standard risk claims;[53] investments in fixed assets, premises, and other real estate owned; common and preferred stock of corporations, including stock acquired for debts previously contracted; all stripped mortgage-backed securities and similar instruments; and commercial and consumer loans (except those assigned to lower risk categories due to recognized guarantees or collateral and loans secured by residential property that qualify for a lower risk weight). This category also includes claims representing capital of a qualifying securities firm.

c. Also included in this category are industrial-development bonds and similar obligations issued under the auspices of states or political subdivisions of the OECD-based group of countries for the benefit of a private party or enterprise where that party or enterprise, not the government entity, is obligated to pay the principal and interest, and all obligations of states or political subdivisions of countries that do not belong to the OECD-based group.

d. The following assets also are assigned a risk weight of 100 percent if they have not been deducted from capital: investments in unconsolidated companies, joint ventures, or associated companies; instruments that qualify as capital issued by other banking organizations; and any intangibles, including

[52] Such assets include all nonlocal currency claims on, and the portions of claims that are guaranteed by, non-OECD central governments and those portions of local currency claims on, or guaranteed by, non-OECD central governments that exceed the local currency liabilities held by subsidiary depository institutions.

[53] Customer liabilities on acceptances outstanding involving nonstandard risk claims, such as claims on U.S. depository institutions, are assigned to the risk category appropriate to the identity of the obligor or, if relevant, the nature of the collateral or guarantees backing the claims. Portions of acceptances conveyed as risk participations to U.S. depository institutions or foreign banks are assigned to the 20 percent risk category appropriate to short-term claims guaranteed by U.S. depository institutions and foreign banks.

those that may have been grandfathered into capital.

*D. Off-Balance Sheet Items*

The face amount of an off-balance sheet item is generally incorporated into risk-weighted assets in two steps. The face amount is first multiplied by a credit conversion factor, except for direct credit substitutes and recourse obligations as discussed in section III.D.1. of this appendix. The resultant credit equivalent amount is assigned to the appropriate risk category according to the obligor or, if relevant, the guarantor, the nature of any collateral, or external credit ratings.[54]

1. *Items with a 100 percent conversion factor.* a. Except as otherwise provided in section III.B.3. of this appendix, the full amount of an asset or transaction supported, in whole or in part, by a direct credit substitute or a recourse obligation. Direct credit substitutes and recourse obligations are defined in section III.B.3. of this appendix.

b. Sale and repurchase agreements and forward agreements. Forward agreements are legally binding contractual obligations to purchase assets with certain drawdown at a specified future date. Such obligations include forward purchases, forward forward deposits placed,[55] and partly-paid shares and securities; they do not include commitments to make residential mortgage loans or forward foreign exchange contracts.

c. Securities lent by a banking organization are treated in one of two ways, depending upon whether the lender is at risk of loss. If a banking organization, as agent for a customer, lends the customer's securities and does not indemnify the customer against loss, then the transaction is excluded from the risk-based capital calculation. If, alternatively, a banking organization lends its own securities or, acting as agent for a customer, lends the customer's securities and indemnifies the customer against loss, the transaction is converted at 100 percent and assigned to the risk weight category appropriate to the obligor, or, if applicable, to any collateral delivered to the lending organization, or the independent custodian acting on the lending organization's behalf. Where a banking organization is acting as agent for a customer in a transaction involving the lending or sale of securities that is collateralized by cash delivered to the banking organization, the transaction is deemed to be collateralized by cash on deposit in a subsidiary depository institution for purposes of determining the appropriate risk-weight category, provided that any indemnification is limited to no more than the difference between the market value of the securities and the cash collateral received and any reinvestment risk associated with that cash collateral is borne by the customer.

d. In the case of direct credit substitutes in which a risk participation[56] has been conveyed, the full amount of the assets that are supported, in whole or in part, by the credit enhancement are converted to a credit equivalent amount at 100 percent. However, the *pro rata* share of the credit equivalent amount that has been conveyed through a risk participation is assigned to whichever risk category is lower: the risk category appropriate to the obligor, after considering any relevant guarantees or collateral, or the risk category appropriate to the institution acquiring the participation.[57] Any remainder is assigned to the risk category appropriate to the obligor, guarantor, or collateral. For example, the *pro rata* share of the full amount of the assets supported, in whole or in part, by a direct credit substitute conveyed as a risk participation to a U.S. domestic depository institution or foreign bank is assigned to the 20 percent risk category.[58]

e. In the case of direct credit substitutes in which a risk participation has been acquired, the acquiring banking organization's percentage share of the direct credit substitute is multiplied by the full amount of the assets that are supported, in whole or in part, by the credit enhancement and converted to a credit equivalent amount at 100 percent. The credit equivalent amount of an acquisition of

[54] The sufficiency of collateral and guarantees for off-balance-sheet items is determined by the market value of the collateral or the amount of the guarantee in relation to the face amount of the item, except for derivative contracts, for which this determination is generally made in relation to the credit equivalent amount. Collateral and guarantees are subject to the same provisions noted under section III.B of this appendix A.

[55] Forward forward deposits accepted are treated as interest rate contracts.

[56] That is, a participation in which the originating banking organization remains liable to the beneficiary for the full amount of the direct credit substitute if the party that has acquired the participation fails to pay when the instrument is drawn.

[57] A risk participation in bankers acceptances conveyed to other institutions is also assigned to the risk category appropriate to the institution acquiring the participation or, if relevant, the guarantor or nature of the collateral.

[58] Risk participations with a remaining maturity of over one year that are conveyed to non-OECD banks are to be assigned to the 100 percent risk category, unless a lower risk category is appropriate to the obligor, guarantor, or collateral.

a risk participation in a direct credit substitute is assigned to the risk category appropriate to the account party obligor or, if relevant, the nature of the collateral or guarantees.

f. In the case of direct credit substitutes that take the form of a syndication where each banking organization is obligated only for its pro rata share of the risk and there is no recourse to the originating banking organization, each banking organization will only include its pro rata share of the assets supported, in whole or in part, by the direct credit substitute in its risk-based capital calculation.[59]

2. *Items with a 50 percent conversion factor*. a. Transaction-related contingencies are converted at 50 percent. Such contingencies include bid bonds, performance bonds, warranties, standby letters of credit related to particular transactions, and performance standby letters of credit, as well as acquisitions of risk participation in performance standby letters of credit. Peformance standby letters of credit represent obligations backing the performance of nonfinancial or commercial contracts or undertakings. To the extent permitted by law or regulation, performance standby letters of credit include arrangements backing, among other things, subcontractors' and suppliers' performance, labor and materials contracts, and construction bids.

b. The unused portion of commitments with an *original* maturity exceeding one year, including underwriting commitments, and commercial and consumer credit commitments also are converted at 50 percent. Original maturity is defined as the length of time between the date the commitment is issued and the earliest date on which: (1) The banking organization can, at its option, unconditionally (without cause) cancel the commitment;[60] and (2) the banking organization is scheduled to (and as a normal practice actually does) review the facility to determine whether or not it should be extended. Such reviews must continue to be conducted at least annually for such a facility to qualify as a short-term commitment.

c.i. Commitments are defined as any legally binding arrangements that obligate a banking organization to extend credit in the form of loans or leases; to purchase loans, securities, or other assets; or to participate in loans and leases. They also include overdraft facilities, revolving credit, home equity and mortgage lines of credit, eligible ABCP liquidity facilities, and similar transactions. Normally, commitments involve a written contract or agreement and a commitment fee, or some other form of consideration. Commitments are included in weighted-risk assets regardless of whether they contain ''material adverse change'' clauses or other provisions that are intended to relieve the issuer of its funding obligation under certain conditions. In the case of commitments structured as syndications, where the banking organization is obligated solely for its *pro rata* share, only the organization's proportional share of the syndicated commitment is taken into account in calculating the risk-based capital ratio.

ii. Banking organizations that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of over one year that are carried in the trading account at 50 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes, and assessed the appropriate risk-based capital treatment in accordance with section III.B.3. of this appendix.

d. Once a commitment has been converted at 50 percent, any portion that has been conveyed to U.S. depository institutions or OECD banks as participations in which the originating banking organization retains the full obligation to the borrower if the participating bank fails to pay when the instrument is drawn, is assigned to the 20 percent risk category. This treatment is analogous to that accorded to conveyances of risk participations in standby letters of credit. The acquisition of a participation in a commitment by a banking organization is converted at 50 percent and assigned to the risk category appropriate to the account party obligor or, if relevant, the nature of the collateral or guarantees.

e. Revolving underwriting facilities (RUFs), note issuance facilities (NIFs), and other similar arrangements also are converted at 50 percent regardless of maturity.

[59] For example, if a banking organization has a 10 percent share of a $10 syndicated direct credit substitute that provides credit support to a $100 loan, then the banking organization's $1 *pro rata* share in the enhancement means that a $10 *pro rata* share of the loan is included in risk weighted assets.

[60] In the case of consumer home equity or mortgage lines of credit secured by liens on 1–4 family residential properties, the bank is deemed able to unconditionally cancel the commitment for the purpose of this criterion if, at its option, it can prohibit additional extensions of credit, reduce the credit line, and terminate the commitment to the full extent permitted by relevant Federal law.

These are facilities under which a borrower can issue on a revolving basis short-term paper in its own name, but for which the underwriting organizations have a legally binding commitment either to purchase any notes the borrower is unable to sell by the roll-over date or to advance funds to the borrower.

3. *Items with a 20 percent conversion factor*. Short-term, self-liquidating trade-related contingencies which arise from the movement of goods are converted at 20 percent. Such contingencies generally include commercial letters of credit and other documentary letters of credit collateralized by the underlying shipments.

4. *Items with a 10 percent conversion factor*. a. Unused portions of eligible ABCP liquidity facilities with an original maturity of one year or less also are converted at 10 percent.

b. Banking organizations that are subject to the market risk rules are required to convert the notional amount of eligible ABCP liquidity facilities, in form or in substance, with an original maturity of one year or less that are carried in the trading account at 10 percent to determine the appropriate credit equivalent amount even though those facilities are structured or characterized as derivatives or other trading book assets. Liquidity facilities that support ABCP, in form or in substance, (including those positions to which the market risk rules may not be applied as set forth in section 2(a) of appendix E of this part) that are not eligible ABCP liquidity facilities are to be considered recourse obligations or direct credit substitutes and assessed the appropriate risk-based capital requirement in accordance with section III.B.3. of this appendix.

5. *Items with a zero percent conversion factor*. These include unused portions of commitments (with the exception of eligible ABCP liquidity facilities) with an original maturity of one year or less, or which are unconditionally cancelable at any time, provided a separate credit decision is made before each drawing under the facility. Unused portions of lines of credit on retail credit cards and related plans are deemed to be short-term commitments if the banking organization has the unconditional right to cancel the line of credit at any time, in accordance with applicable law.

*E. Derivative Contracts (Interest Rate, Exchange Rate, Commodity- (including precious metals) and Equity-Linked Contracts)*

1. *Scope*. Credit equivalent amounts are computed for each of the following off-balance-sheet derivative contracts:

a. Interest Rate Contracts. These include single currency interest rate swaps, basis swaps, forward rate agreements, interest rate options purchased (including caps, collars, and floors purchased), and any other instrument linked to interest rates that gives rise to similar credit risks (including when-issued securities and forward forward deposits accepted).

b. Exchange Rate Contracts. These include cross-currency interest rate swaps, forward foreign exchange contracts, currency options purchased, and any other instrument linked to exchange rates that gives rise to similar credit risks.

c. Equity Derivative Contracts. These include equity-linked swaps, equity-linked options purchased, forward equity-linked contracts, and any other instrument linked to equities that gives rise to similar credit risks.

d. Commodity (including precious metal) Derivative Contracts. These include commodity-linked swaps, commodity-linked options purchased, forward commodity-linked contracts, and any other instrument linked to commodities that gives rise to similar credit risks.

e. Exceptions. Exchange rate contracts with an original maturity of fourteen or fewer calendar days and derivative contracts traded on exchanges that require daily receipt and payment of cash variation margin may be excluded from the risk-based ratio calculation. Gold contracts are accorded the same treatment as exchange rate contracts except that gold contracts with an original maturity of fourteen or fewer calendar days are included in the risk-based ratio calculation. Over-the-counter options purchased are included and treated in the same way as other derivative contracts.

2. *Calculation of credit equivalent amounts*. a. The credit equivalent amount of a derivative contract that is not subject to a qualifying bilateral netting contract in accordance with section III.E.3. of this appendix A is equal to the sum of (i) the current exposure (sometimes referred to as the replacement cost) of the contract; and (ii) an estimate of the potential future credit exposure of the contract.

b. The current exposure is determined by the mark-to-market value of the contract. If the mark-to-market value is positive, then the current exposure is equal to that mark-to-market value. If the mark-to-market value is zero or negative, then the current exposure is zero. Mark-to-market values are measured in dollars, regardless of the currency or currencies specified in the contract and should reflect changes in underlying rates, prices, and indices, as well as counterparty credit quality.

c. The potential future credit exposure of a contract, including a contract with a negative mark-to-market value, is estimated by multiplying the notional principal amount of the contract by a credit conversion factor. Banking organizations should use, subject to examiner review, the effective rather than the apparent or stated notional amount in this calculation. The credit conversion factors are:

CONVERSION FACTORS

[In percent]

| Remaining maturity | Interest rate | Exchange rate and gold | Equity | Commodity, excluding precious metals | Precious metals, except gold |
|---|---|---|---|---|---|
| One year or less | 0.0 | 1.0 | 6.0 | 10.0 | 7.0 |
| Over one to five years | 0.5 | 5.0 | 8.0 | 12.0 | 7.0 |
| Over five years | 1.5 | 7.5 | 10.0 | 15.0 | 8.0 |

d. For a contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity is equal to the time until the next reset date. For an interest rate contract with a remaining maturity of more than one year that meets these criteria, the minimum conversion factor is 0.5 percent.

e. For a contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the contract. A derivative contract not included in the definitions of interest rate, exchange rate, equity, or commodity contracts as set forth in section III.*E*.1. of this appendix A is subject to the same conversion factors as a commodity, excluding precious metals.

f. No potential future exposure is calculated for a single currency interest rate swap in which payments are made based upon two floating rate indices (a so called floating/floating or basis swap); the credit exposure on such a contract is evaluated solely on the basis of the mark-to-market value.

g. The Board notes that the conversion factors set forth above, which are based on observed volatilities of the particular types of instruments, are subject to review and modification in light of changing volatilities or market conditions.

3. *Netting*. a. For purposes of this appendix A, netting refers to the offsetting of positive and negative mark-to-market values when determining a current exposure to be used in the calculation of a credit equivalent amount. Any legally enforceable form of bilateral netting (that is, netting with a single counterparty) of derivative contracts is recognized for purposes of calculating the credit equivalent amount provided that:

i. The netting is accomplished under a written netting contract that creates a single legal obligation, covering all included individual contracts, with the effect that the banking organization would have a claim to receive, or obligation to pay, only the net amount of the sum of the positive and negative mark-to-market values on included individual contracts in the event that a counterparty, or a counterparty to whom the contract has been validly assigned, fails to perform due to any of the following events: default, insolvency, liquidation, or similar circumstances.

ii. The banking organization obtains a written and reasoned legal opinion(s) representing that in the event of a legal challenge—including one resulting from default, insolvency, liquidation, or similar circumstances—the relevant court and administrative authorities would find the banking organization's exposure to be the net amount under:

*1*. The law of the jurisdiction in which the counterparty is chartered or the equivalent location in the case of noncorporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

*2*. The law that governs the individual contracts covered by the netting contract; and

*3*. The law that governs the netting contract.

iii. The banking organization establishes and maintains procedures to ensure that the legal characteristics of netting contracts are kept under review in the light of possible changes in relevant law.

iv. The banking organization maintains in its files documentation adequate to support the netting of derivative contracts, including a copy of the bilateral netting contract and necessary legal opinions.

b. A contract containing a walkaway clause is not eligible for netting for purposes of calculating the credit equivalent amount.[61]

c. A banking organization netting individual contracts for the purpose of calculating credit equivalent amounts of derivative contracts represents that it has met the requirements of this appendix A and all the appropriate documents are in the banking

[61] A walkaway clause is a provision in a netting contract that permits a non-defaulting counterparty to make lower payments than it would make otherwise under the contract, or no payment at all, to a defaulter or to the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the contract.

organization's files and available for inspection by the Federal Reserve. The Federal Reserve may determine that a banking organization's files are inadequate or that a netting contract, or any of its underlying individual contracts, may not be legally enforceable under any one of the bodies of law described in section III.*E*.3.a.ii. of this appendix A. If such a determination is made, the netting contract may be disqualified from recognition for risk-based capital purposes or underlying individual contracts may be treated as though they are not subject to the netting contract.

d. The credit equivalent amount of contracts that are subject to a qualifying bilateral netting contract is calculated by adding (i) the current exposure of the netting contract (net current exposure) and (ii) the sum of the estimates of potential future credit exposures on all individual contracts subject to the netting contract (gross potential future exposure) adjusted to reflect the effects of the netting contract.[62]

e. The net current exposure is the sum of all positive and negative mark-to-market values of the individual contracts included in the netting contract. If the net sum of the mark-to-market values is positive, then the net current exposure is equal to that sum. If the net sum of the mark-to-market values is zero or negative, then the net current exposure is zero. The Federal Reserve may determine that a netting contract qualifies for risk-based capital netting treatment even though certain individual contracts included under the netting contract may not qualify. In such instances, the nonqualifying contracts should be treated as individual contracts that are not subject to the netting contract.

f. Gross potential future exposure, or $A_{gross}$ is calculated by summing the estimates of potential future exposure (determined in accordance with section III.*E*.2 of this appendix A) for each individual contract subject to the qualifying bilateral netting contract.

g. The effects of the bilateral netting contract on the gross potential future exposure are recognized through the application of a formula that results in an adjusted add-on amount ($A_{net}$). The formula, which employs the ratio of net current exposure to gross current exposure (NGR), is expressed as:

$$A_{net} = (0.4 \times A_{gross}) + 0.6(NGR \times A_{gross})$$

h. The NGR may be calculated in accordance with either the counterparty-by-counterparty approach or the aggregate approach.

i. Under the counterparty-by-counterparty approach, the NGR is the ratio of the net current exposure for a netting contract to the gross current exposure of the netting contract. The gross current exposure is the sum of the current exposures of all individual contracts subject to the netting contract calculated in accordance with section III.*E*.2. of this appendix A. Net negative mark-to-market values for individual netting contracts with the same counterparty may not be used to offset net positive mark-to-market values for other netting contracts with the same counterparty.

ii. Under the aggregate approach, the NGR is the ratio of the sum of all of the net current exposures for qualifying bilateral netting contracts to the sum of all of the gross current exposures for those netting contracts (each gross current exposure is calculated in the same manner as in section III.*E*.3.h.i. of this appendix A). Net negative mark-to-market values for individual counterparties may not be used to offset net positive current exposures for other counterparties.

iii. A banking organization must use consistently either the counterparty-by-counterparty approach or the aggregate approach to calculate the NGR. Regardless of the approach used, the NGR should be applied individually to each qualifying bilateral netting contract to determine the adjusted add-on for that netting contract.

i. In the event a netting contract covers contracts that are normally excluded from the risk-based ratio calculation—for example, exchange rate contracts with an original maturity of fourteen or fewer calendar days or instruments traded on exchanges that require daily payment and receipt of cash variation margin—an institution may elect to either include or exclude all mark-to-market values of such contracts when determining net current exposure, provided the method chosen is applied consistently.

4. *Risk Weights*. Once the credit equivalent amount for a derivative contract, or a group of derivative contracts subject to a qualifying bilateral netting contract, has been determined, that amount is assigned to the risk category appropriate to the counterparty, or, if relevant, the guarantor or the nature of any collateral.[63] However,

[62] For purposes of calculating potential future credit exposure to a netting counterparty for foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, total notional principal is defined as the net receipts falling due on each value date in each currency.

[63] For derivative contracts, sufficiency of collateral or guarantees is generally determined by the market value of the collateral or the amount of the guarantee in relation to the credit equivalent amount. Collateral

the maximum risk weight applicable to the credit equivalent amount of such contracts is 50 percent.

5. *Avoidance of double counting.* a. In certain cases, credit exposures arising from the derivative contracts covered by section III.*E.* of this appendix A may already be reflected, in part, on the balance sheet. To avoid double counting such exposures in the assessment of capital adequacy and, perhaps, assigning inappropriate risk weights, counterparty credit exposures arising from the derivative instruments covered by these guidelines may need to be excluded from balance sheet assets in calculating a banking organization's risk-based capital ratios.

b. Examples of the calculation of credit equivalent amounts for contracts covered under this section III.*E.* are contained in Attachment V of this appendix A.

## IV. Minimum Supervisory Ratios and Standards

The interim and final supervisory standards set forth below specify *minimum* supervisory ratios based primarily on broad credit risk considerations. As noted above, the risk-based ratio does not take explicit account of the quality of individual asset portfolios or the range of other types of risks to which banking organizations may be exposed, such as interest rate, liquidity, market or operational risks. For this reason, banking organizations are generally expected to operate with capital positions well above the minimum ratios.

Institutions with high or inordinate levels of risk are expected to operate well above minimum capital standards. Banking organizations experiencing or anticipating significant growth are also expected to maintain capital, including tangible capital positions, well above the minimum levels. For example, most such organizations generally have operated at capital levels ranging from 100 to 200 basis points above the stated minimums. Higher capital ratios could be required if warranted by the particular circumstances or risk profiles of individual banking organizations. In all cases, organizations should hold capital commensurate with the level and nature of all of the risks, including the volume and severity of problem loans, to which they are exposed.

Upon adoption of the risk-based framework, any organization that does not meet the interim or final supervisory ratios, or whose capital is otherwise considered inadequate, is expected to develop and implement a plan acceptable to the Federal Reserve for achieving an adequate level of capital consistent with the provisions of these guidelines or with the special circumstances affecting the individual organization. In addition, such organizations should avoid any actions, including increased risk-taking or unwarranted expansion, that would lower or further erode their capital positions.

### *A. Minimum Risk-Based Ratio After Transition Period*

As reflected in Attachment VI, by year-end 1992, all bank holding companies[64] should meet a minimum ratio of qualifying total capital to weighted risk assets of 8 percent, of which at least 4.0 percentage points should be in the form of Tier 1 capital. For purposes of section IV.A., Tier 1 capital is defined as the sum of core capital elements less goodwill and other intangible assets required to be deducted in accordance with section II.B.1.b. of this appendix. The maximum amount of supplementary capital elements that qualifies as Tier 2 capital is limited to 100 percent of Tier 1 capital. In addition, the combined maximum amount of subordinated debt and intermediate-term preferred stock that qualifies as Tier 2 capital is limited to 50 percent of Tier 1 capital. The maximum amount of the allowance for loan and lease losses that qualifies as Tier 2 capital is limited to 1.25 percent of gross weighted risk assets. Allowances for loan and lease losses in excess of this limit may, of course, be maintained, but would not be included in an organization's total capital. The Federal Reserve will continue to require bank holding companies to maintain reserves at levels fully sufficient to cover losses inherent in their loan portfolios.

Qualifying total capital is calculated by adding Tier 1 capital and Tier 2 capital (limited to 100 percent of Tier 1 capital) and then deducting from this sum certain investments in banking or finance subsidiaries that are not consolidated for accounting or supervisory purposes, reciprocal holdings of banking organizations' capital securities, or other items at the direction of the Federal Reserve. The conditions under which these deductions are to be made and the procedures for making the deductions are discussed above in section II(B).

### *B. Transition Arrangements*

The transition period for implementing the risk-based capital standard ends on December 31, 1992. Initially, the risk-based capital guidelines do not establish a minimum level

and guarantees are subject to the same provisions noted under section III.*B.* of this appendix A.

[64] As noted in section I, bank holding companies with less than $500 million in consolidated assets would generally be exempt from the calculation and analysis of risk-based ratios on a consolidated holding company basis, subject to certain terms and conditions.

of capital. However, by year-end 1990, banking organizations are expected to meet a minimum interim target ratio for qualifying total capital to weighted risk assets of 7.25 percent, at least one-half of which should be in the form of Tier 1 capital. For purposes of meeting the 1990 interim target, the amount of loan loss reserves that may be included in capital is limited to 1.5 percent of weighted risk assets and up to 10 percent of an organization's Tier 1 capital may consist of supplementary capital elements. Thus, the 7.25 percent interim target ratio implies a minimum ratio of Tier 1 capital to weighted risk assets of 3.6 percent (one-half of 7.25) and a minimum ratio of core capital elements to weighted risk assets ratio of 3.25 percent (nine-tenths of the Tier 1 capital ratio).

Through year-end 1990, banking organizations have the option of complying with the minimum 7.25 percent year-end 1990 risk-based capital standard, in lieu of the minimum 5.5 percent primary and 6 percent total capital to total assets ratios set forth in appendix B of this part. In addition, as more fully set forth in appendix D to this part, banking organizations are expected to maintain a minimum ratio of Tier 1 capital to total assets during this transition period.

## ATTACHMENT I—SAMPLE CALCULATION OF RISK-BASED CAPITAL RATIO FOR BANK HOLDING COMPANIES

Example of a banking organization with $6,000 in total capital and the following assets and off-balance sheet items:

| | |
|---|---|
| Balance Sheet Assets: | |
| Cash | $5,000 |
| U.S. Treasuries | 20,000 |
| Balances at domestic banks | 5,000 |
| Loans secured by first liens on 1–4 family residential properties | 5,000 |
| Loans to private corporations | 65,000 |
| Total Balance Sheet Assets | $100,000 |
| Off-Balance Sheet Items: | |
| Standby letters of credit (''SLCs'') backing general obligation debt issues of U.S. municipalities (''GOs'') | $10,000 |
| Long-term legally binding commitments to private corporations | 20,000 |
| Total Off/Balance Sheet Items | $30,000 |

This bank holding company's total capital to *total* assets (leverage) ratio would be: ($6,000/$100,000)=6.00%.

To compute the bank holding company's weighted risk assets:

1. Compute the credit equivalent amount of each off-balance sheet (''OBS'') item.

| OBS item | Face value | | Conversion factor | | Credit equivalent amount |
|---|---|---|---|---|---|
| SLCS backing municipal GOs | $10,000 | × | 1.00 | = | $10,000 |
| Long-term commitments to private corporations | $20,000 | × | 0.50 | = | $10,000 |
| 2. Multiply each balance sheet asset and the credit equivalent amount of each OBS item by the appropriate risk weight. | | | | | |
| 0% Category: | | | | | |
| Cash | 5,000 | | | | |
| U.S. Treasuries | 20,000 | | | | |
| | 25,000 | × | 0 | = | 0 |
| 20% Category: | | | | | |
| Balances at domestic banks | 5,000 | | | | |
| Credit equivalent amounts of SLCs backing GOs of U.S. municipalities | 10,000 | | | | |
| | 15,000 | × | .20 | = | $3,000 |
| 50% Category: | | | | | |
| Loans secured by first liens on 1–4 family residential properties | 5,000 | × | .50 | = | $2,500 |
| 100% Category: | | | | | |
| Loans to private corporations | 65,000 | | | | |
| Credit equivalent amounts of long-term commitments to private corporations | 10,000 | | | | |
| | $75,000 | × | 1.00 | = | 75,000 |
| Total Risk-weighted Assets | | | | | 80,500 |

This bank holding company's ratio of total capital to weighted risk assets (risk-based capital ratio) would be: ($6,000/$80,500)=7.45%

[Reg. Y, 54 FR 4209, Jan. 27, 1989]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting appendix A to part 225, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

EFFECTIVE DATE NOTE: At 73 FR 79606, Dec. 30, 2008, appendix A of part 225 was amended in section II.B. by revising paragraphs 1.a., 1.e.iii., and 1.f. effective Jan. 29, 2009. For the convenience of the user, the revised text is set forth as follows:

## APPENDIX A TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: RISK-BASED MEASURE

* * * * *

II. * * *

B. * * *

1. * * *

a. *Goodwill*. Goodwill is an intangible asset that represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. Goodwill is deducted from the sum of core capital elements in determining tier 1 capital.

* * * * *

e. * * *

iii. Bank holding companies may elect to deduct goodwill, disallowed mortgage servicing assets, disallowed nonmortgage servicing assets, and disallowed credit-enhancing I/Os (both purchased and retained) on a basis that is net of any associated deferred tax liability. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income.

f. *Valuation*. Bank holding companies must review the book value of goodwill and other intangible assets at least quarterly and make adjustments to these values as necessary. The fair value of mortgage servicing assets, nonmortgage servicing assets, purchased credit card relationships, and credit-enhancing I/Os also must be determined at least quarterly. This determination shall include adjustments for any significant changes in original valuation assumptions, including changes in prepayment estimates or account attrition rates. Examiners will review both the book value and the fair value assigned to these assets, together with supporting documentation, during the inspection process. In addition, the Federal Reserve may require, on a case-by-case basis, an independent valuation of a bank holding company's goodwill, other intangible assets, or credit-enhancing I/Os.

* * * * *

## APPENDIX B TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES AND STATE MEMBER BANKS: LEVERAGE MEASURE

The Board of Governors of the Federal Reserve System has adopted minimum capital ratios and guidelines to provide a framework for assessing the adequacy of the capital of bank holding companies and state member banks (collectively ''banking organizations''). The guidelines generally apply to all state member banks and bank holding companies regardless of size and are to be used in the examination and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. The Board of Governors will review the guidelines from time to time for possible adjustment commensurate with changes in the economy, financial markets, and banking practices. In this regard, the Board has determined that during the transition period through year-end 1990 for implementation of the risk-based capital guidelines contained in appendix A to this part and in appendix A to part 208, a banking organization may choose to fulfill the requirements of the guidelines relating capital to total assets contained in this appendix in one of two manners. Until year-end 1990, a banking organization may choose to conform to either the 5.5 percent and 6 percent minimum primary and total capital standards set forth in this appendix, or the 7.25 percent year-end 1990 minimum risk-based capital standard set forth in appendix A to this part and appendix A to part 208. Those organizations that choose to conform during this period to the 7.25 percent year-end 1990 risk-based capital standard will be deemed to be in compliance with the capital adequacy guidelines set forth in this appendix.

Two principal measurements of capital are used—the primary capital ratio and the total capital ratio. The definitions of primary and total capital for banks and bank holding companies and formulas for calculating the capital ratios are set forth below in the definitional sections of these guidelines.

### CAPITAL GUIDELINES

The Board has established a minimum level of primary capital to total assets of 5.5 percent and a minimum level of total capital to total assets of 6.0 percent. Generally, banking organizations are expected to operate above the minimum primary and total capital levels. Those organizations whose operations involve or are exposed to high or inordinate degrees of risk will be expected to hold additional capital to compensate for these risks.

In addition, the Board has established the following three zones for total capital for banking organizations of all sizes:

TOTAL CAPITAL RATIO

[In percent]

| | |
|---|---|
| Zone 1 | Above 7.0. |
| Zone 2 | 6.0 to 7.0. |
| Zone 3 | Below 6.0. |

The capital guidelines assume adequate liquidity and a moderate amount of risk in the loan and investment portfolios and in off-

balance sheet activities. The Board is concerned that some banking organizations may attempt to comply with the guidelines in ways that reduce their liquidity or increase risk. Banking organizations should avoid the practice of attempting to meet the guidelines by decreasing the level of liquid assets in relation to total assets. In assessing compliance with the guidelines, the Federal Reserve will take into account liquidity and the overall degree of risk associated with an organization's operations, including the volume of assets exposed to risk.

The Federal Reserve will also take into account the sale of loans or other assets with recourse and the volume and nature of all off-balance sheet risk. Particularly close attention will be directed to risks associated with standby letters of credit and participation in joint venture activities. The Federal Reserve will review the relationship of all on- and off-balance sheet risks to capital and will require those institutions with high or inordinate levels of risk to hold additional primary capital. In addition, the Federal Reserve will continue to review the need for more explicit procedures for factoring on- and off-balance sheet risks into the assessment of capital adequacy.

The capital guidelines apply to both banks and bank holding companies on a consolidated basis.[1] Some banking organizations are engaged in significant nonbanking activities that typically require capital ratios higher than those of commercial banks alone. The Board believes that, as a matter of both safety and soundness and competitive equity, the degree of leverage common in banking should not automatically extend to nonbanking activities. Consequently, in evaluating the consolidated capital positions of banking organizations, the Board is placing greater weight on the building-block approach for assessing capital requirements. This approach generally provides that nonbank subsidiaries of a banking organization should maintain levels of capital consistent with the levels that have been established by industry norms or standards, by Federal or State regulatory agencies for similar firms that are not affiliated with banking organizations, or that may be established by the Board after taking into account risk factors of a particular industry. The assessment of an organization's consolidated capital adequacy must take into account the amount and nature of all nonbank activities, and an institution's consolidated capital position should at least equal the sum of the capital requirements of the organization's bank and nonbank subsidiaries as well as those of the parent company.

SUPERVISORY ACTION

The nature and intensity of supervisory action will be determined by an organization's compliance with the required minimum primary capital ratio as well as by the zone in which the company's total capital ratio falls. Banks and bank holding companies with primary capital ratios below the 5.5 percent minimum will be considered undercapitalized unless they can demonstrate clear extenuating circumstances. Such banking organizations will be required to submit an acceptable plan for achieving compliance with the capital guidelines and will be subject to denial of applications and appropriate supervisory enforcement actions.

The zone in which an organization's total capital ratio falls will normally trigger the following supervisory responses, subject to qualitative analysis:

For institutions operating in Zone 1, the Federal Reserve will:

—Consider that capital is generally adequate if the primary capital ratio is acceptable to the Federal Reserve and is above the 5.5 percent minimum.

For institutions operating in Zone 2, the Federal Reserve will:

—Pay particular attention to financial factors, such as asset quality, liquidity, off-balance sheet risk, and interest rate risk, as they relate to the adequacy of capital. If these areas are deficient and the Federal Reserve concludes capital is not fully adequate, the Federal Reserve will intensify its monitoring and take appropriate supervisory action.

For institutions operating in Zone 3, the Federal Reserve will:

—Consider that the institution is undercapitalized, absent clear extenuating circumstances;

—Require the institution to submit a comprehensive capital plan, acceptable to the Federal Reserve, that includes a program for achieving compliance with the required minimum ratios within a reasonable time period; and

—Institute appropriate supervisory and/or administrative enforcement action, which may include the issuance of a capital directive or denial of applications, unless a

[1] The guidelines will apply to bank holding companies with less than $150 million in consolidated assets on a bank-only basis unless:

(1) The holding company or any nonbank subsidiary is engaged directly or indirectly in any nonbank activity involving significant leverage or

(2) The holding company or any nonbank subsidiary has outstanding significant debt held by the general public. Debt held by the general public is defined to mean debt held by parties other than financial institutions, officers, directors, and controlling shareholders of the banking organization or their related interests.

capital plan acceptable to the Federal Reserve has been adopted by the institution.

TREATMENT OF INTANGIBLE ASSETS FOR THE PURPOSE OF ASSESSING THE CAPITAL ADEQUACY OF BANK HOLDING COMPANIES AND STATE MEMBER BANKS

In considering the treatment of intangible assets for the purpose of assessing capital adequacy, the Federal Reserve recognizes that the determination of the future benefits and useful lives of certain intangible assets may involve a degree of uncertainty that is not normally associated with other banking assets. Supervisory concern over intangible assets derives from this uncertainty and from the possibility that, in the event an organization experiences financial difficulties, such assets may not provide the degree of support generally associated with other assets. For this reason, the Federal Reserve will carefully review the level and specific character of intangible assets in evaluating the capital adequacy of state member banks and bank holding companies.

The Federal Reserve recognizes that intangible assets may differ with respect to predictability of any income stream directly associated with a particular asset, the existence of a market for the asset, the ability to sell the asset, or the reliability of any estimate of the asset's useful life. Certain intangible assets have predictable income streams and objectively verifiable values and may contribute to an organization's profitability and overall financial strength. The value of other intangibles, such as goodwill, may involve a number of assumptions and may be more subject to changes in general economic circumstances or to changes in an individual institution's future prospects. Consequently, the value of such intangible assets may be difficult to ascertain. Consistent with prudent banking practices and the principle of the diversification of risks, banking organizations should avoid excessive balance sheet concentration in any category or related categories of intangible assets.

*Bank Holding Companies*

While the Federal Reserve will consider the amount and nature of all intangible assets, those holding companies with aggregate intangible assets in excess of 25 percent of tangible primary capital (i.e., stated primary capital less all intangible assets) or those institutions with lesser, although still significant, amounts of goodwill will be subject to close scrutiny. For the purpose of assessing capital adequacy, the Federal Reserve may, on a case-by-case basis, make adjustments to an organization's capital ratios based upon the amount of intangible assets in excess of the 25 percent threshold level or upon the specific character of the organization's intangible assets in relation to its overall financial condition. Such adjustments may require some organizations to raise additional capital.

The Board expects banking organizations (including state member banks) contemplating expansion proposals to ensure that pro forma capital ratios exceed the minimum capital levels without significant reliance on intangibles, particularly goodwill. Consequently, in reviewing acquisition proposals, the Board will take into consideration both the stated primary capital ratio (that is, the ratio without any adjustment for intangible assets) and the primary capital ratio after deducting intangibles. In acting on applications, the Board will take into account the nature and amount of intangible assets and will, as appropriate, adjust capital ratios to include certain intangible assets on a case-by-case basis.

*State Member Banks*

State member banks with intangible assets in excess of 25 percent of intangible primary capital will be subject to close scrutiny. In addition, for the purpose of calculating capital ratios of state member banks, the Federal Reserve will deduct goodwill from primary capital and total capital. The Federal Reserve may, on a case-by-case basis, make further adjustments to a bank's capital ratios based on the amount of intangible assets (aside from goodwill) in excess of the 25 percent threshold level or on the specific character of the bank's intangible assets in relation to its overall financial condition. Such adjustments may require some banks to raise additional capital.

In addition, state member banks and bank holding companies are expected to review periodically the value at which intangible assets are carried on their balance sheets to determine whether there has been any impairment of value or whether changing circumstances warrant a shortening of amortization periods. Institutions should make appropriate reductions in carrying values and amortization periods in light of this review, and examiners will evaluate the treatment of intangible assets during on-site examinations.

DEFINITION OF CAPITAL TO BE USED IN DETERMINING CAPITAL ADEQUACY OF BANK HOLDING COMPANIES AND STATE MEMBER BANKS

*Primary Capital Components*

The components of primary capital are:

—Common stock,
—Perpetual preferred stock (preferred stock that does not have a stated maturity date and that may not be redeemed at the option of the holder),
—Surplus (excluding surplus relating to limited-life preferred stock),
—Undivided profits,
—Contingency and other capital reserves,

—Mandatory convertible instruments,[2]
—Allowance for possible loan and lease losses (exclusive of allocated transfer risk reserves),
—Minority interest in equity accounts of consolidated subsidiaries,
—Perpetual debt instruments (for bank holding companies but not for state member banks).

*Limits on Certain Forms of Primary Capital*

*Bank Holding Companies*. The maximum composite amount of mandatory convertible securities, perpetual debt, and perpetual preferred stock that may be counted as primary capital for bank holding companies is limited to 33.3 percent of all primary capital, including these instruments. Perpetual preferred stock issued prior to November 20, 1985 (or determined by the Federal Reserve to be in the process of being issued prior to that date), shall continue to be included as primary capital.

The maximum composite amount of mandatory convertible securities and perpetual debt that may be counted as primary capital for bank holding companies is limited to 20 percent of all primary capital, including these instruments. The maximum amount of equity commitment notes (a form of mandatory convertible securities) that may be counted as primary capital for a bank holding company is limited to 10 percent of all primary capital, including mandatory convertible securities. Amounts outstanding in excess of these limitations may be counted as secondary capital provided they meet the requirements of secondary capital instruments.

*State Member Banks*. The composite limitations on the amount of mandatory convertible securities and perpetual preferred stock (perpetual debt is not primary capital for state member banks) that may serve as primary capital for bank holding companies shall not be applied formally to state member banks, although the Board shall determine appropriate limits for these forms of primary capital on a case-by-case basis.

The maximum amount of mandatory convertible securities that may be counted as primary capital for state member banks is limited to 16⅔ percent of all primary capital, including mandatory convertible securities. Equity commitment notes, one form of mandatory convertible securities, shall not be included as primary capital for state member banks, except that notes issued by state member banks prior to May 15, 1985, will continue to be included in primary capital. Amounts of mandatory convertible securities in excess of these limitations may be counted as secondary capital if they meet the requirements of secondary capital instruments.

*Secondary Capital Components*

The components of secondary capital are:

—Limited-life preferred stock (including related surplus) and
—Bank subordinated notes and debentures and unsecured long-term debt of the parent company and its nonbank subsidiaries.

*Restrictions Relating to Capital Components*

To qualify as primary or secondary capital, a capital instrument should not contain or be covered by any convenants, terms, or restrictions that are inconsistent with safe and sound banking practices. Examples of such terms are those regarded as unduly interfering with the ability of the bank or holding company to conduct normal banking operations or those resulting in significantly higher dividends or interest payments in the event of a deterioration in the financial condition of the issuer.

The secondary components must meet the following conditions to qualify as capital:

—The instrument must have an original weighted-average maturity of at least seven years.
—The instrument must be unsecured.
—The instrument must clearly state on its face that it is not a deposit and is not insured by a Federal agency.
—Bank debt instruments must be subordinated to claims of depositors.
—For banks only, the aggregate amount of limited-life preferred stock and subordinate debt qualifying as capital may not exceed 50 percent of the amount of the bank's primary capital.

As secondary capital components approach maturity, the banking organization must plan to redeem or replace the instruments while maintaining an adequate overall capital position. Thus, the remaining maturity of secondary capital components will be an important consideration in assessing the adequacy of total capital.

*Capital Ratios*

The primary and total capital ratios for bank holding companies are computed as follows:

Primary capital ratio:

Primary capital components/Total assets + Allowance for loan and lease losses (exclusive of allocated transfer risk reserves)

Total capital ratio:

Primary capital components + Secondary capital components/Total assets + Allowance for loan and lease losses (exclusive of allocated transfer risk reserves)

[2] See the definitional section below that lists the criteria for mandatory convertible instruments to qualify as primary capital.

The primary and total capital ratios for state member banks are computed as follows:

Primary capital ratio:

Primary capital components—Goodwill/Average total assets + Allowance for loan and lease losses (exclusive of allocated transfer risk reserves)—Goodwill

Total capital ratio:

Primary capital components + Secondary capital components—Goodwill/Average total assets + Allowance for loan and lease losses (exclusive of allocated transfer risk reserves)—Goodwill

Generally, period-end amounts will be used to calculate bank holding company ratios. However, the Federal Reserve will discourage temporary balance sheet adjustments or any other ''window dressing'' practices designed to achieve transitory compliance with the guidelines. Banking organizations are expected to maintain adequate capital positions at all times. Thus, the Federal Reserve will, on a case-by-case basis, use average total assets in the calculation of bank holding company capital ratios whenever this approach provides a more meaningful indication of an individual holding company's capital position.

For the calculation of bank capital ratios, ''average total assets'' will generally be defined as the quarterly average total assets figure reported on the bank's Report of Condition. If warranted, however, the Federal Reserve may calculate bank capital ratios based upon total assets as of period-end. All other components of the bank's capital ratios will be based upon period-end balances.

CRITERIA FOR DETERMINING THE PRIMARY CAPITAL STATUS OF MANDATORY CONVERTIBLE SECURITIES OF BANK HOLDING COMPANIES AND STATE MEMBER BANKS

Mandatory convertible securities are subordinated debt instruments that are eventually transformed into common or perpetual preferred stock within a specified period of time, not to exceed 12 years. To be counted as primary capital, mandatory convertible securities must meet the criteria set forth below. These criteria cover the two basic types of mandatory convertible securities: ''equity contract notes''—securities that obligate the holder to take common or perpetual preferred stock of the issuer in lieu of cash for repayment of principal, and ''equity commitment notes''—securities that are redeemable only with the proceeds from the sale of common or perpetual preferred stock. Both equity commitment notes and equity contract notes qualify as primary capital for bank holding companies, but only equity contract notes qualify as primary capital for banks.

*Criteria Applicable to Both Types of Mandatory Convertible Securities*

a. The securities must mature in 12 years or less.

b. The issuer may redeem securities prior to maturity only with the proceeds from the sale of common or perpetual preferred stock of the bank or bank holding company. Any exception to this rule must be approved by the Federal Reserve. The securities may not be redeemed with the proceeds of another issue of mandatory convertible securities. Nor may the issuer repurchase or acquire its own mandatory convertible securities for resale or reissuance.

c. Holders of the securities may not accelerate the payment of principal except in the event of bankruptcy, insolvency, or reorganization.

d. The securities must be subordinate in right of payment to all senior indebtedness of the issuer. In the event that the proceeds of the securities are reloaned to an affiliate, the loan must be subordinated to the same degree as the original issue.

e. An issuer that intends to dedicate the proceeds of an issue of common or perpetual preferred stock to satisfy the funding requirements of an issue of mandatory convertible securities (i.e. the requirement to retire or redeem the notes with the proceeds from the issuance of common or perpetual preferred stock) generally must make such a dedication during the quarter in which the new common or preferred stock is issued.[3] As a general rule, if the dedication is not made within the prescribed period, then the securities issued may not at a later date be dedicated to the retirement or redemption of the mandatory convertible securities.[4]

[3] Common or perpetual preferred stock issued under dividend reinvestment plans or issued to finance acquisitions, including acquisitions of business entities, may be dedicated to the retirement or redemption of the mandatory convertible securities. Documentation certified by an authorized agent of the issuer showing the amount of common stock or perpetual preferred stock issued, the dates of issue, and amounts of such issues dedicated to the retirement or redemption of mandatory convertible securities will satisfy the dedication requirement.

[4] The dedication procedure is necessary to ensure that the primary capital of the issuer is not overstated. For each dollar of common or perpetual preferred proceeds dedicated to the retirement or redemption of the notes, there is a corresponding reduction in the amount of outstanding mandatory securities that may qualify as primary capital. *De minimis* amounts (in relation to primary capital) of common or perpetual preferred stock issued under arrangements in which the

*Continued*

*Additional Criteria Applicable to Equity Contract Notes*

a. The note must contain a contractual provision (or must be issued with a mandatory stock purchase contract) that requires the holder of the instrument to take the common or perpetual stock of the issuer in lieu of cash in satisfaction of the claim for principal repayment. The obligation of the holder to take the common or perpetual preferred stock of the issuer may be waived if, and to the extent that, prior to the maturity date of the obligation, the issuer sells new common or perpetual preferred stock and dedicates the proceeds to the retirement or redemption of the notes. The dedication generally must be made during the quarter in which the new common or preferred stock is issued.

b. A stock purchase contract may be separated from a security only if: (1) The holder of the contract provides sufficient collateral[5] to the issuer, or to an independent trustee for the benefit of the issuer, to assure performance under the contract and (2) the stock purchase contract requires the purchase of common or perpetual preferred stock.

*Additional Criteria Applicable to Equity Commitment Notes*

a. The indenture or note agreement must contain the following two provisions:

1. The proceeds of the sale of common or perpetual preferred stock will be the sole source of repayment for the notes, and the issuer must dedicate the proceeds for the purpose of repaying the notes. (Documentation certified by an authorized agent of the issued showing the amount of common or perpetual preferred stock issued, the dates of issue, and amounts of such issues dedicated to the retirement or redemption of mandatory convertible securities will satisfy the dedication requirement.)

2. By the time that one-third of the life of the securities has run, the issuer must have raised and dedicated an amount equal to one-third of the original principal of the securities. By the time that two-thirds of the life of the securities has run, the issuer must have raised and dedicated an amount equal to two-thirds of the original principal of the securities. At least 60 days prior to the maturity of the securities, the issuer must have raised and dedicated an amount equal to the entire original principal of the securities. Proceeds dedicated to redemption or retirement of the notes must come only from the sale of common or perpetual preferred stock.[6]

b. If the issuer fails to meet any of these periodic funding requirements, the Federal Reserve immediately will cease to treat the unfunded securities as primary capital and will take appropriate supervisory action. In addition, failure to meet the funding requirements will be viewed as a breach of a regulatory commitment and will be taken into consideration by the Board in acting on statutory applications.

c. If a security is issued by a subsidiary of a bank or bank holding company, any guarantee of the principal by that subsidiary's parent bank or bank holding company must be subordinate to the same degree as the security issued by the subsidiary and limited to repayment of the principal amount of the security at its final maturity.

CRITERIA FOR DETERMINING THE PRIMARY CAPITAL STATUS OF PERPETUAL DEBT INSTRUMENTS OF BANK HOLDING COMPANIES

1. The instrument must be unsecured and, if issued by a bank, must be subordinated to the claims of depositors.

2. The instrument may not provide the noteholder with the right to demand repayment of principal except in the event of bankruptcy, insolvency, or reorganization. The instrument must provide that nonpayment of interest shall not trigger repayment of the principal of the perpetual debt note or any other obligation of the issuer, nor shall it constitute prima facie evidence of insolvency or bankruptcy.

3. The issuer shall not voluntarily redeem the debt issue without prior approval of the Federal Reserve, except when the debt is converted to, exchanged for, or simultaneously replaced in like amount by an issue of common or perpetual preferred stock of the issuer or the issuer's parent company.

4. If issued by a bank holding company, a bank subsidiary, or a subsidiary with substantial operations, the instrument must contain a provision that allows the issuer to

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amount of stock issued is not predictable, such as dividend reinvestment plans and employee stock option plans (but excluding public stock offerings and stock issued in connection with acquisitions), should be dedicated by no later than the company's fiscal year end.

[5] Collateral is defined as: (1) Cash or certificates of deposit; (2) U.S. government securities that will mature prior to or simultaneous with the maturity of the equity contract and that have a par or maturity value at least equal to the amount of the holder's obligation under the stock purchase contract; (3) standby letters of credit issued by an insured U.S. bank that is not an affiliate of the issuer; or (4) other collateral as may be designated from time to time by the Federal Reserve.

[6] The funded portions of the securities will be deducted from primary capital to avoid double counting.

defer interest payments on the perpetual debt in the event of, and at the same time as the elimination of dividends on all outstanding common or preferred stock of the issuer (or in the case of a guarantee by a parent company at the same time as the elimination of the dividends of the parent company's common and preferred stock). In the case of a nonoperating subsidiary (a funding subsidiary or one formed to issue securities), the deferral of interest payments must be triggered by elimination of dividends by the parent company.

5. If issued by a bank holding company or a subsidiary with substantial operations, the instrument must convert automatically to common or perpetual preferred stock of the issuer when the issuer's retained earnings and surplus accounts become negative. If an operating subsidiary's perpetual debt is guaranteed by its parent, the debt may convert to the shares of the issuer or guarantor and such conversion may be triggered when the issuer's or parent's retained earnings and surplus accounts become negative. If issued by a nonoperating subsidiary of a bank holding company or bank, the instrument must convert automatically to common or preferred stock of the issuer's parent when the retained earnings and surplus accounts of the issuer's parent become negative.

[Reg. Y, 50 FR 16066, Apr. 24, 1985, as amended at 51 FR 40969, Nov. 12, 1986. Redesignated and amended at 54 FR 4209, Jan. 27, 1989; 55 FR 32832, Aug. 10, 1990; 58 FR 474, Jan. 6, 1993]

## APPENDIX C TO PART 225—SMALL BANK HOLDING COMPANY POLICY STATEMENT

### Policy Statement on Assessment of Financial and Managerial Factors

In acting on applications filed under the Bank Holding Company Act, the Board has adopted, and continues to follow, the principle that bank holding companies should serve as a source of strength for their subsidiary banks. When bank holding companies incur debt and rely upon the earnings of their subsidiary banks as the means of repaying such debt, a question arises as to the probable effect upon the financial condition of the holding company and its subsidiary bank or banks.

The Board believes that a high level of debt at the parent holding company impairs the ability of a bank holding company to provide financial assistance to its subsidiary bank(s) and, in some cases, the servicing requirements on such debt may be a significant drain on the resources of the bank(s). For these reasons, the Board has not favored the use of acquisition debt in the formation of bank holding companies or in the acquisition of additional banks. Nevertheless, the Board has recognized that the transfer of ownership of small banks often requires the use of acquisition debt. The Board, therefore, has permitted the formation and expansion of small bank holding companies with debt levels higher than would be permitted for larger holding companies. Approval of these applications has been given on the condition that small bank holding companies demonstrate the ability to service acquisition debt without straining the capital of their subsidiary banks and, further, that such companies restore their ability to serve as a source of strength for their subsidiary banks within a relatively short period of time.

In the interest of continuing its policy of facilitating the transfer of ownership in banks without compromising bank safety and soundness, the Board has, as described below, adopted the following procedures and standards for the formation and expansion of small bank holding companies subject to this policy statement.

#### 1. APPLICABILITY OF POLICY STATEMENT

This policy statement applies only to bank holding companies with *pro forma* consolidated assets of less than $500 million that (i) are not engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) do not conduct significant off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary; and (iii) do not have a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission. The Board may in its discretion exclude any bank holding company, regardless of asset size, from the policy statement if such action is warranted for supervisory purposes.[1]

While this policy statement primarily applies to the formation of small bank holding companies, it also applies to existing small bank holding companies that wish to acquire an additional bank or company and to transactions involving changes in control, stock redemptions, or other shareholder transactions.[2]

#### 2. ONGOING REQUIREMENTS

The following guidelines must be followed on an ongoing basis for all organizations operating under this policy statement.

A. Reduction in parent company leverage: Small bank holding companies are to reduce their parent company debt consistent with the requirement that all debt be retired within 25 years of being incurred. The Board

[1] [Reserved]

[2] The appropriate Reserve Bank should be contacted to determine the manner in which a specific situation may qualify for treatment under this policy statement.

also expects that these bank holding companies reach a debt to equity ratio of .30:1 or less within 12 years of the incurrence of the debt.[3] The bank holding company must also comply with debt servicing and other requirements imposed by its creditors.

B. Capital adequacy: Each insured depository subsidiary of a small bank holding company is expected to be well-capitalized. Any institution that is not well-capitalized is expected to become well-capitalized within a brief period of time.

C. Dividend restrictions: A small bank holding company whose debt to equity ratio is greater than 1.0:1 is not expected to pay corporate dividends until such time as it reduces its debt to equity ratio to 1.0:1 or less and otherwise meets the criteria set forth in §§225.14(c)(1)(ii), 225.14(c)(2), and 225.14(c)(7) of Regulation Y.[4]

Small bank holding companies formed before the effective date of this policy statement may switch to a plan that adheres to the intent of this statement provided they comply with the requirements set forth above.

3. CORE REQUIREMENTS FOR ALL APPLICANTS

In assessing applications or notices by organizations subject to this policy statement, the Board will continue to take into account a full range of financial and other information about the applicant, and its current and proposed subsidiaries, including the recent trend and stability of earnings, past and prospective growth, asset quality, the ability to meet debt servicing requirements without placing an undue strain on the resources of the bank(s), and the record and competency of management. In addition, the Board will require applicants to meet the following requirements:

A. Minimum down payment: The amount of acquisition debt should not exceed 75 percent of the purchase price of the bank(s) or company to be acquired. When the owner(s)

[3] The term *debt,* as used in the ratio of debt to equity, means any borrowed funds (exclusive of short-term borrowings that arise out of current transactions, the proceeds of which are used for current transactions), and any securities issued by, or obligations of, the holding company that are the functional equivalent of borrowed funds.

Subordinated debt associated with trust preferred securities generally would be treated as debt for purposes of paragraphs 2.C., 3.A., 4.A.i, and 4.B.i. of this policy statement. A bank holding company, however, may exclude from debt an amount of subordinated debt associated with trust preferred securities up to 25 percent of the holding company's equity (as defined below) less goodwill on the parent company's balance sheet in determining compliance with the requirements of such paragraphs of the policy statement. In addition, a bank holding company subject to this Policy Statement that has not issued subordinated debt associated with a new issuance of trust preferred securities after December 31, 2005 may exclude from debt any subordinated debt associated with trust preferred securities until December 31, 2010. Bank holding companies subject to this Policy Statement may also exclude from debt until December 31, 2010, any subordinated debt associated with refinanced issuances of trust preferred securities originally issued on or prior to December 31, 2005, provided that the refinancing does not increase the bank holding company's outstanding amount of subordinated debt. Subordinated debt associated with trust preferred securities will not be included as debt in determining compliance with any other requirements of this policy statement.

The term *equity,* as used in the ratio of debt to equity, means the total stockholders' equity of the bank holding company as defined in accordance with generally accepted accounting principles. In determining the total amount of stockholders' equity, the bank holding company should account for its investments in the common stock of subsidiaries by the equity method of accounting.

Ordinarily the Board does not view redeemable preferred stock as a substitute for common stock in a small bank holding company. Nevertheless, to a limited degree and under certain circumstances, the Board will consider redeemable preferred stock as equity in the capital accounts of the holding company if the following conditions are met: (1) The preferred stock is redeemable only at the option of the issuer and (2) the debt to equity ratio of the holding company would be at or remain below .30:1 following the redemption or retirement of any preferred stock. Preferred stock that is convertible into common stock of the holding company may be treated as equity.

[4] Dividends may be paid by small bank holding companies with debt to equity at or below 1.0:1 and otherwise meeting the requirements of §§225.14(c)(1)(ii), 225.14(c)(2), and 225.14(c)(7) if the dividends are reasonable in amount, do not adversely affect the ability of the bank holding company to service its debt in an orderly manner, and do not adversely affect the ability of the subsidiary banks to be well-capitalized. It is expected that dividends will be eliminated if the holding company is (1) not reducing its debt consistent with the requirement that the debt to equity ratio be reduced to .30:1 within 12 years of consummation of the proposal or (2) not meeting the requirements of its loan agreement(s).

of the holding company incurs debt to finance the purchase of the bank(s) or company, such debt will be considered acquisition debt even though it does not represent an obligation of the bank holding company, unless the owner(s) can demonstrate that such debt can be serviced without reliance on the resources of the bank(s) or bank holding company.

B. Ability to reduce parent company leverage: The bank holding company must clearly be able to reduce its debt to equity ratio and comply with its loan agreement(s) as set forth in paragraph 2A above.

Failure to meet the criteria in this section would normally result in denial of an application.

4. ADDITIONAL APPLICATION REQUIREMENTS FOR EXPEDITED/WAIVED PROCESSING

A. Expedited notices under §§225.14 and 225.23 of Regulation Y: A small bank holding company proposal will be eligible for the expedited processing procedures set forth in §§225.14 and 225.23 of Regulation Y if the bank holding company is in compliance with the ongoing requirements of this policy statement, the bank holding company meets the core requirements for all applicants noted above, and the following requirements are met:

i. The parent bank holding company has a *pro forma* debt to equity ratio of 1.0:1 or less.

ii. The bank holding company meets all of the criteria for expedited action set forth in §§225.14 or 225.23 of Regulation Y.

B. Waiver of stock redemption filing: A small bank holding company will be eligible for the stock redemption filing exception for well-capitalized bank holding companies contained in §225.4(b)(6) if the following requirements are met:

i. The parent bank holding company has a *pro forma d*ebt to equity ratio of 1.0:1 or less.

ii. The bank holding company is in compliance with the ongoing requirements of this policy statement and meets the requirements of §§225.14(c)(1)(ii), 225.14(c)(2), and 225.14(c)(7) of Regulation Y.

[62 FR 9343, Feb. 28, 1997, as amended at 71 FR 9902, Feb. 28, 2006]

## APPENDIX D TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: TIER 1 LEVERAGE MEASURE

### I. OVERVIEW

a. The Board of Governors of the Federal Reserve System has adopted a minimum ratio of tier 1 capital to total assets to assist in the assessment of the capital adequacy of bank holding companies (banking organizations).[1] The principal objectives of this measure is to place a constraint on the maximum degree to which a banking organization can leverage its equity capital base. It is intended to be used as a supplement to the risk-based capital measure.

b. The tier 1 leverage guidelines apply on a consolidated basis to any bank holding company with consolidated assets of $500 million or more. The tier 1 leverage guidelines also apply on a consolidated basis to any bank holding company with consolidated assets of less than $500 million if the holding company (i) is engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) conducts significant off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary; or (iii) has a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission. The Federal Reserve may apply the tier 1 leverage guidelines at its discretion to any bank holding company, regardless of asset size, if such action is warranted for supervisory purposes.[2]

c. The tier 1 leverage guidelines are to be used in the inspection and supervisory process as well as in the analysis of applications acted upon by the Federal Reserve. The Board will review the guidelines from time to time and will consider the need for possible adjustments in light of any significant changes in the economy, financial markets, and banking practices.

### II. THE TIER 1 LEVERAGE RATIO

a. The Board has established a minimum ratio of Tier 1 capital to total assets of 3.0 percent for strong bank holding companies (rated composite ''1'' under the BOPEC rating system of bank holding companies), and for bank holding companies that have implemented the Board's risk-based capital measure for market risk as set forth in appendices A and E of this part. For all other bank holding companies, the minimum ratio of Tier 1 capital to total assets is 4.0 percent. Banking organizations with supervisory, financial, operational, or managerial weaknesses, as well as organizations that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. Moreover, higher capital ratios may be required for any bank holding company if warranted by its particular circumstances or risk profile. In all cases, bank holding companies should hold capital commensurate with the

[1] Supervisory ratios that related capital to total assets for state member banks are outlined in appendix B of this part.

[2] [Reserved]

level and nature of the risks, including the volume and severity of problem loans, to which they are exposed.

b. A banking organization's tier 1 leverage ratio is calculated by dividing its tier 1 capital (the numerator of the ratio) by its average total consolidated assets (the denominator of the ratio). The ratio will also be calculated using period-end assets whenever necessary, on a case-by-case basis. For the purpose of this leverage ratio, the definition of tier 1 capital as set forth in the risk-based capital guidelines contained in appendix A of this part will be used. As a general matter, average total consolidated assets are defined as the quarterly average total assets (defined net of the allowance for loan and lease losses) reported on the organization's Consolidated Financial Statements (FR Y–9C Report), less goodwill; amounts of mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships that, in the aggregate, are in excess of 100 percent of Tier 1 capital; amounts of nonmortgage servicing assets and purchased credit card relationships that, in the aggregate, are in excess of 25 percent of Tier 1 capital; amounts of credit-enhancing interest-only strips that are in excess of 25 percent of Tier 1 capital; all other identifiable intangible assets; any investments in subsidiaries or associated companies that the Federal Reserve determines should be deducted from Tier 1 capital; deferred tax assets that are dependent upon future taxable income, net of their valuation allowance, in excess of the limitation set forth in section II.B.4 of appendix A of this part; and the amount of the total adjusted carrying value of nonfinancial equity investments that is subject to a deduction from Tier 1 capital.[3]

c. Whenever appropriate, including when an organization is undertaking expansion, seeking to engage in new activities or otherwise facing unusual or abnormal risks, the Board will continue to consider the level of an individual organization's tangible tier 1 leverage ratio (after deducting all intangibles) in making an overall assessment of capital adequacy. This is consistent with the Federal Reserve's risk-based capital guidelines and long-standing Federal Reserve policy and practice with regard to leverage guidelines. Organizations experiencing growth, whether internally or by acquisition, are expected to maintain strong capital position substantially above minimum supervisory levels, without significant reliance on intangible assets.

d. Notwithstanding anything in this appendix to the contrary, a bank holding company may deduct from its average total consolidated assets the amount of any asset-backed commercial paper (i) purchased by the bank holding company between September 19, 2008, and January 30, 2009 (unless extended by the Board), from an SEC-registered open-end investment company that holds itself out as a money market mutual fund under SEC Rule 2a–7 (17 CFR 270.2a–7) and (ii) pledged by the bank holding company to a Federal Reserve Bank to secure financing from the ABCP lending facility established by the Board on September 19, 2008.

[Reg. Y, 59 FR 65926, Dec. 22, 1994, as amended by 60 FR 39231, Aug. 1, 1995; 63 FR 30370, June 4, 1998; 63 FR 42676, Aug. 10, 1998; 66 FR 59651, Nov. 29, 2001; 67 FR 3803, Jan. 25, 2002; 70 FR 11838, Mar. 10, 2005; 71 FR 9902, Feb. 28, 2006; 73 FR 55708, Sept. 26, 2008]

## APPENDIX E TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: MARKET RISK MEASURE

### *Section 1. Purpose, Applicability, Scope, and Effective Date*

(a) *Purpose.* The purpose of this appendix is to ensure that bank holding companies (organizations) with significant exposure to market risk maintain adequate capital to support that exposure.[1] This appendix supplements and adjusts the risk-based capital ratio calculations under appendix A of this part with respect to those organizations.

(b) *Applicability.* (1) This appendix applies to any bank holding company whose trading activity[2] (on a worldwide consolidated basis) equals:

(i) 10 percent or more of total assets;[3] or

(ii) $1 billion or more.

(2) The Federal Reserve may additionally apply this appendix to any bank holding company if the Federal Reserve deems it necessary or appropriate for safe and sound banking practices.

(3) The Federal Reserve may exclude a bank holding company otherwise meeting

[3] Deductions from Tier 1 capital and other adjustments are discussed more fully in section II.B. of appendix A of this part.

[1] This appendix is based on a framework developed jointly by supervisory authorities from the countries represented on the Basle Committee on Banking Supervision and endorsed by the Group of Ten Central Bank Governors. The framework is described in a Basle Committee paper entitled ''Amendment to the Capital Accord to Incorporate Market Risks,'' January 1996. Also see modifications issued in September 1997.

[2] Trading activity means the gross sum of trading assets and liabilities as reported in the bank holding company's most recent quarterly Y–9C Report.

[3] Total assets means quarter-end total assets as reported in the bank holding company's most recent Y–9C Report.

the criteria of paragraph (b)(1) of this section from coverage under this appendix if it determines the organization meets such criteria as a consequence of accounting, operational, or similar considerations, and the Federal Reserve deems it consistent with safe and sound banking practices.

(c) *Scope*. The capital requirements of this appendix support market risk associated with an organization's covered positions.

(d) *Effective date*. This appendix is effective as of January 1, 1997. Compliance is not mandatory until January 1, 1998. Subject to supervisory approval, a bank holding company may opt to comply with this appendix as early as January 1, 1997.[4]

*Section 2. Definitions*

For purposes of this appendix, the following definitions apply:

(a) *Covered positions* means all positions in an organization's trading account, and all foreign exchange[5] and commodity positions, whether or not in the trading account.[6] Positions include on-balance-sheet assets and liabilities and off-balance-sheet items. Securities subject to repurchase and lending agreements are included as if still owned by the lender. Covered positions exclude all positions in a banking organization's trading account that, in form or in substance, act as liquidity facilities that provide liquidity support to asset-backed commercial paper. Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.

(b) *Market risk* means the risk of loss resulting from movements in market prices. Market risk consists of general market risk and specific risk components.

(1) *General market risk* means changes in the market value of covered positions resulting from broad market movements, such as changes in the general level of interest rates, equity prices, foreign exchange rates, or commodity prices.

(2) *Specific risk* means changes in the market value of specific positions due to factors other than broad market movements and includes event and default risk as well as idiosyncratic variations.

(c) *Tier 1* and *Tier 2 capital* are defined in appendix A of this part.

(d) *Tier 3 capital* is subordinated debt that is unsecured; is fully paid up; has an original maturity of at least two years; is not redeemable before maturity without prior approval by the Federal Reserve; includes a lock-in clause precluding payment of either interest or principal (even at maturity) if the payment would cause the issuing organization's risk-based capital ratio to fall or remain below the minimum required under appendix A of this part; and does not contain and is not covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practices.

(e) *Value-at-risk (VAR)* means the estimate of the maximum amount that the value of covered positions could decline due to market price or rate movements during a fixed holding period within a stated confidence level, measured in accordance with section 4 of this appendix.

*Section 3. Adjustments to the Risk-Based Capital Ratio Calculations*

(a) *Risk-based capital ratio denominator*. An organization subject to this appendix shall calculate its risk-based capital ratio denominator as follows:

(1) *Adjusted risk-weighted assets*. Calculate adjusted risk-weighted assets, which equals risk-weighted assets (as determined in accordance with appendix A of this part) excluding the risk-weighted amounts of all covered positions (except foreign-exchange positions outside the trading account and over-the-counter derivative positions)[7] and receivables arising from the posting of cash collateral that is associated with securities borrowing transactions to the extent the receivables are collateralized by the market value of the borrowed securities, provided that the following conditions are met:

(i) The transaction is based on securities includable in the trading book that are liquid and readily marketable,

(ii) The transaction is marked to market daily,

(iii) The transaction is subject to daily margin maintenance requirements, and

(iv)(A) The transaction is a securities contract for the purposes of section 555 of the Bankruptcy Code (11 U.S.C. 555), a qualified financial contract for the purposes of section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions for the purposes of sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407), or the Board's Regulation EE (12 CFR Part 231); or

[4] A bank holding company that voluntarily complies with the final rule prior to January 1, 1998, must comply with all of its provisions.

[5] Subject to supervisory review, a bank may exclude structural positions in foreign currencies from its covered positions.

[6] The term trading account is defined in the instructions to the Call Report.

[7] Foreign-exchange positions outside the trading account and all over-the-counter derivative positions, whether or not in the trading account, must be included in adjusted risk-weighted assets as determined in appendix A of this part.

(B) If the transaction does not meet the criteria set forth in paragraph (iv)(A) of this section, then either:

(*1*) The bank has conducted sufficient legal review to reach a well-founded conclusion that:

(*i*) The securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default, including in a bankruptcy, insolvency, or other similar proceeding of the counterparty; and

(*ii*) Under applicable law of the relevant jurisdiction, its rights under the agreement are legal, valid, binding, and enforceable and any exercise of rights under the agreement will not be stayed or avoided; or

(*2*) The transaction is either overnight or unconditionally cancelable at any time by the bank, and the bank has conducted sufficient legal review to reach a well-founded conclusion that:

(*i*) The securities borrowing agreement executed in connection with the transaction provides the bank the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of counterparty default; and

(*ii*) Under the law governing the agreement, its rights under the agreement are legal, valid, binding, and enforceable.

(2) *Measure for market risk.* Calculate the measure for market risk, which equals the sum of the VAR-based capital charge, the specific risk add-on (if any), and the capital charge for de minimis exposures (if any).

(i) *VAR-based capital charge.* The VAR-based capital charge equals the higher of:

(A) The previous day's VAR measure; or

(B) The average of the daily VAR measures for each of the preceding 60 business days multiplied by three, except as provided in section 4(e) of this appendix;

(ii) *Specific risk add-on.* The specific risk add-on is calculated in accordance with section 5 of this appendix; and

(iii) *Capital charge for de minimis exposure.* The capital charge for de minimis exposure is calculated in accordance with section 4(a) of this appendix.

(3) *Market risk equivalent assets.* Calculate market risk equivalent assets by multiplying the measure for market risk (as calculated in paragraph (a)(2) of this section) by 12.5.

(4) *Denominator calculation.* Add market risk equivalent assets (as calculated in paragraph (a)(3) of this section) to adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section). The resulting sum is the organization's risk-based capital ratio denominator.

(b) *Risk-based capital ratio numerator.* An organization subject to this appendix shall calculate its risk-based capital ratio numerator by allocating capital as follows:

(1) *Credit risk allocation.* Allocate Tier 1 and Tier 2 capital equal to 8.0 percent of adjusted risk-weighted assets (as calculated in paragraph (a)(1) of this section).[8]

(2) *Market risk allocation.* Allocate Tier 1, Tier 2, and Tier 3 capital equal to the measure for market risk as calculated in paragraph (a)(2) of this section. The sum of Tier 2 and Tier 3 capital allocated for market risk must not exceed 250 percent of Tier 1 capital allocated for market risk. (This requirement means that Tier 1 capital allocated in this paragraph (b)(2) must equal at least 28.6 percent of the measure for market risk.)

(3) *Restrictions.* (i) The sum of Tier 2 capital (both allocated and excess) and Tier 3 capital (allocated in paragraph (b)(2) of this section) may not exceed 100 percent of Tier 1 capital (both allocated and excess).[9]

(ii) Term subordinated debt (and intermediate-term preferred stock and related surplus) included in Tier 2 capital (both allocated and excess) may not exceed 50 percent of Tier 1 capital (both allocated and excess).

(4) *Numerator calculation.* Add Tier 1 capital (both allocated and excess), Tier 2 capital (both allocated and excess), and Tier 3 capital (allocated under paragraph (b)(2) of this section). The resulting sum is the organization's risk-based capital ratio numerator.

*Section 4. Internal Models*

(a) *General.* For risk-based capital purposes, a bank holding company subject to this appendix must use its internal model to measure its daily VAR, in accordance with the requirements of this section.[10] The Federal Reserve may permit an organization to

[8] An institution may not allocate Tier 3 capital to support credit risk (as calculated under appendix A of this part).

[9] Excess Tier 1 capital means Tier 1 capital that has not been allocated in paragraphs (b)(1) and (b)(2) of this section. Excess Tier 2 capital means Tier 2 capital that has not been allocated in paragraph (b)(1) and (b)(2) of this section, subject to the restrictions in paragraph (b)(3) of this section.

[10] An organization's internal model may use any generally accepted measurement techniques, such as variance-covariance models, historical simulations, or Monte Carlo simulations. However, the level of sophistication and accuracy of an organization's internal model must be commensurate with the nature and size of its covered positions. An organization that modifies its existing modeling procedures to comply with the requirements of this appendix for risk-based capital purposes should, nonetheless,

use alternative techniques to measure the market risk of de minimis exposures so long as the techniques adequately measure associated market risk.

(b) *Qualitative requirements.* A bank holding company subject to this appendix must have a risk management system that meets the following minimum qualitative requirements:

(1) The organization must have a risk control unit that reports directly to senior management and is independent from business trading units.

(2) The organization's internal risk measurement model must be integrated into the daily management process.

(3) The organization's policies and procedures must identify, and the organization must conduct, appropriate stress tests and backtests.[11] The organization's policies and procedures must identify the procedures to follow in response to the results of such tests.

(4) The organization must conduct independent reviews of its risk measurement and risk management systems at least annually.

(c) *Market risk factors.* The organization's internal model must use risk factors sufficient to measure the market risk inherent in all covered positions. The risk factors must address interest rate risk,[12] equity price risk, foreign exchange rate risk, and commodity price risk.

(d) *Quantitative requirements.* For regulatory capital purposes, VAR measures must meet the following quantitative requirements:

(1) The VAR measures must be calculated on a daily basis using a 99 percent, one-tailed confidence level with a price shock equivalent to a ten-business day movement in rates and prices. In order to calculate VAR measures based on a ten-day price shock, the organization may either calculate ten-day figures directly or convert VAR figures based on holding periods other than ten days to the equivalent of a ten-day holding period (for instance, by multiplying a one-day VAR measure by the square root of ten).

(2) The VAR measures must be based on an historical observation period (or effective observation period for an organization using a weighting scheme or other similar method) of at least one year. The organization must update data sets at least once every three months or more frequently as market conditions warrant.

(3) The VAR measures must include the risks arising from the non-linear price characteristics of options positions and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates or prices. An organization with a large or complex options portfolio must measure the volatility of options positions by different maturities.

(4) The VAR measures may incorporate empirical correlations within and across risk categories, provided that the organization's process for measuring correlations is sound. In the event that the VAR measures do not incorporate empirical correlations across risk categories, then the organization must add the separate VAR measures for the four major risk categories to determine its aggregate VAR measure.

(e) *Backtesting.* (1) Beginning one year after a bank holding company starts to comply with this appendix, it must conduct backtesting by comparing each of its most recent 250 business days' actual net trading profit or loss[13] with the corresponding daily VAR measures generated for internal risk measurement purposes and calibrated to a one-day holding period and a 99th percentile, one-tailed confidence level.

(2) Once each quarter, the organization must identify the number of exceptions, that is, the number of business days for which the magnitude of the actual daily net trading loss, if any, exceeds the corresponding daily VAR measure.

(3) A bank holding company must use the multiplication factor indicated in Table 1 of this appendix in determining its capital charge for market risk under section 3(a)(2)(i)(B) of this appendix until it obtains the next quarter's backtesting results, unless the Federal Reserve determines that a different adjustment or other action is appropriate.

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continue to use the internal model it considers most appropriate in evaluating risks for other purposes.

[11] Stress tests provide information about the impact of adverse market events on a bank's covered positions. Backtests provide information about the accuracy of an internal model by comparing an organization's daily VAR measures to its corresponding daily trading profits and losses.

[12] For material exposures in the major currencies and markets, modeling techniques must capture spread risk and must incorporate enough segments of the yield curve—at least six—to capture differences in volatility and less than perfect correlation of rates along the yield curve.

[13] Actual net trading profits and losses typically include such things as realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with trading activities.

TABLE 1—MULTIPLICATION FACTOR BASED ON RESULTS OF BACKTESTING

| Number of exceptions | Multiplication factor |
|---|---|
| 4 or fewer | 3.00 |
| 5 | 3.40 |
| 6 | 3.50 |
| 7 | 3.65 |
| 8 | 3.75 |
| 9. | |
| 10 or more | 4.00 |

*Section 5. Specific Risk*

(a) *Modeled specific risk.* A bank holding company may use its internal model to measure specific risk. If the organization has demonstrated to the Federal Reserve that its internal model measures the specific risk, including event and default risk as well as idiosyncratic variation, of covered debt and equity positions and includes the specific risk measures in the VAR-based capital charge in section 3(a)(2)(i) of this appendix, then the organization has no specific risk add-on for purposes of section 3(a)(2)(ii) of this appendix. The model should explain the historical price variation in the trading portfolio and capture concentration, both magnitude and changes in composition. The model should also be robust to an adverse environment and have been validated through backtesting which assesses whether specific risk is being accurately captured.

(b) *Partially modeled specific risk.* (1) A bank holding company that incorporates specific risk in its internal model but fails to demonstrate to the Federal Reserve that its internal model adequately measures all aspects of specific risk for covered debt and equity positions, including event and default risk, as provided by section 5(a) of this appendix, must calculate its specific risk add-on in accordance with one of the following methods:

(i) If the model is susceptible to valid separation of the VAR measure into a specific risk portion and a general market risk portion, then the specific risk add-on is equal to the previous day's specific risk portion.

(ii) If the model does not separate the VAR measure into a specific risk portion and a general market risk portion, then the specific risk add-on is the sum of the previous day's VAR measures for subportfolios of covered debt and equity positions that contain specific risk.

(2) If a bank holding company models the specific risk of covered debt positions but not covered equity positions (or vice versa), then the bank holding company may determine its specific risk charge for the included positions under section 5(a) or 5(b)(1) of this appendix, as appropriate. The specific risk charge for the positions not included equals the standard specific risk capital charge under paragraph (c) of this section.

(c) *Specific risk not modeled.* If a bank holding company does not model specific risk in accordance with section 5(a) or 5(b) of this appendix, then the organization's specific risk capital charge shall equal the standard specific risk capital charge, calculated as follows:

(1) *Covered debt positions.* (i) For purposes of this section 5, covered debt positions means fixed-rate or floating-rate debt instruments located in the trading account or instruments located in the trading account with values that react primarily to changes in interest rates, including certain non- convertible preferred stock, convertible bonds, and instruments subject to repurchase and lending agreements. Also included are derivatives (including written and purchased options) for which the underlying instrument is a covered debt instrument that is subject to a non-zero specific risk capital charge.

(A) For covered debt positions that are derivatives, an organization must risk-weight (as described in paragraph (c)(1)(iii) of this section) the market value of the effective notional amount of the underlying debt instrument or index portfolio. Swaps must be included as the notional position in the underlying debt instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(B) For covered debt positions that are options, whether long or short, an organization must risk-weight (as described in paragraph (c)(1)(iii) of this section) the market value of the effective notional amount of the underlying debt instrument or index multiplied by the option's delta.

(ii) An organization may net long and short covered debt positions (including derivatives) in identical debt issues or indices.

(iii) An organization must multiply the absolute value of the current market value of each net long or short covered debt position by the appropriate specific risk weighting factor indicated in Table 2 of this appendix. The specific risk capital charge component for covered debt positions is the sum of the weighted values.

TABLE 2—SPECIFIC RISK WEIGHTING FACTORS FOR COVERED DEBT POSITIONS

| Category | Remaining maturity (contractual) | Weighting factor (in percent) |
|---|---|---|
| Government | N/A | 0.00 |
| Qualifying | 6 months or less | 0.25 |
| | Over 6 months to 24 months. | 1.00 |
| | Over 24 months | 1.60 |
| Other | N/A | 8.00 |

(A) The *government* category includes all debt instruments of central governments of OECD-based countries[14] including bonds, Treasury bills, and other short-term instruments, as well as local currency instruments of non-OECD central governments to the extent the organization has liabilities booked in that currency.

(B) The *qualifying* category includes debt instruments of U.S. government-sponsored agencies, general obligation debt instruments issued by states and other political subdivisions of OECD-based countries, multilateral development banks, and debt instruments issued by U.S. depository institutions or OECD banks that do not qualify as capital of the issuing institution.[15] This category also includes other debt instruments, including corporate debt and revenue instruments issued by states and other political subdivisions of OECD countries, that are:

(*1*) Rated investment-grade by at least two nationally recognized credit rating services;

(*2*) Rated investment grade by one nationally recognized credit rating agency and not rated less than investment grade by any other credit rating agency; or

(*3*) Unrated, but deemed to be of comparable investment quality by the reporting organization and the issuer has instruments listed on a recognized stock exchange, subject to review by the Federal Reserve.

(C) The *other* category includes debt instruments that are not included in the government or qualifying categories.

(2) *Covered equity positions.* (i) For purposes of this section 5, covered equity positions means equity instruments located in the trading account and instruments located in the trading account with values that react primarily to changes in equity prices, including voting or non-voting common stock, certain convertible bonds, and commitments to buy or sell equity instruments. Also included are derivatives (including written or purchased options) for which the underlying is a covered equity position.

(A) For covered equity positions that are derivatives, an organization must risk weight (as described in paragraph (c)(2)(iii) of this section) the market value of the effective notional amount of the underlying equity instrument or equity portfolio. Swaps must be included as the notional position in the underlying equity instrument or index portfolio, with a receiving side treated as a long position and a paying side treated as a short position; and

(B) For covered equity positions that are options, whether long or short, an organization must risk weight (as described in paragraph (c)(2)(iii) of this section) the market value of the effective notional amount of the underlying equity instrument or index multiplied by the option's delta.

(ii) An organization may net long and short covered equity positions (including derivatives) in identical equity issues or equity indices in the same market.[16]

(iii)(A) An organization must multiply the absolute value of the current market value of each net long or short covered equity position by a risk weighting factor of 8.0 percent, or by 4.0 percent if the equity is held in a portfolio that is both liquid and well-diversified.[17] For covered equity positions that are index contracts comprising a well-diversified portfolio of equity instruments, the net long or short position is to be multiplied by a risk weighting factor of 2.0 percent.

(B) For covered equity positions from the following futures-related arbitrage strategies, an organization may apply a 2.0 percent risk weighting factor to one side (long or short) of each equity position with the opposite side exempt from charge, subject to review by the Federal Reserve:

(*1*) Long and short positions in exactly the same index at different dates or in different market centers; or

(*2*) Long and short positions in index contracts at the same date in different but similar indices.

(C) For futures contracts on broadly-based indices that are matched by offsetting positions in a basket of stocks comprising the index, an organization may apply a 2.0 percent risk weighting factor to the futures and stock basket positions (long and short), provided that such trades are deliberately entered into and separately controlled, and

[14] Organization for Economic Cooperation and Development (OECD)–based countries is defined in appendix A of this part.

[15] U.S. government-sponsored agencies, multilateral development banks, and OECD banks are defined in appendix A of this part.

[16] An organization may also net positions in depository receipts against an opposite position in the underlying equity or identical equity in different markets, provided that the organization includes the costs of conversion.

[17] A portfolio is liquid and well-diversified if: (1) it is characterized by a limited sensitivity to price changes of any single equity issue or closely related group of equity issues held in the portfolio; (2) the volatility of the portfolio's value is not dominated by the volatility of any individual equity issue or by equity issues from any single industry or economic sector; (3) it contains a large number of individual equity positions, with no single position representing a substantial portion of the portfolio's total market value; and (4) it consists mainly of issues traded on organized exchanges or in well-established over-the-counter markets.

that the basket of stocks comprises at least 90 percent of the capitalization of the index.

(iv) The specific risk capital charge component for covered equity positions is the sum of the weighted values.

[61 FR 47373, Sept. 6, 1996, as amended at 62 FR 68068, Dec. 30, 1997; 64 FR 19038, Apr. 19, 1999; 65 FR 75859, Dec. 5, 2000; 69 FR 44921, July 28, 2004; 71 FR 8937, Feb. 22, 2006]

## APPENDIX F TO PART 225—INTERAGENCY GUIDELINES ESTABLISHING INFORMATION SECURITY STANDARDS

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### I. INTRODUCTION

These Interagency Guidelines Establishing Information Security Standards (Guidelines) set forth standards pursuant to sections 501 and 505 of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 and 6805). These Guidelines address standards for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of customer information.

A. *Scope*. The Guidelines apply to customer information maintained by or on behalf of bank holding companies and their nonbank subsidiaries or affiliates (except brokers, dealers, persons providing insurance, investment companies, and investment advisors), for which the Board has supervisory authority.

B. *Preservation of Existing Authority*. These Guidelines do not in any way limit the authority of the Board to address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices. The Board may take action under these Guidelines independently of, in conjunction with, or in addition to, any other enforcement action available to the Board.

C. *Definitions*. 1. Except as modified in the Guidelines, or unless the context otherwise requires, the terms used in these Guidelines have the same meanings as set forth in sections 3 and 39 of the Federal Deposit Insurance Act (12 U.S.C. 1813 and 1831p–1).

2. For purposes of the Guidelines, the following definitions apply:

a. *Board of directors*, in the case of a branch or agency of a foreign bank, means the managing official in charge of the branch or agency.

b. *Customer* means any customer of the bank holding company as defined in §216.3(h) of this chapter.

c. *Customer information* means any record containing nonpublic personal information, as defined in §216.3(n) of this chapter, about a customer, whether in paper, electronic, or other form, that is maintained by or on behalf of the bank holding company.

d. *Customer information systems* means any methods used to access, collect, store, use, transmit, protect, or dispose of customer information.

e. *Service provider* means any person or entity that maintains, processes, or otherwise is permitted access to customer information through its provision of services directly to the bank holding company.

f. *Subsidiary* means any company controlled by a bank holding company, except a broker, dealer, person providing insurance, investment company, investment advisor, insured depository institution, or subsidiary of an insured depository institution.

### II. STANDARDS FOR SAFEGUARDING CUSTOMER INFORMATION

A. *Information Security Program*. Each bank holding company shall implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the size and complexity of the bank holding company and the nature and scope of its activities. While all parts of the bank holding company are not required to implement a uniform set of policies, all elements of the information security program must be coordinated. A bank holding company also shall ensure that each of its subsidiaries is subject to a comprehensive information security program. The bank holding company may fulfill this requirement either by including a subsidiary within the scope of the bank holding company's comprehensive information security program or by causing the subsidiary to implement a separate comprehensive information security program in accordance with the standards and procedures in sections II and III of this appendix that apply to bank holding companies.

B. *Objectives*. A bank holding company's information security program shall be designed to:

1. Ensure the security and confidentiality of customer information;

2. Protect against any anticipated threats or hazards to the security or integrity of such information; and

3. Protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

III. DEVELOPMENT AND IMPLEMENTATION OF INFORMATION SECURITY PROGRAM

A. *Involve the Board of Directors.* The board of directors or an appropriate committee of the board of each bank holding company shall:

1. Approve the bank holding company's written information security program; and

2. Oversee the development, implementation, and maintenance of the bank holding company's information security program, including assigning specific responsibility for its implementation and reviewing reports from management.

B. *Assess Risk.* Each bank holding company shall:

1. Identify reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of customer information or customer information systems.

2. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of customer information.

3. Assess the sufficiency of policies, procedures, customer information systems, and other arrangements in place to control risks.

C. *Manage and Control Risk.* Each bank holding company shall:

1. Design its information security program to control the identified risks, commensurate with the sensitivity of the information as well as the complexity and scope of the bank holding company's activities. Each bank holding company must consider whether the following security measures are appropriate for the bank holding company and, if so, adopt those measures the bank holding company concludes are appropriate:

a. Access controls on customer information systems, including controls to authenticate and permit access only to authorized individuals and controls to prevent employees from providing customer information to unauthorized individuals who may seek to obtain this information through fraudulent means.

b. Access restrictions at physical locations containing customer information, such as buildings, computer facilities, and records storage facilities to permit access only to authorized individuals;

c. Encryption of electronic customer information, including while in transit or in storage on networks or systems to which unauthorized individuals may have access;

d. Procedures designed to ensure that customer information system modifications are consistent with the bank holding company's information security program;

e. Dual control procedures, segregation of duties, and employee background checks for employees with responsibilities for or access to customer information;

f. Monitoring systems and procedures to detect actual and attempted attacks on or intrusions into customer information systems;

g. Response programs that specify actions to be taken when the bank holding company suspects or detects that unauthorized individuals have gained access to customer information systems, including appropriate reports to regulatory and law enforcement agencies; and

h. Measures to protect against destruction, loss, or damage of customer information due to potential environmental hazards, such as fire and water damage or technological failures.

2. Train staff to implement the bank holding company's information security program.

3. Regularly test the key controls, systems and procedures of the information security program. The frequency and nature of such tests should be determined by the bank holding company's risk assessment. Tests should be conducted or reviewed by independent third parties or staff independent of those that develop or maintain the security programs.

D. *Oversee Service Provider Arrangements.* Each bank holding company shall:

1. Exercise appropriate due diligence in selecting its service providers;

2. Require its service providers by contract to implement appropriate measures designed to meet the objectives of these Guidelines; and

3. Where indicated by the bank holding company's risk assessment, monitor its service providers to confirm that they have satisfied their obligations as required by paragraph D.2. As part of this monitoring, a bank holding company should review audits, summaries of test results, or other equivalent evaluations of its service providers.

E. *Adjust the Program.* Each bank holding company shall monitor, evaluate, and adjust, as appropriate, the information security program in light of any relevant changes in technology, the sensitivity of its customer information, internal or external threats to information, and the bank holding company's own changing business arrangements, such as mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, and changes to customer information systems.

F. *Report to the Board.* Each bank holding company shall report to its board or an appropriate committee of the board at least annually. This report should describe the overall status of the information security program and the bank holding company's compliance with these Guidelines. The reports

should discuss material matters related to its program, addressing issues such as: risk assessment; risk management and control decisions; service provider arrangements; results of testing; security breaches or violations and management's responses; and recommendations for changes in the information security program.

G. *Implement the Standards.*

1. *Effective date.* Each bank holding company must implement an information security program pursuant to these Guidelines by July 1, 2001.

2. *Two-year grandfathering of agreements with service providers.* Until July 1, 2003, a contract that a bank holding company has entered into with a service provider to perform services for it or functions on its behalf satisfies the provisions of section III.D., even if the contract does not include a requirement that the servicer maintain the security and confidentiality of customer information, as long as the bank holding company entered into the contract on or before March 5, 2001.

## SUPPLEMENT A TO APPENDIX F TO PART 225—INTERAGENCY GUIDANCE ON RESPONSE PROGRAMS FOR UNAUTHORIZED ACCESS TO CUSTOMER INFORMATION AND CUSTOMER NOTICE

### I. BACKGROUND

This Guidance[1] interprets section 501(b) of the Gramm-Leach-Bliley Act (''GLBA'') and the Interagency Guidelines Establishing Information Security Standards (the ''Security Guidelines'')[2] and describes response programs, including customer notification procedures, that a financial institution should develop and implement to address unauthorized access to or use of customer information that could result in substantial harm or inconvenience to a customer. The scope of, and definitions of terms used in, this Guidance are identical to those of the Security Guidelines. For example, the term ''customer information'' is the same term used in the Security Guidelines, and means any record containing nonpublic personal information about a customer, whether in paper, electronic, or other form, maintained by or on behalf of the institution.

*A. Interagency Security Guidelines*

Section 501(b) of the GLBA required the Agencies to establish appropriate standards for financial institutions subject to their jurisdiction that include administrative, technical, and physical safeguards, to protect the security and confidentiality of customer information. Accordingly, the Agencies issued Security Guidelines requiring every financial institution to have an information security program designed to:

1. Ensure the security and confidentiality of customer information;

2. Protect against any anticipated threats or hazards to the security or integrity of such information; and

3. Protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

*B. Risk Assessment and Controls*

1. The Security Guidelines direct every financial institution to assess the following risks, among others, when developing its information security program:

a. Reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of customer information or customer information systems;

b. The likelihood and potential damage of threats, taking into consideration the sensitivity of customer information; and

c. The sufficiency of policies, procedures, customer information systems, and other arrangements in place to control risks.[3]

2. Following the assessment of these risks, the Security Guidelines require a financial institution to design a program to address the identified risks. The particular security measures an institution should adopt will depend upon the risks presented by the complexity and scope of its business. At a minimum, the financial institution is required to consider the specific security measures enumerated in the Security Guidelines,[4] and adopt those that are appropriate for the institution, including:

a. Access controls on customer information systems, including controls to authenticate and permit access only to authorized individuals and controls to prevent employees from providing customer information to unauthorized individuals who may seek to obtain this information through fraudulent means;

b. Background checks for employees with responsibilities for access to customer information; and

[1] This Guidance is being jointly issued by the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

[2] 12 CFR part 30, app. B (OCC); 12 CFR part 208, app. D–2 and part 225, app. F (Board); 12 CFR part 364, app. B (FDIC); and 12 CFR part 570, app. B (OTS). The ''Interagency Guidelines Establishing Information Security Standards'' were formerly known as ''The Interagency Guidelines Establishing Information Security Standards.''

[3] *See* Security Guidelines, III.B.

[4] *See* Security Guidelines, III.C.

c. Response programs that specify actions to be taken when the financial institution suspects or detects that unauthorized individuals have gained access to customer information systems, including appropriate reports to regulatory and law enforcement agencies.[5]

*C. Service Providers*

The Security Guidelines direct every financial institution to require its service providers by contract to implement appropriate measures designed to protect against unauthorized access to or use of customer information that could result in substantial harm or inconvenience to any customer.[6]

II. RESPONSE PROGRAM

Millions of Americans, throughout the country, have been victims of identity theft.[7] Identity thieves misuse personal information they obtain from a number of sources, including financial institutions, to perpetrate identity theft. Therefore, financial institutions should take preventative measures to safeguard customer information against attempts to gain unauthorized access to the information. For example, financial institutions should place access controls on customer information systems and conduct background checks for employees who are authorized to access customer information.[8] However, every financial institution should also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems[9] that occur nonetheless. A response program should be a key part of an institution's information security program.[10] The program should be appropriate to the size and complexity of the institution and the nature and scope of its activities.

In addition, each institution should be able to address incidents of unauthorized access to customer information in customer information systems maintained by its domestic and foreign service providers. Therefore, consistent with the obligations in the Guidelines that relate to these arrangements, and with existing guidance on this topic issued by the Agencies,[11] an institution's contract with its service provider should require the service provider to take appropriate actions to address incidents of unauthorized access to the financial institution's customer information, including notification to the institution as soon as possible of any such incident, to enable the institution to expeditiously implement its response program.

*A. Components of a Response Program*

1. At a minimum, an institution's response program should contain procedures for the following:

a. Assessing the nature and scope of an incident, and identifying what customer information systems and types of customer information have been accessed or misused;

b. Notifying its primary Federal regulator as soon as possible when the institution becomes aware of an incident involving unauthorized access to or use of *sensitive* customer information, as defined below;

[5] *See* Security Guidelines, III.C.

[6] *See* Security Guidelines, II.B. and III.D. Further, the Agencies note that, in addition to contractual obligations to a financial institution, a service provider may be required to implement its own comprehensive information security program in accordance with the Safeguards Rule promulgated by the Federal Trade Commission (''FTC''), 16 CFR part 314.

[7] The FTC estimates that nearly 10 million Americans discovered they were victims of some form of identity theft in 2002. *See* The Federal Trade Commission, *Identity Theft Survey Report*, (September 2003), available at *http://www.ftc.gov/os/2003/09/synovatereport.pdf*.

[8] Institutions should also conduct background checks of employees to ensure that the institution does not violate 12 U.S.C. 1829, which prohibits an institution from hiring an individual convicted of certain criminal offenses or who is subject to a prohibition order under 12 U.S.C. 1818(e)(6).

[9] Under the Guidelines, an institution's *customer information systems* consist of all of the methods used to access, collect, store, use, transmit, protect, or dispose of customer information, including the systems maintained by its service providers. *See* Security Guidelines, I.C.2.d (I.C.2.c for OTS).

[10] *See* FFIEC Information Technology Examination Handbook, Information Security Booklet, Dec. 2002 available at *http://www.ffiec.gov/ffiecinfobase/html_pages/infosec_book_frame.htm*. Federal Reserve SR 97–32, Sound Practice Guidance for Information Security for Networks, Dec. 4, 1997; OCC Bulletin 2000–14, ''Infrastructure Threats—Intrusion Risks'' (May 15, 2000), for additional guidance on preventing, detecting, and responding to intrusions into financial institution computer systems.

[11] *See* Federal Reserve SR Ltr. 00–04, Outsourcing of Information and Transaction Processing, Feb. 9, 2000; OCC Bulletin 2001–47, ''Third-Party Relationships Risk Management Principles,'' Nov. 1, 2001; FDIC FIL 68–99, Risk Assessment Tools and Practices for Information System Security, July 7, 1999; OTS Thrift Bulletin 82a, Third Party Arrangements, Sept. 1, 2004.

c. Consistent with the Agencies' Suspicious Activity Report (''SAR'') regulations,[12] notifying appropriate law enforcement authorities, in addition to filing a timely SAR in situations involving Federal criminal violations requiring immediate attention, such as when a reportable violation is ongoing;

d. Taking appropriate steps to contain and control the incident to prevent further unauthorized access to or use of customer information, for example, by monitoring, freezing, or closing affected accounts, while preserving records and other evidence;[13] and

e. Notifying customers when warranted.

2. Where an incident of unauthorized access to customer information involves customer information systems maintained by an institution's service providers, it is the responsibility of the financial institution to notify the institution's customers and regulator. However, an institution may authorize or contract with its service provider to notify the institution's customers or regulator on its behalf.

[12] An institution's obligation to file a SAR is set out in the Agencies' SAR regulations and Agency guidance. *See* 12 CFR 21.11 (national banks, Federal branches and agencies); 12 CFR 208.62 (State member banks); 12 CFR 211.5(k) (Edge and agreement corporations); 12 CFR 211.24(f) (uninsured State branches and agencies of foreign banks); 12 CFR 225.4(f) (bank holding companies and their nonbank subsidiaries); 12 CFR part 353 (State non-member banks); and 12 CFR 563.180 (savings associations). National banks must file SARs in connection with computer intrusions and other computer crimes. *See* OCC Bulletin 2000–14, ''Infrastructure Threats—Intrusion Risks'' (May 15, 2000); Advisory Letter 97–9, ''Reporting Computer Related Crimes'' (November 19, 1997) (general guidance still applicable though instructions for new SAR form published in 65 FR 1229, 1230 (January 7, 2000)). *See also* Federal Reserve SR 01–11, Identity Theft and Pretext Calling, Apr. 26, 2001; SR 97–28, Guidance Concerning Reporting of Computer Related Crimes by Financial Institutions, Nov. 6, 1997; FDIC FIL 48–2000, Suspicious Activity Reports, July 14, 2000; FIL 47–97, Preparation of Suspicious Activity Reports, May 6, 1997; OTS CEO Memorandum 139, Identity Theft and Pretext Calling, May 4, 2001; CEO Memorandum 126, New Suspicious Activity Report Form, July 5, 2000; *http://www.ots.treas.gov/BSA* (for the latest SAR form and filing instructions required by OTS as of July 1, 2003).

[13] *See* FFIEC Information Technology Examination Handbook, Information Security Booklet, Dec. 2002, pp. 68–74.

III. CUSTOMER NOTICE

Financial institutions have an affirmative duty to protect their customers' information against unauthorized access or use. Notifying customers of a security incident involving the unauthorized access or use of the customer's information in accordance with the standard set forth below is a key part of that duty. Timely notification of customers is important to manage an institution's reputation risk. Effective notice also may reduce an institution's legal risk, assist in maintaining good customer relations, and enable the institution's customers to take steps to protect themselves against the consequences of identity theft. When customer notification is warranted, an institution may not forgo notifying its customers of an incident because the institution believes that it may be potentially embarrassed or inconvenienced by doing so.

*A. Standard for Providing Notice*

When a financial institution becomes aware of an incident of unauthorized access to sensitive customer information, the institution should conduct a reasonable investigation to promptly determine the likelihood that the information has been or will be misused. If the institution determines that misuse of its information about a customer has occurred or is reasonably possible, it should notify the affected customer as soon as possible. Customer notice may be delayed if an appropriate law enforcement agency determines that notification will interfere with a criminal investigation and provides the institution with a written request for the delay. However, the institution should notify its customers as soon as notification will no longer interfere with the investigation.

1. Sensitive Customer Information

Under the Guidelines, an institution must protect against unauthorized access to or use of customer information that could result in substantial harm or inconvenience to any customer. Substantial harm or inconvenience is most likely to result from improper access to *sensitive customer information* because this type of information is most likely to be misused, as in the commission of identity theft. For purposes of this Guidance, *sensitive customer information* means a customer's name, address, or telephone number, in conjunction with the customer's social security number, driver's license number, account number, credit or debit card number, or a personal identification number or password that would permit access to the customer's account. *Sensitive customer information* also includes any combination of components of customer information that would

allow someone to log onto or access the customer's account, such as user name and password or password and account number.

2. Affected Customers

If a financial institution, based upon its investigation, can determine from its logs or other data precisely which customers' information has been improperly accessed, it may limit notification to those customers with regard to whom the institution determines that misuse of their information has occurred or is reasonably possible. However, there may be situations where the institution determines that a group of files has been accessed improperly, but is unable to identify which specific customers' information has been accessed. If the circumstances of the unauthorized access lead the institution to determine that misuse of the information is reasonably possible, it should notify all customers in the group.

*B. Content of Customer Notice*

1. Customer notice should be given in a clear and conspicuous manner. The notice should describe the incident in general terms and the type of customer information that was the subject of unauthorized access or use. It also should generally describe what the institution has done to protect the customers' information from further unauthorized access. In addition, it should include a telephone number that customers can call for further information and assistance.[14] The notice also should remind customers of the need to remain vigilant over the next twelve to twenty-four months, and to promptly report incidents of suspected identity theft to the institution. The notice should include the following additional items, when appropriate:

a. A recommendation that the customer review account statements and immediately report any suspicious activity to the institution;

b. A description of fraud alerts and an explanation of how the customer may place a fraud alert in the customer's consumer reports to put the customer's creditors on notice that the customer may be a victim of fraud;

c. A recommendation that the customer periodically obtain credit reports from each nationwide credit reporting agency and have information relating to fraudulent transactions deleted;

d. An explanation of how the customer may obtain a credit report free of charge; and

e. Information about the availability of the FTC's online guidance regarding steps a consumer can take to protect against identity theft. The notice should encourage the customer to report any incidents of identity theft to the FTC, and should provide the FTC's Web site address and toll-free telephone number that customers may use to obtain the identity theft guidance and report suspected incidents of identity theft.[15]

2. The Agencies encourage financial institutions to notify the nationwide consumer reporting agencies prior to sending notices to a large number of customers that include contact information for the reporting agencies.

*C. Delivery of Customer Notice*

Customer notice should be delivered in any manner designed to ensure that a customer can reasonably be expected to receive it. For example, the institution may choose to contact all customers affected by telephone or by mail, or by electronic mail for those customers for whom it has a valid e-mail address and who have agreed to receive communications electronically.

[66 FR 8636, Feb. 1, 2001, as amended at 70 FR 15751, 15753, Mar. 29, 2005; 71 FR 5780, Feb. 3, 2006]

## APPENDIX G TO PART 225—CAPITAL ADEQUACY GUIDELINES FOR BANK HOLDING COMPANIES: INTERNAL-RATINGS-BASED AND ADVANCED MEASUREMENT APPROACHES

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[14] The institution should, therefore, ensure that it has reasonable policies and procedures in place, including trained personnel, to respond appropriately to customer inquiries and requests for assistance.

[15] Currently, the FTC Web site for the ID Theft brochure and the FTC Hotline phone number are *http://www.consumer.gov/idtheft* and 1–877–IDTHEFT. The institution may also refer customers to any materials developed pursuant to section 151(b) of the FACT Act (educational materials developed by the FTC to teach the public how to prevent identity theft).

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## PART I. GENERAL PROVISIONS

### *Section 1. Purpose, Applicability, Reservation of Authority, and Principle of Conservatism*

(a) *Purpose*. This appendix establishes:

(1) Minimum qualifying criteria for bank holding company using bank holding company-specific internal risk measurement and management processes for calculating risk-based capital requirements;

(2) Methodologies for such bank holding company to calculate their risk-based capital requirements; and

(3) Public disclosure requirements for such bank holding company.

(b) *Applicability*. (1) This appendix applies to a bank holding company that:

(i) Has consolidated total assets, as reported on the most recent year-end Consolidated Report of Condition and Income (Call Report) or Thrift Financial Report (TFR), equal to $250 billion or more;

(ii) Has consolidated total on-balance sheet foreign exposure at the most recent year-end equal to $10 billion or more (where total on-balance sheet foreign exposure equals total cross-border claims less claims with head office or guarantor located in another country plus redistributed guaranteed amounts to the country of head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report);

(iii) Is a subsidiary of a depository institution that uses 12 CFR part 3, appendix C, 12 CFR part 208, appendix F, 12 CFR part 325, appendix D, or 12 CFR part 567, appendix C, to calculate its risk-based capital requirements; or

(iv) Is a subsidiary of a bank holding company that uses 12 CFR part 225, appendix G, to calculate its risk-based capital requirements.

(2) Any bank holding company may elect to use this appendix to calculate its risk-based capital requirements.

(3) A bank holding company that is subject to this appendix must use this appendix unless the Federal Reserve determines in writing that application of this appendix is not appropriate in light of the bank holding company's asset size, level of complexity, risk profile, or scope of operations. In making a determination under this paragraph, the Federal Reserve will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

(c) *Reservation of authority*—(1) *Additional capital in the aggregate*. The Federal Reserve may require a bank holding company to hold an amount of capital greater than otherwise required under this appendix if the Federal Reserve determines that the bank holding company's risk-based capital requirement under this appendix is not commensurate with the bank holding company's credit, market, operational, or other risks. In making a determination under this paragraph, the Federal Reserve will apply notice and response procedures in the same manner and to the same extent as the notice and response procedures in 12 CFR 263.202.

(2) *Specific risk-weighted asset amounts*. (i) If the Federal Reserve determines that the risk-weighted asset amount calculated under this appendix by the bank holding company for one or more exposures is not commensurate with the risks associated with those exposures, the Federal Reserve may require the bank holding company to assign a different

risk-weighted asset amount to the exposures, to assign different risk parameters to the exposures (if the exposures are wholesale or retail exposures), or to use different model assumptions for the exposures (if relevant), all as specified by the Federal Reserve.

(ii) If the Federal Reserve determines that the risk-weighted asset amount for operational risk produced by the bank holding company under this appendix is not commensurate with the operational risks of the bank holding company, the Federal Reserve may require the bank holding company to assign a different risk-weighted asset amount for operational risk, to change elements of its operational risk analytical framework, including distributional and dependence assumptions, or to make other changes to the bank holding company's operational risk management processes, data and assessment systems, or quantification systems, all as specified by the Federal Reserve.

(3) *Other supervisory authority*. Nothing in this appendix limits the authority of the Federal Reserve under any other provision of law or regulation to take supervisory or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

(d) *Principle of conservatism*. Notwithstanding the requirements of this appendix, a bank holding company may choose not to apply a provision of this appendix to one or more exposures, provided that:

(1) The bank holding company can demonstrate on an ongoing basis to the satisfaction of the Federal Reserve that not applying the provision would, in all circumstances, unambiguously generate a risk-based capital requirement for each such exposure greater than that which would otherwise be required under this appendix;

(2) The bank holding company appropriately manages the risk of each such exposure;

(3) The bank holding company notifies the Federal Reserve in writing prior to applying this principle to each such exposure; and

(4) The exposures to which the bank holding company applies this principle are not, in the aggregate, material to the bank holding company.

*Section 2. Definitions*

*Advanced internal ratings-based (IRB) systems* means a bank holding company's internal risk rating and segmentation system; risk parameter quantification system; data management and maintenance system; and control, oversight, and validation system for credit risk of wholesale and retail exposures.

*Advanced systems* means a bank holding company's advanced IRB systems, operational risk management processes, operational risk data and assessment systems, operational risk quantification systems, and, to the extent the bank holding company uses the following systems, the internal models methodology, double default excessive correlation detection process, IMA for equity exposures, and IAA for securitization exposures to ABCP programs.

*Affiliate* with respect to a company means any company that controls, is controlled by, or is under common control with, the company.

*Applicable external rating* means:

(1) With respect to an exposure that has multiple external ratings assigned by NRSROs, the lowest solicited external rating assigned to the exposure by any NRSRO; and

(2) With respect to an exposure that has a single external rating assigned by an NRSRO, the external rating assigned to the exposure by the NRSRO.

*Applicable inferred rating* means:

(1) With respect to an exposure that has multiple inferred ratings, the lowest inferred rating based on a solicited external rating; and

(2) With respect to an exposure that has a single inferred rating, the inferred rating.

*Asset-backed commercial paper (ABCP) program* means a program that primarily issues commercial paper that:

(1) Has an external rating; and

(2) Is backed by underlying exposures held in a bankruptcy-remote SPE.

*Asset-backed commercial paper (ABCP) program sponsor* means a bank holding company that:

(1) Establishes an ABCP program;

(2) Approves the sellers permitted to participate in an ABCP program;

(3) Approves the exposures to be purchased by an ABCP program; or

(4) Administers the ABCP program by monitoring the underlying exposures, underwriting or otherwise arranging for the placement of debt or other obligations issued by the program, compiling monthly reports, or ensuring compliance with the program documents and with the program's credit and investment policy.

*Backtesting* means the comparison of a bank holding company's internal estimates with actual outcomes during a sample period not used in model development. In this context, backtesting is one form of out-of-sample testing.

*Bank holding company* is defined in section 2 of the Bank Holding Company Act (12 U.S.C. 1841).

*Benchmarking* means the comparison of a bank holding company's internal estimates with relevant internal and external data or with estimates based on other estimation techniques.

*Business environment and internal control factors* means the indicators of a bank holding company's operational risk profile that

reflect a current and forward-looking assessment of the bank holding company's underlying business risk factors and internal control environment.

*Carrying value* means, with respect to an asset, the value of the asset on the balance sheet of the bank holding company, determined in accordance with GAAP.

*Clean-up call* means a contractual provision that permits an originating bank holding company or servicer to call securitization exposures before their stated maturity or call date. See also *eligible clean-up call*.

*Commodity derivative contract* means a commodity-linked swap, purchased commodity-linked option, forward commodity-linked contract, or any other instrument linked to commodities that gives rise to similar counterparty credit risks.

*Company* means a corporation, partnership, limited liability company, depository institution, business trust, special purpose entity, association, or similar organization.

*Control*. A person or company *controls* a company if it:

(1) Owns, controls, or holds with power to vote 25 percent or more of a class of voting securities of the company; or

(2) Consolidates the company for financial reporting purposes.

*Controlled early amortization provision* means an early amortization provision that meets all the following conditions:

(1) The originating bank holding company has appropriate policies and procedures to ensure that it has sufficient capital and liquidity available in the event of an early amortization;

(2) Throughout the duration of the securitization (including the early amortization period), there is the same pro rata sharing of interest, principal, expenses, losses, fees, recoveries, and other cash flows from the underlying exposures based on the originating bank holding company's and the investors' relative shares of the underlying exposures outstanding measured on a consistent monthly basis;

(3) The amortization period is sufficient for at least 90 percent of the total underlying exposures outstanding at the beginning of the early amortization period to be repaid or recognized as in default; and

(4) The schedule for repayment of investor principal is not more rapid than would be allowed by straight-line amortization over an 18-month period.

*Credit derivative* means a financial contract executed under standard industry credit derivative documentation that allows one party (the protection purchaser) to transfer the credit risk of one or more exposures (reference exposure) to another party (the protection provider). See also *eligible credit derivative*.

*Credit-enhancing interest-only strip (CEIO)* means an on-balance sheet asset that, in form or in substance:

(1) Represents a contractual right to receive some or all of the interest and no more than a minimal amount of principal due on the underlying exposures of a securitization; and

(2) Exposes the holder to credit risk directly or indirectly associated with the underlying exposures that exceeds a pro rata share of the holder's claim on the underlying exposures, whether through subordination provisions or other credit-enhancement techniques.

*Credit-enhancing representations and warranties* means representations and warranties that are made or assumed in connection with a transfer of underlying exposures (including loan servicing assets) and that obligate a bank holding company to protect another party from losses arising from the credit risk of the underlying exposures. Credit-enhancing representations and warranties include provisions to protect a party from losses resulting from the default or nonperformance of the obligors of the underlying exposures or from an insufficiency in the value of the collateral backing the underlying exposures. Credit-enhancing representations and warranties do not include:

(1) Early default clauses and similar warranties that permit the return of, or premium refund clauses that cover, first-lien residential mortgage exposures for a period not to exceed 120 days from the date of transfer, provided that the date of transfer is within one year of origination of the residential mortgage exposure;

(2) Premium refund clauses that cover underlying exposures guaranteed, in whole or in part, by the U.S. government, a U.S. government agency, or a U.S. government sponsored enterprise, provided that the clauses are for a period not to exceed 120 days from the date of transfer; or

(3) Warranties that permit the return of underlying exposures in instances of misrepresentation, fraud, or incomplete documentation.

*Credit risk mitigant* means collateral, a credit derivative, or a guarantee.

*Credit-risk-weighted assets* means 1.06 multiplied by the sum of:

(1) Total wholesale and retail risk-weighted assets;

(2) Risk-weighted assets for securitization exposures; and

(3) Risk-weighted assets for equity exposures.

*Current exposure* means, with respect to a netting set, the larger of zero or the market value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the

transactions. Current exposure is also called replacement cost.

*Default*—(1) *Retail*. (i) A retail exposure of a bank holding company is in default if:

(A) The exposure is 180 days past due, in the case of a residential mortgage exposure or revolving exposure;

(B) The exposure is 120 days past due, in the case of all other retail exposures; or

(C) The bank holding company has taken a full or partial charge-off, write-down of principal, or material negative fair value adjustment of principal on the exposure for credit-related reasons.

(ii) Notwithstanding paragraph (1)(i) of this definition, for a retail exposure held by a non-U.S. subsidiary of the bank holding company that is subject to an internal ratings-based approach to capital adequacy consistent with the Basel Committee on Banking Supervision's ''International Convergence of Capital Measurement and Capital Standards: A Revised Framework'' in a non-U.S. jurisdiction, the bank holding company may elect to use the definition of default that is used in that jurisdiction, provided that the bank holding company has obtained prior approval from the Federal Reserve to use the definition of default in that jurisdiction.

(iii) A retail exposure in default remains in default until the bank holding company has reasonable assurance of repayment and performance for all contractual principal and interest payments on the exposure.

(2) *Wholesale*. (i) A bank holding company's wholesale obligor is in default if:

(A) The bank holding company determines that the obligor is unlikely to pay its credit obligations to the bank holding company in full, without recourse by the bank holding company to actions such as realizing collateral (if held); or

(B) The obligor is past due more than 90 days on any material credit obligation(s) to the bank holding company.[1]

(ii) An obligor in default remains in default until the bank holding company has reasonable assurance of repayment and performance for all contractual principal and interest payments on all exposures of the bank holding company to the obligor (other than exposures that have been fully written-down or charged-off).

*Dependence* means a measure of the association among operational losses across and within units of measure.

*Depository institution* is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

*Derivative contract* means a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivatives, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days.

*Early amortization provision* means a provision in the documentation governing a securitization that, when triggered, causes investors in the securitization exposures to be repaid before the original stated maturity of the securitization exposures, unless the provision:

(1) Is triggered solely by events not directly related to the performance of the underlying exposures or the originating bank holding company (such as material changes in tax laws or regulations); or

(2) Leaves investors fully exposed to future draws by obligors on the underlying exposures even after the provision is triggered.

*Economic downturn conditions* means, with respect to an exposure held by the bank holding company, those conditions in which the aggregate default rates for that exposure's wholesale or retail exposure subcategory (or subdivision of such subcategory selected by the bank holding company) in the exposure's national jurisdiction (or subdivision of such jurisdiction selected by the bank holding company) are significantly higher than average.

*Effective maturity (M)* of a wholesale exposure means:

(1) For wholesale exposures other than repo-style transactions, eligible margin loans, and OTC derivative contracts described in paragraph (2) or (3) of this definition:

(i) The weighted-average remaining maturity (measured in years, whole or fractional) of the expected contractual cash flows from the exposure, using the undiscounted amounts of the cash flows as weights; or

(ii) The nominal remaining maturity (measured in years, whole or fractional) of the exposure.

(2) For repo-style transactions, eligible margin loans, and OTC derivative contracts subject to a qualifying master netting agreement for which the bank holding company does not apply the internal models approach in paragraph (d) of section 32 of this appendix, the weighted-average remaining maturity (measured in years, whole or fractional) of the individual transactions subject to the qualifying master netting agreement, with the weight of each individual transaction set

[1] Overdrafts are past due once the obligor has breached an advised limit or been advised of a limit smaller than the current outstanding balance.

equal to the notional amount of the transaction.

(3) For repo-style transactions, eligible margin loans, and OTC derivative contracts for which the bank holding company applies the internal models approach in paragraph (d) of section 32 of this appendix, the value determined in paragraph (d)(4) of section 32 of this appendix.

*Effective notional amount* means, for an eligible guarantee or eligible credit derivative, the lesser of the contractual notional amount of the credit risk mitigant and the EAD of the hedged exposure, multiplied by the percentage coverage of the credit risk mitigant. For example, the effective notional amount of an eligible guarantee that covers, on a pro rata basis, 40 percent of any losses on a $100 bond would be $40.

*Eligible clean-up call* means a clean-up call that:

(1) Is exercisable solely at the discretion of the originating bank holding company or servicer;

(2) Is not structured to avoid allocating losses to securitization exposures held by investors or otherwise structured to provide credit enhancement to the securitization; and

(3) (i) For a traditional securitization, is only exercisable when 10 percent or less of the principal amount of the underlying exposures or securitization exposures (determined as of the inception of the securitization) is outstanding; or

(ii) For a synthetic securitization, is only exercisable when 10 percent or less of the principal amount of the reference portfolio of underlying exposures (determined as of the inception of the securitization) is outstanding.

*Eligible credit derivative* means a credit derivative in the form of a credit default swap, $n^{th}$-to-default swap, total return swap, or any other form of credit derivative approved by the Federal Reserve, provided that:

(1) The contract meets the requirements of an eligible guarantee and has been confirmed by the protection purchaser and the protection provider;

(2) Any assignment of the contract has been confirmed by all relevant parties;

(3) If the credit derivative is a credit default swap or $n^{th}$-to-default swap, the contract includes the following credit events:

(i) Failure to pay any amount due under the terms of the reference exposure, subject to any applicable minimal payment threshold that is consistent with standard market practice and with a grace period that is closely in line with the grace period of the reference exposure; and

(ii) Bankruptcy, insolvency, or inability of the obligor on the reference exposure to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and similar events;

(4) The terms and conditions dictating the manner in which the contract is to be settled are incorporated into the contract;

(5) If the contract allows for cash settlement, the contract incorporates a robust valuation process to estimate loss reliably and specifies a reasonable period for obtaining post-credit event valuations of the reference exposure;

(6) If the contract requires the protection purchaser to transfer an exposure to the protection provider at settlement, the terms of at least one of the exposures that is permitted to be transferred under the contract provides that any required consent to transfer may not be unreasonably withheld;

(7) If the credit derivative is a credit default swap or $n^{th}$-to-default swap, the contract clearly identifies the parties responsible for determining whether a credit event has occurred, specifies that this determination is not the sole responsibility of the protection provider, and gives the protection purchaser the right to notify the protection provider of the occurrence of a credit event; and

(8) If the credit derivative is a total return swap and the bank holding company records net payments received on the swap as net income, the bank holding company records offsetting deterioration in the value of the hedged exposure (either through reductions in fair value or by an addition to reserves).

*Eligible credit reserves* means all general allowances that have been established through a charge against earnings to absorb credit losses associated with on- or off-balance sheet wholesale and retail exposures, including the allowance for loan and lease losses (ALLL) associated with such exposures but excluding allocated transfer risk reserves established pursuant to 12 U.S.C. 3904 and other specific reserves created against recognized losses.

*Eligible double default guarantor,* with respect to a guarantee or credit derivative obtained by a bank holding company, means:

(1) *U.S.-based entities.* A depository institution, a bank holding company, a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a securities broker or dealer registered with the SEC under the Securities Exchange Act of 1934 (15 U.S.C. 78o *et seq.*), or an insurance company in the business of providing credit protection (such as a monoline bond insurer or re-insurer) that is subject to supervision by a State insurance regulator, if:

(i) At the time the guarantor issued the guarantee or credit derivative or at any time thereafter, the bank holding company assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in

the third-highest investment-grade rating category; and

(ii) The bank holding company currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment-grade rating category; or

(2) *Non-U.S.-based entities*. A foreign bank (as defined in §211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), a non-U.S.-based securities firm, or a non-U.S.-based insurance company in the business of providing credit protection, if:

(i) The bank holding company demonstrates that the guarantor is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be), or has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at least investment grade;

(ii) At the time the guarantor issued the guarantee or credit derivative or at any time thereafter, the bank holding company assigned a PD to the guarantor's rating grade that was equal to or lower than the PD associated with a long-term external rating in the third-highest investment-grade rating category; and

(iii) The bank holding company currently assigns a PD to the guarantor's rating grade that is equal to or lower than the PD associated with a long-term external rating in the lowest investment-grade rating category.

*Eligible guarantee* means a guarantee that:

(1) Is written and unconditional;

(2) Covers all or a pro rata portion of all contractual payments of the obligor on the reference exposure;

(3) Gives the beneficiary a direct claim against the protection provider;

(4) Is not unilaterally cancelable by the protection provider for reasons other than the breach of the contract by the beneficiary;

(5) Is legally enforceable against the protection provider in a jurisdiction where the protection provider has sufficient assets against which a judgment may be attached and enforced;

(6) Requires the protection provider to make payment to the beneficiary on the occurrence of a default (as defined in the guarantee) of the obligor on the reference exposure in a timely manner without the beneficiary first having to take legal actions to pursue the obligor for payment;

(7) Does not increase the beneficiary's cost of credit protection on the guarantee in response to deterioration in the credit quality of the reference exposure; and

(8) Is not provided by an affiliate of the bank holding company, unless the affiliate is an insured depository institution, bank, securities broker or dealer, or insurance company that:

(i) Does not control the bank holding company; and

(ii) Is subject to consolidated supervision and regulation comparable to that imposed on U.S. depository institutions, securities broker-dealers, or insurance companies (as the case may be).

*Eligible margin loan* means an extension of credit where:

(1) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, gold, or conforming residential mortgages;

(2) The collateral is marked to market daily, and the transaction is subject to daily margin maintenance requirements;

(3) The extension of credit is conducted under an agreement that provides the bank holding company the right to accelerate and terminate the extension of credit and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;[2] and

(4) The bank holding company has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

*Eligible operational risk offsets* means amounts, not to exceed expected operational loss, that:

(1) Are generated by internal business practices to absorb highly predictable and reasonably stable operational losses, including reserves calculated consistent with GAAP; and

(2) Are available to cover expected operational losses with a high degree of certainty over a one-year horizon.

*Eligible purchased wholesale exposure* means a purchased wholesale exposure that:

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[2]This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute ''securities contracts'' under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or netting contracts between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(1) The bank holding company or securitization SPE purchased from an unaffiliated seller and did not directly or indirectly originate;

(2) Was generated on an arm's-length basis between the seller and the obligor (intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other do not satisfy this criterion);

(3) Provides the bank holding company or securitization SPE with a claim on all proceeds from the exposure or a pro rata interest in the proceeds from the exposure;

(4) Has an M of less than one year; and

(5) When consolidated by obligor, does not represent a concentrated exposure relative to the portfolio of purchased wholesale exposures.

*Eligible securitization guarantor* means:

(1) A sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Commission, a Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), a multilateral development bank, a depository institution, a bank holding company, a savings and loan holding company (as defined in 12 U.S.C. 1467a) provided all or substantially all of the holding company's activities are permissible for a financial holding company under 12 U.S.C. 1843(k), a foreign bank (as defined in §211.2 of the Federal Reserve Board's Regulation K (12 CFR 211.2)), or a securities firm;

(2) Any other entity (other than a securitization SPE) that has issued and outstanding an unsecured long-term debt security without credit enhancement that has a long-term applicable external rating in one of the three highest investment-grade rating categories; or

(3) Any other entity (other than a securitization SPE) that has a PD assigned by the bank holding company that is lower than or equal to the PD associated with a long-term external rating in the third highest investment-grade rating category.

*Eligible servicer cash advance facility* means a servicer cash advance facility in which:

(1) The servicer is entitled to full reimbursement of advances, except that a servicer may be obligated to make non-reimbursable advances for a particular underlying exposure if any such advance is contractually limited to an insignificant amount of the outstanding principal balance of that exposure;

(2) The servicer's right to reimbursement is senior in right of payment to all other claims on the cash flows from the underlying exposures of the securitization; and

(3) The servicer has no legal obligation to, and does not, make advances to the securitization if the servicer concludes the advances are unlikely to be repaid.

*Equity derivative contract* means an equity-linked swap, purchased equity-linked option, forward equity-linked contract, or any other instrument linked to equities that gives rise to similar counterparty credit risks.

*Equity exposure* means:

(1) A security or instrument (whether voting or non-voting) that represents a direct or indirect ownership interest in, and is a residual claim on, the assets and income of a company, unless:

(i) The issuing company is consolidated with the bank holding company under GAAP;

(ii) The bank holding company is required to deduct the ownership interest from tier 1 or tier 2 capital under this appendix;

(iii) The ownership interest incorporates a payment or other similar obligation on the part of the issuing company (such as an obligation to make periodic payments); or

(iv) The ownership interest is a securitization exposure;

(2) A security or instrument that is mandatorily convertible into a security or instrument described in paragraph (1) of this definition;

(3) An option or warrant that is exercisable for a security or instrument described in paragraph (1) of this definition; or

(4) Any other security or instrument (other than a securitization exposure) to the extent the return on the security or instrument is based on the performance of a security or instrument described in paragraph (1) of this definition.

*Excess spread* for a period means:

(1) Gross finance charge collections and other income received by a securitization SPE (including market interchange fees) over a period minus interest paid to the holders of the securitization exposures, servicing fees, charge-offs, and other senior trust or similar expenses of the SPE over the period; divided by

(2) The principal balance of the underlying exposures at the end of the period.

*Exchange rate derivative contract* means a cross-currency interest rate swap, forward foreign-exchange contract, currency option purchased, or any other instrument linked to exchange rates that gives rise to similar counterparty credit risks.

*Excluded mortgage exposure* means any one- to four-family residential pre-sold construction loan for a residence for which the purchase contract is cancelled that would receive a 100 percent risk weight under section 618(a)(2) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act and under 12 CFR part 225, appendix A, section III.C.3.

*Expected credit loss (ECL)* means:

(1) For a wholesale exposure to a non-defaulted obligor or segment of non-defaulted retail exposures that is carried at fair value

with gains and losses flowing through earnings or that is classified as held-for-sale and is carried at the lower of cost or fair value with losses flowing through earnings, zero.

(2) For all other wholesale exposures to non-defaulted obligors or segments of non-defaulted retail exposures, the product of PD times LGD times EAD for the exposure or segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, the bank holding company's impairment estimate for allowance purposes for the exposure or segment.

(4) Total ECL is the sum of expected credit losses for all wholesale and retail exposures other than exposures for which the bank holding company has applied the double default treatment in section 34 of this appendix.

*Expected exposure (EE)* means the expected value of the probability distribution of non-negative credit risk exposures to a counterparty at any specified future date before the maturity date of the longest term transaction in the netting set. Any negative market values in the probability distribution of market values to a counterparty at a specified future date are set to zero to convert the probability distribution of market values to the probability distribution of credit risk exposures.

*Expected operational loss (EOL)* means the expected value of the distribution of potential aggregate operational losses, as generated by the bank holding company's operational risk quantification system using a one-year horizon.

*Expected positive exposure (EPE)* means the weighted average over time of expected (non-negative) exposures to a counterparty where the weights are the proportion of the time interval that an individual expected exposure represents. When calculating risk-based capital requirements, the average is taken over a one-year horizon.

*Exposure at default (EAD).* (1) For the on-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or eligible margin loan for which the bank holding company determines EAD under section 32 of this appendix), EAD means:

(i) If the exposure or segment is a security classified as available-for-sale, the bank holding company's carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment, less any unrealized gains on the exposure or segment, and plus any unrealized losses on the exposure or segment; or

(ii) If the exposure or segment is not a security classified as available-for-sale, the bank holding company's carrying value (including net accrued but unpaid interest and fees) for the exposure or segment less any allocated transfer risk reserve for the exposure or segment.

(2) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or eligible margin loan for which the bank holding company determines EAD under section 32 of this appendix) in the form of a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the bank holding company's best estimate of net additions to the outstanding amount owed the bank holding company, including estimated future additional draws of principal and accrued but unpaid interest and fees, that are likely to occur over a one-year horizon assuming the wholesale exposure or the retail exposures in the segment were to go into default. This estimate of net additions must reflect what would be expected during economic downturn conditions. Trade-related letters of credit are short-term, self-liquidating instruments that are used to finance the movement of goods and are collateralized by the underlying goods. Transaction-related contingencies relate to a particular transaction and include, among other things, performance bonds and performance-based letters of credit.

(3) For the off-balance sheet component of a wholesale exposure or segment of retail exposures (other than an OTC derivative contract, or a repo-style transaction or eligible margin loan for which the bank holding company determines EAD under section 32 of this appendix) in the form of anything other than a loan commitment, line of credit, trade-related letter of credit, or transaction-related contingency, EAD means the notional amount of the exposure or segment.

(4) EAD for OTC derivative contracts is calculated as described in section 32 of this appendix. A bank holding company also may determine EAD for repo-style transactions and eligible margin loans as described in section 32 of this appendix.

(5) For wholesale or retail exposures in which only the drawn balance has been securitized, the bank holding company must reflect its share of the exposures' undrawn balances in EAD. Undrawn balances of revolving exposures for which the drawn balances have been securitized must be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitized drawn balances.

*Exposure category* means any of the wholesale, retail, securitization, or equity exposure categories.

*External operational loss event data* means, with respect to a bank holding company, gross operational loss amounts, dates, recoveries, and relevant causal information for

operational loss events occurring at organizations other than the bank holding company.

*External rating* means a credit rating that is assigned by an NRSRO to an exposure, provided:

(1) The credit rating fully reflects the entire amount of credit risk with regard to all payments owed to the holder of the exposure. If a holder is owed principal and interest on an exposure, the credit rating must fully reflect the credit risk associated with timely repayment of principal and interest. If a holder is owed only principal on an exposure, the credit rating must fully reflect only the credit risk associated with timely repayment of principal; and

(2) The credit rating is published in an accessible form and is or will be included in the transition matrices made publicly available by the NRSRO that summarize the historical performance of positions rated by the NRSRO.

*Financial collateral* means collateral:

(1) In the form of:

(i) Cash on deposit with the bank holding company (including cash held for the bank holding company by a third-party custodian or trustee);

(ii) Gold bullion;

(iii) Long-term debt securities that have an applicable external rating of one category below investment grade or higher;

(iv) Short-term debt instruments that have an applicable external rating of at least investment grade;

(v) Equity securities that are publicly traded;

(vi) Convertible bonds that are publicly traded;

(vii) Money market mutual fund shares and other mutual fund shares if a price for the shares is publicly quoted daily; or

(viii) Conforming residential mortgages; and

(2) In which the bank holding company has a perfected, first priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent).

*GAAP* means generally accepted accounting principles as used in the United States.

*Gain-on-sale* means an increase in the equity capital (as reported on Schedule HC of the FR Y–9C Report) of a bank holding company that results from a securitization (other than an increase in equity capital that results from the bank holding company's receipt of cash in connection with the securitization).

*Guarantee* means a financial guarantee, letter of credit, insurance, or other similar financial instrument (other than a credit derivative) that allows one party (beneficiary) to transfer the credit risk of one or more specific exposures (reference exposure) to another party (protection provider). See also *eligible guarantee*.

*High volatility commercial real estate (HVCRE) exposure* means a credit facility that finances or has financed the acquisition, development, or construction (ADC) of real property, unless the facility finances:

(1) One- to four-family residential properties; or

(2) Commercial real estate projects in which:

(i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio in the relevant agency's real estate lending standards at 12 CFR part 34, Subpart D (OCC), 12 CFR part 208, appendix C (Federal Reserve); 12 CFR part 365, Subpart D (FDIC); and 12 CFR 560.100–560.101 (OTS).

(ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised ''as completed'' value; and

(iii) The borrower contributed the amount of capital required by paragraph (2)(ii) of this definition before the bank holding company advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full. Permanent financing may be provided by the bank holding company that provided the ADC facility as long as the permanent financing is subject to the bank holding company's underwriting criteria for long-term mortgage loans.

*Inferred rating*. A securitization exposure has an *inferred rating* equal to the external rating referenced in paragraph (2)(i) of this definition if:

(1) The securitization exposure does not have an external rating; and

(2) Another securitization exposure issued by the same issuer and secured by the same underlying exposures:

(i) Has an external rating;

(ii) Is subordinated in all respects to the unrated securitization exposure;

(iii) Does not benefit from any credit enhancement that is not available to the unrated securitization exposure; and

(iv) Has an effective remaining maturity that is equal to or longer than that of the unrated securitization exposure.

*Interest rate derivative contract* means a single-currency interest rate swap, basis swap, forward rate agreement, purchased interest rate option, when-issued securities, or any other instrument linked to interest rates

that gives rise to similar counterparty credit risks.

*Internal operational loss event data* means, with respect to a bank holding company, gross operational loss amounts, dates, recoveries, and relevant causal information for operational loss events occurring at the bank holding company.

*Investing bank holding company* means, with respect to a securitization, a bank holding company that assumes the credit risk of a securitization exposure (other than an originating bank holding company of the securitization). In the typical synthetic securitization, the investing bank holding company sells credit protection on a pool of underlying exposures to the originating bank holding company.

*Investment fund* means a company:

(1) All or substantially all of the assets of which are financial assets; and

(2) That has no material liabilities.

*Investors' interest EAD* means, with respect to a securitization, the EAD of the underlying exposures multiplied by the ratio of:

(1) The total amount of securitization exposures issued by the securitization SPE to investors; divided by

(2) The outstanding principal amount of underlying exposures.

*Loss given default (LGD)* means:

(1) For a wholesale exposure, the greatest of:

(i) Zero;

(ii) The bank holding company's empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the bank holding company would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the bank holding company to the exposure) were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The bank holding company's empirically based best estimate of the economic loss, per dollar of EAD, the bank holding company would expect to incur if the obligor (or a typical obligor in the loss severity grade assigned by the bank holding company to the exposure) were to default within a one-year horizon during economic downturn conditions.

(2) For a segment of retail exposures, the greatest of:

(i) Zero;

(ii) The bank holding company's empirically based best estimate of the long-run default-weighted average economic loss, per dollar of EAD, the bank holding company would expect to incur if the exposures in the segment were to default within a one-year horizon over a mix of economic conditions, including economic downturn conditions; or

(iii) The bank holding company's empirically based best estimate of the economic loss, per dollar of EAD, the bank holding company would expect to incur if the exposures in the segment were to default within a one-year horizon during economic downturn conditions.

(3) The economic loss on an exposure in the event of default is all material credit-related losses on the exposure (including accrued but unpaid interest or fees, losses on the sale of collateral, direct workout costs, and an appropriate allocation of indirect workout costs). Where positive or negative cash flows on a wholesale exposure to a defaulted obligor or a defaulted retail exposure (including proceeds from the sale of collateral, workout costs, additional extensions of credit to facilitate repayment of the exposure, and draw-downs of unused credit lines) occur after the date of default, the economic loss must reflect the net present value of cash flows as of the default date using a discount rate appropriate to the risk of the defaulted exposure.

*Main index* means the Standard & Poor's 500 Index, the FTSE All-World Index, and any other index for which the bank holding company can demonstrate to the satisfaction of the Federal Reserve that the equities represented in the index have comparable liquidity, depth of market, and size of bid-ask spreads as equities in the Standard & Poor's 500 Index and FTSE All-World Index.

*Multilateral development bank* means the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral lending institution or regional development bank in which the U.S. government is a shareholder or contributing member or which the Federal Reserve determines poses comparable credit risk.

*Nationally recognized statistical rating organization (NRSRO)* means an entity registered with the SEC as a nationally recognized statistical rating organization under section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7).

*Netting set* means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or qualifying cross-product master netting agreement. For purposes of the internal models methodology in paragraph (d) of section 32 of this appendix, each transaction that is not subject to such a master netting agreement is its own netting set.

*$N^{th}$-to-default credit derivative* means a credit derivative that provides credit protection only for the $n^{th}$-defaulting reference exposure in a group of reference exposures.

*Obligor* means the legal entity or natural person contractually obligated on a wholesale exposure, except that a bank holding company may treat the following exposures as having separate obligors:

(1) Exposures to the same legal entity or natural person denominated in different currencies;

(2) (i) An income-producing real estate exposure for which all or substantially all of the repayment of the exposure is reliant on the cash flows of the real estate serving as collateral for the exposure; the bank holding company, in economic substance, does not have recourse to the borrower beyond the real estate collateral; and no cross-default or cross-acceleration clauses are in place other than clauses obtained solely out of an abundance of caution; and

(ii) Other credit exposures to the same legal entity or natural person; and

(3) (i) A wholesale exposure authorized under section 364 of the U.S. Bankruptcy Code (11 U.S.C. 364) to a legal entity or natural person who is a debtor-in-possession for purposes of Chapter 11 of the Bankruptcy Code; and

(ii) Other credit exposures to the same legal entity or natural person.

*Operational loss* means a loss (excluding insurance or tax effects) resulting from an operational loss event. Operational loss includes all expenses associated with an operational loss event except for opportunity costs, forgone revenue, and costs related to risk management and control enhancements implemented to prevent future operational losses.

*Operational loss event* means an event that results in loss and is associated with any of the following seven operational loss event type categories:

(1) Internal fraud, which means the operational loss event type category that comprises operational losses resulting from an act involving at least one internal party of a type intended to defraud, misappropriate property, or circumvent regulations, the law, or company policy, excluding diversity- and discrimination-type events.

(2) External fraud, which means the operational loss event type category that comprises operational losses resulting from an act by a third party of a type intended to defraud, misappropriate property, or circumvent the law. Retail credit card losses arising from non-contractual, third-party initiated fraud (for example, identity theft) are external fraud operational losses. All other third-party initiated credit losses are to be treated as credit risk losses.

(3) Employment practices and workplace safety, which means the operational loss event type category that comprises operational losses resulting from an act inconsistent with employment, health, or safety laws or agreements, payment of personal injury claims, or payment arising from diversity- and discrimination-type events.

(4) Clients, products, and business practices, which means the operational loss event type category that comprises operational losses resulting from the nature or design of a product or from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements).

(5) Damage to physical assets, which means the operational loss event type category that comprises operational losses resulting from the loss of or damage to physical assets from natural disaster or other events.

(6) Business disruption and system failures, which means the operational loss event type category that comprises operational losses resulting from disruption of business or system failures.

(7) Execution, delivery, and process management, which means the operational loss event type category that comprises operational losses resulting from failed transaction processing or process management or losses arising from relations with trade counterparties and vendors.

*Operational risk* means the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events (including legal risk but excluding strategic and reputational risk).

*Operational risk exposure* means the 99.9$^{th}$ percentile of the distribution of potential aggregate operational losses, as generated by the bank holding company's operational risk quantification system over a one-year horizon (and not incorporating eligible operational risk offsets or qualifying operational risk mitigants).

*Originating bank holding company*, with respect to a securitization, means a bank holding company that:

(1) Directly or indirectly originated or securitized the underlying exposures included in the securitization; or

(2) Serves as an ABCP program sponsor to the securitization.

*Other retail exposure* means an exposure (other than a securitization exposure, an equity exposure, a residential mortgage exposure, an excluded mortgage exposure, a qualifying revolving exposure, or the residual value portion of a lease exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is either:

(1) An exposure to an individual for non-business purposes; or

(2) An exposure to an individual or company for business purposes if the bank holding company's consolidated business credit exposure to the individual or company is $1 million or less.

*Over-the-counter (OTC) derivative contract* means a derivative contract that is not traded on an exchange that requires the daily receipt and payment of cash-variation margin.

*Probability of default (PD)* means:

(1) For a wholesale exposure to a non-defaulted obligor, the bank holding company's empirically based best estimate of the long-run average one-year default rate for the rating grade assigned by the bank holding company to the obligor, capturing the average default experience for obligors in the rating grade over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the rating grade.

(2) For a segment of non-defaulted retail exposures, the bank holding company's empirically based best estimate of the long-run average one-year default rate for the exposures in the segment, capturing the average default experience for exposures in the segment over a mix of economic conditions (including economic downturn conditions) sufficient to provide a reasonable estimate of the average one-year default rate over the economic cycle for the segment and adjusted upward as appropriate for segments for which seasoning effects are material. For purposes of this definition, a segment for which seasoning effects are material is a segment where there is a material relationship between the time since origination of exposures within the segment and the bank holding company's best estimate of the long-run average one-year default rate for the exposures in the segment.

(3) For a wholesale exposure to a defaulted obligor or segment of defaulted retail exposures, 100 percent.

*Protection amount (P)* means, with respect to an exposure hedged by an eligible guarantee or eligible credit derivative, the effective notional amount of the guarantee or credit derivative, reduced to reflect any currency mismatch, maturity mismatch, or lack of restructuring coverage (as provided in section 33 of this appendix).

*Publicly traded* means traded on:

(1) Any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(2) Any non-U.S.-based securities exchange that:

(i) Is registered with, or approved by, a national securities regulatory authority; and

(ii) Provides a liquid, two-way market for the instrument in question, meaning that there are enough independent bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days.

*Qualifying central counterparty* means a counterparty (for example, a clearinghouse) that:

(1) Facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts;

(2) Requires all participants in its arrangements to be fully collateralized on a daily basis; and

(3) The bank holding company demonstrates to the satisfaction of the Federal Reserve is in sound financial condition and is subject to effective oversight by a national supervisory authority.

*Qualifying cross-product master netting agreement* means a qualifying master netting agreement that provides for termination and close-out netting across multiple types of financial transactions or qualifying master netting agreements in the event of a counterparty's default, provided that:

(1) The underlying financial transactions are OTC derivative contracts, eligible margin loans, or repo-style transactions; and

(2) The bank holding company obtains a written legal opinion verifying the validity and enforceability of the agreement under applicable law of the relevant jurisdictions if the counterparty fails to perform upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding.

*Qualifying master netting agreement* means any written, legally enforceable bilateral agreement, provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including bankruptcy, insolvency, or similar proceeding, of the counterparty;

(2) The agreement provides the bank holding company the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, including upon an event of bankruptcy, insolvency, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions;

(3) The bank holding company has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that:

(i) The agreement meets the requirements of paragraph (2) of this definition; and

(ii) In the event of a legal challenge (including one resulting from default or from bankruptcy, insolvency, or similar proceeding) the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions;

(4) The bank holding company establishes and maintains procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition; and

(5) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it would make otherwise under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).

*Qualifying revolving exposure (QRE)* means an exposure (other than a securitization exposure or equity exposure) to an individual that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and:

(1) Is revolving (that is, the amount outstanding fluctuates, determined largely by the borrower's decision to borrow and repay, up to a pre-established maximum amount);

(2) Is unsecured and unconditionally cancelable by the bank holding company to the fullest extent permitted by Federal law; and

(3) Has a maximum exposure amount (drawn plus undrawn) of up to $100,000.

*Repo-style transaction* means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the bank holding company acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, gold, or conforming residential mortgages;

(2) The transaction is marked-to-market daily and subject to daily margin maintenance requirements;

(3)(i) The transaction is a ''securities contract'' or ''repurchase agreement'' under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e)(8) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)), or a netting contract between or among financial institutions under sections 401–407 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401–4407) or the Federal Reserve Board's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3)(i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the bank holding company the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of default (including upon an event of bankruptcy, insolvency, or similar proceeding) of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions; or

(B) The transaction is:

(*1*) Either overnight or unconditionally cancelable at any time by the bank holding company; and

(*2*) Executed under an agreement that provides the bank holding company the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set off collateral promptly upon an event of counterparty default; and

(4) The bank holding company has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that the agreement meets the requirements of paragraph (3) of this definition and is legal, valid, binding, and enforceable under applicable law in the relevant jurisdictions.

*Residential mortgage exposure* means an exposure (other than a securitization exposure, equity exposure, or excluded mortgage exposure) that is managed as part of a segment of exposures with homogeneous risk characteristics, not on an individual-exposure basis, and is:

(1) An exposure that is primarily secured by a first or subsequent lien on one- to four-family residential property; or

(2) An exposure with an original and outstanding amount of $1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one to four family.

*Retail exposure* means a residential mortgage exposure, a qualifying revolving exposure, or an other retail exposure.

*Retail exposure subcategory* means the residential mortgage exposure, qualifying revolving exposure, or other retail exposure subcategory.

*Risk parameter* means a variable used in determining risk-based capital requirements for wholesale and retail exposures, specifically probability of default (PD), loss given default (LGD), exposure at default (EAD), or effective maturity (M).

*Scenario analysis* means a systematic process of obtaining expert opinions from business managers and risk management experts to derive reasoned assessments of the likelihood and loss impact of plausible high-severity operational losses. Scenario analysis may include the well-reasoned evaluation and use of external operational loss event data, adjusted as appropriate to ensure relevance to a bank holding company's operational risk profile and control structure.

*SEC* means the U.S. Securities and Exchange Commission.

*Securitization* means a traditional securitization or a synthetic securitization.

*Securitization exposure* means an on-balance sheet or off-balance sheet credit exposure that arises from a traditional or synthetic securitization (including credit-enhancing representations and warranties).

*Securitization special purpose entity (securitization SPE)* means a corporation, trust, or other entity organized for the specific purpose of holding underlying exposures of a securitization, the activities of which are limited to those appropriate to accomplish this purpose, and the structure of which is intended to isolate the underlying exposures held by the entity from the credit risk of the seller of the underlying exposures to the entity.

*Senior securitization exposure* means a securitization exposure that has a first priority claim on the cash flows from the underlying exposures. When determining whether a securitization exposure has a first priority claim on the cash flows from the underlying exposures, a bank holding company is not required to consider amounts due under interest rate or currency derivative contracts, fees due, or other similar payments. Both the most senior commercial paper issued by an ABCP program and a liquidity facility that supports the ABCP program may be senior securitization exposures if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows from the underlying exposures except amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

S*ervicer cash advance facility* means a facility under which the servicer of the underlying exposures of a securitization may advance cash to ensure an uninterrupted flow of payments to investors in the securitization, including advances made to cover foreclosure costs or other expenses to facilitate the timely collection of the underlying exposures. See also *eligible servicer cash advance facility*.

*Sovereign entity* means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

*Sovereign exposure* means:

(1) A direct exposure to a sovereign entity; or

(2) An exposure directly and unconditionally backed by the full faith and credit of a sovereign entity.

*Subsidiary* means, with respect to a company, a company controlled by that company.

*Synthetic securitization* means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties through the use of one or more credit derivatives or guarantees (other than a guarantee that transfers only the credit risk of an individual retail exposure);

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures; and

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives, guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities).

*Tier 1 capital* is defined in 12 CFR part 225, appendix A, as modified in part II of this appendix.

*Tier 2 capital* is defined in 12 CFR part 225, appendix A, as modified in part II of this appendix.

*Total qualifying capital* means the sum of tier 1 capital and tier 2 capital, after all deductions required in this appendix.

*Total risk-weighted assets* means:

(1) The sum of:

(i) Credit risk-weighted assets; and

(ii) Risk-weighted assets for operational risk; minus

(2) Excess eligible credit reserves not included in tier 2 capital.

*Total wholesale and retail risk-weighted assets* means the sum of risk-weighted assets for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures; risk-weighted assets for wholesale exposures to defaulted obligors and segments of defaulted retail exposures; risk-weighted assets for assets not defined by an exposure category; and risk-weighted assets for nonmaterial portfolios of exposures (all as determined in section 31 of this appendix) and risk-weighted assets for unsettled transactions (as determined in section 35 of this appendix) minus the amounts deducted from capital pursuant to 12 CFR part 225, appendix A (excluding those deductions reversed in section 12 of this appendix).

*Traditional securitization* means a transaction in which:

(1) All or a portion of the credit risk of one or more underlying exposures is transferred to one or more third parties other than through the use of credit derivatives or guarantees;

(2) The credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority;

(3) Performance of the securitization exposures depends upon the performance of the underlying exposures;

(4) All or substantially all of the underlying exposures are financial exposures (such as loans, commitments, credit derivatives,

guarantees, receivables, asset-backed securities, mortgage-backed securities, other debt securities, or equity securities);

(5) The underlying exposures are not owned by an operating company;

(6) The underlying exposures are not owned by a small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682); and

(7) The underlying exposures are not owned by a firm an investment in which qualifies as a community development investment under 12 U.S.C. 24(Eleventh).

(8) The Federal Reserve may determine that a transaction in which the underlying exposures are owned by an investment firm that exercises substantially unfettered control over the size and composition of its assets, liabilities, and off-balance sheet exposures is not a traditional securitization based on the transaction's leverage, risk profile, or economic substance.

(9) The Federal Reserve may deem a transaction that meets the definition of a traditional securitization, notwithstanding paragraph (5), (6), or (7) of this definition, to be a traditional securitization based on the transaction's leverage, risk profile, or economic substance.

*Tranche* means all securitization exposures associated with a securitization that have the same seniority level.

*Underlying exposures* means one or more exposures that have been securitized in a securitization transaction.

*Unexpected operational loss (UOL)* means the difference between the bank holding company's operational risk exposure and the bank holding company's expected operational loss.

*Unit of measure* means the level (for example, organizational unit or operational loss event type) at which the bank holding company's operational risk quantification system generates a separate distribution of potential operational losses.

*Value-at-Risk (VaR)* means the estimate of the maximum amount that the value of one or more exposures could decline due to market price or rate movements during a fixed holding period within a stated confidence interval.

*Wholesale exposure* means a credit exposure to a company, natural person, sovereign entity, or governmental entity (other than a securitization exposure, retail exposure, excluded mortgage exposure, or equity exposure). Examples of a wholesale exposure include:

(1) A non-tranched guarantee issued by a bank holding company on behalf of a company;

(2) A repo-style transaction entered into by a bank holding company with a company and any other transaction in which a bank holding company posts collateral to a company and faces counterparty credit risk;

(3) An exposure that a bank holding company treats as a covered position under 12 CFR part 225, appendix E for which there is a counterparty credit risk capital requirement;

(4) A sale of corporate loans by a bank holding company to a third party in which the bank holding company retains full recourse;

(5) An OTC derivative contract entered into by a bank holding company with a company;

(6) An exposure to an individual that is not managed by a bank holding company as part of a segment of exposures with homogeneous risk characteristics; and

(7) A commercial lease.

*Wholesale exposure subcategory* means the HVCRE or non-HVCRE wholesale exposure subcategory.

### *Section 3. Minimum Risk-Based Capital Requirements*

(a) Except as modified by paragraph (c) of this section or by section 23 of this appendix, each bank holding company must meet a minimum ratio of:

(1) Total qualifying capital to total risk-weighted assets of 8.0 percent; and

(2) Tier 1 capital to total risk-weighted assets of 4.0 percent.

(b) Each bank holding company must hold capital commensurate with the level and nature of all risks to which the bank holding company is exposed.

(c) When a bank holding company subject to 12 CFR part 225, appendix E calculates its risk-based capital requirements under this appendix, the bank holding company must also refer to 12 CFR part 225, appendix E for supplemental rules to calculate risk-based capital requirements adjusted for market risk.

## PART II. QUALIFYING CAPITAL

### *Section 11. Additional Deductions*

(a) *General.* A bank holding company that uses this appendix must make the same deductions from its tier 1 capital and tier 2 capital required in 12 CFR part 225, appendix A, except that:

(1) A bank holding company is not required to deduct certain equity investments and CEIOs (as provided in section 12 of this appendix); and

(2) A bank holding company also must make the deductions from capital required by paragraphs (b) and (c) of this section.

(b) *Deductions from tier 1 capital.* A bank holding company must deduct from tier 1 capital any gain-on-sale associated with a securitization exposure as provided in paragraph (a) of section 41 and paragraphs (a)(1), (c), (g)(1), and (h)(1) of section 42 of this appendix.

(c) *Deductions from tier 1 and tier 2 capital.* A bank holding company must deduct the exposures specified in paragraphs (c)(1) through (c)(7) in this section 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the bank holding company's actual tier 2 capital, however, the bank holding company must deduct the excess from tier 1 capital.

(1) *Credit-enhancing interest-only strips (CEIOs).* In accordance with paragraphs (a)(1) and (c) of section 42 of this appendix, any CEIO that does not constitute gain-on-sale.

(2) *Non-qualifying securitization exposures.* In accordance with paragraphs (a)(4) and (c) of section 42 of this appendix, any securitization exposure that does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach under sections 43, 44, and 45 of this appendix, respectively.

(3) *Securitizations of non-IRB exposures.* In accordance with paragraphs (c) and (g)(4) of section 42 of this appendix, certain exposures to a securitization any underlying exposure of which is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure.

(4) *Low-rated securitization exposures.* In accordance with section 43 and paragraph (c) of section 42 of this appendix, any securitization exposure that qualifies for and must be deducted under the Ratings-Based Approach.

(5) *High-risk securitization exposures subject to the Supervisory Formula Approach.* In accordance with paragraphs (b) and (c) of section 45 of this appendix and paragraph (c) of section 42 of this appendix, certain high-risk securitization exposures (or portions thereof) that qualify for the Supervisory Formula Approach.

(6) *Eligible credit reserves shortfall.* In accordance with paragraph (a)(1) of section 13 of this appendix, any eligible credit reserves shortfall.

(7) *Certain failed capital markets transactions.* In accordance with paragraph (e)(3) of section 35 of this appendix, the bank holding company's exposure on certain failed capital markets transactions.

(8) A bank holding company must also deduct an amount equal to the minimum regulatory capital requirement established by the regulator of any insurance underwriting subsidiary of the holding company. For U.S.-based insurance underwriting subsidiaries, this amount generally would be 200 percent of the subsidiary's Authorized Control Level as established by the appropriate state regulator of the insurance company.

*Section 12. Deductions and Limitations Not Required.*

(a) *Deduction of CEIOs.* A bank holding company is not required to make the deductions from capital for CEIOs in 12 CFR part 225, appendix A, section II.B.1.e.

(b) *Deduction for certain equity investments.* A bank holding company is not required to make the deductions from capital for nonfinancial equity investments in 12 CFR part 225, appendix A, section II.B.5.

*Section 13. Eligible Credit Reserves*

(a) *Comparison of eligible credit reserves to expected credit losses*—(1) *Shortfall of eligible credit reserves.* If a bank holding company's eligible credit reserves are less than the bank holding company's total expected credit losses, the bank holding company must deduct the shortfall amount 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the bank holding company's actual tier 2 capital, the bank holding company must deduct the excess amount from tier 1 capital.

(2) *Excess eligible credit reserves.* If a bank holding company's eligible credit reserves exceed the bank holding company's total expected credit losses, the bank holding company may include the excess amount in tier 2 capital to the extent that the excess amount does not exceed 0.6 percent of the bank holding company's credit-risk-weighted assets.

(b) *Treatment of allowance for loan and lease losses.* Regardless of any provision in 12 CFR part 225, appendix A, the ALLL is included in tier 2 capital only to the extent provided in paragraph (a)(2) of this section and in section 24 of this appendix.

PART III. QUALIFICATION

*Section 21. Qualification Process*

(a) *Timing.* (1) A bank holding company that is described in paragraph (b)(1) of section 1 of this appendix must adopt a written implementation plan no later than six months after the later of April 1, 2008, or the date the bank holding company meets a criterion in that section. The implementation plan must incorporate an explicit first floor period start date no later than 36 months after the later of April 1, 2008, or the date the bank holding company meets at least one criterion under paragraph (b)(1) of section 1 of this appendix. The Federal Reserve may extend the first floor period start date.

(2) A bank holding company that elects to be subject to this appendix under paragraph (b)(2) of section 1 of this appendix must adopt a written implementation plan.

(b) *Implementation plan.* (1) The bank holding company's implementation plan must address in detail how the bank holding company complies, or plans to comply, with the qualification requirements in section 22 of this appendix. The bank holding company also must maintain a comprehensive and sound planning and governance process to

oversee the implementation efforts described in the plan. At a minimum, the plan must:

(i) Comprehensively address the qualification requirements in section 22 of this appendix for the bank holding company and each consolidated subsidiary (U.S. and foreign-based) of the bank holding company with respect to all portfolios and exposures of the bank holding company and each of its consolidated subsidiaries;

(ii) Justify and support any proposed temporary or permanent exclusion of business lines, portfolios, or exposures from application of the advanced approaches in this appendix (which business lines, portfolios, and exposures must be, in the aggregate, immaterial to the bank holding company);

(iii) Include the bank holding company's self-assessment of:

(A) The bank holding company's current status in meeting the qualification requirements in section 22 of this appendix; and

(B) The consistency of the bank holding company's current practices with the Federal Reserve's supervisory guidance on the qualification requirements;

(iv) Based on the bank holding company's self-assessment, identify and describe the areas in which the bank holding company proposes to undertake additional work to comply with the qualification requirements in section 22 of this appendix or to improve the consistency of the bank holding company's current practices with the Federal Reserve's supervisory guidance on the qualification requirements (gap analysis);

(v) Describe what specific actions the bank holding company will take to address the areas identified in the gap analysis required by paragraph (b)(1)(iv) of this section;

(vi) Identify objective, measurable milestones, including delivery dates and a date when the bank holding company's implementation of the methodologies described in this appendix will be fully operational;

(vii) Describe resources that have been budgeted and are available to implement the plan; and

(viii) Receive approval of the bank holding company's board of directors.

(2) The bank holding company must submit the implementation plan, together with a copy of the minutes of the board of directors' approval, to the Federal Reserve at least 60 days before the bank holding company proposes to begin its parallel run, unless the Federal Reserve waives prior notice.

(c) *Parallel run.* Before determining its risk-based capital requirements under this appendix and following adoption of the implementation plan, the bank holding company must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the bank holding company complies with the qualification requirements in section 22 of this appendix to the satisfaction of the Federal Reserve. During the parallel run, the bank holding company must report to the Federal Reserve on a calendar quarterly basis its risk-based capital ratios using 12 CFR part 225, appendix A and the risk-based capital requirements described in this appendix. During this period, the bank holding company is subject to 12 CFR part 225, appendix A.

(d) *Approval to calculate risk-based capital requirements under this appendix.* The Federal Reserve will notify the bank holding company of the date that the bank holding company may begin its first floor period if the Federal Reserve determines that:

(1) The bank holding company fully complies with all the qualification requirements in section 22 of this appendix;

(2) The bank holding company has conducted a satisfactory parallel run under paragraph (c) of this section; and

(3) The bank holding company has an adequate process to ensure ongoing compliance with the qualification requirements in section 22 of this appendix.

(e) *Transitional floor periods.* Following a satisfactory parallel run, a bank holding company is subject to three transitional floor periods.

(1) *Risk-based capital ratios during the transitional floor periods*—(i) *Tier 1 risk-based capital ratio.* During a bank holding company's transitional floor periods, the bank holding company's tier 1 risk-based capital ratio is equal to the lower of:

(A) The bank holding company's floor-adjusted tier 1 risk-based capital ratio; or

(B) The bank holding company's advanced approaches tier 1 risk-based capital ratio.

(ii) *Total risk-based capital ratio.* During a bank holding company's transitional floor periods, the bank holding company's total risk-based capital ratio is equal to the lower of:

(A) The bank holding company's floor-adjusted total risk-based capital ratio; or

(B) The bank holding company's advanced approaches total risk-based capital ratio.

(2) *Floor-adjusted risk-based capital ratios.* (i) A bank holding company's floor-adjusted tier 1 risk-based capital ratio during a transitional floor period is equal to the bank holding company's tier 1 capital as calculated under 12 CFR part 225, appendix A, divided by the product of:

(A) The bank holding company's total risk-weighted assets as calculated under 12 CFR part 225, appendix A; and

(B) The appropriate transitional floor percentage in Table 1.

(ii) A bank holding company's floor-adjusted total risk-based capital ratio during a transitional floor period is equal to the sum of the bank holding company's tier 1 and tier 2 capital as calculated under 12 CFR part 225, appendix A, divided by the product of:

(A) The bank holding company's total risk-weighted assets as calculated under 12 CFR part 225, appendix A; and

(B) The appropriate transitional floor percentage in Table 1.

(iii) A bank holding company that meets the criteria in paragraph (b)(1) or (b)(2) of section 1 of this appendix as of April 1, 2008, must use 12 CFR part 225, appendix A during the parallel run and as the basis for its transitional floors.

TABLE 1—TRANSITIONAL FLOORS

| Transitional floor period | Transitional floor percentage |
|---|---|
| First floor period | 95 percent. |
| Second floor period | 90 percent. |
| Third floor period | 85 percent. |

(3) *Advanced approaches risk-based capital ratios.* (i) A bank holding company's advanced approaches tier 1 risk-based capital ratio equals the bank holding company's tier 1 risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(ii) A bank holding company's advanced approaches total risk-based capital ratio equals the bank holding company's total risk-based capital ratio as calculated under this appendix (other than this section on transitional floor periods).

(4) *Reporting.* During the transitional floor periods, a bank holding company must report to the Federal Reserve on a calendar quarterly basis both floor-adjusted risk-based capital ratios and both advanced approaches risk-based capital ratios.

(5) *Exiting a transitional floor period.* A bank holding company may not exit a transitional floor period until the bank holding company has spent a minimum of four consecutive calendar quarters in the period and the Federal Reserve has determined that the bank holding company may exit the floor period. The Federal Reserve's determination will be based on an assessment of the bank holding company's ongoing compliance with the qualification requirements in section 22 of this appendix.

(6) *Interagency study.* After the end of the second transition year (2010), the Federal banking agencies will publish a study that evaluates the advanced approaches to determine if there are any material deficiencies. For any primary Federal supervisor to authorize any institution to exit the third transitional floor period, the study must determine that there are no such material deficiencies that cannot be addressed by then-existing tools, or, if such deficiencies are found, they are first remedied by changes to this appendix. Notwithstanding the preceding sentence, a primary Federal supervisor that disagrees with the finding of material deficiency may not authorize any institution under its jurisdiction to exit the third transitional floor period unless it provides a public report explaining its reasoning.

*Section 22. Qualification Requirements*

(a) *Process and systems requirements.* (1) A bank holding company must have a rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital.

(2) The systems and processes used by a bank holding company for risk-based capital purposes under this appendix must be consistent with the bank holding company's internal risk management processes and management information reporting systems.

(3) Each bank holding company must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the bank holding company's size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a bank holding company's risk-based capital requirements are located at any affiliate of the bank holding company, the bank holding company itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of its own credit risk and operational risk exposures.

(b) *Risk rating and segmentation systems for wholesale and retail exposures.* (1) A bank holding company must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for the bank holding company's wholesale and retail exposures.

(2) For wholesale exposures:

(i) A bank holding company must have an internal risk rating system that accurately and reliably assigns each obligor to a single rating grade (reflecting the obligor's likelihood of default). A bank holding company may elect, however, not to assign to a rating grade an obligor to whom the bank holding company extends credit based solely on the financial strength of a guarantor, provided that all of the bank holding company's exposures to the obligor are fully covered by eligible guarantees, the bank holding company applies the PD substitution approach in paragraph (c)(1) of section 33 of this appendix to all exposures to that obligor, and the bank holding company immediately assigns the obligor to a rating grade if a guarantee can no longer be recognized under this appendix. The bank holding company's wholesale obligor rating system must have at least seven discrete rating grades for non-defaulted obligors and at least one rating grade for defaulted obligors.

(ii) Unless the bank holding company has chosen to directly assign LGD estimates to

each wholesale exposure, the bank holding company must have an internal risk rating system that accurately and reliably assigns each wholesale exposure to a loss severity rating grade (reflecting the bank holding company's estimate of the LGD of the exposure). A bank holding company employing loss severity rating grades must have a sufficiently granular loss severity grading system to avoid grouping together exposures with widely ranging LGDs.

(3) For retail exposures, a bank holding company must have an internal system that groups retail exposures into the appropriate retail exposure subcategory, groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics, and assigns accurate and reliable PD and LGD estimates for each segment on a consistent basis. The bank holding company's system must identify and group in separate segments by subcategories exposures identified in paragraphs (c)(2)(ii) and (iii) of section 31 of this appendix.

(4) The bank holding company's internal risk rating policy for wholesale exposures must describe the bank holding company's rating philosophy (that is, must describe how wholesale obligor rating assignments are affected by the bank holding company's choice of the range of economic, business, and industry conditions that are considered in the obligor rating process).

(5) The bank holding company's internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the bank holding company receives new material information, but no less frequently than annually. The bank holding company's retail exposure segmentation system must provide for the review and update (as appropriate) of assignments of retail exposures to segments whenever the bank holding company receives new material information, but generally no less frequently than quarterly.

(c) *Quantification of risk parameters for wholesale and retail exposures.* (1) The bank holding company must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters for the bank holding company's wholesale and retail exposures.

(2) Data used to estimate the risk parameters must be relevant to the bank holding company's actual wholesale and retail exposures, and of sufficient quality to support the determination of risk-based capital requirements for the exposures.

(3) The bank holding company's risk parameter quantification process must produce appropriately conservative risk parameter estimates where the bank holding company has limited relevant data, and any adjustments that are part of the quantification process must not result in a pattern of bias toward lower risk parameter estimates.

(4) The bank holding company's risk parameter estimation process should not rely on the possibility of U.S. government financial assistance, except for the financial assistance that the U.S. government has a legally binding commitment to provide.

(5) Where the bank holding company's quantifications of LGD directly or indirectly incorporate estimates of the effectiveness of its credit risk management practices in reducing its exposure to troubled obligors prior to default, the bank holding company must support such estimates with empirical analysis showing that the estimates are consistent with its historical experience in dealing with such exposures during economic downturn conditions.

(6) PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data.

(7) Default, loss severity, and exposure amount data must include periods of economic downturn conditions, or the bank holding company must adjust its estimates of risk parameters to compensate for the lack of data from periods of economic downturn conditions.

(8) The bank holding company's PD, LGD, and EAD estimates must be based on the definition of default in this appendix.

(9) The bank holding company must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(10) The bank holding company must at least annually conduct a comprehensive review and analysis of reference data to determine relevance of reference data to the bank holding company's exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default contained in this appendix.

(d) *Counterparty credit risk model.* A bank holding company must obtain the prior written approval of the Federal Reserve under section 32 of this appendix to use the internal models methodology for counterparty credit risk.

(e) *Double default treatment.* A bank holding company must obtain the prior written approval of the Federal Reserve under section 34 of this appendix to use the double default treatment.

(f) *Securitization exposures*. A bank holding company must obtain the prior written approval of the Federal Reserve under section 44 of this appendix to use the Internal Assessment Approach for securitization exposures to ABCP programs.

(g) *Equity exposures model*. A bank holding company must obtain the prior written approval of the Federal Reserve under section 53 of this appendix to use the Internal Models Approach for equity exposures.

(h) *Operational risk*—(1) *Operational risk management processes*. A bank holding company must:

(i) Have an operational risk management function that:

(A) Is independent of business line management; and

(B) Is responsible for designing, implementing, and overseeing the bank holding company's operational risk data and assessment systems, operational risk quantification systems, and related processes;

(ii) Have and document a process (which must capture business environment and internal control factors affecting the bank holding company's operational risk profile) to identify, measure, monitor, and control operational risk in bank holding company products, activities, processes, and systems; and

(iii) Report operational risk exposures, operational loss events, and other relevant operational risk information to business unit management, senior management, and the board of directors (or a designated committee of the board).

(2) *Operational risk data and assessment systems*. A bank holding company must have operational risk data and assessment systems that capture operational risks to which the bank holding company is exposed. The bank holding company's operational risk data and assessment systems must:

(i) Be structured in a manner consistent with the bank holding company's current business activities, risk profile, technological processes, and risk management processes; and

(ii) Include credible, transparent, systematic, and verifiable processes that incorporate the following elements on an ongoing basis:

(A) *Internal operational loss event data*. The bank holding company must have a systematic process for capturing and using internal operational loss event data in its operational risk data and assessment systems.

(*1*) The bank holding company's operational risk data and assessment systems must include a historical observation period of at least five years for internal operational loss event data (or such shorter period approved by the Federal Reserve to address transitional situations, such as integrating a new business line).

(*2*) The bank holding company must be able to map its internal operational loss event data into the seven operational loss event type categories.

(*3*) The bank holding company may refrain from collecting internal operational loss event data for individual operational losses below established dollar threshold amounts if the bank holding company can demonstrate to the satisfaction of the Federal Reserve that the thresholds are reasonable, do not exclude important internal operational loss event data, and permit the bank holding company to capture substantially all the dollar value of the bank holding company's operational losses.

(B) *External operational loss event data*. The bank holding company must have a systematic process for determining its methodologies for incorporating external operational loss event data into its operational risk data and assessment systems.

(C) *Scenario analysis*. The bank holding company must have a systematic process for determining its methodologies for incorporating scenario analysis into its operational risk data and assessment systems.

(D) *Business environment and internal control factors*. The bank holding company must incorporate business environment and internal control factors into its operational risk data and assessment systems. The bank holding company must also periodically compare the results of its prior business environment and internal control factor assessments against its actual operational losses incurred in the intervening period.

(3) *Operational risk quantification systems*. (i) The bank holding company's operational risk quantification systems:

(A) Must generate estimates of the bank holding company's operational risk exposure using its operational risk data and assessment systems;

(B) Must employ a unit of measure that is appropriate for the bank holding company's range of business activities and the variety of operational loss events to which it is exposed, and that does not combine business activities or operational loss events with demonstrably different risk profiles within the same loss distribution;

(C) Must include a credible, transparent, systematic, and verifiable approach for weighting each of the four elements, described in paragraph (h)(2)(ii) of this section, that a bank holding company is required to incorporate into its operational risk data and assessment systems;

(D) May use internal estimates of dependence among operational losses across and within units of measure if the bank holding company can demonstrate to the satisfaction of the Federal Reserve that its process for estimating dependence is sound, robust to a variety of scenarios, and implemented with

integrity, and allows for the uncertainty surrounding the estimates. If the bank holding company has not made such a demonstration, it must sum operational risk exposure estimates across units of measure to calculate its total operational risk exposure; and

(E) Must be reviewed and updated (as appropriate) whenever the bank holding company becomes aware of information that may have a material effect on the bank holding company's estimate of operational risk exposure, but the review and update must occur no less frequently than annually.

(ii) [Reserved]

(i) *Data management and maintenance.* (1) A bank holding company must have data management and maintenance systems that adequately support all aspects of its advanced systems and the timely and accurate reporting of risk-based capital requirements.

(2) A bank holding company must retain data using an electronic format that allows timely retrieval of data for analysis, validation, reporting, and disclosure purposes.

(3) A bank holding company must retain sufficient data elements related to key risk drivers to permit adequate monitoring, validation, and refinement of its advanced systems.

(j) *Control, oversight, and validation mechanisms.* (1) The bank holding company's senior management must ensure that all components of the bank holding company's advanced systems function effectively and comply with the qualification requirements in this section.

(2) The bank holding company's board of directors (or a designated committee of the board) must at least annually review the effectiveness of, and approve, the bank holding company's advanced systems.

(3) A bank holding company must have an effective system of controls and oversight that:

(i) Ensures ongoing compliance with the qualification requirements in this section;

(ii) Maintains the integrity, reliability, and accuracy of the bank holding company's advanced systems; and

(iii) Includes adequate governance and project management processes.

(4) The bank holding company must validate, on an ongoing basis, its advanced systems. The bank holding company's validation process must be independent of the advanced systems' development, implementation, and operation, or the validation process must be subjected to an independent review of its adequacy and effectiveness. Validation must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the advanced systems;

(ii) An ongoing monitoring process that includes verification of processes and benchmarking; and

(iii) An outcomes analysis process that includes back-testing.

(5) The bank holding company must have an internal audit function independent of business-line management that at least annually assesses the effectiveness of the controls supporting the bank holding company's advanced systems and reports its findings to the bank holding company's board of directors (or a committee thereof).

(6) The bank holding company must periodically stress test its advanced systems. The stress testing must include a consideration of how economic cycles, especially downturns, affect risk-based capital requirements (including migration across rating grades and segments and the credit risk mitigation benefits of double default treatment).

(k) *Documentation.* The bank holding company must adequately document all material aspects of its advanced systems.

*Section 23. Ongoing Qualification*

(a) *Changes to advanced systems.* A bank holding company must meet all the qualification requirements in section 22 of this appendix on an ongoing basis. A bank holding company must notify the Federal Reserve when the bank holding company makes any change to an advanced system that would result in a material change in the bank holding company's risk-weighted asset amount for an exposure type, or when the bank holding company makes any significant change to its modeling assumptions.

(b) *Failure to comply with qualification requirements.* (1) If the Federal Reserve determines that a bank holding company that uses this appendix and has conducted a satisfactory parallel run fails to comply with the qualification requirements in section 22 of this appendix, the Federal Reserve will notify the bank holding company in writing of the bank holding company's failure to comply.

(2) The bank holding company must establish and submit a plan satisfactory to the Federal Reserve to return to compliance with the qualification requirements.

(3) In addition, if the Federal Reserve determines that the bank holding company's risk-based capital requirements are not commensurate with the bank holding company's credit, market, operational, or other risks, the Federal Reserve may require such a bank holding company to calculate its risk-based capital requirements:

(i) Under 12 CFR part 225, appendix A; or

(ii) Under this appendix with any modifications provided by the Federal Reserve.

*Section 24. Merger and Acquisition Transitional Arrangements*

(a) *Mergers and acquisitions of companies without advanced systems.* If a bank holding

company merges with or acquires a company that does not calculate its risk-based capital requirements using advanced systems, the bank holding company may use 12 CFR part 225, appendix A to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the merger or acquisition consummates. The Federal Reserve may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the bank holding company must submit to the Federal Reserve an implementation plan for using its advanced systems for the acquired company. During the period when 12 CFR part 225, appendix A apply to the merged or acquired company, any ALLL, net of allocated transfer risk reserves established pursuant to 12 U.S.C. 3904, associated with the merged or acquired company's exposures may be included in the acquiring bank holding company's tier 2 capital up to 1.25 percent of the acquired company's risk-weighted assets. All general allowances of the merged or acquired company must be excluded from the bank holding company's eligible credit reserves. In addition, the risk-weighted assets of the merged or acquired company are not included in the bank holding company's credit-risk-weighted assets but are included in total risk-weighted assets. If a bank holding company relies on this paragraph, the bank holding company must disclose publicly the amounts of risk-weighted assets and qualifying capital calculated under this appendix for the acquiring bank holding company and under 12 CFR part 225, appendix A for the acquired company.

(b) *Mergers and acquisitions of companies with advanced systems*—(1) If a bank holding company merges with or acquires a company that calculates its risk-based capital requirements using advanced systems, the bank holding company may use the acquired company's advanced systems to determine the risk-weighted asset amounts for, and deductions from capital associated with, the merged or acquired company's exposures for up to 24 months after the calendar quarter during which the acquisition or merger consummates. The Federal Reserve may extend this transition period for up to an additional 12 months. Within 90 days of consummating the merger or acquisition, the bank holding company must submit to the Federal Reserve an implementation plan for using its advanced systems for the merged or acquired company.

(2) If the acquiring bank holding company is not subject to the advanced approaches in this appendix at the time of acquisition or merger, during the period when 12 CFR part 225, appendix A apply to the acquiring bank holding company, the ALLL associated with the exposures of the merged or acquired company may not be directly included in tier 2 capital. Rather, any excess eligible credit reserves associated with the merged or acquired company's exposures may be included in the bank holding company's tier 2 capital up to 0.6 percent of the credit-risk-weighted assets associated with those exposures.

## PART IV. RISK-WEIGHTED ASSETS FOR GENERAL CREDIT RISK

### *Section 31. Mechanics for Calculating Total Wholesale and Retail Risk-Weighted Assets*

(a) *Overview*. A bank holding company must calculate its total wholesale and retail risk-weighted asset amount in four distinct phases:

(1) Phase 1—categorization of exposures;

(2) Phase 2—assignment of wholesale obligors and exposures to rating grades and segmentation of retail exposures;

(3) Phase 3—assignment of risk parameters to wholesale exposures and segments of retail exposures; and

(4) Phase 4—calculation of risk-weighted asset amounts.

(b) *Phase 1—Categorization*. The bank holding company must determine which of its exposures are wholesale exposures, retail exposures, securitization exposures, or equity exposures. The bank holding company must categorize each retail exposure as a residential mortgage exposure, a QRE, or an other retail exposure. The bank holding company must identify which wholesale exposures are HVCRE exposures, sovereign exposures, OTC derivative contracts, repo-style transactions, eligible margin loans, eligible purchased wholesale exposures, unsettled transactions to which section 35 of this appendix applies, and eligible guarantees or eligible credit derivatives that are used as credit risk mitigants. The bank holding company must identify any on-balance sheet asset that does not meet the definition of a wholesale, retail, equity, or securitization exposure, as well as any non-material portfolio of exposures described in paragraph (e)(4) of this section.

(c) *Phase 2—Assignment of wholesale obligors and exposures to rating grades and retail exposures to segments—(1) Assignment of wholesale obligors and exposures to rating grades*.

(i) The bank holding company must assign each obligor of a wholesale exposure to a single obligor rating grade and must assign each wholesale exposure to which it does not directly assign an LGD estimate to a loss severity rating grade.

(ii) The bank holding company must identify which of its wholesale obligors are in default.

(2) *Segmentation of retail exposures*. (i) The bank holding company must group the retail exposures in each retail subcategory into

segments that have homogeneous risk characteristics.

(ii) The bank holding company must identify which of its retail exposures are in default. The bank holding company must segment defaulted retail exposures separately from non-defaulted retail exposures.

(iii) If the bank holding company determines the EAD for eligible margin loans using the approach in paragraph (b) of section 32 of this appendix, the bank holding company must identify which of its retail exposures are eligible margin loans for which the bank holding company uses this EAD approach and must segment such eligible margin loans separately from other retail exposures.

(3) *Eligible purchased wholesale exposures.* A bank holding company may group its eligible purchased wholesale exposures into segments that have homogeneous risk characteristics. A bank holding company must use the wholesale exposure formula in Table 2 in this section to determine the risk-based capital requirement for each segment of eligible purchased wholesale exposures.

(d) *Phase 3—Assignment of risk parameters to wholesale exposures and segments of retail exposures*—(1) *Quantification process.* Subject to the limitations in this paragraph (d), the bank holding company must:

(i) Associate a PD with each wholesale obligor rating grade;

(ii) Associate an LGD with each wholesale loss severity rating grade or assign an LGD to each wholesale exposure;

(iii) Assign an EAD and M to each wholesale exposure; and

(iv) Assign a PD, LGD, and EAD to each segment of retail exposures.

(2) *Floor on PD assignment.* The PD for each wholesale obligor or retail segment may not be less than 0.03 percent, except for exposures to or directly and unconditionally guaranteed by a sovereign entity, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, or a multilateral development bank, to which the bank holding company assigns a rating grade associated with a PD of less than 0.03 percent.

(3) *Floor on LGD estimation.* The LGD for each segment of residential mortgage exposures (other than segments of residential mortgage exposures for which all or substantially all of the principal of each exposure is directly and unconditionally guaranteed by the full faith and credit of a sovereign entity) may not be less than 10 percent.

(4) *Eligible purchased wholesale exposures.* A bank holding company must assign a PD, LGD, EAD, and M to each segment of eligible purchased wholesale exposures. If the bank holding company can estimate ECL (but not PD or LGD) for a segment of eligible purchased wholesale exposures, the bank holding company must assume that the LGD of the segment equals 100 percent and that the PD of the segment equals ECL divided by EAD. The estimated ECL must be calculated for the exposures without regard to any assumption of recourse or guarantees from the seller or other parties.

(5) *Credit risk mitigation—credit derivatives, guarantees, and collateral.* (i) A bank holding company may take into account the risk reducing effects of eligible guarantees and eligible credit derivatives in support of a wholesale exposure by applying the PD substitution or LGD adjustment treatment to the exposure as provided in section 33 of this appendix or, if applicable, applying double default treatment to the exposure as provided in section 34 of this appendix. A bank holding company may decide separately for each wholesale exposure that qualifies for the double default treatment under section 34 of this appendix whether to apply the double default treatment or to use the PD substitution or LGD adjustment treatment without recognizing double default effects.

(ii) A bank holding company may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment.

(iii) Except as provided in paragraph (d)(6) of this section, a bank holding company may take into account the risk reducing effects of collateral in support of a wholesale exposure when quantifying the LGD of the exposure and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment.

(6) *EAD for OTC derivative contracts, repo-style transactions, and eligible margin loans.* (i) A bank holding company must calculate its EAD for an OTC derivative contract as provided in paragraphs (c) and (d) of section 32 of this appendix. A bank holding company may take into account the risk-reducing effects of financial collateral in support of a repo-style transaction or eligible margin loan and of any collateral in support of a repo-style transaction that is included in the bank holding company's VaR-based measure under 12 CFR part 225, appendix E through an adjustment to EAD as provided in paragraphs (b) and (d) of section 32 of this appendix. A bank holding company that takes collateral into account through such an adjustment to EAD under section 32 of this appendix may not reflect such collateral in LGD.

(ii) A bank holding company may attribute an EAD of zero to:

(A) Derivative contracts that are publicly traded on an exchange that requires the daily receipt and payment of cash-variation margin;

(B) Derivative contracts and repo-style transactions that are outstanding with a qualifying central counterparty (but not for

those transactions that a qualifying central counterparty has rejected); and

(C) Credit risk exposures to a qualifying central counterparty in the form of clearing deposits and posted collateral that arise from transactions described in paragraph (d)(6)(ii)(B) of this section.

(7) *Effective maturity*. An exposure's M must be no greater than five years and no less than one year, except that an exposure's M must be no less than one day if the exposure has an original maturity of less than one year and is not part of a bank holding company's ongoing financing of the obligor. An exposure is not part of a bank holding company's ongoing financing of the obligor if the bank holding company:

(i) Has a legal and practical ability not to renew or roll over the exposure in the event of credit deterioration of the obligor;

(ii) Makes an independent credit decision at the inception of the exposure and at every renewal or roll over; and

(iii) Has no substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor.

(e) *Phase 4—Calculation of risk-weighted assets*—(1) *Non-defaulted exposures*. (i) A bank holding company must calculate the dollar risk-based capital requirement for each of its wholesale exposures to a non-defaulted obligor (except eligible guarantees and eligible credit derivatives that hedge another wholesale exposure and exposures to which the bank holding company applies the double default treatment in section 34 of this appendix) and segments of non-defaulted retail exposures by inserting the assigned risk parameters for the wholesale obligor and exposure or retail segment into the appropriate risk-based capital formula specified in Table 2 and multiplying the output of the formula (K) by the EAD of the exposure or segment. Alternatively, a bank holding company may apply a 300 percent risk weight to the EAD of an eligible margin loan if the bank holding company is not able to meet the agencies' requirements for estimation of PD and LGD for the margin loan.

Table 2 – IRB Risk-Based Capital Formulas for Wholesale Exposures to Non-Defaulted Obligors and Segments of Non-Defaulted Retail Exposures[1]

| | | |
|---|---|---|
| Retail | **Capital Requirement (K) Non-Defaulted Exposures** | $K = \left[ LGD \times N\left( \frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right]$ |
| | **Correlation Factor (R)** | For residential mortgage exposures: $R = 0.15$ |
| | | For qualifying revolving exposures: $R = 0.04$ |
| | | For other retail exposures: $R = 0.03 + 0.13 \times e^{-35 \times PD}$ |
| Wholesale | **Capital Requirement (K) Non-Defaulted Exposures** | $K = \left[ LGD \times N\left( \frac{N^{-1}(PD) + \sqrt{R} \times N^{-1}(0.999)}{\sqrt{1-R}} \right) - (LGD \times PD) \right] \times \left( \frac{1 + (M - 2.5) \times b}{1 - 1.5 \times b} \right)$ |
| | **Correlation Factor (R)** | For HVCRE exposures: $R = 0.12 + 0.18 \times e^{-50 \times PD}$ |
| | | For wholesale exposures other than HVCRE exposures: $R = 0.12 + 0.12 \times e^{-50 \times PD}$ |
| | **Maturity Adjustment (b)** | $b = (0.11852 - 0.05478 \times \ln(PD))^2$ |

[1]N(.) means the cumulative distribution function for a standard normal random variable. $N^{-1}$(.) means the inverse cumulative distribution function for a standard normal random variable. The symbol e refers to the base of the natural logarithms, and the function ln(.) refers to the natural logarithm of the expression within parentheses. The formulas apply when PD is greater than zero. If PD equals zero, the capital requirement K is set equal to zero.

(ii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a non-defaulted obligor and segment of non-defaulted retail exposures calculated in paragraph (e)(1)(i) of this section and in paragraph (e) of section 34 of this appendix equals the total dollar risk-based capital requirement for those exposures and segments.

(iii) The aggregate risk-weighted asset amount for wholesale exposures to non-defaulted obligors and segments of non-defaulted retail exposures equals the total dollar risk-based capital requirement calculated in paragraph (e)(1)(ii) of this section multiplied by 12.5.

(2) *Wholesale exposures to defaulted obligors and segments of defaulted retail exposures.* (i) The dollar risk-based capital requirement for each wholesale exposure to a defaulted obligor equals 0.08 multiplied by the EAD of the exposure.

(ii) The dollar risk-based capital requirement for a segment of defaulted retail exposures equals 0.08 multiplied by the EAD of the segment.

(iii) The sum of all the dollar risk-based capital requirements for each wholesale exposure to a defaulted obligor calculated in paragraph (e)(2)(i) of this section plus the dollar risk-based capital requirements for each segment of defaulted retail exposures

calculated in paragraph (e)(2)(ii) of this section equals the total dollar risk-based capital requirement for those exposures and segments.

(iv) The aggregate risk-weighted asset amount for wholesale exposures to defaulted obligors and segments of defaulted retail exposures equals the total dollar risk-based capital requirement calculated in paragraph (e)(2)(iii) of this section multiplied by 12.5.

(3) *Assets not included in a defined exposure category*. (i) A bank holding company may assign a risk-weighted asset amount of zero to cash owned and held in all offices of subsidiary depository institutions or in transit and for gold bullion held in either a subsidiary depository institution's own vaults, or held in another depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities.

(ii) The risk-weighted asset amount for the residual value of a retail lease exposure equals such residual value.

(iii) The risk-weighted asset amount for any other on-balance-sheet asset that does not meet the definition of a wholesale, retail, securitization, or equity exposure equals the carrying value of the asset.

(4) *Non-material portfolios of exposures*. The risk-weighted asset amount of a portfolio of exposures for which the bank holding company has demonstrated to the Federal Reserve's satisfaction that the portfolio (when combined with all other portfolios of exposures that the bank holding company seeks to treat under this paragraph) is not material to the bank holding company is the sum of the carrying values of on-balance sheet exposures plus the notional amounts of off-balance sheet exposures in the portfolio. For purposes of this paragraph (e)(4), the notional amount of an OTC derivative contract that is not a credit derivative is the EAD of the derivative as calculated in section 32 of this appendix.

*Section 32. Counterparty Credit Risk of Repo-Style Transactions, Eligible Margin Loans, and OTC Derivative Contracts*

(a) *In General*. (1) This section describes two methodologies—a collateral haircut approach and an internal models methodology—that a bank holding company may use instead of an LGD estimation methodology to recognize the benefits of financial collateral in mitigating the counterparty credit risk of repo-style transactions, eligible margin loans, collateralized OTC derivative contracts, and single product netting sets of such transactions and to recognize the benefits of any collateral in mitigating the counterparty credit risk of repo-style transactions that are included in a bank holding company's VaR-based measure under 12 CFR part 225, appendix E. A third methodology, the simple VaR methodology, is available for single product netting sets of repo-style transactions and eligible margin loans.

(2) This section also describes the methodology for calculating EAD for an OTC derivative contract or a set of OTC derivative contracts subject to a qualifying master netting agreement. A bank holding company also may use the internal models methodology to estimate EAD for qualifying cross-product master netting agreements.

(3) A bank holding company may only use the standard supervisory haircut approach with a minimum 10-business-day holding period to recognize in EAD the benefits of conforming residential mortgage collateral that secures repo-style transactions (other than repo-style transactions included in the bank holding company's VaR-based measure under 12 CFR part 225, appendix E), eligible margin loans, and OTC derivative contracts.

(4) A bank holding company may use any combination of the three methodologies for collateral recognition; however, it must use the same methodology for similar exposures.

(b) *EAD for eligible margin loans and repo-style transactions*—(1) *General*. A bank holding company may recognize the credit risk mitigation benefits of financial collateral that secures an eligible margin loan, repo-style transaction, or single-product netting set of such transactions by factoring the collateral into its LGD estimates for the exposure. Alternatively, a bank holding company may estimate an unsecured LGD for the exposure, as well as for any repo-style transaction that is included in the bank holding company's VaR-based measure under 12 CFR part 225, appendix E, and determine the EAD of the exposure using:

(i) The collateral haircut approach described in paragraph (b)(2) of this section;

(ii) For netting sets only, the simple VaR methodology described in paragraph (b)(3) of this section; or

(iii) The internal models methodology described in paragraph (d) of this section.

(2) *Collateral haircut approach*—(i) *EAD equation*. A bank holding company may determine EAD for an eligible margin loan, repo-style transaction, or netting set by setting EAD equal to max $\{0, [(\Sigma E - \Sigma C) + \Sigma(Es \times Hs) + \Sigma(Efx \times Hfx)]\}$, where:

(A) $\Sigma E$ equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the bank holding company has lent, sold subject to repurchase, or posted as collateral to the counterparty under the transaction (or netting set));

(B) $\Sigma C$ equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the bank holding company has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the transaction (or netting set));

(C) Es equals the absolute value of the net position in a given instrument or in gold (where the net position in a given instrument or in gold equals the sum of the current market values of the instrument or gold the bank holding company has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of that same instrument or gold the bank holding company has borrowed, purchased subject to resale, or taken as collateral from the counterparty);

(D) Hs equals the market price volatility haircut appropriate to the instrument or gold referenced in Es;

(E) Efx equals the absolute value of the net position of instruments and cash in a currency that is different from the settlement currency (where the net position in a given currency equals the sum of the current market values of any instruments or cash in the currency the bank holding company has lent, sold subject to repurchase, or posted as collateral to the counterparty minus the sum of the current market values of any instruments or cash in the currency the bank holding company has borrowed, purchased subject to resale, or taken as collateral from the counterparty); and

(F) Hfx equals the haircut appropriate to the mismatch between the currency referenced in Efx and the settlement currency.

(ii) *Standard supervisory haircuts.* (A) Under the standard supervisory haircuts approach:

(*1*) A bank holding company must use the haircuts for market price volatility (Hs) in Table 3, as adjusted in certain circumstances as provided in paragraph (b)(2)(ii)(A)(*3*) and (*4*) of this section;

TABLE 3—STANDARD SUPERVISORY MARKET PRICE VOLATILITY HAIRCUTS [1]

| Applicable external rating grade category for debt securities | Residual maturity for debt securities | Issuers exempt from the 3 basis point floor | Other issuers |
|---|---|---|---|
| Two highest investment-grade rating categories for long-term ratings/highest investment-grade rating category for short-term ratings. | ≤ 1 year | 0.005 | 0.01 |
| | >1 year, ≤ 5 years | 0.02 | 0.04 |
| | > 5 years | 0.04 | 0.08 |
| Two lowest investment-grade rating categories for both short- and long-term ratings. | ≤ 1 year | 0.01 | 0.02 |
| | > 1 year, ≤ 5 years | 0.03 | 0.06 |
| | > 5 years | 0.06 | 0.12 |
| One rating category below investment grade | All | 0.15 | 0.25 |
| Main index equities (including convertible bonds) and gold | | 0.15 | |
| Other publicly traded equities (including convertible bonds), conforming residential mortgages, and nonfinancial collateral. | | 0.25 | |
| Mutual funds | | Highest haircut applicable to any security in which the fund can invest. | |
| Cash on deposit with the bank holding company (including a certificate of deposit issued by the bank holding company). | | 0 | |

[1] The market price volatility haircuts in Table 3 are based on a ten-business-day holding period.

(*2*) For currency mismatches, a bank holding company must use a haircut for foreign exchange rate volatility (Hfx) of 8 percent, as adjusted in certain circumstances as provided in paragraph (b)(2)(ii)(A)(*3*) and (*4*) of this section.

(*3*) For repo-style transactions, a bank holding company may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(*1*) and (*2*) of this section by the square root of ½ (which equals 0.707107).

(*4*) A bank holding company must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions) where and as appropriate to take into account the illiquidity of an instrument.

(iii) *Own internal estimates for haircuts.* With the prior written approval of the Federal Reserve, a bank holding company may calculate haircuts (Hs and Hfx) using its own internal estimates of the volatilities of market prices and foreign exchange rates.

(A) To receive Federal Reserve approval to use its own internal estimates, a bank holding company must satisfy the following minimum quantitative standards:

(*1*) A bank holding company must use a 99th percentile one-tailed confidence interval.

(*2*) The minimum holding period for a repo-style transaction is five business days and for an eligible margin loan is ten business days. When a bank holding company calculates an own-estimates haircut on a $T_N$-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut ($H_M$) is

calculated using the following square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}\text{, where}$$

(*i*) $T_M$ equals 5 for repo-style transactions and 10 for eligible margin loans;

(*ii*) $T_N$ equals the holding period used by the bank holding company to derive $H_N$; and

(*iii*) $H_N$ equals the haircut based on the holding period $T_N$.

(*3*) A bank holding company must adjust holding periods upwards where and as appropriate to take into account the illiquidity of an instrument.

(*4*) The historical observation period must be at least one year.

(*5*) A bank holding company must update its data sets and recompute haircuts no less frequently than quarterly and must also reassess data sets and haircuts whenever market prices change materially.

(B) With respect to debt securities that have an applicable external rating of investment grade, a bank holding company may calculate haircuts for categories of securities. For a category of securities, the bank holding company must calculate the haircut on the basis of internal volatility estimates for securities in that category that are representative of the securities in that category that the bank holding company has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. In determining relevant categories, the bank holding company must at a minimum take into account:

(*1*) The type of issuer of the security;

(*2*) The applicable external rating of the security;

(*3*) The maturity of the security; and

(*4*) The interest rate sensitivity of the security.

(C) With respect to debt securities that have an applicable external rating of below investment grade and equity securities, a bank holding company must calculate a separate haircut for each individual security.

(D) Where an exposure or collateral (whether in the form of cash or securities) is denominated in a currency that differs from the settlement currency, the bank holding company must calculate a separate currency mismatch haircut for its net position in each mismatched currency based on estimated volatilities of foreign exchange rates between the mismatched currency and the settlement currency.

(E) A bank holding company's own estimates of market price and foreign exchange rate volatilities may not take into account the correlations among securities and foreign exchange rates on either the exposure or collateral side of a transaction (or netting set) or the correlations among securities and foreign exchange rates between the exposure and collateral sides of the transaction (or netting set).

(3) *Simple VaR methodology*. With the prior written approval of the Federal Reserve, a bank holding company may estimate EAD for a netting set using a VaR model that meets the requirements in paragraph (b)(3)(iii) of this section. In such event, the bank holding company must set EAD equal to max {0, [(ΣE—ΣC) + PFE]}, where:

(i) ΣE equals the value of the exposure (the sum of the current market values of all instruments, gold, and cash the bank holding company has lent, sold subject to repurchase, or posted as collateral to the counterparty under the netting set);

(ii) ΣC equals the value of the collateral (the sum of the current market values of all instruments, gold, and cash the bank holding company has borrowed, purchased subject to resale, or taken as collateral from the counterparty under the netting set); and

(iii) PFE (potential future exposure) equals the bank holding company's empirically based best estimate of the 99th percentile, one-tailed confidence interval for an increase in the value of (ΣE—ΣC) over a five-business-day holding period for repo-style transactions or over a ten-business-day holding period for eligible margin loans using a minimum one-year historical observation period of price data representing the instruments that the bank holding company has lent, sold subject to repurchase, posted as collateral, borrowed, purchased subject to resale, or taken as collateral. The bank holding company must validate its VaR model, including by establishing and maintaining a rigorous and regular back-testing regime.

(c) *EAD for OTC derivative contracts*. (1) A bank holding company must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section.

(2) A bank holding company must determine the EAD for multiple OTC derivative contracts that are subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(6) of this section or using the internal models methodology described in paragraph (d) of this section.

(3) *Counterparty credit risk for credit derivatives*. Notwithstanding the above, (i) A bank holding company that purchases a credit derivative that is recognized under section 33 or 34 of this appendix as a credit risk mitigant for an exposure that is not a covered position under 12 CFR part 225, appendix E need not compute a separate counterparty credit risk capital requirement under this section so long as the bank holding company

does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(ii) A bank holding company that is the protection provider in a credit derivative must treat the credit derivative as a wholesale exposure to the reference obligor and need not compute a counterparty credit risk capital requirement for the credit derivative under this section, so long as it does so consistently for all such credit derivatives and either includes all or excludes all such credit derivatives that are subject to a master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes (unless the bank holding company is treating the credit derivative as a covered position under 12 CFR part 225, appendix E, in which case the bank holding company must compute a supplemental counterparty credit risk capital requirement under this section).

(4) *Counterparty credit risk for equity derivatives.* A bank holding company must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under part VI (unless the bank holding company is treating the contract as a covered position under 12 CFR part 225, appendix E). In addition, if the bank holding company is treating the contract as a covered position under 12 CFR part 225, appendix E and in certain other cases described in section 55 of this appendix, the bank holding company must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this part.

(5) *Single OTC derivative contract.* Except as modified by paragraph (c)(7) of this section, the EAD for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the bank holding company's current credit exposure and potential future credit exposure (PFE) on the derivative contract.

(i) *Current credit exposure.* The current credit exposure for a single OTC derivative contract is the greater of the mark-to-market value of the derivative contract or zero.

(ii) *PFE.* The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative mark-to-market value, is calculated by multiplying the notional principal amount of the derivative contract by the appropriate conversion factor in Table 4. For purposes of calculating either the PFE under this paragraph or the gross PFE under paragraph (c)(6) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency. For any OTC derivative contract that does not fall within one of the specified categories in Table 4, the PFE must be calculated using the ''other'' conversion factors. A bank holding company must use an OTC derivative contract's effective notional principal amount (that is, its apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than its apparent or stated notional principal amount in calculating PFE. PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 4—CONVERSION FACTOR MATRIX FOR OTC DERIVATIVE CONTRACTS [1]

| Remaining maturity [2] | Interest rate | Foreign exchange rate and gold | Credit (investment-grade reference obligor) [3] | Credit (non-investment-grade reference obligor) | Equity | Precious metals (except gold) | Other |
|---|---|---|---|---|---|---|---|
| One year or less | 0.00 | 0.01 | 0.05 | 0.10 | 0.06 | 0.07 | 0.10 |
| Over one to five years | 0.005 | 0.05 | 0.05 | 0.10 | 0.08 | 0.07 | 0.12 |
| Over five years | 0.015 | 0.075 | 0.05 | 0.10 | 0.10 | 0.08 | 0.15 |

[1] For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A bank holding company must use the column labeled ''Credit (investment-grade reference obligor)'' for a credit derivative whose reference obligor has an outstanding unsecured long-term debt security without credit enhancement that has a long-term applicable external rating of at least investment grade. A bank holding company must use the column labeled ''Credit (non-investment-grade reference obligor)'' for all other credit derivatives.

(6) *Multiple OTC derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (c)(7) of this section, the EAD for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE exposure for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) *Net current credit exposure.* The net current credit exposure is the greater of:

(A) The net sum of all positive and negative mark-to-market values of the individual OTC derivative contracts subject to the qualifying master netting agreement; or

(B) zero.

(ii) *Adjusted sum of the PFE.* The adjusted sum of the PFE, Anet, is calculated as Anet = (0.4×Agross)+(0.6×NGR×Agross), where:

(A) Agross = the gross PFE (that is, the sum of the PFE amounts (as determined under paragraph (c)(5)(ii) of this section) for each individual OTC derivative contract subject to the qualifying master netting agreement); and

(B) NGR = the net to gross ratio (that is, the ratio of the net current credit exposure to the gross current credit exposure). In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (c)(5)(i) of this section) of all individual OTC derivative contracts subject to the qualifying master netting agreement.

(7) *Collateralized OTC derivative contracts.* A bank holding company may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or single-product netting set of OTC derivatives by factoring the collateral into its LGD estimates for the contract or netting set. Alternatively, a bank holding company may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set that is marked to market on a daily basis and subject to a daily margin maintenance requirement by estimating an unsecured LGD for the contract or netting set and adjusting the EAD calculated under paragraph (c)(5) or (c)(6) of this section using the collateral haircut approach in paragraph (b)(2) of this section. The bank holding company must substitute the EAD calculated under paragraph (c)(5) or (c)(6) of this section for ΣE in the equation in paragraph (b)(2)(i) of this section and must use a ten-business-day minimum holding period ($T_M = 10$).

(d) *Internal models methodology.* (1) With prior written approval from the Federal Reserve, a bank holding company may use the internal models methodology in this paragraph (d) to determine EAD for counterparty credit risk for OTC derivative contracts (collateralized or uncollateralized) and single-product netting sets thereof, for eligible margin loans and single-product netting sets thereof, and for repo-style transactions and single-product netting sets thereof. A bank holding company that uses the internal models methodology for a particular transaction type (OTC derivative contracts, eligible margin loans, or repo-style transactions) must use the internal models methodology for all transactions of that transaction type. A bank holding company may choose to use the internal models methodology for one or two of these three types of exposures and not the other types. A bank holding company may also use the internal models methodology for OTC derivative contracts, eligible margin loans, and repo-style transactions subject to a qualifying cross-product netting agreement if:

(i) The bank holding company effectively integrates the risk mitigating effects of cross-product netting into its risk management and other information technology systems; and

(ii) The bank holding company obtains the prior written approval of the Federal Reserve. A bank holding company that uses the internal models methodology for a transaction type must receive approval from the Federal Reserve to cease using the methodology for that transaction type or to make a material change to its internal model.

(2) Under the internal models methodology, a bank holding company uses an internal model to estimate the expected exposure (EE) for a netting set and then calculates EAD based on that EE.

(i) The bank holding company must use its internal model's probability distribution for changes in the market value of a netting set that are attributable to changes in market variables to determine EE.

(ii) Under the internal models methodology, EAD = α x effective EPE, or, subject to Federal Reserve approval as provided in paragraph (d)(7), a more conservative measure of EAD.

$$\text{(A) EffectiveEPE}_{t_k} = \sum_{k=1}^{n} \text{EffectiveEE}_{t_k} \times \Delta t_k$$

(that is, effective EPE is the time-weighted average of effective EE where the weights are the proportion that an individual effective EE represents in a one-year time interval) where:

(*1*) Effective $EE_{t_k}$ = max (Effective $EE_{t_{k-1}}$, $EE_{t_k}$) (that is, for a specific $date_{t_k}$, effective EE is the greater of EE at that date or the effective EE at the previous date); and

(*2*) $_{t_k}$ represents the kth future time period in the model and there are n time periods represented in the model over the first year; and

(B) α = 1.4 except as provided in paragraph (d)(6), or when the Federal Reserve has determined that the bank holding company must

set α higher based on the bank holding company's specific characteristics of counterparty credit risk.

(iii) A bank holding company may include financial collateral currently posted by the counterparty as collateral (but may not include other forms of collateral) when calculating EE.

(iv) If a bank holding company hedges some or all of the counterparty credit risk associated with a netting set using an eligible credit derivative, the bank holding company may take the reduction in exposure to the counterparty into account when estimating EE. If the bank holding company recognizes this reduction in exposure to the counterparty in its estimate of EE, it must also use its internal model to estimate a separate EAD for the bank holding company's exposure to the protection provider of the credit derivative.

(3) To obtain Federal Reserve approval to calculate the distributions of exposures upon which the EAD calculation is based, the bank holding company must demonstrate to the satisfaction of the Federal Reserve that it has been using for at least one year an internal model that broadly meets the following minimum standards, with which the bank holding company must maintain compliance:

(i) The model must have the systems capability to estimate the expected exposure to the counterparty on a daily basis (but is not expected to estimate or report expected exposure on a daily basis).

(ii) The model must estimate expected exposure at enough future dates to reflect accurately all the future cash flows of contracts in the netting set.

(iii) The model must account for the possible non-normality of the exposure distribution, where appropriate.

(iv) The bank holding company must measure, monitor, and control current counterparty exposure and the exposure to the counterparty over the whole life of all contracts in the netting set.

(v) The bank holding company must be able to measure and manage current exposures gross and net of collateral held, where appropriate. The bank holding company must estimate expected exposures for OTC derivative contracts both with and without the effect of collateral agreements.

(vi) The bank holding company must have procedures to identify, monitor, and control specific wrong-way risk throughout the life of an exposure. Wrong-way risk in this context is the risk that future exposure to a counterparty will be high when the counterparty's probability of default is also high.

(vii) The model must use current market data to compute current exposures. When estimating model parameters based on historical data, at least three years of historical data that cover a wide range of economic conditions must be used and must be updated quarterly or more frequently if market conditions warrant. The bank holding company should consider using model parameters based on forward-looking measures, where appropriate.

(viii) A bank holding company must subject its internal model to an initial validation and annual model review process. The model review should consider whether the inputs and risk factors, as well as the model outputs, are appropriate.

(4) *Maturity*. (i) If the remaining maturity of the exposure or the longest-dated contract in the netting set is greater than one year, the bank holding company must set M for the exposure or netting set equal to the lower of five years or M(EPE),[3] where:

$$\text{(A)}\quad M(EPE) = 1 + \frac{\sum_{t_k > 1\,year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1\,year} effectiveEE_k \times \Delta t_k \times df_k}$$

(B) $df_k$ is the risk-free discount factor for future time period $t_k$; and

(C) $\Delta t_k = t_k - t_{k-1}$.

(ii) If the remaining maturity of the exposure or the longest-dated contract in the netting set is one year or less, the bank holding company must set M for the exposure or netting set equal to one year, except as provided in paragraph (d)(7) of section 31 of this appendix.

(5) *Collateral agreements*. A bank holding company may capture the effect on EAD of a

[3] Alternatively, a bank holding company that uses an internal model to calculate a one-sided credit valuation adjustment may use the effective credit duration estimated by the model as M(EPE) in place of the formula in paragraph (d)(4).

collateral agreement that requires receipt of collateral when exposure to the counterparty increases but may not capture the effect on EAD of a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates. For this purpose, a collateral agreement means a legal contract that specifies the time when, and circumstances under which, the counterparty is required to pledge collateral to the bank holding company for a single financial contract or for all financial contracts in a netting set and confers upon the bank holding company a perfected, first priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the bank holding company with a right to close out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the bank holding company's exercise of rights under the agreement may be stayed or avoided under applicable law in the relevant jurisdictions. Two methods are available to capture the effect of a collateral agreement:

(i) With prior written approval from the Federal Reserve, a bank holding company may include the effect of a collateral agreement within its internal model used to calculate EAD. The bank holding company may set EAD equal to the expected exposure at the end of the margin period of risk. The margin period of risk means, with respect to a netting set subject to a collateral agreement, the time period from the most recent exchange of collateral with a counterparty until the next required exchange of collateral plus the period of time required to sell and realize the proceeds of the least liquid collateral that can be delivered under the terms of the collateral agreement and, where applicable, the period of time required to rehedge the resulting market risk, upon the default of the counterparty. The minimum margin period of risk is five business days for repo-style transactions and ten business days for other transactions when liquid financial collateral is posted under a daily margin maintenance requirement. This period should be extended to cover any additional time between margin calls; any potential closeout difficulties; any delays in selling collateral, particularly if the collateral is illiquid; and any impediments to prompt re-hedging of any market risk.

(ii) A bank holding company that can model EPE without collateral agreements but cannot achieve the higher level of modeling sophistication to model EPE with collateral agreements can set effective EPE for a collateralized netting set equal to the lesser of:

(A) The threshold, defined as the exposure amount at which the counterparty is required to post collateral under the collateral agreement, if the threshold is positive, plus an add-on that reflects the potential increase in exposure of the netting set over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from current exposure of zero over the margin period of risk. The margin period of risk must be at least five business days for netting sets consisting only of repo-style transactions subject to daily remargining and daily marking-to-market, and ten business days for all other netting sets; or

(B) Effective EPE without a collateral agreement.

(6) *Own estimate of alpha*. With prior written approval of the Federal Reserve, a bank holding company may calculate alpha as the ratio of economic capital from a full simulation of counterparty exposure across counterparties that incorporates a joint simulation of market and credit risk factors (numerator) and economic capital based on EPE (denominator), subject to a floor of 1.2. For purposes of this calculation, economic capital is the unexpected losses for all counterparty credit risks measured at a 99.9 percent confidence level over a one-year horizon. To receive approval, the bank holding company must meet the following minimum standards to the satisfaction of the Federal Reserve:

(i) The bank holding company's own estimate of alpha must capture in the numerator the effects of:

(A) The material sources of stochastic dependency of distributions of market values of transactions or portfolios of transactions across counterparties;

(B) Volatilities and correlations of market risk factors used in the joint simulation, which must be related to the credit risk factor used in the simulation to reflect potential increases in volatility or correlation in an economic downturn, where appropriate; and

(C) The granularity of exposures (that is, the effect of a concentration in the proportion of each counterparty's exposure that is driven by a particular risk factor).

(ii) The bank holding company must assess the potential model uncertainty in its estimates of alpha.

(iii) The bank holding company must calculate the numerator and denominator of alpha in a consistent fashion with respect to modeling methodology, parameter specifications, and portfolio composition.

(iv) The bank holding company must review and adjust as appropriate its estimates of the numerator and denominator of alpha on at least a quarterly basis and more frequently when the composition of the portfolio varies over time.

(7) *Other measures of counterparty exposure.* With prior written approval of the Federal Reserve, a bank holding company may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 (or higher under the terms of paragraph (d)(2)(ii)(B) of this section) times EPE for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The bank holding company must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. For material portfolios of new OTC derivative products, the bank holding company may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of this section meets the conservatism requirement of this paragraph for a period not to exceed 180 days. For immaterial portfolios of OTC derivative contracts, the bank holding company generally may assume that the current exposure methodology in paragraphs (c)(5) and (c)(6) of this section meets the conservatism requirement of this paragraph.

*Section 33. Guarantees and Credit Derivatives: PD Substitution and LGD Adjustment Approaches*

(a) *Scope.* (1) This section applies to wholesale exposures for which:

(i) Credit risk is fully covered by an eligible guarantee or eligible credit derivative; or

(ii) Credit risk is covered on a pro rata basis (that is, on a basis in which the bank holding company and the protection provider share losses proportionately) by an eligible guarantee or eligible credit derivative.

(2) Wholesale exposures on which there is a tranching of credit risk (reflecting at least two different levels of seniority) are securitization exposures subject to the securitization framework in part V.

(3) A bank holding company may elect to recognize the credit risk mitigation benefits of an eligible guarantee or eligible credit derivative covering an exposure described in paragraph (a)(1) of this section by using the PD substitution approach or the LGD adjustment approach in paragraph (c) of this section or, if the transaction qualifies, using the double default treatment in section 34 of this appendix. A bank holding company's PD and LGD for the hedged exposure may not be lower than the PD and LGD floors described in paragraphs (d)(2) and (d)(3) of section 31 of this appendix.

(4) If multiple eligible guarantees or eligible credit derivatives cover a single exposure described in paragraph (a)(1) of this section, a bank holding company may treat the hedged exposure as multiple separate exposures each covered by a single eligible guarantee or eligible credit derivative and may calculate a separate risk-based capital requirement for each separate exposure as described in paragraph (a)(3) of this section.

(5) If a single eligible guarantee or eligible credit derivative covers multiple hedged wholesale exposures described in paragraph (a)(1) of this section, a bank holding company must treat each hedged exposure as covered by a separate eligible guarantee or eligible credit derivative and must calculate a separate risk-based capital requirement for each exposure as described in paragraph (a)(3) of this section.

(6) A bank holding company must use the same risk parameters for calculating ECL as it uses for calculating the risk-based capital requirement for the exposure.

(b) *Rules of recognition.* (1) A bank holding company may only recognize the credit risk mitigation benefits of eligible guarantees and eligible credit derivatives.

(2) A bank holding company may only recognize the credit risk mitigation benefits of an eligible credit derivative to hedge an exposure that is different from the credit derivative's reference exposure used for determining the derivative's cash settlement value, deliverable obligation, or occurrence of a credit event if:

(i) The reference exposure ranks pari passu (that is, equally) with or is junior to the hedged exposure; and

(ii) The reference exposure and the hedged exposure are exposures to the same legal entity, and legally enforceable cross-default or cross-acceleration clauses are in place to assure payments under the credit derivative are triggered when the obligor fails to pay under the terms of the hedged exposure.

(c) *Risk parameters for hedged exposures*—(1) *PD substitution approach*—(i) *Full coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, a bank holding company may recognize the guarantee or credit derivative in determining the bank holding company's risk-based capital requirement for the hedged exposure by substituting the PD associated with the rating grade of the protection provider for the PD associated with the rating grade of the obligor in the risk-based capital formula applicable to the guarantee or credit derivative in Table 2 and using the appropriate LGD as described in paragraph (c)(1)(iii) of this section. If the bank holding company determines that full substitution of the protection provider's PD leads to an inappropriate degree of risk mitigation, the bank holding company may substitute a higher PD than that of the protection provider.

(ii) *Partial coverage.* If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section

and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the bank holding company must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The bank holding company must calculate its risk-based capital requirement for the protected exposure under section 31 of this appendix, where PD is the protection provider's PD, LGD is determined under paragraph (c)(1)(iii) of this section, and EAD is P. If the bank holding company determines that full substitution leads to an inappropriate degree of risk mitigation, the bank holding company may use a higher PD than that of the protection provider.

(B) The bank holding company must calculate its risk-based capital requirement for the unprotected exposure under section 31 of this appendix, where PD is the obligor's PD, LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(C) The treatment in this paragraph (c)(1)(ii) is applicable when the credit risk of a wholesale exposure is covered on a partial pro rata basis or when an adjustment is made to the effective notional amount of the guarantee or credit derivative under paragraph (d), (e), or (f) of this section.

(iii) *LGD of hedged exposures*. The LGD of a hedged exposure under the PD substitution approach is equal to:

(A) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the bank holding company with the option to receive immediate payout upon triggering the protection; or

(B) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the bank holding company with the option to receive immediate payout upon triggering the protection.

(2) *LGD adjustment approach*—(i) *Full coverage*. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is greater than or equal to the EAD of the hedged exposure, the bank holding company's risk-based capital requirement for the hedged exposure is the greater of:

(A) The risk-based capital requirement for the exposure as calculated under section 31 of this appendix, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative; or

(B) The risk-based capital requirement for a direct exposure to the protection provider as calculated under section 31 of this appendix, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD equal to the EAD of the hedged exposure.

(ii) *Partial coverage*. If an eligible guarantee or eligible credit derivative meets the conditions in paragraphs (a) and (b) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the bank holding company must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize the credit risk mitigation benefit of the guarantee or credit derivative.

(A) The bank holding company's risk-based capital requirement for the protected exposure would be the greater of:

(*1*) The risk-based capital requirement for the protected exposure as calculated under section 31 of this appendix, with the LGD of the exposure adjusted to reflect the guarantee or credit derivative and EAD set equal to P; or

(*2*) The risk-based capital requirement for a direct exposure to the guarantor as calculated under section 31 of this appendix, using the PD for the protection provider, the LGD for the guarantee or credit derivative, and an EAD set equal to P.

(B) The bank holding company must calculate its risk-based capital requirement for the unprotected exposure under section 31 of this appendix, where PD is the obligor's PD, LGD is the hedged exposure's LGD (not adjusted to reflect the guarantee or credit derivative), and EAD is the EAD of the original hedged exposure minus P.

(3) *M of hedged exposures*. The M of the hedged exposure is the same as the M of the exposure if it were unhedged.

(d) *Maturity mismatch*. (1) A bank holding company that recognizes an eligible guarantee or eligible credit derivative in determining its risk-based capital requirement for a hedged exposure must adjust the effective notional amount of the credit risk mitigant to reflect any maturity mismatch between the hedged exposure and the credit risk mitigant.

(2) A maturity mismatch occurs when the residual maturity of a credit risk mitigant is less than that of the hedged exposure(s).

(3) The residual maturity of a hedged exposure is the longest possible remaining time before the obligor is scheduled to fulfill its obligation on the exposure. If a credit risk mitigant has embedded options that may reduce its term, the bank holding company (protection purchaser) must use the shortest possible residual maturity for the credit risk mitigant. If a call is at the discretion of the protection provider, the residual maturity of the credit risk mitigant is at the first call date. If the call is at the discretion of the

bank holding company (protection purchaser), but the terms of the arrangement at origination of the credit risk mitigant contain a positive incentive for the bank holding company to call the transaction before contractual maturity, the remaining time to the first call date is the residual maturity of the credit risk mitigant. For example, where there is a step-up in cost in conjunction with a call feature or where the effective cost of protection increases over time even if credit quality remains the same or improves, the residual maturity of the credit risk mitigant will be the remaining time to the first call.

(4) A credit risk mitigant with a maturity mismatch may be recognized only if its original maturity is greater than or equal to one year and its residual maturity is greater than three months.

(5) When a maturity mismatch exists, the bank holding company must apply the following adjustment to the effective notional amount of the credit risk mitigant: $Pm = E \times (t - 0.25)/(T - 0.25)$, where:

(i) Pm = effective notional amount of the credit risk mitigant, adjusted for maturity mismatch;

(ii) E = effective notional amount of the credit risk mitigant;

(iii) t = the lesser of T or the residual maturity of the credit risk mitigant, expressed in years; and

(iv) T = the lesser of five or the residual maturity of the hedged exposure, expressed in years.

(e) *Credit derivatives without restructuring as a credit event.* If a bank holding company recognizes an eligible credit derivative that does not include as a credit event a restructuring of the hedged exposure involving forgiveness or postponement of principal, interest, or fees that results in a credit loss event (that is, a charge-off, specific provision, or other similar debit to the profit and loss account), the bank holding company must apply the following adjustment to the effective notional amount of the credit derivative: $Pr = Pm \times 0.60$, where:

(1) Pr = effective notional amount of the credit risk mitigant, adjusted for lack of restructuring event (and maturity mismatch, if applicable); and

(2) Pm = effective notional amount of the credit risk mitigant adjusted for maturity mismatch (if applicable).

(f) *Currency mismatch.* (1) If a bank holding company recognizes an eligible guarantee or eligible credit derivative that is denominated in a currency different from that in which the hedged exposure is denominated, the bank holding company must apply the following formula to the effective notional amount of the guarantee or credit derivative: $Pc = Pr \times (1 - H_{FX})$, where:

(i) Pc = effective notional amount of the credit risk mitigant, adjusted for currency mismatch (and maturity mismatch and lack of restructuring event, if applicable);

(ii) Pr = effective notional amount of the credit risk mitigant (adjusted for maturity mismatch and lack of restructuring event, if applicable); and

(iii) $H_{FX}$ = haircut appropriate for the currency mismatch between the credit risk mitigant and the hedged exposure.

(2) A bank holding company must set $H_{FX}$ equal to 8 percent unless it qualifies for the use of and uses its own internal estimates of foreign exchange volatility based on a ten-business-day holding period and daily marking-to-market and remargining. A bank holding company qualifies for the use of its own internal estimates of foreign exchange volatility if it qualifies for:

(i) The own-estimates haircuts in paragraph (b)(2)(iii) of section 32 of this appendix;

(ii) The simple VaR methodology in paragraph (b)(3) of section 32 of this appendix; or

(iii) The internal models methodology in paragraph (d) of section 32 of this appendix.

(3) A bank holding company must adjust $H_{FX}$ calculated in paragraph (f)(2) of this section upward if the bank holding company revalues the guarantee or credit derivative less frequently than once every ten business days using the square root of time formula provided in paragraph (b)(2)(iii)(A)(*2*) of section 32 of this appendix.

*Section 34. Guarantees and Credit Derivatives: Double Default Treatment*

(a) *Eligibility and operational criteria for double default treatment.* A bank holding company may recognize the credit risk mitigation benefits of a guarantee or credit derivative covering an exposure described in paragraph (a)(1) of section 33 of this appendix by applying the double default treatment in this section if all the following criteria are satisfied.

(1) The hedged exposure is fully covered or covered on a pro rata basis by:

(i) An eligible guarantee issued by an eligible double default guarantor; or

(ii) An eligible credit derivative that meets the requirements of paragraph (b)(2) of section 33 of this appendix and is issued by an eligible double default guarantor.

(2) The guarantee or credit derivative is:

(i) An uncollateralized guarantee or uncollateralized credit derivative (for example, a credit default swap) that provides protection with respect to a single reference obligor; or

(ii) An nth-to-default credit derivative (subject to the requirements of paragraph (m) of section 42 of this appendix).

(3) The hedged exposure is a wholesale exposure (other than a sovereign exposure).

(4) The obligor of the hedged exposure is not:

(i) An eligible double default guarantor or an affiliate of an eligible double default guarantor; or

(ii) An affiliate of the guarantor.

(5) The bank holding company does not recognize any credit risk mitigation benefits of the guarantee or credit derivative for the hedged exposure other than through application of the double default treatment as provided in this section.

(6) The bank holding company has implemented a process (which has received the prior, written approval of the Federal Reserve) to detect excessive correlation between the creditworthiness of the obligor of the hedged exposure and the protection provider. If excessive correlation is present, the bank holding company may not use the double default treatment for the hedged exposure.

(b) *Full coverage.* If the transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is at least equal to the EAD of the hedged exposure, the bank holding company may determine its risk-weighted asset amount for the hedged exposure under paragraph (e) of this section.

(c) *Partial coverage.* If the transaction meets the criteria in paragraph (a) of this section and the protection amount (P) of the guarantee or credit derivative is less than the EAD of the hedged exposure, the bank holding company must treat the hedged exposure as two separate exposures (protected and unprotected) in order to recognize double default treatment on the protected portion of the exposure.

(1) For the protected exposure, the bank holding company must set EAD equal to P and calculate its risk-weighted asset amount as provided in paragraph (e) of this section.

(2) For the unprotected exposure, the bank holding company must set EAD equal to the EAD of the original exposure minus P and then calculate its risk-weighted asset amount as provided in section 31 of this appendix.

(d) *Mismatches.* For any hedged exposure to which a bank holding company applies double default treatment, the bank holding company must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33 of this appendix.

(e) *The double default dollar risk-based capital requirement.* The dollar risk-based capital requirement for a hedged exposure to which a bank holding company has applied double default treatment is $K_{DD}$ multiplied by the EAD of the exposure. $K_{DD}$ is calculated according to the following formula: $K_{DD} = K_o \times (0.15 + 160 \times PD_g)$,

Where:

(1)

$$K_O = LGD_g \times \left[ N\left( \frac{N^{-1}(PD_o) + N^{-1}(0.999)\sqrt{\rho_{os}}}{\sqrt{1-\rho_{os}}} \right) - PD_o \right] \times \left[ \frac{1+(M-2.5)\times b}{1-1.5\times b} \right]$$

(2) $PD_g$ = PD of the protection provider.

(3) $PD_o$ = PD of the obligor of the hedged exposure.

(4) $LGD_g$ = (i) The lower of the LGD of the hedged exposure (not adjusted to reflect the guarantee or credit derivative) and the LGD of the guarantee or credit derivative, if the guarantee or credit derivative provides the bank holding company with the option to receive immediate payout on triggering the protection; or

(ii) The LGD of the guarantee or credit derivative, if the guarantee or credit derivative does not provide the bank holding company with the option to receive immediate payout on triggering the protection.

(5) $\rho_{OS}$ (asset value correlation of the obligor) is calculated according to the appropriate formula for (R) provided in Table 2 in section 31 of this appendix, with PD equal to $PD_o$.

(6) b (maturity adjustment coefficient) is calculated according to the formula for b provided in Table 2 in section 31 of this appendix, with PD equal to the lesser of $PD_o$ and $PD_g$.

(7) M (maturity) is the effective maturity of the guarantee or credit derivative, which may not be less than one year or greater than five years.

*Section 35. Risk-Based Capital Requirement for Unsettled Transactions*

(a) *Definitions.* For purposes of this section:

(1) *Delivery-versus-payment (DvP) transaction* means a securities or commodities transaction in which the buyer is obligated to make payment only if the seller has made delivery of the securities or commodities and the seller is obligated to deliver the securities or commodities only if the buyer has made payment.

(2) *Payment-versus-payment (PvP) transaction* means a foreign exchange transaction in which each counterparty is obligated to make a final transfer of one or more currencies only if the other counterparty has

made a final transfer of one or more currencies.

(3) *Normal settlement period.* A transaction has a *normal settlement period* if the contractual settlement period for the transaction is equal to or less than the market standard for the instrument underlying the transaction and equal to or less than five business days.

(4) *Positive current exposure.* The positive current exposure of a bank holding company for a transaction is the difference between the transaction value at the agreed settlement price and the current market price of the transaction, if the difference results in a credit exposure of the bank holding company to the counterparty.

(b) *Scope.* This section applies to all transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery. This section does not apply to:

(1) Transactions accepted by a qualifying central counterparty that are subject to daily marking-to-market and daily receipt and payment of variation margin;

(2) Repo-style transactions, including unsettled repo-style transactions (which are addressed in sections 31 and 32 of this appendix);

(3) One-way cash payments on OTC derivative contracts (which are addressed in sections 31 and 32 of this appendix); or

(4) Transactions with a contractual settlement period that is longer than the normal settlement period (which are treated as OTC derivative contracts and addressed in sections 31 and 32 of this appendix).

(c) *System-wide failures.* In the case of a system-wide failure of a settlement or clearing system, the Federal Reserve may waive risk-based capital requirements for unsettled and failed transactions until the situation is rectified.

(d) *Delivery-versus-payment (DvP) and payment-versus-payment (PvP) transactions.* A bank holding company must hold risk-based capital against any DvP or PvP transaction with a normal settlement period if the bank holding company's counterparty has not made delivery or payment within five business days after the settlement date. The bank holding company must determine its risk-weighted asset amount for such a transaction by multiplying the positive current exposure of the transaction for the bank holding company by the appropriate risk weight in Table 5.

TABLE 5—RISK WEIGHTS FOR UNSETTLED DVP AND PVP TRANSACTIONS

| Number of business days after contractual settlement date | Risk weight to be applied to positive current exposure (percent) |
|---|---|
| From 5 to 15 | 100 |
| From 16 to 30 | 625 |
| From 31 to 45 | 937.5 |
| 46 or more | 1,250 |

(e) *Non-DvP/non-PvP (non-delivery-versus-payment/non-payment-versus-payment) transactions.* (1) A bank holding company must hold risk-based capital against any non-DvP/non-PvP transaction with a normal settlement period if the bank holding company has delivered cash, securities, commodities, or currencies to its counterparty but has not received its corresponding deliverables by the end of the same business day. The bank holding company must continue to hold risk-based capital against the transaction until the bank holding company has received its corresponding deliverables.

(2) From the business day after the bank holding company has made its delivery until five business days after the counterparty delivery is due, the bank holding company must calculate its risk-based capital requirement for the transaction by treating the current market value of the deliverables owed to the bank holding company as a wholesale exposure.

(i) A bank holding company may assign an obligor rating to a counterparty for which it is not otherwise required under this appendix to assign an obligor rating on the basis of the applicable external rating of any outstanding unsecured long-term debt security without credit enhancement issued by the counterparty.

(ii) A bank holding company may use a 45 percent LGD for the transaction rather than estimating LGD for the transaction provided the bank holding company uses the 45 percent LGD for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(iii) A bank holding company may use a 100 percent risk weight for the transaction provided the bank holding company uses this risk weight for all transactions described in paragraphs (e)(1) and (e)(2) of this section.

(3) If the bank holding company has not received its deliverables by the fifth business day after the counterparty delivery was due, the bank holding company must deduct the current market value of the deliverables owed to the bank holding company 50 percent from tier 1 capital and 50 percent from tier 2 capital.

(f) *Total risk-weighted assets for unsettled transactions.* Total risk-weighted assets for unsettled transactions is the sum of the risk-weighted asset amounts of all DvP, PvP, and non-DvP/non-PvP transactions.

PART V. RISK-WEIGHTED ASSETS FOR SECURITIZATION EXPOSURES

*Section 41. Operational Criteria for Recognizing the Transfer of Risk*

(a) *Operational criteria for traditional securitizations.* A bank holding company that transfers exposures it has originated or purchased to a securitization SPE or other third party in connection with a traditional securitization may exclude the exposures from the calculation of its risk-weighted assets only if each of the conditions in this paragraph (a) is satisfied. A bank holding company that meets these conditions must hold risk-based capital against any securitization exposures it retains in connection with the securitization. A bank holding company that fails to meet these conditions must hold risk-based capital against the transferred exposures as if they had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the transaction. The conditions are:

(1) The transfer is considered a sale under GAAP;

(2) The bank holding company has transferred to third parties credit risk associated with the underlying exposures; and

(3) Any clean-up calls relating to the securitization are eligible clean-up calls.

(b) *Operational criteria for synthetic securitizations.* For synthetic securitizations, a bank holding company may recognize for risk-based capital purposes the use of a credit risk mitigant to hedge underlying exposures only if each of the conditions in this paragraph (b) is satisfied. A bank holding company that fails to meet these conditions must hold risk-based capital against the underlying exposures as if they had not been synthetically securitized. The conditions are:

(1) The credit risk mitigant is financial collateral, an eligible credit derivative from an eligible securitization guarantor or an eligible guarantee from an eligible securitization guarantor;

(2) The bank holding company transfers credit risk associated with the underlying exposures to third parties, and the terms and conditions in the credit risk mitigants employed do not include provisions that:

(i) Allow for the termination of the credit protection due to deterioration in the credit quality of the underlying exposures;

(ii) Require the bank holding company to alter or replace the underlying exposures to improve the credit quality of the pool of underlying exposures;

(iii) Increase the bank holding company's cost of credit protection in response to deterioration in the credit quality of the underlying exposures;

(iv) Increase the yield payable to parties other than the bank holding company in response to a deterioration in the credit quality of the underlying exposures; or

(v) Provide for increases in a retained first loss position or credit enhancement provided by the bank holding company after the inception of the securitization;

(3) The bank holding company obtains a well-reasoned opinion from legal counsel that confirms the enforceability of the credit risk mitigant in all relevant jurisdictions; and

(4) Any clean-up calls relating to the securitization are eligible clean-up calls.

*Section 42. Risk-Based Capital Requirement for Securitization Exposures*

(a) *Hierarchy of approaches.* Except as provided elsewhere in this section:

(1) A bank holding company must deduct from tier 1 capital any after-tax gain-on-sale resulting from a securitization and must deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale.

(2) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and qualifies for the Ratings-Based Approach in section 43 of this appendix, a bank holding company must apply the Ratings-Based Approach to the exposure.

(3) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the bank holding company may either apply the Internal Assessment Approach in section 44 of this appendix to the exposure (if the bank holding company, the exposure, and the relevant ABCP program qualify for the Internal Assessment Approach) or the Supervisory Formula Approach in section 45 of this appendix to the exposure (if the bank holding company and the exposure qualify for the Supervisory Formula Approach).

(4) If a securitization exposure does not require deduction under paragraph (a)(1) of this section and does not qualify for the Ratings-Based Approach, the Internal Assessment Approach, or the Supervisory Formula Approach, the bank holding company must deduct the exposure from total capital in accordance with paragraph (c) of this section.

(5) If a securitization exposure is an OTC derivative contract (other than a credit derivative) that has a first priority claim on the cash flows from the underlying exposures (notwithstanding amounts due under interest rate or currency derivative contracts, fees due, or other similar payments), with approval of the Federal Reserve, a bank holding company may choose to set the risk-weighted asset amount of the exposure equal to the amount of the exposure as determined in paragraph (e) of this section rather than apply the hierarchy of approaches described

in paragraphs (a) (1) through (4) of this section.

(b) *Total risk-weighted assets for securitization exposures.* A bank holding company's total risk-weighted assets for securitization exposures is equal to the sum of its risk-weighted assets calculated using the Ratings-Based Approach in section 43 of this appendix, the Internal Assessment Approach in section 44 of this appendix, and the Supervisory Formula Approach in section 45 of this appendix, and its risk-weighted assets amount for early amortization provisions calculated in section 47 of this appendix.

(c) *Deductions.* (1) If a bank holding company must deduct a securitization exposure from total capital, the bank holding company must take the deduction 50 percent from tier 1 capital and 50 percent from tier 2 capital. If the amount deductible from tier 2 capital exceeds the bank holding company's tier 2 capital, the bank holding company must deduct the excess from tier 1 capital.

(2) A bank holding company may calculate any deduction from tier 1 capital and tier 2 capital for a securitization exposure net of any deferred tax liabilities associated with the securitization exposure.

(d) *Maximum risk-based capital requirement.* Regardless of any other provisions of this part, unless one or more underlying exposures does not meet the definition of a wholesale, retail, securitization, or equity exposure, the total risk-based capital requirement for all securitization exposures held by a single bank holding company associated with a single securitization (including any risk-based capital requirements that relate to an early amortization provision of the securitization but excluding any risk-based capital requirements that relate to the bank holding company's gain-on-sale or CEIOs associated with the securitization) may not exceed the sum of:

(1) The bank holding company's total risk-based capital requirement for the underlying exposures as if the bank holding company directly held the underlying exposures; and

(2) The total ECL of the underlying exposures.

(e) *Amount of a securitization exposure.* (1) The amount of an on-balance sheet securitization exposure that is not a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is:

(i) The bank holding company's carrying value minus any unrealized gains and plus any unrealized losses on the exposure, if the exposure is a security classified as available-for-sale; or

(ii) The bank holding company's carrying value, if the exposure is not a security classified as available-for-sale.

(2) The amount of an off-balance sheet securitization exposure that is not an OTC derivative contract (other than a credit derivative) is the notional amount of the exposure. For an off-balance-sheet securitization exposure to an ABCP program, such as a liquidity facility, the notional amount may be reduced to the maximum potential amount that the bank holding company could be required to fund given the ABCP program's current underlying assets (calculated without regard to the current credit quality of those assets).

(3) The amount of a securitization exposure that is a repo-style transaction, eligible margin loan, or OTC derivative contract (other than a credit derivative) is the EAD of the exposure as calculated in section 32 of this appendix.

(f) *Overlapping exposures.* If a bank holding company has multiple securitization exposures that provide duplicative coverage of the underlying exposures of a securitization (such as when a bank holding company provides a program-wide credit enhancement and multiple pool-specific liquidity facilities to an ABCP program), the bank holding company is not required to hold duplicative risk-based capital against the overlapping position. Instead, the bank holding company may apply to the overlapping position the applicable risk-based capital treatment that results in the highest risk-based capital requirement.

(g) *Securitizations of non-IRB exposures.* If a bank holding company has a securitization exposure where any underlying exposure is not a wholesale exposure, retail exposure, securitization exposure, or equity exposure, the bank holding company must:

(1) If the bank holding company is an originating bank holding company, deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization and deduct from total capital in accordance with paragraph (c) of this section the portion of any CEIO that does not constitute gain-on-sale;

(2) If the securitization exposure does not require deduction under paragraph (g)(1), apply the RBA in section 43 of this appendix to the securitization exposure if the exposure qualifies for the RBA;

(3) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA, apply the IAA in section 44 of this appendix to the exposure (if the bank holding company, the exposure, and the relevant ABCP program qualify for the IAA); and

(4) If the securitization exposure does not require deduction under paragraph (g)(1) and does not qualify for the RBA or the IAA, deduct the exposure from total capital in accordance with paragraph (c) of this section.

(h) *Implicit support.* If a bank holding company provides support to a securitization in excess of the bank holding company's contractual obligation to provide credit support to the securitization (implicit support):

(1) The bank holding company must hold regulatory capital against all of the underlying exposures associated with the securitization as if the exposures had not been securitized and must deduct from tier 1 capital any after-tax gain-on-sale resulting from the securitization; and

(2) The bank holding company must disclose publicly:

(i) That it has provided implicit support to the securitization; and

(ii) The regulatory capital impact to the bank holding company of providing such implicit support.

(i) *Eligible servicer cash advance facilities.* Regardless of any other provisions of this part, a bank holding company is not required to hold risk-based capital against the undrawn portion of an eligible servicer cash advance facility.

(j) *Interest-only mortgage-backed securities.* Regardless of any other provisions of this part, the risk weight for a non-credit-enhancing interest-only mortgage-backed security may not be less than 100 percent.

(k) *Small-business loans and leases on personal property transferred with recourse.* (1) Regardless of any other provisions of this appendix, a bank holding company that has transferred small-business loans and leases on personal property (small-business obligations) with recourse must include in risk-weighted assets only the contractual amount of retained recourse if all the following conditions are met:

(i) The transaction is a sale under GAAP.

(ii) The bank holding company establishes and maintains, pursuant to GAAP, a non-capital reserve sufficient to meet the bank holding company's reasonably estimated liability under the recourse arrangement.

(iii) The loans and leases are to businesses that meet the criteria for a small-business concern established by the Small Business Administration under section 3(a) of the Small Business Act (15 U.S.C. 632).

(iv) The bank holding company is well capitalized, as defined in the Federal Reserve's prompt corrective action regulation at 12 CFR part 208, Subpart D. For purposes of determining whether a bank holding company is well capitalized for purposes of this paragraph, the bank holding company's capital ratios must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section.

(2) The total outstanding amount of recourse retained by a bank holding company on transfers of small-business obligations receiving the capital treatment specified in paragraph (k)(1) of this section cannot exceed 15 percent of the bank holding company's total qualifying capital.

(3) If a bank holding company ceases to be well capitalized or exceeds the 15 percent capital limitation, the preferential capital treatment specified in paragraph (k)(1) of this section will continue to apply to any transfers of small-business obligations with recourse that occurred during the time that the bank holding company was well capitalized and did not exceed the capital limit.

(4) The risk-based capital ratios of the bank holding company must be calculated without regard to the capital treatment for transfers of small-business obligations with recourse specified in paragraph (k)(1) of this section as provided in 12 CFR part 225, appendix A.

(l) *Consolidated ABCP programs.* (1) A bank holding company that qualifies as a primary beneficiary and must consolidate an ABCP program as a variable interest entity under GAAP may exclude the consolidated ABCP program assets from risk-weighted assets if the bank holding company is the sponsor of the ABCP program. If a bank holding company excludes such consolidated ABCP program assets from risk-weighted assets, the bank holding company must hold risk-based capital against any securitization exposures of the bank holding company to the ABCP program in accordance with this part.

(2) If a bank holding company either is not permitted, or elects not, to exclude consolidated ABCP program assets from its risk-weighted assets, the bank holding company must hold risk-based capital against the consolidated ABCP program assets in accordance with this appendix but is not required to hold risk-based capital against any securitization exposures of the bank holding company to the ABCP program.

(m) *$N^{th}$-to-default credit derivatives*—(1) *First-to-default credit derivatives*—(i) *Protection purchaser.* A bank holding company that obtains credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-based capital requirement for the underlying exposures as if the bank holding company synthetically securitized the underlying exposure with the lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(ii) *Protection provider.* A bank holding company that provides credit protection on a group of underlying exposures through a first-to-default credit derivative must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 of this appendix (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements of the individual underlying exposures, up to a maximum of 100 percent.

(2) *Second-or-subsequent-to-default credit derivatives*—(i) *Protection purchaser*. (A) A bank holding company that obtains credit protection on a group of underlying exposures through a $n^{th}$-to-default credit derivative (other than a first-to-default credit derivative) may recognize the credit risk mitigation benefits of the derivative only if:

(*1*) The bank holding company also has obtained credit protection on the same underlying exposures in the form of first-through-(n-1)-to-default credit derivatives; or

(*2*) If n-1 of the underlying exposures have already defaulted.

(B) If a bank holding company satisfies the requirements of paragraph (m)(2)(i)(A) of this section, the bank holding company must determine its risk-based capital requirement for the underlying exposures as if the bank holding company had only synthetically securitized the underlying exposure with the $n^{th}$ lowest risk-based capital requirement and had obtained no credit risk mitigant on the other underlying exposures.

(ii) *Protection provider*. A bank holding company that provides credit protection on a group of underlying exposures through a $n^{th}$-to-default credit derivative (other than a first-to-default credit derivative) must determine its risk-weighted asset amount for the derivative by applying the RBA in section 43 of this appendix (if the derivative qualifies for the RBA) or, if the derivative does not qualify for the RBA, by setting its risk-weighted asset amount for the derivative equal to the product of:

(A) The protection amount of the derivative;

(B) 12.5; and

(C) The sum of the risk-based capital requirements of the individual underlying exposures (excluding the n-1 underlying exposures with the lowest risk-based capital requirements), up to a maximum of 100 percent.

*Section 43. Ratings-Based Approach (RBA)*

(a) *Eligibility requirements for use of the RBA*—(1) *Originating bank holding company*. An originating bank holding company must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has two or more external ratings or inferred ratings (and may not use the RBA if the exposure has fewer than two external ratings or inferred ratings).

(2) *Investing bank holding company*. An investing bank holding company must use the RBA to calculate its risk-based capital requirement for a securitization exposure if the exposure has one or more external or inferred ratings (and may not use the RBA if the exposure has no external or inferred rating).

(b) *Ratings-based approach*. (1) A bank holding company must determine the risk-weighted asset amount for a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42 of this appendix) by the appropriate risk weight provided in Table 6 and Table 7.

(2) A bank holding company must apply the risk weights in Table 6 when the securitization exposure's applicable external or applicable inferred rating represents a long-term credit rating, and must apply the risk weights in Table 7 when the securitization exposure's applicable external or applicable inferred rating represents a short-term credit rating.

(i) A bank holding company must apply the risk weights in column 1 of Table 6 or Table 7 to the securitization exposure if:

(A) N (as calculated under paragraph (e)(6) of section 45 of this appendix) is six or more (for purposes of this section only, if the notional number of underlying exposures is 25 or more or if all of the underlying exposures are retail exposures, a bank holding company may assume that N is six or more unless the bank holding company knows or has reason to know that N is less than six); and

(B) The securitization exposure is a senior securitization exposure.

(ii) A bank holding company must apply the risk weights in column 3 of Table 6 or Table 7 to the securitization exposure if N is less than six, regardless of the seniority of the securitization exposure.

(iii) Otherwise, a bank holding company must apply the risk weights in column 2 of Table 6 or Table 7.

TABLE 6—LONG-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

| Applicable external or inferred rating (Illustrative rating example) | Column 1 | Column 2 | Column 3 |
|---|---|---|---|
| | Risk weights for senior securitization exposures backed by granular pools | Risk weights for non-senior securitization exposures backed by granular pools | Risk weights for securitization exposures backed by non-granular pools |
| Highest investment grade (for example, AAA) | 7% | 12% | 20% |
| Second highest investment grade (for example, AA) | 8% | 15% | 25% |
| Third-highest investment grade—positive designation (for example, A+) | 10% | 18% | 35% |
| Third-highest investment grade (for example, A) | 12% | 20% | |

TABLE 6—LONG-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA—Continued

| Applicable external or inferred rating (Illustrative rating example) | Column 1 | Column 2 | Column 3 |
|---|---|---|---|
| | Risk weights for senior securitization exposures backed by granular pools | Risk weights for non-senior securitization exposures backed by granular pools | Risk weights for securitization exposures backed by non-granular pools |
| Third-highest investment grade—negative designation (for example, A−) | 20% | 35% | |
| Lowest investment grade—positive designation (for example, BBB+) | 35% | 50% | |
| Lowest investment grade (for example, BBB) | 60% | 75% | |
| Lowest investment grade—negative designation (for example, BBB−) | 100% | | |
| One category below investment grade—positive designation (for example, BB+) | 250% | | |
| One category below investment grade (for example, BB) | 425% | | |
| One category below investment grade—negative designation (for example, BB−) | 650% | | |
| More than one category below investment grade | Deduction from tier 1 and tier 2 capital. | | |

TABLE 7—SHORT-TERM CREDIT RATING RISK WEIGHTS UNDER RBA AND IAA

| Applicable external or inferred rating (Illustrative rating example) | Column 1 | Column 2 | Column 3 |
|---|---|---|---|
| | Risk weights for senior securitization exposures backed by granular pools | Risk weights for non-senior securitization exposures backed by granular pools | Risk weights for securitization exposures backed by non-granular pools |
| Highest investment grade (for example, A1) | 7% | 12% | 20% |
| Second highest investment grade (for example, A2) | 12% | 20% | 35% |
| Third highest investment grade (for example, A3) | 60% | 75% | 75% |
| All other ratings | Deduction from tier 1 and tier 2 capital. | | |

*Section 44. Internal Assessment Approach (IAA)*

(a) *Eligibility requirements.* A bank holding company may apply the IAA to calculate the risk-weighted asset amount for a securitization exposure that the bank holding company has to an ABCP program (such as a liquidity facility or credit enhancement) if the bank holding company, the ABCP program, and the exposure qualify for use of the IAA.

(1) *Bank holding company qualification criteria.* A bank holding company qualifies for use of the IAA if the bank holding company has received the prior written approval of the Federal Reserve. To receive such approval, the bank holding company must demonstrate to the Federal Reserve's satisfaction that the bank holding company's internal assessment process meets the following criteria:

(i) The bank holding company's internal credit assessments of securitization exposures must be based on publicly available rating criteria used by an NRSRO.

(ii) The bank holding company's internal credit assessments of securitization exposures used for risk-based capital purposes must be consistent with those used in the bank holding company's internal risk management process, management information reporting systems, and capital adequacy assessment process.

(iii) The bank holding company's internal credit assessment process must have sufficient granularity to identify gradations of risk. Each of the bank holding company's internal credit assessment categories must correspond to an external rating of an NRSRO.

(iv) The bank holding company's internal credit assessment process, particularly the stress test factors for determining credit enhancement requirements, must be at least as conservative as the most conservative of the publicly available rating criteria of the NRSROs that have provided external ratings to the commercial paper issued by the ABCP program.

(A) Where the commercial paper issued by an ABCP program has an external rating from two or more NRSROs and the different NRSROs' benchmark stress factors require different levels of credit enhancement to achieve the same external rating equivalent, the bank holding company must apply the NRSRO stress factor that requires the highest level of credit enhancement.

(B) If any NRSRO that provides an external rating to the ABCP program's commercial paper changes its methodology (including stress factors), the bank holding company must evaluate whether to revise its internal assessment process.

(v) The bank holding company must have an effective system of controls and oversight that ensures compliance with these operational requirements and maintains the integrity and accuracy of the internal credit assessments. The bank holding company must have an internal audit function independent from the ABCP program business line and internal credit assessment process that assesses at least annually whether the controls over the internal credit assessment process function as intended.

(vi) The bank holding company must review and update each internal credit assessment whenever new material information is available, but no less frequently than annually.

(vii) The bank holding company must validate its internal credit assessment process on an ongoing basis and at least annually.

(2) *ABCP-program qualification criteria.* An ABCP program qualifies for use of the IAA if all commercial paper issued by the ABCP program has an external rating.

(3) *Exposure qualification criteria.* A securitization exposure qualifies for use of the IAA if the exposure meets the following criteria:

(i) The bank holding company initially rated the exposure at least the equivalent of investment grade.

(ii) The ABCP program has robust credit and investment guidelines (that is, underwriting standards) for the exposures underlying the securitization exposure.

(iii) The ABCP program performs a detailed credit analysis of the sellers of the exposures underlying the securitization exposure.

(iv) The ABCP program's underwriting policy for the exposures underlying the securitization exposure establishes minimum asset eligibility criteria that include the prohibition of the purchase of assets that are significantly past due or of assets that are defaulted (that is, assets that have been charged off or written down by the seller prior to being placed into the ABCP program or assets that would be charged off or written down under the program's governing contracts), as well as limitations on concentration to individual obligors or geographic areas and the tenor of the assets to be purchased.

(v) The aggregate estimate of loss on the exposures underlying the securitization exposure considers all sources of potential risk, such as credit and dilution risk.

(vi) Where relevant, the ABCP program incorporates structural features into each purchase of exposures underlying the securitization exposure to mitigate potential credit deterioration of the underlying exposures. Such features may include wind-down triggers specific to a pool of underlying exposures.

(b) *Mechanics.* A bank holding company that elects to use the IAA to calculate the risk-based capital requirement for any securitization exposure must use the IAA to calculate the risk-based capital requirements for all securitization exposures that qualify for the IAA approach. Under the IAA, a bank holding company must map its internal assessment of such a securitization exposure to an equivalent external rating from an NRSRO. Under the IAA, a bank holding company must determine the risk-weighted asset amount for such a securitization exposure by multiplying the amount of the exposure (as defined in paragraph (e) of section 42 of this appendix) by the appropriate risk weight in Table 6 and Table 7 in paragraph (b) of section 43 of this appendix.

*Section 45. Supervisory Formula Approach (SFA)*

(a) *Eligibility requirements.* A bank holding company may use the SFA to determine its risk-based capital requirement for a securitization exposure only if the bank holding company can calculate on an ongoing basis each of the SFA parameters in paragraph (e) of this section.

(b) *Mechanics.* Under the SFA, a securitization exposure incurs a deduction from total capital (as described in paragraph (c) of section 42 of this appendix) and/or an SFA risk-based capital requirement, as determined in paragraph (c) of this section. The risk-weighted asset amount for the securitization exposure equals the SFA risk-based capital requirement for the exposure multiplied by 12.5.

(c) *The SFA risk-based capital requirement.* (1) If $K_{IRB}$ is greater than or equal to L + T, the entire exposure must be deducted from total capital.

(2) If $K_{IRB}$ is less than or equal to L, the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) 0.0056 * T; or

(ii) S[L + T] − S[L].

(3) If $K_{IRB}$ is greater than L and less than L + T, the bank holding company must deduct from total capital an amount equal to UE*TP*($K_{IRB}$ − L), and the exposure's SFA risk-based capital requirement is UE multiplied by TP multiplied by the greater of:

(i) 0.0056 * (T − ($K_{IRB}$ − L)); or

(ii) S[L + T] − S[$K_{IRB}$].

(d) *The supervisory formula:*

$$(1)\ S[Y] = \begin{cases} Y & \text{when } Y \le K_{IRB} \\ K_{IRB} + K[Y] - K[K_{IRB}] + \dfrac{d \cdot K_{IRB}}{20}\left(1 - e^{\frac{20 \cdot (K_{IRB} - Y)}{K_{IRB}}}\right) & \text{when } Y > K_{IRB} \end{cases}$$

$$(2)\ K[Y] = (1-h) \cdot \left[\left(1 - \beta[Y; a, b]\right) \cdot Y + \beta[Y; a+1, b] \cdot c\right]$$

$$(3)\ h = \left(1 - \frac{K_{IRB}}{EWALGD}\right)^N$$

$$(4)\ a = g \cdot c$$

$$(5)\ b = g \cdot (1-c)$$

$$(6)\ c = \frac{K_{IRB}}{1-h}$$

$$(7)\ g = \frac{(1-c) \cdot c}{f} - 1$$

$$(8)\ f = \frac{v + K_{IRB}^{\ 2}}{1-h} - c^2 + \frac{(1 - K_{IRB}) \cdot K_{IRB} - v}{(1-h) \cdot 1000}$$

$$(9)\ v = K_{IRB} \cdot \frac{(EWALGD - K_{IRB}) + .25 \cdot (1 - EWALGD)}{N}$$

$$(10)\ d = 1 - (1-h) \cdot (1 - \beta[K_{IRB}; a, b]).$$

(11) In these expressions, β[Y; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at Y. In the case where N = 1 and EWALGD = 100 percent, S[Y] in formula (1) must be calculated with K[Y] set equal to the product of $K_{IRB}$ and Y, and d set equal to $1 - K_{IRB}$.

(e) *SFA parameters*—(1) *Amount of the underlying exposures (UE).* UE is the EAD of any underlying exposures that are wholesale and retail exposures (including the amount of any funded spread accounts, cash collateral accounts, and other similar funded credit enhancements) plus the amount of any underlying exposures that are securitization exposures (as defined in paragraph (e) of section 42 of this appendix) plus the adjusted carrying value of any underlying exposures that are equity exposures (as defined in paragraph (b) of section 51 of this appendix).

(2) *Tranche percentage (TP).* TP is the ratio of the amount of the bank holding company's securitization exposure to the amount of the tranche that contains the securitization exposure.

(3) *Capital requirement on underlying exposures ($K_{IRB}$).* (i) $K_{IRB}$ is the ratio of:

(A) The sum of the risk-based capital requirements for the underlying exposures plus the expected credit losses of the underlying exposures (as determined under this appendix as if the underlying exposures were directly held by the bank holding company); to

(B) UE.

(ii) The calculation of $K_{IRB}$ must reflect the effects of any credit risk mitigant applied to the underlying exposures (either to an individual underlying exposure, to a group of underlying exposures, or to the entire pool of underlying exposures).

(iii) All assets related to the securitization are treated as underlying exposures, including assets in a reserve account (such as a cash collateral account).

(4) *Credit enhancement level (L).* (i) L is the ratio of:

(A) The amount of all securitization exposures subordinated to the tranche that contains the bank holding company's securitization exposure; to

(B) UE.

(ii) A bank holding company must determine L before considering the effects of any tranche-specific credit enhancements.

(iii) Any gain-on-sale or CEIO associated with the securitization may not be included in L.

(iv) Any reserve account funded by accumulated cash flows from the underlying exposures that is subordinated to the tranche that contains the bank holding company's securitization exposure may be included in the numerator and denominator of L to the extent cash has accumulated in the account. Unfunded reserve accounts (that is, reserve accounts that are to be funded from future cash flows from the underlying exposures) may not be included in the calculation of L.

(v) In some cases, the purchase price of receivables will reflect a discount that provides credit enhancement (for example, first loss protection) for all or certain tranches of the securitization. When this arises, L should be calculated inclusive of this discount if the discount provides credit enhancement for the securitization exposure.

(5) *Thickness of tranche (T).* T is the ratio of:

(i) The amount of the tranche that contains the bank holding company's securitization exposure; to

(ii) UE.

(6) *Effective number of exposures (N).* (i) Unless the bank holding company elects to use the formula provided in paragraph (f) of this section,

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2}$$

where $EAD_i$ represents the EAD associated with the ith instrument in the pool of underlying exposures.

(ii) Multiple exposures to one obligor must be treated as a single underlying exposure.

(iii) In the case of a re-securitization (that is, a securitization in which some or all of the underlying exposures are themselves securitization exposures), the bank holding company must treat each underlying exposure as a single underlying exposure and must not look through to the originally securitized underlying exposures.

(7) *Exposure-weighted average loss given default (EWALGD).* EWALGD is calculated as:

$$EWALGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where $LGD_i$ represents the average LGD associated with all exposures to the ith obligor. In the case of a re-securitization, an LGD of 100 percent must be assumed for the underlying exposures that are themselves securitization exposures.

(f) *Simplified method for computing N and EWALGD.* (1) If all underlying exposures of a securitization are retail exposures, a bank holding company may apply the SFA using the following simplifications:

(i) h = 0; and

(ii) v = 0.

(2) Under the conditions in paragraphs (f)(3) and (f)(4) of this section, a bank holding company may employ a simplified method for calculating N and EWALGD.

(3) If $C_1$ is no more than 0.03, a bank holding company may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure or EWALGD = 1 if one or more of the underlying exposures is a securitization exposure, and may set N equal to the following amount:

$$N = \frac{1}{C_1 C_m + \left(\frac{C_m - C_1}{m-1}\right)\max(1 - mC_1, 0)}$$

where:

(i) $C_m$ is the ratio of the sum of the amounts of the 'm' largest underlying exposures to UE; and

(ii) The level of m is to be selected by the bank holding company.

(4) Alternatively, if only $C_1$ is available and $C_1$ is no more than 0.03, the bank holding company may set EWALGD = 0.50 if none of the underlying exposures is a securitization exposure or EWALGD = 1 if one or more of the underlying exposures is a securitization exposure and may set $N = 1/C_1$.

*Section 46. Recognition of Credit Risk Mitigants for Securitization Exposures*

(a) *General.* An originating bank holding company that has obtained a credit risk mitigant to hedge its securitization exposure to a synthetic or traditional securitization that satisfies the operational criteria in section 41 of this appendix may recognize the credit risk mitigant, but only as provided in this section. An investing bank holding company that has obtained a credit risk mitigant to hedge a securitization exposure may recognize the credit risk mitigant, but only as provided in this section. A bank holding company that has used the RBA in section 43 of this appendix or the IAA in section 44 of this appendix to calculate its risk-based capital requirement for a securitization exposure whose external or inferred rating (or equivalent internal rating under the IAA) reflects the benefits of a credit risk mitigant provided to the associated securitization or that supports some or all of the underlying exposures may not use the credit risk mitigation rules in this section to further reduce its risk-based capital requirement for the exposure to reflect that credit risk mitigant.

(b) *Collateral*—(1) *Rules of recognition.* A bank holding company may recognize financial collateral in determining the bank holding company's risk-based capital requirement for a securitization exposure (other than a repo-style transaction, an eligible margin loan, or an OTC derivative contract for which the bank holding company has reflected collateral in its determination of exposure amount under section 32 of this appendix) as follows. The bank holding company's risk-based capital requirement for the collateralized securitization exposure is equal to the risk-based capital requirement for the securitization exposure as calculated under the RBA in section 43 of this appendix or under the SFA in section 45 of this appendix multiplied by the ratio of adjusted exposure amount (SE*) to original exposure amount (SE), where:

(i) SE* = max {0, [SE—C x (1 − Hs − Hfx)]};

(ii) SE = the amount of the securitization exposure calculated under paragraph (e) of section 42 of this appendix;

(iii) C = the current market value of the collateral;

(iv) Hs = the haircut appropriate to the collateral type; and

(v) Hfx = the haircut appropriate for any currency mismatch between the collateral and the exposure.

(2) *Mixed collateral.* Where the collateral is a basket of different asset types or a basket of assets denominated in different currencies, the haircut on the basket will be

$$H = \sum_i a_i H_i,$$

where $a_i$ is the current market value of the asset in the basket divided by the current market value of all assets in the basket and $H_i$ is the haircut applicable to that asset.

(3) *Standard supervisory haircuts.* Unless a bank holding company qualifies for use of and uses own-estimates haircuts in paragraph (b)(4) of this section:

(i) A bank holding company must use the collateral type haircuts (Hs) in Table 3;

(ii) A bank holding company must use a currency mismatch haircut (Hfx) of 8 percent if the exposure and the collateral are denominated in different currencies;

(iii) A bank holding company must multiply the supervisory haircuts obtained in paragraphs (b)(3)(i) and (ii) by the square root of 6.5 (which equals 2.549510); and

(iv) A bank holding company must adjust the supervisory haircuts upward on the basis of a holding period longer than 65 business days where and as appropriate to take into account the illiquidity of the collateral.

(4) *Own estimates for haircuts.* With the prior written approval of the Federal Reserve, a bank holding company may calculate haircuts using its own internal estimates of market price volatility and foreign exchange volatility, subject to paragraph (b)(2)(iii) of section 32 of this appendix. The minimum holding period (TM) for securitization exposures is 65 business days.

(c) *Guarantees and credit derivatives*—(1) *Limitations on recognition.* A bank holding

company may only recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank holding company's risk-based capital requirement for a securitization exposure.

(2) *ECL for securitization exposures.* When a bank holding company recognizes an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank holding company's risk-based capital requirement for a securitization exposure, the bank holding company must also:

(i) Calculate ECL for the protected portion of the exposure using the same risk parameters that it uses for calculating the risk-weighted asset amount of the exposure as described in paragraph (c)(3) of this section; and

(ii) Add the exposure's ECL to the bank holding company's total ECL.

(3) *Rules of recognition.* A bank holding company may recognize an eligible guarantee or eligible credit derivative provided by an eligible securitization guarantor in determining the bank holding company's risk-based capital requirement for the securitization exposure as follows:

(i) *Full coverage.* If the protection amount of the eligible guarantee or eligible credit derivative equals or exceeds the amount of the securitization exposure, the bank holding company may set the risk-weighted asset amount for the securitization exposure equal to the risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31 of this appendix), using the bank holding company's PD for the guarantor, the bank holding company's LGD for the guarantee or credit derivative, and an EAD equal to the amount of the securitization exposure (as determined in paragraph (e) of section 42 of this appendix).

(ii) *Partial coverage.* If the protection amount of the eligible guarantee or eligible credit derivative is less than the amount of the securitization exposure, the bank holding company may set the risk-weighted asset amount for the securitization exposure equal to the sum of:

(A) *Covered portion.* The risk-weighted asset amount for a direct exposure to the eligible securitization guarantor (as determined in the wholesale risk weight function described in section 31 of this appendix), using the bank holding company's PD for the guarantor, the bank holding company's LGD for the guarantee or credit derivative, and an EAD equal to the protection amount of the credit risk mitigant; and

(B) *Uncovered portion.* (1) 1.0 minus the ratio of the protection amount of the eligible guarantee or eligible credit derivative to the amount of the securitization exposure); multiplied by

(*2*) The risk-weighted asset amount for the securitization exposure without the credit risk mitigant (as determined in sections 42–45 of this appendix).

(4) *Mismatches.* The bank holding company must make applicable adjustments to the protection amount as required in paragraphs (d), (e), and (f) of section 33 of this appendix for any hedged securitization exposure and any more senior securitization exposure that benefits from the hedge. In the context of a synthetic securitization, when an eligible guarantee or eligible credit derivative covers multiple hedged exposures that have different residual maturities, the bank holding company must use the longest residual maturity of any of the hedged exposures as the residual maturity of all the hedged exposures.

*Section 47. Risk-Based Capital Requirement for Early Amortization Provisions*

(a) *General.* (1) An originating bank holding company must hold risk-based capital against the sum of the originating bank holding company's interest and the investors' interest in a securitization that:

(i) Includes one or more underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit; and

(ii) Contains an early amortization provision.

(2) For securitizations described in paragraph (a)(1) of this section, an originating bank holding company must calculate the risk-based capital requirement for the originating bank holding company's interest under sections 42–45 of this appendix, and the risk-based capital requirement for the investors' interest under paragraph (b) of this section.

(b) *Risk-weighted asset amount for investors' interest.* The originating bank holding company's risk-weighted asset amount for the investors' interest in the securitization is equal to the product of the following 5 quantities:

(1) The investors' interest EAD;

(2) The appropriate conversion factor in paragraph (c) of this section;

(3) $K_{IRB}$ (as defined in paragraph (e)(3) of section 45 of this appendix);

(4) 12.5; and

(5) The proportion of the underlying exposures in which the borrower is permitted to vary the drawn amount within an agreed limit under a line of credit.

(c) *Conversion factor.* (1) (i) Except as provided in paragraph (c)(2) of this section, to calculate the appropriate conversion factor, a bank holding company must use Table 8 for a securitization that contains a controlled early amortization provision and must use Table 9 for a securitization that contains a

non-controlled early amortization provision. In circumstances where a securitization contains a mix of retail and nonretail exposures or a mix of committed and uncommitted exposures, a bank holding company may take a pro rata approach to determining the conversion factor for the securitization's early amortization provision. If a pro rata approach is not feasible, a bank holding company must treat the mixed securitization as a securitization of nonretail exposures if a single underlying exposure is a nonretail exposure and must treat the mixed securitization as a securitization of committed exposures if a single underlying exposure is a committed exposure.

(ii) To find the appropriate conversion factor in the tables, a bank holding company must divide the three-month average annualized excess spread of the securitization by the excess spread trapping point in the securitization structure. In securitizations that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average annualized excess spread, the excess spread trapping point is 4.5 percent.

TABLE 8—CONTROLLED EARLY AMORTIZATION PROVISIONS

| | Uncommitted | Committed |
|---|---|---|
| Retail Credit Lines | Three-month average annualized excess spread Conversion Factor (CF).<br>133.33% of trapping point or more, 0% CF.<br>less than 133.33% to 100% of trapping point, 1% CF.<br>less than 100% to 75% of trapping point, 2% CF.<br>less than 75% to 50% of trapping point, 10% CF.<br>less than 50% to 25% of trapping point, 20% CF.<br>less than 25% of trapping point, 40% CF. | 90% CF |
| Non-retail Credit Lines | 90% CF | 90% CF |

TABLE 9—NON-CONTROLLED EARLY AMORTIZATION PROVISIONS

| | Uncommitted | Committed |
|---|---|---|
| Retail Credit Lines | Three-month average annualized excess spread Conversion Factor (CF).<br>133.33% of trapping point or more, 0% CF.<br>less than 133.33% to 100% of trapping point, 5% CF.<br>less than 100% to 75% of trapping point, 15% CF.<br>less than 75% to 50% of trapping point, 50% CF.<br>less than 50% of trapping point, 100% CF. | 100% CF |
| Non-retail Credit Lines | 100% CF | 100% CF |

(2) For a securitization for which all or substantially all of the underlying exposures are residential mortgage exposures, a bank holding company may calculate the appropriate conversion factor using paragraph (c)(1) of this section or may use a conversion factor of 10 percent. If the bank holding company chooses to use a conversion factor of 10 percent, it must use that conversion factor for all securitizations for which all or substantially all of the underlying exposures are residential mortgage exposures.

## PART VI. RISK-WEIGHTED ASSETS FOR EQUITY EXPOSURES

### *Section 51. Introduction and Exposure Measurement*

(a) *General.* To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to investment funds, a bank holding company may apply either the Simple Risk Weight Approach (SRWA) in section 52 of this appendix or, if it qualifies to do so, the Internal Models Approach (IMA) in section 53 of this appendix. A bank holding company must use the look-through approaches in section 54 of this appendix to calculate its risk-weighted asset amounts for equity exposures to investment funds.

(b) *Adjusted carrying value.* For purposes of this part, the adjusted carrying value of an equity exposure is:

(1) For the on-balance sheet component of an equity exposure, the bank holding company's carrying value of the exposure reduced by any unrealized gains on the exposure that are reflected in such carrying value but excluded from the bank holding company's tier 1 and tier 2 capital; and

(2) For the off-balance sheet component of an equity exposure, the effective notional principal amount of the exposure, the size of which is equivalent to a hypothetical on-balance sheet position in the underlying equity instrument that would evidence the same change in fair value (measured in dollars) for a given small change in the price of the underlying equity instrument, minus the adjusted carrying value of the on-balance sheet

component of the exposure as calculated in paragraph (b)(1) of this section. For unfunded equity commitments that are unconditional, the effective notional principal amount is the notional amount of the commitment. For unfunded equity commitments that are conditional, the effective notional principal amount is the bank holding company's best estimate of the amount that would be funded under economic downturn conditions.

*Section 52. Simple Risk Weight Approach (SRWA)*

(a) *General.* Under the SRWA, a bank holding company's aggregate risk-weighted asset amount for its equity exposures is equal to the sum of the risk-weighted asset amounts for each of the bank holding company's individual equity exposures (other than equity exposures to an investment fund) as determined in this section and the risk-weighted asset amounts for each of the bank holding company's individual equity exposures to an investment fund as determined in section 54 of this appendix.

(b) *SRWA computation for individual equity exposures.* A bank holding company must determine the risk-weighted asset amount for an individual equity exposure (other than an equity exposure to an investment fund) by multiplying the adjusted carrying value of the equity exposure or the effective portion and ineffective portion of a hedge pair (as defined in paragraph (c) of this section) by the lowest applicable risk weight in this paragraph (b).

(1) *0 percent risk weight equity exposures.* An equity exposure to an entity whose credit exposures are exempt from the 0.03 percent PD floor in paragraph (d)(2) of section 31 of this appendix is assigned a 0 percent risk weight.

(2) *20 percent risk weight equity exposures.* An equity exposure to a Federal Home Loan Bank or Farmer Mac is assigned a 20 percent risk weight.

(3) *100 percent risk weight equity exposures.* The following equity exposures are assigned a 100 percent risk weight:

(i) *Community development equity exposures.* An equity exposure that qualifies as a community development investment under 12 U.S.C. 24 (Eleventh), excluding equity exposures to an unconsolidated small business investment company and equity exposures held through a consolidated small business investment company described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682).

(ii) *Effective portion of hedge pairs.* The effective portion of a hedge pair.

(iii) *Non-significant equity exposures.* Equity exposures, excluding exposures to an investment firm that would meet the definition of a traditional securitization were it not for the Federal Reserve's application of paragraph (8) of that definition and has greater than immaterial leverage, to the extent that the aggregate adjusted carrying value of the exposures does not exceed 10 percent of the bank holding company's tier 1 capital plus tier 2 capital.

(A) To compute the aggregate adjusted carrying value of a bank holding company's equity exposures for purposes of this paragraph (b)(3)(iii), the bank holding company may exclude equity exposures described in paragraphs (b)(1), (b)(2), (b)(3)(i), and (b)(3)(ii) of this section, the equity exposure in a hedge pair with the smaller adjusted carrying value, and a proportion of each equity exposure to an investment fund equal to the proportion of the assets of the investment fund that are not equity exposures or that meet the criterion of paragraph (b)(3)(i) of this section. If a bank holding company does not know the actual holdings of the investment fund, the bank holding company may calculate the proportion of the assets of the fund that are not equity exposures based on the terms of the prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. If the sum of the investment limits for all exposure classes within the fund exceeds 100 percent, the bank holding company must assume for purposes of this paragraph (b)(3)(iii) that the investment fund invests to the maximum extent possible in equity exposures.

(B) When determining which of a bank holding company's equity exposures qualify for a 100 percent risk weight under this paragraph, a bank holding company first must include equity exposures to unconsolidated small business investment companies or held through consolidated small business investment companies described in section 302 of the Small Business Investment Act of 1958 (15 U.S.C. 682), then must include publicly traded equity exposures (including those held indirectly through investment funds), and then must include non-publicly traded equity exposures (including those held indirectly through investment funds).

(4) *300 percent risk weight equity exposures.* A publicly traded equity exposure (other than an equity exposure described in paragraph (b)(6) of this section and including the ineffective portion of a hedge pair) is assigned a 300 percent risk weight.

(5) *400 percent risk weight equity exposures.* An equity exposure (other than an equity exposure described in paragraph (b)(6) of this section) that is not publicly traded is assigned a 400 percent risk weight.

(6) *600 percent risk weight equity exposures.* An equity exposure to an investment firm that:

(i) Would meet the definition of a traditional securitization were it not for the Federal Reserve's application of paragraph (8) of that definition; and

(ii) Has greater than immaterial leverage is assigned a 600 percent risk weight.

(c) *Hedge transactions*—(1) *Hedge pair.* A hedge pair is two equity exposures that form an effective hedge so long as each equity exposure is publicly traded or has a return that is primarily based on a publicly traded equity exposure.

(2) *Effective hedge.* Two equity exposures form an effective hedge if the exposures either have the same remaining maturity or each has a remaining maturity of at least three months; the hedge relationship is formally documented in a prospective manner (that is, before the bank holding company acquires at least one of the equity exposures); the documentation specifies the measure of effectiveness (E) the bank holding company will use for the hedge relationship throughout the life of the transaction; and the hedge relationship has an E greater than or equal to 0.8. A bank holding company must measure E at least quarterly and must use one of three alternative measures of E:

(i) Under the dollar-offset method of measuring effectiveness, the bank holding company must determine the ratio of value change (RVC). The RVC is the ratio of the cumulative sum of the periodic changes in value of one equity exposure to the cumulative sum of the periodic changes in the value of the other equity exposure. If RVC is positive, the hedge is not effective and E equals 0. If RVC is negative and greater than or equal to −1 (that is, between zero and −1), then E equals the absolute value of RVC. If RVC is negative and less than −1, then E equals 2 plus RVC.

(ii) Under the variability-reduction method of measuring effectiveness:

$$E = 1 - \frac{\sum_{t=1}^{T}\left(X_t - X_{t-1}\right)^2}{\sum_{t=1}^{T}\left(A_t - A_{t-1}\right)^2}, \text{ where}$$

(A) $X_t = A_t - B_t$;

(B) $A_t$ = the value at time t of one exposure in a hedge pair; and

(C) $B_t$ = the value at time t of the other exposure in a hedge pair.

(iii) Under the regression method of measuring effectiveness, E equals the coefficient of determination of a regression in which the change in value of one exposure in a hedge pair is the dependent variable and the change in value of the other exposure in a hedge pair is the independent variable. However, if the estimated regression coefficient is positive, then the value of E is zero.

(3) The effective portion of a hedge pair is E multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

(4) The ineffective portion of a hedge pair is (1–E) multiplied by the greater of the adjusted carrying values of the equity exposures forming a hedge pair.

*Section 53. Internal Models Approach (IMA)*

(a) *General.* A bank holding company may calculate its risk-weighted asset amount for equity exposures using the IMA by modeling publicly traded and non-publicly traded equity exposures (in accordance with paragraph (c) of this section) or by modeling only publicly traded equity exposures (in accordance with paragraph (d) of this section).

(b) *Qualifying criteria.* To qualify to use the IMA to calculate risk-based capital requirements for equity exposures, a bank holding company must receive prior written approval from the Federal Reserve. To receive such approval, the bank holding company must demonstrate to the Federal Reserve's satisfaction that the bank holding company meets the following criteria:

(1) The bank holding company must have one or more models that:

(i) Assess the potential decline in value of its modeled equity exposures;

(ii) Are commensurate with the size, complexity, and composition of the bank holding company's modeled equity exposures; and

(iii) Adequately capture both general market risk and idiosyncratic risk.

(2) The bank holding company's model must produce an estimate of potential losses for its modeled equity exposures that is no less than the estimate of potential losses produced by a VaR methodology employing a 99.0 percent, one-tailed confidence interval of the distribution of quarterly returns for a benchmark portfolio of equity exposures comparable to the bank holding company's modeled equity exposures using a long-term sample period.

(3) The number of risk factors and exposures in the sample and the data period used for quantification in the bank holding company's model and benchmarking exercise must be sufficient to provide confidence in

the accuracy and robustness of the bank holding company's estimates.

(4) The bank holding company's model and benchmarking process must incorporate data that are relevant in representing the risk profile of the bank holding company's modeled equity exposures, and must include data from at least one equity market cycle containing adverse market movements relevant to the risk profile of the bank holding company's modeled equity exposures. In addition, the bank holding company's benchmarking exercise must be based on daily market prices for the benchmark portfolio. If the bank holding company's model uses a scenario methodology, the bank holding company must demonstrate that the model produces a conservative estimate of potential losses on the bank holding company's modeled equity exposures over a relevant long-term market cycle. If the bank holding company employs risk factor models, the bank holding company must demonstrate through empirical analysis the appropriateness of the risk factors used.

(5) The bank holding company must be able to demonstrate, using theoretical arguments and empirical evidence, that any proxies used in the modeling process are comparable to the bank holding company's modeled equity exposures and that the bank holding company has made appropriate adjustments for differences. The bank holding company must derive any proxies for its modeled equity exposures and benchmark portfolio using historical market data that are relevant to the bank holding company's modeled equity exposures and benchmark portfolio (or, where not, must use appropriately adjusted data), and such proxies must be robust estimates of the risk of the bank holding company's modeled equity exposures.

(c) *Risk-weighted assets calculation for a bank holding company modeling publicly traded and non-publicly traded equity exposures.* If a bank holding company models publicly traded and non-publicly traded equity exposures, the bank holding company's aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 (as determined under section 52 of this appendix) and each equity exposure to an investment fund (as determined under section 54 of this appendix); and

(2) The greater of:

(i) The estimate of potential losses on the bank holding company's equity exposures (other than equity exposures referenced in paragraph (c)(1) of this section) generated by the bank holding company's internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the bank holding company's publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 of this appendix, and are not equity exposures to an investment fund;

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs; and

(C) 300 percent multiplied by the aggregate adjusted carrying value of the bank holding company's equity exposures that are not publicly traded, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 of this appendix, and are not equity exposures to an investment fund.

(d) *Risk-weighted assets calculation for a bank holding company using the IMA only for publicly traded equity exposures.* If a bank holding company models only publicly traded equity exposures, the bank holding company's aggregate risk-weighted asset amount for its equity exposures is equal to the sum of:

(1) The risk-weighted asset amount of each equity exposure that qualifies for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 (as determined under section 52 of this appendix), each equity exposure that qualifies for a 400 percent risk weight under paragraph (b)(5) of section 52 or a 600 percent risk weight under paragraph (b)(6) of section 52 (as determined under section 52 of this appendix), and each equity exposure to an investment fund (as determined under section 54 of this appendix); and

(2) The greater of:

(i) The estimate of potential losses on the bank holding company's equity exposures (other than equity exposures referenced in paragraph (d)(1) of this section) generated by the bank holding company's internal equity exposure model multiplied by 12.5; or

(ii) The sum of:

(A) 200 percent multiplied by the aggregate adjusted carrying value of the bank holding company's publicly traded equity exposures that do not belong to a hedge pair, do not qualify for a 0 percent, 20 percent, or 100 percent risk weight under paragraphs (b)(1) through (b)(3)(i) of section 52 of this appendix, and are not equity exposures to an investment fund; and

(B) 200 percent multiplied by the aggregate ineffective portion of all hedge pairs.

*Section 54. Equity Exposures to Investment Funds*

(a) *Available approaches.* (1) Unless the exposure meets the requirements for a community development equity exposure in paragraph (b)(3)(i) of section 52 of this appendix, a bank holding company must determine the

risk-weighted asset amount of an equity exposure to an investment fund under the Full Look-Through Approach in paragraph (b) of this section, the Simple Modified Look-Through Approach in paragraph (c) of this section, the Alternative Modified Look-Through Approach in paragraph (d) of this section, or, if the investment fund qualifies for the Money Market Fund Approach, the Money Market Fund Approach in paragraph (e) of this section.

(2) The risk-weighted asset amount of an equity exposure to an investment fund that meets the requirements for a community development equity exposure in paragraph (b)(3)(i) of section 52 of this appendix is its adjusted carrying value.

(3) If an equity exposure to an investment fund is part of a hedge pair and the bank holding company does not use the Full Look-Through Approach, the bank holding company may use the ineffective portion of the hedge pair as determined under paragraph (c) of section 52 of this appendix as the adjusted carrying value for the equity exposure to the investment fund. The risk-weighted asset amount of the effective portion of the hedge pair is equal to its adjusted carrying value.

(b) *Full Look-Through Approach.* A bank holding company that is able to calculate a risk-weighted asset amount for its proportional ownership share of each exposure held by the investment fund (as calculated under this appendix as if the proportional ownership share of each exposure were held directly by the bank holding company) may either:

(1) Set the risk-weighted asset amount of the bank holding company's exposure to the fund equal to the product of:

(i) The aggregate risk-weighted asset amounts of the exposures held by the fund as if they were held directly by the bank holding company; and

(ii) The bank holding company's proportional ownership share of the fund; or

(2) Include the bank holding company's proportional ownership share of each exposure held by the fund in the bank holding company's IMA.

(c) *Simple Modified Look-Through Approach.* Under this approach, the risk-weighted asset amount for a bank holding company's equity exposure to an investment fund equals the adjusted carrying value of the equity exposure multiplied by the highest risk weight in Table 10 that applies to any exposure the fund is permitted to hold under its prospectus, partnership agreement, or similar contract that defines the fund's permissible investments (excluding derivative contracts that are used for hedging rather than speculative purposes and that do not constitute a material portion of the fund's exposures).

TABLE 10—MODIFIED LOOK-THROUGH APPROACHES FOR EQUITY EXPOSURES TO INVESTMENT FUNDS

| Risk weight | Exposure class |
|---|---|
| 0 percent | Sovereign exposures with a long-term applicable external rating in the highest investment-grade rating category and sovereign exposures of the United States. |
| 20 percent | Non-sovereign exposures with a long-term applicable external rating in the highest or second-highest investment-grade rating category; exposures with a short-term applicable external rating in the highest investment-grade rating category; and exposures to, or guaranteed by, depository institutions, foreign banks (as defined in 12 CFR 211.2), or securities firms subject to consolidated supervision and regulation comparable to that imposed on U.S. securities broker-dealers that are repo-style transactions or bankers' acceptances. |
| 50 percent | Exposures with a long-term applicable external rating in the third-highest investment-grade rating category or a short-term applicable external rating in the second-highest investment-grade rating category. |
| 100 percent | Exposures with a long-term or short-term applicable external rating in the lowest investment-grade rating category. |
| 200 percent | Exposures with a long-term applicable external rating one rating category below investment grade. |
| 300 percent | Publicly traded equity exposures. |
| 400 percent | Non-publicly traded equity exposures; exposures with a long-term applicable external rating two rating categories or more below investment grade; and exposures without an external rating (excluding publicly traded equity exposures). |
| 1,250 percent | OTC derivative contracts and exposures that must be deducted from regulatory capital or receive a risk weight greater than 400 percent under this appendix. |

(d) *Alternative Modified Look-Through Approach.* Under this approach, a bank holding company may assign the adjusted carrying value of an equity exposure to an investment fund on a pro rata basis to different risk weight categories in Table 10 based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. The risk-weighted asset amount for the bank holding company's equity exposure to the investment fund equals the sum of each portion of the adjusted carrying value assigned to an exposure class multiplied by the applicable risk weight. If the sum of the

investment limits for exposure classes within the fund exceeds 100 percent, the bank holding company must assume that the fund invests to the maximum extent permitted under its investment limits in the exposure class with the highest risk weight under Table 10, and continues to make investments in order of the exposure class with the next highest risk weight under Table 10 until the maximum total investment level is reached. If more than one exposure class applies to an exposure, the bank holding company must use the highest applicable risk weight. A bank holding company may exclude derivative contracts held by the fund that are used for hedging rather than for speculative purposes and do not constitute a material portion of the fund's exposures.

(e) *Money Market Fund Approach*. The risk-weighted asset amount for a bank holding company's equity exposure to an investment fund that is a money market fund subject to 17 CFR 270.2a–7 and that has an applicable external rating in the highest investment-grade rating category equals the adjusted carrying value of the equity exposure multiplied by 7 percent.

*Section 55. Equity Derivative Contracts*

Under the IMA, in addition to holding risk-based capital against an equity derivative contract under this part, a bank holding company must hold risk-based capital against the counterparty credit risk in the equity derivative contract by also treating the equity derivative contract as a wholesale exposure and computing a supplemental risk-weighted asset amount for the contract under part IV. Under the SRWA, a bank holding company may choose not to hold risk-based capital against the counterparty credit risk of equity derivative contracts, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a bank holding company using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

PART VII. RISK-WEIGHTED ASSETS FOR OPERATIONAL RISK

*Section 61. Qualification Requirements for Incorporation of Operational Risk Mitigants*

(a) *Qualification to use operational risk mitigants*. A bank holding company may adjust its estimate of operational risk exposure to reflect qualifying operational risk mitigants if:

(1) The bank holding company's operational risk quantification system is able to generate an estimate of the bank holding company's operational risk exposure (which does not incorporate qualifying operational risk mitigants) and an estimate of the bank holding company's operational risk exposure adjusted to incorporate qualifying operational risk mitigants; and

(2) The bank holding company's methodology for incorporating the effects of insurance, if the bank holding company uses insurance as an operational risk mitigant, captures through appropriate discounts to the amount of risk mitigation:

(i) The residual term of the policy, where less than one year;

(ii) The cancellation terms of the policy, where less than one year;

(iii) The policy's timeliness of payment;

(iv) The uncertainty of payment by the provider of the policy; and

(v) Mismatches in coverage between the policy and the hedged operational loss event.

(b) *Qualifying operational risk mitigants*. Qualifying operational risk mitigants are:

(1) Insurance that:

(i) Is provided by an unaffiliated company that has a claims payment ability that is rated in one of the three highest rating categories by a NRSRO;

(ii) Has an initial term of at least one year and a residual term of more than 90 days;

(iii) Has a minimum notice period for cancellation by the provider of 90 days;

(iv) Has no exclusions or limitations based upon regulatory action or for the receiver or liquidator of a failed depository institution; and

(v) Is explicitly mapped to a potential operational loss event; and

(2) Operational risk mitigants other than insurance for which the Federal Reserve has given prior written approval. In evaluating an operational risk mitigant other than insurance, the Federal Reserve will consider whether the operational risk mitigant covers potential operational losses in a manner equivalent to holding regulatory capital.

*Section 62. Mechanics of Risk-Weighted Asset Calculation*

(a) If a bank holding company does not qualify to use or does not have qualifying operational risk mitigants, the bank holding company's dollar risk-based capital requirement for operational risk is its operational risk exposure minus eligible operational risk offsets (if any).

(b) If a bank holding company qualifies to use operational risk mitigants and has qualifying operational risk mitigants, the bank holding company's dollar risk-based capital requirement for operational risk is the greater of:

(1) The bank holding company's operational risk exposure adjusted for qualifying operational risk mitigants minus eligible operational risk offsets (if any); or

(2) 0.8 multiplied by the difference between:

(i) The bank holding company's operational risk exposure; and

(ii) Eligible operational risk offsets (if any).

(c) The bank holding company's risk-weighted asset amount for operational risk equals the bank holding company's dollar risk-based capital requirement for operational risk determined under paragraph (a) or (b) of this section multiplied by 12.5.

## PART VIII. DISCLOSURE

### *Section 71. Disclosure Requirements*

(a) Each bank holding company must publicly disclose each quarter its total and tier 1 risk-based capital ratios and their components (that is, tier 1 capital, tier 2 capital, total qualifying capital, and total risk-weighted assets).[4]

(b)(1) Each consolidated bank holding company that is not a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction and has successfully completed its parallel run must provide timely public disclosures each calendar quarter of the information in tables 11.1–11.11 below. If a significant change occurs, such that the most recent reported amounts are no longer reflective of the bank holding company's capital adequacy and risk profile, then a brief discussion of this change and its likely impact must be provided as soon as practicable thereafter. Qualitative disclosures that typically do not change each quarter (for example, a general summary of the bank holding company's risk management objectives and policies, reporting system, and definitions) may be disclosed annually, provided any significant changes to these are disclosed in the interim. Management is encouraged to provide all of the disclosures required by this appendix in one place on the bank holding company's public Web site.[5] The bank holding company must make these disclosures publicly available for each of the last three years (that is, twelve quarters) or such shorter period since it began its first floor period.

(2) Each bank holding company is required to have a formal disclosure policy approved by the board of directors that addresses its approach for determining the disclosures it makes. The policy must address the associated internal controls and disclosure controls and procedures. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the disclosures required by this appendix, and must ensure that appropriate review of the disclosures takes place. One or more senior officers of the bank holding company must attest that the disclosures meet the requirements of this appendix.

(3) If a bank holding company believes that disclosure of specific commercial or financial information would prejudice seriously its position by making public information that is either proprietary or confidential in nature, the bank holding company need not disclose those specific items, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed.

TABLE 11.1—SCOPE OF APPLICATION

| | |
|---|---|
| Qualitative Disclosures | (a) The name of the top corporate entity in the group to which the appendix applies.<br>(b) An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities[6] within the group that are fully consolidated; that are deconsolidated and deducted; for which the regulatory capital requirement is deducted; and that are neither consolidated nor deducted (for example, where the investment is risk-weighted).<br>(c) Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group. |

[4] Other public disclosure requirements continue to apply—for example, Federal securities law and regulatory reporting requirements.

[5] Alternatively, a bank holding company may provide the disclosures in more than one place, as some of them may be included in public financial reports (for example, in Management's Discussion and Analysis included in SEC filings) or other regulatory reports. The bank holding company must provide a summary table on its public Web site that specifically indicates where all the disclosures may be found (for example, regulatory report schedules, page numbers in annual reports).

[6] Entities include securities, insurance and other financial subsidiaries, commercial subsidiaries (where permitted), and significant minority equity investments in insurance, financial and commercial entities.

TABLE 11.1—SCOPE OF APPLICATION—Continued

| | |
|---|---|
| Quantitative Disclosures | (d) The aggregate amount of surplus capital of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the regulatory capital of the consolidated group.<br>(e) The aggregate amount by which actual regulatory capital is less than the minimum regulatory capital requirement in all subsidiaries with regulatory capital requirements and the name(s) of the subsidiaries with such deficiencies. |

TABLE 11.2—CAPITAL STRUCTURE

| | |
|---|---|
| Qualitative Disclosures | (a) Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments. |
| Quantitative Disclosures | (b) The amount of tier 1 capital, with separate disclosure of:<br>• Common stock/surplus;<br>• Retained earnings;<br>• Minority interests in the equity of subsidiaries;<br>• Restricted core capital elements as defined in 12 CFR part 225, appendix A;<br>• Regulatory calculation differences deducted from tier 1 capital;[7] and<br>• Other amounts deducted from tier 1 capital, including goodwill and certain intangibles.<br>(c) The total amount of tier 2 capital.<br>(d) Other deductions from capital.[8]<br>(e) Total eligible capital. |

TABLE 11.3—CAPITAL ADEQUACY

| | |
|---|---|
| Qualitative disclosures | (a) A summary discussion of the bank holding company's approach to assessing the adequacy of its capital to support current and future activities. |
| Quantitative disclosures | (b) Risk-weighted assets for credit risk from:<br>• Wholesale exposures;<br>• Residential mortgage exposures;<br>• Qualifying revolving exposures;<br>• Other retail exposures;<br>• Securitization exposures;<br>• Equity exposures<br>  • Equity exposures subject to the simple risk weight approach; and<br>  • Equity exposures subject to the internal models approach.<br>(c) Risk-weighted assets for market risk as calculated under [the market risk rule]:[9]<br>• Standardized approach for specific risk; and<br>• Internal models approach for specific risk. |

[7] Representing 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 1 capital.

[8] Including 50 percent of the amount, if any, by which total expected credit losses as calculated within the IRB approach exceed eligible credit reserves, which must be deducted from tier 2 capital.

[9] Risk-weighted assets determined under [the market risk rule] are to be disclosed only for the approaches used.

TABLE 11.3—CAPITAL ADEQUACY—Continued

| | |
|---|---|
| | (d) Risk-weighted assets for operational risk.<br>(e) Total and tier 1 risk-based capital ratios: [10]<br>• For the top consolidated group; and<br>• For each DI subsidiary. |

GENERAL QUALITATIVE DISCLOSURE REQUIREMENT

For each separate risk area described in tables 11.4 through 11.11, the bank holding company must describe its risk management objectives and policies, including:

• Strategies and processes;

• The structure and organization of the relevant risk management function;

• The scope and nature of risk reporting and/or measurement systems;

• Policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

TABLE 11.4[11]—CREDIT RISK: GENERAL DISCLOSURES

| | |
|---|---|
| Qualitative Disclosures | (a) The general qualitative disclosure requirement with respect to credit risk (excluding counterparty credit risk disclosed in accordance with Table 11.6), including:<br>• Definitions of past due and impaired (for accounting purposes);<br>• Description of approaches followed for allowances, including statistical methods used where applicable; and<br>• Discussion of the bank holding company's credit risk management policy. |
| Quantitative Disclosures | (b) Total credit risk exposures and average credit risk exposures, after accounting offsets in accordance with GAAP,[12] and without taking into account the effects of credit risk mitigation techniques (for example, collateral and netting), over the period broken down by major types of credit exposure.[13]<br>(c) Geographic[14] distribution of exposures, broken down in significant areas by major types of credit exposure.<br>(d) Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.<br>(e) Remaining contractual maturity breakdown (for example, one year or less) of the whole portfolio, broken down by major types of credit exposure.<br>(f) By major industry or counterparty type:<br>• Amount of impaired loans;<br>• Amount of past due loans;[15]<br>• Allowances; and<br>• Charge-offs during the period. |

[10] Total risk-weighted assets should also be disclosed.

[11] Table 4 does not include equity exposures.

[12] For example, FASB Interpretations 39 and 41.

[13] For example, bank holding companies could apply a breakdown similar to that used for accounting purposes. Such a breakdown might, for instance, be (a) loans, off-balance sheet commitments, and other non-derivative off-balance sheet exposures, (b) debt securities, and (c) OTC derivatives.

[14] Geographical areas may comprise individual countries, groups of countries, or regions within countries. A bank holding company might choose to define the geographical areas based on the way the company's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas must be specified.

[15] A bank holding company is encouraged also to provide an analysis of the aging of past-due loans.

TABLE 11.4[11]—CREDIT RISK: GENERAL DISCLOSURES—Continued

| | |
|---|---|
| | (g) Amount of impaired loans and, if available, the amount of past due loans broken down by significant geographic areas including, if practical, the amounts of allowances related to each geographical area.[16]<br>(h) Reconciliation of changes in the allowance for loan and lease losses.[17] |

TABLE 11.5—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS

| | |
|---|---|
| Qualitative disclosures | (a) Explanation and review of the:<br>• Structure of internal rating systems and relation between internal and external ratings;<br>• Use of risk parameter estimates other than for regulatory capital purposes;<br>• Process for managing and recognizing credit risk mitigation (see table 11.7); and<br>• Control mechanisms for the rating system, including discussion of independence, accountability, and rating systems review.<br>(b) Description of the internal ratings process, provided separately for the following:<br>• Wholesale category;<br>• Retail subcategories;<br>  • Residential mortgage exposures;<br>  • Qualifying revolving exposures; and<br>  • Other retail exposures.<br>For each category and subcategory the description should include:<br>• The types of exposure included in the category/subcategories; and<br>• The definitions, methods and data for estimation and validation of PD, LGD, and EAD, including assumptions employed in the derivation of these variables.[18] |

[16] The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

[17] The reconciliation should include the following: A description of the allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts provided (or reversed) for estimated probable loan losses during the period; any other adjustments (for example, exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing balance of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

[18] This disclosure does not require a detailed description of the model in full—it should provide the reader with a broad overview of the model approach, describing definitions of the variables and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the four category/subcategories. The bank holding company should disclose any significant differences in approach to estimating these variables within each category/subcategories.

TABLE 11.5—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB RISK-BASED CAPITAL FORMULAS—Continued

| | |
|---|---|
| Quantitative disclosures: Risk assessment. | (c) For wholesale exposures, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk: [19]<br>• Total EAD; [20]<br>• Exposure-weighted average LGD (percentage);<br>• Exposure-weighted average risk weight; and<br>• Amount of undrawn commitments and exposure-weighted average EAD for wholesale exposures.<br>For each retail subcategory, present the disclosures outlined above across a sufficient number of segments to allow for a meaningful differentiation of credit risk. |
| Quantitative disclosures: Historical results. | (d) Actual losses in the preceding period for each category and subcategory and how this differs from past experience. A discussion of the factors that impacted the loss experience in the preceding period—for example, has the bank holding company experienced higher than average default rates, loss rates or EADs.<br>(e) Bank holding company's estimates compared against actual outcomes over a longer period.[21] At a minimum, this should include information on estimates of losses against actual losses in the wholesale category and each retail subcategory over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each category/subcategory.[22] Where appropriate, the bank holding company should further decompose this to provide analysis of PD, LGD, and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[23] |

[19] The PD, LGD and EAD disclosures in Table 11.5(c) should reflect the effects of collateral, qualifying master netting agreements, eligible guarantees and eligible credit derivatives as defined in part I. Disclosure of each PD grade should include the exposure-weighted average PD for each grade. Where a bank holding company aggregates PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used for regulatory capital purposes.

[20] Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

[21] These disclosures are a way of further informing the reader about the reliability of the information provided in the ''quantitative disclosures: risk assessment'' over the long run. The disclosures are requirements from year-end 2010; in the meantime, early adoption is encouraged. The phased implementation is to allow a bank holding company sufficient time to build up a longer run of data that will make these disclosures meaningful.

[22] This regulation is not prescriptive about the period used for this assessment. Upon implementation, it might be expected that a bank holding company would provide these disclosures for as long run of data as possible—for example, if a bank holding company has 10 years of data, it might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

[23] A bank holding company should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the ''quantitative disclosures: risk assessment.'' In particular, it should provide this information where there are material differences between its estimates of PD, LGD or EAD compared to actual outcomes over the long run. The bank holding company should also provide explanations for such differences.

TABLE 11.6—GENERAL DISCLOSURE FOR COUNTERPARTY CREDIT RISK OF OTC DERIVATIVE CONTRACTS, REPO-STYLE TRANSACTIONS, AND ELIGIBLE MARGIN LOANS

| | |
|---|---|
| Qualitative Disclosures | (a) The general qualitative disclosure requirement with respect to OTC derivatives, eligible margin loans, and repo-style transactions, including:<br>• Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures;<br>• Discussion of policies for securing collateral, valuing and managing collateral, and establishing credit reserves;<br>• Discussion of the primary types of collateral taken;<br>• Discussion of policies with respect to wrong-way risk exposures; and<br>• Discussion of the impact of the amount of collateral the bank holding company would have to provide if the bank holding company were to receive a credit rating downgrade. |
| Quantitative Disclosures | (b) Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, for example, cash, government securities), and net unsecured credit exposure.[24] Also report measures for EAD used for regulatory capital for these transactions, the notional value of credit derivative hedges purchased for counterparty credit risk protection, and, for bank holding companies not using the internal models methodology in section 32(d) of this appendix, the distribution of current credit exposure by types of credit exposure.[25]<br>(c) Notional amount of purchased and sold credit derivatives, segregated between use for the bank holding company's own credit portfolio and for its intermediation activities, including the distribution of the credit derivative products used, broken down further by protection bought and sold within each product group.<br>(d) The estimate of alpha if the bank holding company has received supervisory approval to estimate alpha. |

[24] Net unsecured credit exposure is the credit exposure after considering the benefits from legally enforceable netting agreements and collateral arrangements, without taking into account haircuts for price volatility, liquidity, etc.

[25] This may include interest rate derivative contracts, foreign exchange derivative contracts, equity derivative contracts, credit derivatives, commodity or other derivative contracts, repo-style transactions, and eligible margin loans.

TABLE 11.7—CREDIT RISK MITIGATION [26] [27] [28]

| | |
|---|---|
| Qualitative Disclosures | (a) The general qualitative disclosure requirement with respect to credit risk mitigation including:<br>• Policies and processes for, and an indication of the extent to which the bank holding company uses, on- and off-balance sheet netting;<br>• Policies and processes for collateral valuation and management;<br>• A description of the main types of collateral taken by the bank holding company;<br>• The main types of guarantors/credit derivative counterparties and their creditworthiness; and<br>• Information about (market or credit) risk concentrations within the mitigation taken. |
| Quantitative Disclosures | (b) For each separately disclosed portfolio, the total exposure (after, where applicable, on-or off-balance sheet netting) that is covered by guarantees/credit derivatives. |

TABLE 11.8—SECURITIZATION

| | |
|---|---|
| Qualitative disclosures | (a) The general qualitative disclosure requirement with respect to securitization (including synthetics), including a discussion of:<br>• The bank holding company's objectives relating to securitization activity, including the extent to which these activities transfer credit risk of the underlying exposures away from the bank holding company to other entities;<br>• The roles played by the bank holding company in the securitization process [29] and an indication of the extent of the bank holding company's involvement in each of them; and<br>• The regulatory capital approaches (for example, RBA, IAA and SFA) that the bank holding company follows for its securitization activities.<br>(b) Summary of the bank holding company's accounting policies for securitization activities, including:<br>• Whether the transactions are treated as sales or financings;<br>• Recognition of gain-on-sale;<br>• Key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and<br>• Treatment of synthetic securitizations.<br>(c) Names of NRSROs used for securitizations and the types of securitization exposure for which each agency is used. |

[26] At a minimum, a bank holding company must provide the disclosures in Table 11.7 in relation to credit risk mitigation that has been recognized for the purposes of reducing capital requirements under this appendix. Where relevant, bank holding companies are encouraged to give further information about mitigants that have not been recognized for that purpose.

[27] Credit derivatives that are treated, for the purposes of this appendix, as synthetic securitization exposures should be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

[28] Counterparty credit risk-related exposures disclosed pursuant to Table 11.6 should be excluded from the credit risk mitigation disclosures in Table 11.7.

[29] For example: originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, or swap provider.

TABLE 11.8—SECURITIZATION—Continued

| | |
|---|---|
| Quantitative disclosures | (d) The total outstanding exposures securitized by the bank holding company in securitizations that meet the operational criteria in section 41 of this appendix (broken down into traditional/synthetic), by underlying exposure type.[30] [31] [32]<br>(e) For exposures securitized by the bank holding company in securitizations that meet the operational criteria in Section 41 of this appendix:<br>• Amount of securitized assets that are impaired/past due; and<br>• Losses recognized by the bank holding company during the current period[33] broken down by exposure type.<br>(f) Aggregate amount of securitization exposures broken down by underlying exposure type.<br>(g) Aggregate amount of securitization exposures and the associated IRB capital requirements for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted from capital should be disclosed separately by type of underlying asset.<br>(h) For securitizations subject to the early amortization treatment, the following items by underlying asset type for securitized facilities:<br>• The aggregate drawn exposures attributed to the seller's and investors' interests; and<br>• The aggregate IRB capital charges incurred by the bank holding company against the investors' shares of drawn balances and undrawn lines.<br>(i) Summary of current year's securitization activity, including the amount of exposures securitized (by exposure type), and recognized gain or loss on sale by asset type. |

TABLE 11.9—OPERATIONAL RISK

| | |
|---|---|
| Qualitative disclosures | (a) The general qualitative disclosure requirement for operational risk.<br>(b) Description of the AMA, including a discussion of relevant internal and external factors considered in the bank holding company's measurement approach.<br>(c) A description of the use of insurance for the purpose of mitigating operational risk. |

TABLE 11.10—EQUITIES NOT SUBJECT TO MARKET RISK RULE

| | |
|---|---|
| Qualitative Disclosures | (a) The general qualitative disclosure requirement with respect to equity risk, including: |

[30] Underlying exposure types may include, for example, one- to four-family residential loans, home equity lines, credit card receivables, and auto loans.

[31] Securitization transactions in which the originating bank holding company does not retain any securitization exposure should be shown separately but need only be reported for the year of inception.

[32] Where relevant, a bank holding company is encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other bank holding company securitization activities.

[33] For example, charge-offs/allowances (if the assets remain on the bank holding company's balance sheet) or write-downs of I/O strips and other residual interests.

TABLE 11.10—EQUITIES NOT SUBJECT TO MARKET RISK RULE—Continued

| | |
|---|---|
| | • Differentiation between holdings on which capital gains are expected and those held for other objectives, including for relationship and strategic reasons; and<br>• Discussion of important policies covering the valuation of and accounting for equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices. |
| Quantitative Disclosures | (b) Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly-quoted share values where the share price is materially different from fair value.<br>(c) The types and nature of investments, including the amount that is:<br>• Publicly traded; and<br>• Non-publicly traded.<br>(d) The cumulative realized gains (losses) arising from sales and liquidations in the reporting period.<br>(e) • Total unrealized gains (losses) [34]<br>• Total latent revaluation gains (losses) [35]<br>• Any amounts of the above included in tier 1 and/or tier 2 capital.<br>(f) Capital requirements broken down by appropriate equity groupings, consistent with the bank holding company's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition regarding regulatory capital requirements.[36] |

TABLE 11.11—INTEREST RATE RISK FOR NON-TRADING ACTIVITIES

| | |
|---|---|
| Qualitative disclosures | (a) The general qualitative disclosure requirement, including the nature of interest rate risk for non-trading activities and key assumptions, including assumptions regarding loan prepayments and behavior of non-maturity deposits, and frequency of measurement of interest rate risk for non-trading activities. |
| Quantitative disclosures | (b) The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring interest rate risk for non-trading activities, broken down by currency (as appropriate). |

[34] Unrealized gains (losses) recognized in the balance sheet but not through earnings.

[35] Unrealized gains (losses) not recognized either in the balance sheet or through earnings.

[36] This disclosure should include a breakdown of equities that are subject to the 0 percent, 20 percent, 100 percent, 300 percent, 400 percent, and 600 percent risk weights, as applicable.

[Reg. Y, 72 FR 69396, 69431, Dec. 7, 2007; 73 FR 21690, Apr. 22, 2008]

# PART 226—TRUTH IN LENDING (REGULATION Z)

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SUPPLEMENT I TO PART 226—OFFICIAL STAFF INTERPRETATIONS

AUTHORITY: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637 (c)(5).

EFFECTIVE DATE NOTE: At 73 FR 44599, July 30, 2008, the authority citation to part 226 was revised, effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth below.

AUTHORITY: 12 U.S.C. 3806; 15 U.S.C. 1604, 1637(c)(5), and 1639(l).

SOURCE: Reg. Z, 46 FR 20892, Apr. 7, 1981, unless otherwise noted.

## Subpart A—General

### § 226.1 Authority, purpose, coverage, organization, enforcement and liability.

(a) *Authority*. This regulation, known as Regulation Z, is issued by the Board of Governors of the Federal Reserve System to implement the Federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 *et seq.*). This regulation also implements title XII, section 1204 of the Competitive Equality Banking Act of

1987 (Pub. L. 100–86, 101 Stat. 552). Information-collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 *et seq.* and have been assigned OMB number 7100–0199.

(b) *Purpose.* The purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation also gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes. The regulation does not govern charges for consumer credit. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling. It also imposes limitations on home equity plans that are subject to the requirements of § 226.5b and mortgages that are subject to the requirements of § 226.32. The regulation prohibits certain acts or practices in connection with credit secured by a consumer's principal dwelling.

(c) *Coverage.* (1) In general, this regulation applies to each individual or business that offers or extends credit when four conditions are met: (i) The credit is offered or extended to consumers; (ii) the offering or extension of credit is done regularly;[1] (iii) the credit is subject to a finance charge or is payable by a written agreement in more than 4 installments; and (iv) the credit is primarily for personal, family, or household purposes.

(2) If a credit card is involved, however, certain provisions apply even if the credit is not subject to a finance charge, or is not payable by a written agreement in more than 4 installments, or if the credit card is to be used for business purposes.

(3) In addition, certain requirements of § 226.5b apply to persons who are not creditors but who provide applications for home equity plans to consumers.

[1] The meaning of *regularly* is explained in the definition of *creditor* in § 226.2(a).

(d) *Organization.* The regulation is divided into subparts and appendices as follows:

(1) Subpart A contains general information. It sets forth: (i) The authority, purpose, coverage, and organization of the regulation; (ii) the definitions of basic terms; (iii) the transactions that are exempt from coverage; and (iv) the method of determining the finance charge.

(2) Subpart B contains the rules for open-end credit. It requires that initial disclosures and periodic statements be provided, as well as additional disclosures for credit and charge card applications and solicitations and for home equity plans subject to the requirements of §§ 226.5a and 226.5b, respectively.

(3) Subpart C relates to closed-end credit. It contains rules on disclosures, treatment of credit balances, annual percentage rate calculations, rescission requirements, and advertising.

(4) Subpart D contains rules on oral disclosures, Spanish language disclosure in Puerto Rico, record retention, effect on state laws, state exemptions, and rate limitations.

(5) Subpart E contains special rules for mortgage transactions. Section 226.32 requires certain disclosures and provides limitations for loans that have rates and fees above specified amounts. Section 226.33 requires disclosures, including the total annual loan cost rate, for reverse mortgage transactions. Section 226.34 prohibits specific acts and practices in connection with mortgage transactions.

(6) Several appendices contain information such as the procedures for determinations about state laws, state exemptions and issuance of staff interpretations, special rules for certain kinds of credit plans, a list of enforcement agencies, and the rules for computing annual percentage rates in closed-end credit transactions and total annual loan cost rates for reverse mortgage transactions.

(e) *Enforcement and liability.* Section 108 of the act contains the administrative enforcement provisions. Sections 112, 113, 130, 131, and 134 contain provisions relating to liability for failure to comply with the requirements of the act and the regulation. Section 1204(c)

of title XII of the Competitive Equality Banking Act of 1987, Pub. L. 100–86, 101 Stat. 552, incorporates by reference administrative enforcement and civil liability provisions of sections 108 and 130 of the act.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 52 FR 43181, Nov. 9, 1987; 54 FR 13865, Apr. 6, 1989; 54 FR 24686, June 9, 1989; 60 FR 15471, Mar. 24, 1995; 66 FR 65617, Dec. 20, 2001]

EFFECTIVE DATE NOTE: At 73 FR 44599, July 30, 2008, § 226.1 was amended by revising paragraph (d)(5), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

**§ 226.1 Authority, purpose, coverage, organization, enforcement and liability.**

* * * * *

(d) * * *

* * * * *

(5) Subpart E contains special rules for mortgage transactions. Section 226.32 requires certain disclosures and provides limitations for loans that have rates and fees above specified amounts. Section 226.33 requires disclosures, including the total annual loan cost rate, for reverse mortgage transactions. Section 226.34 prohibits specific acts and practices in connection with mortgage transactions that are subject to § 226.32. Section 226.35 prohibits specific acts and practices in connection with higher-priced mortgage loans, as defined in § 226.35(a). Section 226.36 prohibits specific acts and practices in connection with credit secured by a consumer's principal dwelling.

* * * * *

**§ 226.2 Definitions and rules of construction.**

(a) *Definitions.* For purposes of this regulation, the following definitions apply:

(1) *Act* means the Truth in Lending Act (15 U.S.C. 1601 *et seq.*).

(2) *Advertisement* means a commercial message in any medium that promotes, directly or indirectly, a credit transaction.

(3) [Reserved][2]

(4) *Billing cycle* or *cycle* means the interval between the days or dates of regular periodic statements. These intervals shall be equal and no longer than a quarter of a year. An interval will be considered equal if the number of days in the cycle does not vary more than 4 days from the regular day or date of the periodic statement.

(5) *Board* means the Board of Governors of the Federal Reserve System.

(6) *Business day* means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. However, for purposes of rescission under §§ 226.15 and 226.23, and for purposes of § 226.31, the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

(7) *Card issuer* means a person that issues a credit card or that person's agent with respect to the card.

(8) *Cardholder* means a natural person to whom a credit card is issued for consumer credit purposes, or a natural person who has agreed with the card issuer to pay consumer credit obligations arising from the issuance of a credit card to another natural person. For purposes of § 226.12(a) and (b), the term includes any person to whom a credit card is issued for any purpose, including business, commercial, or agricultural use, or a person who has agreed with the card issuer to pay obligations arising from the issuance of such a credit card to another person.

(9) *Cash price* means the price at which a creditor, in the ordinary course of business, offers to sell for cash the property or service that is the subject of the transaction. At the creditor's option, the term may include the price of accessories, services related to the sale, service contracts and taxes and fees for license, title, and registration. The term does not include any finance charge.

(10) *Closed-end credit* means consumer credit other than *open-end credit* as defined in this section.

(11) *Consumer* means a cardholder or a natural person to whom consumer credit is offered or extended. However, for purposes of rescission under §§ 226.15

[2] [Reserved]

and 226.23, the term also includes a natural person in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest.

(12) *Consumer credit* means credit offered or extended to a consumer primarily for personal, family, or household purposes.

(13) *Consummation* means the time that a consumer becomes contractually obligated on a credit transaction.

(14) *Credit* means the right to defer payment of debt or to incur debt and defer its payment.

(15) *Credit card* means any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit. *Charge card* means a credit card on an account for which no periodic rate is used to compute a finance charge.

(16) *Credit sale* means a sale in which the seller is a creditor. The term includes a bailment or lease (unless terminable without penalty at any time by the consumer) under which the consumer:

(i) Agrees to pay as compensation for use a sum substantially equivalent to, or in excess of, the total value of the property and services involved; and

(ii) Will become (or has the option to become), for no additional consideration or for nominal consideration, the owner of the property upon compliance with the agreement.

(17) *Creditor* means: (i) A person (A) who regularly extends consumer credit[3] that is subject to a finance charge or is payable by written agreement in more than 4 installments (not including a downpayment), and (B) to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract.

(ii) For purposes of §§ 226.4(c)(8) (discounts), 226.9(d) (Finance charge imposed at time of transaction), and 226.12(e) (Prompt notification of returns and crediting of refunds), a person that honors a credit card.

(iii) For purposes of subpart B, any card issuer that extends either open-end credit or credit that is not subject to a finance charge and is not payable by written agreement in more than 4 installments.

(iv) For purposes of subpart B (except for the credit and charge card disclosures contained in §§ 226.5(a) and 226.9 (e) and (f), the finance charge disclosures contained in §§ 226.6(a) and 226.7 (d) through (g) and the right of rescission set forth in § 226.15) and subpart C, any card issuer that extends closed-end credit that is subject to a finance charge or is payable by written agreement in more than 4 installments.

(18) *Downpayment* means an amount, including the value of any property used as a trade-in, paid to a seller to reduce the cash price of goods or services purchased in a credit sale transaction. 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 1 to 4 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.

[3] A person regularly extends consumer credit only if it extended credit (other than credit subject to the requirements of § 226.32) more than 25 times (or more than 5 times for transactions secured by a dwelling) in the preceding calendar year. If a person did not meet these numerical standards in the preceding calendar year, the numerical standards shall be applied to the current calendar year. A person regularly extends consumer credit if, in any 12-month period, the person originates more than one credit extension that is subject to the requirements of § 226.32 or one or more such credit extensions through a mortgage broker.

(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 disclosure 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 this regulation, they refer to a consumer credit obligation or transaction, depending upon the context. Where the word *credit* is used in this 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.

[Reg. Z, 46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981, as amended at 47 FR 7392, Feb. 19, 1982; 48 FR 14886, Apr. 6, 1983; 54 FR 13865, Apr. 6, 1989; 60 FR 15471, Mar. 24, 1995; 61 FR 49245, Sept. 19, 1996; 69 FR 16773, Mar. 31, 2004]

EFFECTIVE DATE NOTE: At 73 FR 44599, July 30, 2008, § 226.2 was amended by revising paragraph (a)(6), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

**§ 226.2 Definitions and rules of construction.**

(a) * * *

(6) ''*Business Day*'' means a day on which the creditor's offices are open to the public for carrying on substantially all of its business functions. However, for purposes of rescission under §§ 226.15 and 226.23, and for purposes of § 226.19(a)(1)(ii) and § 226.31, the term means all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103(a), such as New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

* * * * *

**§ 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

[4] The provisions in § 226.12 (a) and (b) governing the issuance of credit cards and the liability for their unauthorized use apply to all credit cards, even if the credit cards are issued for use in connection with extensions of credit that otherwise are exempt under this section.

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.*).

[46 FR 20892, Apr. 7, 1981, as amended at 48 FR 14886, Apr. 6, 1983; 49 FR 46991, Nov. 30, 1984]

### § 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.

(3) *Special rule; mortgage broker fees*. Fees charged by a mortgage broker (including fees paid by the consumer directly to the broker or to the creditor for delivery to the broker) are finance charges even if the creditor does not require the consumer to use a mortgage broker and even if the creditor does not retain any portion of the charge.

(b) *Example of finance charge*. The finance charge includes the following types of charges, except for charges specifically excluded by paragraphs (c) through (e) of this section:

(1) Interest, time price differential, and any amount payable under an add-on or discount system of additional charges.

(2) Service, transaction, activity, and carrying charges, including any charge imposed on a checking or other transaction account to the extent that the charge exceeds the charge for a similar account without a credit feature.

(3) Points, loan fees, assumption fees, finder's fees, and similar charges.

(4) Appraisal, investigation, and credit report fees.

(5) Premiums or other charges for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss.

(6) Charges imposed on a creditor by another person for purchasing or accepting a consumer's obligation, if the consumer is required to pay the charges in cash, as an addition to the obligation, or as a deduction from the proceeds of the obligation.

(7) Premiums or other charges for credit life, accident, health, or loss-of-income insurance, written in connection with a credit transaction.

(8) Premiums or other charges for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property, written in connection with a credit transaction.

(9) Discounts for the purpose of inducing payment by a means other than the use of credit.

(10) *Debt cancellation fees*. Charges or premiums paid for debt cancellation coverage written in connection with a credit transaction, whether or not the debt cancellation coverage is insurance under applicable law.

(c) *Charges excluded from the finance charge*. The following charges are not finance charges:

(1) Application fees charged to all applicants for credit, whether or not credit is actually extended.

(2) Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.

(3) Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.

(4) Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis.

(5) Seller's points.

(6) Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.

(7) *Real-estate related fees*. The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:

(i) Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.

(ii) Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents.

(iii) Notary and credit report fees.

(iv) Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest infestation or flood hazard determinations.

(v) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

(8) Discounts offered to induce payment for a purchase by cash, check, or other means, as provided in section 167(b) of the Act.

(d) *Insurance and debt cancellation coverage*—(1) *Voluntary credit insurance premiums*. Premiums for credit life, accident, health or loss-of-income insurance may be excluded from the finance charge if the following conditions are met:

(i) The insurance coverage is not required by the creditor, and this fact is disclosed in writing.

(ii) The premium for the initial term of insurance coverage is disclosed. If the term of insurance is less than the term of the transaction, the term of insurance also shall be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

(iii) The consumer signs or initials an affirmative written request for the insurance after receiving the disclosures specified in this paragraph. Any consumer in the transaction may sign or initial the request.

(2) Premiums for insurance against loss of or damage to property, or against liability arising out of the ownership or use of property,[5] may be excluded from the finance charge if the following conditions are met:

(i) The insurance coverage may be obtained from a person of the consumer's choice,[6] and this fact is disclosed.

(ii) If the coverage is obtained from or through the creditor, the premium

[5] This includes single interest insurance if the insurer waives all right of subrogation against the consumer.

[6] A creditor may reserve the right to refuse to accept, for reasonable cause, an insurer offered by the consumer.

for the initial term of insurance coverage shall be disclosed. If the term of insurance is less than the term of the transaction, the term of insurance shall also be disclosed. The premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving an insurance plan that limits the total amount of indebtedness subject to coverage.

(3) *Voluntary debt cancellation fees.* (i) Charges or premiums paid for debt cancellation coverage of the type specified in paragraph (d)(3)(ii) of this section may be excluded from the finance charge, whether or not the coverage is insurance, if the following conditions are met:

(A) The debt cancellation agreement or coverage is not required by the creditor, and this fact is disclosed in writing;

(B) The fee or premium for the initial term of coverage is disclosed. If the term of coverage is less than the term of the credit transaction, the term of coverage also shall be disclosed. The fee or premium may be disclosed on a unit-cost basis only in open-end credit transactions, closed-end credit transactions by mail or telephone under § 226.17(g), and certain closed-end credit transactions involving a debt cancellation agreement that limits the total amount of indebtedness subject to coverage;

(C) The consumer signs or initials an affirmative written request for coverage after receiving the disclosures specified in this paragraph. Any consumer in the transaction may sign or initial the request.

(ii) Paragraph (d)(3)(i) of this section applies to fees paid for debt cancellation coverage that provides for cancellation of all or part of the debtor's liability for amounts exceeding the value of the collateral securing the obligation, or in the event of the loss of life, health, or income or in case of accident.

(e) *Certain security interest charges.* If itemized and disclosed, the following charges may be excluded from the finance charge:

(1) Taxes and fees prescribed by law that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest.

(2) The premium for insurance in lieu of perfecting a security interest to the extent that the premium does not exceed the fees described in paragraph (e)(1) of this section that otherwise would be payable.

(3) *Taxes on security instruments.* Any tax levied on security instruments or on documents evidencing indebtedness if the payment of such taxes is a requirement for recording the instrument securing the evidence of indebtedness.

(f) *Prohibited offsets.* Interest, dividends, or other income received or to be received by the consumer on deposits or investments shall not be deducted in computing the finance charge.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 61 FR 49245, Sept. 19, 1996]

## Subpart B—Open-End Credit

### § 226.5 General disclosure requirements.

(a) *Form of disclosures.* (1) The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing,[7] in a form that the consumer may keep.[8] The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. § 7001 *et seq.*). The disclosures required by §§ 226.5a, 226.5b, and 226.16 may be provided to

[7] The disclosure required by section 226.9(d) when a finance charge is imposed at the time of a transaction need not be written.

[8] The disclosures required under § 226.5a for credit and charge card applications and solicitations, the home equity disclosures required under § 226.5b(d), the alternative summary billing rights statement provided for in § 226.9(a)(2s), the credit and charge card renewal disclosures required under § 226.9(e), and the disclosures made under § 226.10(b) about payment requirements need not be in a form that the consumer can keep.

the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections.

(2) The terms *finance charge* and *annual percentage rate*, when required to be disclosed with a corresponding amount or percentage rate, shall be more conspicuous than any other required disclosure.[9]

(3) Certain disclosures required under § 226.5a for credit and charge card applications and solicitations must be provided in a tabular format or in a prominent location in accordance with the requirements of that section.

(4) For rules governing the form of disclosures for home equity plans, see § 226.5b(a).

(b) *Time of disclosures*—(1) *Initial disclosures*. The creditor shall furnish the initial disclosure statement required by § 226.6 before the first transaction is made under the plan.

(2) *Periodic statements*. (i) The creditor shall mail or deliver a periodic statement as required by § 226.7 for each billing cycle at the end of which an account has a debit or credit balance of more than $1 or on which a finance charge has been imposed. A periodic statement need not be sent for an account if the creditor deems it uncollectible, or if delinquency collection proceedings have been instituted, or if furnishing the statement would violate Federal law.

(ii) The creditor shall mail or deliver the periodic statement at least 14 days prior to any date or the end of any time period required to be disclosed under § 226.7(j) in order for the consumer to avoid an additional finance or other charge.[10] A creditor that fails to meet this requirement shall not collect any finance or other charge imposed as a result of such failure.

(3) *Credit and charge card application and solicitation disclosures*. The card issuer shall furnish the disclosures for credit and charge card applications and solicitations in accordance with the timing requirements of § 226.5a.

(4) *Home equity plans*. Disclosures for home equity plans shall be made in accordance with the timing requirements of § 226.5b(b).

(c) *Basis of disclosures and use of estimates*. Disclosures shall reflect the terms of the legal obligation between the parties. If any information necessary for accurate disclosure is unknown to the creditor, it shall make the disclosure based on the best information reasonably available and shall state clearly that the disclosure is an estimate.

(d) *Multiple creditors; multiple consumers*. If the credit plan involves more than one creditor, only one set of disclosures shall be given, and the creditors shall agree among themselves which creditor must comply with the requirements that this regulation imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the account. If the right of rescission under § 226.15 is applicable, however, the disclosures required by §§ 226.6 and 226.15(b) shall be made to each consumer having the right to rescind.

(e) *Effect of subsequent events*. If a disclosure becomes inaccurate because of an event that occurs after the creditor mails or delivers the disclosures, the resulting inaccuracy is not a violation of this regulation, although new disclosures may be required under § 226.9(c).

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 54 FR 13865, Apr. 6, 1989; 54 FR 24686, June 9, 1989; 65 FR 58908, Oct. 3, 2000; 66 FR 17338, Mar. 30, 2001; 72 FR 63473, Nov. 9, 2007]

### § 226.5a Credit and charge card applications and solicitations.

(a) *General rules*. The card issuer shall provide the disclosures required under this section on or with a solicitation or an application to open a credit or charge card account.

[9] The terms need not be more conspicuous when used under § 226.5a generally for credit and charge card applications and solicitations under § 226.7(d) on periodic statements, under § 226.9(e) in credit and charge card renewal disclosures, and under § 226.16 in advertisements. (But see special rule for annual percentage rate for purchases, § 226.5a(b)(1).)

[10] This timing requirement does not apply if the creditor is unable to meet the requirement because of an act of God, war, civil disorder, natural disaster, or strike.

(1) *Definition of solicitation.* For purposes of this section, the term *solicitation* means an offer by the card issuer to open a credit or charge card account that does not require the consumer to complete an application.

(2) *Form of disclosures.* (i) The disclosures in paragraphs (b) (1) through (7) of this section shall be provided in a prominent location on or with an application or a solicitation, or other applicable document, and in the form of a table with headings, content, and format substantially similar to any of the applicable tables found in appendix G.

(ii) The disclosures in paragraphs (b)(8) through (11) of this section shall be provided either in the table containing the disclosures in paragraphs (b)(1) through (7), or clearly and conspicuously elsewhere on or with the application or solicitation.

(iii) The disclosure required under paragraph (b)(5) of this section shall contain the term *grace period*.

(iv) The terminology in the disclosures under paragraph (b) of this section shall be consistent with that to be used in the disclosures under §§ 226.6 and 226.7.

(v) For an application or a solicitation that is accessed by the consumer in electronic form, the disclosures required under this section may be provided to the consumer in electronic form on or with the application or solicitation.

(3) *Exceptions.* This section does not apply to home-equity plans accessible by a credit or charge card that are of the type subject to the requirements of § 226.5b; overdraft lines of credit tied to asset accounts accessed by check-guarantee cards or by debit cards; or lines of credit accessed by check-guarantee cards or by debit cards that can be used only at automated teller machines.

(4) *Fees based on a percentage.* If the amount of any fee required to be disclosed under this section is determined on the basis of a percentage of another amount, the percentage used and the identification of the amount against which the percentage is applied may be disclosed instead of the amount of the fee.

(5) *Certain fees that vary by state.* If the amount of any fee referred to in paragraphs (b)(8) through (11) of this section varies from state to state, the card issuer may disclose the range of the fees instead of the amount for each state, if the disclosure includes a statement that the amount of the fee varies from state to state.

(b) *Required disclosures.* The card issuer shall disclose the items in this paragraph on or with an application or a solicitation in accordance with the requirements of paragraphs (c), (d), or (e) of this section. A credit card issuer shall disclose all applicable items in this paragraph except for paragraph (b)(7) of this section. A charge card issuer shall disclose the applicable items in paragraphs (b)(2), (4), and (7) through (11) of this section.

(1) *Annual percentage rate.* Each periodic rate that may be used to compute the finance charge on an outstanding balance for purchases, a cash advance, or a balance transfer, expressed as an annual percentage rate (as determined by § 226.14(b)). When more than one rate applies for a category of transactions, the range of balances to which each rate is applicable shall also be disclosed. The annual percentage rate for purchases disclosed pursuant to this paragraph shall be in at least 18-point type, except for the following: a temporary initial rate that is lower than the rate that will apply after the temporary rate expires, and a penalty rate that will apply upon the occurrence of one or more specific events.

(i) If the account has a variable rate, the card issuer shall also disclose the fact that the rate may vary and how the rate is determined.

(ii) When variable rate disclosures are provided under paragraph (c) of this section, an annual percentage rate disclosure is accurate if the rate was in effect within 60 days before mailing the disclosures. When variable rate disclosures are provided under paragraph (e) of this section, an annual percentage rate disclosure is accurate if the rate was in effect within 30 days before printing the disclosures. Disclosures provided by electronic communication are subject to paragraph (b)(1)(iii) of this section.

(iii) When variable rate disclosures are provided by electronic communication, an annual percentage rate disclosure is accurate if the rate was in effect within 30 days before mailing the disclosures to a consumer's electronic mail address. If disclosures are made available at another location such as the card issuer's Internet web site, the annual percentage rate must be one in effect within the last 30 days.

(2) *Fees for issuance or availability*. Any annual or other periodic fee, expressed as an annualized amount, or any other fee that may be imposed for the issuance or availability of a credit or charge card, including any fee based on account activity or inactivity.

(3) *Minimum finance charge*. Any minimum or fixed finance charge that could be imposed during a billing cycle.

(4) *Transaction charges*. Any transaction charge imposed for the use of the card for purchases.

(5) *Grace period*. The date by which or the period within which any credit extended for purchases may be repaid without incurring a finance charge. If no grace period is provided, that fact must be disclosed. If the length of the grace period varies, the card issuer may disclose the range of days, the minimum number of days, or the average number of days in the grace period, if the disclosure is identified as a range, minimum, or average.

(6) *Balance computation method*. The name of the balance computation method listed in paragraph (g) of this section that is used to determine the balance for purchases on which the finance charge is computed, or an explanation of the method used if it is not listed. The explanation may appear outside the table if the table contains a reference to the explanation. In determining which balance computation method to disclose, the card issuer shall assume that credit extended for purchases will not be repaid within the grace period, if any.

(7) *Statement on charge card payments*. A statement that charges incurred by use of the charge card are due when the periodic statement is received.

(8) *Cash advance fee*. Any fee imposed for an extension of credit in the form of cash.

(9) *Late payment fee*. Any fee imposed for a late payment.

(10) *Over-the-limit fee*. Any fee imposed for exceeding a credit limit.

(11) *Balance transfer fee*. Any fee imposed to transfer an outstanding balance.

(c) *Direct-mail and electronic applications and solicitations*. The card issuer shall disclose the applicable items in paragraph (b) of this section on or with an application or solicitation that is mailed to consumers or provided by electronic communication.

(d) *Telephone applications and solicitations*—(1) *Oral disclosure*. The card issuer shall orally disclose the information in paragraphs (b) (1) through (7) of this section, to the extent applicable, in a telephone application or solicitation initiated by the card issuer.

(2) *Alternative disclosure*. The oral disclosure under paragraph (d)(1) of this section need not be given if the card issuer either does not impose a fee described in paragraph (b)(2) of this section or does not impose such a fee unless the consumer uses the card, and the card issuer discloses in writing within 30 days after the consumer requests the card (but in no event later than the delivery of the card) the following:

(i) The applicable information in paragraph (b) of this section; and

(ii) The fact that the consumer need not accept the card or pay any fee disclosed unless the consumer uses the card.

(e) *Applications and solicitations made available to general public*. The card issuer shall provide disclosures, to the extent applicable, on or with an application or solicitation that is made available to the general public, including one contained in a catalog, magazine, or other generally available publication. The disclosures shall be provided in accordance with paragraph (e)(1), (2) or (3) of this section.

(1) *Disclosure of required credit information*. The card issuer may disclose in a prominent location on the application or solicitation the following:

(i) The applicable information in paragraph (b) of this section;

(ii) The date the required information was printed, including a statement

that the required information was accurate as of that date and is subject to change after that date; and

(iii) A statement that the consumer should contact the card issuer for any change in the required information since it was printed, and a toll-free telephone number or a mailing address for that purpose.

(2) *Inclusion of certain initial disclosures.* The card issuer may disclose on or with the application or solicitation the following:

(i) The disclosures required under § 226.6 (a) through (c); and

(ii) A statement that the consumer should contact the card issuer for any change in the required information, and a toll-free telephone number or a mailing address for that purpose.

(3) *No disclosure of credit information.* If none of the items in paragraph (b) of this section is provided on or with the application or solicitation, the card issuer may state in a prominent location on the application or solicitation the following:

(i) There are costs associated with the use of the card; and

(ii) The consumer may contact the card issuer to request specific information about the costs, along with a toll-free telephone number and a mailing address for that purpose.

(4) *Prompt response to requests for information.* Upon receiving a request for any of the information referred to in this paragraph, the card issuer shall promptly and fully disclose the information requested.

(f) *Special charge card rule—card issuer and person extending credit not the same person.* If a cardholder may by use of a charge card access an open-end credit plan that is not maintained by the charge card issuer, the card issuer need not provide the disclosures in paragraphs (c), (d) or (e) of this section for the open-end credit plan if the card issuer states on or with an application or a solicitation the following:

(1) The card issuer will make an independent decision whether to issue the card;

(2) The charge card may arrive before the decision is made about extending credit under the open-end credit plan; and

(3) Approval for the charge card does not constitute approval for the open-end credit plan.

(g) *Balance computation methods defined.* The following methods may be described by name. Methods that differ due to variations such as the allocation of payments, whether the finance charge begins to accrue on the transaction date or the date of posting the transaction, the existence or length of a grace period, and whether the balance is adjusted by charges such as late fees, annual fees and unpaid finance charges do not constitute separate balance computation methods.

(1)(i) *Average daily balance (including new purchases).* This balance is figured by adding the outstanding balance (including new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle.

(ii) *Average daily balance (excluding new purchases).* This balance is figured by adding the outstanding balance (excluding new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle.

(2)(i) *Two-cycle average daily balance (including new purchases).* This balance is the sum of the average daily balances for two billing cycles. The first balance is for the current billing cycle, and is figured by adding the outstanding balance (including new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle. The second balance is for the preceding billing cycle.

(ii) *Two-cycle average daily balance (excluding new purchases).* This balance is the sum of the average daily balances for two billing cycles. The first balance is for the current billing cycle, and is figured by adding the outstanding balance (excluding new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle. The second balance is for the preceding billing cycle.

(3) *Adjusted balance.* This balance is figured by deducting payments and credits made during the billing cycle

from the outstanding balance at the beginning of the billing cycle.

(4) *Previous balance.* This balance is the outstanding balance at the beginning of the billing cycle.

[Reg. Z, 54 FR 13865, Apr. 6, 1989, as amended at 54 FR 24686, June 9, 1989; 54 FR 32954, Aug. 11, 1989; 65 FR 17131, Mar. 31, 2000; 65 FR 58908, Oct. 3, 2000; 66 FR 17338, Mar. 30, 2001; 72 FR 63473, Nov. 9, 2007]

### § 226.5b Requirements for home equity plans.

The requirements of this section apply to open-end credit plans secured by the consumer's dwelling. For purposes of this section, an annual percentage rate is the annual percentage rate corresponding to the periodic rate as determined under § 226.14(b).

(a) *Form of disclosures*—(1) *General.* The disclosures required by paragraph (d) of this section shall be made clearly and conspicuously and shall be grouped together and segregated from all unrelated information. The disclosures may be provided on the application form or on a separate form. The disclosure described in paragraph (d)(4)(iii), the itemization of third-party fees described in paragraph (d)(8), and the variable-rate information described in paragraph (d)(12) of this section may be provided separately from the other required disclosures.

(2) *Precedence of certain disclosures.* The disclosures described in paragraph (d)(1) through (4)(ii) of this section shall precede the other required disclosures.

(3) For an application that is accessed by the consumer in electronic form, the disclosures required under this section may be provided to the consumer in electronic form on or with the application.

(b) *Time of disclosures.* The disclosures and brochure required by paragraphs (d) and (e) of this section shall be provided at the time an application is provided to the consumer.[10a]

(c) *Duties of third parties*—Persons other than the creditor who provide applications to consumers for home equity plans must provide the brochure required under paragraph (e) of this section at the time an application is provided. If such persons have the disclosures required under paragraph (d) of this section for a creditor's home equity plan, they also shall provide the disclosures at such time.[10a]

(d) *Content of disclosures.* The creditor shall provide the following disclosures, as applicable:

(1) *Retention of information.* A statement that the consumer should make or otherwise retain a copy of the disclosures.

(2) *Conditions for disclosed terms.* (i) A statement of the time by which the consumer must submit an application to obtain specific terms disclosed and an identification of any disclosed term that is subject to change prior to opening the plan.

(ii) A statement that, if a disclosed term changes (other than a change due to fluctuations in the index in a variable-rate plan) prior to opening the plan and the consumer therefore elects not to open the plan, the consumer may receive a refund of all fees paid in connection with the application.

(3) *Security interest and risk to home.* A statement that the creditor will acquire a security interest in the consumer's dwelling and that loss of the dwelling may occur in the event of default.

(4) *Possible actions by creditor.* (i) A statement that, under certain conditions, the creditor may terminate the plan and require payment of the outstanding balance in full in a single payment and impose fees upon termination; prohibit additional extensions of credit or reduce the credit limit; and, as specified in the initial agreement, implement certain changes in the plan.

(ii) A statement that the consumer may receive, upon request, information about the conditions under which such actions may occur.

(iii) In lieu of the disclosure required under paragraph (d)(4)(ii) of this section, a statement of such conditions.

(5) *Payment terms.* The payment terms of the plan, including:

[10a] The disclosures and the brochure may be delivered or placed in the mail not later than three business days following receipt of a consumer's application in the case of applications contained in magazines or other publications, or when the application is received by telephone or through an intermediary agent or broker.

(i) The length of the draw period and any repayment period.

(ii) An explanation of how the minimum periodic payment will be determined and the timing of the payments. If paying only the minimum periodic payments may not repay any of the principal or may repay less than the outstanding balance, a statement of this fact, as well as a statement that a balloon payment may result.[10b]

(iii) An example, based on a $10,000 outstanding balance and a recent annual percentage rate,[10c] showing the minimum periodic payment, any balloon payment, and the time it would take to repay the $10,000 outstanding balance if the consumer made only those payments and obtained no additional extensions of credit.

If different payment terms may apply to the draw and any repayment period, or if different payment terms may apply within either period, the disclosures shall reflect the different payment terms.

(6) *Annual percentage rate.* For fixed-rate plans, a recent annual percentage rate[10c] imposed under the plan and a statement that the rate does not include costs other than interest.

(7) *Fees imposed by creditor.* An itemization of any fees imposed by the creditor to open, use, or maintain the plan, stated as a dollar amount or percentage, and when such fees are payable.

(8) *Fees imposed by third parties to open a plan.* A good faith estimate, stated as a single dollar amount or range, of any fees that may be imposed by persons other than the creditor to open the plan, as well as a statement that the consumer may receive, upon request, a good faith itemization of such fees. In lieu of the statement, the itemization of such fees may be provided.

(9) *Negative amortization.* A statement that negative amortization may occur and that negative amortization increases the principal balance and reduces the consumer's equity in the dwelling.

(10) *Transaction requirements.* Any limitations on the number of extensions of credit and the amount of credit that may be obtained during any time period, as well as any minimum outstanding balance and minimum draw requirements, stated as dollar amounts or percentages.

(11) *Tax implications.* A statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan.

(12) *Disclosures for variable-rate plans.* For a plan in which the annual percentage rate is variable, the following disclosures, as applicable:

(i) The fact that the annual percentage rate, payment, or term may change due to the variable-rate feature.

(ii) A statement that the annual percentage rate does not include costs other than interest.

(iii) The index used in making rate adjustments and a source of information about the index.

(iv) An explanation of how the annual percentage rate will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(v) A statement that the consumer should ask about the current index value, margin, discount or premium, and annual percentage rate.

(vi) A statement that the initial annual percentage rate is not based on the index and margin used to make later rate adjustments, and the period of time such initial rate will be in effect.

(vii) The frequency of changes in the annual percentage rate.

(viii) Any rules relating to changes in the index value and the annual percentage rate and resulting changes in the payment amount, including, for example, an explanation of payment limitations and rate carryover.

[10b] A balloon payment results if paying the minimum periodic payments does not fully amortize the outstanding balance by a specified date or time, and the consumer must repay the entire outstanding balance at such time.

[10c] For fixed-rate plans, a recent annual percentage rate is a rate that has been in effect under the plan within the twelve months preceding the date the disclosures are provided to the consumer. For variable-rate plans, a recent annual percentage rate is the most recent rate provided in the historical example described in paragraph (d)(12)(xi) of this section or a rate that has been in effect under the plan since the date of the most recent rate in the table.

(ix) A statement of any annual or more frequent periodic limitations on changes in the annual percentage rate (or a statement that no annual limitation exists), as well as a statement of the maximum annual percentage rate that may be imposed under each payment option.

(x) The minimum periodic payment required when the maximum annual percentage rate for each payment option is in effect for a $10,000 outstanding balance, and a statement of the earliest date or time the maximum rate may be imposed.

(xi) An historical example, based on a $10,000 extension of credit, illustrating how annual percentage rates and payments would have been affected by index value changes implemented according to the terms of the plan. The historical example shall be based on the most recent 15 years of index values (selected for the same time period each year) and shall reflect all significant plan terms, such as negative amortization, rate carryover, rate discounts, and rate and payment limitations, that would have been affected by the index movement during the period.

(xii) A statement that rate information will be provided on or with each periodic statement.

(e) *Brochure.* The home equity brochure published by the Board or a suitable substitute shall be provided.

(f) *Limitations on home equity plans.* No creditor may, by contract or otherwise:

(1) Change the annual percentage rate unless:

(i) Such change is based on an index that is not under the creditor's control; and

(ii) Such index is available to the general public.

(2) Terminate a plan and demand repayment of the entire outstanding balance in advance of the original term (except for reverse mortgage transactions that are subject to paragraph (f)(4) of this section) unless:

(i) There is fraud or material misrepresentation by the consumer in connection with the plan;

(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance;

(iii) Any action or inaction by the consumer adversely affects the creditor's security for the plan, or any right of the creditor in such security; or

(iv) Federal law dealing with credit extended by a depository institution to its executive officers specifically requires that as a condition of the plan the credit shall become due and payable on demand, provided that the creditor includes such a provision in the initial agreement.

(3) Change any term, except that a creditor may:

(i) Provide in the initial agreement that it may prohibit additional extensions of credit or reduce the credit limit during any period in which the maximum annual percentage rate is reached. A creditor also may provide in the initial agreement that specified changes will occur if a specified event takes place (for example, that the annual percentage rate will increase a specified amount if the consumer leaves the creditor's employment).

(ii) Change the index and margin used under the plan if the original index is no longer available, the new index has an historical movement substantially similar to that of the original index, and the new index and margin would have resulted in an annual percentage rate substantially similar to the rate in effect at the time the original index became unavailable.

(iii) Make a specified change if the consumer specifically agrees to it in writing at that time.

(iv) Make a change that will unequivocally benefit the consumer throughout the remainder of the plan.

(v) Make an insignificant change to terms.

(vi) Prohibit additional extensions of credit or reduce the credit limit applicable to an agreement during any period in which:

(A) The value of the dwelling that secures the plan declines significantly below the dwelling's appraised value for purposes of the plan;

(B) The creditor reasonably believes that the consumer will be unable to fulfill the repayment obligations under the plan because of a material change in the consumer's financial circumstances;

(C) The consumer is in default of any material obligation under the agreement;

(D) The creditor is precluded by government action from imposing the annual percentage rate provided for in the agreement;

(E) The priority of the creditor's security interest is adversely affected by government action to the extent that the value of the security interest is less than 120 percent of the credit line; or

(F) The creditor is notified by its regulatory agency that continued advances constitute an unsafe and unsound practice.

(4) For reverse mortgage transactions that are subject to § 226.33, terminate a plan and demand repayment of the entire outstanding balance in advance of the original term except:

(i) In the case of default;

(ii) If the consumer transfers title to the property securing the note;

(iii) If the consumer ceases using the property securing the note as the primary dwelling; or

(iv) Upon the consumer's death.

(g) *Refund of fees.* A creditor shall refund all fees paid by the consumer to anyone in connection with an application if any term required to be disclosed under paragraph (d) of this section changes (other than a change due to fluctuations in the index in a variable-rate plan) before the plan is opened and, as a result, the consumer elects not to open the plan.

(h) *Imposition of nonrefundable fees.* Neither a creditor nor any other person may impose a nonrefundable fee in connection with an application until three business days after the consumer receives the disclosures and brochure required under this section.[10d]

[Reg. Z, 54 FR 24686, June 9, 1989, as amended at 55 FR 38312, Sept. 18, 1990; 55 FR 42148, Oct. 17, 1990; 57 FR 34681, Aug. 6, 1992; 60 FR 15471, Mar. 24, 1995; 66 FR 17338, Mar. 30, 2001; 72 FR 63474, Nov. 9, 2007]

[10d] If the disclosures and brochure are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

## § 226.6 Initial disclosure statement.

The creditor shall disclose to the consumer, in terminology consistent with that to be used on the periodic statement, each of the following items, to the extent applicable:

(a) *Finance charge.* The circumstances under which a finance charge will be imposed and an explanation of how it will be determined, as follows:

(1) A statement of when finance charges begin to accrue, including an explanation of whether or not any time period exists within which any credit extended may be repaid without incurring a finance charge. If such a time period is provided, a creditor may, at its option and without disclosure, impose no finance charge when payment is received after the time period's expiration.

(2) A disclosure of each periodic rate that may be used to compute the finance charge, the range of balances to which it is applicable,[11] and the corresponding annual percentage rate.[12] When different periodic rates apply to different types of transactions, the types of transactions to which the periodic rates apply shall also be disclosed.

(3) An explanation of the method used to determine the balance on which the finance charge may be computed.

(4) An explanation of how the amount of any finance charge will be determined,[13] including a description of how any finance charge other than the periodic rate will be determined.

(b) *Other charges.* The amount of any charge other than a finance charge that may be imposed as part of the plan, or an explanation of how the charge will be determined.

(c) *Security interests.* The fact that the creditor has or will acquire a security

[11] A creditor is not required to adjust the range of balances disclosure to reflect the balance below which only a minimum charge applies.

[12] If a creditor is offering a variable rate plan, the creditor shall also disclose: (1) The circumstances under which the rate(s) may increase; (2) any limitations on the increase; and (3) the effect(s) of an increase.

[13] If no finance charge is imposed when the outstanding balance is less than a certain amount, no disclosure is required of that fact or of the balance below which no finance charge will be imposed.

interest in the property purchased under the plan, or in other property identified by item or type.

(d) *Statement of billing rights.* A statement that outlines the consumer's rights and the creditor's responsibilities under §§ 226.12(c) and 226.13 and that is substantially similar to the statement found in appendix G.

(e) *Home equity plan information.* The following disclosures described in § 226.5b(d), as applicable:

(1) A statement of the conditions under which the creditor may take certain action, as described in § 226.5b(d)(4)(i), such as terminating the plan or changing the terms.

(2) The payment information described in § 226.5b(d)(5) (i) and (ii) for both the draw period and any repayment period.

(3) A statement that negative amortization may occur as described in § 226.5b(d)(9).

(4) A statement of any transaction requirements as described in § 226.5b(d)(10).

(5) A statement regarding the tax implications as described in § 226.5b(d)(11).

(6) A statement that the annual percentage rate imposed under the plan does not include costs other than interest as described in §§ 226.5b(d)(6) and (d)(12)(ii).

(7) The variable-rate disclosures described in § 226.5b(d)(12) (viii), (x), (xi), and (xii), as well as the disclosure described in § 226.5b(d)(5)(iii), unless the disclosures provided with the application were in a form the consumer could keep and included a representative payment example for the category of payment option chosen by the consumer.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 54 FR 24688, June 9, 1989]

### § 226.7 Periodic statement.

The creditor shall furnish the consumer with a periodic statement that discloses the following items, to the extent applicable:

(a) *Previous balance.* The account balance outstanding at the beginning of the billing cycle.

(b) *Identification of transactions.* An identification of each credit transaction in accordance with § 226.8.

(c) *Credits.* Any credit to the account during the billing cycle, including the amount and the date of crediting. The date need not be provided if a delay in crediting does not result in any finance or other charge.

(d) *Periodic rates.* Each periodic rate that may be used to compute the finance charge, the range of balances to which it is applicable,[14] and the corresponding annual percentage rate.[15] If different periodic rates apply to different types of transactions, the types of transactions to which the periodic rates apply shall also be disclosed.

(e) *Balance on which finance charge computed.* The amount of the balance to which a periodic rate was applied and an explanation of how that balance was determined. When a balance is determined without first deducting all credits and payments made during the billing cycle, that fact and the amount of the credits and payments shall be disclosed.

(f) *Amount of finance charge.* The amount of any finance charge debited or added to the account during the billing cycle, using the term *finance charge.* The components of the finance charge shall be individually itemized and identified to show the amount(s) due to the appliction of any periodic rates and the amount(s) of any other type of finance charge. If there is more than one periodic rate, the amount of the finance charge attributable to each rate need not be separately itemized and identified.

(g) *Annual percentage rate.* When a finance charge is imposed during the billing cycle, the annual percentage rate(s) determined under § 226.14, using the term *annual percentage rate.*

(h) *Other charges.* The amounts, itemized and identified by type, of any charges other than finance charges debited to the account during the billing cycle.

(i) *Closing date of billing cycle; new balance.* The closing date of the billing cycle and the account balance outstanding on that date.

(j) *Free-ride period.* The date by which or the time period within which the

[14] See footnotes 11 and 13.

[15] If a variable rate plan is involved, the creditor shall disclose the fact that the periodic rate(s) may vary.

new balance or any portion of the new balance must be paid to avoid additional finance charges. If such a time period is provided, a creditor may, at its option and without disclosure, impose no finance charge when payment is received after the time period's expiration.

(k) *Address for notice of billing errors.* The address to be used for notice of billing errors. Alternatively, the address may be provided on the billing rights statement permitted by § 226.9(a)(2).

[46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981]

### § 226.8 Identification of transactions.

The creditor shall identify credit transactions on or with the first periodic statement that reflects the transaction by furnishing the following information, as applicable.[16]

(a) *Sale credit.* For each credit transaction involving the sale of property or services, the following rules shall apply:

(1) *Copy of credit document provided.* When an actual copy of the receipt or other credit document is provided with the first periodic statement reflecting the transaction, the transaction is sufficiently identified if the amount of the transaction and either the date of the transaction or the date of debiting the transaction to the consumer's account are disclosed on the copy or on the periodic statement.

(2) *Copy of credit document not provided—creditor and seller same or related person(s).* When the creditor and the seller are the same person or related persons, and an actual copy of the receipt or other credit document is not provided with the periodic statement, the creditor shall disclose the amount and date of the transaction, and a brief identification[17] of the property or services purchased.[18]

(3) *Copy of credit document not provided—creditor and seller not same or related person(s).* When the creditor and seller are not the same person or related persons, and an actual copy of the receipt or other credit document is not provided with the periodic statement, the creditor shall disclose the amount and date of the transaction; the seller's name; and the city, and state or foreign country where the transaction took place.[19]

(b) *Nonsale credit.* A nonsale credit transaction is sufficiently identified if the first periodic statement reflecting the transaction discloses a brief identification of the transaction;[20] the amount of the transaction; and at least one of the following dates: the date of the transaction, the date of debiting the transaction to the consumer's account, or, if the consumer signed the credit document, the date appearing on the document. If an actual copy of the receipt or other credit document is provided and that copy shows the amount and at least one of the specified dates,

[16] Failure to disclose the information required by this section shall not be deemed a failure to comply with the regulation if: (1) The creditor maintains procedures reasonably adapted to obtain and provide the information; and (2) the creditor treats an inquiry for clarification or documentation as a notice of a billing error, including correcting the account in accordance with § 226.13(e). This applies to transactions that take place outside a state, as defined in § 226.2(a), whether or not the creditor maintains procedures reasonably adapted to obtain the required information.

[17] As an alternative to the brief identification, the creditor may disclose a number or symbol that also appears on the receipt or other credit document given to the consumer, if the number or symbol reasonably identifies that transaction with that creditor, and if the creditor treats an inquiry for clarification or documentation as a notice of a billing error, including correcting the account in accordance with § 226.13(e).

[18] An identification of property or services may be replaced by the seller's name and location of the transaction when: (1) The creditor and the seller are the same person; (2) the creditor's open-end plan has fewer than 15,000 accounts; (3) the creditor provides the consumer with point-of-sale documentation for that transaction; and (4) the creditor treats an inquiry for clarification or documentation as a notice of a billing error, including correcting the account in accordance with § 226.13(e).

[19] The creditor may omit the address or provide any suitable designation that helps the consumer to identify the transaction when the transaction (1) took place at a location that is not fixed; (2) took place in the consumer's home; or (3) was a mail or telephone order.

[20] See Footnote 17.

the brief identification may be omitted.

[46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981]

### § 226.9 Subsequent disclosure requirements.

(a) *Furnishing statement of billing rights*—(1) *Annual statement.* The creditor shall mail or deliver the billing rights statement required by § 226.6(d) at least once per calendar year, at intervals of not less than 6 months nor more than 18 months, either to all consumers or to each consumer entitled to receive a periodic statement under § 226.5(b)(2) for any one billing cycle.

(2) *Alternative summary statement.* As an alternative to paragraph (a)(1) of this section, the creditor may mail or deliver, on or with each periodic statement, a statement substantially similar to that in appendix G.

(b) *Disclosures for supplemental credit devices and additional features*—(1) If a creditor, within 30 days after mailing or delivering the initial disclosures under § 226.6(a), adds a credit feature to the consumer's account or mails or delivers to the consumer a credit device for which the finance charge terms are the same as those previously disclosed, no additional disclosures are necessary. After 30 days, if the creditor adds a credit feature or furnishes a credit device (other than as a renewal, resupply, or the original issuance of a credit card) on the same finance charge terms, the creditor shall disclose, before the consumer uses the feature or device for the first time, that it is for use in obtaining credit under the terms previously disclosed.

(2) Whenever a credit feature is added or a credit device is mailed or delivered, and the finance charge terms for the feature or device differ from disclosures previously given, the disclosures required by § 226.6(a) that are applicable to the added feature or device shall be given before the consumer uses the feature or device for the first time.

(c) *Change in terms*—(1) *Written notice required.* Whenever any term required to be disclosed under § 226.6 is changed or the required minimum periodic payment is increased, the creditor shall mail or deliver written notice of the change to each consumer who may be affected. The notice shall be mailed or delivered at least 15 days prior to the effective date of the change. The 15-day timing requirement does not apply if the change has been agreed to by the consumer, or if a periodic rate or other finance charge is increased because of the consumer's delinquency or default; the notice shall be given, however, before the effective date of the change.

(2) *Notice not required.* No notice under this section is required when the change involves late payment charges, charges for documentary evidence, or over-the-limit charges; a reduction of any component of a finance or other charge; suspension of future credit privileges or termination of an account or plan; or when the change results from an agreement involving a court proceeding, or from the consumer's default or delinquency (other than an increase in the periodic rate or other finance charge).

(3) *Notice for home equity plans.* If a creditor prohibits additional extensions of credit or reduces the credit limit applicable to a home equity plan pursuant to § 226.5b(f)(3)(i) or § 226.5b(f)(3)(vi), the creditor shall mail or deliver written notice of the action to each consumer who will be affected. The notice must be provided not later than three business days after the action is taken and shall contain specific reasons for the action. If the creditor requires the consumer to request reinstatement of credit privileges, the notice also shall state that fact.

(d) *Finance charge imposed at time of transaction.* (1) Any person, other than the card issuer, who imposes a finance charge at the time of honoring a consumer's credit card, shall disclose the amount of that finance charge prior to its imposition.

(2) The card issuer, if other than the person honoring the consumer's credit card, shall have no responsibility for the disclosure required by paragraph (d)(1) of this section, and shall not consider any such charge for purposes of §§ 226.5a, 226.6 and 226.7.

(e) *Disclosures upon renewal of credit or charge card*—(1) *Notice prior to renewal.* Except as provided in paragraph (e)(2) of this section, a card issuer that imposes any annual or other periodic

fee to renew a credit or charge card account of the type subject to § 226.5a, including any fee based on account activity or inactivity, shall mail or deliver written notice of the renewal to the cardholder. The notice shall be provided at least 30 days or one billing cycle, whichever is less, before the mailing or the delivery of the periodic statement on which the renewal fee is initially charged to the account. The notice shall contain the following information:

(i) The disclosures contained in § 226.5a(b) (1) through (7) that would apply if the account were renewed;[20a] and

(ii) How and when the cardholder may terminate credit availability under the account to avoid paying the renewal fee.

(2) *Delayed notice.* The disclosures required by paragraph (e)(1) of this section may be provided later than the time in paragraph (e)(1) of this section, but no later than the mailing or the delivery of the periodic statement on which the renewal fee is initially charged to the account, if the card issuer also discloses at that time that:

(i) The cardholder has 30 days from the time the periodic statement is mailed or delivered to avoid paying the fee or to have the fee recredited if the cardholder terminates credit availability under the account; and

(ii) The cardholder may use the card during the interim period without having to pay the fee.

(3) *Notification on periodic statements.* The disclosures required by this paragraph may be made on or with a periodic statement. If any of the disclosures are provided on the back of a periodic statement, the card issuer shall include a reference to those disclosures on the front of the statement.

(f) *Change in credit card account insurance provided*—(1) *Notice prior to change.* If a credit card issuer plans to change the provider of insurance for repayment of all or part of the outstanding balance of an open-end credit card account of the type subject to § 226.5a, the card issuer shall mail or deliver the cardholder written notice of the change not less than 30 days before the change in providers occurs. The notice shall also include the following items, to the extent applicable:

(i) Any increase in the rate that will result from the change;

(ii) Any substantial decrease in coverage that will result from the change; and

(iii) A statement that the cardholder may discontinue the insurance.

(2) *Notice when change in provider occurs.* If a change described in paragraph (f)(1) of this section occurs, the card issuer shall provide the cardholder with a written notice no later than 30 days after the change, including the following items, to the extent applicable:

(i) The name and address of the new insurance provider;

(ii) A copy of the new policy or group certificate containing the basic terms of the insurance, including the rate to be charged; and

(iii) A statement that the cardholder may discontinue the insurance.

(3) *Substantial decrease in coverage.* For purposes of this paragraph, a substantial decrease in coverage is a decrease in a significant term of coverage that might reasonably be expected to affect the cardholder's decision to continue the insurance. Significant terms of coverage include, for example, the following:

(i) Type of coverage provided;

(ii) Age at which coverage terminates or becomes more restrictive;

(iii) Maximum insurable loan balance, maximum periodic benefit payment, maximum number of payments, or other term affecting the dollar amount of coverage or benefits provided;

(iv) Eligibility requirements and number and identity of persons covered;

(v) Definition of a key term of coverage such as disability;

(vi) Exclusions from or limitations on coverage; and

(vii) Waiting periods and whether coverage is retroactive.

(4) *Combined notification.* The notices required by paragraph (f) (1) and (2) of this section may be combined provided the timing requirement of paragraph (f)(1) of this section is met. The notices

[20a] These disclosures need not be provided in tabular format or in a prominent location.

may be provided on or with a periodic statement.

[Reg. Z, 46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981, as amended at 54 FR 13867, Apr. 6, 1989; 54 FR 24688, June 9, 1989; 54 FR 32954, Aug. 11, 1989; 55 FR 38312, Sept. 18, 1990; 55 FR 42148, Oct. 17, 1990]

### § 226.10 Prompt crediting of payments.

(a) *General rule*. A creditor shall credit a payment to the consumer's account as of the date of receipt, except when a delay in crediting does not result in a finance or other charge or except as provided in paragraph (b) of this section.

(b) *Specific requirements for payments*. If a creditor specifies, on or with the periodic statement, requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the creditor shall credit the payment within 5 days of receipt.

(c) *Adjustment of account*. If a creditor fails to credit a payment, as required by paragraphs (a) and (b) of this section, in time to avoid the imposition of finance or other charges, the creditor shall adjust the consumer's account so that the charges imposed are credited to the consumer's account during the next billing cycle.

### § 226.11 Treatment of credit balances.

When a credit balance in excess of $1 is created on a credit account (through transmittal of funds to a creditor in excess of the total balance due on an account, through rebates of unearned finance charges or insurance premiums, or through amounts otherwise owed to or held for the benefit of a consumer), the creditor shall:

(a) Credit the amount of the credit balance to the consumer's account;

(b) Refund any part of the remaining credit balance within 7 business days from receipt of a written request from the consumer; and

(c) Make a good faith effort to refund to the consumer by cash, check, or money order, or credit to a deposit account of the consumer, any part of the credit balance remaining in the account for more than 6 months. No further action is required if the consumer's current location is not known to the creditor and cannot be traced through the consumer's last known address or telephone number.

### § 226.12 Special credit card provisions.

(a) *Issuance of credit cards*. Regardless of the purpose for which a credit card is to be used, including business, commercial, or agricultural use, no credit card shall be issued to any person except:

(1) In response to an oral or written request or application for the card; or

(2) As a renewal of, or substitute for, an accepted credit card.[21]

(b) *Liability of cardholder for unauthorized use*—(1) *Limitation on amount*. The liability of a cardholder for unauthorized use[22] of a credit card shall not exceed the lesser of $50 or the amount of money, property, labor, or services obtained by the unauthorized use before notification to the card issuer under paragraph (b)(3) of this section.

(2) *Conditions of liability*. A cardholder shall be liable for unauthorized use of a credit card only if:

(i) The credit card is an accepted credit card;

(ii) The card issuer has provided adequate notice[23] of the cardholder's maximum potential liability and of means by which the card issuer may be notified of loss or theft of the card. The notice shall state that the cardholder's liability shall not exceed $50 (or any lesser amount) and that the cardholder may give oral or written notification,

[21] For purposes of this section, *accepted credit card* means any credit card that a cardholder has requested or applied for and received, or has signed, used, or authorized another person to use to obtain credit. Any credit card issued as a renewal or substitute in accordance with this paragraph becomes an accepted credit card when received by the cardholder.

[22] *Unauthorized use* means the use of a credit card by a person, other than the cardholder, who does not have actual, implied, or apparent authority for such use, and from which the cardholder receives no benefit.

[23] *Adequate notice* means a printed notice to a cardholder that sets forth clearly the pertinent facts so that the cardholder may reasonably be expected to have noticed it and understood its meaning. The notice may be given by any means reasonably assuring receipt by the cardholder.

and shall describe a means of notification (for example, a telephone number, an address, or both); and

(iii) The card issuer has provided a means to identify the cardholder on the account or the authorized user of the card.

(3) *Notification to card issuer*. Notification to a card issuer is given when steps have been taken as may be reasonably required in the ordinary course of business to provide the card issuer with the pertinent information about the loss, theft, or possible unauthorized use of a credit card, regardless of whether any particular officer, employee, or agent of the card issuer does, in fact, receive the information. Notification may be given, at the option of the person giving it, in person, by telephone, or in writing. Notification in writing is considered given at the time of receipt or, whether or not received, at the expiration of the time ordinarily required for transmission, whichever is earlier.

(4) *Effect of other applicable law or agreement*. If state law or an agreement between a cardholder and the card issuer imposes lesser liability than that provided in this paragraph, the lesser liability shall govern.

(5) *Business use of credit cards*. If 10 or more credit cards are issued by one card issuer for use by the employees of an organization, this section does not prohibit the card issuer and the organization from agreeing to liability for unauthorized use without regard to this section. However, liability for unauthorized use may be imposed on an employee of the organization, by either the card issuer or the organization, only in accordance with this section.

(c) *Right of cardholder to assert claims or defenses against card issuer*[24]—(1) *General rule*. When a person who honors a credit card fails to resolve satisfactorily a dispute as to property or services purchased with the credit card in a consumer credit transaction, the cardholder may assert against the card issuer all claims (other than tort claims) and defenses arising out of the transaction and relating to the failure to resolve the dispute. The cardholder may withhold payment up to the amount of credit outstanding for the property or services that gave rise to the dispute and any finance or other charges imposed on that amount.[25]

(2) *Adverse credit reports prohibited*. If, in accordance with paragraph (c)(1) of this section, the cardholder withholds payment of the amount of credit outstanding for the disputed transaction, the card issuer shall not report that amount as delinquent until the dispute is settled or judgment is rendered.

(3) *Limitations*. The rights stated in paragraphs (c)(1) and (2) of this section apply only if:

(i) The cardholder has made a good faith attempt to resolve the dispute with the person honoring the credit card; and

(ii) The amount of credit extended to obtain the property or services that result in the assertion of the claim or defense by the cardholder exceeds $50, and the disputed transaction occurred in the same state as the cardholder's current designated address or, if not within the same state, within 100 miles from that address.[26]

[24] This paragraph does not apply to the use of a check guarantee card or a debit card in connection with an overdraft credit plan, or to a check guarantee card used in connection with cash advance checks.

[25] The amount of the claim or defense that the cardholder may assert shall not exceed the amount of credit outstanding for the disputed transaction at the time the cardholder first notifies the card issuer or the person honoring the credit card of the existence of the claim or defense. To determine the amount of credit outstanding for purposes of this section, payments and other credits shall be applied to: (1) Late charges in the order of entry to the account; then to (2) finance charges in the order of entry to the account; and then to (3) any other debits in the order of entry to the account. If more than one item is included in a single extension of credit, credits are to be distributed pro rata according to prices and applicable taxes.

[26] The limitations stated in paragraph (c)(3)(ii) of this section shall not apply when the person honoring the credit card: (1) Is the same person as the card issuer; (2) is controlled by the card issuer directly or indirectly; (3) is under the direct or indirect control of a third person that also directly or indirectly controls the card issuer; (4) controls the card issuer directly or indirectly; (5) is a franchised dealer in the card issuer's products or services; or (6) has obtained the order for the disputed transaction through a mail solicitation made or participated in by the card issuer.

(d) *Offsets by card issuer prohibited.* (1) A card issuer may not take any action, either before or after termination of credit card privileges, to offset a cardholder's indebtedness arising from a consumer credit transaction under the relevant credit card plan against funds of the cardholder held on deposit with the card issuer.

(2) This paragraph does not alter or affect the right of a card issuer acting under state or Federal law to do any of the following with regard to funds of a cardholder held on deposit with the card issuer if the same procedure is constitutionally available to creditors generally: obtain or enforce a consensual security interest in the funds; attach or otherwise levy upon the funds; or obtain or enforce a court order relating to the funds.

(3) This paragraph does not prohibit a plan, if authorized in writing by the cardholder, under which the card issuer may periodically deduct all or part of the cardholder's credit card debt from a deposit account held with the card issuer (subject to the limitations in § 226.13(d)(1)).

(e) *Prompt notification of returns and crediting of refunds.* (1) When a creditor other than the card issuer accepts the return of property or forgives a debt for services that is to be reflected as a credit to the consumer's credit card account, that creditor shall, within 7 business days from accepting the return or forgiving the debt, transmit a credit statement to the card issuer through the card issuer's normal channels for credit statements.

(2) The card issuer shall, within 3 business days from receipt of a credit statement, credit the consumer's account with the amount of the refund.

(3) If a creditor other than a card issuer routinely gives cash refunds to consumers paying in cash, the creditor shall also give credit or cash refunds to consumers using credit cards, unless it discloses at the time the transaction is consummated that credit or cash refunds for returns are not given. This section does not require refunds for returns nor does it prohibit refunds in kind.

(f) *Discounts; tie-in arrangements.* No card issuer may, by contract or otherwise:

(1) Prohibit any person who honors a credit card from offering a discount to a consumer to induce the consumer to pay by cash, check, or similar means rather than by use of a credit card or its underlying account for the purchase of property or services; or

(2) Require any person who honors the card issuer's credit card to open or maintain any account or obtain any other service not essential to the operation of the credit card plan from the card issuer or any other person, as a condition of participation in a credit card plan. If maintenance of an account for clearing purposes is determined to be essential to the operation of the credit card plan, it may be required only if no service charges or minimum balance requirements are imposed.

(g) *Relation to Electronic Fund Transfer Act and Regulation E.* For guidance on whether Regulation Z (12 CFR part 226) or Regulation E (12 CFR part 205) applies in instances involving both credit and electronic fund transfer aspects, refer to Regulation E, 12 CFR 205.12(a) regarding issuance and liability for unauthorized use. On matters other than issuance and liability, this section applies to the credit aspects of combined credit/electronic fund transfer transactions, as applicable.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 65 FR 17131, Mar. 31, 2000]

### § 226.13 Billing error resolution.[27]

(a) *Definition of billing error.* For purposes of this section, the term *billing error* means:

(1) A reflection on or with a periodic statement of an extension of credit that is not made to the consumer or to a person who has actual, implied, or apparent authority to use the consumer's credit card or open-end credit plan.

(2) A reflection on or with a periodic statement of an extension of credit

[27] A creditor shall not accelerate any part of the consumer's indebtedness or restrict or close a consumer's account solely because the consumer has exercised in good faith rights provided by this section. A creditor may be subject to the forfeiture penalty under section 161(e) of the Act for failure to comply with any of the requirements of this section.

that is not identified in accordance with the requirements of §§ 226.7(b) and 226.8.

(3) A reflection on or with a periodic statement of an extension of credit for property or services not accepted by the consumer or the consumer's designee, or not delivered to the consumer or the consumer's designee as agreed.

(4) A reflection on a periodic statement of the creditor's failure to credit properly a payment or other credit issued to the consumer's account.

(5) A reflection on a periodic statement of a computational or similar error of an accounting nature that is made by the creditor.

(6) A reflection on a periodic statement of an extension of credit for which the consumer requests additional clarification, including documentary evidence.

(7) The creditor's failure to mail or deliver a periodic statement to the consumer's last known address if that address was received by the creditor, in writing, at least 20 days before the end of the billing cycle for which the statement was required.

(b) *Billing error notice.*[28] A billing error notice is a written notice[29] from a consumer that:

(1) Is received by a creditor at the address disclosed under § 226.7(k) no later than 60 days after the creditor transmitted the first periodic statement that reflects the alleged billing error;

(2) Enables the creditor to identify the consumer's name and account number; and

(3) To the extent possible, indicates the consumer's belief and the reasons for the belief that a billing error exists, and the type, date, and amount of the error.

(c) *Time for resolution; general procedures.* (1) The creditor shall mail or deliver written acknowledgment to the consumer within 30 days of receiving a billing error notice, unless the creditor has complied with the appropriate resolution procedures of paragraphs (e) and (f) of this section, as applicable, within the 30-day period; and

(2) The creditor shall comply with the appropriate resolution procedures of paragraphs (e) and (f) of this section, as applicable, within 2 complete billing cycles (but in no event later than 90 days) after receiving a billing error notice.

(d) *Rules pending resolution.* Until a billing error is resolved under paragraph (e) or (f) of this section, the following rules apply:

(1) *Consumer's right to withhold disputed amount; collection action prohibited.* The consumer need not pay (and the creditor may not try to collect) any portion of any required payment that the consumer believes is related to the disputed amount (including related finance or other charges).[30] If the cardholder maintains a deposit account with the card issuer and has agreed to pay the credit card indebtedness by periodic deductions from the cardholder's deposit account, the card issuer shall not deduct any part of the disputed amount or related finance or other charges if a billing error notice is received any time up to 3 business days before the scheduled payment date.

(2) *Adverse credit reports prohibited.* The creditor or its agent shall not (directly or indirectly) make or threaten to make an adverse report to any person about the consumer's credit standing, or report that an amount or account is delinquent, because the consumer failed to pay the disputed amount or related finance or other charges.

[28] The creditor need not comply with the requirements of paragraphs (c) through (g) of this section if the consumer concludes that no billing error occurred and voluntarily withdraws the billing error notice.

[29] The creditor may require that the written notice not be made on the payment medium or other material accompanying the periodic statement if the creditor so stipulates in the billing rights statement required by §§ 226.6(d) and 226.9(a).

[30] A creditor is not prohibited from taking action to collect any undisputed portion of the item or bill; from deducting any disputed amount and related finance or other charges from the consumer's credit limit on the account; or from reflecting a disputed amount and related finance or other charges on a periodic statement, provided that the creditor indicates on or with the periodic statement that payment of any disputed amount and related finance or other charges is not required pending the creditor's compliance with this section.

(e) *Procedures if billing error occurred as asserted.* If a creditor determines that a billing error occurred as asserted, it shall within the time limits in paragraph (c)(2) of this section:

(1) Correct the billing error and credit the consumer's account with any disputed amount and related finance or other charges, as applicable; and

(2) Mail or deliver a correction notice to the consumer.

(f) *Procedures if different billing error or no billing error occurred.* If, after conducting a reasonable investigation,[31] a creditor determines that no billing error occurred or that a different billing error occurred from that asserted, the creditor shall within the time limits in paragraph (c)(2) of this section:

(1) Mail or deliver to the consumer an explanation that sets forth the reasons for the creditor's belief that the billing error alleged by the consumer is incorrect in whole or in part;

(2) Furnish copies of documentary evidence of the consumer's indebtedness, if the consumer so requests; and

(3) If a different billing error occurred, correct the billing error and credit the consumer's account with any disputed amount and related finance or other charges, as applicable.

(g) *Creditor's rights and duties after resolution.* If a creditor, after complying with all of the requirements of this section, determines that a consumer owes all or part of the disputed amount and related finance or other charges, the creditor:

(1) Shall promptly notify the consumer in writing of the time when payment is due and the portion of the disputed amount and related finance or other charges that the consumer still owes;

(2) Shall allow any time period disclosed under §§ 226.6(a)(1) and 226.7(j), during which the consumer can pay the amount due under paragraph (g)(1) of this section without incurring additional finance or other charges;

(3) May report an account or amount as delinquent because the amount due under paragraph (g)(1) of this section remains unpaid after the creditor has allowed any time period disclosed under §§ 226.6(a)(1) and 266.7(j) or 10 days (whichever is longer) during which the consumer can pay the amount; but

(4) May not report that an amount or account is delinquent because the amount due under paragraph (g)(1) of the section remains unpaid, if the creditor receives (within the time allowed for payment in paragraph (g)(3) of this section) further written notice from the consumer that any portion of the billing error is still in dispute, unless the creditor also:

(i) Promptly reports that the amount or account is in dispute;

(ii) Mails or delivers to the consumer (at the same time the report is made) a written notice of the name and address of each person to whom the creditor makes a report; and

(iii) Promptly reports any subsequent resolution of the reported delinquency to all persons to whom the creditor has made a report.

(h) *Reassertion of billing error.* A creditor that has fully complied with the requirements of this section has no further responsibilities under this section (other than as provided in paragraph (g)(4) of this section) if a consumer reasserts substantially the same billing error.

(i) *Relation to Electronic Fund Transfer Act and Regulation E.* If an extension of credit is incident to an electronic fund transfer, under an agreement between a consumer and a financial institution to extend credit when the consumer's account is overdrawn or to maintain a specified minimum balance in the consumer's account, the creditor shall comply with the requirements of Regulation E, 12 CFR 205.11 governing error resolution rather than those of paragraphs (a), (b), (c), (e), (f), and (h) of this section.

[31] If a consumer submits a billing error notice alleging either the nondelivery of property or services under paragraph (a)(3) of this section or that information appearing on a periodic statement is incorrect because a person honoring the consumer's credit card has made an incorrect report to the card issuer, the creditor shall not deny the assertion unless it conducts a reasonable investigation and determines that the property or services were actually delivered, mailed, or sent as agreed or that the information was correct.

**§ 226.14 Determination of annual percentage rate.**

(a) *General rule.* The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate. An annual percentage rate shall be considered accurate if it is not more than ⅛ of 1 percentage point above or below the annual percentage rate determined in accordance with this section.[31a]

(b) *Annual percentage rate for §§ 226.5a and 226.5b disclosures, for initial disclosures and for advertising purposes.* Where one or more periodic rates may be used to compute the finance charge, the annual percentage rate(s) to be disclosed for purposes of §§ 226.5a, 226.5b, 226.6, and 226.16 shall be computed by multiplying each periodic rate by the number of periods in a year.

(c) *Annual percentage rate for periodic statements.* The annual percentage rate(s) to be disclosed for purposes of § 226.7(d) shall be computed by multiplying each periodic rate by the number of periods in a year and, for purposes of § 226.7(g), shall be determined as follows:

(1) If the finance charge is determined solely by applying one or more periodic rates, at the creditor's option, either:

(i) By multiplying each periodic rate by the number of periods in a year; or

(ii) By dividing the total finance charge for the billing cycle by the sum of the balances to which the periodic rates were applied and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year.

(2) If the finance charge imposed during the billing cycle is or includes a minimum, fixed, or other charge not due to the application of a periodic rate, other than a charge with respect to any specific transaction during the billing cycle, by dividing the total finance charge for the billing cycle by the amount of the balance(s) to which it is applicable[32] and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year.[33]

(3) If the finance charge imposed during the billing cycle is or includes a charge relating to a specific transaction during the billing cycle (even if the total finance charge also includes any other minimum, fixed, or other charge not due to the application of a periodic rate), by dividing the total finance charge imposed during the billing cycle by the total of all balances and other amounts on which a finance charge was imposed during the billing cycle without duplication, and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year,[34] except that the annual percentage rate shall not be less than the largest rate determined by multiplying each periodic rate imposed during the billing cycle by the number of periods in a year.[35]

(4) If the finance charge imposed during the billing cycle is or includes a minimum, fixed, or other charge not due to the application of a periodic rate and the total finance charge imposed during the billing cycle does not exceed 50 cents for a monthly or longer billing cycle, or the pro rata part of 50 cents for a billing cycle shorter than monthly, at the creditor's option, by multiplying each applicable periodic rate by the number of periods in a year, notwithstanding the provisions of paragraphs (c)(2) and (3) of this section.

(d) *Calculations where daily periodic rate applied.* If the provisions of paragraph (c)(1)(ii) or (2) of this section apply and all or a portion of the finance charge is determined by the application of one or more daily periodic

[31a] An error in disclosure of the annual percentage rate or finance charge shall not, in itself, be considered a violation of this regulation if: (1) The error resulted from a corresponding error in a calculation tool used in good faith by the creditor; and (2) upon discovery of the error, the creditor promptly discontinues use of that calculation tool for disclosure purposes, and notifies the Board in writing of the error in the calculation tool.

[32] If there is no balance to which the finance charge is applicable, an annual percentage rate cannot be determined under this section.

[33] Where the finance charge imposed during the billing cycle is or includes a loan fee, points, or similar charge that relates to the opening of the account, the amount of such charge shall not be included in the calculation of the annual percentage rate.

[34] See appendix F regarding determination of the denominator of the fraction under this paragraph.

[35] See footnote 33.

rates, the annual percentage rate may be determined either:

(1) By dividing the total finance charge by the average of the daily balances and multiplying the quotient by the number of billing cycles in a year; or

(2) By dividing the total finance charge by the sum of the daily balances and multiplying the quotient by 365.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 47 FR 756, Jan. 7, 1982; 48 FR 14886, Apr. 6, 1983; 54 FR 24688, June 9, 1989]

### § 226.15 Right of rescission.

(a) *Consumer's right to rescind.* (1)(i) Except as provided in paragraph (a)(1)(ii) of this section, in a credit plan in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind: each credit extension made under the plan; the plan when the plan is opened; a security interest when added or increased to secure an existing plan; and the increase when a credit limit on the plan is increased.

(ii) As provided in section 125(e) of the Act, the consumer does not have the right to rescind each credit extension made under the plan if such extension is made in accordance with a previously established credit limit for the plan.

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram, or other means of written communication. Notice is considered given when mailed, or when filed for telegraphic transmission, or, if sent by other means, when delivered to the creditor's designated place of business.

(3) The consumer may exercise the right to rescind until midnight of the third business day following the occurrence described in paragraph (a)(1) of this section that gave rise to the right of rescission, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures,[36] whichever occurs last. If the required notice and material disclosures are not delivered, the right to rescind shall expire 3 years after the occurrence giving rise to the right of rescission, or upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act.

(4) When more than one consumer has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

(b) *Notice of right to rescind.* In any transaction or occurrence subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act). The notice shall identify the transaction or occurrence and clearly and conspicuously disclose the following:

(1) The retention or acquisition of a security interest in the consumer's principal dwelling.

(2) The consumer's right to rescind, as described in paragraph (a)(1) of this section.

(3) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.

(4) The effects of rescission, as described in paragraph (d) of this section.

(5) The date the rescission period expires.

(c) *Delay of creditor's performance.* Unless a consumer waives the right to rescind under paragraph (e) of this section, no money shall be disbursed other than in escrow, no services shall be performed, and no materials delivered until after the rescission period has expired and the creditor is reasonably

[36] The term *material disclosures* means the information that must be provided to satisfy the requirements in § 226.6 with regard to the method of determining the finance charge and the balance upon which a finance charge will be imposed, the annual percentage rate, the amount or method of determining the amount of any membership or participation fee that may be imposed as part of the plan, and the payment information described in § 226.5b(d)(5)(i) and (ii) that is required under § 226.6(e)(2).

satisfied that the consumer has not rescinded. A creditor does not violate this section if a third party with no knowledge of the event activating the rescission right does not delay in providing materials or services, as long as the debt incurred for those materials or services is not secured by the property subject to rescission.

(d) *Effects of rescission.* (1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void, and the consumer shall not be liable for any amount, including any finance charge.

(2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.

(3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.

(4) The procedures outlined in paragraphs (d)(2) and (3) of this section may be modified by court order.

(e) *Consumer's waiver of right to rescind.* (1) The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind. Printed forms for this purpose are prohibited, except as provided in paragraph (e)(2) of this section.

(2) The need of the consumer to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1993, pursuant to 42 U.S.C. 5170, to be a major disaster area because of severe storms and flooding in the Midwest.[36a] In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(3) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1994 to be a major disaster area, pursuant to 42 U.S.C. 5170, because of severe storms and flooding in the South.[36b] In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(4) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during October 1994 to be a major disaster area, pursuant to 42 U.S.C. 5170, because of severe storms and flooding in Texas.[36c] In this instance, creditors may use printed

[36a] A list of the affected areas will be maintained by the Board.

[36b] A list of the affected areas will be maintained and published by the Board. Such areas now include parts of Alabama, Florida, and Georgia.

[36c] A list of the affected areas will be maintained and published by the Board. Such areas now include the following counties in Texas: Angelina, Austin, Bastrop, Brazos, Brazoria, Burleson, Chambers, Fayette, Fort Bend, Galveston, Grimes, Hardin, Harris, Houston, Jackson, Jasper, Jefferson, Lee, Liberty, Madison, Matagorda, Montgomery, Nacagdoches, Orange, Polk, San Augustine,

forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(f) *Exempt transactions.* The right to rescind does not apply to the following:

(1) A residential mortgage transaction.

(2) A credit plan in which a state agency is a creditor.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 54 FR 24688, June 9, 1989; 58 FR 40583, July 29, 1993; 59 FR 40204, Aug. 5, 1994; 59 FR 63715, Dec. 9, 1994; 66 FR 17338, Mar. 30, 2001; 72 FR 63474, Nov. 9, 2007]

### § 226.16 Advertising.

(a) *Actually available terms.* If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the creditor.

(b) *Advertisement of terms that require additional disclosures.* If any of the terms required to be disclosed under § 226.6 is set forth in an advertisement, the advertisement shall also clearly and conspicuously set forth the following:[36d]

(1) Any minimum, fixed, transaction, activity or similar charge that could be imposed.

(2) Any periodic rate that may be applied expressed as an annual percentage rate as determined under § 226.14(b). If the plan provides for a variable periodic rate, that fact shall be disclosed.

(3) Any membership or participation fee that could be imposed.

(c) *Catalogs or other multiple-page advertisements; electronic advertisements.* (1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (b) of this section, it shall be considered a single advertisement if:

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of terms set forth in § 226.6 appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) complies with this paragraph if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

(d) *Additional requirements for home equity plans*—(1) *Advertisement of terms that require additional disclosures.* If any of the terms required to be disclosed under § 226.6(a) or (b) or the payment terms of the plan are set forth, affirmatively or negatively, in an advertisement for a home equity plan subject to the requirements of § 226.5b, the advertisement also shall clearly and conspicuously set forth the following:

(i) Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range.

(ii) Any periodic rate used to compute the finance charge, expressed as an annual percentage rate as determined under section § 226.14(b).

(iii) The maximum annual percentage rate that may be imposed in a variable-rate plan.

(2) *Discounted and premium rates.* If an advertisement states an initial annual percentage rate that is not based on the index and margin used to make later rate adjustments in a variable-rate plan, the advertisement also shall state the period of time such rate will be in effect, and, with equal prominence to the initial rate, a reasonably current annual percentage rate that would have been in effect using the index and margin.

(3) *Balloon payment.* If an advertisement contains a statement about any minimum periodic payment, the advertisement also shall state, if applicable, that a balloon payment may result.[36e]

(4) *Tax implications.* An advertisement that states that any interest expense

San Jacinto, Shelby, Trinity, Victoria, Washington, Waller, Walker, and Wharton.

[36d] The disclosures given in accordance with § 226.5a do not constitute advertising terms for purposes of the requirements of this section.

[36e] See footnote 10b.

incurred under the home equity plan is or may be tax deductible may not be misleading in this regard.

(5) *Misleading terms.* An advertisement may not refer to a home equity plan as ''free money'' or contain a similarly misleading term.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 54 FR 13867, Apr. 6, 1989; 54 FR 24688, June 9, 1989; 54 FR 28665, July 7, 1989; 58 FR 40583, July 29, 1993; 59 FR 40204, Aug. 5, 1994; 59 FR 63715, Dec. 9, 1994; 66 FR 17338, Mar. 30, 2001; 72 FR 63474, Nov. 9, 2007]

EFFECTIVE DATE NOTE: At 73 FR 44599, July 30, 2008, §226.16 was amended by revising paragraph (d)(2) through (d)(4), and adding new paragraphs (d)(6) and (e), effective Oct. 1, 2009. For the convenience of the user, the added and revised text is set forth as follows:

**§ 226.16 Advertising.**

* * * * *

(d) * * *

* * * * *

(2) *Discounted and premium rates.* If an advertisement states an initial annual percentage rate that is not based on the index and margin used to make later rate adjustments in a variable-rate plan, the advertisement also shall state with equal prominence and in close proximity to the initial rate:

(i) The period of time such initial rate will be in effect; and

(ii) A reasonably current annual percentage rate that would have been in effect using the index and margin.

(3) *Balloon payment.* If an advertisement contains a statement of any minimum periodic payment and a balloon payment may result if only the minimum periodic payments are made, even if such a payment is uncertain or unlikely, the advertisement also shall state with equal prominence and in close proximity to the minimum periodic payment statement that a balloon payment may result, if applicable.[36e] A balloon payment results if paying the minimum periodic payments does not fully amortize the outstanding balance by a specified date or time, and the consumer is required to repay the entire outstanding balance at such time. If a balloon payment will occur when the consumer makes only the minimum payments required under the plan, an advertisement for such a program which contains any statement of any minimum periodic payment shall also state with equal prominence and in close proximity to the minimum periodic payment statement:

(i) That a balloon payment will result; and

(ii) The amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

(4) *Tax implications.* An advertisement that states that any interest expense incurred under the home-equity plan is or may be tax deductible may not be misleading in this regard. If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a home-equity plan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:

(i) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(ii) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

* * * * *

(6) *Promotional rates and payments*—(i) *Definitions.* The following definitions apply for purposes of paragraph (d)(6) of this section:

(A) *Promotional rate.* The term ''promotional rate'' means, in a variable-rate plan, any annual percentage rate that is not based on the index and margin that will be used to make rate adjustments under the plan, if that rate is less than a reasonably current annual percentage rate that would be in effect under the index and margin that will be used to make rate adjustments under the plan.

(B) *Promotional payment.* The term ''promotional payment'' means—

(*1*) For a variable-rate plan, any minimum payment applicable for a promotional period that:

(*i*) Is not derived by applying the index and margin to the outstanding balance when such index and margin will be used to determine other minimum payments under the plan; and

(*ii*) Is less than other minimum payments under the plan derived by applying a reasonably current index and margin that will be used to determine the amount of such payments, given an assumed balance.

(*2*) For a plan other than a variable-rate plan, any minimum payment applicable for a promotional period if that payment is less than other payments required under the plan given an assumed balance.

(C) *Promotional period.* A ''promotional period'' means a period of time, less than the

[36e] [Reserved]

full term of the loan, that the promotional rate or promotional payment may be applicable.

(ii) *Stating the promotional period and post-promotional rate or payments.* If any annual percentage rate that may be applied to a plan is a promotional rate, or if any payment applicable to a plan is a promotional payment, the following must be disclosed in any advertisement, other than television or radio advertisements, in a clear and conspicuous manner with equal prominence and in close proximity to each listing of the promotional rate or payment:

(A) The period of time during which the promotional rate or promotional payment will apply;

(B) In the case of a promotional rate, any annual percentage rate that will apply under the plan. If such rate is variable, the annual percentage rate must be disclosed in accordance with the accuracy standards in §§ 226.5b, or 226.16(b)(1)(ii) as applicable; and

(C) In the case of a promotional payment, the amounts and time periods of any payments that will apply under the plan. In variable-rate transactions, payments that will be determined based on application of an index and margin shall be disclosed based on a reasonably current index and margin.

(iii) *Envelope excluded.* The requirements in paragraph (d)(6)(ii) of this section do not apply to an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

(e) *Alternative disclosures—television or radio advertisements.* An advertisement for a home-equity plan subject to the requirements of § 226.5b made through television or radio stating any of the terms requiring additional disclosures under paragraph (b) or (d)(1) of this section may alternatively comply with paragraph (b) or (d)(1) of this section by stating the information required by paragraph (b)(2) of this section or paragraph (d)(1)(ii) of this section, as applicable, and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain additional cost information.

## Subpart C—Closed-End Credit

### § 226.17 General disclosure requirements.

(a) *Form of disclosures.* (1) The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 *et seq.*). The disclosures required by §§ 226.17(g), 226.19(b), and 226.24 may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related[37] to the disclosures required under § 226.18.[38] The itemization of the amount financed under § 226.18(c)(1) must be separate from the other disclosures under that section.

(2) The terms *finance charge* and *annual percentage rate*, when required to be disclosed under § 226.18 (d) and (e) together with a corresponding amount or percentage rate, shall be more conspicuous than any other disclosure, except the creditor's identity under § 226.18(a).

(b) *Time of disclosures.* The creditor shall make disclosures before consummation of the transaction. In certain residential mortgage transactions, special timing requirements are set forth in § 226.19(a). In certain variable-rate transactions, special timing requirements for variable-rate disclosures are set forth in § 226.19(b) and § 226.20(c). In certain transactions involving mail or telephone orders or a series of sales, the timing of disclosures may be delayed in accordance with paragraphs (g) and (h) of this section.

(c) *Basis of disclosures and use of estimates.* (1) The disclosures shall reflect the terms of the legal obligation between the parties.

[37] The disclosures may include an acknowledgment of receipt, the date of the transaction, and the consumer's name, address, and account number.

[38] The following disclosures may be made together with or separately from other required disclosures: the creditor's identity under § 226.18(a), the variable rate example under § 226.18(f)(1)(iv), insurance or debt cancellation under § 226.18(n), and certain security interest charges under § 226.18(o).

(2)(i) If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided to the consumer, and shall state clearly that the disclosure is an estimate.

(ii) For a transaction in which a portion of the interest is determined on a per-diem basis and collected at consummation, any disclosure affected by the per-diem interest shall be considered accurate if the disclosure is based on the information known to the creditor at the time that the disclosure documents are prepared for consummation of the transaction.

(3) The creditor may disregard the effects of the following in making calculations and disclosures.

(i) That payments must be collected in whole cents.

(ii) That dates of scheduled payments and advances may be changed because the scheduled date is not a business day.

(iii) That months have different numbers of days.

(iv) The occurrence of leap year.

(4) In making calculations and disclosures, the creditor may disregard any irregularity in the first period that falls within the limits described below and any payment schedule irregularity that results from the irregular first period:

(i) For transactions in which the term is less than 1 year, a first period not more than 6 days shorter or 13 days longer than a regular period;

(ii) For transactions in which the term is at least 1 year and less than 10 years, a first period not more than 11 days shorter or 21 days longer than a regular period; and

(iii) For transactions in which the term is at least 10 years, a first period shorter than or not more than 32 days longer than a regular period.

(5) If an obligation is payable on demand, the creditor shall make the disclosures based on an assumed maturity of 1 year. If an alternate maturity date is stated in the legal obligation between the parties, the disclosures shall be based on that date.

(6)(i) A series of advances under an agreement to extend credit up to a certain amount may be considered as one transaction.

(ii) When a multiple-advance loan to finance the construction of a dwelling may be permanently financed by the same creditor, the construction phase and the permanent phase may be treated as either one transaction or more than one transaction.

(d) *Multiple creditors; multiple consumers*. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor must comply with the requirements that this regulation imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable under § 226.23, however, the disclosures shall be made to each consumer who has the right to rescind.

(e) *Effect of subsequent events*. If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of this regulation, although new disclosures may be required under paragraph (f) of this section, § 226.19, or § 226.20.

(f) *Early disclosures*. If disclosures required by this subpart are given before the date of consummation of a transaction and a subsequent event makes them inaccurate, the creditor shall disclose before consummation:[39]

(1) Any changed term unless the term was based on an estimate in accordance with § 226.17(c)(2) and was labelled an estimate;

(2) All changed terms, if the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed earlier by more than ⅛ of 1 percentage point in a regular transaction, or more than ¼ of 1 percentage point in an irregular transaction, as defined in § 226.22(a).

(g) *Mail or telephone orders—delay in disclosures*. If a creditor receives a purchase order or a request for an extension of credit by mail, telephone, or

[39] For certain residential mortgage transactions, § 226.19(a)(2) permits redisclosure no later than consummation or settlement, whichever is later.

facsimile machine without face-to-face or direct telephone solicitation, the creditor may delay the disclosures until the due date of the first payment, if the following information for representative amounts or ranges of credit is made available in written form or in electronic form to the consumer or to the public before the actual purchase order or request:

(1) The cash price or the principal loan amount.

(2) The total sale price.

(3) The finance charge.

(4) The annual percentage rate, and if the rate may increase after consummation, the following disclosures:

(i) The circumstances under which the rate may increase.

(ii) Any limitations on the increase.

(iii) The effect of an increase.

(5) The terms of repayment.

(h) *Series of sales—delay in disclosures.* If a credit sale is one of a series made under an agreement providing that subsequent sales may be added to an outstanding balance, the creditor may delay the required disclosures until the due date of the first payment for the current sale, if the following two conditions are met:

(1) The consumer has approved in writing the annual percentage rate or rates, the range of balances to which they apply, and the method of treating any unearned finance charge on an existing balance.

(2) The creditor retains no security interest in any property after the creditor has received payments equal to the cash price and any finance charge attributable to the sale of that property. For purposes of this provision, in the case of items purchased on different dates, the first purchased is deemed the first item paid for; in the case of items purchased on the same date, the lowest priced is deemed the first item paid for.

(i) *Interim student credit extensions.* For each transaction involving an interim credit extension under a student credit program, the creditor need not make the following disclosures: the finance charge under § 226.18(d), the payment schedule under § 226.18(g), the total of payments under § 226.18(h), or the total sale price under § 226.18(j).

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 52 FR 48670, Dec. 24, 1987; 61 FR 49246, Sept. 19, 1996; 66 FR 17338, Mar. 30, 2001; 67 FR 16982, Apr. 9, 2002; 72 FR 63474, Nov. 9, 2007]

EFFECTIVE DATE NOTE: At 73 FR 44600, July 30, 2008, § 226.17 was amended by revising paragraphs (b) and (f), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

**§ 226.17 General disclosure requirements.**

* * * * *

(b) *Time of disclosures.* The creditor shall make disclosures before consummation of the transaction. In certain mortgage transactions, special timing requirements are set forth in § 226.19(a). In certain variable-rate transactions, special timing requirements for variable-rate disclosures are set forth in § 226.19(b) and § 226.20(c). In certain transactions involving mail or telephone orders or a series of sales, the timing of the disclosures may be delayed in accordance with paragraphs (g) and (h) of this section.

* * * * *

(f) *Early disclosures.* If disclosures required by this subpart are given before the date of consummation of a transaction and a subsequent event makes them inaccurate, the creditor shall disclose before consummation (except that, for certain mortgage transactions, § 226.19(a)(2) permits redisclosure no later than consummation or settlement, whichever is later).[39]

* * * * *

**§ 226.18 Content of disclosures.**

For each transaction, the creditor shall disclose the following information as applicable:

(a) *Creditor.* The identity of the creditor making the disclosures.

(b) *Amount financed.* The *amount financed*, using that term, and a brief description such as *the amount of credit provided to you or on your behalf.* The amount financed is calculated by:

(1) Determining the principal loan amount or the cash price (subtracting any downpayment);

(2) Adding any other amounts that are financed by the creditor and are not part of the finance charge; and

[39] [Reserved]

(3) Subtracting any prepaid finance charge.

(c) *Itemization of amount financed.* (1) A separate written itemization of the amount financed, including:[40]

(i) The amount of any proceeds distributed directly to the consumer.

(ii) The amount credited to the consumer's account with the creditor.

(iii) Any amounts paid to other persons by the creditor on the consumer's behalf. The creditor shall identify those persons.[41]

(iv) The prepaid finance charge.

(2) The creditor need not comply with paragraph (c)(1) of this section if the creditor provides a statement that the consumer has the right to receive a written itemization of the amount financed, together with a space for the consumer to indicate whether it is desired, and the consumer does not request it.

(d) *Finance charge.* The *finance charge,* using that term, and a brief description such as ''the dollar amount the credit will cost you.''

(1) *Mortgage loans.* In a transaction secured by real property or a dwelling, the disclosed finance charge and other disclosures affected by the disclosed finance charge (including the amount financed and the annual percentage rate) shall be treated as accurate if the amount disclosed as the finance charge:

(i) Is understated by no more than $100; or

(ii) Is greater than the amount required to be disclosed.

(2) *Other credit.* In any other transaction, the amount disclosed as the finance charge shall be treated as accurate if, in a transaction involving an amount financed of $1,000 or less, it is not more than $5 above or below the amount required to be disclosed; or, in a transaction involving an amount financed of more than $1,000, it is not more than $10 above or below the amount required to be disclosed.

(e) *Annual percentage rate.* The *annual percentage rate,* using that term, and a brief description such as ''the cost of your credit as a yearly rate.''[42]

(f) *Variable rate.* (1) If the annual percentage rate may increase after consummation in a transaction not secured by the consumer's principal dwelling or in a transaction secured by the consumer's principal dwelling with a term of one year or less, the following disclosures:[43]

(i) The circumstances under which the rate may increase.

(ii) Any limitations on the increase.

(iii) The effect of an increase.

(iv) An example of the payment terms that would result from an increase.

(2) If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures:

(i) The fact that the transaction contains a variable-rate feature.

(ii) A statement that variable-rate disclosures have been provided earlier.

(g) *Payment schedule.* The number, amounts, and timing of payments scheduled to repay the obligation.

(1) In a demand obligation with no alternate maturity date, the creditor may comply with this paragraph by disclosing the due dates or payment periods of any scheduled interest payments for the first year.

(2) In a transaction in which a series of payments varies because a finance charge is applied to the unpaid principal balance, the creditor may comply with this paragraph by disclosing the following information:

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[40] Good faith estimates of settlement costs provided for transactions subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) may be substituted for the disclosures required by paragraph (c) of this section.

[41] The following payees may be described using generic or other general terms and need not be further identified: public officials or government agencies, credit reporting agencies, appraisers, and insurance companies.

[42] For any transaction involving a finance charge of $5 or less on an amount financed of $75 or less, or a finance charge of $7.50 or less on an amount financed of more than $75, the creditor need not disclose the annual percentage rate.

[43] Information provided in accordance with §§ 226.18(f)(2) and 226.19(b) may be substituted for the disclosures required by paragraph (f)(1) of this section.

(i) The dollar amounts of the largest and smallest payments in the series.

(ii) A reference to the variations in the other payments in the series.

(h) *Total of payments.* The *total of payments,* using that term, and a descriptive explanation such as ''the amount you will have paid when you have made all scheduled payments.''[44]

(i) *Demand feature.* If the obligation has a demand feature, that fact shall be disclosed. When the disclosures are based on an assumed maturity of 1 year as provided in § 226.17(c)(5), that fact shall also be disclosed.

(j) *Total sale price.* In a credit sale, the *total sale price,* using that term, and a descriptive explanation (including the amount of any downpayment) such as ''the total price of your purchase on credit, including your downpayment of $____.'' The total sale price is the sum of the cash price, the items described in paragraph (b)(2), and the finance charge disclosed under paragraph (d) of this section.

(k) *Prepayment.* (1) When an obligation includes a finance charge computed from time to time by application of a rate to the unpaid principal balance, a statement indicating whether or not a penalty may be imposed if the obligation is prepaid in full.

(2) When an obligation includes a finance charge other than the finance charge described in paragraph (k)(1) of this section, a statement indicating whether or not the consumer is entitled to a rebate of any finance charge if the obligation is prepaid in full.

(l) *Late payment.* Any dollar or percentage charge that may be imposed before maturity due to a late payment, other than a deferral or extension charge.

(m) *Security interest.* The fact that the creditor has or will acquire a security interest in the property purchased as part of the transaction, or in other property identified by item or type.

(n) *Insurance and debt cancellation.* The items required by § 226.4(d) in order to exclude certain insurance premiums and debt cancellation fees from the finance charge.

(o) *Certain security interest charges.* The disclosures required by § 226.4(e) in order to exclude from the finance charge certain fees prescribed by law or certain premiums for insurance in lieu of perfecting a security interest.

(p) *Contract reference.* A statement that the consumer should refer to the appropriate contract document for information about nonpayment, default, the right to accelerate the maturity of the obligation, and prepayment rebates and penalties. At the creditor's option, the statement may also include a reference to the contract for further information about security interests and, in a residential mortgage transaction, about the creditor's policy regarding assumption of the obligation.

(q) *Assumption policy.* In a residential mortgage transaction, a statement whether or not a subsequent purchaser of the dwelling from the consumer may be permitted to assume the remaining obligation on its original terms.

(r) *Required deposit.* If the creditor requires the consumer to maintain a deposit as a condition of the specific transaction, a statement that the annual percentage rate does not reflect the effect of the required deposit.[45]

[46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981, as amended at 52 FR 48670, Dec. 24, 1987; 61 FR 49246, Sept. 19, 1996]

### § 226.19 Certain residential mortgage and variable-rate transactions.

(a) *Residential mortgage transactions subject to RESPA*—(1) *Time of disclosures.* In a residential mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) the creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier.

(2) *Redisclosure required.* If the annual percentage rate at the time of consummation varies from the annual percentage rate disclosed earlier by more

[44] In any transaction involving a single payment, the creditor need not disclose the total of payments.

[45] A required deposit need not include, for example: (1) An escrow account for items such as taxes, insurance or repairs; (2) a deposit that earns not less than 5 percent per year; or (3) payments under a Morris Plan.

than ⅛ of 1 percentage point in a regular transaction or more than ¼ of 1 percentage point in an irregular transaction, as defined in § 226.22, the creditor shall disclose all the changed terms no later than consummation or settlement.

(b) *Certain variable-rate transactions.*[45a] If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures must be provided at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier:[45b]

(1) The booklet titled *Consumer Handbook on Adjustable Rate Mortgages* published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

(2) A loan program disclosure for each variable-rate program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:

(i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) At the option of the creditor, either of the following:

(A) A historical example, based on a $10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program disclosure. The example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limitations, that would have been affected by the index movement during the period.

(B) The maximum interest rate and payment for a $10,000 loan originated at the initial interest rate (index value plus margin, adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan and a statement that the periodic payment may increase or decrease substantially depending on changes in the rate.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on either:

(A) The most recent payment shown in the historical example in paragraph (b)(2)(viii)(A) of this section; or

(B) The initial interest rate used to calculate the maximum interest rate and payment in paragraph (b)(2)(viii)(B) of this section.

(x) The fact that the loan program contains a demand feature.

(xi) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xii) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

[45a] Information provided in accordance with variable-rate regulations of other federal agencies may be substituted for the disclosures required by paragraph (b) of this section.

[45b] Disclosures may be delivered or placed in the mail not later than three business days following receipt of a consumer's application when the application reaches the creditor by telephone, or through an intermediary agent or broker.

(c) *Electronic disclosures.* For an application that is accessed by the consumer in electronic form, the disclosures required by paragraph (b) of this section may be provided to the consumer in electronic form on or with the application.

[Reg. Z, 52 FR 48670, Dec. 24, 1987; 53 FR 467, Jan. 7, 1988, as amended at 61 FR 49246, Sept. 19, 1996; 62 FR 63443, Dec. 1, 1997; 72 FR 63474, Nov. 9, 2007]

EFFECTIVE DATE NOTE: At 73 FR 44600, July 30, 2008, § 226.19 was amended by revising the heading and paragraph (a)(1), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

**§ 226.19 Certain mortgage and variable-rate transactions.**

(a) *Mortgage transactions subject to RESPA*—(1)(i) *Time of disclosures.* In a mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) that is secured by the consumer's principal dwelling, other than a home equity line of credit subject to § 226.5b, the creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier.

(ii) *Imposition of fees.* Except as provided in paragraph (a)(1)(iii) of this section, neither a creditor nor any other person may impose a fee on the consumer in connection with the consumer's application for a mortgage transaction subject to paragraph (a)(1)(i) of this section before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section. If the disclosures are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

(iii) *Exception to fee restriction.* A creditor or other person may impose a fee for obtaining the consumer's credit history before the consumer has received the disclosures required by paragraph (a)(1)(i) of this section, provided the fee is *bona fide* and reasonable in amount.

* * * * *

**§ 226.20 Subsequent disclosure requirements.**

(a) *Refinancings.* A refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation undertaken by the same consumer. A refinancing is a new transaction requiring new disclosures to the consumer. The new finance charge shall include any unearned portion of the old finance charge that is not credited to the existing obligation. The following shall not be treated as a refinancing:

(1) A renewal of a single payment obligation with no change in the original terms.

(2) A reduction in the annual percentage rate with a corresponding change in the payment schedule.

(3) An agreement involving a court proceeding.

(4) A change in the payment schedule or a change in collateral requirements as a result of the consumer's default or delinquency, unless the rate is increased, or the new amount financed exceeds the unpaid balance plus earned finance charge and premiums for continuation of insurance of the types described in § 226.4(d).

(5) The renewal of optional insurance purchased by the consumer and added to an existing transaction, if disclosures relating to the initial purchase were provided as required by this subpart.

(b) *Assumptions.* An assumption occurs when a creditor expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction. Before the assumption occurs, the creditor shall make new disclosures to the subsequent consumer, based on the remaining obligation. If the finance charge originally imposed on the existing obligation was an add-on or discount finance charge, the creditor need only disclose:

(1) The unpaid balance of the obligation assumed.

(2) The total charges imposed by the creditor in connection with the assumption.

(3) The information required to be disclosed under § 226.18(k), (l), (m), and (n).

(4) The annual percentage rate originally imposed on the obligation.

(5) The payment schedule under § 226.18(g) and the total of payments under § 226.18(h) based on the remaining obligation.

(c) *Variable-rate adjustments.*[45c] An adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable-rate transaction subject to § 226.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a payment at a new level is due, the following disclosures, as applicable, must be delivered or placed in the mail:

(1) The current and prior interest rates.

(2) The index values upon which the current and prior interest rates are based.

(3) The extent to which the creditor has foregone any increase in the interest rate.

(4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance.

(5) The payment, if different from that referred to in paragraph (c)(4) of this section, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

[46 FR 20892, Apr. 7, 1981, as amended at 52 FR 48671, Dec. 24, 1987]

### § 226.21 Treatment of credit balances.

When a credit balance in excess of $1 is created in connection with a transaction (through transmittal of funds to a creditor in excess of the total balance due on an account, through rebates of unearned finance charges or insurance premiums, or through amounts otherwise owed to or held for the benefit of a consumer), the creditor shall:

(a) Credit the amount of the credit balance to the consumer's account;

(b) Refund any part of the remaining credit balance, upon the written request of the consumer; and

(c) Make a good faith effort to refund to the consumer by cash, check, or money order, or credit to a deposit account of the consumer, any part of the credit balance remaining in the account for more than 6 months, except that no further action is required if the consumer's current location is not known to the creditor and cannot be traced through the consumer's last known address or telephone number.

### § 226.22 Determination of annual percentage rate.

(a) *Accuracy of annual percentage rate.* (1) The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made. The annual percentage rate shall be determined in accordance with either the actuarial method or the United States Rule method. Explanations, equations and instructions for determining the annual percentage rate in accordance with the actuarial method are set forth in appendix J to this regulation.[45d]

(2) As a general rule, the annual percentage rate shall be considered accurate if it is not more than ⅛ of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a)(1) of this section.

(3) In an irregular transaction, the annual percentage rate shall be considered accurate if it is not more than ¼ of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a)(1) of this section.[46]

(4) *Mortgage loans.* If the annual percentage rate disclosed in a transaction secured by real property or a dwelling

[45c] Information provided in accordance with variable-rate subsequent disclosure regulations of other federal agencies may be substituted for the disclosure required by paragraph (c) of this section.

[45d] An error in disclosure of the annual percentage rate or finance charge shall not, in itself, be considered a violation of this regulation if: (1) The error resulted from a corresponding error in a calculation tool used in good faith by the creditor; and (2) upon discovery of the error, the creditor promptly discontinues use of that calculation tool for disclosure purposes and notifies the Board in writing of the error in the calculation tool.

[46] For purposes of paragraph (a)(3) of this section, an irregular transaction is one that includes one or more of the following features: multiple advances, irregular payment periods, or irregular payment amounts (other than an irregular first period or an irregular first or final payment).

varies from the actual rate determined in accordance with paragraph (a)(1) of this section, in addition to the tolerances applicable under paragraphs (a)(2) and (3) of this section, the disclosed annual percentage rate shall also be considered accurate if:

(i) The rate results from the disclosed finance charge; and

(ii)(A) The disclosed finance charge would be considered accurate under § 226.18(d)(1); or

(B) For purposes of rescission, if the disclosed finance charge would be considered accurate under § 226.23(g) or (h), whichever applies.

(5) *Additional tolerance for mortgage loans.* In a transaction secured by real property or a dwelling, in addition to the tolerances applicable under paragraphs (a)(2) and (3) of this section, if the disclosed finance charge is calculated incorrectly but is considered accurate under § 226.18(d)(1) or § 226.23(g) or (h), the disclosed annual percentage rate shall be considered accurate:

(i) If the disclosed finance charge is understated, and the disclosed annual percentage rate is also understated but it is closer to the actual annual percentage rate than the rate that would be considered accurate under paragraph (a)(4) of this section;

(ii) If the disclosed finance charge is overstated, and the disclosed annual percentage rate is also overstated but it is closer to the actual annual percentage rate than the rate that would be considered accurate under paragraph (a)(4) of this section.

(b) *Computation tools.* (1) The Regulation Z Annual Percentage Rate Tables produced by the Board may be used to determine the annual percentage rate, and any rate determined from those tables in accordance with the accompanying instructions complies with the requirements of this section. Volume I of the tables applies to single advance transactions involving up to 480 monthly payments or 104 weekly payments. It may be used for regular transactions and for transactions with any of the following irregularities: an irregular first period, an irregular first payment, and an irregular final payment. Volume II of the tables applies to transactions involving multiple advances and any type of payment or period irregularity.

(2) Creditors may use any other computation tool in determining the annual percentage rate if the rate so determined equals the rate determined in accordance with appendix J, within the degree of accuracy set forth in paragraph (a) of this section.

(c) *Single add-on rate transactions.* If a single add-on rate is applied to all transactions with maturities up to 60 months and if all payments are equal in amount and period, a single annual percentage rate may be disclosed for all those transactions, so long as it is the highest annual percentage rate for any such transaction.

(d) *Certain transactions involving ranges of balances.* For purposes of disclosing the annual percentage rate referred to in § 226.17(g)(4) (Mail or telephone orders—delay in disclosures) and (h) (Series of sales—delay in disclosures), if the same finance charge is imposed on all balances within a specified range of balances, the annual percentage rate computed for the median balance may be disclosed for all the balances. However, if the annual percentage rate computed for the median balance understates the annual percentage rate computed for the lowest balance by more than 8 percent of the latter rate, the annual percentage rate shall be computed on whatever lower balance will produce an annual percentage rate that does not result in an understatement of more than 8 percent of the rate determined on the lowest balance.

[46 FR 20892, Apr. 7, 1981, as amended at 47 FR 756, Jan. 7, 1982; 48 FR 14886, Apr. 6, 1983; 61 FR 49246, Sept. 19, 1996]

### § 226.23 Right of rescission.

(a) *Consumer's right to rescind.* (1) In a credit transaction in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind the transaction, except for

transactions described in paragraph (f) of this section.[47]

(2) To exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business.

(3) The consumer may exercise the right to rescind until midnight of the third business day following consummation, delivery of the notice required by paragraph (b) of this section, or delivery of all material disclosures,[48] whichever occurs last. If the required notice or material disclosures are not delivered, the right to rescind shall expire 3 years after consummation, upon transfer of all of the consumer's interest in the property, or upon sale of the property, whichever occurs first. In the case of certain administrative proceedings, the rescission period shall be extended in accordance with section 125(f) of the Act.

(4) When more than one consumer in a transaction has the right to rescind, the exercise of the right by one consumer shall be effective as to all consumers.

(b)(1) *Notice of right to rescind.* In a transaction subject to rescission, a creditor shall deliver two copies of the notice of the right to rescind to each consumer entitled to rescind (one copy to each if the notice is delivered in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act). The notice shall be on a separate document that identifies the transaction and shall clearly and conspicuously disclose the following:

(i) The retention or acquisition of a security interest in the consumer's principal dwelling.

(ii) The consumer's right to rescind the transaction.

(iii) How to exercise the right to rescind, with a form for that purpose, designating the address of the creditor's place of business.

(iv) The effects of rescission, as described in paragraph (d) of this section.

(v) The date the rescission period expires.

(2) *Proper form of notice.* To satisfy the disclosure requirements of paragraph (b)(1) of this section, the creditor shall provide the appropriate model form in Appendix H of this part or a substantially similar notice.

(c) *Delay of creditor's performance.* Unless a consumer waives the right of rescission under paragraph (e) of this section, no money shall be disbursed other than in escrow, no services shall be performed and no materials delivered until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded.

(d) *Effects of rescission.* (1) When a consumer rescinds a transaction, the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge.

(2) Within 20 calendar days after receipt of a notice of rescission, the creditor shall return any money or property that has been given to anyone in connection with the transaction and shall take any action necessary to reflect the termination of the security interest.

(3) If the creditor has delivered any money or property, the consumer may retain possession until the creditor has met its obligation under paragraph (d)(2) of this section. When the creditor has complied with that paragraph, the consumer shall tender the money or property to the creditor or, where the latter would be impracticable or inequitable, tender its reasonable value. At the consumer's option, tender of property may be made at the location of the property or at the consumer's

[47] For purposes of this section, the addition to an existing obligation of a security interest in a consumer's principal dwelling is a transaction. The right of rescission applies only to the addition of the security interest and not the existing obligation. The creditor shall deliver the notice required by paragraph (b) of this section but need not deliver new material disclosures. Delivery of the required notice shall begin the rescission period.

[48] The term ''material disclosures'' means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total payments, the payment schedule, and the disclosures and limitations referred to in § 226.32 (c) and (d).

residence. Tender of money must be made at the creditor's designated place of business. If the creditor does not take possession of the money or property within 20 calendar days after the consumer's tender, the consumer may keep it without further obligation.

(4) The procedures outlined in paragraphs (d) (2) and (3) of this section may be modified by court order.

(e) *Consumer's waiver of right to rescind*. (1) The consumer may modify or waive the right to rescind if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the right to rescind, and bears the signature of all the consumers entitled to rescind. Printed forms for this purpose are prohibited, except as provided in paragraph (e)(2) of this section.

(2) The need of the consumer to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1993, pursuant to 42 U.S.C. 5170, to be a major disaster area because of severe storms and flooding in the Midwest.[48a] In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(3) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during June through September 1994 to be a major disaster area, pursuant to 42 U.S.C. 5170, because of severe storms and flooding in the South.[48b] In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(4) The consumer's need to obtain funds immediately shall be regarded as a bona fide personal financial emergency provided that the dwelling securing the extension of credit is located in an area declared during October 1994 to be a major disaster area, pursuant to 42 U.S.C. 5170, because of severe storms and flooding in Texas.[48c] In this instance, creditors may use printed forms for the consumer to waive the right to rescind. This exemption to paragraph (e)(1) of this section shall expire one year from the date an area was declared a major disaster.

(f) *Exempt transactions*. The right to rescind does not apply to the following:

(1) A residential mortgage transaction.

(2) A refinancing or consolidation by the same creditor of an extension of credit already secured by the consumer's principal dwelling. The right of rescission shall apply, however, to the extent the new amount financed exceeds the unpaid principal balance, any earned unpaid finance charge on the existing debt, and amounts attributed solely to the costs of the refinancing or consolidation.

(3) A transaction in which a state agency is a creditor.

(4) An advance, other than an initial advance, in a series of advances or in a series of single-payment obligations that is treated as a single transaction under § 226.17(c)(6), if the notice required by paragraph (b) of this section and all material disclosures have been given to the consumer.

(5) A renewal of optional insurance premiums that is not considered a refinancing under § 226.20(a)(5).

[48a] A list of the affected areas will be maintained by the Board.

[48b] A list of the affected areas will be maintained and published by the Board. Such areas now include parts of Alabama, Florida, and Georgia.

[48c] A list of the affected areas will be maintained and published by the Board. Such areas now include the following counties in Texas: Angelina, Austin, Bastrop, Brazos, Brazoria, Burleson, Chambers, Fayette, Fort Bend, Galveston, Grimes, Hardin, Harris, Houston, Jackson, Jasper, Jefferson, Lee, Liberty, Madison, Matagorda, Montgomery, Nacagdoches, Orange, Polk, San Augustine, San Jacinto, Shelby, Trinity, Victoria, Washington, Waller, Walker, and Wharton.

(g) *Tolerances for accuracy*—(1) *One-half of 1 percent tolerance.* Except as provided in paragraphs (g)(2) and (h)(2) of this section, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than ½ of 1 percent of the face amount of the note or $100, whichever is greater; or

(ii) is greater than the amount required to be disclosed.

(2) *One percent tolerance.* In a refinancing of a residential mortgage transaction with a new creditor (other than a transaction covered by § 226.32), if there is no new advance and no consolidation of existing loans, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than 1 percent of the face amount of the note or $100, whichever is greater; or

(ii) is greater than the amount required to be disclosed.

(h) *Special rules for foreclosures*—(1) *Right to rescind.* After the initiation of foreclosure on the consumer's principal dwelling that secures the credit obligation, the consumer shall have the right to rescind the transaction if:

(i) A mortgage broker fee that should have been included in the finance charge was not included; or

(ii) The creditor did not provide the properly completed appropriate model form in appendix H of this part, or a substantially similar notice of rescission.

(2) *Tolerance for disclosures.* After the initiation of foreclosure on the consumer's principal dwelling that secures the credit obligation, the finance charge and other disclosures affected by the finance charge (such as the amount financed and the annual percentage rate) shall be considered accurate for purposes of this section if the disclosed finance charge:

(i) is understated by no more than $35; or

(ii) is greater than the amount required to be disclosed.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 51 FR 45299, Dec. 18, 1986; 58 FR 40583, July 29, 1993; 59 FR 40204, Aug. 5, 1994; 59 FR 63715, Dec. 9, 1994; 60 FR 15471, Mar. 24, 1995; 61 FR 49247, Sept. 19, 1996; 66 FR 17338, Mar. 30, 2001; 72 FR 63474, Nov. 9, 2007]

EFFECTIVE DATE NOTE: At 73 FR 44601, July 30, 2008, § 226.23 was amended by revising footnote 48 to paragraph (a)(3) to read ''The term ''material disclosures'' means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule, and the disclosures and limitations referred to in §§ 226.32(c) and (d) and 226.35(b)(2)'', effective Oct. 1, 2009.

## § 226.24 Advertising.

(a) *Actually available terms.* If an advertisement for credit states specific credit terms, it shall state only those terms that actually are or will be arranged or offered by the creditor.

(b) *Advertisement of rate of finance charge.* If an advertisement states a rate of finance charge, it shall state the rate as an ''annual percentage rate,'' using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. The advertisement shall not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate.

(c) *Advertisement of terms that require additional disclosures.* (1) If any of the following terms is set forth in an advertisement, the advertisement shall meet the requirements of paragraph (c)(2) of this section:

(i) The amount or percentage of any downpayment.

(ii) The number of payments or period of repayment.

(iii) The amount of any payment.

(iv) The amount of any finance charge.

(2) An advertisement stating any of the terms in paragraph (c)(1) of this section shall state the following terms,[49] as applicable:

[49] An example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used.

(i) The amount or percentage of the downpayment.

(ii) The terms of repayment.

(iii) The *annual percentage rate*, using that term, and, if the rate may be increased after consummation, that fact.

(d) *Catalogs or other multiple-page advertisements; electronic advertisements*. (1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (c)(2) of this section, it shall be considered a single advertisement if:

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of terms of the credit terms in paragraph (c)(1) of this section appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site) complies with paragraph (c)(2) of this section if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 66 FR 17338, Mar. 30, 2001; 72 FR 63474, Nov. 9, 2007]

EFFECTIVE DATE NOTE: At 73 FR 44601, July 30, 2008, § 226.24 was amended by redesignating paragraphs (b) through (d) as paragraphs (c) through (e), respectively, adding new paragraph (b), revising newly designated paragraphs (c) through (e), removing and reserving footnote 49, and adding new paragraphs (f) through (i), effective Oct. 1, 2009. For the convenience of the user, the added and revised text is set forth as follows:

**§ 226.24 Advertising.**

* * * * *

(b) *Clear and conspicuous standard*. Disclosures required by this section shall be made clearly and conspicuously.

(c) *Advertisement of rate of finance charge*. If an advertisement states a rate of finance charge, it shall state the rate as an ''annual percentage rate,'' using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. If an advertisement is for credit not secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate. If an advertisement is for credit secured by a dwelling, the advertisement shall not state any other rate, except that a simple annual rate that is applied to an unpaid balance may be stated in conjunction with, but not more conspicuously than, the annual percentage rate.

(d) *Advertisement of terms that require additional disclosures*—(1) *Triggering terms*. If any of the following terms is set forth in an advertisement, the advertisement shall meet the requirements of paragraph (d)(2) of this section:

(i) The amount or percentage of any downpayment.

(ii) The number of payments or period of repayment.

(iii) The amount of any payment.

(iv) The amount of any finance charge.

(2) *Additional terms*. An advertisement stating any of the terms in paragraph (d)(1) of this section shall state the following terms,[49] as applicable (an example of one or more typical extensions of credit with a statement of all the terms applicable to each may be used):

(i) The amount or percentage of the downpayment.

(ii) The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment.

(iii) The ''annual percentage rate,'' using that term, and, if the rate may be increased after consummation, that fact.

(e) *Catalogs or other multiple-page advertisements; electronic advertisements*—(1) If a catalog or other multiple-page advertisement, or an electronic advertisement (such as an advertisement appearing on an Internet Web site), gives information in a table or schedule in sufficient detail to permit determination of the disclosures required by paragraph (d)(2) of this section, it shall be considered a single advertisement if—

(i) The table or schedule is clearly and conspicuously set forth; and

(ii) Any statement of the credit terms in paragraph (d)(1) of this section appearing anywhere else in the catalog or advertisement clearly refers to the page or location where the table or schedule begins.

(2) A catalog or other multiple-page advertisement or an electronic advertisement

[49] [Reserved]

(such as an advertisement appearing on an Internet Web site) complies with paragraph (d)(2) of this section if the table or schedule of terms includes all appropriate disclosures for a representative scale of amounts up to the level of the more commonly sold higher-priced property or services offered.

(f) *Disclosure of Rates and Payments in Advertisements for Credit Secured by a Dwelling*—(1) *Scope*. The requirements of this paragraph apply to any advertisement for credit secured by a dwelling, other than television or radio advertisements, including promotional materials accompanying applications.

(2) *Disclosure of rates*—(i) *In general*. If an advertisement for credit secured by a dwelling states a simple annual rate of interest and more than one simple annual rate of interest will apply over the term of the advertised loan, the advertisement shall disclose in a clear and conspicuous manner:

(A) Each simple annual rate of interest that will apply. In variable-rate transactions, a rate determined by adding an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each simple annual rate of interest will apply; and

(C) The annual percentage rate for the loan. If such rate is variable, the annual percentage rate shall comply with the accuracy standards in §§ 226.17(c) and 226.22.

(ii) *Clear and conspicuous requirement*. For purposes of paragraph (f)(2)(i) of this section, clearly and conspicuously disclosed means that the required information in paragraphs (f)(2)(i)(A) through (C) shall be disclosed with equal prominence and in close proximity to any advertised rate that triggered the required disclosures. The required information in paragraph (f)(2)(i)(C) may be disclosed with greater prominence than the other information.

(3) *Disclosure of payments*—(i) *In general*. In addition to the requirements of paragraph (c) of this section, if an advertisement for credit secured by a dwelling states the amount of any payment, the advertisement shall disclose in a clear and conspicuous manner:

(A) The amount of each payment that will apply over the term of the loan, including any balloon payment. In variable-rate transactions, payments that will be determined based on the application of the sum of an index and margin shall be disclosed based on a reasonably current index and margin;

(B) The period of time during which each payment will apply; and

(C) In an advertisement for credit secured by a first lien on a dwelling, the fact that the payments do not include amounts for taxes and insurance premiums, if applicable, and that the actual payment obligation will be greater.

(ii) *Clear and conspicuous requirement*. For purposes of paragraph (f)(3)(i) of this section, a clear and conspicuous disclosure means that the required information in paragraphs (f)(3)(i)(A) and (B) shall be disclosed with equal prominence and in close proximity to any advertised payment that triggered the required disclosures, and that the required information in paragraph (f)(3)(i)(C) shall be disclosed with prominence and in close proximity to the advertised payments.

(4) *Envelope excluded*. The requirements in paragraphs (f)(2) and (f)(3) of this section do not apply to an envelope in which an application or solicitation is mailed, or to a banner advertisement or pop-up advertisement linked to an application or solicitation provided electronically.

(g) *Alternative disclosures—television or radio advertisements*. An advertisement made through television or radio stating any of the terms requiring additional disclosures under paragraph (d)(2) of this section may comply with paragraph (d)(2) of this section either by:

(1) Stating clearly and conspicuously each of the additional disclosures required under paragraph (d)(2) of this section; or

(2) Stating clearly and conspicuously the information required by paragraph (d)(2)(iii) of this section and listing a toll-free telephone number, or any telephone number that allows a consumer to reverse the phone charges when calling for information, along with a reference that such number may be used by consumers to obtain additional cost information.

(h) *Tax implications*. If an advertisement distributed in paper form or through the Internet (rather than by radio or television) is for a loan secured by the consumer's principal dwelling, and the advertisement states that the advertised extension of credit may exceed the fair market value of the dwelling, the advertisement shall clearly and conspicuously state that:

(1) The interest on the portion of the credit extension that is greater than the fair market value of the dwelling is not tax deductible for Federal income tax purposes; and

(2) The consumer should consult a tax adviser for further information regarding the deductibility of interest and charges.

(i) *Prohibited acts or practices in advertisements for credit secured by a dwelling*. The following acts or practices are prohibited in advertisements for credit secured by a dwelling:

(1) *Misleading advertising of ''fixed'' rates and payments*. Using the word ''fixed'' to refer to rates, payments, or the credit transaction in an advertisement for variable-rate transactions or other transactions where the payment will increase, unless:

(i) In the case of an advertisement solely for one or more variable-rate transactions,

(A) The phrase ''Adjustable-Rate Mortgage,'' ''Variable-Rate Mortgage,'' or ''ARM'' appears in the advertisement before the first use of the word ''fixed'' and is at least as

conspicuous as any use of the word ''fixed'' in the advertisement; and

(B) Each use of the word ''fixed'' to refer to a rate or payment is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period;

(ii) In the case of an advertisement solely for non-variable-rate transactions where the payment will increase (*e.g.*, a stepped-rate mortgage transaction with an initial lower payment), each use of the word ''fixed'' to refer to the payment is accompanied by an equally prominent and closely proximate statement of the time period for which the payment is fixed, and the fact that the payment will increase after that period; or

(iii) In the case of an advertisement for both variable-rate transactions and non-variable-rate transactions,

(A) The phrase ''Adjustable-Rate Mortgage,'' ''Variable-Rate Mortgage,'' or ''ARM'' appears in the advertisement with equal prominence as any use of the term ''fixed,'' ''Fixed-Rate Mortgage,'' or similar terms; and

(B) Each use of the word ''fixed'' to refer to a rate, payment, or the credit transaction either refers solely to the transactions for which rates are fixed and complies with paragraph (i)(1)(ii) of this section, if applicable, or, if it refers to the variable-rate transactions, is accompanied by an equally prominent and closely proximate statement of the time period for which the rate or payment is fixed, and the fact that the rate may vary or the payment may increase after that period.

(2) *Misleading comparisons in advertisements.* Making any comparison in an advertisement between actual or hypothetical credit payments or rates and any payment or simple annual rate that will be available under the advertised product for a period less than the full term of the loan, unless:

(i) *In general.* The advertisement includes a clear and conspicuous comparison to the information required to be disclosed under sections 226.24(f)(2) and (3); and

(ii) *Application to variable-rate transactions.* If the advertisement is for a variable-rate transaction, and the advertised payment or simple annual rate is based on the index and margin that will be used to make subsequent rate or payment adjustments over the term of the loan, the advertisement includes an equally prominent statement in close proximity to the payment or rate that the payment or rate is subject to adjustment and the time period when the first adjustment will occur.

(3) *Misrepresentations about government endorsement.* Making any statement in an advertisement that the product offered is a ''government loan program'', ''government-supported loan'', or is otherwise endorsed or sponsored by any federal, state, or local government entity, unless the advertisement is for an FHA loan, VA loan, or similar loan program that is, in fact, endorsed or sponsored by a federal, state, or local government entity.

(4) *Misleading use of the current lender's name.* Using the name of the consumer's current lender in an advertisement that is not sent by or on behalf of the consumer's current lender, unless the advertisement:

(i) Discloses with equal prominence the name of the person or creditor making the advertisement; and

(ii) Includes a clear and conspicuous statement that the person making the advertisement is not associated with, or acting on behalf of, the consumer's current lender.

(5) *Misleading claims of debt elimination.* Making any misleading claim in an advertisement that the mortgage product offered will eliminate debt or result in a waiver or forgiveness of a consumer's existing loan terms with, or obligations to, another creditor.

(6) *Misleading use of the term ''counselor''.* Using the term ''counselor'' in an advertisement to refer to a for-profit mortgage broker or mortgage creditor, its employees, or persons working for the broker or creditor that are involved in offering, originating or selling mortgages.

(7) *Misleading foreign-language advertisements.* Providing information about some trigger terms or required disclosures, such as an initial rate or payment, only in a foreign language in an advertisement, but providing information about other trigger terms or required disclosures, such as information about the fully-indexed rate or fully amortizing payment, only in English in the same advertisement.

## Subpart D—Miscellaneous

### § 226.25 Record retention.

(a) *General rule.* A creditor shall retain evidence of compliance with this regulation (other than advertising requirements under §§ 226.16 and 226.24) for 2 years after the date disclosures are required to be made or action is required to be taken. The administrative agencies responsible for enforcing the regulation may require creditors under their jurisdictions to retain records for a longer period if necessary to carry out their enforcement responsibilities under section 108 of the act.

(b) *Inspection of records.* A creditor shall permit the agency responsible for enforcing this regulation with respect to that creditor to inspect its relevant records for compliance.

### § 226.26 Use of annual percentage rate in oral disclosures.

(a) *Open-end credit.* In an oral response to a consumer's inquiry about the cost of open-end credit, only the annual percentage rate or rates shall be stated, except that the periodic rate or rates also may be stated. If the annual percentage rate cannot be determined in advance because there are finance charges other than a periodic rate, the corresponding annual percentage rate shall be stated, and other cost information may be given.

(b) *Closed-end credit.* In an oral response to a consumer's inquiry about the cost of closed-end credit, only the annual percentage rate shall be stated, except that a simple annual rate or periodic rate also may be stated if it is applied to an unpaid balance. If the annual percentage rate cannot be determined in advance, the annual percentage rate for a sample transaction shall be stated, and other cost information for the consumer's specific transaction may be given.

### § 226.27 Language of disclosures.

Disclosures required by this regulation may be made in a language other than English, provided that the disclosures are made available in English upon the consumer's request. This requirement for providing English disclosures on request does not apply to advertisements subject to §§ 226.16 and 226.24.

[66 FR 17339, Mar. 30, 2001]

### § 226.28 Effect on State laws.

(a) *Inconsistent disclosure requirements.* (1) Except as provided in paragraph (d) of this section, State law requirements that are inconsistent with the requirements contained in chapter 1 (General Provisions), chapter 2 (Credit Transactions), or chapter 3 (Credit Advertising) of the act and the implementing provisions of this regulation are preempted to the extent of the inconsistency. A State law is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law. A State law is contradictory if it requires the use of the same term to represent a different amount or a different meaning than the Federal law, or if it requires the use of a term different from that required in the Federal law to describe the same item. A creditor, State, or other interested party may request the Board to determine whether a State law requirement is inconsistent. After the Board determines that a State law is inconsistent, a creditor may not make disclosures using the inconsistent term or form.

(2)(i) State law requirements are inconsistent with the requirements contained in sections 161 (Correction of billing errors) or 162 (Regulation of credit reports) of the Act and the implementing provisions of this regulation and are preempted if they provide rights, responsibilities, or procedures for consumers or creditors that are different from those required by the Federal law. However, a State law that allows a consumer to inquire about an open-end credit account and imposes on the creditor an obligation to respond to such inquiry after the time allowed in the Federal law for the consumer to submit written notice of a billing error shall not be preempted in any situation where the time period for making written notice under this regulation has expired. If a creditor gives written notice of a consumer's rights under such State law, the notice shall state that reliance on the longer time period available under State law may result in the loss of important rights that could be preserved by acting more promptly under Federal law; it shall also explain that the State law provisions apply only after expiration of the time period for submitting a proper written notice of a billing error under the Federal law. If the State disclosures are made on the same side of a page as the required Federal disclosures, the State disclosures shall appear under a demarcation line below the Federal disclosures, and the Federal disclosures shall be identified by a heading indicating that they are made in compliance with Federal law.

(ii) State law requirements are inconsistent with the requirements contained in chapter 4 (Credit billing) of the Act (other than section 161 or 162) and the implementing provisions of this regulation and are preempted if

the creditor cannot comply with State law without violating Federal law.

(iii) A State may request the Board to determine whether its law is inconsistent with chapter 4 of the Act and its implementing provisions.

(b) *Equivalent disclosure requirements.* If the Board determines that a disclosure required by state law (other than a requirement relating to the finance charge, annual percentage rate, or the disclosures required under § 226.32) is substantially the same in meaning as a disclosure required under the act or this regulation, creditors in that state may make the state disclosure in lieu of the federal disclosure. A creditor, State, or other interested party may request the Board to determine whether a State disclosure is substantially the same in meaning as a Federal disclosure.

(c) *Request for determination.* The procedures under which a request for a determination may be made under this section are set forth in appendix A.

(d) *Special rule for credit and charge cards.* State law requirements relating to the disclosure of credit information in any credit or charge card application or solicitation that is subject to the requirements of section 127(c) of chapter 2 of the act (§ 226.5a of the regulation) or in any renewal notice for a credit or charge card that is subject to the requirements of section 127(d) of chapter 2 of the act (§ 226.9(e) of the regulation) are preempted. State laws relating to the enforcement of section 127 (c) and (d) of the act are not preempted.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 54 FR 13867, Apr. 6, 1989; 54 FR 32954, Aug. 11, 1989; 60 FR 15471, Mar. 24, 1995]

### § 226.29 State exemptions.

(a) *General rule.* Any State may apply to the Board to exempt a class of transactions within the State from the requirements of chapter 2 (Credit transactions) or chapter 4 (Credit billing) of the Act and the corresponding provisions of this regulation. The Board shall grant an exemption if it determines that:

(1) The State law is substantially similar to the Federal law or, in the case of chapter 4, affords the consumer greater protection than the Federal law; and

(2) There is adequate provision for enforcement.

(b) *Civil liability.* (1) No exemptions granted under this section shall extend to the civil liability provisions of sections 130 and 131 of the Act.

(2) If an exemption has been granted, the disclosures required by the applicable State law (except any additional requirements not imposed by Federal law) shall constitute the disclosures required by this Act.

(c) *Applications.* The procedures under which a State may apply for an exemption under this section are set forth in appendix B.

[46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981]

### § 226.30 Limitation on rates.

A creditor shall include in any consumer credit contract secured by a dwelling and subject to the act and this regulation the maximum interest rate that may be imposed during the term of the obligation[50] when:

(a) In the case of closed-end credit, the annual percentage rate may increase after consummation, or

(b) In the case of open-end credit, the annual percentage rate may increase during the plan.

[52 FR 43181, Nov. 9, 1987]

## Subpart E—Special Rules for Certain Home Mortgage Transactions

SOURCE: Reg. Z, 60 FR 15471, Mar. 24, 1995, unless otherwise noted.

### § 226.31 General rules.

(a) *Relation to other subparts in this part.* The requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of this part.

(b) *Form of disclosures.* The creditor shall make the disclosures required by this subpart clearly and conspicuously

[50] Compliance with this section will constitute compliance with the disclosure requirements on limitations on increases in footnote 12 to §§ 226.6(a)(2) and 226.18(f)(2) until October 1, 1988.

in writing, in a form that the consumer may keep. The disclosures required by this subpart may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. § 7001 *et seq.*).

(c) *Timing of disclosure*—(1) *Disclosures for certain closed-end home mortgages.* The creditor shall furnish the disclosures required by § 226.32 at least three business days prior to consummation of a mortgage transaction covered by § 226.32.

(i) *Change in terms.* After complying with paragraph (c)(1) of this section and prior to consummation, if the creditor changes any term that makes the disclosures inaccurate, new disclosures shall be provided in accordance with the requirements of this subpart.

(ii) *Telephone disclosures.* A creditor may provide new disclosures by telephone if the consumer initiates the change and if, at consummation:

(A) The creditor provides new written disclosures; and

(B) The consumer and creditor sign a statement that the new disclosures were provided by telephone at least three days prior to consummation.

(iii) *Consumer's waiver of waiting period before consummation.* The consumer may, after receiving the disclosures required by paragraph (c)(1) of this section, modify or waive the three-day waiting period between delivery of those disclosures and consummation if the consumer determines that the extension of credit is needed to meet a bona fide personal financial emergency. To modify or waive the right, the consumer shall give the creditor a dated written statement that describes the emergency, specifically modifies or waives the waiting period, and bears the signature of all the consumers entitled to the waiting period. Printed forms for this purpose are prohibited, except when creditors are permitted to use printed forms pursuant to § 226.23(e)(2).

(2) *Disclosures for reverse mortgages.* The creditor shall furnish the disclosures required by § 226.33 at least three business days prior to:

(i) Consummation of a closed-end credit transaction; or

(ii) The first transaction under an open-end credit plan.

(d) *Basis of disclosures and use of estimates*—(1) *Legal Obligation.* Disclosures shall reflect the terms of the legal obligation between the parties.

(2) *Estimates.* If any information necessary for an accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available at the time the disclosure is provided, and shall state clearly that the disclosure is an estimate.

(3) *Per-diem interest.* For a transaction in which a portion of the interest is determined on a per-diem basis and collected at consummation, any disclosure affected by the per-diem interest shall be considered accurate if the disclosure is based on the information known to the creditor at the time that the disclosure documents are prepared.

(e) *Multiple creditors; multiple consumers.* If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor must comply with the requirements that this part imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable under § 226.15 or § 226.23, however, the disclosures shall be made to each consumer who has the right to rescind.

(f) *Effect of subsequent events.* If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of Regulation Z (12 CFR part 226), although new disclosures may be required for mortgages covered by § 226.32 under paragraph (c) of this section, § 226.9(c), § 226.19, or § 226.20.

(g) *Accuracy of annual percentage rate.* For purposes of § 226.32, the annual percentage rate shall be considered accurate, and may be used in determining whether a transaction is covered by § 226.32, if it is accurate according to the requirements and within the tolerances under § 226.22. The finance charge tolerances for rescission under

§ 226.23(g) or (h) shall not apply for this purpose.

[Reg. Z, 60 FR 15471, Mar. 24, 1995, as amended at 60 FR 29969, June 7, 1995; 61 FR 49247, Sept. 19, 1996; 66 FR 17339, Mar. 30, 2001; 72 FR 63475, Nov. 9, 2007]

### § 226.32 Requirements for certain closed-end home mortgages.

(a) *Coverage*. (1) Except as provided in paragraph (a)(2) of this section, the requirements of this section apply to a consumer credit transaction that is secured by the consumer's principal dwelling, and in which either:

(i) The annual percentage rate at consummation will exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on Treasury securities having comparable periods of maturity to the loan maturity as of the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

(ii) The total points and fees payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount, or $400; the $400 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1.

(2) This section does not apply to the following:

(i) A residential mortgage transaction.

(ii) A reverse mortgage transaction subject to § 226.33.

(iii) An open-end credit plan subject to subpart B of this part.

(b) *Definitions*. For purposes of this subpart, the following definitions apply:

(1) For purposes of paragraph (a)(1)(ii) of this section, *points and fees* means:

(i) All items required to be disclosed under § 226.4(a) and 226.4(b), except interest or the time-price differential;

(ii) All compensation paid to mortgage brokers;

(iii) All items listed in § 226.4(c)(7) (other than amounts held for future payment of taxes) unless the charge is reasonable, the creditor receives no direct or indirect compensation in connection with the charge, and the charge is not paid to an affiliate of the creditor; and

(iv) Premiums or other charges for credit life, accident, health, or loss-of-income insurance, or debt-cancellation coverage (whether or not the debt-cancellation coverage is insurance under applicable law) that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income or in the case of accident, written in connection with the credit transaction.

(2) *Affiliate* means any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.).

(c) *Disclosures*. In addition to other disclosures required by this part, in a mortgage subject to this section, the creditor shall disclose the following in conspicuous type size:

(1) *Notices*. The following statement: ''You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.''

(2) *Annual percentage rate*. The annual percentage rate.

(3) *Regular payment; balloon payment*. The amount of the regular monthly (or other periodic) payment and the amount of any balloon payment. The regular payment disclosed under this paragraph shall be treated as accurate if it is based on an amount borrowed that is deemed accurate and is disclosed under paragraph (c)(5) of this section.

(4) *Variable-rate*. For variable-rate transactions, a statement that the interest rate and monthly payment may increase, and the amount of the single maximum monthly payment, based on the maximum interest rate required to be disclosed under § 226.30.

(5) *Amount borrowed*. For a mortgage refinancing, the total amount the consumer will borrow, as reflected by the face amount of the note; and where the

amount borrowed includes premiums or other charges for optional credit insurance or debt-cancellation coverage, that fact shall be stated, grouped together with the disclosure of the amount borrowed. The disclosure of the amount borrowed shall be treated as accurate if it is not more than $100 above or below the amount required to be disclosed.

(d) *Limitations.* A mortgage transaction subject to this section shall not include the following terms:

(1)(i) *Balloon payment.* For a loan with a term of less than five years, a payment schedule with regular periodic payments that when aggregated do not fully amortize the outstanding principal balance.

(ii) *Exception.* The limitations in paragraph (d)(1)(i) of this section do not apply to loans with maturities of less than one year, if the purpose of the loan is a ''bridge'' loan connected with the acquisition or construction of a dwelling intended to become the consumer's principal dwelling.

(2) *Negative amortization.* A payment schedule with regular periodic payments that cause the principal balance to increase.

(3) *Advance payments.* A payment schedule that consolidates more than two periodic payments and pays them in advance from the proceeds.

(4) *Increased interest rate.* An increase in the interest rate after default.

(5) *Rebates.* A refund calculated by a method less favorable than the actuarial method (as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d)), for rebates of interest arising from a loan acceleration due to default.

(6) *Prepayment penalties.* Except as allowed under paragraph (d)(7) of this section, a penalty for paying all or part of the principal before the date on which the principal is due. A prepayment penalty includes computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992.

(7) *Prepayment penalty exception.* A mortgage transaction subject to this section may provide for a prepayment penalty otherwise permitted by law (including a refund calculated according to the rule of 78s) if:

(i) The penalty can be exercised only for the first five years following consummation;

(ii) The source of the prepayment funds is not a refinancing by the creditor or an affiliate of the creditor; and

(iii) At consummation, the consumer's total monthly debts (including amounts owed under the mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified by the consumer's signed financial statement, a credit report, and payment records for employment income.

(8) *Due-on-demand clause.* A demand feature that permits the creditor to terminate the loan in advance of the original maturity date and to demand repayment of the entire outstanding balance, except in the following circumstances:

(i) There is fraud or material misrepresentation by the consumer in connection with the loan;

(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance; or

(iii) There is any action or inaction by the consumer that adversely affects the creditor's security for the loan, or any right of the creditor in such security.

[Reg. Z, 60 FR 15472, Mar. 24, 1995, as amended at 60 FR 29969, June 7, 1995; 66 FR 65617, Dec. 20, 2001]

EFFECTIVE DATE NOTE: At 73 FR 44602, July 30, 2008, § 226.32 was amended by revising paragraphs (d)(6) and (7), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

**§ 226.32 Requirements for certain closed-end home mortgages.**

* * * * *

(d) * * *

(6) *Prepayment penalties.* Except as allowed under paragraph (d)(7) of this section, a penalty for paying all or part of the principal before the date on which the principal is due. A prepayment penalty includes computing a refund of unearned interest by a method that is less favorable to the consumer than the actuarial method, as defined by section 933(d) of the Housing and Community Development Act of 1992, 15 U.S.C. 1615(d).

(7) *Prepayment penalty exception.* A mortgage transaction subject to this section may

provide for a prepayment penalty (including a refund calculated according to the rule of 78s) otherwise permitted by law if, under the terms of the loan:

(i) The penalty will not apply after the two-year period following consummation;

(ii) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor;

(iii) At consummation, the consumer's total monthly debt payments (including amounts owed under the mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified in accordance with § 226.34(a)(4)(ii); and

(iv) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

* * * * *

**§ 226.33 Requirements for reverse mortgages.**

(a) *Definition*. For purposes of this subpart, *reverse mortgage transaction* means a nonrecourse consumer credit obligation in which:

(1) A mortgage, deed of trust, or equivalent consensual security interest securing one or more advances is created in the consumer's principal dwelling; and

(2) Any principal, interest, or shared appreciation or equity is due and payable (other than in the case of default) only after:

(i) The consumer dies;

(ii) The dwelling is transferred; or

(iii) The consumer ceases to occupy the dwelling as a principal dwelling.

(b) *Content of disclosures*. In addition to other disclosures required by this part, in a reverse mortgage transaction the creditor shall provide the following disclosures in a form substantially similar to the model form found in paragraph (d) of appendix K of this part:

(1) *Notice*. A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because the consumer has received the disclosures required by this section or has signed an application for a reverse mortgage loan.

(2) *Total annual loan cost rates*. A good-faith projection of the total cost of the credit, determined in accordance with paragraph (c) of this section and expressed as a table of ''total annual loan cost rates,'' using that term, in accordance with appendix K of this part.

(3) *Itemization of pertinent information*. An itemization of loan terms, charges, the age of the youngest borrower and the appraised property value.

(4) *Explanation of table*. An explanation of the table of total annual loan cost rates as provided in the model form found in paragraph (d) of appendix K of this part.

(c) *Projected total cost of credit*. The projected total cost of credit shall reflect the following factors, as applicable:

(1) *Costs to consumer*. All costs and charges to the consumer, including the costs of any annuity the consumer purchases as part of the reverse mortgage transaction.

(2) *Payments to consumer*. All advances to and for the benefit of the consumer, including annuity payments that the consumer will receive from an annuity that the consumer purchases as part of the reverse mortgage transaction.

(3) *Additional creditor compensation*. Any shared appreciation or equity in the dwelling that the creditor is entitled by contract to receive.

(4) *Limitations on consumer liability*. Any limitation on the consumer's liability (such as nonrecourse limits and equity conservation agreements).

(5) *Assumed annual appreciation rates*. Each of the following assumed annual appreciation rates for the dwelling:

(i) 0 percent.

(ii) 4 percent.

(iii) 8 percent.

(6) *Assumed loan period*. (i) Each of the following assumed loan periods, as provided in appendix L of this part:

(A) Two years.

(B) The actuarial life expectancy of the consumer to become obligated on the reverse mortgage transaction (as of that consumer's most recent birthday). In the case of multiple consumers, the period shall be the actuarial life expectancy of the youngest consumer (as of that consumer's most recent birthday).

(C) The actuarial life expectancy specified by paragraph (c)(6)(i)(B) of this section, multiplied by a factor of

1.4 and rounded to the nearest full year.

(ii) At the creditor's option, the actuarial life expectancy specified by paragraph (c)(6)(i)(B) of this section, multiplied by a factor of .5 and rounded to the nearest full year.

### § 226.34 Prohibited acts or practices in connection with credit secured by a consumer's dwelling.

(a) *Prohibited acts or practices for loans subject to § 226.32.* A creditor extending mortgage credit subject to § 226.32 shall not—

(1) *Home improvement contracts.* Pay a contractor under a home improvement contract from the proceeds of a mortgage covered by § 226.32, other than:

(i) By an instrument payable to the consumer or jointly to the consumer and the contractor; or

(ii) At the election of the consumer, through a third-party escrow agent in accordance with terms established in a written agreement signed by the consumer, the creditor, and the contractor prior to the disbursement.

(2) *Notice to assignee.* Sell or otherwise assign a mortgage subject to § 226.32 without furnishing the following statement to the purchaser or assignee: ''Notice: This is a mortgage subject to special rules under the federal Truth in Lending Act. Purchasers or assignees of this mortgage could be liable for all claims and defenses with respect to the mortgage that the borrower could assert against the creditor.''

(3) *Refinancings within one-year period.* Within one year of having extended credit subject to § 226.32, refinance any loan subject to § 226.32 to the same borrower into another loan subject to § 226.32, unless the refinancing is in the borrower's interest. An assignee holding or servicing an extension of mortgage credit subject to § 226.32, shall not, for the remainder of the one-year period following the date of origination of the credit, refinance any loan subject to § 226.32 to the same borrower into another loan subject to § 226.32, unless the refinancing is in the borrower's interest. A creditor (or assignee) is prohibited from engaging in acts or practices to evade this provision, including a pattern or practice of arranging for the refinancing of its own loans by affiliated or unaffiliated creditors, or modifying a loan agreement (whether or not the existing loan is satisfied and replaced by the new loan) and charging a fee.

(4) *Repayment ability.* Engage in a pattern or practice of extending credit subject to § 226.32 to a consumer based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment. There is a presumption that a creditor has violated this paragraph (a)(4) if the creditor engages in a pattern or practice of making loans subject to § 226.32 without verifying and documenting consumers' repayment ability.

(b) *Prohibited acts or practices for dwelling-secured loans; open-end credit.* In connection with credit secured by the consumer's dwelling that does not meet the definition in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of § 226.32.

[Reg. Z, 66 FR 65618, Dec. 20, 2001]

EFFECTIVE DATE NOTE: At 73 FR 44603, July 30, 2008, § 226.34 was amended by revising the heading and paragraph (a)(4), effective Oct. 1, 2009. For the convenience of the user, the revised text is set forth as follows:

### § 226.34 Prohibited acts or practices in connection with credit subject to § 226.32.

(a) * * *

(4) *Repayment ability.* Extend credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations.

(i) *Mortgage-related obligations.* For purposes of this paragraph (a)(4), mortgage-related obligations are expected property taxes, premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), and similar expenses.

(ii) *Verification of repayment ability.* Under this paragraph (a)(4) a creditor must verify the consumer's repayment ability as follows:

(A) A creditor must verify amounts of income or assets that it relies on to determine repayment ability, including expected income or assets, by the consumer's Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or

other third-party documents that provide reasonably reliable evidence of the consumer's income or assets.

(B) Notwithstanding paragraph (a)(4)(ii)(A), a creditor has not violated paragraph (a)(4)(ii) if the amounts of income and assets that the creditor relied upon in determining repayment ability are not materially greater than the amounts of the consumer's income or assets that the creditor could have verified pursuant to paragraph (a)(4)(ii)(A) at the time the loan was consummated.

(C) A creditor must verify the consumer's current obligations.

(iii) *Presumption of compliance.* A creditor is presumed to have complied with this paragraph (a)(4) with respect to a transaction if the creditor:

(A) Verifies the consumer's repayment ability as provided in paragraph (a)(4)(ii);

(B) Determines the consumer's repayment ability using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations and mortgage-related obligations as defined in paragraph (a)(4)(i); and

(C) Assesses the consumer's repayment ability taking into account at least one of the following: The ratio of total debt obligations to income, or the income the consumer will have after paying debt obligations.

(iv) *Exclusions from presumption of compliance.* Notwithstanding the previous paragraph, no presumption of compliance is available for a transaction for which:

(A) The regular periodic payments for the first seven years would cause the principal balance to increase; or

(B) The term of the loan is less than seven years and the regular periodic payments when aggregated do not fully amortize the outstanding principal balance.

(v) *Exemption.* This paragraph (a)(4) does not apply to temporary or ''bridge'' loans with terms of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months.

* * * * *

### § 226.35 Prohibited acts or practices in connection with higher-priced mortgage loans.

(a) *Higher-priced mortgage loans*—(1) For purposes of this section, a higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling.

(2) ''Average prime offer rate'' means an annual percentage rate that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Board publishes average prime offer rates for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Board uses to derive these rates.

(3) Notwithstanding paragraph (a)(1) of this section, the term ''higher-priced mortgage loan'' does not include a transaction to finance the initial construction of a dwelling, a temporary or ''bridge'' loan with a term of twelve months or less, such as a loan to purchase a new dwelling where the consumer plans to sell a current dwelling within twelve months, a reverse-mortgage transaction subject to § 226.33, or a home equity line of credit subject to § 226.5b.

(b) *Rules for higher-priced mortgage loans.* Higher-priced mortgage loans are subject to the following restrictions:

(1) *Repayment ability.* A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 226.34(a)(4).

(2) *Prepayment penalties.* A loan may not include a penalty described by § 226.32(d)(6) unless:

(i) The penalty is otherwise permitted by law, including § 226.32(d)(7) if the loan is a mortgage transaction described in § 226.32(a); and

(ii) Under the terms of the loan—

(A) The penalty will not apply after the two-year period following consummation;

(B) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor; and

(C) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

(3) *Escrows*—(i) *Failure to escrow for property taxes and insurance*. Except as provided in paragraph (b)(3)(ii) of this section, a creditor may not extend a loan secured by a first lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss.

(ii) *Exemptions for loans secured by shares in a cooperative and for certain condominium units*—(A) Escrow accounts need not be established for loans secured by shares in a cooperative; and

(B) Insurance premiums described in paragraph (b)(3)(i) of this section need not be included in escrow accounts for loans secured by condominium units, where the condominium association has an obligation to the condominium unit owners to maintain a master policy insuring condominium units.

(iii) *Cancellation*. A creditor or servicer may permit a consumer to cancel the escrow account required in paragraph (b)(3)(i) of this section only in response to a consumer's dated written request to cancel the escrow account that is received no earlier than 365 days after consummation.

(iv) *Definition of escrow account*. For purposes of this section, ''escrow account'' shall have the same meaning as in 24 CFR 3500.17(b) as amended.

(4) *Evasion; open-end credit*. In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

[Reg. Z, 73 FR 44603, July 30, 2008]

EFFECTIVE DATE NOTE: By Reg. Z, 73 FR 44603, July 30, 2008, § 226.35 was added, effective October 1, 2009, except for (b)(3) which is effective on April 1, 2010.

## § 226.36 Prohibited acts or practices in connection with credit secured by a consumer's principal dwelling.

(a) *Mortgage broker defined*. For purposes of this section, the term ''mortgage broker'' means a person, other than an employee of a creditor, who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person. The term includes a person meeting this definition, even if the consumer credit obligation is initially payable to such person, unless the person provides the funds for the transaction at consummation out of the person's own resources, out of deposits held by the person, or by drawing on a bona fide warehouse line of credit.

(b) *Misrepresentation of value of consumer's dwelling*—(1) *Coercion of appraiser*. In connection with a consumer credit transaction secured by a consumer's principal dwelling, no creditor or mortgage broker, and no affiliate of a creditor or mortgage broker shall directly or indirectly coerce, influence, or otherwise encourage an appraiser to misstate or misrepresent the value of such dwelling.

(i) Examples of actions that violate this paragraph (b)(1) include:

(A) Implying to an appraiser that current or future retention of the appraiser depends on the amount at which the appraiser values a consumer's principal dwelling;

(B) Excluding an appraiser from consideration for future engagement because the appraiser reports a value of a consumer's principal dwelling that does not meet or exceed a minimum threshold;

(C) Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan;

(D) Failing to compensate an appraiser because the appraiser does not value a consumer's principal dwelling at or above a certain amount; and

(E) Conditioning an appraiser's compensation on loan consummation.

(ii) Examples of actions that do not violate this paragraph (b)(1) include:

(A) Asking an appraiser to consider additional information about a consumer's principal dwelling or about comparable properties;

(B) Requesting that an appraiser provide additional information about the basis for a valuation;

(C) Requesting that an appraiser correct factual errors in a valuation;

(D) Obtaining multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value;

(E) Withholding compensation from an appraiser for breach of contract or substandard performance of services as provided by contract; and

(F) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

(2) *When extension of credit prohibited.* In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of paragraph (b)(1) of this section in connection with an appraisal shall not extend credit based on such appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

(3) *Appraiser defined.* As used in this paragraph (b), an appraiser is a person who engages in the business of providing assessments of the value of dwellings. The term ''appraiser'' includes persons that employ, refer, or manage appraisers and affiliates of such persons.

(c) *Servicing practices.* (1) In connection with a consumer credit transaction secured by a consumer's principal dwelling, no servicer shall—

(i) Fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, or except as provided in paragraph (c)(2) of this section;

(ii) Impose on the consumer any late fee or delinquency charge in connection with a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within any applicable grace period; or

(iii) Fail to provide, within a reasonable time after receiving a request from the consumer or any person acting on behalf of the consumer, an accurate statement of the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

(2) If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.

(3) For purposes of this paragraph (c), the terms ''servicer'' and ''servicing'' have the same meanings as provided in 24 CFR 3500.2(b), as amended.

(d) This section does not apply to a home equity line of credit subject to § 226.5b.

[Reg. Z, 73 FR 44604, July 30, 2008]

EFFECTIVE DATE NOTE: By Reg. Z, 73 FR 44604, July 30, 2008, § 226.36 was added, effective October 1, 2009.

## APPENDIX A TO PART 226—EFFECT ON STATE LAWS

### REQUEST FOR DETERMINATION

A request for a determination that a State law is inconsistent or that a State law is substantially the same as the Act and regulation shall be in writing and addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. The request shall be made pursuant to the procedures herein and the Board's Rules of Procedure (12 CFR Part 262).

### SUPPORTING DOCUMENTS

A request for a determination shall include the following items:

(1) The text of the State statute, regulation, or other document that is the subject of the request.

(2) Any other statute, regulation, or judicial or administrative opinion that implements, interprets, or applies the relevant provision.

(3) A comparison of the State law with the corresponding provision of the Federal law, including a full discussion of the basis for

the requesting party's belief that the State provision is either inconsistent or substantially the same.

(4) Any other information that the requesting party believes may assist the Board in its determination.

PUBLIC NOTICE OF DETERMINATION

Notice that the Board intends to make a determination (either on request or on its own motion) will be published in the FEDERAL REGISTER, with an opportunity for public comment, unless the Board finds that notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest and publishes its reasons for such decision.

Subject to the Board's Rules Regarding Availability of Information (12 CFR Part 261), all requests made, including any documents and other material submitted in support of the requests, will be made available for public inspection and copying.

NOTICE AFTER DETERMINATION

Notice of a final determination will be published in the FEDERAL REGISTER, and the Board will furnish a copy of such notice to the party who made the request and to the appropriate State official.

*Reversal of Determination*

The Board reserves the right to reverse a determination for any reason bearing on the coverage or effect of State or Federal law.

Notice of reversal of a determination will be published in the FEDERAL REGISTER and a copy furnished to the appropriate State official.

[Reg. Z, 46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981]

## APPENDIX B TO PART 226—STATE EXEMPTIONS

APPLICATION

Any State may apply to the Board for a determination that a class of transactions subject to State law is exempt from the requirements of the Act and this regulation. An application shall be in writing and addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, and shall be signed by the appropriate State official. The application shall be made pursuant to the procedures herein and the Board's Rules of Procedure (12 CFR Part 262).

SUPPORTING DOCUMENTS

An application shall be accompanied by:

(1) The text of the State statute or regulation that is the subject of the application, and any other statute, regulation, or judicial or administrative opinion that implements, interprets, or applies it.

(2) A comparison of the State law with the corresponding provisions of the Federal law.

(3) The text of the State statute or regulation that provides for civil and criminal liability and administrative enforcement of the State law.

(4) A statement of the provisions for enforcement, including an identification of the State office that administers the relevant law, information on the funding and the number and qualifications of personnel engaged in enforcement, and a description of the enforcement procedures to be followed, including information on examination procedures, practices, and policies. If an exemption application extends to federally chartered institutions, the applicant must furnish evidence that arrangements have been made with the appropriate Federal agencies to ensure adequate enforcement of State law in regard to such creditors.

(5) A statement of reasons to support the applicant's claim that an exemption should be granted.

PUBLIC NOTICE OF APPLICATION

Notice of an application will be published, with an opportunity for public comment, in the FEDERAL REGISTER, unless the Board finds that notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest and publishes its reasons for such decision.

Subject to the Board's Rules Regarding Availability of Information (12 CFR Part 261), all applications made, including any documents and other material submitted in support of the applications, will be made available for public inspection and copying. A copy of the application also will be made available at the Federal Reserve Bank of each district in which the applicant is situated.

FAVORABLE DETERMINATION

If the Board determines on the basis of the information before it that an exemption should be granted, notice of the exemption will be published in the FEDERAL REGISTER, and a copy furnished to the applicant and to each Federal official responsible for administrative enforcement.

The appropriate State official shall inform the Board within 30 days of any change in its relevant law or regulations. The official shall file with the Board such periodic reports as the Board may require.

The Board will inform the appropriate State official of any subsequent amendments to the Federal law, regulation, interpretations, or enforcement policies that might require an amendment to State law, regulation, interpretations, or enforcement procedures.

ADVERSE DETERMINATION

If the Board makes an initial determination that an exemption should not be granted, the Board will afford the applicant a reasonable opportunity to demonstrate further that an exemption is proper. If the Board ultimately finds that an exemption should not be granted, notice of an adverse determination will be published in the FEDERAL REGISTER and a copy furnished to the applicant.

REVOCATION OF EXEMPTION

The Board reserves the right to revoke an exemption if at any time it determines that the standards required for an exemption are not met.

Before taking such action, the Board will notify the appropriate State official of its intent, and will afford the official such opportunity as it deems appropriate in the circumstances to demonstrate that revocation is improper. If the Board ultimately finds that revocation is proper, notice of the Board's intention to revoke such exemption will be published in the FEDERAL REGISTER with a reasonable period of time for interested persons to comment.

Notice of revocation of an exemption will be published in the FEDERAL REGISTER. A copy of such notice will be furnished to the appropriate State official and to the Federal officials responsible for enforcement. Upon revocation of an exemption, creditors in that State shall then be subject to the requirements of the Federal law.

## APPENDIX C TO PART 226—ISSUANCE OF STAFF INTERPRETATIONS

OFFICIAL STAFF INTERPRETATIONS

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this regulation. These interpretations provide the protection afforded under section 130(f) of the Act. Except in unusual circumstances, such interpretations will not be issued separately but will be incorporated in an official commentary to the regulation which will be amended periodically.

REQUESTS FOR ISSUANCE OF OFFICIAL STAFF INTERPRETATIONS

A request for an official staff interpretation shall be in writing and addressed to the Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551. The request shall contain a complete statement of all relevant facts concerning the issue, including copies of all pertinent documents.

SCOPE OF INTERPRETATIONS

No staff interpretations will be issued approving creditors' forms, statements, or calculation tools or methods. This restriction does not apply to forms, statements, tools, or methods whose use is required or sanctioned by a government agency.

## APPENDIX D TO PART 226—MULTIPLE ADVANCE CONSTRUCTION LOANS

Section 226.17(c)(6) permits creditors to treat multiple advance loans to finance construction of a dwelling that may be permanently financed by the same creditor either as a single transaction or as more than one transaction. If the actual schedule of advances is not known, the following methods may be used to estimate the interest portion of the finance charge and the annual percentage rate and to make disclosures. If the creditor chooses to disclose the construction phase separately, whether interest is payable periodically or at the end of construction, part I may be used. If the creditor chooses to disclose the construction and the permanent financing as one transaction, part II may be used.

*Part I—Construction Period Disclosed Separately*

A. If interest is payable only on the amount actually advanced for the time it is outstanding:

1. Estimated interest—Assume that one-half of the commitment amount is outstanding at the contract interest rate for the entire construction period.

2. Estimated annual percentage rate—Assume a single payment loan that matures at the end of the construction period. The finance charge is the sum of the estimated interest and any prepaid finance charge. The amount financed for computation purposes is determined by subtracting any prepaid finance charge from one-half of the commitment amount.

3. Repayment schedule—The number and amounts of any interest payments may be omitted in disclosing the payment schedule under §226.18(g). The fact that interest payments are required and the timing of such payments shall be disclosed.

4. Amount financed—The amount financed for disclosure purposes is the entire commitment amount less any prepaid finance charge.

B. If interest is payable on the entire commitment amount without regard to the dates or amounts of actual disbursement:

1. Estimated interest—Assume that the entire commitment amount is outstanding at the contract interest rate for the entire construction period.

2. Estimated annual percentage rate—Assume a single payment loan that matures at

the end of the construction period. The finance charge is the sum of the estimated interest and any prepaid finance charge. The amount financed for computation purposes is determined by subtracting any prepaid finance charge from one-half of the commitment amount.

3. Repayment schedule—Interest payments shall be disclosed in making the repayment schedule disclosure under §226.18(g).

4. Amount financed - The amount financed for disclosure purposes is the entire commitment amount less any prepaid finance charge.

Example:

Assume a $50,000 loan commitment at 10.5% interest with a 5-month construction period and a prepaid finance charge of 2 points.

| (A) | | (B) | |
|---|---|---|---|
| Estimated Interest: | | | |
| $25,000 x .105 ÷ 12 x 5 = $1,093.75 | | $50,000 x .105 ÷ 12 x 5 = $2,187.50 | |
| Estimated APR: | | | |
| $\frac{(1,093.75 + 1,000) \times 100}{(25,000 - 1,000)} \div 5 \times 12 =$ | 20.94% | $\frac{(2,187.50 + 1,000) \times 100}{(25,000 - 1,000)} \div 5 \times 12 =$ | 31.88% |
| Disclosures: | | | |
| Amount financed | $49,000.00 | | $49,000.00 |
| Prepaid finance charge | 1,000.00 | | 1,000.00 |
| FINANCE CHARGE (Estimate) | 2,093.75 | | 3,187.50 |
| ANNUAL PERCENTAGE RATE (Estimate) | 20.94% | | 31.88% |
| Repayment: One payment of principal of $50,000 on 12-12-80. Interest on the amount of credit outstanding will be paid monthly. | | 4 monthly payments of $437.50, beginning 8-12-80, and a final payment of $50,437.50 on 12-12-80. | |
| Total of payments (Estimate) | $51,093.75 | | $52,187.50 |

Part II - Construction and permanent financing disclosed as one transaction.

A. The creditor shall estimate the interest payable during the construction period to be included in the total finance charge as follows:

1. If interest is payable only on the amount actually advanced for the time it is outstanding, assume that one-half of the commitment amount is outstanding at the contract interest rate for the entire construction period.

2. If interest is payable on the entire commitment amount without regard to the dates or amounts of actual disbursement, assume that the entire commitment amount is outstanding at the contract rate for the entire construction period.

B. The creditor shall compute the estimated annual percentage rate as follows:

1. Estimated interest payable during the construction period shall be treated for computation purposes as a prepaid finance charge (although it shall not be treated as a prepaid finance charge for disclosure purposes).

2. The number of payments shall not include any payments of interest only that are made during the construction period.

3. The first payment period shall consist of one-half of the construction period plus the period between the end of the construction period and the first amortization payment.

C. The creditor shall disclose the repayment schedule as follows:

1. For loans under paragraph A.1. of Part II, without reflecting the number or amounts of payments of interest only that are made during the construction period. The fact that interest payments must be made and the timing of such payments shall be disclosed.

2. For loans under paragraph A.2. of Part II, including any payments of interest only that are made during the construction period.

D. The creditor shall disclose the amount financed as the entire commitment amount less any prepaid finance charge.

Example:

Assume a $50,000 loan commitment at 10.5% interest with a 5-month construction period and a prepaid finance charge of 2 points, followed by 30-year permanent financing at the same rate with monthly amortization payments of $457.37.

Computation of Estimated APR

| | | Interest on Amount Advanced | Interest on Entire Commitment | |
|---|---|---|---|---|
| Estimated construction interest: | | | | |
| $25,000 x .105 ÷ 12 x 5 | = | $1,093.75 | $50,000 x .105 ÷ 12 x 5 = $2,187.50 | |
| Estimated total finance charge: | | | | |
| 360 x $457.37 = | $164,653.20 | | $164,653.20 | |
| Principal | - 50,000.00 | | - 50,000.00 | |
| Interest on Permanent Fin. | 114,653.20 | | 114,653.20 | |
| Construction Interest | + 1,093.75 | | + 2,187.50 | |
| Points | + 1,000.00 | $116,746.95 | + 1,000.00 | $117,840.70 |

| | | | | |
|---|---|---|---|---|
| Estimated amount financed: | | | | |
| Principal | $ 50,000.00 | | $ 50,000.00 | |
| Construction Interest | - 1,093.75 | | - 2,187.50 | |
| Points | - 1,000.00 | $ 47,906.25 | - 1,000.00 | $ 46,812.50 |
| Number of payments | | 360 | | 360 |
| Payment amount | | $ 457.37 | | $ 457.37 |
| First payment period (5 ÷ 2) + 1 | | 3 1/2 months | (5 ÷ 2) + 1 | 3 1/2 months |
| Estimated APR (Actuarial) | | 10.75% | | 11.03% |
| Estimated APR (Volume I): | | | | |
| 11,674,695 / 47,906.25 = 243.70 = FC/$100 | | | 11,784,070 / 46,812.50 = 251.73 = FC/$100 | |
| First period adjustment = 3 mo., 15 days = +5.0 | | | First period adjustment = 3 mo., 15 days = +5.0 | |
| Using 365 payment line, the figure closest to 243.70 is 247.00, which corresponds to an APR of | | 11% | Using 365 payment line, the figure closest to 251.73 is 253.93, which corresponds to an APR of | 11.25% |
| | | Disclosures | | |
| Amount financed | | $ 49,000.00 | | $ 49,000.00 |
| Prepaid finance charge | | 1,000.00 | | 1,000.00 |
| FINANCE CHARGE (Estimate) | | 116,746.95 | | 117,840.70 |
| ANNUAL PERCENTAGE RATE (Estimate) | | 11% | | 11.25% |
| Repayment: Interest on the amount of credit outstanding during the construction period will be paid monthly, followed by 360 monthly payments of $457.37, beginning 1-12-81. | | | 5 monthly payments of $437.50 beginning 8-12-80, followed by 360 monthly payments of $457.37 beginning 1-12-81. | |
| Total of payments (Estimate) | | $165,746.95 | | $166,840.70 |

**[46 FR 20892, Apr. 7, 1981; 46 FR 29246, June 1, 1981]**

## APPENDIX E TO PART 226—RULES FOR CARD ISSUERS THAT BILL ON A TRANSACTION-BY-TRANSACTION BASIS

The following provisions of Subpart B apply if credit cards are issued and (1) the card issuer and the seller are the same or related persons; (2) no finance charge is imposed; (3) consumers are billed in full for each use of the card on a transaction-by-transaction basis, by means of an invoice or other statement reflecting each use of the card; and (4) no cumulative account is maintained which reflects the transactions by each consumer during a period of time, such as a month:

*Section 226.6(d), and, as applicable, § 226.6(b) and (c).* The disclosure required by §226.6(b) shall be limited to those charges that are or may be imposed as a result of the deferral of payment by use of the card, such as late payment or delinquency charges.

*Section 226.7(b) and § 226.7(k).* Creditors may comply by placing the required disclosures on the invoice or statement sent to the consumer for each transaction.

*Section 226.9(a).* Creditors may comply by mailing or delivering the statement required by §226.6(d) (See appendix G–3) to each consumer receiving a transaction invoice during a one-month period chosen by the card issuer or by sending either the statement prescribed by §226.6(d) or an alternative billing error rights statement substantially similar

to that in appendix G–4, with each invoice sent to a consumer.

*Section 226.9(c).*

*Section 226.10.*

*Section 226.11.* This section applies when a card issuer receives a payment or other credit that exceeds by more than $1 the amount due, as shown on the transaction invoice. The requirement to credit amounts to an account may be complied with by other reasonable means, such as by a credit memorandum. Since no periodic statement is provided, a notice of the credit balance shall be sent to the consumer within a reasonable period of time following its occurrence unless a refund of the credit balance is mailed or delivered to the consumer within 7 business days of its receipt by the card issuer.

*Section 226.12 including § 226.12(c) and (d), as applicable.* Section 226.12(e) is inapplicable.

*Section 226.13, as applicable.* All references to *periodic statement* shall be read to indicate the invoice or other statement for the relevant transaction. All actions with regard to correcting and adjusting a consumer's account may be taken by issuing a refund or a new invoice, or by other appropriate means consistent with the purposes of the section.

*Section 226.15, as applicable.*

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 46 FR 60190, Dec. 9, 1981]

## APPENDIX F TO PART 226—ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CERTAIN OPEN-END CREDIT PLANS

In determining the denominator of the fraction under § 226.14(c)(3), no amount will be used more than once when adding the sum of the balances[1] subject to periodic rates to the sum of the amounts subject to specific transaction charges. In every case, the full amount of transactions subject to specific transaction charges shall be included in the denominator. Other balances or parts of balances shall be included according to the manner of determining the balance subject to a periodic rate, as illustrated in the following examples of accounts on monthly billing cycles:

1. PREVIOUS BALANCE—NONE.

A specific transaction of $100 occurs on the first day of the billing cycle. The average daily balance is $100. A specific transaction charge of 3% is applicable to the specific transaction. The periodic rate is 1½% applicable to the average daily balance. The numerator is the amount of the finance charge, which is $4.50. The denominator is the amount of the transaction (which is $100), plus the amount by which the balance subject to the periodic rate exceeds the amount of the specific transactions (such excess in this case is 0), totaling $100.

The annual percentage rate is the quotient (which is 4½%) multiplied by 12 (the number of months in a year), i.e., 54%.

2. Previous balance—$100.

A specific transaction of $100 occurs at the midpoint of the billing cycle. The average daily balance is $150. A specific transaction charge of 3% is applicable to the specific transaction. The periodic rate is 1½% applicable to the average daily balance. The numerator is the amount of the finance charge which is $5.25. The denominator is the amount of the transaction (which is $100), plus the amount by which the balance subject to the periodic rate exceeds the amount of the specific transaction (such excess in this case is $50), totaling $150. As explained in example 1, the annual percentage rate is 3½% × 12 = 42%.

3. If, in example 2, the periodic rate applies only to the previous balance, the numerator is $4.50 and the denominator is $200 (the amount of the transaction, $100, plus the balance subject only to the periodic rate, the $100 previous balance). As explained in example 1, the annual percentage rate is 2¼% × 12 = 27%.

4. If, in example 2, the periodic rate applies only to an adjusted balance (previous balance less payments and credits) and the consumer made a payment of $50 at the midpoint of the billing cycle, the numerator is $3.75 and the denominator is $150 (the amount of the transaction, $100, plus the balance subject to the periodic rate, the $50 adjusted balance). As explained in example 1, the annual percentage rate is 2½% × 12 = 30%.

5. Previous balance—$100.

A specific transaction (check) of $100 occurs at the midpoint of the billing cycle. The average daily balance is $150. The specific transaction charge is $.25 per check. The periodic rate is 1½% applied to the average daily balance. The numerator is the amount of the finance charge, which is $2.50 and includes the $.25 check charge and the $2.25 resulting from the application of the periodic rate. The denominator is the full amount of the specific transaction (which is $100) plus the amount by which the average daily balance exceeds the amount of the specific transaction (which in this case is $50), totaling $150. As explained in example 1, the annual percentage rate would be 1⅔% × 12 = 20%.

6. Previous balance—none.

A specific transaction of $100 occurs at the midpoint of the billing cycle. The average daily balance is $50. The specific transaction charge is 3% of the transaction amount or

[1] Where a portion of the finance charge is determined by application of one or more daily periodic rates, the phrase *sum of the balances* shall also mean the *average of daily balances*.

$3.00. The periodic rate is 1½% per month applied to the average daily balance. The numerator is the amount of the finance charge, which is $3.75, including the $3.00 transaction charge and $.75 resulting from application of the periodic rate. The denominator is the full amount of the specific transaction ($100) plus the amount by which the balance subject to the periodic rate exceeds the amount of the transaction ($0). Where the specific transaction amount exceeds the balance subject to the periodic rate, the resulting number is considered to be zero rather than a negative number ($50 − $100= − $50). The denominator, in this case, is $100. As explained in example 1, the annual percentage rate is 3¾% × 12 = 45%.

## APPENDIX G TO PART 226—OPEN-END MODEL FORMS AND CLAUSES

G–1 Balance-Computation Methods Model Clauses (§§ 226.6 and 226.7)
G–2 Liability for Unauthorized Use Model Clause (§ 226.12)
G–3 Long-Form Billing-Error Rights Model Form (§§ 226.6 and 226.9)
G–4 Alternative Billing-Error Rights Model Form (§ 226.9)
G–5 Rescission Model Form (When Opening an Account) (§ 226.15)
G–6 Rescission Model Form (For Each Transaction) (§ 226.15)
G–7 Rescission Model Form (When Increasing the Credit Limit) (§ 226.15)
G–8 Rescission Model Form (When Adding a Security Interest) (§ 226.15)
G–9 Rescission Model Form (When Increasing the Security) (§ 226.15)
G–10(A) Applications and Solicitations Model Forms (Credit Cards) (§ 226.5a(b))
G–10(B) Applications and Solicitations Sample (Credit Card) (§ 226.5a(b))
G–10(C) Applications and Solicitations Model Form (Charge Cards) (§ 226.5a(b))
G–11 Applications and Solicitations Made Available to General Public Model Clauses (§ 226.5a(e))
G–12 Charge Card Model Clause (When Access to Plan Offered by Another) (§ 226.5a(f))
G–13(A) Change in Insurance Provider Model Form (Combined Notice) (§ 226.9(f))
G–13(B) Change in Insurance Provider Model Form (§ 226.9(f)(2))
G–14A Home Equity Sample
G–14B Home Equity Sample
G–15 Home Equity Model Clauses

## G-1 -- Balance Computation Methods Model Clauses

### (a) Adjusted balance method

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "adjusted balance" of your account. We get the "adjusted balance" by taking the balance you owed at the end of the previous billing cycle and subtracting [any unpaid finance charges and] any payments and credits received during the present billing cycle.

### (b) Previous balance method

We figure [a portion of] the finance charge on your account by applying the periodic rate to the amount you owe at the beginning of each billing cycle [minus any unpaid finance charges.] We do not subtract any payments or credits received during the billing cycle. [The amount of payments and credits to your account this billing cycle was $_____.]

### (c) Average daily balance method (excluding current transactions)

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "average daily balance" of your account (excluding current transactions). To get the "average daily balance" we take the beginning balance of your account each day and subtract any payments or credits [and any unpaid finance charges]. We do not add in any new [purchases/advances/loans]. This gives us the daily balance. Then, we add all the daily balances for the billing cycle together and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

### (d) Average daily balance method (including current transactions)

We figure [a portion of] the finance charge on your account by applying the periodic rate to the "average daily balance" of your account (including current transactions). To get the "average daily balance" we take the beginning balance of your account each day, add any new [purchases/advances/loans], and subtract any payments or credits, [and unpaid finance charges]. This gives us the daily balance. Then, we add up all the daily balances for the billing cycle and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

### (e) Ending balance method

We figure [a portion of] the finance charge on your account by applying the periodic rate to the amount you owe at the end of each cycle (including new purchases and deducting payments and credits made during the billing cycle).

## G-2 -- Liability for Unauthorized Use Model Clause

You may be liable for the unauthorized use of your credit card [or other term that describes the credit card.] You will not be liable for unauthorized use that occurs after you notify [name of card issuer or its designee] at [address], orally or in writing, of the loss, theft, or possible unauthorized use. In any case, your liability will not exceed [insert $50 or any lesser amount under agreement with the cardholder.]

## G-3—Long Form Billing Error Rights Model Form

YOUR BILLING RIGHTS
KEEP THIS NOTICE FOR FUTURE USE

This notice contains important information about your rights and our responsibilities under the Fair Credit Billing Act.

**Notify Us In Case of Errors or Questions About Your Bill**

If you think your bill is wrong, or if you need more information about a transaction on your bill, write us [on a separate sheet] at [address] [the address listed on your bill]. Write to us as soon as possible. We must hear from you no later than 60 days after we sent you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information:

- Your name and account number.
- The dollar amount of the suspected error.
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are not sure about.

If you have authorized us to pay your credit card bill automatically from your savings or checking account, you can stop the payment on any amount you think is wrong. To stop the payment your letter must reach us three business days before the automatic payment is scheduled to occur.

**Your Rights and Our Responsibilities After We Receive Your Written Notice**

We must acknowledge your letter within 30 days, unless we have corrected the error by then. Within 90 days, we must either correct the error or explain why we believe the bill was correct.

After we receive your letter, we cannot try to collect any amount you question, or report you as delinquent. We can continue to bill you for the amount you question, including finance charges, and we can apply any unpaid amount against your credit limit. You do not have to pay any questioned amount while we are investigating, but you are still obligated to pay the parts of your bill that are not in question.

If we find that we made a mistake on your bill, you will not have to pay any finance charges related to any questioned amount. If we didn't make a mistake, you may have to pay finance charges, and you will have to make up any missed payments on the questioned amount. In either case, we will send you a statement of the amount you owe and the date that it is due.

If you fail to pay the amount that we think you owe, we may report you as delinquent. However, if our explanation does not satisfy you and you write to us within ten days telling us that you still refuse to pay, we must tell anyone we report you to that you have a question about your bill. And, we must tell you the name of anyone we reported you to. We must tell anyone we report you to that the matter has been settled between us when it finally is.

If we don't follow these rules, we can't collect the first $50 of the questioned amount, even if your bill was correct.

**Special Rule for Credit Card Purchases**

If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services. There are two limitations on this right:

(a) You must have made the purchase in your home state or, if not within your home state, within 100 miles of your current mailing address; and
(b) The purchase price must have been more than $50.

These limitations do not apply if we own or operate the merchant, or if we mailed you the advertisement for the property or services.

## G-4—Alternative Billing Error Rights Model Form

BILLING RIGHTS SUMMARY

**In Case of Errors or Questions About Your Bill**

If you think your bill is wrong, or if you need more information about a transaction on your bill, write us [on a separate sheet] at [address] [the address shown on your bill] as soon as possible. We must hear from you no later than 60 days after we sent you the first bill on which the error or problem appeared. You can telephone us, but doing so will not preserve your rights.

In your letter, give us the following information:

- Your name and account number.
- The dollar amount of the suspected error.
- Describe the error and explain, if you can, why you believe there is an error. If you need more information, describe the item you are unsure about.

You do not have to pay any amount in question while we are investigating, but you are still obligated to pay the parts of your bill that are not in question. While we investigate your question, we cannot report you as delinquent or take any action to collect the amount you question.

**Special Rule for Credit Card Purchases**

If you have a problem with the quality of goods or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may not have to pay the remaining amount due on the goods or services. You have this protection only when the purchase price was more than $50 and the purchase was made in your home state or within 100 miles of your mailing address. (If we own or operate the merchant, or if we mailed you the advertisement for the property or services, all purchases are covered regardless of amount or location of purchase.)

## G-5—Rescission Model Form (When Opening An Account)

NOTICE OF RIGHT TO CANCEL

**1. Your Right to Cancel.**
We have agreed to establish an open-end credit account for you, and you have agreed to give us a [mortgage/lien/security interest] [on/in] your home as security for the account. You have a legal right under federal law to cancel the account, without cost, within three business days after the latest of the following events:

(1) the opening date of your account which is

_____; or

(2) the date you received your Truth-in-Lending disclosures; or
(3) the date you received this notice of your right to cancel the account.

If you cancel the account, the [mortgage/lien/security interest] [on/in] your home is also cancelled. Within 20 days of receiving your notice, we must take the necessary steps to reflect the fact that the [mortgage/lien/security interest] [on/in] your home has been cancelled. We must return to you any money or property you have given to us or to anyone else in connection with the account.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address shown below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**2. How to Cancel.**
If you decide to cancel the account, you may do so by notifying us, in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice no matter how you notify us because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date)
(or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____ _____
Consumer's Signature Date

## G-6—Rescission Model Form (For Each Transaction)

NOTICE OF RIGHT TO CANCEL

**1. Your Right to Cancel.**
We have extended credit to you under your open-end credit account. This extension of credit will increase the amount you owe on your account. We already have a [mortgage/lien/security interest] [on/in] your home as security for your account. You have a legal right under federal law to cancel the extension of credit, without cost, within three business days after the latest of the following events:

(1) the date of the additional extension of credit which is

_____; or

(2) the date you received your Truth-in-Lending disclosures; or

(3) the date you received this notice of your right to cancel the additional extension of credit.

If you cancel the additional extension of credit, your cancellation will only apply to the additional amount and to any increase in the [mortgage/lien/security interest] that resulted because of the additional amount. It will not affect the amount you presently owe, and it will not affect the [mortgage/lien/security interest] we already have [on/in] your home. Within 20 calendar days after we receive your notice of cancellation, we must take the necessary steps to reflect the fact that any increase in the [mortgage/lien/security interest] [on/in] your home has been cancelled. We must also return to you any money or property you have given to us or to anyone else in connection with this extension of credit.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address shown below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**2. How to Cancel.**
If you decide to cancel the additional extension of credit, you may do so by notifying us, in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice no matter how you notify us because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date) (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____ _____
Consumer's Signature Date

## G-7—Rescission Model Form (When Increasing the Credit Limit)

NOTICE OF RIGHT TO CANCEL

**1. Your Right to Cancel.**
We have agreed to increase the credit limit on your open-end credit account. We have a [mortgage/lien/security interest] [on/in] your home as security for your account. Increasing the credit limit will increase the amount of the [mortgage/lien/security interest] [on/in] your home. You have a legal right under federal law to cancel the increase in your credit limit, without cost, within three business days after the latest of the following events:

(1) the date of the increase in your credit limit which is

_____; or

(2) the date you received your Truth-in-Lending disclosures; or

(3) the date you received this notice of your right to cancel the increase in your credit limit.

If you cancel, your cancellation will apply only to the increase in your credit limit and to the [mortgage/lien/security interest] that resulted from the increase in your credit limit. It will not affect the amount you presently owe, and it will not affect the [mortgage/lien/security interest] we already have [on/in] your home. Within 20 calendar days after we receive your notice of cancellation, we must take the necessary steps to reflect the fact that any increase in the [mortgage/lien/security interest] [on/in] your home has been cancelled. We must also return to you any money or property you have given to us or to anyone else in connection with this increase.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address shown below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**2. How to Cancel.**
If you decide to cancel the increase in your credit limit, you may do so by notifying us, in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice no matter how you notify us because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date) (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____ _____

Consumer's Signature Date

## G-8—Rescission Model Form (When Adding a Security Interest)

NOTICE OF RIGHT TO CANCEL

**1. Your Right to Cancel.**
You have agreed to give us a [mortgage/lien/security interest] [on/in] your home as security for your existing open-end credit account. You have a legal right under federal law to cancel the [mortgage/lien/security interest], without cost, within three business days after the latest of the following events:

(1) the date of the [mortgage/lien/security interest]

which is _____; or
(2) the date you received your Truth-in-Lending disclosures; or
(3) the date you received this notice of your right to cancel the [mortgage/lien/security interest].

If you cancel the [mortgage/lien/security interest], your cancellation will apply only to the [mortgage/lien/security interest]. It will not affect the amount you owe on your account. Within 20 calendar days after we receive your notice of cancellation, we must take the necessary steps to reflect that any [mortgage/lien/security interest] [on/in] your home has been cancelled. We must also return to you any money or property you have given to us or to anyone else in connection with this increase.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may make the offer at your home or at the location of the property. Money must be returned to the address shown below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**2. How to Cancel.**
If you decide to cancel the [mortgage/lien/security interest], you may do so by notifying us, in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice no matter how you notify us because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date)
(or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____ _____
Consumer's Signature Date

## G-9—Rescission Model Form (When Increasing the Security)

NOTICE OF RIGHT TO CANCEL

**1. Your Right to Cancel.**
You have agreed to increase the amount of the [mortgage/lien/security interest] [on/in] your home that we hold as security for your open-end credit account. You have a legal right under federal law to cancel the increase, without cost, within three business days after the latest of the following events:

(1) the date of the increase in the security which is

_____; or

(2) the date you received your Truth-in-Lending disclosures; or

(3) the date you received this notice of your right to cancel the increase in the security.

If you cancel the increase in the security, your cancellation will apply only to the increase in the amount of the [mortgage/lien/security interest]. It will not affect the amount you presently owe on your account, and it will not affect the [mortgage/lien/security interest] we already have [on/in] your home. Within 20 calendar days after we receive your notice of cancellation, we must take the necessary steps to reflect that any increase in the [mortgage/lien/security interest] [on/in] your home has been cancelled. We must also return to you any money or property you have given to us or to anyone else in connection with this increase.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address shown below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**2. How to Cancel.**
If you decide to cancel the increase in security, you may do so by notifying us, in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice no matter how you notify us because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date)
(or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL.

_____ _____
Consumer's Signature Date

G–10(A)—Applications and Solicitations Model Form (Credit Cards)

| | |
|---|---|
| **Annual percentage rate (APR) for purchases** | _____% until (expiration date),<br>after that, _____ % |
| **Other APRs** | Balance transfer APR: _____%<br>Cash advance APR: _____%<br>Penalty APR: _____ % See explanation below* |
| **Variable-rate information** | Your APR may vary.<br>The rate for [purchases] [cash advances][balance transfers] is determined by (explanation). See explanation below** |
| **Grace period for repayment of balances for purchases** | [ __ days] [until ____ ] [not less than __ days] [between __ and __days] [ __ days on average]<br><br>[You have no grace period in which to repay your balance for purchases before a finance charge will be imposed.] |
| **Method of computing the balance for purchases** | |
| **Annual fees** | [Annual] [Membership] fee: $ _____ per year]<br><br>[(type of fee): $ _____ per year]<br>[(type of fee): $ _____ ] |
| **Minimum finance charge** | $ _____ |
| **Transaction fee for purchases** | [$ _____ ] [ _____ % of _____ ] |
| **Transaction fee for cash advances**: [$ ____ ] [ __ % of ____ ]<br>**Balance transfer fee:** [ $____] [ ___% of ____]<br>**Late-payment fee**: [$ ____ ] [ ___ % of ____ ]<br>**Over-the-credit-limit fee**: $ ___ | |

* Explanation of penalty.
**Explanation of variable rate.

G–10(B)—Applications and Solicitations Sample (Credit Cards)

| | |
|---|---|
| **Annual percentage rate (APR) for purchases** | 2.9% until 11/1/00,<br>after that, 14.9% |
| **Other APRs** | Cash advance APR: 15.9%<br>Balance transfer APR: 15.9%<br>Penalty rate: 23.9%. See explanation below.* |
| **Variable-rate information** | Your APR for purchase transactions may vary. The rate is determined monthly by adding 5.9% to the Prime Rate** |
| **Grace period for repayment of balances for purchases** | 25 days on average |
| **Method of computing the balance for purchases** | Average daily balance (excluding new purchases) |
| **Annual fees** | None |
| **Minimum finance charge** | $ .50 |
| **Transaction fee for cash advances**: 3% of the amount advanced<br>**Balance transfer fee:** 3% of the amount transferred<br>**Late-payment fee**: $ 25<br>**Over-the-credit-limit fee**: $ 25 | |

* Explanation of penalty.

** The Prime Rate used to determine your APR is the rate published in _____ on the ___ day of the prior month.

G-10(C) -- Applications and Solicitations Model Form (Charge Cards)

| Annual fees | Transaction fee for purchases | Transaction fee for cash advances, and fees for paying late or exceeding the credit limit |
|---|---|---|
| [Annual fee: $____ per year]<br>[Membership fee: $____ per year]<br>[(*type of fee*): $____ per year]<br>[(*type of fee*): $____ ] | [$____ ]<br>[ __% of ____ ] | Transaction fee for cash advances: [$____ ] [ __% of ____ ]<br>Late payment fee: [$____ ] [ __% of ____ ]<br>Over-the-credit-limit fee: $____ |
| All charges made on this charge card are due and payable when you receive your periodic statement. | | |

## G-11 -- Applications and Solicitations Made Available to General Public Model Clauses

### (a) Disclosure of Required Credit Information

The information about the costs of the card described in this [application] [solicitation] is accurate as of (*month year*). This information may have changed after that date. To find out what may have changed, [call us at (*telephone number*)] [write to us at (*address*)].

### (b) Disclosure With Account Opening Statement

To find out about changes in the information in this [application] [solicitation], [call us at (*telephone number*)] [write to us at (*address*)].

### (c) No Disclosure of Credit Information

There are costs associated with the use of this card. To obtain information about these costs, call us at (*telephone number*) or write to us at (*address*).

## G-12 -- Charge Card Model Clause (When Access to Plan Offered by Another)

This charge card may allow you to access credit offered by another creditor. Our decision about issuing you a charge card will be independent of the other creditor's decision about allowing you access to a line of credit. Therefore, approval by us to issue you a card does not constitute approval by the other creditor to grant you credit privileges. If we issue you a charge card, you may receive it before the other creditor decides whether or not to grant you credit privileges.

## G-13(A) -- Change in Insurance Provider Model Form (Combined Notice)

The credit card account you have with us is insured. This is to notify you that we plan to replace your current coverage with insurance coverage from a different insurer.

If we obtain insurance for your account from a different insurer, you may cancel the insurance.

[Your premium rate will increase to $__ per __.]

[Your coverage will be affected by the following:

- [ ] The elimination of a type of coverage previously provided to you. [(*explanation*)] [See __ of the attached policy for details.]
- [ ] A lowering of the age at which your coverage will terminate or will become more restrictive. [(*explanation*)] [See __ of the attached policy or certificate for details.]
- [ ] A decrease in your maximum insurable loan balance, maximum periodic benefit payment, maximum number of payments, or any other decrease in the dollar amount of your coverage or benefits. [(*explanation*)] [See __ of the attached policy or certificate for details.]
- [ ] A restriction on the eligibility for benefits for you or others. [(*explanation*)] [See __ of the attached policy or certificate for details.]
- [ ] A restriction in the definition of "disability" or other key term of coverage. [(*explanation*)] [See __ of the attached policy or certificate for details.]
- [ ] The addition of exclusions or limitations that are broader or other than those under the current coverage. [(*explanation*)] [See __ of the attached policy or certificate for details.]
- [ ] An increase in the elimination (waiting) period or a change to nonretroactive coverage. [(*explanation*)] [See __ of the attached policy or certificate for details).]]

[The name and mailing address of the new insurer providing the coverage for your account is (*name and address*).]

## G-13(B) -- Change in Insurance Provider Model Form

We have changed the insurer providing the coverage for your account. The new insurer's name and address are (*name and address*). A copy of the new policy or certificate is attached.

You may cancel the insurance for your account.

**G-14A -- Home Equity Sample**

## IMPORTANT TERMS
## of our
## HOME EQUITY LINE OF CREDIT

This disclosure contains important information about our Home Equity Line of Credit. You should read it carefully and keep a copy for your records.

**Availability of Terms:** To obtain the terms described below, you must submit your application before January 1, 1990.

If these terms change (other than the annual percentage rate) and you decide, as a result, not to enter into an agreement with us, you are entitled to a refund of any fees that you have paid to us or anyone else in connection with your application.

**Security Interest:** We will take a mortgage on your home. You could lose your home if you do not meet the obligations in your agreement with us.

**Possible Actions:** Under certain circumstances, we can (1) terminate your line, require you to pay us the entire outstanding balance in one payment, and charge you certain fees; (2) refuse to make additional extensions of credit; and (3) reduce your credit limit.

If you ask, we will give you more specific information concerning when we can take these actions.

**Minimum Payment Requirements:** You can obtain advances of credit for 10 years (the "draw period"). During the draw period, payments will be due monthly. Your minimum monthly payment will equal the greater of $100 or 1/360th of the outstanding balance plus the finance charges that have accrued on the outstanding balance.

After the draw period ends, you will no longer be able to obtain credit advances and must pay the outstanding balance over 5 years (the "repayment period"). During the repayment period, payments will be due monthly. Your minimum monthly payment will equal 1/60th of the balance that was outstanding at the end of the draw period plus the finance charges that have accrued on the remaining balance.

**Minimum Payment Example:** If you made only the minimum monthly payments and took no other credit advances, it would take 15 years to pay off a credit advance of $10,000 at an ANNUAL PERCENTAGE RATE of 12%. During that period, you would make 120 monthly payments varying between $127.78 and $100.00 followed by 60 monthly payments varying between $187.06 and $118.08.

**Fees and Charges:** To open and maintain a line of credit, you must pay the following fees to us:

- Application fee: $150 (due at application)
- Points: 1% of credit limit (due when account opened)
- Annual maintenance fee: $75 (due each year)

You also must pay certain fees to third parties to open a line. These fees generally total between $500 and $900. If you ask, we will give you an itemization of the fees you will have to pay to third parties.

**Minimum Draw and Balance Requirements:** The minimum credit advance you can receive is $500. You must maintain an outstanding balance of at least $100.

**Tax Deductibility:** You should consult a tax advisor regarding the deductibility of interest and charges for the line.

**Variable-Rate Information:** The line has a variable-rate feature, and the annual percentage rate (corresponding to the periodic rate) and the minimum payment can change as a result.

The annual percentage rate includes only interest and not other costs.

The annual percentage rate is based on the value of an index. The index is the monthly average prime rate charged by banks and is published in the *Federal Reserve Bulletin*. To determine the annual percentage rate that will apply to your line, we add a margin to the value of the index.

Ask us for the current index value, margin and annual percentage rate. After you open a credit line, rate information will be provided on periodic statements that we will send you.

**Rate Changes:** The annual percentage rate can change each month. The maximum ANNUAL PERCENTAGE RATE that can apply is 18%. Except for this 18% "cap," there is no limit on the amount by which the rate can change during any one-year period.

**Maximum Rate and Payment Examples:** If you had an outstanding balance of $10,000 during the draw period, the minimum monthly payment at the maximum ANNUAL PERCENTAGE RATE of 18% would be $177.78. This annual percentage rate could be reached during the first month of the draw period.

If you had an outstanding balance of $10,000 at the beginning of the repayment period, the minimum monthly payment at the maximum ANNUAL PERCENTAGE RATE of 18% would be $316.67. This annual percentage rate could be reached during the first month of the repayment period.

**Historical Example:** The following table shows how the annual percentage rate and the minimum monthly payments for a single $10,000 credit advance would have changed based on changes in the index over the past 15 years. The index values are from September of each year. While only one payment amount per year is shown, payments would have varied during each year.

The table assumes that no additional credit advances were taken, that only the minimum payments were made each month, and that the rate remained constant during each year. It does not necessarily indicate how the index or your payments will change in the future.

| Year | Index (%) | Margin * (%) | | ANNUAL PERCENTAGE RATE (%) | Minimum Monthly Payment ($) |
|---|---|---|---|---|---|
| 1974 | 12.00 | 2 | | 14.00 | 144.44 |
| 1975 | 7.88 | 2 | | 9.88 | 106.50 |
| 1976 | 7.00 | 2 | | 9.00 | 100.00 |
| 1977 | 7.13 | 2 | | 9.13 | 100.00 |
| 1978 | 9.41 | 2 | *Draw Period* | 11.41 | 105.47 |
| 1979 | 12.90 | 2 | | 14.90 | 126.16 |
| 1980 | 12.23 | 2 | | 14.23 | 117.53 |
| 1981 | 20.08 | 2 | | 18.00** | 138.07 |
| 1982 | 13.50 | 2 | | 15.50 | 117.89 |
| 1983 | 11.00 | 2 | | 13.00 | 100.00 |
| 1984 | 12.97 | 2 | | 14.97 | 203.81 |
| 1985 | 9.50 | 2 | | 11.50 | 170.18 |
| 1986 | 7.50 | 2 | *Repayment Period* | 9.50 | 149.78 |
| 1987 | 8.70 | 2 | | 10.70 | 141.50 |
| 1988 | 10.00 | 2 | | 12.00 | 130.55 |

* This is a margin we have used recently.
** This rate reflects the 18% rate cap.

## G-14B -- Home Equity Sample

### IMPORTANT TERMS
### of our
### HOME EQUITY LINE OF CREDIT

This disclosure contains important information about our Home Equity Line of Credit. You should read it carefully and keep a copy for your records.

**Availability of Terms:** All of the terms described below are subject to change.

If these terms change (other than the annual percentage rate) and you decide, as a result, not to enter into an agreement with us, you are entitled to a refund of any fees you paid to us or anyone else in connection with your application.

**Security Interest:** We will take a mortgage on your home. You could lose your home if you do not meet the obligations in your agreement with us.

**Possible Actions:** We can terminate your line, require you to pay us the entire outstanding balance in one payment, and charge you certain fees if:

· You engage in fraud or material misrepresentation in connection with the line.

· You do not meet the repayment terms.

· Your action or inaction adversely affects the collateral or our rights in the collateral.

We can refuse to make additional extensions of credit or reduce your credit limit if:

· The value of the dwelling securing the line declines significantly below its appraised value for purposes of the line.

· We reasonably believe you will not be able to meet the repayment requirements due to a material change in your financial circumstances.

· You are in default of a material obligation in the agreement.

· Government action prevents us from imposing the annual percentage rate provided for or impairs our security interest such that the value of the interest is less than 120 percent of the credit line.

· A regulatory agency has notified us that continued advances would constitute an unsafe and unsound practice.

· The maximum annual percentage rate is reached.

The initial agreement permits us to make certain changes to the terms of the agreement at specified times or upon the occurrence of specified events.

**Minimum Payment Requirements:** You can obtain advances of credit for 10 years (the "draw period"). You can choose one of three payment options for the draw period:

· *Monthly interest-only payments.* Under this option, your payments will be due monthly and will equal the finance charges that accrued on the outstanding balance during the preceding month.

· *Quarterly interest-only payments.* Under this option, your payments will be due quarterly and will equal the finance charges that accrued on the outstanding balance during the preceding quarter.

· *2% of the balance.* Under this option, your payments will be due monthly and will equal 2% of the outstanding balance on your line plus finance charges that accrued on the outstanding balance during the preceding month.

If the payment determined under any option is less than $50, the minimum payment will equal $50 or the outstanding balance on your line, whichever is less.

Under both the monthly and quarterly interest-only payment options, the minimum payment will not reduce the principal that is outstanding on your line.

After the draw period ends, you will no longer be able to obtain credit advances and must repay the outstanding balance (the "repayment period"). The length of the repayment period will depend on the balance outstanding at the beginning of it. During the repayment period, payments will be due monthly and will equal 3% of the outstanding balance on your line plus finance charges that accrued on the outstanding balance or $50, whichever is greater.

**Minimum Payment Examples:** If you took a single $10,000 advance and the ANNUAL PERCENTAGE RATE was 9.52%:

· Under the monthly interest-only payment option, it would take 18 years and 1 month to pay off the advance if you made only the minimum payments. During that period, you would make 120 payments of $79.33, followed by 96 payments varying between $379.33 and $50 and one final payment of $10.75.

· Under the 2% of the balance payment option, it would take 10 years and 8 months to pay off the advance if you made only the minimum payments. During that period, you would make 120 payments varying between $279.33 and $50, followed by 7 payments of $50 and one final payment of $21.53.

**Fees and Charges:** To open and maintain a line of credit, you must pay us the following fees:

- Application fee: $100 (due at application)
- Points: 1% of credit limit (due when account opened)
- Annual maintenance fee: $50 during the first 3 years, $75 thereafter (due each year)

You also must pay certain fees to third parties to open a line. These fees generally total between $500 and $900. If you ask, we will give you an itemization of the fees you will have to pay to third parties.

**Minimum Draw Requirement:** The minimum credit advance that you can receive is $200.

**Tax Deductibility:** You should consult a tax advisor regarding the deductibility of interest and charges for the line.

**Variable-Rate Feature:** The line has a variable-rate feature, and the annual percentage rate (corresponding to the periodic rate) and the minimum monthly payment can change as a result.

The annual percentage rate includes only interest and not other costs.

The annual percentage rate is based on the value of an index. During the draw period, the index is the monthly average prime rate charged by banks. During the repayment period, the index is the weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year. Information on these indices is published in the *Federal Reserve Bulletin*. To determine the annual percentage rate that will apply to your line, we add a margin to the value of the index.

The initial annual percentage rate is "discounted" -- it is not based on the index and margin used for later rate adjustments. The initial rate will be in effect for the first year your credit line is open.

Ask us for the current index values, margin, discount and annual percentage rate. After you open a credit line, rate information will be provided on periodic statements that we send you.

**Rate Changes:** The annual percentage rate can change monthly. The maximum ANNUAL PERCENTAGE RATE that can apply is 18%. Apart from this rate "cap," there is no limit on the amount by which the rate can change during any one-year period.

**Maximum Rate and Payment Examples:** If the ANNUAL PERCENTAGE RATE during the draw period equaled the 18% maximum and you had an outstanding balance of $10,000:

· Under the monthly interest-only payment option, the minimum monthly payment would be $150.

· Under the 2% of the balance payment option, the minimum monthly payment would be $350.

This annual percentage rate could be reached during the first month of the draw period.

If you had an outstanding balance of $10,000 during the repayment period, the minimum monthly payment at the maximum ANNUAL PERCENTAGE RATE of 18% would be $450. This annual percentage rate could be reached during the first month of the repayment period.

**Historical Example:** The following table shows how the annual percentage rate and the monthly payments for a single $10,000 credit advance would have changed based on changes in the indices over the past 15 years. For the draw period, the index values for the prime rate are from September of each year. For the repayment period, the index values for the yield on U.S. Treasury securities are from the first week ending in July. While only one payment amount per year is shown, payments under the 2% of the balance payment option and during the repayment period would have varied during each year.

The table assumes that no additional credit advances were taken, that only the minimum payments were made, and that the rate remained constant during each year. It does not necessarily indicate how the indices or your payments will change in the future.

| | Year | Index | Margin* | ANNUAL PERCENTAGE RATE | Monthly Interest-Only Payments | Monthly 2% of Balance Payments |
|---|---|---|---|---|---|---|
| | | % | % | % | ($) | ($) |
| | 1974 | 12.00 | 2 | 10.00** | 83.33 | 283.33 |
| | 1975 | 7.88 | 2 | 9.88 | 82.33 | 221.55 |
| | 1976 | 7.00 | 2 | 9.00 | 75.00 | 169.34 |
| | 1977 | 7.13 | 2 | 9.13 | 76.08 | 133.41 |
| *Draw* | 1978 | 9.41 | 2 | 11.41 | 95.08 | 111.89 |
| *Period* | 1979 | 12.90 | 2 | 14.90 | 124.17 | 96.46 |
| | 1980 | 12.23 | 2 | 14.23 | 118.58 | 74.39 |
| | 1981 | 20.08 | 2 | 18.00*** | 150.00 | 64.13 |
| | 1982 | 13.50 | 2 | 15.50 | 129.17 | 50.00 |
| | 1983 | 11.00 | 2 | 13.00 | 108.33 | 50.00 |
| | 1984 | 12.17 | 2 | 14.17 | 418.08 | 50.00 |
| *Repayment* | 1985 | 7.66 | 2 | 9.66 | 264.01 | |
| *Period* | 1986 | 6.36 | 2 | 8.36 | 177.96 | |
| | 1987 | 6.71 | 2 | 8.71 | 124.45 | |
| | 1988 | 7.52 | 2 | 9.52 | 87.92 | |

* This is a margin we have used recently.
** This rate reflects a 4% "discount" we have used recently.
***This rate reflects the18% rate cap.

## G-15 -- Home Equity Model Clauses

**(a) Retention of Information:** This disclosure contains important information about our Home Equity Line of Credit. You should read it carefully and keep a copy for your records.

**(b) Availability of Terms:** To obtain the terms described below, you must submit your application before (*date*). However the (*description of terms*) are subject to change.

*or*

All of the terms described below are subject to change.

If these terms change [(other than the annual percentage rate)] and you decide, as a result, not to enter into an agreement with us, you are entitled to a refund of any fees you paid to us or anyone else in connection with your application.

**(c) Security Interest:** We will take a [security interest in/mortgage on] your home. You could lose your home if you do not meet the obligations in your agreement with us.

**(d) Possible Actions:** Under certain circumstances, we can (1) terminate your line, require you to pay us the entire outstanding balance in one payment [, and charge you certain fees]; (2) refuse to make additional extensions of credit; (3) reduce your credit limit [; and (4) make specific changes that are set forth in your agreement with us].

If you ask, we will give you more specific information about when we can take these actions.

*or*

**Possible Actions:** We can terminate your account, require you to pay us the entire outstanding balance in one payment[, and charge you certain fees] if:

· You engage in fraud or material misrepresentation in connection with the line.

· You do not meet the repayment terms.

· Your action or inaction adversely affects the collateral or our rights in the collateral.

We can refuse to make additional extensions of credit or reduce your credit limit if:

· The value of the dwelling securing the line declines significantly below its appraised value for purposes of the line.

· We reasonably believe you will not be able to meet the repayment requirements due to a material change in your financial circumstances.

· You are in default of a material obligation in the agreement.

· Government action prevents us from imposing the annual percentage rate provided for or impairs our security interest such that the value of the interest is less than 120 percent of the credit line.

· A regulatory agency has notified us that continued advances would constitute an unsafe and unsound practice.

· The maximum annual percentage rate is reached.

[The initial agreement permits us to make certain changes to the terms of the agreement at specified times or upon the occurrence of specified events.]

**(e) Minimum Payment Requirements:** The length of the [draw period/repayment period] is (*length*). Payments will be due (*frequency*). Your minimum payment will equal (*how payment determined*).

[The minimum payment will not reduce the principal that is outstanding on your line./The minimum payment will not fully repay the principal that is outstanding on your line.] You will then be required to pay the entire balance in a single "balloon" payment.

**(f) Minimum Payment Example:** If you made only the minimum payments and took no other credit advances, it would take (*length of time*) to pay off a credit advance of $10,000 at an ANNUAL PERCENTAGE RATE of (*recent rate*). During that period, you would make (*number*) (*frequency*) payments of $___.

**(g) Fees and Charges:** To open and maintain a line of credit, you must pay the following fees to us:

(*Description of fee*) [$___/__% of _____] (*When payable*)

(*Description of fee*) [$___/__% of _____] (*When payable*)

You also must pay certain fees to third parties. These fees generally total [$___/__% of _____/between $___ and $___]. If you ask, we will give you an itemization of the fees you will have to pay to third parties.

**(h) Minimum Draw and Balance Requirements:** The minimum credit advance you can receive is $___. You must maintain an outstanding balance of at least $___.

**(i) Negative Amortization:** Under some circumstances, your payments will not cover the finance charges that accrue and "negative amortization" will occur. Negative amortization will increase the amount that you owe us and reduce your equity in your home.

**(j) Tax Deductibility:** You should consult a tax advisor regarding the deductibility of interest and charges for the line.

**(k) Other Products:** If you ask, we will provide you with information on our other available home equity lines.

**(l) Variable-Rate Feature:** The plan has a variable-rate feature and the annual percentage rate (corresponding to the periodic rate) and the [minimum payment/term of the line] can change as a result.

The annual percentage rate includes only interest and not other costs.

The annual percentage rate is based on the value of an index. The index is the (*identification of index*) and is [published in/available from] (*source of information*). To determine the annual percentage rate that will apply to your line, we add a margin to the value of the index.

[The initial annual percentage rate is "discounted" -- it is not based on the index and margin used for later rate adjustments. The initial rate will be in effect for (*period*).]

Ask us for the current index value, margin, [discount,] and annual percentage rate. After you open a credit line, rate information will be provided on periodic statements that we send you.

**(m) Rate Changes:** The annual percentage rate can change (*frequency*). [The rate cannot increase by more than __ percentage points in any one year period./There is no limit on the amount by which the rate can change in any one year period.] [The maximum ANNUAL PERCENTAGE RATE that can apply is __%./The ANNUAL PERCENTAGE RATE cannot increase by more than __ percentage points above the initial rate.] [Ask us for the specific rate limitations that will apply to your credit line.]

**(n) Maximum Rate and Payment Examples:** If you had an outstanding balance of $10,000, the minimum payment at the maximum ANNUAL PERCENTAGE RATE of __% would be $___. This annual percentage rate could be reached (*when maximum rate could be reached*).

**(o) Historical Example:** The following table shows how the annual percentage rate and the minimum payments for a single $10,000 credit advance would have changed based on changes in the index over the past 15 years. The index values are from (*when values are measured*). [While only one payment amount per year is shown, payments would have varied during each year.]

The table assumes that no additional credit advances were taken, that only the minimum payments were made, and that the rate remained constant during each year. It does not necessarily indicate how the index or your payments will change in the future.

| Year | Index | Margin | ANNUAL PERCENTAGE RATE | Minimum Payment |
|---|---|---|---|---|
| | (%) | (%) | (%) | ($) |
| 1975 | | | | |
| 1976 | | | | |
| 1977 | | | | |
| 1978 | | | | |
| 1979 | | | | |
| 1980 | | | | |
| 1981 | | | | |
| 1982 | | | | |
| 1983 | | | | |
| 1984 | | | | |
| 1985 | | | | |
| 1986 | | | | |
| 1987 | | | | |
| 1988 | | | | |
| 1989 | | | | |

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 46 FR 60191, Dec. 9, 1981; 54 FR 13868, Apr. 6, 1989; 54 FR 24689, June 9, 1989; 55 FR 38312, Sept. 18, 1990; 65 FR 58908, Oct. 3, 2000]

## APPENDIX H TO PART 226—CLOSED-END MODEL FORMS AND CLAUSES

H–1—Credit Sale Model Form (§ 226.18)
H–2—Loan Model Form (§ 226.18)
H–3—Amount Financed Itemization Model Form (§ 226.18(c))
H–4(A)—Variable-Rate Model Clauses (§ 226.18(f)(1))
H–4(B)—Variable-Rate Model Clauses (§ 226.18(f)(2))
H–4(C)—Variable-Rate Model Clauses (§ 226.19(b))
H–4(D)—Variable-Rate Model Clauses (§ 226.20(c))
H–5—Demand Feature Model Clauses (§ 226.18(I))
H–6—Assumption Policy Model Clause (§ 226.18(q))
H–7—Required Deposit Model Clause (§ 226.18(r))
H–8—Rescission Model Form (General) (§ 226.23)
H–9—Rescission Model Form (Refinancing With Original Creditor) (§ 226.23)
H–10—Credit Sale Sample
H–11—Installment Loan Sample
H–12—Refinancing Sample
H–13—Mortgage with Demand Feature Sample
H–14—Variable-Rate Mortgage Sample (§ 226.19(b))
H–15—Graduated Payment Mortgage Sample
H–16—Mortgage Sample (§ 226.32)

H-1—Credit Sale Model Form

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. | Total Sale Price<br>The total cost of your purchase on credit, including your downpayment of<br>$ _____. |
|---|---|---|---|---|
| % | $ | $ | $ | $ |

You have the right to receive at this time an itemization of the Amount Financed.
☐ I want an itemization. ☐ I do not want an itemization.

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| | | |
| | | |

**Insurance**
Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

| Type | Premium | Signature |
|---|---|---|
| Credit Life | | I want credit life insurance. _____ Signature |
| Credit Disability | | I want credit disability insurance. _____ Signature |
| Credit Life and Disability | | I want credit life and disability insurance. _____ Signature |

You may obtain property insurance from anyone you want that is acceptable to (creditor). If you get the insurance from (creditor), you will pay $_____.

**Security:** You are giving a security interest in:
☐ the goods or property being purchased.
☐ (brief description of other property).

**Filing fees** $ _____ **Non-filing insurance** $ _____

**Late Charge:** If a payment is late, you will be charged $ _____/_____% of the payment.

**Prepayment:** If you pay off early, you
☐ may ☐ will not have to pay a penalty.
☐ may ☐ will not be entitled to a refund of part of the finance charge.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

_____
e means an estimate

H-2—Loan Model Form

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. |
|---|---|---|---|
| % | $ | $ | $ |

You have the right to receive at this time an itemization of the Amount Financed.
☐ I want an itemization. ☐ I do not want an itemization.

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| | | |
| | | |

**Insurance**
Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

| Type | Premium | Signature |
|---|---|---|
| Credit Life | | I want credit life insurance. _____ Signature |
| Credit Disability | | I want credit disability insurance. _____ Signature |
| Credit Life and Disability | | I want credit life and disability insurance. _____ Signature |

You may obtain property insurance from anyone you want that is acceptable to (creditor). If you get the insurance from (creditor), you will pay $_____.

**Security:** You are giving a security interest in:
☐ the goods or property being purchased.
☐ (brief description of other property).

**Filing fees** $ _____ **Non-filing insurance** $ _____

**Late Charge:** If a payment is late, you will be charged $ _____ /_____% of the payment.

**Prepayment:** If you pay off early, you
☐ may ☐ will not have to pay a penalty.
☐ may ☐ will not be entitled to a refund of part of the finance charge.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

_____
**e means an estimate**

## H-3—Amount Financed Itemization Model Form

Itemization of the Amount Financed of $_____

$_____ Amount given to you directly

$_____ Amount paid on your account

Amount paid to others on your behalf

$_____ to [public officials] [credit bureau] [appraiser] [insurance company]

$_____ to (name of another creditor)

$_____ to (other)

$_____ Prepaid finance charge

## H-4(A)—Variable-Rate Model Clauses

The annual percentage rate may increase during the term of this transaction if:
[the prime interest rate of (creditor) increases.]
[the balance in your deposit account falls below $_____.]
[you terminate your employment with (employer) .]

[The interest rate will not increase above _____%.]
[The maximum interest rate increase at one time will be _____%.]
[The rate will not increase more than once every (time period) .]

Any increase will take the form of:
[higher payment amounts.]
[more payments of the same amount.]
[a larger amount due at maturity.]

*Example based on the specific transaction*
[If the interest rate increases by _____% in (time period),
[your regular payments will increase to $_____.]
[you will have to make _____ additional payments.]
[your final payment will increase to $_____.]]

*Example based on a typical transaction*
[If your loan were for $_____ at _____% for (term) and the rate increased to _____% in (time period),
[your regular payments would increase by $_____.]
[you would have to make _____ additional payments.]
[your final payment would increase by $_____.]]

## H-4(B)—Variable-Rate Model Clauses

Your loan contains a variable-rate feature. Disclosures about the variable-rate feature have been provided to you earlier.

*H–4(C)—Variable-Rate Model Clauses*

This disclosure describes the features of the adjustable-rate mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

*How Your Interest Rate and Payment Are Determined*

• Your interest rate will be based on [an index plus a margin] [a formula].

• Your payment will be based on the interest rate, loan balance, and loan term.

—[The interest rate will be based on (identification of index) plus our margin. Ask for our current interest rate and margin.]

—[The interest rate will be based on (identification of formula). Ask us for our current interest rate.]

—Information about the index [formula for rate adjustments] is published [can be found] _____.

—[The initial interest rate is not based on the (index) (formula) used to make later adjustments. Ask us for the amount of current interest rate discounts.]

*How Your Interest Rate Can Change*

• Your interest rate can change (frequency).

• [Your interest rate cannot increase or decrease more than _____ percentage points at each adjustment.]

• Your interest rate cannot increase [or decrease] more than _____ percentage points over the term of the loan.

*How Your Payment Can Change*

• Your payment can change (frequency) based on changes in the interest rate.

• [Your payment cannot increase more than (amount or percentage) at each adjustment.]

• You will be notified in writing _____ days before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount, and loan balance.

• [You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about your interest rates, payment amount, and loan balance.]

• [For example, on a $10,000 [term] loan with an initial interest rate of _____ [(the rate shown in the interest rate column below for the year 19 _____)] [(in effect (month) (year)], the maximum amount that the interest rate can rise under this program is _____ percentage points, to _____%, and the monthly payment can rise from a first-year payment of $_____ to a maximum of $_____ in the _____ year. To see what your payments would be, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, the monthly payment for a mortgage amount of $60,000 would be: $60,000 ÷ $10,000 = 6; 6 × _____ = $_____ per month.)]

*[Example*

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1982 to 1996. This does not necessarily indicate how your index will change in the future.

The example is based on the following assumptions:

| | |
|---|---|
| Amount | $10,000 |
| Term | _____ |
| Change date | _____ |
| Payment adjustment | (frequency) |
| Interest adjustment | (frequency) |
| [Margin]* | _____ |
| Caps _____ [periodic interest rate cap] | |
| _____ [lifetime interest rate cap | |
| _____ [payment cap] | |
| [Interest rate carryover] | |
| [Negative amortization] | |
| [Interest rate discount]** | |
| Index.....(identification of index or formula) | |

*This is a margin we have used recently, your margin may be different.

**This is the amount of a discount we have provided recently; your loan may be discounted by a different amount.]

| Year | Index (%) | Margin (Percentage points) | Interest Rate (%) | Monthly Payment ($) | Remaining Balance ($) |
|---|---|---|---|---|---|
| 1982 | | | | | |
| 1983 | | | | | |
| 1984 | | | | | |
| 1985 | | | | | |
| 1986 | | | | | |
| 1987 | | | | | |
| 1988 | | | | | |
| 1989 | | | | | |
| 1990 | | | | | |
| 1991 | | | | | |
| 1992 | | | | | |

| Year | Index (%) | Margin (Percentage points) | Interest Rate (%) | Monthly Payment ($) | Remaining Balance ($) |
|---|---|---|---|---|---|
| 1993 | | | | | |
| 1994 | | | | | |
| 1995 | | | | | |
| 1996 | | | | | |

Note: To see what your payments would have been during that period, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, in 1996 the monthly payment for a mortgage amount of $60,000 taken out in 1982 would be: $60,000÷$10,000=6; 6×_____=$_____ per month.)

## H–4(D)—Variable-Rate Model Clauses

Your new interest rate will be _____%, which is based on an index value of _____%.
Your previous interest rate was _____%, which was based on an index value of _____%.
[The new interest rate does not reflect a change of _____ percentage point in the index value which was not added because of _____.]
[The new payment will be $_____.]
[Your new loan balance is $_____.]
[Your (new) (existing) payment will not be sufficient to cover the interest due and the difference will be added to the loan amount. The payment amount needed to pay your loan in full by the end of the term at the new interest rate is $_____.]
[The following interest rate adjustments have been implemented this year without changing your payment: _____.
These interest rates were based on the following index values: _____.]

## H–5—Demand Feature Model Clauses

This obligation [is payable on demand.]
[has a demand feature.]
[All disclosures are based on an assumed maturity of one year.]

## H–6—Assumption Policy Model Clause

Assumption: Someone buying your house [may, subject to conditions, be allowed to] [cannot] assume the remainder of the mortgage on the original terms.

## H–7—Required Deposit Model Clause

The annual percentage rate does not take into account your required deposit.

## H-8—Rescission Model Form (General)

NOTICE OF RIGHT TO CANCEL

**Your Right to Cancel**

You are entering into a transaction that will result in a [mortgage/lien/security interest] [on/in] your home. You have a legal right under federal law to cancel this transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of the transaction, which is

_____; or

(2) the date you received your Truth in Lending disclosures; or

(3) the date you received this notice of your right to cancel.

If you cancel the transaction, the [mortgage/lien/security interest] is also cancelled. Within 20 calendar days after we receive your notice, we must take the steps necessary to reflect the fact that the [mortgage/lien/security interest] [on/in] your home has been cancelled, and we must return to you any money or property you have given to us or to anyone else in connection with this transaction.

You may keep any money or property we have given you until we have done the things mentioned above, but you must then offer to return the money or property. If it is impractical or unfair for you to return the property, you must offer its reasonable value. You may offer to return the property at your home or at the location of the property. Money must be returned to the address below. If we do not take possession of the money or property within 20 calendar days of your offer, you may keep it without further obligation.

**How to Cancel**

If you decide to cancel this transaction, you may do so by notifying us in writing, at

(creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of (date) (or midnight of the third business day following the latest of the three events listed above). If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

_____ _____

Consumer's Signature Date

H–9—RESCISSION MODEL FORM (REFINANCING WITH ORIGINAL CREDITOR)

NOTICE OF RIGHT TO CANCEL

Your Right To Cancel

You are entering into a new transaction to increase the amount of credit previously provided to you. Your home is the security for this new transaction. You have a legal right under federal law to cancel this new transaction, without cost, within three business days from whichever of the following events occurs last:

(1) the date of this new transaction, which is _____; or

(2) the date you received your new Truth in Lending disclosures; or

(3) the date you received this notice of your right to cancel.

If you cancel this new transaction, it will not affect any amount that you presently owe. Your home is the security for that amount. Within 20 calendar days after we receive your notice of cancellation of this new transaction, we must take the steps necessary to reflect the fact that your home does not secure the increase of credit. We must also return any money you have given to us or anyone else in connection with this new transaction.

You may keep any money we have given you in this new transaction until we have done the things mentioned above, but you must then offer to return the money at the address below.

If we do not take possession of the money within 20 calendar days of your offer, you may keep it without further obligation.

HOW TO CANCEL

If you decide to cancel this new transaction, you may do so by notifying us in writing, at

_____

(Creditor's name and business address).

You may use any written statement that is signed and dated by you and states your intention to cancel, or you may use this notice by dating and signing below. Keep one copy of this notice because it contains important information about your rights.

If you cancel by mail or telegram, you must send the notice no later than midnight of

_____

(Date) _____

(or midnight of the third business day following the latest of the three events listed above).

If you send or deliver your written notice to cancel some other way, it must be delivered to the above address no later than that time.

I WISH TO CANCEL

_____

Consumer's Signature

_____

Date

H-10—Credit Sale Sample

**Big Wheel Auto**

Alice Green

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. | Total Sale Price<br>The total cost of your purchase on credit, including your downpayment of<br>$ 1500 — |
|---|---|---|---|---|
| 14.84 % | $ 1496.80 | $ 6107.50 | $ 7604.30 | $ 9129.30 |

You have the right to receive at this time an itemization of the Amount Financed.
☐ I want an itemization. ☒ I do not want an itemization.

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| 36 | $211.23 | Monthly beginning 6-1-81 |
| | | |

**Insurance**

Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

| Type | Premium | Signature | |
|---|---|---|---|
| Credit Life | $120 — | I want credit life insurance. | Alice Green<br>Signature |
| Credit Disability | | I want credit disability insurance. | Signature |
| Credit Life and Disability | | I want credit life and disability insurance. | Signature |

**Security:** You are giving a security interest in:
☒ the goods being purchased.
☐ _____.

**Filing fees** $ 12.50 **Non-filing insurance** $ _____

**Late Charge:** If a payment is late, you will be charged $10.

**Prepayment:** If you pay off early, you
☐ may ☐ will not have to pay a penalty.
☒ may ☐ will not be entitled to a refund of part of the finance charge.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

I have received a copy of this statement.

Alice Green 5-1-81
Signature Date

e means an estimate

H-11—Installment Loan Sample

**Friendly Bank & Trust Co.**
700 East Street
Little Creek, USA

Lisa Stone
22-4859-22
300 Maple Avenue
Little Creek, USA

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled |
|---|---|---|---|
| 12 % | $ 675.31 | $ 5000- | $ 5675.31 |

You have the right to receive at this time an itemization of the Amount Financed.
☐ I want an itemization. ☒ I do not want an itemization.

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| 1 | $262.03 e | 6/1/81 |
| 23 | $235.36 | Monthly beginning 7/1/81 |

**Late Charge:** If a payment is late, you will be charged $5 or 10% of the payment, whichever is less.

**Prepayment:** If you pay off early, you ☒ may ☐ will not have to pay a penalty.

**Required Deposit:** The annual percentage rate does not take into account your required deposit.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate

H-12—Refinancing Sample

**Everyone's Credit Union** Date: April 1, 1981

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. |
|---|---|---|---|
| 15 % | $1285.06 | $5177.73 | $6462.79 |

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| 35 | $179.53 | monthly starting 5-1-81 |
| 1 | $179.24 | 4-1-84 |

**Insurance**

Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

| Type | Premium | Signature |
|---|---|---|
| Credit Life | | I want credit life insurance. Signature _____ |
| Credit Disability | $177.73 | I want credit disability insurance. Signature Joseph Day |

**Security:** You are giving a security interest in: ☐ the goods or property being purchased. ☒ your automobile.

**Late Charge:** If a payment is late, you will be charged 20% of the interest due with a minimum charge of $.05.

**Prepayment:** If you pay off early, you will not have to pay a penalty.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate

Itemization of the Amount Financed of $ 5177.73

$ 1000- Amount given to you directly
$ 3000- Amount paid on your account

Amount paid to others on your behalf
$ _____ to public officials
$ 500- to Coop Credit Union
$ 500- to Acme Finance Co.
$ 177.73 to Pan-Galactic Ins. Co.
$ _____ for credit report

$ _____ Prepaid finance charge

H-13—Mortgage with Demand Feature Sample

**Mortgage Savings and Loan Assoc.**
Date: April 15, 1981

Glenn Jones
700 Oak Drive
Little Creek, USA

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. |
|---|---|---|---|
| 14.85 % | $156,551.54 | $44,605.66 | $201,157.20 |

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due |
|---|---|---|
| 360 | $558.77 | Monthly beginning 6/1/81 |

This obligation has a demand feature.

You may obtain property insurance from anyone you want that is acceptable to Mortgage Savings and Loan Assoc.. If you get the insurance from Mortgage Savings and Loan Assoc. you will pay $ 150-/year

**Security:** You are giving a security interest in:
☒ the goods or property being purchased.
☐ _____.

**Late Charge:** If a payment is late, you will be charged $ N/A 5 % of the payment.

**Prepayment:** If you pay off early, you may have to pay a penalty.

**Assumption:** Someone buying your house may, subject to conditions, be allowed to assume the remainder of the mortgage on the original terms.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate

*H–14—Variable-Rate Mortgage Sample*

This disclosure describes the features of the adjustable-rate mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

*How Your Interest Rate and Payment Are Determined*

• Your interest rate will be based on an index rate plus a margin.

• Your payment will be based on the interest rate, loan balance, and loan term.

—The interest rate will be based on the weekly average yield on United States Treasury securities adjusted to a constant maturity of 1 year (your index), plus our margin. Ask us for our current interest rate and margin.

—Information about the index rate is published weekly in the Wall Street Journal.

• Your interest rate will equal the index rate plus our margin unless your interest rate "caps" limit the amount of change in the interest rate.

*How Your Interest Rate Can Change*

• Your interest rate can change yearly.

• Your interest rate cannot increase or decrease more than 2 percentage points per year.

• Your interest rate cannot increase or decrease more than 5 percentage points over the term of the loan.

*How Your Monthly Payment Can Change*

• Your monthly payment can increase or decrease substantially based on annual changes in the interest rate.

• [For example, on a $10,000, 30-year loan with an initial interest rate of 12.41 percent in effect in July 1996, the maximum amount that the interest rate can rise under this program is 5 percentage points, to 17.41 percent, and the monthly payment can rise from a first-year payment of $106.03 to a maximum of $145.34 in the fourth year. To see what your payment is, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, the monthly payment for a mortgage amount of $60,000 would be: $60,000÷$10,000=6; 6×106.03=$636.18 per month.)

• You will be notified in writing 25 days before the annual payment adjustment may be made. This notice will contain information about your interest rates, payment amount and loan balance.]

*[Example*

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1982 to 1996. This does not necessarily indicate how your index will change in the future. The example is based on the following assumptions:

Amount ..... $10,000
Term ..... 30 years
Payment adjustment ..... 1 year
Interest adjustment ..... 1 year
Margin ..... 3 percentage points
Caps_____ 2 percentage points annual interest rate
_____ 5 percentage points lifetime interest rate
Index_____ Weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year.

| Year (as of 1st week ending in July) | Index (%) | Margin* (percentage points) | Interest Rate (%) | Monthly Payment ($) | Remaining Balance ($) |
|---|---|---|---|---|---|
| 1982 | 14.41 | 3 | 17.41 | 145.90 | 9,989.37 |
| 1983 | 9.78 | 3 | **15.41 | 129.81 | 9,969.66 |
| 1984 | 12.17 | 3 | 15.17 | 127.91 | 9,945.51 |
| 1985 | 7.66 | 3 | **13.17 | 112.43 | 9,903.70 |
| 1986 | 6.36 | 3 | ***12.41 | 106.73 | 9,848.94 |
| 1987 | 6.71 | 3 | ***12.41 | 106.73 | 9,786.98 |
| 1988 | 7.52 | 3 | ***12.41 | 106.73 | 9,716.88 |
| 1989 | 7.97 | 3 | ***12.41 | 106.73 | 9,637.56 |
| 1990 | 8.06 | 3 | ***12.41 | 106.73 | 9,547.83 |
| 1991 | 6.40 | 3 | ***12.41 | 106.73 | 9,446.29 |
| 1992 | 3.96 | 3 | ***12.41 | 106.73 | 9,331.56 |
| 1993 | 3.42 | 3 | ***12.41 | 106.73 | 9,201.61 |
| 1994 | 5.47 | 3 | ***12.41 | 106.73 | 9,054.72 |
| 1995 | 5.53 | 3 | ***12.41 | 106.73 | 8,888.52 |
| 1996 | 5.82 | 3 | ***12.41 | 106.73 | 8,700.37 |

*This is a margin we have used recently; your margin may be different.
**This interest rate reflects a 2 percentage point annual interest rate cap.
***This interest rate reflects a 5 percentage point lifetime interest rate cap.
Note: To see what your payments would have been during that period, divide your mortgage amount by $10,000; then multiply the monthly payment by that amount. (For example, in 1996 the monthly payment for a mortgage amount of $60,000 taken out in 1982 would be: $60,000÷$10,000=6; 6×$106.73=$640.38.)

• You will be notified in writing 25 days before the annual payment adjustment may be made. This notice will contain information about your interest rates, payment amount and loan balance.]

H-15—Graduated Payment Mortgage Sample

**Convenient Savings and Loan** Account number: 4862-88

Michael Jones
500 Walnut Court, Little Creek USA

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate. | FINANCE CHARGE<br>The dollar amount the credit will cost you. | Amount Financed<br>The amount of credit provided to you or on your behalf. | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled. |
|---|---|---|---|
| 15.37 % | $177,970.44 | $43,777 | $221,548.44 |

Your payment schedule will be:

| Number of Payments | Amount of Payments | When Payments Are Due | |
|---|---|---|---|
| 12 | $446.62 | monthly beginning | 6/1/81 |
| 12 | $479.67 | " " | 6/1/82 |
| 12 | $515.11 | " " | 6/1/83 |
| 12 | $553.13 | " " | 6/1/84 |
| 12 | $593.91 | " " | 6/1/85 |
| 300 | varying from $637.68 to $627.37 | " " | 6/1/86 |

**Security:** You are giving a security interest in the property being purchased.

**Late Charge:** If a payment is late, you will be charged 5% of the payment.

**Prepayment:** If you pay off early, you
☒ may ☐ will not have to pay a penalty.
☒ may ☐ will not be entitled to a refund of part of the finance charge.

**Assumption:** Someone buying your home cannot assume the remainder of the mortgage on the original terms.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date, and prepayment refunds and penalties.

e means an estimate

H-16—Mortgage Sample

**You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application.**

**If you obtain this loan, the lender will have a mortgage on your home.**

**YOU COULD LOSE YOUR HOME, AND ANY MONEY YOU HAVE PUT INTO IT, IF YOU DO NOT MEET YOUR OBLIGATIONS UNDER THE LOAN.**

You are borrowing $_____ (optional credit insurance is ☐ is not ☐ included in this amount).

The annual percentage rate on your loan will be: _____%.

Your regular [frequency] payment will be: $_____.
[At the end of your loan, you will still owe us: $ [balloon amount].]

[Your interest rate may increase. Increases in the interest rate could increase your payment. The highest amount your payment could increase is to $_____.]

[46 FR 20892, Apr. 7, 1981, as amended at 46 FR 29246, June 1, 1981; 52 FR 52 FR 48671, Dec. 24, 1987; 53 FR 467, Jan. 7, 1988; Reg. Z, 60 FR 15473, Mar. 24, 1995; 61 FR 49247, Sept. 19, 1996; 62 FR 63444, 63445, Dec. 1, 1997; 62 FR 66179, Dec. 17, 1997; Reg. Z, 63 FR 2723, Jan. 16, 1998; 66 FR 65618, Dec. 20, 2001]

## APPENDIX I TO PART 226—FEDERAL ENFORCEMENT AGENCIES

The following list indicates which federal agency enforces Regulation Z for particular classes of businesses. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

*National banks and federal branches and federal agencies of foreign banks*

District office of the Office of the Comptroller of the Currency for the district in which the institution is located.

*State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act*

Federal Reserve Bank serving the district in which the institution is located.

*Non-member insured banks and insured state branches of foreign banks*

Federal Deposit Insurance Corporation Regional director for the region in which the institution is located.

SAVINGS INSTITUTIONS INSURED UNDER THE SAVINGS ASSOCIATION INSURANCE FUND OF THE FDIC AND FEDERALLY CHARTERED SAVINGS BANKS INSURED UNDER THE BANK INSURANCE FUND OF THE FDIC (BUT NOT INCLUDING STATE-CHARTERED SAVINGS BANKS INSURED UNDER THE BANK INSURANCE FUND).

Office of Thrift Supervision Regional Director for the region in which the institution is located.

FEDERAL CREDIT UNIONS

Regional office of the National Credit Union Administration serving the area in which the Federal credit union is located.

AIR CARRIERS

Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, SW., Washington, DC 20590.

CREDITORS SUBJECT TO PACKERS AND STOCKYARDS ACT

Nearest Packers and Stockyards Administration area supervisor.

FEDERAL LAND BANKS, FEDERAL LAND BANK ASSOCIATIONS, FEDERAL INTERMEDIATE CREDIT BANKS AND PRODUCTION CREDIT ASSOCIATIONS.

Farm Credit Administration, 490 L'Enfant Plaza, SW., Washington, DC 20578.

RETAIL, DEPARTMENT STORES, CONSUMER FINANCE COMPANIES, ALL OTHER CREDITORS, AND ALL NONBANK CREDIT CARD ISSUERS (CREDITORS OPERATING ON A LOCAL OR REGIONAL BASIS SHOULD USE THE ADDRESS OF THE FTC REGIONAL OFFICE IN WHICH THEY OPERATE.)

Division of Credit Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, DC 20580.

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 50 FR 8708, Mar. 5, 1985; 54 FR 53539, Dec. 29, 1989; 56 FR 51322, Oct. 11, 1991; 57 FR 20400, May 13, 1992]

## APPENDIX J TO PART 226—ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CLOSED-END CREDIT TRANSACTIONS

### (A) INTRODUCTION

(1) Section 226.22(a) of Regulation Z provides that the annual percentage rate for other than open end credit transactions shall be determined in accordance with either the actuarial method or the United States Rule method. This appendix contains an explanation of the actuarial method as well as equations, instructions and examples of how this method applies to single advance and multiple advance transactions.

(2) Under the actuarial method, at the end of each unit-period (or fractional unit-period) the unpaid balance of the amount financed is increased by the finance charge earned during that period and is decreased by the total payment (if any) made at the end of that period. The determination of unit-periods and fractional unit-periods shall be consistent with the definitions and rules in paragraphs (b) (3), (4) and (5) of this section and the general equation in paragraph (b)(8) of this section.

(3) In contrast, under the United States Rule method, at the end of each payment period, the unpaid balance of the amount financed is increased by the finance charge earned during that payment period and is decreased by the payment made at the end of that payment period. If the payment is less than the finance charge earned, the adjustment of the unpaid balance of the amount financed is postponed until the end of the next payment period. If at that time the sum of the two payments is still less than the total earned finance charge for the two payment periods, the adjustment of the unpaid balance of the amount financed is postponed still another payment period, and so forth.

### (B) INSTRUCTIONS AND EQUATIONS FOR THE ACTUARIAL METHOD

*(1) General Rule*

The annual percentage rate shall be the nominal annual percentage rate determined

by multiplying the unit-period rate by the number of unit-periods in a year.

*(2) Term of the Transaction*

The term of the transaction begins on the date of its consummation, except that if the finance charge or any portion of it is earned beginning on a later date, the term begins on the later date. The term ends on the date the last payment is due, except that if an advance is scheduled after that date, the term ends on the later date. For computation purposes, the length of the term shall be equal to the time interval between any point in time on the beginning date to the same point in time on the ending date.

*(3) Definitions of Time Intervals*

(i) A period is the interval of time between advances or between payments and includes the interval of time between the date the finance charge begins to be earned and the date of the first advance thereafter or the date of the first payment thereafter, as applicable.

(ii) A common period is any period that occurs more than once in a transaction.

(iii) A standard interval of time is a day, week, semimonth, month, or a multiple of a week or a month up to, but not exceeding, 1 year.

(iv) All months shall be considered equal. Full months shall be measured from any point in time on a given date of a given month to the same point in time on the same date of another month. If a series of payments (or advances) is scheduled for the last day of each month, months shall be measured from the last day of the given month to the last day of another month. If payments (or advances) are scheduled for the 29th or 30th of each month, the last day of February shall be used when applicable.

*(4) Unit-period*

(i) In all transactions other than a single advance, single payment transaction, the unit-period shall be that common period, not to exceed 1 year, that occurs most frequently in the transaction, except that

(A) If 2 or more common periods occur with equal frequency, the smaller of such common periods shall be the unit-period; or

(B) If there is no common period in the transaction, the unit-period shall be that period which is the average of all periods rounded to the nearest whole standard interval of time. If the average is equally near 2 standard intervals of time, the lower shall be the unit-period.

(ii) In a single advance, single payment transaction, the unit-period shall be the term of the transaction, but shall not exceed 1 year.

*(5) Number of Unit-periods Between 2 Given Dates*

(i) The number of days between 2 dates shall be the number of 24-hour intervals between any point in time on the first date to the same point in time on the second date.

(ii) If the unit-period is a month, the number of full unit-periods between 2 dates shall be the number of months measured back from the later date. The remaining fraction of a unit-period shall be the number of days measured forward from the earlier date to the beginning of the first full unit-period, divided by 30. If the unit-period is a month, there are 12 unit-periods per year.

(iii) If the unit-period is a semimonth or a multiple of a month not exceeding 11 months, the number of days between 2 dates shall be 30 times the number of full months measured back from the later date, plus the number of remaining days. The number of full unit-periods and the remaining fraction of a unit-period shall be determined by dividing such number of days by 15 in the case of a semimonthly unit-period or by the appropriate multiple of 30 in the case of a multimonthly unit-period. If the unit-period is a semimonth, the number of unit-periods per year shall be 24. If the number of unit-periods is a multiple of a month, the number of unit-periods per year shall be 12 divided by the number of months per unit-period.

(iv) If the unit-period is a day, a week, or a multiple of a week, the number of full unit-periods and the remaining fractions of a unit-period shall be determined by dividing the number of days between the 2 given dates by the number of days per unit-period. If the unit-period is a day, the number of unit-periods per year shall be 365. If the unit-period is a week or a multiple of a week, the number of unit-periods per year shall be 52 divided by the number of weeks per unit-period.

(v) If the unit-period is a year, the number of full unit-periods between 2 dates shall be the number of full years (each equal to 12 months) measured back from the later date. The remaining fraction of a unit-period shall be

(A) The remaining number of months divided by 12 if the remaining interval is equal to a whole number of months, or

(B) The remaining number of days divided by 365 if the remaining interval is *not* equal to a whole number of months.

(vi) 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, the number of unit-periods in the term shall be 1, and the number of unit-periods per year shall be 12 divided by the number of months in the term or 365 divided by the number of days in the term.

(vii) In a single advance, single payment transaction in which the term is less than a year and is *not* equal to a whole number of

months, the number of unit-periods in the term shall be 1, and the number of unit-periods per year shall be 365 divided by the number of days in the term.

*(6) Percentage Rate for a Fraction of a Unit-period*

The percentage rate of finance charge for a fraction (less than 1) of a unit-period shall be equal to such fraction multiplied by the percentage rate of finance charge per unit-period.

(7) Symbols. The symbols used to express the terms of a transaction in the equation set forth in paragraph (b)(8) of this section are defined as follows:

$A_k$ = The amount of the kth advance.

$q_k$ = The number of full unit-periods from the beginning of the term of the transaction to the kth advance.

$e_k$ = The fraction of a unit-period in the time interval from the beginning of the term of the transaction to the kth advance.

m = The number of advances.

$P_j$ = The amount of the jth payment.

$t_j$ = The number of full unit-periods from the beginning of the term of the transaction to the jth payment.

$f_j$ = The fraction of a unit-period in the time interval from the beginning of the term of the transaction to the jth payment.

n = The number of payments.

i = The percentage rate of finance charge per unit-period, expressed as a decimal equivalent.

Symbols used in the examples shown in this appendix are defined as follows:

$\ddot{a}_{\overline{x}|}$ = The present value of 1 per unit-period for x unit-periods, first payment due immediately.

$$= 1 + \frac{1}{(1+i)} + \frac{1}{(1+i)^2} + \ldots\ldots\ldots\ldots + \frac{1}{(1+i)^{x-1}}$$

w = The number of unit-periods per year.

I = wi x 100 = The nominal annual percentage rate.

(8) General equation. The following equation sets forth the relationship among the terms of a transaction:

$$\frac{A_1}{(1+e_1 i)(1+i)^{q_1}} + \frac{A_2}{(1+e_2 i)(1+i)^{q_2}} + \ldots + \frac{A_m}{(1+e_m i)(1+i)^{q_m}} =$$

$$\frac{P_1}{(1+f_1 i)(1+i)^{t_1}} + \frac{P_2}{(1+f_2 i)(1+i)^{t_2}} + \ldots + \frac{P_n}{(1+f_n i)(1+i)^{t_n}}$$

(9) Solution of general equation by iteration process. (i) The general equation in paragraph (b)(8) of this section, when applied to a simple transaction in which a loan of $1000 is repaid by 36 monthly payments of $33.61 each, takes the special form:

$$A = \frac{33.61\ \ddot{a}_{\overline{36}|}}{(1+i)}$$

Step 1: Let $I_1$ = estimated annual percentage rate = 12.50 %

Evaluate expression for A, letting $i = I_1/(100w)$ = .010416667

Result (referred to as A')= 1004.674391

Step 2: Let $I_2 = I_1 + .1$ = 12.60 %

Evaluate expression for A, letting $i = I_2/(100w)$ = .010500000

Result (referred to as A'') = 1003.235366

Step 3: Interpolate for I (annual percentage rate):

$$I = I_1 + .1\left[\frac{(A - A')}{(A''-A')}\right]$$

$$= 12.50 + .1\left[\frac{(1000.000000 - 1004.674391)}{(1003.235366 - 1004.674391)}\right] = 12.82483042\ \%$$

Step 4: First iteration, let $I_1$ = 12.82483042 % and repeat Steps 1, 2, and 3 obtaining a new I = 12.82557859 %

Second iteration, let $I_1$ = 12.82557859 % and repeat Steps 1, 2, and 3 obtaining a new I = 12.82557529 %

In this case, no further iterations are required to obtain the annual percentage rate correct to two decimal places, 12.83%.

(ii) When the iteration approach is used, it is expected that calculators or computers will be programmed to carry all available decimals throughout the calculation and that enough iterations will be performed to make virtually certain that the annual percentage rate obtained, when rounded to 2 decimals, is correct. Annual percentage rates in the examples below were obtained by using a 10 digit programmable calculator and the iteration procedure described above.

(c) Examples for the actuarial method. (1) Single advance transaction, with or without an odd first period, and otherwise regular. The general equation in paragraph (b)(8) of this section can be put in the following special form for this type of transaction:

$$A = \frac{1}{(1+fi)(1+i)^{t}}\left(P\,\ddot{a}_{\overline{n}|}\right)$$

Example (i): Monthly payments (regular first period)

Amount advanced (A) = $5000. Payment (P) = $230.
Number of payments (n) = 24.
Unit-period = 1 month. Unit-periods per year (w) = 12.
Advance, 1-10-78. First payment, 2-10-78.
From 1-10-78 through 2-10-78 = 1 unit-period. (t = 1; f= 0)
Annual percentage rate (I) = wi = .0969 = 9.69 %

Example (ii): Monthly payments (long first period)

Amount advanced (A) = $6000. Payment (P) = $200.
Number of payments (n) = 36.
Unit-period = 1 month. Unit-periods per year (w) = 12.
Advance, 2-10-78. First payment, 4-1-78.
From 3-1-78 through 4-1-78 = 1 unit-period. (t = 1)
From 2-10-78 through 3-1-78 = 19 days. (f = 19/30)
Annual percentage rate (I) = wi = .1182 = 11.82%

Example (iii): Semimonthly payments (short first period)

Amount advanced (A) = $5000. Payment (P) = $219.17.
Number of payments (n) = 24.
Unit-period = 1/2 month. Unit-periods per year (w) = 24.
Advance, 2-23-78. First payment, 3-1-78. Payments made on 1st and 16th of each month.
From 2-23-78 through 3-1-78 = 6 days. (t = 0; f = 6/15)
Annual percentage rate (I) = wi = .1034 = 10.34 %

Example (iv): Quarterly payments (long first period)

Amount advanced (A) = $10,000. Payment (P) = $385.
Number of payments (n) = 40.
Unit-period = 3 months. Unit-periods per year (w) = 4.
Advance, 5-23-78. First payment, 10-1-78.
From 7-1-78 through 10-1-78 = 1 unit-period. (t = 1)
From 6-1-78 through 7-1-78 = 1 month = 30 days. From 5-23-78 through 6-1-78 = 9 days. (f = 39/90)
Annual percentage rate (I) = wi = .0897 = 8.97 %

Example (v): Weekly payments (long first period)

Amount advanced (A) = $500. Payment (P) = $17.60.
Number of payments (n) = 30.
Unit-period = 1 week. Unit-periods per year (w) = 52.
Advance, 3-20-78. First payment, 4-21-78.
From 3-24-78 through 4-21-78 = 4 unit-periods. (t = 4)
From 3-20-78 through 3-24-78 = 4 days. (f = 4/7)
Annual percentage rate (I) = wi = .1496 = 14.96 %

(2) Single advance transaction, with an odd first payment, with or without an odd first period, and otherwise regular. The general equation in paragraph (b)(8) of this section can be put in the following special form for this type of transaction:

$$A = \frac{1}{(1+fi)(1+i)^{t}} \left[ P_1 + \frac{P\,\ddot{a}_{\overline{n-1}|}}{(1+i)} \right]$$

Example (i): Monthly payments (regular first period and irregular first payment)

Amount advanced (A) = $5000. First payment $\left(P_1\right)$ = $250.
Regular payment (P) = $230. Number of payments (n) = 24.
Unit-period = 1 month. Unit-periods per year (w) = 12.
Advance, 1-10-78. First payment, 2-10-78.
From 1-10-78 through 2-10-78 = 1 unit-period. (t = 1; f = 0)
Annual percentage rate (I) = wi = .1008 = 10.08%

Example (ii): Payments every 4 weeks (long first period and irregular first payment)

Amount advanced (A) = $400. First payment $\left(P_1\right)$ = $39.50.
Regular payment (P) = $38.31. Number of payments (n) = 12.
Unit-period = 4 weeks. Unit-periods per year (w) = 52/4 = 13.
Advance, 3-18-78. First payment, 4-20-78.
From 3-23-78 through 4-20-78 = 1 unit-period. (t = 1)
From 3-18-78 through 3-23-78 = 5 days. (f = 5/28)
Annual percentage rate (I) = wi = .2850 = 28.50%

(3) Single advance transaction, with an odd final payment, with or without an odd first period, and otherwise regular. The general equation in paragraph (b)(8) of this section can be put in the following special form for this type of transaction:

$$A = \frac{1}{(1+fi)(1+i)^{t}} \left[ P\,\ddot{a}_{\overline{n-1}|} + \frac{Pn}{(1+i)^{n-1}} \right]$$

Example (i): Monthly payments (regular first period and irregular final payment)

Amount advanced (A) = $5000. Regular payment (P) = $230.
Final payment $\left(P_n\right)$ = $280. Number of payments (n) = 24.
Unit-period = 1 month. Unit-periods per year (w) = 12.
Advance, 1-10-78. First payment, 2-10-78.
From 1-10-78 through 2-10-78 = 1 unit-period. (t = 1; f = 0)
Annual percentage rate (I) = wi = .1050 = 10.50%

Example (ii): Payments every 2 weeks (short first period and irregular final payment)

Amount advanced (A) = $200. Regular payment (P) = $9.50.
Final payment $\left(P_n\right)$ = $30. Number of payments (n) = 20.
Unit-period = 2 weeks. Unit-periods per year (w) = 52/2 = 26.
Advance, 4-3-78. First payment, 4-11-78.
From 4-3-78 through 4-11-78 = 8 days. (t = 0; f = 8/14)
Annual percentage rate (I) = wi = .1222 = 12.22%

(4) Single advance transaction, with an odd first payment, odd final payment, with or without an odd first period, and otherwise regular. The general equation in paragraph (b)(8) of this section can be put in the following special form for this type of transaction:

$$A = \frac{1}{(1+fi)(1+i)^t}\left[P_1 + \frac{P\,\ddot{a}_{\overline{n-2}|}}{(1+i)} + \frac{P_n}{(1+i)^{n-1}}\right]$$

Example (i): Monthly payments (regular first period, irregular first payment, and irregular final payment)

Amount advanced (A) = $5000. First payment $\left(P_1\right)$ = $250.
Regular payment (P) = $230. Final payment $\left(P_n\right)$ = $280.
Number of payments (n) = 24. Unit-period = 1 month.
Unit-periods per year (w) = 12.
Advance, 1-10-78. First payment, 2-10-78.
From 1-10-78 through 2-10-78 = 1 unit-period. (t = 1; f = 0)
Annual percentage rate (I) = wi = .1090 = 10.90%

Example (ii): Payments every two months (short first period, irregular first payment, and irregular final payment)

Amount advanced (A) = $8000. First payment $\left(P_1\right)$ = $449.36.
Regular payment (P) = $465. Final payment $\left(P_n\right)$ = $200.
Number of payments (n) = 20. Unit-period = 2 months.
Unit-periods per year (w) = 12/2 = 6.
Advance, 1-10-78. First payment, 3-1-78.
From 2-1-78 through 3-1-78 = 1 month. From 1-10-78 through 2-1-78 = 22 days. (t = 0; f = 52/60)
Annual percentage rate (I) = wi = .0730 = 7.30%

(5) Single advance, single payment transaction. The general equation in paragraph (b)(8) of this section can be put in the special forms below for single advance, single payment transactions. Forms 1 through 3 are for the direct determination of the annual percentage rate under special conditions. Form 4 requires the use of the iteration procedure of paragraph (b)(9) of this section and can be used for all single advance, single payment transactions regardless of term.

Form 1 - Term less than 1 year:

$$I = 100w\left(\frac{P}{A} - 1\right)$$

Form 2 - Term more than 1 year but less than 2 years:

$$I = \frac{50}{f}\left\{\left[(1 + f)^2 + 4f\left(\frac{P}{A} - 1\right)\right]^{1/2} - (1 + f)\right\}$$

Form 3 - Term equal to exactly a year or exact multiple of a year:

$$I = 100\left[\left(\frac{P}{A}\right)^{1/t} - 1\right]$$

Form 4 - Special form for iteration procedure (no restriction on term):

$$A = \frac{P}{(1 + fi)(1 + i)^t}$$

Example (i): Single advance, single payment (term of less than 1 year, measured in days)

Amount advanced (A) = $1000. Payment (P) = $1080.
Unit-period = 255 days. Unit-periods per year (w) = 365/255.
Advance, 1-3-78. Payment, 9-15-78.
From 1-3-78 through 9-15-78 = 255 days. (t = 1; f = 0)
Annual percentage rate (I) = wi = .1145 = 11.45%. (Use Form 1 or 4.)

Example (ii): Single advance, single payment (term of less than 1 year, measured in exact calendar months)

Amount advanced (A) = $1000. Payment (P) = $1044.
Unit-period = 6 months. Unit-periods per year (w) = 2.
Advance, 7-15-78. Payment, 1-15-79.
From 7-15-78 through 1-15-79 = 6 mos. (t = 1; f = 0)
Annual percentage rate (I) = wi = .0880 = 8.80%. (Use Form 1 or 4.)

Example (iii): Single advance, single payment (term of more than 1 year but less than 2 years, fraction measured in exact months)

Amount advanced (A) = $1000. Payment (P) = $1135.19.
Unit-period = 1 year. Unit-periods per year (w) = 1.
Advance, 7-17-78. Payment, 1-17-80.
From 1-17-79 through 1-17-80 = 1 unit-period. (t = 1)
From 7-17-78 through 1-17-79 = 6 mos. (f = 6/12)
Annual percentage rate (I) = wi = .0876 = 8.76%. (Use Form 2 or 4.)

Example (iv): Single advance, single payment (term of exactly 2 years)

Amount advanced (A) = $1000. Payment (P) = $1240.
Unit-period = 1 year. Unit-periods per year (w) = 1.
Advance, 1-3-78. Payment, 1-3-80.
From 1-3-78 through 1-3-79 = 1 unit-period. (t = 2; f = 0)
Annual percentage rate (I) = wi = .1136 = 11.36%. (Use Form 3 or 4.)

(6) Complex single advance transaction.

Example (i): Skipped payment loan (payments every 4 weeks)

A loan of $2135 is advanced on 1-25-78. It is to be repaid by 24 payments of $100 each. Payments are due every 4 weeks beginning 2-20-78. However, in those months in which 2 payments would be due, only the first of the 2 payments is made and the following payment is delayed by 2 weeks to place it in the next month.
Unit-period = 4 weeks. Unit-periods per year (w) = 52/4 = 13.
First series of payments begins 26 days after 1-25-78.
$(t_1 = 0;\ f_1 = 26/28)$

Second series of payments begins 9 unit-periods plus 2 weeks after start of first series. $(t_2 = 10;\ f_2 = 12/28)$

Third series of payments begins 6 unit-periods plus 2 weeks after start of second series. $(t_3 = 16;\ f_3 = 26/28)$

Last series of payments begins 6 unit-periods plus 2 weeks after start of third series. $(t_4 = 23;\ f_4 = 12/28)$

The general equation in paragraph (b)(8) of this section can be written in the special form:

$$2135 = \frac{100\,\ddot{a}_{\overline{9}|}}{(1+(26/28)i)} + \frac{100\,\ddot{a}_{\overline{6}|}}{(1+(12/28)i)(1+i)^{10}} + \frac{100\,\ddot{a}_{\overline{6}|}}{(1+(26/28)i)(1+i)^{16}} + \frac{100\,\ddot{a}_{\overline{3}|}}{(1+(12/28)i)(1+i)^{23}}$$

Annual percentage rate (I) = wi = .1200 = 12.00%

Example (ii): Skipped payment loan plus single payments

A loan of $7350 on 3-3-78 is to be repaid by 3 monthly payments of $1000 each beginning 9-15-78, plus a single payment of $2000 on 3-15-79, plus 3 more monthly payments of $750 each beginning 9-15-79, plus a final payment of $1000 on 2-1-80.
Unit-period = 1 month. Unit-periods per year (w) = 12.
First series of payments begins 6 unit-periods plus 12 days after 3-3-78. ($t_1 = 6$; $f_1 = 12/30$)

Second series of payments (single payment) occurs 12 unit-periods plus 12 days after 3-3-78. ($t_2 = 12$; $f_2 = 12/30$)

Third series of payments begins 18 unit-periods plus 12 days after 3-3-78. ($t_3 = 18$; $f_3 = 12/30$)

Final payment occurs 22 unit-periods plus 29 days after 3-3-78. ($t_4 = 22$; $f_4 = 29/30$)

The general equation in paragraph (b)(8) of this section can be written in the special form:

$$7350 = \frac{1000\ \ddot{a}_{\overline{3}|}}{(1+(12/30)i)(1+i)^{6}} + \frac{2000}{(1+(12/30)i)(1+i)^{12}} + \frac{750\ \ddot{a}_{\overline{3}|}}{(1+(12/30)i)(1+i)^{18}} + \frac{1000}{(1+(29/30)i)(1+i)^{22}}$$

Annual percentage rate (I) = wi = .1022 = 10.22%

Example (iii): Mortgage with varying payments

A loan of $39,688.56 (net) on 4-10-78 is to be repaid by 360 monthly payments beginning 6-1-78. Payments are the same for 12 months at a time as follows:

| Year | Monthly payment | Year | Monthly payment | Year | Monthly payment |
|---|---|---|---|---|---|
| 1 | $291.81 | 11 | $385.76 | 21 | $380.43 |
| 2 | 300.18 | 12 | 385.42 | 22 | 379.60 |
| 3 | 308.78 | 13 | 385.03 | 23 | 378.68 |
| 4 | 317.61 | 14 | 384.62 | 24 | 377.69 |
| 5 | 326.65 | 15 | 384.17 | 25 | 376.60 |
| 6 | 335.92 | 16 | 383.67 | 26 | 375.42 |
| 7 | 345.42 | 17 | 383.13 | 27 | 374.13 |
| 8 | 355.15 | 18 | 382.54 | 28 | 372.72 |
| 9 | 365.12 | 19 | 381.90 | 29 | 371.18 |
| 10 | 375.33 | 20 | 381.20 | 30 | 369.50 |

Unit-period = 1 month. Unit-periods per year (w) = 12.
From 5-1-78 through 6-1-78 = 1 unit-period. (t = 1)
From 4-10-78 through 5-1-78 = 21 days. (f = 21/30)

The general equation in paragraph (b)(8) of this section can be written in the special form:

$$39{,}688.56 = \frac{\ddot{a}_{\overline{12}|}}{(1+(21/30)i)(1+i)} \left[ 291.81 + \frac{300.18}{(1+i)^{12}} + \frac{308.78}{(1+i)^{24}} + \ldots \ldots + \frac{369.50}{(1+i)^{348}} \right]$$

Annual percentage rate (I) = wi = .0980 = 9.80%

(7) Multiple advance transactions.

Example (i): Construction loan

Three advances of $20,000 each are made on 4-10-79, 6-12-79, and 9-18-79. Repayment is by 240 monthly payments of $612.36 each beginning 12-10-79.
Unit-period = 1 month. Unit-periods per year (w) = 12.
From 4-10-79 through 6-12-79 = (2+2/30) unit-periods.
From 4-10-79 through 9-18-79 = (5+8/30) unit-periods.
From 4-10-79 through 12-10-79 = (8) unit-periods.

The general equation in paragraph (b)(8) of this section is changed to the single advance mode by treating the 2nd and 3rd advances as negative payments:

$$20{,}000 = \frac{612.36\ \ddot{a}_{\overline{240}|}}{(1+i)^{8}} - \frac{20{,}000}{(1+(2/30)i)(1+i)^{2}} - \frac{20{,}000}{(1+(8/30)i)(1+i)^{5}}$$

Annual percentage rate (I) = wi = .1025 = 10.25%

Example (ii): Student loan

A student loan consists of 8 advances: $1800 on 9-5-78, 9-5-79, 9-5-80, and 9-5-81; plus $1000 on 1-5-79, 1-5-80, 1-5-81, and 1-5-82. The borrower is to make 50 monthly payments of $240 each beginning 7-1-78 (prior to first advance).
Unit-period = 1 month. Unit-periods per year (w) = 12.
Zero point is date of first payment since it precedes first advance.
From 7-1-78 to 9-5-78 = (2 + 4/30) unit-periods.

" " " 9-5-79 = (14 + 4/30) "

" " " 9-5-80 = (26 + 4/30) "

" " " 9-5-81 = (38 + 4/30) "

" " " 1-5-79 = (6 + 4/30) "

" " " 1-5-80 = (18 + 4/30) "

" " " 1-5-81 = (30 + 4/30) "

" " " 1-5-82 = (42 + 4/30) "

Since the zero point is date of first payment, the general equation in paragraph (b)(8) of this section is written in the single advance form below by treating the first payment as a negative advance and the 8 advances as negative payments:

$$-240 = \frac{240\ \ddot{a}_{\overline{49}|}}{(1+i)} - \frac{1800}{(1+(4/30)i)}\left[\frac{1}{(1+i)^{2}} + \frac{1}{(1+i)^{14}} + \frac{1}{(1+i)^{26}} + \frac{1}{(1+i)^{38}}\right]$$

$$- \frac{1000}{(1+(4/30)i)}\left[\frac{1}{(1+i)^{6}} + \frac{1}{(1+i)^{18}} + \frac{1}{(1+i)^{30}} + \frac{1}{(1+i)^{42}}\right]$$

Annual percentage rate (I) = wi = .3204 = 32.04%

[46 FR 20892, Apr. 7, 1981, as amended at 46 FR 29246, June 1, 1981]

[Reg. Z, 46 FR 20892, Apr. 7, 1981, as amended at 46 FR 29246, June 1, 1981]

## APPENDIX K TO PART 226—TOTAL ANNUAL LOAN COST RATE COMPUTATIONS FOR REVERSE MORTGAGE TRANSACTIONS

(a) *Introduction.* Creditors are required to disclose a series of total annual loan cost rates for each reverse mortgage transaction. This appendix contains the equations creditors must use in computing the total annual loan cost rate for various transactions, as well as instructions, explanations, and examples for various transactions. This appendix is modeled after appendix J of this part (Annual Percentage Rates Computations for Closed-end Credit Transactions); creditors should consult appendix J of this part for additional guidance in using the formulas for reverse mortgages.

(b) *Instructions and equations for the total annual loan cost rate*—(1) *General rule.* The total annual loan cost rate shall be the nominal total annual loan cost rate determined by multiplying the unit-period rate by the number of unit-periods in a year.

(2) *Term of the transaction.* For purposes of total annual loan cost disclosures, the term of a reverse mortgage transaction is assumed to begin on the first of the month in which consummation is expected to occur. If a loan cost or any portion of a loan cost is initially incurred beginning on a date later than consummation, the term of the transaction is assumed to begin on the first of the month in which that loan cost is incurred. For purposes of total annual loan cost disclosures, the term ends on each of the assumed loan periods specified in § 226.33(c)(6).

(3) *Definitions of time intervals.*

(i) A *period* is the interval of time between advances.

(ii) A *common period* is any period that occurs more than once in a transaction.

(iii) A *standard interval of time* is a day, week, semimonth, month, or a multiple of a week or a month up to, but not exceeding, 1 year.

(iv) All months shall be considered to have an equal number of days.

(4) *Unit-period.* (i) In all transactions other than single-advance, single-payment transactions, the unit-period shall be that common period, not to exceed one year, that occurs most frequently in the transaction, except that:

(A) If two or more common periods occur with equal frequency, the smaller of such common periods shall be the unit-period; or

(B) If there is no common period in the transaction, the unit-period shall be that period which is the average of all periods rounded to the nearest whole standard interval of time. If the average is equally near two standard intervals of time, the lower shall be the unit-period.

(ii) In a single-advance, single-payment transaction, the unit-period shall be the term of the transaction, but shall not exceed one year.

(5) *Number of unit-periods between two given dates.* (i) The number of days between two dates shall be the number of 24-hour intervals between any point in time on the first date to the same point in time on the second date.

(ii) If the unit-period is a month, the number of full unit-periods between two dates shall be the number of months. If the unit-period is a month, the number of unit-periods per year shall be 12.

(iii) If the unit-period is a semimonth or a multiple of a month not exceeding 11 months, the number of days between two dates shall be 30 times the number of full months. The number of full unit-periods shall be determined by dividing the number of days by 15 in the case of a semimonthly unit-period or by the appropriate multiple of 30 in the case of a multimonthly unit-period. If the unit-period is a semimonth, the number of unit-periods per year shall be 24. If the number of unit-periods is a multiple of a month, the number of unit-periods per year shall be 12 divided by the number of months per unit-period.

(iv) If the unit-period is a day, a week, or a multiple of a week, the number of full unit-periods shall be determined by dividing the number of days between the two given dates by the number of days per unit-period. If the unit-period is a day, the number of unit-periods per year shall be 365. If the unit-period is a week or a multiple of a week, the number of unit-periods per year shall be 52 divided by the number of weeks per unit-period.

(v) If the unit-period is a year, the number of full unit-periods between two dates shall be the number of full years (each equal to 12 months).

(6) *Symbols.* The symbols used to express the terms of a transaction in the equation set forth in paragraph (b)(8) of this appendix are defined as follows:

$A_j$=The amount of each periodic or lump-sum advance to the consumer under the reverse mortgage transaction.

i=Percentage rate of the total annual loan cost per unit-period, expressed as a decimal equivalent.

j=The number of unit-periods until the jth advance.

n=The number of unit-periods between consummation and repayment of the debt.

$P_n$=Min ($Bal_n$, $Val_n$). This is the maximum amount that the creditor can be repaid at the specified loan term.

$Bal_n$=Loan balance at time of repayment, including all costs and fees incurred by the consumer (including any shared appreciation or shared equity amount) compounded to time n at the creditor's contract rate of interest.

$Val_n = Val_0 (1 + \sigma)^y$, where $Val_0$ is the property value at consummation, $\sigma$ is the assumed

annual rate of appreciation for the dwelling, and y is the number of years in the assumed term. $Val_n$ must be reduced by the amount of any equity reserved for the consumer by agreement between the parties, or by 7 percent (or the amount or percentage specified in the credit agreement), if the amount required to be repaid is limited to the net proceeds of sale.

σ = The summation operator.

Symbols used in the examples shown in this appendix are defined as follows:

$FV_{x\neg}i$ = The future value of 1 per unit period for x unit periods, first advance due immediately (at time = 0, which is consummation).

$$= \sum_{j=0}^{x-1} (1+i)^{x-j}$$

$$= (1+i)^x + (1+i)^{x-1} + \cdots (1+i)^1; \text{ or}$$

$$= \frac{(1+i)^n - 1}{i} \times (1+i)$$

w=The number of unit-periods per year.

I=wi×100=the nominal total annual loan cost rate.

(7) *General equation.* The total annual loan cost rate for a reverse mortgage transaction must be determined by first solving the following formula, which sets forth the relationship between the advances to the consumer and the amount owed to the creditor under the terms of the reverse mortgage agreement for the loan cost rate per unit-period (the loan cost rate per unit-period is then multiplied by the number of unit-periods per year to obtain the total annual loan cost rate I; that is, I = wi):

$$\sum_{j=0}^{n-1} A_j (1+i)^{n-j} = P_n$$

(8) *Solution of general equation by iteration process.* (i) The general equation in paragraph (b)(7) of this appendix, when applied to a simple transaction for a reverse mortgage loan of equal monthly advances of $350 each, and with a total amount owed of $14,313.08 at an assumed repayment period of two years, takes the special form:

$$P_n = 350\ FV_{24\neg}\ i, \text{ or}$$

$$P_n = 350 \times \left[ \frac{(1+i)^n - 1}{i} \times (1+i) \right]$$

Using the iteration procedures found in steps 1 through 4 of (b)(9)(i) of appendix J of this part, the total annual loan cost rate, correct to two decimals, is 48.53%.

(ii) In using these iteration procedures, it is expected that calculators or computers will be programmed to carry all available decimals throughout the calculation and that enough iterations will be performed to make virtually certain that the total annual loan cost rate obtained, when rounded to two decimals, is correct. Total annual loan cost rates in the examples below were obtained by using a 10-digit programmable calculator and the iteration procedure described in appendix J of this part.

(9) *Assumption for discretionary cash advances.* If the consumer controls the timing of advances made after consummation (such as in a credit line arrangement), the creditor must use the general formula in paragraph (b)(7) of this appendix. The total annual loan cost rate shall be based on the assumption that 50 percent of the principal loan amount is advanced at closing, or in the case of an open-end transaction, at the time the consumer becomes obligated under the plan. Creditors shall assume the advances are made at the interest rate then in effect and that no further advances are made to, or repayments made by, the consumer during the term of the transaction or plan.

(10) *Assumption for variable-rate reverse mortgage transactions.* If the interest rate for a reverse mortgage transaction may increase during the loan term and the amount or timing is not known at consummation, creditors shall base the disclosures on the initial interest rate in effect at the time the disclosures are provided.

(11) *Assumption for closing costs.* In calculating the total annual loan cost rate, creditors shall assume all closing and other consumer costs are financed by the creditor.

(c) *Examples of total annual loan cost rate computations*—(1) *Lump-sum advance at consummation.*

Lump-sum advance to consumer at consummation: $30,000

Total of consumer's loan costs financed at consummation: $4,500

Contract interest rate: 11.60%

Estimated time of repayment (based on life expectancy of a consumer at age 78): 10 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 4%

$P_{10}$ = Min (103,385.84, 137,662.72)

$$30{,}000(1+i)^{10-0}+\sum_{j=0}^{9}0(1+i)^{10-j}=103{,}385.84$$

i = .1317069438

Total annual loan cost rate (100(.1317069438 × 1)) = 13.17%

(2) *Monthly advance beginning at consummation.*

Monthly advance to consumer, beginning at consummation: $492.51

Total of consumer's loan costs financed at consummation: $4,500

Contract interest rate: 9.00%

Estimated time of repayment (based on life expectancy of a consumer at age 78): 10 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 8%

$$P_{120}=\text{Min}\,(107{,}053.63,\ 200{,}780.02)$$

$$492.51\times\left[\frac{(1+i)^{120}-1}{i}\times(1+i)\right]=107{,}053.63$$

$$i=.009061140$$

Total annual loan cost rate (100(.009061140 × 12))=10.87%

(3) *Lump sum advance at consummation and monthly advances thereafter.*

Lump sum advance to consumer at consummation: $10,000

Monthly advance to consumer, beginning at consummation: $725

Total of consumer's loan costs financed at consummation: $4,500

Contract rate of interest: 8.5%

Estimated time of repayment (based on life expectancy of a consumer at age 75): 12 years

Appraised value of dwelling at consummation: $100,000

Assumed annual dwelling appreciation rate: 8%

$$P_{144}=\text{Min}\,(221{,}818.30,\ 234{,}189.82)$$

$$10{,}000(1+i)^{144-0}+\sum_{j=0}^{143}725(1+i)^{144-j}=221{,}818.30$$

$$i=.007708844$$

Total annual loan cost rate (100(.007708844 × 12)) = 9.25%

(d) *Reverse mortgage model form and sample form*—(1) *Model form.*

TOTAL ANNUAL LOAN COST RATE

*Loan Terms*

Age of youngest borrower:
Appraised property value:
Interest rate:
Monthly advance:
Initial draw:
Line of credit:

*Initial Loan Charges*

Closing costs:
Mortgage insurance premium:
Annuity cost:

*Monthly Loan Charges*

Servicing fee:

*Other Charges:*

Mortgage insurance:
Shared Appreciation:

*Repayment Limits*

| Assumed annual appreciation | Total annual loan cost rate | | | |
|---|---|---|---|---|
| | 2-year loan term | [ ]-year loan term] | [ ]-year loan term | [ ]-year loan term |
| 0% | | [ ] | | |
| 4% | | [ ] | | |
| 8% | | [ ] | | |

The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the total annual loan cost rate will be.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three [four] loan terms: 2 years, [half of life expectancy for someone your age,] that life expectancy, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%, 4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

SIGNING AN APPLICATION OR RECEIVING THESE DISCLOSURES DOES NOT REQUIRE YOU TO COMPLETE THIS LOAN

(2) Sample Form.

TOTAL ANNUAL LOAN COST RATE

*Loan Terms*

Age of youngest borrower: 75
Appraised property value: $100,000
Interest rate: 9%
Monthly advance: $301.80
Initial draw: $1,000
Line of credit: $4,000

*Initial Loan Charges*

Closing costs: $5,000
Mortgage insurance premium: None
Annuity cost: None

*Monthly Loan Charges*

Servicing fee: None

*Other Charges*

Mortgage insurance: None
Shared Appreciation: None

*Repayment Limits*

Net proceeds estimated at 93% of projected home sale

| Assumed annual appreciation | Total annual loan cost rate | | | |
|---|---|---|---|---|
| | 2-year loan term | [6-year loan term] | 12-year loan term | 17-year loan term |
| 0% | 39.00% | [14.94%] | 9.86% | 3.87% |
| 4% | 39.00% | [14.94%] | 11.03% | 10.14% |
| 8% | 39.00% | [14.94%] | 11.03% | 10.20% |

The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the total annual loan cost rate will be.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three [four] loan terms: 2 years, [half of life expectancy for someone your age,] that life expectancy, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%,4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not disposition costs—costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

SIGNING AN APPLICATION OR RECEIVING THESE DISCLOSURES DOES NOT REQUIRE YOU TO COMPLETE THIS LOAN

[Reg. Z, 60 FR 15474, Mar. 24, 1995, as amended at 60 FR 50400, Sept. 29, 1995]

## APPENDIX L TO PART 226—ASSUMED LOAN PERIODS FOR COMPUTATIONS OF TOTAL ANNUAL LOAN COST RATES

(a) *Required tables.* In calculating the total annual loan cost rates in accordance with appendix K of this part, creditors shall assume three loan periods, as determined by the following table.

(b) *Loan periods.*

(1) Loan Period 1 is a two-year loan period.

(2) Loan Period 2 is the life expectancy in years of the youngest borrower to become obligated on the reverse mortgage loan, as shown in the U.S. Decennial Life Tables for 1979–1981 for females, rounded to the nearest whole year.

(3) Loan Period 3 is the life expectancy figure in Loan Period 3, multiplied by 1.4 and rounded to the nearest full year (life expectancy figures at .5 have been rounded up to 1).

(4) At the creditor's option, an additional period may be included, which is the life expectancy figure in Loan Period 2, multiplied by .5 and rounded to the nearest full year (life expectancy figures at .5 have been rounded up to 1).

| Age of youngest borrower | Loan period 1 (in years) | [Optional loan period (in years)] | Loan period 2 (life expectancy) (in years) | Loan period 3 (in years) |
|---|---|---|---|---|
| 62 | 2 | [11] | 21 | 29 |
| 63 | 2 | [10] | 20 | 28 |
| 64 | 2 | [10] | 19 | 27 |
| 65 | 2 | [9] | 18 | 25 |
| 66 | 2 | [9] | 18 | 25 |
| 67 | 2 | [9] | 17 | 24 |
| 68 | 2 | [8] | 16 | 22 |
| 69 | 2 | [8] | 16 | 22 |
| 70 | 2 | [8] | 15 | 21 |
| 71 | 2 | [7] | 14 | 20 |
| 72 | 2 | [7] | 13 | 18 |
| 73 | 2 | [7] | 13 | 18 |
| 74 | 2 | [6] | 12 | 17 |
| 75 | 2 | [6] | 12 | 17 |
| 76 | 2 | [6] | 11 | 15 |
| 77 | 2 | [5] | 10 | 14 |
| 78 | 2 | [5] | 10 | 14 |
| 79 | 2 | [5] | 9 | 13 |
| 80 | 2 | [5] | 9 | 13 |
| 81 | 2 | [4] | 8 | 11 |
| 82 | 2 | [4] | 8 | 11 |
| 83 | 2 | [4] | 7 | 10 |
| 84 | 2 | [4] | 7 | 10 |
| 85 | 2 | [3] | 6 | 8 |
| 86 | 2 | [3] | 6 | 8 |
| 87 | 2 | [3] | 6 | 8 |
| 88 | 2 | [3] | 5 | 7 |
| 89 | 2 | [3] | 5 | 7 |
| 90 | 2 | [3] | 5 | 7 |
| 91 | 2 | [2] | 4 | 6 |
| 92 | 2 | [2] | 4 | 6 |
| 93 | 2 | [2] | 4 | 6 |
| 94 | 2 | [2] | 4 | 6 |
| 95 and over | 2 | [2] | 3 | 4 |

[60 FR 15476, Mar. 24, 1995]

## SUPPLEMENT I TO PART 226—OFFICIAL STAFF INTERPRETATIONS

### INTRODUCTION

1. *Official status.* This commentary is the vehicle by which the staff of the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation Z, as revised effective April 1, 1981. Good faith compliance with this commentary affords protection from liability under 130(f) of the Truth in Lending Act. Section 130(f) (15 U.S.C. 1640) protects creditors from civil liability for any act done or omitted in good faith in conformity with any interpretation issued by a duly authorized official or employee of the Federal Reserve System.

2. *Procedure for requesting interpretations.* Under appendix C of the regulation, anyone may request an official staff interpretation. Interpretations that are adopted will be incorporated in this commentary following publication in the FEDERAL REGISTER. No official staff interpretations are expected to be issued other than by means of this commentary.

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

4. *Rules of construction.* (a) Lists that appear in the commentary may be exhaustive or illustrative; the appropriate construction should be clear from the context. In most cases, illustrative lists are introduced by phrases such as ''including, but not limited to,'' ''among other things,'' ''for example,'' or ''such as.''

(b) Throughout the commentary and regulation, reference to the regulation should be construed to refer to revised Regulation Z, unless the context indicates that a reference to previous Regulation Z is also intended.

(c) Throughout the commentary, reference to ''this section'' or ''this paragraph'' means the section or paragraph in the regulation that is the subject of the comment.

5. *Comment designations.* Each comment in the commentary is identified by a number and the regulatory section or paragraph which it interprets. The comments are designated with as much specificity as possible according to the particular regulatory provision addressed. For example, some of the comments to §226.18(b) are further divided by paragraph, such as Comment 18(b)(1)–1 and Comment 18(b)(2)–1. In other cases, comments have more general application and are designated, for example, as Comment 18–1 or Comment 18(b)–1. This introduction may be cited as Comments I–1 through I–7. Comments to the appendices may be cited, for example, as Comment app. A–1.

6. *Cross-references.* The following cross-references to related material appear at the end of each section of the commentary:

(a) ''Statute''—those sections of the Truth in Lending Act on which the regulatory provision is based (and any other relevant statutes);

(b) ''Other sections''—other provisions in the regulation necessary to understand that section;

(c) ''Previous regulation''—parallel provisions in previous Regulation Z; and

(d) ''1981 changes''—a brief description of the major changes made by the 1981 revisions to Regulation Z.

Where appropriate a fifth category (''Other regulations'') provides cross-references to other regulations.

7. *Transition rules.* (a) Though compliance with the revised regulation is not mandatory until April 1, 1982, creditors may begin complying as of April 1, 1981. During the intervening year, a creditor may convert its entire operation to the new requirements at one time, or it may convert to the new requirements in stages. In general, however, a creditor may not mix the regulatory requirements when making disclosures for a particular closed-end transaction or open-end account; all the disclosures for a single closed-end transaction (or open-end account) must be made in accordance with the previous regulation, or all the disclosures must be made in accordance with the revised regulation. As an exception to the general rule, the revised rescission rules and the revised advertising rules may be followed even if the disclosures are based on the previous regulation. For purposes of this regulation, the creditor is not required to take any particular action beyond the requirements of the revised regulation to indicate its conversion to the revised regulation.

(b) The revised regulation may be relied on to determine if any disclosures are required for a particular transaction or to determine if a person is a *creditor* subject to Truth in Lending requirements, whether or not other operations have been converted to the revised regulation. For example, layaway plans are not subject to the revised regulation, nor are oral agreements to lend money if there is no finance charge. These provisions may be relied on even if the creditor is making other disclosures under the previous regulation. The new rules governing whether or not disclosures must be made for refinancings and assumptions are also available to a creditor that has not yet converted its operations to the revised regulation.

(c) In addition to the above rules, applicable to both open-end and closed-end credit, the following guidelines are relevant to open-end credit:

• The creditor need not remake initial disclosures that were made under the previous regulation, even if the revised periodic statements contain terminology that is inconsistent with those initial disclosures.

• A creditor may add inserts to its old open-end forms in order to convert them to the revised rules until such time as the old forms are used up.

• No change-in-terms notice is required for changes resulting from the conversion to the revised regulation.

• The previous billing rights statements are substantially similar to the revised billing rights statements and may continue to be used, except that, if the creditor has an automatic debit program, it must use the revised automatic debit provision.

• For those creditors wishing to use the annual billing rights statement, the creditor may count from the date on which it sent its last statement under the previous regulation in determining when to give the first statement under the new regulation. For example, if the creditor sent a semi-annual statement in June 1981, and converts to the new regulation in October 1981, the creditor must give the billing rights statement sometime in 1982, and it must not be fewer than 6 nor more than 18 months after the June statement.

• Section 226.11 of the revised regulation affects only credit balances that are created on or after the date the creditor converts the account to the revised regulation.

SUBPART A—GENERAL

*Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability*

*1(c) Coverage.*

1. *Foreign applicability.* Regulation Z applies to all persons (including branches of foreign banks and sellers located in the United States) that extend consumer credit to residents (including resident aliens) of any state as defined in §226.2. If an account is located in the United States and credit is extended to a U.S. resident, the transaction is subject to the regulation. This will be the case whether or not a particular advance or purchase on the account takes place in the United States and whether or not the extender of credit is chartered or based in the United States or a foreign country. Thus, a U.S. resident's use in Europe of a credit card issued by a bank in the consumer's home town is covered by the regulation. The regulation does not apply to a foreign branch of a U.S. bank when the foreign branch extends credit to a U.S. citizen residing or visiting abroad or to a foreign national abroad.

References

*Statute:* Section 102.
*Other sections:* None.
*Previous regulation:* §226.1.
*1981 changes:* A discussion of coverage has been added to §226.1 so that the reader will understand from the start what is subject to the regulation. Language has also been added to explain the reorganization of the regulation into subparts that group together the provisions relating to general matters, open-end credit, closed-end credit, and miscellaneous rules. The provisions on consumer leasing have been issued by the Board as a separate regulation, Regulation M (12 CFR part 213).

*Section 226.2—Definitions and Rules of Construction*

*2(a) Definitions.*

*2(a)(2) Advertisement.*

1. *Coverage.* Only commercial messages that promote consumer credit transactions requiring disclosures are advertisements. Messages inviting, offering, or otherwise announcing generally to prospective customers the availability of credit transactions, whether in visual, oral, or print media, are covered by Regulation Z (12 CFR part 226).

i. Examples include:

A. Messages in a newspaper, magazine, leaflet, promotional flyer, or catalog.

B. Announcements on radio, television, or public address system.

C. On-line messages, such as on the Internet.

D. Direct mail literature or other printed material on any exterior or interior sign.

E. Point-of-sale displays.

F. Telephone solicitations.

G. Price tags that contain credit information.

H. Letters sent to customers as part of an organized solicitation of business.

I. Messages on checking account statements offering auto loans at a stated annual percentage rate.

J. Communications promoting a new open-end plan or closed-end transaction.

ii. The term does *not* include:

A. Direct personal contacts, such as follow-up letters, cost estimates for individual consumers, or oral or written communication relating to the negotiation of a specific transaction.

B. Informational material, for example, interest rate and loan term memos, distributed only to business entities.

C. Notices required by federal or state law, if the law mandates that specific information be displayed and only the information so mandated is included in the notice.

D. News articles the use of which is controlled by the news medium.

E. Market research or educational materials that do not solicit business.

F. Communications about an existing credit account (for example, a promotion encouraging additional or different uses of an existing credit card account).

2. *Persons covered.* All *persons* must comply with the advertising provisions in §§226.16 and 226.24, not just those that meet the definition of creditor in §226.2(a)(17). Thus, home builders, merchants, and others who are not themselves creditors must comply with the advertising provisions of the regulation if they advertise consumer credit transactions. However, under section 145 of the act, the owner and the personnel of the medium, in which an advertisement appears, or through which it is disseminated, are not subject to civil liability for violations.

*2(a)(3) [Reserved]*

*2(a)(4) Billing cycle or cycle.*

1. *Intervals.* In open-end credit plans, the billing cycle determines the intervals for which periodic disclosure statements are required; these intervals are also used as measuring points for other duties of the creditor. Typically, billing cycles are monthly, but they may be more frequent or less frequent (but not less frequent than quarterly).

2. *Creditors that do not bill.* The term *cycle* is interchangeable with *billing cycle* for definitional purposes, since some creditors' cycles do not involve the sending of bills in the traditional sense but only statements of account activity. This is commonly the case with financial institutions when periodic payments are made through payroll deduction or through automatic debit of the consumer's asset account.

3. *Equal cycles.* Although cycles must be equal, there is a permissible variance to account for weekends, holidays, and differences in the number of days in months. If the actual date of each statement does not vary by more than 4 days from a fixed *day* (for example, the third Thursday of each month) or *date* (for example, the 15th of each month) that the creditor regularly uses, the intervals between statements are considered equal. The requirement that cycles be equal applies even if the creditor applies a daily periodic rate to determine the finance charge. The requirement that intervals be equal does not apply to the transitional billing cycle that can occur when the creditor occasionally changes its billing cycles so as to establish a new statement day or date. (See the commentary to §226.9(c).)

4. *Payment reminder.* The sending of a regular payment reminder (rather than a late payment notice) establishes a cycle for which the creditor must send periodic statements.

*2(a)(6) Business day.*

1. *Business function test.* Activities that indicate that the creditor is open for substantially all of its business functions include the availability of personnel to make loan disbursements, to open new accounts, and to handle credit transaction inquiries. Activities that indicate that the creditor is not open for substantially all of its business functions include a retailer merely accepting credit cards for purchases or a bank having its customer-service windows open only for limited purposes such as deposits and withdrawals, bill paying, and related services.

2. *Rescission rule.* A more precise rule for what is a business day (all calendar days except Sundays and the federal legal holidays listed in 5 U.S.C. 6103(a)) applies when the right of rescission or mortgages subject to §226.32 are involved. (See also comment 31(c)(1)–1.) Four federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, federal offices and other entities might observe the holiday on the preceding Friday (July 3). The observed holiday (in the example, July 3) is a business day for purposes of rescission or the delivery of disclosures for certain high-cost mortgages covered by §226.32.

*2(a)(7) Card issuer.*

1. *Agent.* An agent of a card issuer is considered a card issuer. Because agency relationships are traditionally defined by contract and by state or other applicable law, the regulation does not define agent. Merely providing services relating to the production of credit cards or data processing for others, however, does not make one the agent of the card issuer. In contrast, a financial institution may become the agent of the card issuer if an agreement between the institution and the card issuer provides that the cardholder may use a line of credit with the financial institution to pay obligations incurred by use of the credit card.

*2(a)(8) Cardholder.*

1. *General rule.* A cardholder is a natural person at whose request a card is issued for consumer credit purposes or who is a co-obligor or guarantor for such a card issued to another. The second category does not include an employee who is a co-obligor or guarantor on a card issued to the employer for business purposes, nor does it include a person who is merely the authorized user of a card issued to another.

2. *Limited application of regulation.* For the limited purposes of the rules on issuance of credit cards and liability for unauthorized use, a cardholder includes *any* person, including an organization, to whom a card is issued for *any* purpose—including a business, agricultural, or commercial purpose.

3. *Issuance.* See the commentary to §226.12(a).

4. *Dual-purpose cards and dual-card systems.* Some card issuers offer dual-purpose cards that are for business as well as consumer purposes. If a card is issued to an individual for consumer purposes, the fact that an organization has guaranteed to pay the debt does not make it business credit. On the other hand, if a card is issued for business purposes, the fact that an individual sometimes uses it for consumer purchases does not subject the card issuer to the provisions on periodic statements, billing error resolution, and other protections afforded to consumer credit. Some card issuers offer dual-card systems—that is, they issue two cards to the same individual, one intended for business use, the other for consumer or personal use. With such a system, the same person may be a cardholder for general purposes when using the card issued for consumer use, and a cardholder only for the limited purposes of the

restrictions on issuance and liability when using the card issued for business purposes.

*2(a)(9) Cash price.*

1. *Components.* This amount is a starting point in computing the amount financed and the total sale price under § 226.18 for credit sales. Any charges imposed equally in cash and credit transactions may be included in the cash price, or they may be treated as other amounts financed under § 226.18(b)(2).

2. *Service contracts.* Service contracts include contracts for the repair or the servicing of goods, such as mechanical breakdown coverage, even if such a contract is characterized as insurance under state law.

3. *Rebates.* The creditor has complete flexibility in the way it treats rebates for purposes of disclosure and calculation. See the commentary to § 226.18(b).

*2(a)(10) Closed-end credit.*

1. *General.* The coverage of this term is defined by exclusion. That is, it includes any credit arrangement that does not fall within the definition of open-end credit. Subpart C contains the disclosure rules for closed-end credit when the obligation is subject to a finance charge or is payable by written agreement in more than 4 installments.

*2(a)(11) Consumer.*

1. *Scope.* Guarantors, endorsers, and sureties are not generally consumers for purposes of the regulation, but they may be entitled to rescind under certain circumstances and they may have certain rights if they are obligated on credit card plans.

2. *Rescission rules.* For purposes of rescission under §§ 226.15 and 226.23, a consumer includes any natural person whose ownership interest in his or her principal dwelling is subject to the risk of loss. Thus, if a security interest is taken in A's ownership interest in a house and that house is A's principal dwelling, A is a consumer for purposes of rescission, even if A is not liable, either primarily or secondarily, on the underlying consumer credit transaction. An ownership interest does not include, for example, leaseholds or inchoate rights, such as dower.

3. *Land trusts.* Credit extended to land trusts, as described in the commentary to § 226.3(a), is considered to be extended to a natural person for purposes of the definition of consumer.

*2(a)(12) Consumer credit.*

1. *Primary purpose.* There is no precise test for what constitutes credit offered or extended for personal, family, or household purposes, nor for what constitutes the primary purpose. See, however, the discussion of business purposes in the commentary to § 226.3(a).

*2(a)(13) Consummation.*

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

2. *Credit v. sale.* Consummation does not occur when the consumer becomes contractually committed to a *sale* transaction, unless the consumer also becomes legally obligated to accept a particular credit arrangement. For example, when a consumer pays a nonrefundable deposit to purchase an automobile, a purchase contact may be created, but consummation for purposes of the regulation does not occur unless the consumer also contracts for financing at that time.

*2(a)(14) Credit.*

1. *Exclusions.* The following situations are not considered credit for purposes of the regulation:

• Layaway plans, unless the consumer is contractually obligated to continue making payments. Whether the consumer is so obligated is a matter to be determined under applicable law. The fact that the consumer is not entitled to a refund of any amounts paid towards the cash price of the merchandise does not bring layaways within the definition of credit.

• Tax liens, tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy. However, third-party financing of such obligations (for example, a bank loan obtained to pay off a tax lien) is credit for purposes of the regulation.

• Insurance premium plans that involve payment in installments with each installment representing the payment for insurance coverage for a certain future period of time, unless the consumer is contractually obligated to continue making payments.

• Home improvement transactions that involve progress payments, if the consumer pays, as the work progresses, only for work completed and has no contractual obligation to continue making payments.

• *Borrowing* against the accrued cash value of an insurance policy or a pension account, if there is no independent obligation to repay.

• Letters of credit.

• The execution of option contracts. However, there may be an extension of credit when the option is exercised, if there is an agreement at that time to defer payment of a debt.

• Investment plans in which the party extending capital to the consumer risks the loss of the capital advanced. This includes, for example, an arrangement with a home purchaser in which the investor pays a portion of the downpayment and of the periodic

mortgage payments in return for an ownership interest in the property, and shares in any gain or loss of property value.

• Mortgage assistance plans administered by a government agency in which a portion of the consumer's monthly payment amount is paid by the agency. No finance charge is imposed on the subsidy amount and that amount is due in a lump-sum payment on a set date or upon the occurrence of certain events. (If payment is not made when due, a new note imposing a finance charge may be written, which may then be subject to the regulation.)

2. *Payday loans; deferred presentment.* Credit includes a transaction in which a cash advance is made to a consumer in exchange for the consumer's personal check, or in exchange for the consumer's authorization to debit the consumer's deposit account, and where the parties agree either that the check will not be cashed or deposited, or that the consumer's deposit account will not be debited, until a designated future date. This type of transaction is often referred to as a ''payday loan'' or ''payday advance'' or ''deferred presentment loan.'' A fee charged in connection with such a transaction may be a finance charge for purposes of § 226.4, regardless of how the fee is characterized under state law. Where the fee charged constitutes a finance charge under § 226.4 and the person advancing funds regularly extends consumer credit, that person is a creditor and is required to provide disclosures consistent with the requirements of Regulation Z. See § 226.2(a)(17).

*2(a)(15) Credit card.*

1. *Usable from time to time.* A credit card must be usable from time to time. Since this involves the possibility of repeated use of a single device, checks and similar instruments that can be used only once to obtain a single credit extension are not credit cards.

2. *Examples.* i. Examples of credit cards include:

A. A card that guarantees checks or similar instruments, if the asset account is also tied to an overdraft line or if the instrument directly accesses a line of credit.

B. A card that accesses both a credit and an asset account (that is, a debit-credit card).

C. An identification card that permits the consumer to defer payment on a purchase.

D. An identification card indicating loan approval that is presented to a merchant or to a lender, whether or not the consumer signs a separate promissory note for each credit extension.

E. A card or device that can be activated upon receipt to access credit, even if the card has a substantive use other than credit, such as a purchase-price discount card. Such a card or device is a credit card notwithstanding the fact that the recipient must first contact the card issuer to access or activate the credit feature.

ii. In contrast, a credit card does not include, for example:

A. A check-guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft.

B. Any card, key, plate, or other device that is used in order to obtain petroleum products for business purposes from a wholesale distribution facility or to gain access to that facility, and that is required to be used without regard to payment terms.

3. *Charge card.* Generally, charge cards are cards used in connection with an account on which outstanding balances cannot be carried from one billing cycle to another and are payable when a periodic statement is received. Under the regulation, a reference to credit cards generally includes charge cards. The term *charge card* is, however, distinguished from *credit card* in §§ 226.5a, 226.9(e), 226.9(f), and 226.28(d), and appendices G–10 through G–13. When the term *credit card* is used in those provisions, it refers to credit cards other than charge cards.

*2(a)(16) Credit sale.*

1. *Special disclosure.* If the seller is a creditor in the transaction, the transaction is a credit sale and the special credit sale disclosures (that is, the disclosures under § 226.18(j)) must be given. This applies even if there is more than one creditor in the transaction and the creditor making the disclosures is not the seller. See the commentary to § 226.17(d).

2. *Sellers who arrange credit.* If the seller of the property or services involved arranged for financing but is not a creditor as to that sale, the transaction is not a credit sale. Thus, if a seller assists the consumer in obtaining a direct loan from a financial institution and the consumer's note is payable to the financial institution, the transaction is a loan and only the financial institution is a creditor.

3. *Refinancings.* Generally, when a credit sale is refinanced within the meaning of § 226.20(a), loan disclosures should be made. However, if a new sale of goods or services is also involved, the transaction is a credit sale.

4. *Incidental sales.* Some lenders *sell* a product or service—such as credit, property, or health insurance—as part of a loan transaction. Section 226.4 contains the rules on whether the cost of credit life, disability or property insurance is part of the finance charge. If the insurance is financed, it may be disclosed as a separate credit sale transaction or disclosed as part of the primary transaction; if the latter approach is taken, either loan or credit sale disclosures may be made. See the commentary to § 226.17(c)(1) for further discussion of this point.

5. *Credit extensions for educational purposes.* A credit extension for educational purposes in which an educational institution is the creditor may be treated as either a credit sale or a loan, regardless of whether the funds are given directly to the student, credited to the student's account, or disbursed to other persons on the student's behalf. The disclosure of the total sale price need not be given if the transaction is treated as a loan.

*2(a)(17) Creditor.*

1. *General.* The definition contains four independent tests. If any one of the tests is met, the person is a creditor for purposes of that particular test.

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

1. *Prerequisites.* This test is composed of 2 requirements, both of which must be met in order for a particular credit extension to be subject to the regulation and for the credit extension to count towards satisfaction of the numerical tests mentioned in footnote 3 to §226.2(a)(17). *First*, there must be either or both of the following:

• A written (rather than oral) agreement to pay in more than 4 installments. A letter that merely confirms an oral agreement does not constitute a written agreement for purposes of the definition.

• A finance charge imposed for the credit. The obligation to pay the finance charge need not be in writing.

*Second*, the obligation must be payable to the person in order for that person to be considered a creditor. If an obligation is made payable to *bearer*, the creditor is the one who initially accepts the obligation.

2. *Assignees.* If an obligation is initially payable to one person, that person is the creditor even if the obligation by its terms is simultaneously assigned to another person. For example:

• An auto dealer and a bank have a business relationship in which the bank supplies the dealer with credit sale contracts that are initially made payable to the dealer and provide for the immediate assignment of the obligation to the bank. The dealer and purchaser execute the contract only after the bank approves the creditworthiness of the purchaser. Because the obligation is initially payable on its face to the dealer, the dealer is the only creditor in the transaction.

3. *Numerical tests.* The examples below illustrate how the numerical tests of footnote 3 are applied. The examples assume that consumer credit with a finance charge or written agreement for more than 4 installments was extended in the years in question and that the person did not extend such credit in 1982.

4. *Counting transactions.* For purposes of closed-end credit, the creditor counts each credit transaction. For open-end credit, *transactions* means accounts, so that outstanding accounts are counted instead of individual credit extensions. Normally the number of transactions is measured by the preceding calendar year; if the requisite number is met, then the person is a creditor for all transactions in the current year. However, if the person did not meet the test in the preceding year, the number of transactions is measured by the current calendar year. For example, if the person extends consumer credit 26 times in 1983, it is a creditor for purposes of the regulation for the last extension of credit in 1983 and for all extensions of consumer credit in 1984. On the other hand, if a business begins in 1983 and extends consumer credit 20 times, it is not a creditor for purposes of the regulation in 1983. If it extends consumer credit 75 times in 1984, however, it becomes a creditor for purposes of the regulation (and must begin making disclosures) after the 25th extension of credit in that year and is a creditor for all extensions of consumer credit in 1985.

5. *Relationship between consumer credit in general and credit secured by a dwelling.* Extensions of credit secured by a dwelling are counted towards the 25-extensions test. For example, if in 1983 a person extends unsecured consumer credit 23 times and consumer credit secured by a dwelling twice, it becomes a creditor for the succeeding extensions of credit, whether or not they are secured by a dwelling. On the other hand, extensions of consumer credit not secured by a dwelling are *not* counted towards the number of credit extensions secured by a dwelling. For example, if in 1983 a person extends credit not secured by a dwelling 8 times and credit secured by a dwelling 3 times, it is not a creditor.

6. *Effect of satisfying one test.* Once one of the numerical tests is satisfied, the person is also a creditor for the other type of credit. For example, in 1983 a person extends consumer credit secured by a dwelling 5 times. That person is a creditor for all succeeding credit extensions, whether they involve credit secured by a dwelling or not.

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

• A bank is the trustee for 3 trusts: Trust A makes 15 extensions of consumer credit annually; Trust B makes 10 extensions of consumer credit annually; and Trust C makes 30 extensions of consumer credit annually. Only Trust C is a creditor for purposes of the regulation.

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. Unless each participant's account is an individual plan and trust, the creditor should apply the numerical tests to the plan as a whole rather than to the individual account, even if the loan amount is determined

by reference to the balance in the individual account and the repayments are credited to the individual account. The person to whom the obligation is originally made payable (whether the plan, the trust, or the trustee) is the creditor for purposes of the act and regulation.

*Paragraph 2(a)(17)(ii).* [Reserved]

*Paragraph 2(a)(17)(iii).*

1. *Card issuers subject to Subpart B.* Section 226.2(a)(17)(iii) makes certain card issuers creditors for purposes of the open-end credit provisions of the regulation. This includes, for example, the issuers of so-called travel and entertainment cards that expect repayment at the first billing and do not impose a finance charge. Since all disclosures are to be made only as applicable, such card issuers would omit finance charge disclosures. Other provisions of the regulation regarding such areas as scope, definitions, determination of which charges are finance charges, Spanish language disclosures, record retention, and use of model forms, also apply to such card issuers.

*Paragraph 2(a)(17)(iv).*

1. *Card issuers subject to Subparts B and C.* Section 226.2(a)(17)(iv) includes as creditors card issuers extending closed-end credit in which there is a finance charge or an agreement to pay in more than 4 installments. These card issuers are subject to the appropriate provisions of Subparts B and C, as well as to the general provisions.

*2(a)(18) Downpayment.*

1. *Allocation.* If a consumer makes a lump-sum payment, partially to reduce the cash price and partially to pay prepaid finance charges, only the portion attributable to reducing the cash price is part of the downpayment. (See the commentary to §226.2(a)(23).)

2. *Pick-up payments.* Creditors may treat the deferred portion of the down-payment, often referred to as *pick-up payments,* in a number of ways. If the pick-up payment is treated as part of the downpayment:

• It is subtracted in arriving at the amount financed under §226.18(b).

• It may, but need not, be reflected in the payment schedule under §226.18(g).

If the pick-up payment does not meet the definition (for example, if it is payable after the second regularly scheduled payment) or if the creditor chooses not to treat it as part of the downpayment:

• It must be included in the amount financed.

• It must be shown in the payment schedule.

Whichever way the pick-up payment is treated, the total of payments under §226.18(h) must equal the sum of the payments disclosed under §226.18(g).

3. *Effect of existing liens.* i. *No cash payment.* In a credit sale, the ''downpayment'' may only be used to reduce the cash price. For example, when a trade-in is used as the downpayment and the existing lien on an automobile to be traded in exceeds the value of the automobile, creditors must disclose a zero on the downpayment line rather than a negative number. To illustrate, assume a consumer owes $10,000 on an existing automobile loan and that the trade-in value of the automobile is only $8,000, leaving a $2,000 deficit. The creditor should disclose a downpayment of $0, not −$2,000.

ii. *Cash payment.* If the consumer makes a cash payment, creditors may, at their option, disclose the entire cash payment as the downpayment, or apply the cash payment first to any excess lien amount and disclose any remaining cash as the downpayment. In the above example:

A. If the downpayment disclosed is equal to the cash payment, the $2,000 deficit must be reflected as an additional amount financed under §226.18(b)(2).

B. If the consumer provides $1,500 in cash (which does not extinguish the $2,000 deficit), the creditor may disclose a downpayment of $1,500 or of $0.

C. If the consumer provides $3,000 in cash, the creditor may disclose a downpayment of $3,000 or of $1,000.

*2(a)(19) Dwelling.*

1. *Scope.* A dwelling need not be the consumer's *principal* residence to fit the definition and thus a vacation or second home could be a dwelling. However, for purposes of the definition of residential mortgage transaction and the right to rescind, a dwelling must be the principal residence of the consumer. See the commentary to §§226.2(a)(24), 226.15, and 226.23.

2. *Use as a residence.* Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings.

3. *Relation to exemptions.* Any transaction involving a security interest in a consumer's principal dwelling (as well as in any real property) remains subject to the regulation despite the general exemption in §226.3(b) for credit extensions over $25,000.

*2(a)(20) Open-end credit.*

1. *General.* This definition describes the characteristics of open-end credit (for which the applicable disclosure and other rules are contained in Subpart B), as distinct from closed-end credit. Open-end credit is consumer credit that is extended under a plan and meets *all 3* criteria set forth in the definition.

2. *Existence of a plan.* The definition requires that there be a plan, which connotes a contractual arrangement between the creditor and the consumer. Some creditors offer programs containing a number of different credit features. The consumer has a single account with the institution that can be

accessed repeatedly via a number of sub-accounts established for the different program features and rate structures. Some features of the program might be used repeatedly (for example, an overdraft line) while others might be used infrequently (such as the part of the credit line available for secured credit). If the program as a whole is subject to prescribed terms and otherwise meets the definition of open-end credit, such a program would be considered a single, multi-featured plan.

3. *Repeated transactions.* Under this criterion, the creditor must reasonably contemplate repeated transactions. This means that the credit plan must be usable from time to time and the creditor must legitimately expect that there will be repeat business rather than a one-time credit extension. The creditor must expect repeated dealings with consumers under the credit plan as a whole and need not believe a consumer will reuse a particular feature of the plan. The determination of whether a creditor can reasonably contemplate repeated transactions requires an objective analysis. Information that much of the creditor's customer base with accounts under the plan make repeated transactions over some period of time is relevant to the determination, particularly when the plan is opened primarily for the financing of infrequently purchased products or services. A standard based on reasonable belief by a creditor necessarily includes some margin for judgmental error. The fact that particular consumers do not return for further credit extensions does not prevent a plan from having been properly characterized as open-end. For example, if much of the customer base of a clothing store makes repeat purchases, the fact that some consumers use the plan only once would not affect the characterization of the store's plan as open-end credit. The criterion regarding repeated transactions is a question of fact to be decided in the context of the creditor's type of business and the creditor's relationship with its customers. For example:

i. It would be more reasonable for a thrift institution chartered for the benefit of its members to contemplate repeated transactions with a member than for a seller of aluminum siding to make the same assumption about its customers.

ii. It would be more reasonable for a financial institution to make advances from a line of credit for the purchase of an automobile than for an automobile dealer to sell a car under an open-end plan.

4. *Finance charge on an outstanding balance.* The requirement that a finance charge may be computed and imposed from time to time on the outstanding balance means that there is no specific amount financed for the plan for which the finance charge, total of payments, and payment schedule can be calculated. A plan may meet the definition of open-end credit even though a finance charge is not normally imposed, provided the creditor has the right, under the plan, to impose a finance charge from time to time on the outstanding balance. For example, in some plans, such as certain *china club* plans, a finance charge is not imposed if the consumer pays all or a specified portion of the outstanding balance within a given time period. Such a plan could meet the finance charge criterion, if the creditor has the right to impose a finance charge, even though the consumer actually pays no finance charges during the existence of the plan because the consumer takes advantage of the option to pay the balance (either in full or in installments) within the time necessary to avoid finance charges.

5. *Reusable line.* The total amount of credit that may be extended during the existence of an open-end plan is unlimited because available credit is generally replenished as earlier advances are repaid. A line of credit is self-replenishing even though the plan itself has a fixed expiration date, as long as during the plan's existence the consumer may use the line, repay, and reuse the credit. The creditor may verify credit information such as the consumer's continued income and employment status or information for security purposes. This criterion of unlimited credit distinguishes open-end credit from a series of advances made pursuant to a close-end credit loan commitment. For example:

• Under a closed-end commitment, the creditor might agree to lend a total of $10,000 in a series of advances as needed by the consumer. When a consumer has borrowed the full $10,000, no more is advanced under that particular agreement, even if there has been repayment of a portion of the debt.

This criterion does not mean that the creditor must establish a specific credit limit for the line of credit or that the line of credit must always be replenished to its original amount. The creditor may reduce a credit limit or refuse to extend new credit in a particular case due to changes in the economy, the creditor's financial condition, or the consumer's creditworthiness. (The rules in §226.5b(f), however, limit the ability of a creditor to suspend credit advances for home equity plans.) While consumers should have a reasonable expectation of obtaining credit as long as they remain current and within any preset credit limits, further extensions of credit need not be an absolute right in order for the plan to meet the self-replenishing criterion.

6. *Open-end real estate mortgages.* Some credit plans call for negotiated advances under so-called open-end real estate mortgages. Each such plan must be independently measured against the definition of open-end credit, regardless of the terminology used in the industry to describe the plan. The fact

that a particular plan is called an open-end real estate mortgage, for example, does not, by itself, mean that it is open-end credit under the regulation.

*2(a)(21) Periodic rate.*

1. *Basis.* The periodic rate may be stated as a percentage (for example, 1½% per month) or as a decimal equivalent (for example, .015 monthly). It may be based on any portion of a year the creditor chooses. Some creditors use 1/360 of an annual rate as their periodic rate. These creditors:

• May disclose a 1/360 rate as a *daily* periodic rate, without further explanation, if it is in fact only applied 360 days per year. But if the creditor applies that rate for 365 days, the creditor must note that fact and, of course, disclose the true annual percentage rate.

• Would have to apply the rate to the balance to disclose the annual percentage rate with the degree of accuracy required in the regulation (that is, within ⅛ of 1 percentage point of the rate based on the actual 365 days in the year).

2. *Transaction charges. Periodic rate* does not include initial one-time transaction charges, even if the charge is computed as a percentage of the transaction amount.

*2(a)(22) Person.*

1. *Joint ventures.* A joint venture is an organization and is therefore a person.

2. *Attorneys.* An attorney and his or her client are considered to be the same person for purposes of this regulation when the attorney is acting within the scope of the attorney-client relationship with regard to a particular transaction.

3. *Trusts.* A trust and its trustee are considered to be the same person for purposes of this regulation.

*2(a)(23) Prepaid finance charge.*

1. *General.* Prepaid finance charges must be taken into account under § 226.18(b) in computing the disclosed amount financed, and must be disclosed if the creditor provides an itemization of the amount financed under § 226.18(c).

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

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

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

3. *Exclusions. Add-on* and *discount* finance charges are not prepaid finance charges for purposes of this regulation. Finance charges are not *prepaid* merely because they are precomputed, whether or not a portion of the charge will be rebated to the consumer upon prepayment. See the commentary to § 226.18(b).

4. *Allocation of lump-sum payments.* In a credit sale transaction involving a lump-sum payment by the consumer and a discount or other item that is a finance charge under § 226.4, the discount or other item is a prepaid finance charge to the extent the lump-sum payment is not applied to the cash price. For example, a seller sells property to a consumer for $10,000, requires the consumer to pay $3,000 at the time of the purchase, and finances the remainder as a closed-end credit transaction. The cash price of the property is $9,000. The seller is the creditor in the transaction and therefore the $1,000 difference between the credit and cash prices (the discount) is a finance charge. (See the commentary to §§ 226.4(b)(9) and 226.4(c)(5).) If the creditor applies the entire $3,000 to the cash price and adds the $1,000 finance charge to the interest on the $6,000 to arrive at the total finance charge, all of the $3,000 lump-sum payment is a downpayment and the discount is not a prepaid finance charge. However, if the creditor only applies $2,000 of the lump-sum payment to the cash price, then $2,000 of the $3,000 is a downpayment and the $1,000 discount is a prepaid finance charge.

*2(a)(24) Residential mortgage transaction.*

1. *Relation to other sections.* This term is important in six provisions in the regulation:

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

2. *Lien status.* The definition is not limited to first lien transactions. For example, a consumer might assume a paid-down first mortgage (or borrow part of the purchase price) and borrow the balance of the purchase price from a creditor who takes a second mortgage. The second mortgage transaction is a *residential mortgage transaction* if the dwelling purchased is the consumer's principal residence.

3. *Principal dwelling.* A consumer can only have *one* principal dwelling at a time. Thus, a vacation or other second home would not be a principal dwelling. However, if a consumer buys or builds a new dwelling that will become the consumer's principal dwelling within a year or upon the completion of construction, the new dwelling is considered

the principal dwelling for purposes of applying this definition to a particular transaction. See the commentary to §§226.15(a) and 226.23(a).

4. *Construction financing.* If a transaction meets the definition of a residential mortgage transaction and the creditor chooses to disclose it as several transactions under §226.17(c)(6), each one is considered to be a residential mortgage transaction, even if different creditors are involved. For example:

• The creditor makes a construction loan to finance the initial construction of the consumer's principal dwelling, and the loan will be disbursed in 5 advances. The creditor gives 6 sets of disclosures (5 for the construction phase and 1 for the permanent phase). Each one is a residential mortgage transaction.

• One creditor finances the initial construction of the consumer's principal dwelling and another creditor makes a loan to satisfy the construction loan and provide permanent financing. Both transactions are residential mortgage transactions.

5. *Acquisition.* i. A residential mortgage transaction finances the acquisition of a consumer's principal dwelling. The term does not include a transaction involving a consumer's principal dwelling if the consumer had previously purchased and acquired some interest to the dwelling, even though the consumer had not acquired full legal title.

ii. Examples of new transactions involving a previously acquired dwelling include the financing of a balloon payment due under a land sale contract and an extension of credit made to a joint owner of property to buy out the other joint owner's interest. In these instances, disclosures are not required under §226.18(q) or §226.19(a) (assumability policies and early disclosures for residential mortgage transactions). However, the rescission rules of §§226.15 and 226.23 do apply to these new transactions.

iii. In other cases, the disclosure and rescission rules do not apply. For example, where a buyer enters into a written agreement with the creditor holding the seller's mortgage, allowing the buyer to assume the mortgage, if the buyer had previously purchased the property and agreed with the seller to make the mortgage payments, §226.20(b) does not apply (assumptions involving residential mortgages).

6. *Multiple purpose transactions.* A transaction meets the definition of this section if any part of the loan proceeds will be used to finance the acquisition or initial construction of the consumer's principal dwelling. For example, a transaction to finance the initial construction of the consumer's principal dwelling is a residential mortgage transaction even if a portion of the funds will be disbursed directly to the consumer or used to satisfy a loan for the purchase of the land on which the dwelling will be built.

7. *Construction on previously acquired vacant land.* A residential mortgage transaction includes a loan to finance the construction of a consumer's principal dwelling on a vacant lot previously acquired by the consumer.

*2(a)(25) Security interest.*

1. *Threshold test.* The threshold test is whether a particular interest in property is recognized as a security interest under applicable law. The regulation does not determine whether a particular interest is a security interest under applicable law. If the creditor is unsure whether a particular interest is a security interest under applicable law (for example, if statutes and case law are either silent or inconclusive on the issue), the creditor may at its option consider such interests as security interests for Truth in Lending purposes. However, the regulation and the commentary do exclude specific interests, such as after-acquired property and accessories, from the scope of the definition regardless of their categorization under applicable law, and these named exclusions may not be disclosed as security interests under the regulation. (But see the discussion of exclusions elsewhere in the commentary to §226.2(a)(25).)

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

3. *Incidental interests.* Incidental interests in property that are not security interests include, among other things:

• Assignment of rents.

• Right to condemnation proceeds.

• Interests in accessories and replacements.

• Interests in escrow accounts, such as for taxes and insurance.

• Waiver of homestead or personal property rights.

The notion of an *incidental interest* does not encompass an explicit security interest in an insurance policy if that policy is the primary collateral for the transaction—for example, in an insurance premium financing transaction.

4. *Operation of law.* Interests that arise solely by operation of law are excluded from the general definition. Also excluded are interests arising by operation of law that are

merely repeated or referred to in the contract. However, if the creditor has an interest that arises by operation of law, such as a vendor's lien, and takes an independent security interest in the same property, such as a UCC security interest, the latter interest is a disclosable security interest unless otherwise provided.

5. *Rescission rules.* Security interests that arise solely by operation of law are security interests for purposes of rescission. Examples of such interests are mechanics' and materialmen's liens.

6. *Specificity of disclosure.* A creditor need not separately disclose multiple security interests that it may hold in the same collateral. The creditor need only disclose that the transaction is secured by the collateral, even when security interests from prior transactions remain of record and a new security interest is taken in connection with the transaction. In disclosing the fact that the transaction is secured by the collateral, the creditor also need not disclose how the security interest arose. For example, in a closed-end credit transaction, a rescission notice need not specifically state that a new security interest is ''acquired'' or an existing security interest is ''retained'' in the transaction.

The acquisition or retention of a security interest in the consumer's principal dwelling instead may be disclosed in a rescission notice with a general statement such as the following: ''Your home is the security for the new transaction.''

*2(b) Rules of construction.*

1. *Footnotes.* Footnotes are used extensively in the regulation to provide special exceptions and more detailed explanations and examples. Material that appears in a footnote has the same legal weight as material in the body of the regulation.

2. *Amount.* The numerical amount must be a dollar amount unless otherwise indicated. For example, in a closed-end transaction (Subpart C), the amount financed and the amount of any payment must be expressed as a dollar amount. In some cases, an amount should be expressed as a percentage. For example, in disclosures provided before the first transaction under an open-end plan (Subpart B), creditors are permitted to explain how the amount of any finance charge will be determined; where a cash advance fee (which is a finance charge) is a percentage of each cash advance, the amount of the finance charge for that fee is expressed as a percentage.

References

*Statute:* Section 103.

*Other sections:* None.

*Other regulations:* Regulation E (12 CFR 205.2(d)).

*Previous regulation:* Sections 226.2, 226.8, and 226.9.

*1981 changes:* Section 226.2 implements amended section 103 of the act. Separate definitions for *comparative index of credit cost, discount, organization, period, real property, real property transaction, regular price,* and *surcharge* have been deleted. The definitions relating specifically to consumer leases are now found in the separate consumer leasing regulation, Regulation M (12 CFR Part 213).

Several terms are now defined elsewhere in the regulation or commentary rather than in §226.2. For example, *finance charge* is described and explained in §226.4, and *agricultural purpose* is discussed in the commentary to §226.3. Some terms, such as *unauthorized use,* are now defined as part of the substantive sections to which they apply. Other terms previously defined, such as *customer* and *organization,* are merged into new definitions. Section 226.2 contains new definitions for *arranger of credit, business day, closed-end credit, consumer, consummation, downpayment, prepaid finance charge,* and *residential mortgage transaction.*

The major changes in the definitions are as follows:

*Arranger of credit* has a significantly different meaning. It reflects the statutory amendment that limits *arrangers* to those who regularly arrange credit extensions for persons who are not themselves creditors. This definition was deleted effective October 1, 1982.

*Billing cycle* largely restates the prior definition, but requires cycles to be regular, and allows the four-day variance to be measured from a regular day as well as date. The definition also incorporates an interpretation that cycles may be no longer than quarterly.

*Business day* is new in the sense that the term previously appeared only in a footnote to the rescission provision, but it is now of general applicability. The general rule that it is a day when the creditor is open for business is new, but the rule for rescission purposes is the same as in the previous regulation.

*Cash price* now explicitly permits inclusion of various incidental charges imposed equally in cash and credit transactions.

*Consumer* has a narrower meaning in that guarantors, sureties, and endorsers are excluded from the general definition.

*Consumer credit* reflects the new statutory exemption for agricultural credit.

*Consummation* is a significant departure from longstanding interpretations of the previous definition. It now focuses only on the time the consumer becomes contractually obligated, rather than the time the consumer pays a nonrefundable fee or suffers an economic penalty for failing to go forward with the credit transaction.

*Credit* generally parallels the previous definition, but modifies the previous interpretations of the definition by excluding more transactions.

*Creditor* reflects the statutory amendments to the act that were intended to eliminate the problem of multiple creditors in a transaction. The *regularly* standard is still used, but it is now defined in terms of the frequency of the credit extensions. The new definition also requires that there be a *written* agreement to pay in more than 4 installments if no finance charge is imposed. Finally, the obligation must be initially payable to a person for that person to be the creditor.

*Dwelling* reflects the statutory amendment that expanded the scope of the definition to include *any* residential structure, whether or not it is real property under state law.

*Open-end credit* reflects the amended statutory definition requiring that the creditor reasonably contemplate repeated transactions. The new definition no longer requires the consumer to have the privilege of paying either in installments or in full.

*Periodic rate* combines the previous definitions of *period* and *periodic rate* with clarification in the commentary concerning transaction charges and 360-day-year factors.

*Security interest* is much narrower than the previous definition. Reflecting the legislative history of the simplification amendments, incidental interests are expressly excluded from the definition. Except for purposes of rescission, interests that arise solely by operation of law are also excluded.

*Section 226.3—Exempt Transactions*

*3(a) Business, commercial, agricultural, or organizational credit.*

1. *Primary purposes.* A creditor must determine in each case if the transaction is primarily for an exempt purpose. If some question exists as to the primary purpose for a credit extension, the creditor is, of course, free to make the disclosures, and the fact that disclosures are made under such circumstances is not controlling on the question of whether the transaction was exempt.

2. *Factors.* In determining whether credit to finance an acquisition—such as securities, antiques, or art—is primarily for business or commercial purposes (as opposed to a consumer purpose), the following factors should be considered:

• The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.

• The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.

• The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.

• The size of the transaction. The larger the transaction, the more likely it is to be business purpose.

• The borrower's statement of purpose for the loan.

Examples of business-purpose credit include:

• A loan to expand a business, even if it is secured by the borrower's residence or personal property.

• A loan to improve a principal residence by putting in a business office.

• A business account used occasionally for consumer purposes.

Examples of consumer-purpose credit include:

• Credit extensions by a company to its employees or agents if the loans are used for personal purposes.

• A loan secured by a mechanic's tools to pay a child's tuition.

• A personal account used occasionally for business purposes.

3. *Non-owner-occupied rental property.* Credit extended to acquire, improve, or maintain rental property (regardless of the number of housing units) that is not owner-occupied is deemed to be for business purposes. This includes, for example, the acquisition of a warehouse that will be leased or a single-family house that will be rented to another person to live in. If the owner expects to occupy the property for more than 14 days during the coming year, the property cannot be considered non-owner-occupied and this special rule will not apply. For example, a beach house that the owner will occupy for a month in the coming summer and rent out the rest of the year is owner occupied and is not governed by this special rule. See Comment 3(a)–4, however, for rules relating to owner-occupied rental property.

4. *Owner-occupied rental property.* If credit is extended to acquire, improve, or maintain rental property that is or will be owner-occupied within the coming year, different rules apply:

• Credit extended to acquire the rental property is deemed to be for business purposes if it contains more than *2* housing units.

• Credit extended to improve or maintain the rental property is deemed to be for business purposes if it contains more than *4* housing units. Since the amended statute defines *dwelling* to include 1 to 4 housing units, this rule preserves the right of rescission for credit extended for purposes other than acquisition.

Neither of these rules means that an extension of credit for property containing fewer than the requisite number of units is necessarily consumer credit. In such cases, the determination of whether it is business or

consumer credit should be made by considering the factors listed in Comment 3(a)–2.

5. *Business credit later refinanced.* Business-purpose credit that is exempt from the regulation may later be rewritten for consumer purposes. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor.

6. *Agricultural purpose.* An *agricultural purpose* includes the planting, propagating, nurturing, harvesting, catching, storing, exhibiting, marketing, transporting, processing, or manufacturing of food, beverages (including alcoholic beverages), flowers, trees, livestock, poultry, bees, wildlife, fish, or shellfish by a natural person engaged in farming, fishing, or growing crops, flowers, trees, livestock, poultry, bees, or wildlife. The exemption also applies to a transaction involving real property that includes a dwelling (for example, the purchase of a farm with a homestead) if the transaction is primarily for agricultural purposes.

7. *Organizational credit.* The exemption for transactions in which the borrower is not a natural person applies, for example, to loans to corporations, partnerships, associations, churches, unions, and fraternal organizations. The exemption applies regardless of the purpose of the credit extension and regardless of the fact that a natural person may guarantee or provide security for the credit.

8. *Land trusts.* Credit extended for consumer purposes to a land trust is considered to be credit extended to a natural person rather than credit extended to an organization. In some jurisdictions, a financial institution financing a residential real estate transaction for an individual uses a land trust mechanism. Title to the property is conveyed to the land trust for which the financial institution itself is trustee. The underlying installment note is executed by the financial institution in its capacity as trustee and payment is secured by a trust deed, reflecting title in the financial institution as trustee. In some instances, the consumer executes a personal guaranty of the indebtedness. The note provides that it is payable only out of the property specifically described in the trust deed and that the trustee has no personal liability on the note. Assuming the transactions are for personal, family, or household purposes, these transactions are subject to the regulation since in substance (if not form) consumer credit is being extended.

*3(b) Credit over $25,000 not secured by real property or a dwelling.*

1. *Coverage.* Since a mobile home can be a dwelling under §226.2(a)(19), this exemption does not apply to a credit extension secured by a mobile home used or expected to be used as the principal dwelling of the consumer, even if the credit exceeds $25,000. A loan commitment for closed-end credit in excess of $25,000 is exempt even though the amounts actually drawn never actually reach $25,000.

2. *Open-end credit.* An open-end credit plan is exempt under §226.3(b) (unless secured by real property or personal property used or expected to be used as the consumer's principal dwelling) if either of the following conditions is met:

• The creditor makes a firm commitment to lend over $25,000 with no requirement of additional credit information for any advances.

• The initial extension of credit on the line exceeds $25,000.

If a security interest is taken at a later time in any real property, or in personal property used or expected to be used as the consumer's principal dwelling, the plan would no longer be exempt. The creditor must comply with all of the requirements of the regulation including, for example, providing the consumer with an initial disclosure statement. If the security interest being added is in the consumer's principal dwelling, the creditor must also give the consumer the right to rescind the security interest. (See the commentary to §226.15 concerning the right of rescission.)

3. *Closed-end credit—subsequent changes.* A closed-end loan for over $25,000 may later be rewritten for $25,000 or less, or a security interest in real property or in personal property used or expected to be used as the consumer's principal dwelling may be added to an extension of credit for over $25,000. Such a transaction is consumer credit requiring disclosures only if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes undertaken by the same obligor. (See the commentary to §226.23(a)(1) regarding the right of rescission when a security interest in a consumer's principal dwelling is added to a previously exempt transaction.)

*3(c) Public utility credit.*

1. *Examples.* Examples of public utility services include:

• Gas, water, or electrical services.

• Cable television services.

• Installation of new sewer lines, water lines, conduits, telephone poles, or metering equipment in an area not already serviced by the utility.

The exemption does *not* apply to extensions of credit, for example:

• To purchase appliances such as gas or electric ranges, grills, or telephones.

• To finance home improvements such as new heating or air conditioning systems.

*3(d) Securities or commodities accounts.*

1. *Coverage.* This exemption does not apply to a transaction with a broker registered solely with the state, or to a separate credit

extension in which the proceeds are used to purchase securities.

*3(e) Home fuel budget plans.*

1. *Definition.* Under a typical home fuel budget plan, the fuel dealer estimates the total cost of fuel for the season, bills the customer for an average monthly payment, and makes an adjustment in the final payment for any difference between the estimated and the actual cost of the fuel. Fuel is delivered as needed, no finance charge is assessed, and the customer may withdraw from the plan at any time. Under these circumstances, the arrangement is exempt from the regulation, even if a charge to cover the billing costs is imposed.

*3(f) Student loan programs.*

1. *Coverage.* This exemption applies to the Guaranteed Student Loan program (administered by the Federal government, State, and private non-profit agencies), the Auxiliary Loans to Assist Students (also known as PLUS) program, and the National Direct Student Loan program.

References

*Statute:* Sections 103 (s) and (t) and 104.

*Other sections:* Section 226.12 (a) and (b).

*Previous regulation:* Section 226.3 and Interpretations §§ 226.301 and 226.302.

*1981 changes:* The business credit exemption has been expanded to include credit for agricultural purposes. The rule of Interpretation § 226.302, concerning credit relating to structures containing more than 4 housing units, has been modified and somewhat expanded by providing more exclusions for transactions involving rental property.

The exemption for transactions above $25,000 secured by real estate has been narrowed; all transactions secured by the consumer's principal dwelling (even if not considered real property) are now subject to the regulation.

The public utility exemption now covers the financing of the extension of a utility into an area not earlier served by the utility, in addition to the financing of services.

The securities credit exemption has been extended to broker-dealers registered with the CFTC as well as the SEC.

A new exemption has been created for home fuel budget plans.

*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 that credit customers who are members of the group and do not qualify for the discount pay no more than the nonmember 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 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.

2. *Costs of doing business.* Charges absorbed by the creditor as a cost of doing business are not finance charges, even though the creditor may take such costs into consideration in determining the interest rate to be charged or the cash price of the property or service sold. However, if the creditor separately imposes a charge on the consumer to cover certain costs, the charge is a finance charge if it otherwise meets the definition. For example:

• A discount imposed on a credit obligation when it is assigned by a seller-creditor to another party is not a finance charge as long as the discount is not separately imposed on the consumer. (See § 226.4(b)(6).)

• A tax imposed by a state or other governmental body on a creditor is not a finance charge if the creditor absorbs the tax as a cost of doing business and does not separately impose the tax on the consumer. (For

additional discussion of the treatment of taxes, see other commentary to §226.4(a).)

3. *Forfeitures of interest.* If the creditor reduces the interest rate it pays or stops paying interest on the consumer's deposit account or any portion of it for the term of a credit transaction (including, for example, an overdraft on a checking account or a loan secured by a certificate of deposit), the interest lost is a finance charge. (See the commentary to §226.4(c)(6).) For example:

• A consumer borrows $5,000 for 90 days and secures it with a $10,000 certificate of deposit paying 15% interest. The creditor charges the consumer an interest rate of 6% on the loan and stops paying interest on $5,000 of the $10,000 certificate for the term of the loan. The interest lost is a finance charge and must be reflected in the annual percentage rate on the loan.

However, the consumer must be *entitled* to the interest that is not paid in order for the lost interest to be a finance charge. For example:

• A consumer wishes to buy from a financial institution a $10,000 certificate of deposit paying 15% interest but has only $4,000. The financial institution offers to lend the consumer $6,000 at an interest rate of 6%, but will pay the 15% interest only on the amount of the consumer's deposit, $4,000. The creditor's failure to pay interest on the $6,000 does not result in an additional finance charge on the extension of credit, provided the consumer is entitled by the deposit agreement with the financial institution to interest only on the amount of the consumer's deposit.

• A consumer enters into a combined time deposit/credit agreement with a financial institution that establishes a time deposit account and an open-end line of credit. The line of credit may be used to borrow against the funds in the time deposit. The agreement provides for an interest rate on any credit extension of, for example, 1%. In addition, the agreement states that the creditor will pay 0% interest on the amount of the time deposit that corresponds to the amount of the credit extension(s). The interest that is not paid on the time deposit by the financial institution is not a finance charge (and therefore does not affect the annual percentage rate computation).

4. *Treatment of fees for use of automated teller machines.* Any charge imposed on a cardholder by a card issuer for the use of an automated teller machine (ATM) to obtain a cash advance (whether in a proprietary, shared, interchange, or other system) 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. (See the commentary to §226.6(b).)

5. *Taxes.* i. Generally, a tax imposed by a state or other governmental body solely on a creditor is a finance charge if the creditor separately imposes the charge on the consumer.

ii. In contrast, a tax is not a finance charge (even if the tax is collected by the creditor) if applicable law imposes the tax:

A. Solely on the consumer;

B. On the creditor and the consumer jointly;

C. On the credit transaction, without indicating which party is liable for the tax; or

D. On the creditor, if applicable law directs or authorizes the creditor to pass the tax on to the consumer. (For purposes of this section, if applicable law is silent as to passing on the tax, the law is deemed not to authorize passing it on.)

iii. For example, a stamp tax, property tax, intangible tax, or any other state or local tax imposed on the consumer, or on the credit transaction, is not a finance charge even if the tax is collected by the creditor.

iv. In addition, a tax is not a finance charge if it is excluded from the finance charge by an other provision of the regulation or commentary (for example, if the tax is imposed uniformly in cash and credit transactions).

*4(a)(1) Charges by third parties.*

1. *Choosing the provider of a required service.* An example of a third-party charge included in the finance charge is the cost of required mortgage insurance, even if the consumer is allowed to choose the insurer.

2. *Annuities associated with reverse mortgages.* Some creditors offer annuities in connection with a reverse mortgage transaction. The amount of the premium is a finance charge if the creditor requires the purchase of the annuity incident to the credit. Examples include the following:

i. The credit documents reflect the purchase of an annuity from a specific provider or providers.

ii. The creditor assesses an additional charge on consumers who do not purchase an annuity from a specific provider.

iii. The annuity is intended to replace in whole or in part the creditor's payments to the consumer either immediately or at some future date.

*4(a)(2) Special rule; closing agent charges.*

1. *General.* This rule applies to charges by a third party serving as the closing agent for the particular loan. An example of a closing agent charge included in the finance charge is a courier fee where the creditor requires the use of a courier.

2. *Required closing agent.* If the creditor requires the use of a closing agent, fees charged by the closing agent are included in the finance charge only if the creditor requires the particular service, requires the imposition of the charge, or retains a portion

of the charge. Fees charged by a third-party closing agent may be otherwise excluded from the finance charge under § 226.4. For example, a fee that would be paid in a comparable cash transaction may be excluded under § 226.4(a). A charge for conducting or attending a closing is a finance charge and may be excluded only if the charge is included in and is incidental to a lump-sum closing fee excluded under § 226.4(c)(7).

*4(a)(3) Special rule; mortgage broker fees.*

1. *General.* A fee charged by a mortgage broker is excluded from the finance charge if it is the type of fee that is also excluded when charged by the creditor. For example, to exclude an application fee from the finance charge under § 226.4(c)(1), a mortgage broker must charge the fee to all applicants for credit, whether or not credit is extended.

2. *Coverage.* This rule applies to charges paid by consumers to a mortgage broker in connection with a consumer credit transaction secured by real property or a dwelling.

3. *Compensation by lender.* The rule requires all mortgage broker fees to be included in the finance charge. Creditors sometimes compensate mortgage brokers under a separate arrangement with those parties. Creditors may draw on amounts paid by the consumer, such as points or closing costs, to fund their payment to the broker. Compensation paid by a creditor to a mortgage broker under an agreement is not included as a separate component of a consumer's total finance charge (although this compensation may be reflected in the finance charge if it comes from amounts paid by the consumer to the creditor that are finance charges, such as points and interest).

*4(b) Examples of finance charges.*

1. *Relationship to other provisions.* Charges or fees shown as examples of finance charges in § 226.4(b) may be excludable under § 226.4(c), (d), or (e). For example:

• Premiums for credit life insurance, shown as an example of a finance charge under § 226.4(b)(7), may be excluded if the requirements of § 226.4(d)(1) are met.

• Appraisal fees mentioned in § 226.4(b)(4) are excluded for real property or residential mortgage transactions under § 226.4(c)(7).

*Paragraph 4(b)(2).*

1. *Checking account charges.* A checking or transaction account charge imposed in connection with a credit feature is a finance charge under § 226.4(b)(2) to the extent the charge exceeds the charge for a similar account without a credit feature. If a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under § 226.4(b)(2). To illustrate:

i. A $5 service charge is imposed on an account with an overdraft line of credit (where the institution has agreed in writing to pay an overdraft), while a $3 service charge is imposed on an account without a credit feature; the $2 difference is a finance charge. (If the difference is not related to account activity, however, it may be excludable as a participation fee. See the commentary to § 226.4(c)(4).)

ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning each item on a similar account without a credit feature; the $5 charge is not a finance charge.

*Paragraph 4(b)(3).*

1. *Assumption fees.* The assumption fees mentioned in § 226.4(b)(3) are finance charges only when the assumption occurs and the fee is imposed on the new buyer. The assumption fee is a finance charge in the new buyer's transaction.

*Paragraph 4(b)(5).*

1. *Credit loss insurance.* Common examples of the insurance against credit loss mentioned in § 226.4(b)(5) are mortgage guaranty insurance, holder in due course insurance, and repossession insurance. Such premiums must be included in the finance charge only for the period that the creditor requires the insurance to be maintained.

2. *Residual value insurance.* Where a creditor requires a consumer to maintain residual value insurance or where the creditor is a beneficiary of a residual value insurance policy written in connection with an extension of credit (as is the case in some forms of automobile balloon payment financing, for example), the premiums for the insurance must be included in the finance charge for the period that the insurance is to be maintained. If a creditor pays for residual value insurance and absorbs the payment as a cost of doing business, such costs are not considered finance charges. (See comment 4(a)–2.)

*Paragraphs 4(b) (7) and (8).*

1. *Pre-existing insurance policy.* The insurance discussed in § 226.4(b) (7) and (8) does not include an insurance policy (such as a life or an automobile collision insurance policy) that is already owned by the consumer, even if the policy is assigned to or otherwise made payable to the creditor to satisfy an insurance requirement. Such a policy is not ''written in connection with'' the transaction, as long as the insurance was not purchased for use in that credit extension, since it was previously owned by the consumer.

2. *Insurance written in connection with a transaction.* Insurance sold after consummation in closed-end credit transactions or after the opening of a plan in open-end credit transactions is not ''written in connection with'' the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because

the consumer requests insurance after consummation or the opening of a plan (although credit sale disclosures may be required for the insurance sold after consummation if it is financed).

3. *Substitution of life insurance.* The premium for a life insurance policy purchased and assigned to satisfy a credit life insurance requirement must be included in the finance charge, but only to the extent of the cost of the credit life insurance if purchased from the creditor or the actual cost of the policy (if that is less than the cost of the insurance available from the creditor). If the creditor does not offer the required insurance, the premium to be included in the finance charge is the cost of a policy of insurance of the type, amount, and term required by the creditor.

4. *Other insurance.* Fees for required insurance not of the types described in § 226.4(b)(7) and (8) are finance charges and are not excludable. For example:

• The premium for a hospitalization insurance policy, if it is required to be purchased only in a credit transaction, is a finance charge.

*Paragraph 4(b)(9).*

1. *Discounts for payment by other than credit.* The discounts to induce payment by other than credit mentioned in § 226.4(b)(9) include, for example, the following situation:

• The seller of land offers individual tracts for $10,000 each. If the purchaser pays cash, the price is $9,000, but if the purchaser finances the tract with the seller the price is $10,000. The $1,000 difference is a finance charge for those who buy the tracts on credit.

2. *Exception for cash discounts.* Discounts offered to induce consumers to pay for property or services by cash, check, or other means not involving the use of either an open-end credit plan or a credit card (whether open-end or closed-end credit is extended on the card) may be excluded from the finance charge under section 167(b) of the Act (as amended by Pub. L. 97–25, July 27, 1981). The discount may be in whatever amount the seller desires, either as a percentage of the regular price (as defined in section 103(z) of the Act, as amended) or a dollar amount. This provision applies only to transactions involving an open-end credit plan or a credit card. The merchant must offer the discount to prospective buyers whether or not they are cardholders or members of the open-end credit plan. The merchant may, however, make other distinctions. For example:

• The merchant may limit the discount to payment by cash, and not offer it for payment by check or by use of a debit card.

• The merchant may establish a discount plan that allows a 15% discount for payment by cash, a 10% discount for payment by check, and a 5% discount for payment by a particular credit card. None of these discounts is a finance charge.

Section 171(c) of the Act excludes section 167(b) discounts from treatment as a finance charge or other charge for credit under any state usury or disclosure laws.

3. *Determination of the regular price.* The *regular price* is critical in determining whether the difference between the price charged to cash customers and credit customers is a *discount* or a *surcharge*, as these terms are defined in amended section 103 of the Act. The *regular price* is defined in section 103 of the Act as—

. . . the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged for the property or service when payment is made by use of an open-end credit account or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted. . . .

For example, in the sale of motor vehicle fuel, the tagged or posted price is the price displayed at the pump. As a result, the higher price (the open-end credit or credit card price) must be displayed at the pump, either alone or along with the cash price. Service station operators may designate separate pumps or separate islands as being for either cash or credit purchases and display only the appropriate prices at the various pumps. If a pump is capable of displaying on its meter either a cash or a credit price depending upon the consumer's means of payment, both the cash price and the credit price must be displayed at the pump. A service station operator may display the cash price of fuel by itself on a curb sign, as long as the sign clearly indicates that the price is limited to cash purchases.

*4(b)(10) Debt cancellation fees.*

1. *Definition.* Debt cancellation coverage provides for payment or satisfaction of all or part of a debt when a specified event occurs. The term includes guaranteed automobile protection or ''GAP'' agreements, which pay or satisfy the remaining debt after property insurance benefits are exhausted.

*4(c) Charges excluded from the finance charge.*

*Paragraph 4(c)(1).*

1. *Application fees.* An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans, However, if the fee is to be excluded from the finance charge under § 226.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.

*Paragraph 4(c)(2).*

1. *Late payment charges.* Late payment charges can be excluded from the finance charge under §226.4(c)(2) whether or not the person imposing the charge continues to extend credit on the account or continues to provide property or services to the consumer. In determining whether a charge is for actual unanticipated late payment on a 30-day account, for example, factors to be considered include:

• The terms of the account. For example, is the consumer required by the account terms to pay the account balance in full each month? If not, the charge may be a finance charge.

• The practices of the creditor in handling the accounts. For example, regardless of the terms of the account, does the creditor allow consumers to pay the accounts over a period of time without demanding payment in full or taking other action to collect? If no effort is made to collect the full amount due, the charge may be a finance charge.

Section 226.4(c)(2) applies to late payment charges imposed for failure to make payments as agreed, as well as failure to pay an account in full when due.

2. *Other excluded charges.* Charges for ''delinquency, default, or a similar occurrence'' include, for example, charges for reinstatement of credit privileges or for summitting as payment a check that is later returned unpaid.

*Paragraph 4(c)(3).*

1. *Assessing interest on an overdraft balance.* A charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

*Paragraph 4(c)(4).*

1. *Participation fees—periodic basis.* The participation fees mentioned in §226.4(c)(4) do not necessarily have to be formal membership fees, nor are they limited to credit card plans. The provision applies to any credit plan in which payment of a fee is a condition of access to the plan itself, but it does not apply to fees imposed separately on individual closed-end transactions. The fee may be charged on a monthly, annual, or other periodic basis; a one-time, non-recurring fee imposed at the time an account is opened is not a fee that is charged on a periodic basis, and may not be treated as a participation fee.

2. *Participation fees—exclusions.* Minimum monthly charges, charges for non-use of a credit card, and other charges based on either account activity or the amount of credit available under the plan are not excluded from the finance charge by §226.4(c)(4). Thus, for example, a fee that is charged and then refunded to the consumer based on the extent to which the consumer uses the credit available would be a finance charge. (See the commentary to §226.4(b)(2). Also, see comment 14(c)–7 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.)

*Paragraph 4(c)(5).*

1. *Seller's points.* The seller's points mentioned in §226.4(c)(5) include any charges imposed by the creditor upon the non-creditor seller of property for providing credit to the buyer or for providing credit on certain terms. These charges are excluded from the finance charge even if they are passed on to the buyer, for example, in the form of a higher sales price. Seller's points are frequently involved in real estate transactions guaranteed or insured by governmental agencies. A *commitment fee* paid by a non-creditor seller (such as a real estate developer) to the creditor should be treated as seller's points. Buyer's points (that is, points charged to the buyer by the creditor), however, are finance charges.

2. *Other seller-paid amounts.* Mortgage insurance premiums and other finance charges are sometimes paid at or before consummation or settlement on the borrower's behalf by a noncreditor seller. The creditor should treat the payment made by the seller as seller's points and exclude it from the finance charge if, based on the seller's payment, the consumer is not legally bound to the creditor for the charge. A creditor who gives disclosures before the payment has been made should base them on the best information reasonably available.

*Paragraph 4(c)(6).*

1. *Lost interest.* Certain federal and state laws mandate a percentage differential between the interest rate paid on a deposit and the rate charged on a loan secured by that deposit. In some situations because of usury limits the creditor must reduce the interest rate paid on the deposit and, as a result, the consumer loses some of the interest that would otherwise have been earned. Under §226.4(c)(6), such *lost interest* need not be included in the finance charge. This rule applies only to an interest reduction imposed because a rate differential is required by law and a usury limit precludes compliance by any other means. If the creditor imposes a differential that exceeds that required, only the lost interest attributable to the excess amount is a finance charge. (See the commentary to §226.4(a).)

*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, the cost of verifying or confirming information connected to the item is also excluded. For example, credit report fees cover not only the cost of the report, but also the cost of verifying information in the report. In all cases, charges excluded under §226.4(c)(7) must be bona fide and reasonable.

2. *Lump sum charges.* If a lump sum charged for several services 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 lump sum charged for conducting or attending a closing (for example, by a lawyer or 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 if a fee for the incidental services would be a finance charge if it were imposed separately.

3. *Charges assessed during the loan term.* Real estate or residential mortgage transaction charges excluded under §226.4(c)(7) are those charges imposed solely in connection with the initial decision to grant credit. This would include, for example, a fee to search for tax liens on the property or to determine if flood insurance is required. The exclusion does not apply to fees for services to be performed periodically during the loan term, regardless of when the fee is collected. For example, a fee for one or more determinations during the loan term of the current tax lien status or flood insurance requirements is a finance charge, regardless of whether the fee is imposed at closing, or when the service is performed. If a creditor is uncertain about what portion of a fee to be paid at consummation or loan closing is related to the initial decision to grant credit, the entire fee may be treated as a finance charge.

*4(d) Insurance and debt cancellation coverage.*

1. *General.* Section 226.4(d) permits insurance premiums and charges and debt-cancellation charges to be excluded from the finance charge. The required disclosures must be made in writing. The rules on location of insurance and debt-cancellation disclosures for closed-end transactions are in §226.17(a). For purposes of §226.4(d), all references to insurance also include debt cancellation coverage unless the context indicates otherwise.

2. *Timing of disclosures.* If disclosures are given early, for example under §226.17(f) or §226.19(a), the creditor need not redisclose if the actual premium is different at the time of consummation. If insurance disclosures are not given at the time of early disclosure and insurance is in fact written in connection with the transaction, the disclosures under §226.4(d) must be made in order to exclude the premiums from the finance charge.

3. *Premium rate increases.* The creditor should disclose the premium amount based on the rates currently in effect and need not designate it as an estimate even if the premium rates may increase. An increase in insurance rates after consummation of a closed-end credit transaction or during the life of an open-end credit plan does not require redisclosure in order to exclude the additional premium from treatment as a finance charge.

4. *Unit-cost disclosures.* i. *Open-end credit.* The premium or fee for insurance or debt cancellation for the initial term of coverage may be disclosed on a unit-cost basis in open-end credit transactions. The cost per unit should be based on the initial term of coverage, unless one of the options under comment 4(d)–12 is available.

ii. *Closed-end credit.* One of the transactions for which unit-cost disclosures (such as 50 cents per year for each $100 of the amount financed) may be used in place of the total insurance premium involves a particular kind of insurance plan. For example, a consumer with a current indebtedness of $8,000 is covered by a plan of credit life insurance coverage with a maximum of $10,000. The consumer requests an additional $4,000 loan to be covered by the same insurance plan. Since the $4,000 loan exceeds, in part, the maximum amount of indebtedness that can be covered by the plan, the creditor may properly give the insurance cost disclosures on the $4,000 loan on a unit-cost basis.

5. *Required credit life insurance.* Credit life, accident, health, or loss-of-income insurance must be voluntary in order for the premium or charges to be excluded from the finance charge. Whether the insurance is in fact required or optional is a factual question. If the insurance is required, the premiums must be included in the finance charge, whether the insurance is purchased from the creditor or from a third party. If the consumer is required to elect one of several options—such as to purchase credit life insurance, or to assign an existing life insurance policy, or to pledge security such as a certificate of deposit—and the consumer purchases the credit life insurance policy, the premium must be included in the finance charge. (If the consumer assigns a preexisting policy or pledges security instead, no premium is included in the finance charge. The security interest would be disclosed under §226.6(c) or §226.18(m). See the commentary to §226.4(b)(7) and (8).)

6. *Other types of voluntary insurance.* Insurance is not credit life, accident, health, or loss-of-income insurance if the creditor or the credit account of the consumer is not the beneficiary of the insurance coverage. If

such insurance is not required by the creditor as an incident to or a condition of credit, it is not covered by §226.4.

7. *Signatures.* If the creditor offers a number of insurance options under §226.4(d), the creditor may provide a means for the consumer to sign or initial for each option, or it may provide for a single authorizing signature or initial with the options selected designated by some other means, such as a check mark. The insurance authorization may be signed or initialed by any consumer, as defined in §226.2(a)(11), or by an authorized user on a credit card account.

8. *Property insurance.* To exclude property insurance premiums or charges from the finance charge, the creditor must allow the consumer to choose the insurer and disclose that fact. This disclosure must be made whether or not the property insurance is available from or through the creditor. The requirement that an option be given does not require that the insurance be readily available from other sources. The premium or charge must be disclosed only if the consumer elects to purchase the insurance from the creditor; in such a case, the creditor must also disclose the term of the property insurance coverage if it is less than the term of the obligation.

9. *Single interest insurance.* Blanket and specific single interest coverage are treated the same for purposes of the regulation. A charge for either type of single interest insurance may be excluded from the finance charge if:

• The insurer waives any right of subrogation.

• The other requirements of §226.4(d)(2) are met. This includes, of course, giving the consumer the option of obtaining the insurance from a person of the consumer's choice. The creditor need not ascertain whether the consumer is able to purchase the insurance from someone else.

10. *Single-interest insurance defined.* The term *single-interest insurance* as used in the regulation refers only to the types of coverage traditionally included in the term *vendor's single-interest insurance* (or *VSI*), that is, protection of tangible property against normal property damage, concealment, confiscation, conversion, embezzlement, and skip. Some comprehensive insurance policies may include a variety of additional coverages, such as repossession insurance and holder-in-due-course insurance. These types of coverage do not constitute single-interest insurance for purposes of the regulation, and premiums for them do not qualify for exclusion from the finance charge under §226.4(d). If a policy that is primarily VSI also provides coverages that are not VSI or other property insurance, a portion of the premiums must be allocated to the nonexcludable coverages and included in the finance charge. However, such allocation is not required if the total premium in fact attributable to all of the non-VSI coverages included in the policy is $1.00 or less (or $5.00 or less in the case of a multi-year policy).

11. *Initial term.* i. The initial term of the insurance or debt cancellation coverage determines the period for which a premium amount or fee must be disclosed, unless one of the options discussed under comment 4(d)–12 is available. For purposes of §226.4(d), the initial term is the period for which the insurer or creditor is obligated to provide coverage, even though the consumer may be allowed to cancel the coverage or coverage may end due to nonpayment before that term expires.

ii. For example:

A. The initial term of a property insurance policy on an automobile that is written for one year is one year even though premiums are paid monthly and the term of the credit transaction is four years.

B. The initial term of an insurance policy is the full term of the credit transaction if the consumer pays or finances a single premium in advance.

12. *Initial term; alternative.* i. *General.* A creditor has the option of providing cost disclosures on the basis of an assumed initial term of one year of insurance or debt-cancellation coverage instead of a longer initial term (provided the premium or fee is clearly labeled as being for one year) if:

A. The initial term is indefinite or not clear, or

B. The consumer has agreed to pay a premium or fee that is assessed periodically but the consumer is under no obligation to continue the coverage, whether or not the consumer has made an initial payment.

ii. *Open-end plans.* For open-end plans, a creditor also has the option of providing unit-cost disclosure on the basis of a period that is less than one year if the consumer has agreed to pay a premium or fee that is assessed periodically, for example monthly, but the consumer is under no obligation to continue the coverage.

iii. *Examples.* To illustrate:

A. A credit life insurance policy providing coverage for a 30-year mortgage loan has an initial term of 30 years, even though premiums are paid monthly and the consumer is not required to continue the coverage. Disclosures may be based on the initial term, but the creditor also has the option of making disclosures on the basis of coverage for an assumed initial term of one year.

13. *Loss-of-income insurance.* The loss-of-income insurance mentioned in §226.4(d) includes involuntary unemployment insurance, which provides that some or all of the consumer's payments will be made if the consumer becomes unemployed involuntarily.

*4(d)(3) Voluntary debt cancellation fees.*

1. *General.* Fees charged for the specialized form of debt cancellation agreement known

as guaranteed automobile protection (''GAP'') agreements must be disclosed according to §226.4(d)(3) rather than according to §226.4(d)(2) for property insurance.

2. *Disclosures*. Creditors can comply with §226.4(d)(3) by providing a disclosure that refers to debt cancellation coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.

*4(e) Certain security interest charges.*

1. *Examples*.

i. *Excludable charges*. Sums must be actually paid to public officials to be excluded from the finance charge under §226.4(e) (1) and (3). Examples are charges or other fees required for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents, as well as intangible property or other taxes even when the charges or fees are imposed by the state solely on the creditor and charged to the consumer (if the tax must be paid to record a security interest). (See comment 4(a)–5 regarding the treatment of taxes, generally.)

ii. *Charges not excludable*. If the obligation is between the creditor and a third party (an assignee, for example), charges or other fees for filing or recording security agreements, mortgages, continuation statements, termination statements, and similar documents relating to that obligation are not excludable from the finance charge under this section.

2. *Itemization*. The various charges described in §226.4(e) (1) and (3) may be totaled and disclosed as an aggregate sum, or they may be itemized by the specific fees and taxes imposed. If an aggregate sum is disclosed, a general term such as security interest fees or filing fees may be used.

3. *Notary fees*. In order for a notary fee to be excluded under §226.4(e)(1), all of the following conditions must be met:

• The document to be notarized is one used to perfect, release, or continue a security interest.

• The document is required by law to be notarized.

• A notary is considered a public official under applicable law.

• The amount of the fee is set or authorized by law.

4. *Non-filing insurance*. The exclusion in §226.4(e)(2) is available only if non-filing insurance is purchased. If the creditor collects and simply retains a fee as a sort of *self-insurance* against non-filing it may not be excluded from the finance charge. If the non-filing insurance premium exceeds the amount of the fees excludable from the finance charge under §226.4(e)(1), only the excess is a finance charge. For example:

• The fee for perfecting a security interest is $5.00 and the fee for releasing the security interest is $3.00. The creditor charges $10.00 for non-filing insurance. Only $8.00 of the $10.00 is excludable from the finance charge.

*4(f) Prohibited offsets.*

1. *Earnings on deposits or investments*. The rule that the creditor shall not deduct any earnings by the consumer or deposits or investments applies whether or not the creditor has a security interest in the property.

References

*Statute:* Sections 106, 167, and 171(c).

*Other sections:* Sections 226.9(d) and 226.12.

*Previous regulation:* Section 226.4 and Interpretations §§226.401 through 226.407.

*1981 changes:* While generally continuing the rules under the previous regulation, §226.4 reflects amendments to section 106 of the act and makes certain other changes in the rules for determining the finance charge. For example, §226.4(a) expressly excludes from the finance charge amounts payable in comparable cash transactions. Section 226.8(o) of the previous regulation, dealing with discounts for prompt payment of a credit sale, was deleted in the revised regulation since the general test for a finance charge now focuses on a comparison of cash and credit transactions. With respect to various exclusions from the finance charge: application fees imposed on all applicants are no longer finance charges; continuing to extend credit to a consumer is no longer a controlling test for determining whether a late payment charge is bona fide; seller's points are not to be included in the finance charge; and the special exclusions for real estate transactions apply to all *residential mortgage transactions*.

The simplified rules for excluding insurance from the finance charge allow unit-cost disclosure in certain closed-end credit transactions; permit initials as well as signatures on the authorization; permit any consumer to authorize insurance for other consumers; and delete the requirement that the authorization be separately dated.

SUBPART B—OPEN-END CREDIT

*Section 226.5—General Disclosure Requirements*

*5(a) Form of disclosures.*

*Paragraph 5(a)(1).*

1. *Clear and conspicuous*. The *clear and conspicuous* standard requires that disclosures be in a reasonably understandable form. Except where otherwise provided, the standard does not require that disclosures be segregated from other material or located in any particular place on the disclosure statement, or that numerical amounts or percentages be in any particular type size. (But see comments 5a(a)(2)–1 and –2 for special rules concerning §226.5a disclosures for credit card

applications and solicitations.) The standard does not prohibit:

• Pluralizing required terminology (*finance charge* and *annual percentage rate*).

• Adding to the required disclosures such items as contractual provisions, explanations of contract terms, state disclosures, and translations.

• Sending promotional material with the required disclosures.

• Using commonly accepted or readily understandable abbreviations (such as *mo.* for *month* or *TX* for *Texas*) in making any required disclosures.

• Using codes or symbols such as *APR* (for annual percentage rate), *FC* (for finance charge), or *Cr* (for credit balance), so long as a legend or description of the code or symbol is provided on the disclosure statement.

2. *Integrated document.* The creditor may make both the initial disclosures (§ 226.6) and the periodic statement disclosures (§ 226.7) on more than one page, and use both the front and the reverse sides, so long as the pages constitute an integrated document. An integrated document would not include disclosure pages provided to the consumer at different times or disclosures interspersed on the same page with promotional material. An integrated document would include, for example:

• Multiple pages provided in the same envelope that cover related material and are folded together, numbered consecutively, or clearly labelled to show that they relate to one another.

• A brochure that contains disclosures and explanatory material about a range of services the creditor offers, such as credit, checking account, and electronic fund transfer features.

*Paragraph 5(a)(2).*

1. *When disclosures must be more conspicuous.* The term *finance charge* and *annual percentage rate,* when required to be used with a number, must be disclosed more conspicuously than other required disclosures, except in the cases provided in footnote 9. At the creditor's option, *finance charge* and *annual percentage rate* may also be disclosed more conspicuously than the other required disclosures even when the regulation does not so require. The following examples illustrate these rules:

• In disclosing the annual percentage rate as required by § 226.6(a)(2), the term *annual percentage rate* is subject to the *more conspicuous* rule.

• In disclosing the amount of the finance charge, required by § 226.7(f), the term *finance charge* is subject to the *more conspicuous* rule.

• Although neither *finance charge* nor *annual percentage rate* need be emphasized when used as part of general informational material or in textual descriptions of other terms, emphasis is permissible in such cases. For example, when the terms appear as part of the explanations required under § 226.6(a) (3) and (4), they may be equally conspicuous as the disclosures required under §§ 226.6(a)(2) and 226.7(g).

2. *Making disclosures more conspicuous.* In disclosing the terms *finance charge* and *annual percentage rate* more conspicuously, only the words *finance charge* and *annual percentage rate* should be accentuated. For example, if the term *total finance charge* is used, only *finance charge* should be emphasized. The disclosures may be made more conspicuous by, for example:

• Capitalizing the words when other disclosures are printed in lower case.

• Putting them in bold print or a contrasting color.

• Underlining them.

• Setting them off with asterisks.

• Printing them in larger type.

3. *Disclosure of figures—exception to more conspicuous* rule. The terms *annual percentage rate* and *finance charge* need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs).

*5(b) Time of disclosures.*

*5(b)(1) Initial disclosures.*

1. *Disclosure before the first transaction.* The rule that the initial disclosure statement must be furnished ''before the first transaction'' requires delivery of the initial disclosure statement before the consumer becomes obligated on the plan. For example, the initial disclosures must be given before the consumer makes the first purchase (such as when a consumer opens a credit plan and makes purchases contemporaneously at a retail store), receives the first advance, or pays any fees or charges under the plan other than an application fee or refundable membership fee (see below). The prohibition on the payment of fees other than application or refundable membership fees before initial disclosures are provided does not apply to home equity plans subject to § 226.5b. See the commentary to § 226.5b(h) regarding the collection of fees for home equity plans covered by § 226.5b.

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

• If the consumer receives a cash advance check at the same time the Truth in Lending disclosures are provided, disclosures are still timely if the consumer can, after receiving

the disclosures, return the cash advance check to the creditor without obligation (for example, without paying finance charges).

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

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

2. *Reactivation of suspended account.* If an account is temporarily suspended (for example, because the consumer has exceeded a credit limit, or because a credit card is reported lost or stolen) and then is reactivated, no new initial disclosures are required.

3. *Reopening closed account.* If an account has been closed (for example, due to inactivity, cancellation, or expiration) and then is reopened, new initial disclosures are required. No new initial disclosures are required, however, when the account is closed merely to assign it a new number (for example, when a credit card is reported lost or stolen) and the *new* account then continues on the same terms.

4. *Converting closed-end to open-end credit.* If a closed-end credit transaction is converted to an open-end credit account under a written agreement with the consumer, the initial disclosures under § 226.6 must be given before the consumer becomes obligated on the open-end credit plan. (See the commentary to § 226.17 on converting open-end credit to closed-end credit.)

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 balance transfer occurs. Card issuers that are subject to the requirements of § 226.5a may establish procedures that comply with both sections in a single disclosure statement.

*5(b)(2) Periodic statements.*

*Paragraph 5(b)(2)(i).*

1. *Periodic statements not required.* Periodic statements need not be sent in the following cases:

• If the creditor adjusts an account balance so that at the end of the cycle the balance is less than $1—so long as no finance charge has been imposed on the account for that cycle.

• If a statement was returned as undeliverable. If a new address is provided, however, within a reasonable time before the creditor must send a statement, the creditor must resume sending statements. Receiving the address at least 20 days before the end of a cycle would be a reasonable amount of time to prepare the statement for that cycle. For example, if an address is received 22 days before the end of the June cycle, the creditor must send the periodic statement for the June cycle. (See § 226.13(a)(7).)

2. *Termination of credit privileges.* When an open-end account is terminated without being converted to closed-end credit under a written agreement, the creditor must continue to provide periodic statements to those consumers entitled to receive them under § 226.5(b)(2)((i) (for example, when an open-end credit plan ends and consumers are paying off outstanding balances) and must continue to follow all of the other open-end credit requirements and procedures in subpart B.

*Paragraph 5(b)(2)(ii).*

1. *14-day rule.* The 14-day rule for mailing or delivering periodic statements does not apply if charges (for example, transaction or activity charges) are imposed regardless of the timing of a periodic statement. The 14-day rule does apply, for example:

• If current debits retroactively become subject to finance charges when the balance is not paid in full by a specified date.

• If charges other than finance charges will accrue when the consumer does not make timely payments (for example, late payment charges or charges for exceeding a credit limit).

2. *Computer malfunction.* Footnote 10 does not extend to the failure to provide a periodic statement because of computer malfunction.

3. *Calling for periodic statements.* When the consumer initiates a request, the creditor may permit, but may not require, consumers to pick up their periodic statements. If the consumer wishes to pick up the statement and the plan has a free-ride period, the statement must be made available in accordance with the 14-day rule.

*5(c) Basis of disclosures and use of estimates.*

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

• The legal obligation is determined by applicable state or other law.

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

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

2. *Estimates—obtaining information.* Disclosures may be estimated when the exact information is unknown at the time disclosures are made. Information is unknown if it is not reasonably available to the creditor at the time disclosures are made. The *reasonably available* standard requires that the

creditor, acting in good faith, exercise due diligence in obtaining information. In using estimates, the creditor is not required to disclose the basis for the estimated figures, but may include such explanations as additional information. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to insurance companies for the cost of insurance.

3. *Estimates—redisclosure.* If the creditor makes estimated disclosures, redisclosure is not required for that consumer, even though more accurate information becomes available before the first transaction. For example, in an open-end plan to be secured by real estate, the creditor may estimate the appraisal fees to be charged; such an estimate might reasonably be based on the prevailing market rates for similar appraisals. If the exact appraisal fee is determinable after the estimate is furnished but before the consumer receives the first advance under the plan, no new disclosure is necessary.

4. *Deferred payment transactions.* See comment 7–3(iv).

*5(d) Multiple creditors; multiple consumers.*

1. *Multiple creditors.* Under §226.5(d):

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

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

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

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

2. *Multiple consumers.* Disclosures may be made to either obligor on a joint account. Disclosure responsibilities are not satisfied by giving disclosures to only a surety or guarantor for a principal obligor or to an authorized user. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under §226.15.

*5(e) Effect of subsequent events.*

1. *Events causing inaccuracies.* Inaccuracies in disclosures are not violations if attributable to events occurring after disclosures are made. For example, when the consumer fails to fulfill a prior commitment to keep the collateral insured and the creditor then provides the coverage and charges the consumer for it, such a change does not make the original disclosures inaccurate. The creditor may, however, be required to provide a new disclosure(s) under §226.9(c).

2. *Use of inserts.* When changes in a creditor's plan affect required disclosures, the creditor may use inserts with outdated disclosure forms. Any insert:

• Should clearly refer to the disclosure provision it replaces.

• Need not be physically attached or affixed to the basic disclosure statement.

• May be used only until the supply of outdated forms is exhausted.

References

*Statute:* Sections 121 (a) through (c), 122 (a) and (b), 124, 127 (a) and (b), and 163(a).

*Other sections:* Sections 226.6, 226.7, and 226.9.

*Previous regulation:* Sections 226.6 (a) and (c) through (g), and 226.7 (a) through (c).

*1981 changes:* Section 226.5 implements amendments to the act and reflects several simplifying changes to the regulation. The use of required terminology, except for *finance charge* and *annual percentage rate,* is no longer required. Type size requirements have been deleted. Initial and periodic statement disclosures may be multi-page, so long as they constitute an integrated statement. New rules are provided for the basis of disclosures and for the use of estimates. The rules for credit plans involving multiple creditors or multiple consumers now provide that only one creditor need make the disclosures and that the disclosures need be made to only one primarily liable consumer.

*Section 226.5a Credit and Charge Card Applications and Solicitations*

1. *General.* Section 226.5a generally requires that credit disclosures be contained in application forms and preapproved solicitations initiated by a card issuer to open a credit or charge card account. (See the commentary to §226.5a(a)(3) and (e) for exceptions; see also §226.2(a)(15) and accompanying commentary for the definition of charge card.)

2. *Combining disclosures.* The initial disclosures required by §226.6 do not substitute for the disclosures required by §226.5a; however, a card issuer may establish procedures so that a single disclosure statement meets the requirements of both sections. For example, if a card issuer in complying with §226.5a(e)(2) provides all the applicable disclosures required under §226.6, in a form that the consumer may keep and in accordance with the other format and timing requirements for that section, the issuer satisfies the initial disclosure requirements under §226.6 as well as the disclosure requirements of §226.5a(e)(2). Or if, in complying with

§ 226.5a(c) or § 226.5a(d)(2), a card issuer provides an integrated document that the consumer may keep, and provides the § 226.5a disclosures (in a tabular format) along with the additional disclosures required under § 226.6 (presented outside of the table), the card issuer satisfies the requirements of both §§ 226.5a and 226.6.

*5a(a) General Rules*

*5a(a)(2) Form of Disclosures*

1. *Clear and conspicuous standard.* For purposes of § 226.5a disclosures, *clear and conspicuous* means in a reasonably understandable form and readily noticeable to the consumer. As to type size, disclosures in 12-point type are deemed to be readily noticeable for purposes of § 226.5a. Disclosures printed in less than 12-point type do not automatically violate the standard; however, disclosures in less than 8-point type would likely be too small to satisfy the standard. Disclosures that are transmitted by electronic communication are judged for purposes of the clear and conspicuous standard based on the form in which they are provided even though they may be viewed by the consumer in a different form.

2. *Prominent location.* i. *Generally.* Certain of the required disclosures provided on or with an application or solicitation must be prominently located. Disclosures are deemed to be prominently located, for example, if the disclosures are on the same page as an application or solicitation reply form. If the disclosures appear elsewhere, they are deemed to be prominently located if the application or solicitation reply form contains a clear and conspicuous reference to the location of the disclosures and indicates that they contain rate, fee, and other cost information, as applicable. Disclosures required by § 226.5a(b) that are placed outside the table must begin on the same page as the table but need not end on the same page.

ii. *Electronic disclosures.* Electronic disclosures are deemed to be prominently located if:

A. They are posted on a web site and the application or solicitation reply form is linked to the disclosures in a manner that prevents the consumer from by-passing the disclosures before submitting the application or reply form; or

B. They are located on the same page as an application or solicitation reply form, that contains a clear and conspicuous reference to the location of the disclosures and indicates that they contain rate, fee, and other cost information, as applicable.

3. *Multiple accounts or varying terms.* If a tabular format is required to be used, card issuers offering several types of accounts may disclose the various terms for the accounts in a single table or may provide a separate table for each account. Similarly, if rates or other terms vary from state to state, card issuers may list the states and the various disclosures in a single table or in separate tables.

4. *Additional information.* The table containing the disclosures required by § 226.5a should contain only the information required or permitted by this section. (See the commentary to § 226.5a(b) for guidance on information permitted in the table.) Other credit information may be presented on or with an application or solicitation, provided such information appears outside the required table.

5. *Location of certain disclosures.* A card issuer has the option of disclosing any of the fees in § 226.5a(b) (8) through (10) in the required table or outside the table.

6. *Terminology.* In general, § 226.5a(a)(2)(iv) requires that the terminology used for the disclosures specified in § 226.5a(b) be consistent with that used in the disclosures under §§ 226.6 and 226.7. This standard requires that the § 226.5a(b) disclosures be close in meaning to those under §§ 226.6 and 226.7; however, the terminology used need not be identical. In addition, § 226.5a(a)(2)(i) requires that the headings, content, and format of the tabular disclosures be substantially similar, but need not be identical, to the tables in appendix G. A special rule applies to the grace period disclosure, however: the term *grace period* must be used, either in the heading or in the text of the disclosure.

7. *Deletion of inapplicable disclosures.* Generally, disclosures need only be given as applicable. Card issuers may, therefore, delete inapplicable headings and their corresponding boxes in the table. For example, if no transaction fee is imposed for purchases, the disclosure form may contain the heading *Transaction fee for purchases* and a box showing *none,* or the heading and box may be deleted from the table. There is an exception for the grace period disclosure, however: even if no grace period exists, that fact must be stated.

8. *Form of electronic disclosures provided on or with electronic applications or solicitations.* Card issuers must provide the disclosures required by this section on or with a blank application or reply form that is made available to the consumer in electronic form, such as on a card issuer's Internet Web site. Card issuers have flexibility in satisfying this requirement. Methods card issuers could use to satisfy the requirement include, but are not limited to, the following examples:

i. The disclosures could automatically appear on the screen when the application or reply form appears;

ii. The disclosures could be located on the same Web page as the application or reply form (whether or not they appear on the initial screen), if the application or reply form contains a clear and conspicuous reference to the location of the disclosures and indicates

that the disclosures contain rate, fee, and other cost information, as applicable;

iii. Card issuers could provide a link to the electronic disclosures on or with the application (or reply form) as long as consumers cannot bypass the disclosures before submitting the application or reply form. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

iv. The disclosures could be located on the same web page as the application or reply form without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application or reply.

Whatever method is used, a card issuer need not confirm that the consumer has read the disclosures. For disclosures required to be provided in tabular form, card issuers must satisfy the requirements with respect to electronic disclosures set forth in comment 5a(a)(2)–2(ii).

9. *Form of disclosures.* Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses a credit card application or solicitation electronically (other than as described under ii. below), such as online at a home computer, the card issuer must provide the disclosures in electronic form (such as with the application or solicitation on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application or solicitation. If the issuer instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the card issuer's office, and accesses a credit card application or solicitation electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the card issuer to provide applications or solicitations to consumers), the issuer may provide disclosures in either electronic or paper form, provided the issuer complies with the timing and delivery (''on or with'') requirements of the regulation.

*5a(a)(3) Exceptions*

1. *Coverage.* Certain exceptions to the coverage of § 226.5a are stated in § 226.5a(a)(3); in addition, the requirements of § 226.5a do not apply to the following:

- Lines of credit accessed solely by account numbers
- Addition of a credit or charge card to an existing open-end plan

2. *Noncoverage of consumer initiated* requests. Applications provided to a consumer upon request are not covered by § 226.5a, even if the request is made in response to the card issuer's invitation to apply for a card account. To illustrate, if a card issuer invites consumers to call a toll-free number or to return a response card to obtain an application, the application sent in response to the consumer's request need not contain the disclosures required under § 226.5a. Similarly, if the card issuer invites consumers to call and make an oral application on the telephone, § 226.5a does not apply to the application made by the consumer. If, however, the card issuer calls a consumer or initiates a telephone discussion with a consumer about opening a card account and contemporaneously takes an oral application, such applications are subject to § 226.5a, specifically § 226.5a(d).

3. *General purpose applications.* The requirements of this section do not apply to general purpose applications unless the application, or material accompanying it, indicates that it can be used to open a credit or charge card account.

*5a(a)(5) Certain Fees that Vary by State*

1. *Manner of disclosing range.* If the card issuer discloses a range of fees instead of disclosing the amount of the fee imposed in each state, the range may be stated as the lowest authorized fee (zero, if there are one or more states where no fee applies) to the highest authorized fee.

*5a(b) Required Disclosures*

*5a(b)(1) Annual Percentage Rate*

1. *Periodic rate.* The periodic rate, expressed as such, may be disclosed in the table in addition to the required disclosure of the corresponding annual percentage rate.

2. *Variable-rate accounts—definition.* For purposes of § 226.5a(b)(1), a variable-rate account exists when rate changes are part of the plan and are tied to an index or formula. (See the commentary to § 226.6(a)(2) for examples of variable-rate plans.)

3. *Variable-rate accounts—rates in effect.* For variable-rate disclosures in direct mail applications and solicitations subject to § 226.5a(c), and in applications and solicitations made available to the general public subject to § 226.5a(e), the rules concerning accuracy of the annual percentage rate are stated in § 226.5a(b)(1)(ii). For variable-rate disclosures in telephone applications and solicitations subject to § 226.5a(d), the card issuer must provide an annual percentage rate currently applicable when oral disclosures are provided under § 226.5a(d)(1). For the alternate disclosures under § 226.5a(d)(2), the card issuer must provide the annual percentage rate in effect at the time the disclosures are mailed or delivered. A rate in effect also includes the rate as of a specified date (which rate is then updated from time to time, for example, each calendar month) or an estimated rate provided in accordance with § 226.5(c).

4. *Variable-rate accounts—other disclosures.* In describing how the applicable rate will be determined, the card issuer must identify the index or formula and disclose any margin or spread added to the index or formula in setting the rate. The card issuer may disclose the margin or spread as a range of the highest and lowest margins that may be applicable to the account. A disclosure of any applicable limitations on rate increases or decreases may also be included in the table.

5. *Introductory rates—discounted rates.* If the initial rate is temporary and is lower than the rate that will apply after the temporary rate expires, the card issuer must disclose the annual percentage rate that would otherwise apply to the account. In a fixed-rate account, the card issuer must disclose the rate that will apply after the introductory rate expires. In a variable-rate account, the card issuer must disclose a rate based on the index or formula applicable to the account in accordance with the rules in §226.5a(b)(1)(ii) and comment 5a(b)(1)–3. An initial discounted rate may be provided in the table along with the rate required to be disclosed if the card issuer also discloses the time period during which the introductory rate will remain in effect.

6. *Introductory rates—premium rates.* If the initial rate is temporary and is higher than the permanently applicable rate, the card issuer must disclose the initial rate in the table. The initial rate must be in at least 18-point type unless the issuer also discloses in the table the permanently applicable rate. The issuer may disclose in the table the permanently applicable rate that would otherwise apply if the issuer also discloses the time period during which the initial rate will remain in effect. In that case, the permanently applicable rate must be in at least 18-point type.

7. *Increased penalty rates.* If the initial rate may increase upon the occurrence of one or more specific events, such as a late payment or an extension of credit that exceeds the credit limit, the card issuer must disclose in the table the initial rate and the increased penalty rate that may apply. If the penalty rate is based on an index and an increased margin, the issuer must also disclose in the table the index and the margin as well as the specific event or events that may result in the increased rate, such as ''applies to accounts 60 days late.'' If the penalty rate cannot be determined at the time disclosures are given, the issuer must provide an explanation of the specific event or events that may result in imposing an increased rate. In describing the specific event or events that may result in an increased rate, issuers need not be as detailed as for the disclosures required under §226.6(a)(2). For issuers using a tabular format, the specific event or events must be placed outside the table and an asterisk or other means shall be used to direct the consumer to the additional information. At its option, the issuer may include in the explanation of the penalty rate the period for which the increased rate will remain in effect, such as ''until you make three timely payments.'' The issuer need not disclose an increased rate that is imposed when credit privileges are permanently terminated.

*5a(b)(2) Fees for Issuance or Availability*

1. *Membership fees.* Membership fees for opening an account must be disclosed under this paragraph. A membership fee to join an organization that provides a credit or charge card as a privilege of membership must be disclosed only if the card is issued automatically upon membership. Such a fee need not be disclosed if membership results merely in eligibility to apply for an account.

2. *Enhancements.* Fees for optional services in addition to basic membership privileges in a credit or charge card account (for example, travel insurance or card-registration services) should not be disclosed in the table if the basic account may be opened without paying such fees.

3. *One-time fees.* Disclosure of non-periodic fees is limited to fees related to opening the account, such as one-time membership fees. The following are examples of fees that should not be disclosed in the table:

- Fees for reissuing a lost or stolen card
- Statement reproduction fees
- Application fees described in §226.4(c)(1)

4. *Waived or reduced fees.* If fees required to be disclosed are waived or reduced for a limited time, the introductory fees or the fact of fee waivers may be provided in the table in addition to the required fees if the card issuer also discloses how long the fees or waivers will remain in effect.

5. *Fees stated as annual amount.* Fees imposed periodically must be stated as an annual total. For example, if a fee is imposed quarterly, the disclosures would state the total amount of the fees for one year. (See, however, the commentary to §226.9(e) with regard to disclosure of such fees in renewal notices.)

*5a(b)(4) Transaction Charges*

1. *Charges imposed by person other than card issuer.* Charges imposed by a third party, such as a seller of goods, would not be disclosed under this section; the third party would be responsible for disclosing the charge under §226.9(d)(1).

*5a(b)(5) Grace Period*

1. *How disclosure is made.* The card issuer may, but need not, refer to the beginning or ending point of any grace period and briefly state any conditions on the applicability of the grace period. For example, the grace period disclosure might read ''30 days'' or ''30 days from the date of the periodic statement

(provided you have paid your previous balance in full by the due date).''

*5a(b)(6) Balance Computation Method*

1. *Form of disclosure*. In cases where the card issuer uses a balance calculation method that is identified by name in the regulation, the card issuer may only disclose the name of the method in the table. In cases where the card issuer uses a balance computation method that is not identified by name in the regulation, the disclosure in the table should clearly explain the method in as much detail as set forth in the descriptions of balance methods in section 226.5a(g). The explanation need not be as detailed as that required for the disclosures under §226.6(a)(3). (See the commentary to §226.5a(g) for guidance on particular methods.)

2. *Determining the method*. In determining the appropriate balance computation method for purchases for disclosure purposes, the card issuer must assume that a purchase balance will exist at the end of any grace period. Thus, for example, if the average daily balance method will include new purchases or cover two billing cycles only if purchase balances are not paid within the grace period, the card issuer would disclose the name of the average daily balance method that includes new purchases or covers two billing cycles, respectively. The card issuer should not assume the existence of a purchase balance, however, in making other disclosures under §226.5a(b).

*5a(b)(7) Statement on Charge Card Payments*

1. *Applicability and content*. The disclosure that charges are payable upon receipt of the periodic statement is applicable only to charge card accounts. In making this disclosure, the card issuer may make such modifications as are necessary to more accurately reflect the circumstances of repayment under the account. For example, the disclosure might read, ''Charges are due and payable upon receipt of the periodic statement and must be paid no later than 15 days after receipt of such statement.''

*5a(b)(8) Cash Advance Fee*

1. *Applicability*. The card issuer must disclose only those fees it imposes for a cash advance that are finance charges under §226.4. For example, a charge for a cash advance at an automated teller machine (ATM) would be disclosed under §226.5a(b)(8) if no similar charge is imposed for ATM transactions not involving an extension of credit. (See comment 4(a)–5 for a description of such a fee.)

*5a(b)(9) Late Payment Fee*

1. *Applicability*. The disclosure of the fee for a late payment includes only those fees that will be imposed for actual, unanticipated late payments. (See the commentary to §226.4(c)(2) for additional guidance on late payment fees.)

*5a(b)(10) Over-the-Limit Fee*

1. *Applicability*. The disclosure of fees for exceeding a credit limit does not include fees for other types of default or for services related to exceeding the limit. For example, no disclosure is required of fees for reinstating credit privileges or fees for the dishonor of checks on an account that, if paid, would cause the credit limit to be exceeded.

*5a(c) Direct Mail Applications and Solicitations*

1. *Accuracy*. In general, disclosures in direct mail applications and solicitations must be accurate as of the time of mailing. (An accurate variable annual percentage rate is one in effect within 60 days before mailing.)

2. *Mailed publications*. Applications or solicitations contained in generally available publications mailed to consumers (such as subscription magazines) are subject to the requirements applicabIe to *take-ones* in §226.5a(e), rather than the direct mail requirements of §226.5a(c). However, if a primary purpose of a card issuer's mailing is to offer credit or charge card accounts—for example, where a card issuer ''prescreens'' a list of potential cardholders using credit criteria, and then mails to the targeted group its catalog containing an application or a solicitation for a card account—the direct mail rules apply. In addition, a card issuer may use a single application form as a *take-one* (in racks in public locations, for example) and for direct mailings, if the card issuer complies with the requirements of §226.5a(c) even when the form is used as a *take-one*—that is, by presenting the required §226.5a disclosures in a tabular format. When used in a direct mailing, the credit term disclosures must be accurate as of the mailing date whether or not the §226.5a(e)(1) (ii) and (iii) disclosures are included; when used in a take-one, the disclosures must be accurate for as long as the take-one forms remain available to the public if the §226.5a(e)(1) (ii) and (iii) disclosures are omitted. (If those disclosures are included in the take-one, the credit term disclosures need only be accurate as of the printing date.)

*5a(d) Telephone Applications and Solicitations*

1. *Coverage*. This paragraph applies if:

• A telephone conversation between a card issuer and consumer may result in the issuance of a card as a consequence of an issuer-initiated offer to open an account for which the issuer does not require any application (that is, a *preapproved* telephone solicitation).

• The card issuer initiates the contact and at the same time takes application information over the telephone.

This paragraph does not apply to:

• Telephone applications initiated by the consumer.

• Situations where no card will be issued—because, for example, the consumer indicates that he or she does not want the card, or the card issuer decides either during the telephone conversation or later not to issue the card.

*5a(e) Applications and Solicitations Made Available to General Public*

1. *Coverage*. Applications and solicitations made available to the general public include what are commonly referred to as *take-one* applications typically found at counters in banks and retail establishments, as well as applications contained in catalogs, magazines and other generally available publications. In the case of credit unions, this paragraph applies to applications and solicitations to open card accounts made available to those in the general field of membership.

2. *Cross-selling*. If a card issuer invites a consumer to apply for a credit or charge card (for example, where the issuer engages in cross-selling), an application provided to the consumer at the consumer's request is not considered an application made available to the general public and therefore is not subject to §226.5a(e). For example, the following are not covered:

• A consumer applies in person for a car loan at a financial institution and the loan officer invites the consumer to apply for a credit or charge card account; the consumer accepts the invitation.

• An employee of a retail establishment, in the course of processing a sales transaction using a bank credit card, asks a customer if he or she would like to apply for the retailer's credit or charge card; the customer responds affirmatively.

3. *Toll-free telephone number*. If a card issuer, in complying with any of the disclosure options of §226.5a(e), provides a telephone number for consumers to call to obtain credit information, the number must be toll-free for nonlocal calls made from an area code other than the one used in the card issuer's dialing area. Alternatively, a card issuer may provide any telephone number that allows a consumer to call for information and reverse the telephone charges.

*5a(e)(1) Disclosure of Required Credit Information*

1. *Date of printing*. Disclosure of the month and year fulfills the requirement to disclose the date an application was printed.

2. *Form of disclosures*. The disclosures specified in §226.5a(e)(1) (ii) and (iii) may appear either in or outside the table containing the required credit disclosures.

*5a(e)(2) Inclusion of Certain Initial Disclosures*

1. *Accuracy of disclosures*. The disclosures required by §226.5a(e)(2) generally must be current as of the time they are made available to the public. Disclosures are considered to be made available at the time they are placed in public locations (in the case of *take-ones*) or mailed to consumers (in the case of publications).

2. *Accuracy—exception*. If a card issuer discloses all the information required by §226.5a(e)(1)(ii) on the application or solicitation, the disclosures under §226.5a(e)(2) need only be current as of the date of printing. (A current variable annual percentage rate would be one in effect within 30 days before printing.)

*5a(e)(3) No Disclosure of Credit Information*

1. *When disclosure option available*. A card issuer may use this option only if the issuer does not include on or with the application or solicitation any statement that refers to the credit disclosures required by §226.5a(b). Statements such as *no annual fee*, *low interest rate*, *favorable rates*, and *low costs* are deemed to refer to the required credit disclosures and, therefore, may not be included on or with the solicitation or application, if the card issuer chooses to use this option.

*5a(e)(4) Prompt Response to Requests for Information*

1. *Prompt disclosure*. Information is promptly disclosed if it is given within 30 days of a consumer's request for information but in no event later than delivery of the credit or charge card.

2. *Information disclosed*. When a consumer requests credit information, card issuers need not provide all the required credit disclosures in all instances. For example, if disclosures have been provided in accordance with §226.5a(e) (1) or (2) and a consumer calls or writes a card issuer to obtain information about changes in the disclosures, the issuer need only provide the items of information that have changed from those previously disclosed on or with the application or solicitation. If a consumer requests information about particular items, the card issuer need only provide the requested information. If, however, the card issuer has made disclosures in accordance with the option in §226.5a(e)(3) and a consumer calls or writes the card issuer requesting information about costs, all the required disclosure information must be given.

3. *Manner of response*. A card issuer's response to a consumer's request for credit information may be provided orally or in writing, regardless of the manner in which the consumer's request is received by the issuer.

Furthermore, the card issuer may provide the information listed in either §226.5a(e) (1) or (2). Information provided in writing need not be in a tabular format.

*5a(f) Special Charge Card Rule—Card Issuer and Person Extending Credit Not the Same Person*

1. *Duties of charge card issuer.* Although the charge card issuer is not required to disclose information about the underlying open-end credit plan if the card issuer meets the conditions set forth in §226.5a(f), the card issuer must disclose the information relating to the charge card plan itself.

2. *Duties of creditor maintaining open-end plan.* Section 226.5a does not impose disclosure requirements on the creditor that maintains the underlying open-end credit plan. This is the case even though the creditor offering the open-end credit plan may be considered an agent of the charge card issuer. (See comment 2(a)(7)–1.)

3. *Form of disclosures.* The disclosures required by §226.5a(f) may appear either in or outside the table containing the required credit disclosures in circumstances where a tabular format is required.

*5a(g) Balance Computation Methods Defined*

1. *Daily balance method.* Card issuers using the daily balance method may disclose it using the name *average daily balance (including new purchases)* or *average daily balance (excluding new purchases)*, as appropriate. Alternatively, such card issuers may explain the method. (See comment 7(e)–5 for a discussion of the daily balance method.)

2. *Two-cycle average daily balance methods.* The *two-cycle average daily balance* methods described in §226.5a(g)(2) (i) and (ii) include those methods in which the average daily balances for two billing cycles may be added together to compute the finance charge. Such methods also include those in which a periodic rate is applied separately to the balance in each cycle, and the resulting finance charges are added together. The method is a *two-cycle average daily balance* even if the finance charge is based on both the current and prior cycle balances only under certain circumstances, such as when purchases during a prior cycle were carried over into the current cycle and no finance charge was assessed during the prior cycle. Furthermore, the method is a *two-cycle average daily balance method* if the balances for both the current and prior cycles are average daily balances, even if those balances are figured differently. For example, the name *two-cycle average daily balance (excluding new purchases)* should be used to describe a method in which the finance charge for the current cycle, figured on an average daily balance excluding new purchases, will be added to the finance charge for the prior cycle, figured on an average daily balance of only new purchases during that prior cycle.

*Section 226.5b Requirements for Home Equity Plans*

1. *Coverage.* This section applies to all open-end credit plans secured by the consumer's *dwelling*, as defined in §226.2(a)(19), and is not limited to plans secured by the consumer's principal dwelling. (See the commentary to §226.3(a), which discusses whether transactions are consumer or business-purpose credit, for guidance on whether a home equity plan is subject to Regulation Z.)

2. *Changes to home equity plans entered into on or after November 7, 1989.* Section 226.9(c) applies if, by written agreement under §226.5b(f)(3)(iii), a creditor changes the terms of a home equity plan—entered into on or after November 7, 1989—at or before its scheduled expiration, for example, by renewing a plan on different terms. A new plan results, however, if the plan is renewed (with or without changes to the terms) after the scheduled expiration. The new plan is subject to all open-end credit rules, including §§226.5b, 226.6, and 226.15.

3. *Transition rules and renewals of preexisting plans.* The requirements of this section do not apply to home equity plans entered into before November 7, 1989. The requirements of this section also do not apply if the original consumer, on or after November 7, 1989, renews a plan entered into prior to that date (with or without changes to the terms). If, on or after November 7, 1989, a security interest in the consumer's dwelling is added to a line of credit entered into before that date, the substantive restrictions of this section apply for the remainder of the plan, but no new disclosures are required under this section.

4. *Disclosure of repayment phase—applicability of requirements.* Some plans provide in the initial agreement for a period during which no further draws may be taken and repayment of the amount borrowed is made. All of the applicable disclosures in this section must be given for the repayment phase. Thus, for example, a creditor must provide payment information about the repayment phase as well as about the draw period, as required by §226.5b(d)(5). If the rate that will apply during the repayment phase is fixed at a known amount, the creditor must provide an annual percentage rate under §226.5b(d)(6) for that phase. If, however, a creditor uses an index to determine the rate that will apply at the time of conversion to the repayment phase—even if the rate will thereafter be fixed—the creditor must provide the information in §226.5b(d)(12), as applicable.

5. *Payment terms—applicability of closed-end provisions and substantive rules.* All payment terms that are provided for in the initial agreement are subject to the requirements of subpart B and not subpart C of the regulation. Payment terms that are subsequently

added to the agreement may be subject to subpart B or to subpart C, depending on the circumstances. The following examples apply these general rules to different situations:

• If the initial agreement provides for a repayment phase or for other payment terms such as options permitting conversion of part or all of the balance to a fixed rate during the draw period, these terms must be disclosed pursuant to §§ 226.5b and 226.6, and not under subpart C. Furthermore, the creditor must continue to provide periodic statements under § 226.7 and comply with other provisions of subpart B (such as the substantive requirements of § 226.5b(f)) throughout the plan, including the repayment phase.

• If the consumer and the creditor enter into an agreement during the draw period to repay all or part of the principal balance on different terms (for example, with a fixed rate of interest) and the amount of available credit will be replenished as the principal balance is repaid, the creditor must continue to comply with subpart B. For example, the creditor must continue to provide periodic statements and comply with the substantive requirements of § 226.5b(f) throughout the plan.

• If the consumer and creditor enter into an agreement during the draw period to repay all or part of the principal balance and the amount of available credit will not be replenished as the principal balance is repaid, the creditor must give closed-end credit disclosures pursuant to subpart C for that new agreement. In such cases, subpart B, including the substantive rules, does not apply to the closed-end credit transaction, although it will continue to apply to any remaining open-end credit available under the plan.

6. *Spreader clause*. When a creditor holds a mortgage or deed of trust on the consumer's dwelling and that mortgage or deed of trust contains a *spreader clause* (also known as a *dragnet* or cross-collateralization clause), subsequent occurrences such as the opening of an open-end plan are subject to the rules applicable to home equity plans to the same degree as if a security interest were taken directly to secure the plan, unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent open-end credit extensions.

*5b(a) Form of Disclosures*

*5b(a)(1) General*

1. *Written disclosures*. The disclosures required under this section must be clear and conspicuous and in writing, but need not be in a form the consumer can keep. (See the commentary to § 226.6(e) for special rules when disclosures required under § 226.5b(d) are given in a retainable form.)

2. *Disclosure of annual percentage rate—more conspicuous requirement*. As provided in § 226.5(a)(2), when the term *annual percentage rate* is required to be disclosed with a number, it must be more conspicuous than other required disclosures.

3. *Segregation of disclosures*. While most of the disclosures must be grouped together and segregated from all unrelated information, the creditor is permitted to include information that explains or expands on the required disclosures, including, for example:

• Any prepayment penalty
• How a substitute index may be chosen
• Actions the creditor may take short of terminating and accelerating an outstanding balance
• Renewal terms
• Rebate of fees

An example of information that does not explain or expand on the required disclosures and thus cannot be included is the creditor's underwriting criteria, although the creditor could provide such information separately from the required disclosures.

4. *Method of providing disclosures*. A creditor may provide a single disclosure form for all of its home equity plans, as long as the disclosure describes all aspects of the plans. For example, if the creditor offers several payment options, all such options must be disclosed. (See, however, the commentary to § 226.5b(d)(5)(iii) and (d)(12) (x) and (xi) for disclosure requirements relating to these provisions.) If any aspects of a plan are linked together, the creditor must disclose clearly the relationship of the terms to each other. For example, if the consumer can only obtain a particular payment option in conjunction with a certain variable-rate feature, this fact must be disclosed. A creditor has the option of providing separate disclosure forms for multiple options or variations in features. For example, a creditor that offers different payment options for the draw period may prepare separate disclosure forms for the two payment options. A creditor using this alternative, however, must include a statement on each disclosure form that the consumer should ask about the creditor's other home equity programs. (This disclosure is required only for those programs available generally to the public. Thus, if the only other programs available are employee preferred-rate plans, for example, the creditor would not have to provide this statement.) A creditor that receives a request for information about other available programs must provide the additional disclosures as soon as reasonably possible.

5. *Form of electronic disclosures provided on or with electronic applications*. Creditors must provide the disclosures required by this section (including the brochure) on or with a blank application that is made available to the consumer in electronic form, such as on a creditor's Internet Web site. Creditors have flexibility in satisfying this requirement.

Methods creditors could use to satisfy the requirement include, but are not limited to, the following examples:

i. The disclosures could automatically appear on the screen when the application appears;

ii. The disclosures could be located on the same web page as the application (whether or not they appear on the initial screen), if the application contains a clear and conspicuous reference to the location of the disclosures and indicates that the disclosures contain rate, fee, and other cost information, as applicable;

iii. Creditors could provide a link to the electronic disclosures on or with the application as long as consumers cannot bypass the disclosures before submitting the application. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

iv. The disclosures could be located on the same web page as the application without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application.

Whatever method is used, a creditor need not confirm that the consumer has read the disclosures.

*5b(a)(2) Precedence of Certain Disclosures*

1. *Precedence rule*. The list of conditions provided at the creditor's option under §226.5b(d)(4)(iii) need not precede the other disclosures.

*Paragraph 5b(a)(3)*

1. *Form of disclosures*. Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses a home equity credit line application electronically (other than as described under ii. below), such as online at a home computer, the creditor must provide the disclosures in electronic form (such as with the application form on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application. If the creditor instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the creditor's office, and accesses a home equity credit line application electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the creditor to provide applications to consumers), the creditor may provide disclosures in either electronic or paper form, provided the creditor complies with the timing, delivery, and retainability requirements of the regulation.

*5b(b) Time of Disclosures*

1. *Mail and telephone applications*. If the creditor sends applications through the mail, the disclosures and a brochure must accompany the application. If an application is taken over the telephone, the disclosures and brochure may be delivered or mailed within three business days of taking the application. If an application is mailed to the consumer following a telephone request, however, the creditor also must send the disclosures and a brochure along with the application.

2. *General purpose applications*. The disclosures and a brochure need not be provided when a general purpose application is given to a consumer unless (1) the application or materials accompanying it indicate that it can be used to apply for a home equity plan or (2) the application is provided in response to a consumer's specific inquiry about a home equity plan. On the other hand, if a general purpose application is provided in response to a consumer's specific inquiry only about credit other than a home equity plan, the disclosures and brochure need not be provided even if the application indicates it can be used for a home equity plan, unless it is accompanied by promotional information about home equity plans.

3. *Publicly-available applications*. Some creditors make applications for home equity plans, such as *take-ones*, available without the need for a consumer to request them. These applications must be accompanied by the disclosures and a brochure, such as by attaching the disclosures and brochure to the application form.

4. *Response cards*. A creditor may solicit consumers for its home equity plan by mailing a *response card* which the consumer returns to the creditor to indicate interest in the plan. If the only action taken by the creditor upon receipt of the response card is to send the consumer an application form or to telephone the consumer to discuss the plan, the creditor need not send the disclosures and brochure with the response card.

5. *Denial or withdrawal of application*. In situations where footnote 10a permits the creditor a three-day delay in providing disclosures and the brochure, if the creditor determines within that period that an application will not be approved, the creditor need not provide the consumer with the disclosures or brochure. Similarly, if the consumer withdraws the application within this three-day period, the creditor need not provide the disclosures or brochure.

6. *Intermediary agent or broker*. In determining whether or not an application involves an *intermediary agent or broker* as discussed in footnote 10a, creditors should consult the provisions in comment 19(b)–3.

*5b(c) Duties of Third Parties*

1. *Disclosure requirements.* Although third parties who give applications to consumers for home equity plans must provide the brochure required under §226.5b(e) in all cases, such persons need provide the disclosures required under §226.5b(d) only in certain instances. A third party has no duty to obtain disclosures about a creditor's home equity plan or to create a set of disclosures based on what it knows about a creditor's plan. If, however, a creditor provides the third party with disclosures along with its application form, the third party must give the disclosures to the consumer with the application form. The duties under this section are those of the third party; the creditor is not responsible for ensuring that a third party complies with those obligations. If an intermediary agent or broker takes an application over the telephone or receives an application contained in a magazine or other publication, footnote 10a permits that person to mail the disclosures and brochure within three business days of receipt of the application. (See the commentary to §226.5b(h) about imposition of nonrefundable fees.)

*5b(d) Content of Disclosures*

1. *Disclosures given as applicable.* The disclosures required under this section need be made only as applicable. Thus, for example, if negative amortization cannot occur in a home equity plan, a reference to it need not be made.

2. *Duty to respond to requests for information.* If the consumer, prior to the opening of a plan, requests information as suggested in the disclosures (such as the current index value or margin), the creditor must provide this information as soon as reasonably possible after the request.

*5b(d)(1) Retention of Information*

1. *When disclosure not required.* The creditor need not disclose that the consumer should make or otherwise retain a copy of the disclosures if they are retainable—for example, if the disclosures are not part of an application that must be returned to the creditor to apply for the plan.

*5b(d)(2) Conditions for Disclosed Terms*

*Paragraph 5b(d)(2)(i)*

1. *Guaranteed terms.* The requirement that the creditor disclose the time by which an application must be submitted to obtain the disclosed terms does not require the creditor to guarantee any terms. If a creditor chooses not to guarantee any terms, it must disclose that all of the terms are subject to change prior to opening the plan. The creditor also is permitted to guarantee some terms and not others, but must indicate which terms are subject to change.

2. *Date for obtaining disclosed terms.* The creditor may disclose either a specific date or a time period for obtaining the disclosed terms. If the creditor discloses a time period, the consumer must be able to determine from the disclosure the specific date by which an application must be submitted to obtain any guaranteed terms. For example, the disclosure might read, ''To obtain the following terms, you must submit your application within 60 days after the date appearing on this disclosure,'' provided the disclosure form also shows the date.

*Paragraph 5b(d)(2)(ii)*

1. *Relation to other provisions.* Creditors should consult the rules in §226.5b(g) regarding refund of fees.

*5b(d)(4) Possible Actions by Creditor*

*Paragraph 5b(d)(4)(i)*

1. *Fees imposed upon termination.* This disclosure applies only to fees (such as penalty or prepayment fees) that the creditor imposes if it terminates the plan prior to normal expiration. The disclosure does not apply to fees that are imposed either when the plan expires in accordance with the agreement or if the consumer terminates the plan prior to its scheduled maturity. In addition, the disclosure does not apply to fees associated with collection of the debt, such as attorneys fees and court costs, or to increases in the annual percentage rate linked to the consumer's failure to make payments. The actual amount of the fee need not be disclosed.

2. *Changes specified in the initial agreement.* If changes may occur pursuant to §226.5b(f)(3)(i), a creditor must state that certain changes will be implemented as specified in the initial agreement.

*Paragraph 5b(d)(4)(iii)*

1. *Disclosure of conditions.* In making this disclosure, the creditor may provide a highlighted copy of the document that contains such information, such as the contract or security agreement. The relevant items must be distinguished from the other information contained in the document. For example, the creditor may provide a cover sheet that specifically points out which contract provisions contain the information, or may mark the relevant items on the document itself. As an alternative to disclosing the conditions in this manner, the creditor may simply describe the conditions using the language in §§226.5b(f)(2)(i)–(iii), 226.5b(f)(3)(i) (regarding freezing the line when the maximum annual percentage rate is reached), and 226.5b(f)(3)(vi) or language that is substantially similar. The condition contained

in §226.5b(f)(2)(iv) need not be stated. In describing specified changes that may be implemented during the plan, the creditor may provide a disclosure such as ''Our agreement permits us to make certain changes to the terms of the line at specified times or upon the occurrence of specified events.''

2. *Form of disclosure.* The list of conditions under §226.5b(d)(4)(iii) may appear with the segregated disclosures or apart from them. If the creditor elects to provide the list of conditions with the segregated disclosures, the list need not comply with the precedence rule in §226.5b(a)(2).

*5b(d)(5) Payment Terms*

*Paragraph 5b(d)(5)(i)*

1. *Length of the plan.* The combined length of the draw period and any repayment period need not be stated. If the length of the repayment phase cannot be determined because, for example, it depends on the balance outstanding at the beginning of the repayment period, the creditor must state that the length is determined by the size of the balance. If the length of the plan is indefinite (for example, because there is no time limit on the period during which the consumer can take advances), the creditor must state that fact.

2. *Renewal provisions.* If, under the credit agreement, a creditor retains the right to review a line at the end of the specified draw period and determine whether to renew or extend the draw period of the plan, the possibility of renewal or extension—regardless of its likelihood—should be ignored for purposes of the disclosures. For example, if an agreement provides that the draw period is five years and that the creditor may renew the draw period for an additional five years, the possibility of renewal should be ignored and the draw period should be considered five years. (See the commentary accompanying §226.9(c)(1) dealing with change in terms requirements.)

*Paragraph 5b(d)(5)(ii)*

1. *Determination of the minimum periodic payment.* This disclosure must reflect how the minimum periodic payment is determined, but need only describe the principal and interest components of the payment. Other charges that may be part of the payment (as well as the balance computation method) may, but need not, be described under this provision.

2. *Fixed rate and term payment options during draw period.* If the home equity plan permits the consumer to repay all or part of the balance during the draw period at a fixed rate (rather than a variable rate) and over a specified time period, this feature must be disclosed. To illustrate, a variable-rate plan may permit a consumer to elect during a ten-year draw period to repay all or a portion of the balance over a three-year period at a fixed rate. The creditor must disclose the rules relating to this feature including the period during which the option can be selected, the length of time over which repayment can occur, any fees imposed for such a feature, and the specific rate or a description of the index and margin that will apply upon exercise of this choice. For example, the index and margin disclosure might state: ''If you choose to convert any portion of your balance to a fixed rate, the rate will be the highest prime rate published in the 'Wall Street Journal' that is in effect at the date of conversion plus a margin.'' If the fixed rate is to be determined according to an index, it must be one that is outside the creditor's control and is publicly available in accordance with §226.5b(f)(1). The effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example required in §226.5b(d)(12)(xi).

3. *Balloon payments.* In programs where the occurrence of a balloon payment is possible, the creditor must disclose the possibility of a balloon payment even if such a payment is uncertain or unlikely. In such cases, the disclosure might read, ''Your minimum payments may not be sufficient to fully repay the principal that is outstanding on your line. If they are not, you will be required to pay the entire outstanding balance in a single payment.'' In programs where a balloon payment will occur, such as programs with interest-only payments during the draw period and no repayment period, the disclosures must state that fact. For example, the disclosure might read, ''Your minimum payments will not repay the principal that is outstanding on your line. You will be required to pay the entire outstanding balance in a single payment.'' In making this disclosure, the creditor is not required to use the term ''balloon payment.'' The creditor also is not required to disclose the amount of the balloon payment. (See, however, the requirement under §226.5b(d)(5)(iii).) The balloon payment disclosure does not apply in cases where repayment of the entire outstanding balance would occur only as a result of termination and acceleration. The creditor also need not make a disclosure about balloon payments if the final payment could not be more than twice the amount of other minimum payments under the plan.

*Paragraph 5b(d)(5)(iii)*

1. *Minimum periodic payment example.* In disclosing the payment example, the creditor may assume that the credit limit as well as the outstanding balance is $10,000 if such an assumption is relevant to calculating payments. (If the creditor only offers lines of credit for less than $10,000, the creditor may

assume an outstanding balance of $5,000 instead of $10,000 in making this disclosure.) The example should reflect the payment comprised only of principal and interest. Creditors may provide an additional example reflecting other charges that may be included in the payment, such as credit insurance premiums. Creditors may assume that all months have an equal number of days, that payments are collected in whole cents, and that payments will fall on a business day even though they may be due on a non-business day. For variable-rate plans, the example must be based on the last rate in the historical example required in §226.5b(d)(12)(xi), or a more recent rate. In cases where the last rate shown in the historical example is different from the index value and margin (for example, due to a rate cap), creditors should calculate the rate by using the index value and margin. A discounted rate may not be considered a more recent rate in calculating this payment example for either variable- or fixed-rate plans.

2. *Representative examples.* In plans with multiple payment options within the draw period or within any repayment period, the creditor may provide representative examples as an alternative to providing examples for each payment option. The creditor may elect to provide representative payment examples based on three categories of payment options. The first category consists of plans that permit minimum payment of only accrued finance charges (*interest only* plans). The second category includes plans in which a fixed percentage or a fixed fraction of the outstanding balance or credit limit (for example, 2% of the balance or 1/180th of the balance) is used to determine the minimum payment. The third category includes all other types of minimum payment options, such as a specified dollar amount plus any accrued finance charges. Creditors may classify their minimum payment arrangements within one of these three categories even if other features exist, such as varying lengths of a draw or repayment period, required payment of past due amounts, late charges, and minimum dollar amounts. The creditor may use a single example within each category to represent the payment options in that category. For example, if a creditor permits minimum payments of 1%, 2%, 3% or 4% of the outstanding balance, it may pick one of these four options and provide the example required under §226.5b(d)(5)(iii) for that option alone.

The example used to represent a category must be an option commonly chosen by consumers, or a typical or representative example. (See the commentary to §226.5b(d)(12) (x) and (xi) for a discussion of the use of representative examples for making those disclosures. Creditors using a representative example within each category must use the same example for purposes of the disclosures under §226.5b (d)(5)(iii) and (d)(12) (x) and (xi).) Creditors may use representative examples under §226.5b(d)(5) only with respect to the payment example required under paragraph (d)(5)(iii). Creditors must provide a full narrative description of all payment options under §226.5b(d)(5) (i) and (ii).

3. *Examples for draw and repayment periods.* Separate examples must be given for the draw and repayment periods unless the payments are determined the same way during both periods. In setting forth payment examples for any repayment period under this section (and the historical example under §226.5b(d)(12)(xi)), creditors should assume a $10,000 advance is taken at the beginning of the draw period and is reduced according to the terms of the plan. Creditors should not assume an additional advance is taken at any time, including at the beginning of any repayment period.

4. *Reverse mortgages.* Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, in addition to permitting the consumer to obtain advances, may involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer's death. Repayment of the reverse mortgage (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these plans, creditors must apply the following rules, as applicable:

• If the reverse mortgage has a specified period for advances and disbursements but repayment is due only upon occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as ''The disclosures assume that you will repay the line at the time the draw period and our payments to you end. As provided in your agreement, your repayment may be rquired at a different time.'' The single payment should be considered the ''minimum periodic payment'' and consequently would not be treated as a balloon payment. The example of the minimum payment under §226.5b(d)(5)(iii) should assume a single $10,000 draw.

• If the reverse mortgage has neither a specified period for advances or disbursements nor a specified repayment date and

these terms will be determined solely by reference to future events, including the consumer's death, the creditor may assume that the draws and disbursements will end upon the consumer's death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures upon the occurrence of the event estimated to be most likely to occur first.)

• In making the disclosures, the creditor must assume that all draws and disbursements and accrued interest will be paid by the consumer. For example, if the note has a non-recourse provision providing that the consumer is not obligated for an amount greater than the value of the house, the creditor must nonetheless assume that the full amount to be drawn or disbursed will be repaid. In this case, however, the creditor may include a statement such as ''The disclosures assume full repayment of the amount advanced plus accrued interest, although the amount you may be required to pay is limited by your agreement.''

• Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. The creditor must disclose the appreciation feature, including describing how the creditor's share will be determined, any limitations, and when the feature may be exercised.

*5b(d)(6) Annual Percentage Rate*

1. *Preferred-rate plans*. If a creditor offers a preferential fixed-rate plan in which the rate will increase a specified amount upon the occurrence of a specified event, the creditor must disclose the specific amount the rate will increase.

*5b(d)(7) Fees Imposed by Creditor*

1. *Applicability*. The fees referred to in §226.5b(d)(7) include items such as application fees, points, annual fees, transaction fees, fees to obtain checks to access the plan, and fees imposed for converting to a repayment phase that is provided for in the original agreement. This disclosure includes any fees that are imposed by the creditor to use or maintain the plan, whether the fees are kept by the creditor or a third party. For example, if a creditor requires an annual credit report on the consumer and requires the consumer to pay this fee to the creditor or directly to the third party, the fee must be specifically stated. Third party fees to open the plan that are initially paid by the consumer to the creditor may be included in this disclosure or in the disclosure under §226.5b(d)(8).

2. *Manner of describing fees*. Charges may be stated as an estimated dollar amount for each fee, or as a percentage of a typical or representative amount of credit. The creditor may provide a stepped fee schedule in which a fee will increase a specified amount at a specified date. (See the discussion contained in the commentary to §226.5b(f)(3)(i).)

3. *Fees not required to be disclosed*. Fees that are not imposed to open, use, or maintain a plan, such as fees for researching an account, photocopying, paying late, stopping payment, having a check returned, exceeding the credit limit, or closing out an account do not have to be disclosed under this section. Credit report and appraisal fees imposed to investigate whether a condition permitting a freeze continues to exist—as discussed in the commentary to §226.5b(f)(3)(vi)—are not required to be disclosed under this section or §226.5b(d)(8).

4. *Rebates of closing costs*. If closing costs are imposed they must be disclosed, regardless of whether such costs may be rebated later (for example, rebated to the extent of any interest paid during the first year of the plan).

5. *Terms used in disclosure*. Creditors need not use the terms *finance charge* or *other charge* in describing the fees imposed by the creditor under this section or those imposed by third parties under §226.5b(d)(8).

*5b(d)(8) Fees Imposed by Third Parties to Open a Plan*

1. *Applicability*. Section 226.5b(d)(8) applies only to fees imposed by third parties to open the plan. Thus, for example, this section does not require disclosure of a fee imposed by a government agency at the end of a plan to release a security interest. Fees to be disclosed include appraisal, credit report, government agency, and attorneys fees. In cases where property insurance is required by the creditor, the creditor either may disclose the amount of the premium or may state that property insurance is required. For example, the disclosure might state, ''You must carry insurance on the property that secures this plan.''

2. *Itemization of third-party fees*. In all cases creditors must state the total of third-party fees as a single dollar amount or a range except that the total need not include costs for property insurance if the creditor discloses that such insurance is required. A creditor has two options with regard to providing the more detailed information about third party fees. Creditors may provide a statement that the consumer may request more specific cost information about third party fees from the creditor. As an alternative to including this statement, creditors may provide an

itemization of such fees (by type and amount) with the early disclosures. Any itemization provided upon the consumer's request need not include a disclosure about property insurance.

3. *Manner of describing fees.* A good faith estimate of the amount of fees must be provided. Creditors may provide, based on a typical or representative amount of credit, a range for such fees or state the dollar amount of such fees. Fees may be expressed on a unit cost basis, for example, $5 per $1,000 of credit.

4. *Rebates of third party fees.* Even if fees imposed by third parties may be rebated, they must be disclosed. (See the commentary to § 226.5b(d)(7).)

*5b(d)(9) Negative Amortization*

1. *Disclosure required.* In transactions where the minimum payment will not or may not be sufficient to cover the interest that accrues on the outstanding balance, the creditor must disclose that negative amortization will or may occur. This disclosure is required whether or not the unpaid interest is added to the outstanding balance upon which interest is computed. A disclosure is not required merely because a loan calls for nonamortizing or partially amortizing payments.

*5b(d)(10) Transaction Requirements*

1. *Applicability.* A limitation on automated teller machine usage need not be disclosed under this paragraph unless that is the only means by which the consumer can obtain funds.

*5b(d)(12) Disclosures for Variable-Rate Plans*

1. *Variable-rate provisions.* Sample forms in appendix G–14 provide illustrative guidance on the variable-rate rules.

*Paragraph 5b(d)(12)(iv)*

1. *Determination of annual percentage rate.* If the creditor adjusts its index through the addition of a margin, the disclosure might read, ''Your annual percentage rate is based on the index plus a margin.'' The creditor is not required to disclose a specific value for the margin.

*Paragraph 5b(d)(12)(viii)*

1. *Preferred-rate provisions.* This paragraph requires disclosure of preferred-rate provisions, where the rate will increase upon the occurrence of some event, such as the borrower-employee leaving the creditor's employ or the consumer closing an existing deposit account with the creditor.

2. *Provisions on conversion to fixed rates.* The commentary to § 226.5b(d)(5)(ii) discusses the disclosure requirements for options permitting the consumer to convert from a variable rate to a fixed rate.

*Paragraph 5b(d)(12)(ix)*

1. *Periodic limitations on increases in rates.* The creditor must disclose any annual limitations on increases in the annual percentage rate. If the creditor bases its rate limitation on 12 monthly billing cycles, such a limitation should be treated as an annual cap. Rate limitations imposed on less than an annual basis must be stated in terms of a specific amount of time. For example, if the creditor imposes rate limitations on only a semiannual basis, this must be expressed as a rate limitation for a six-month time period. If the creditor does not impose periodic limitations (annual or shorter) on rate increases, the fact that there are no annual rate limitations must be stated.

2. *Maximum limitations on increases in rates.* The maximum annual percentage rate that may be imposed under each payment option over the term of the plan (including the draw period and any repayment period provided for in the initial agreement) must be provided. The creditor may disclose this rate as a specific number (for example, 18%) or as a specific amount above the initial rate. For example, this disclosure might read, ''The maximum annual percentage rate that can apply to your line will be 5 percentage points above your initial rate.'' If the creditor states the maximum rate as a specific amount above the initial rate, the creditor must include a statement that the consumer should inquire about the rate limitations that are currently available. If an initial discount is not taken into account in applying maximum rate limitations, that fact must be disclosed. If separate overall limitations apply to rate increases resulting from events such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations also must be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations.

3. *Form of disclosures.* The creditor need not disclose each periodic or maximum rate limitation that is currently available. Instead, the creditor may disclose the range of the lowest and highest periodic and maximum rate limitations that may be applicable to the creditor's home equity plans. Creditors using this alternative must include a statement that the consumer should inquire about the rate limitations that are currently available.

*Paragraph 5b(d)(12)(x)*

1. *Maximum rate payment example.* In calculating the payment creditors should assume the maximum rate is in effect. Any discounted or premium initial rates or periodic rate limitations should be ignored for purposes of this disclosure. If a range is used to disclose the maximum cap under § 226.5b(d)(12)(ix), the highest rate in the

range must be used for the disclosure under this paragraph. As an alternative to making disclosures based on each payment option, the creditor may choose a representative example within the three categories of payment options upon which to base this disclosure. (See the commentary to §226.5b(d)(5).) However, separate examples must be provided for the draw period and for any repayment period unless the payment is determined the same way in both periods. Creditors should calculate the example for the repayment period based on an assumed $10,000 balance. (See the commentary to §226.5b(d)(5) for a discussion of the circumstances in which a creditor may use a lower outstanding balance.)

2. *Time the maximum rate could be reached.* In stating the date or time when the maximum rate could be reached, creditors should assume the rate increases as rapidly as possible under the plan. In calculating the date or time, creditors should factor in any discounted or premium initial rates and periodic rate limitations. This disclosure must be provided for the draw phase and any repayment phase. Creditors should assume the index and margin shown in the last year of the historical example (or a more recent rate) is in effect at the beginning of each phase.

*Paragraph 5b(d)(12)(xi)*

1. *Index movement.* Index values and annual percentage rates must be shown for the entire 15 years of the historical example and must be based on the most recent 15 years. The example must be updated annually to reflect the most recent 15 years of index values as soon as reasonably possible after the new index value becomes available. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values have been available and may start the historical example at the year for which values are first available.

2. *Selection of index values.* The historical example must reflect the method of choosing index values for the plan. For example, if an average of index values is used in the plan, averages must be used in the example, but if an index value as of a particular date is used, a single index value must be shown. The creditor is required to assume one date (or one period, if an average is used) within a year on which to base the history of index values. The creditor may choose to use index values as of any date or period as long as the index value as of this date or period is used for each year in the example. Only one index value per year need be shown, even if the plan provides for adjustments to the annual percentage rate or payment more than once in a year. In such cases, the creditor can assume that the index rate remained constant for the full year for the purpose of calculating the annual percentage rate and payment.

3. *Selection of margin.* A value for the margin must be assumed in order to prepare the example. A creditor may select a representative margin that it has used with the index during the six months preceding preparation of the disclosures and state that the margin is one that it has used recently. The margin selected may be used until the creditor annually updates the disclosure form to reflect the most recent 15 years of index values.

4. *Amount of discount or premium.* In reflecting any discounted or premium initial rate, the creditor may select a discount or premium that it has used during the six months preceding preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the example for as long as it is in effect. The creditor may assume that a discount or premium that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example.

5. *Rate limitations.* Limitations on both periodic and maximum rates must be reflected in the historical example. If ranges of rate limitations are provided under §226.5b(d)(12)(ix), the highest rates provided in those ranges must be used in the example. Rate limitations that may apply more often than annually should be treated as if they were annual limitations. For example, if a creditor imposes a 1% cap every six months, this should be reflected in the example as if it were a 2% annual cap.

6. *Assumed advances.* The creditor should assume that the $10,000 balance is an advance taken at the beginning of the first billing cycle and is reduced according to the terms of the plan, and that the consumer takes no subsequent draws. As discussed in the commentary to §226.5b(d)(5), creditors should not assume an additional advance is taken at the beginning of any repayment period. If applicable, the creditor may assume the $10,000 is both the advance and the credit limit. (See the commentary to §226.5b(d)(5) for a discussion of the circumstances in which a creditor may use a lower outstanding balance.)

7. *Representative payment options.* The creditor need not provide an historical example for all of its various payment options, but may select a representative payment option within each of the three categories of payments upon which to base its disclosure. (See the commentary to §226.5b(d)(5).)

8. *Payment information.* The payment figures in the historical example must reflect all significant program terms. For example, features such as rate and payment caps, a discounted initial rate, negative amortization, and rate carryover must be taken into account in calculating the payment figures if these would have applied to the plan. The

historical example should include payments for as much of the length of the plan as would occur during a 15-year period. For example:

• If the draw period is 10 years and the repayment period is 15 years, the example should illustrate the entire 10-year draw period and the first 5 years of the repayment period.

• If the length of the draw period is 15 years and there is a 15-year repayment phase, the historical example must reflect the payments for the 15-year draw period and would not show any of the repayment period. No additional historical example would be required to reflect payments for the repayment period.

• If the length of the plan is less than 15 years, payments in the historical example need only be shown for the number of years in the term. In such cases, however, the creditor must show the index values, margin and annual percentage rates and continue to reflect all significant plan terms such as rate limitations for the entire 15 years.

A creditor need show only a single payment per year in the example, even though payments may vary during a year. The calculations should be based on the actual payment computation formula, although the creditor may assume that all months have an equal number of days. The creditor may assume that payments are made on the last day of the billing cycle, the billing date or the payment due date, but must be consistent in the manner in which the period used to illustrate payment information is selected. Information about balloon payments and remaining balance may, but need not, be reflected in the example.

9. *Disclosures for repayment period.* The historical example must reflect all features of the repayment period, including the appropriate index values, margin, rate limitations, length of the repayment period, and payments. For example, if different indices are used during the draw and repayment periods, the index values for that portion of the 15 years that reflect the repayment period must be the values for the appropriate index.

10. *Reverse mortgages.* The historical example for reverse mortgages should reflect 15 years of index values and annual percentage rates, but the payment column should be blank until the year that the single payment will be made, assuming that payment is estimated to occur within 15 years. (See the commentary to §226.5b(d)(5) for a discussion of reverse mortgages.)

*5b(e) Brochure*

1. *Substitutes.* A brochure is a suitable substitute for the Board's home equity brochure if it is, at a minimum, comparable to the Board's brochure in substance and comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the Board's brochure.

2. *Effect of third party delivery of brochure.* If a creditor determines that a third party has provided a consumer with the required brochure pursuant to §226.5b(c), the creditor need not give the consumer a second brochure.

*5b(f) Limitations on Home Equity Plans*

1. *Coverage.* Section 226.5b(f) limits both actions that may be taken and language that may be included in contracts, and applies to any assignee or holder as well as to the original creditor. The limitations apply to the draw period and any repayment period, and to any renewal or modification of the original agreement.

*Paragraph 5b(f)(1)*

1. *External index.* A creditor may change the annual percentage rate for a plan only if the change is based on an index outside the creditor's control. Thus, a creditor may not make rate changes based on its own prime rate or cost of funds and may not reserve a contractual right to change rates at its discretion. A creditor is permitted, however, to use a published prime rate, such as that in the Wall Street Journal, even if the bank's own prime rate is one of several rates used to establish the published rate.

2. *Publicly available.* The index must be available to the public. A publicly available index need not be published in a newspaper, but it must be one the consumer can independently obtain (by telephone, for example) and use to verify rates imposed under the plan.

3. *Provisions not prohibited.* This paragraph does not prohibit rate changes that are specifically set forth in the agreement. For example, stepped-rate plans, in which specified rates are imposed for specified periods, are permissible. In addition, preferred-rate provisions, in which the rate increases by a specified amount upon the occurrence of a specified event, also are permissible.

*Paragraph 5b(f)(2)*

1. *Limitations on termination and acceleration.* In general, creditors are prohibited from terminating and accelerating payment of the outstanding balance before the scheduled expiration of a plan. However, creditors may take these actions in the four circumstances specified in §226.5b(f)(2). Creditors are not permitted to specify in their contracts any other events that allow termination and acceleration beyond those permitted by the regulation. Thus, for example, an agreement may not provide that the balance is payable on demand nor may it provide that the account will be terminated and the balance accelerated if the rate cap is reached.

2. *Other actions permitted*. If an event permitting termination and acceleration occurs, a creditor may instead take actions short of terminating and accelerating. For example, a creditor could temporarily or permanently suspend further advances, reduce the credit limit, change the payment terms, or require the consumer to pay a fee. A creditor also may provide in its agreement that a higher rate or higher fees will apply in circumstances under which it would otherwise be permitted to terminate the plan and accelerate the balance. A creditor that does not immediately terminate an account and accelerate payment or take another permitted action may take such action at a later time, provided one of the conditions permitting termination and acceleration exists at that time.

*Paragraph 5b(f)(2)(i)*

1. *Fraud or material misrepresentation*. A creditor may terminate a plan and accelerate the balance if there has been fraud or material misrepresentation by the consumer in connection with the plan. This exception includes fraud or misrepresentation at any time, either during the application process or during the draw period and any repayment period. What constitutes fraud or misrepresentation is determined by applicable state law and may include acts of omission as well as overt acts, as long as any necessary intent on the part of the consumer exists.

*Paragraph 5b(f)(2)(ii)*

1. *Failure to meet repayment terms*. A creditor may terminate a plan and accelerate the balance when the consumer fails to meet the repayment terms provided for in the agreement. However, a creditor may terminate and accelerate under this provision only if the consumer actually fails to make payments. For example, a creditor may not terminate and accelerate if the consumer, in error, sends a payment to the wrong location, such as a branch rather than the main office of the creditor. If a consumer files for or is placed in bankruptcy, the creditor may terminate and accelerate under this provision if the consumer fails to meet the repayment terms of the agreement. This section does not override any state or other law that requires a right-to-cure notice, or otherwise places a duty on the creditor before it can terminate a plan and accelerate the balance.

*Paragraph 5b(f)(2)(iii)*

1. *Impairment of security*. A creditor may terminate a plan and accelerate the balance if the consumer's action or inaction adversely affects the creditor's security for the plan, or any right of the creditor in that security. Action or inaction by third parties does not, in itself, permit the creditor to terminate and accelerate.

2. *Examples*. A creditor may terminate and accelerate, for example, if:

- The consumer transfers title to the property or sells the property without the permission of the creditor
- The consumer fails to maintain required insurance on the dwelling
- The consumer fails to pay taxes on the property
- The consumer permits the filing of a lien senior to that held by the creditor
- The sole consumer obligated on the plan dies
- The property is taken through eminent domain
- A prior lienholder forecloses

By contrast, the filing of a judgment against the consumer would permit termination and acceleration only if the amount of the judgment and collateral subject to the judgment is such that the creditor's security is adversely affected. If the consumer commits waste or otherwise destructively uses or fails to maintain the property such that the action adversely affects the security, the plan may be terminated and the balance accelerated. Illegal use of the property by the consumer would permit termination and acceleration if it subjects the property to seizure. If one of two consumers obligated on a plan dies the creditor may terminate the plan and accelerate the balance if the security is adversely affected. If the consumer moves out of the dwelling that secures the plan and that action adversely affects the security, the creditor may terminate a plan and accelerate the balance.

*Paragraph 5b(f)(3)*

1. *Scope of provision*. In general, a creditor may not change the terms of a plan after it is opened. For example, a creditor may not increase any fee or impose a new fee once the plan has been opened, even if the fee is charged by a third party, such as a credit reporting agency, for a service. The change of terms prohibition applies to all features of a plan, not only those required to be disclosed under this section. For example, this provision applies to charges imposed for late payment, although this fee is not required to be disclosed under §226.5b(d)(7).

2. *Charges not covered*. There are three charges not covered by this provision. A creditor may pass on increases in taxes since such charges are imposed by a governmental body and are beyond the control of the creditor. In addition, a creditor may pass on increases in premiums for property insurance that are excluded from the finance charge under §226.4(d)(2), since such insurance provides a benefit to the consumer independent of the use of the line and is often maintained notwithstanding the line. A creditor also

may pass on increases in premiums for credit insurance that are excluded from the finance charge under §226.4(d)(1), since the insurance is voluntary and provides a benefit to the consumer.

*Paragraph 5b(f)(3)(i)*

1. *Changes provided for in agreement.* A creditor may provide in the initial agreement that further advances will be prohibited or the credit line reduced during any period in which the maximum annual percentage rate is reached. A creditor also may provide for other specific changes to take place upon the occurrence of specific events. Both the triggering event and the resulting modification must be stated with specificity. For example, in home equity plans for employees, the agreement could provide that a specified higher rate or margin will apply if the borrower's employment with the creditor ends. A contract could contain a stepped-rate or stepped-fee schedule providing for specified changes in the rate or the fees on certain dates or after a specified period of time. A creditor also may provide in the initial agreement that it will be entitled to a share of the appreciation in the value of the property as long as the specific appreciation share and the specific circumstances which require the payment of it are set forth. A contract may permit a consumer to switch among minimum payment options during the plan.

2. *Prohibited provisions.* A creditor may not include a general provision in its agreement permitting changes to any or all of the terms of the plan. For example, creditors may not include ''boilerplate'' language in the agreement stating that they reserve the right to change the fees imposed under the plan. In addition, a creditor may not include any ''triggering events'' or responses that the regulation expressly addresses in a manner different from that provided in the regulation. For example, an agreement may not provide that the margin in a variable-rate plan will increase if there is a material change in the consumer's financial circumstances, because the regulation specifies that temporarily freezing the line or lowering the credit limit is the permissible response to a material change in the consumer's financial circumstances. Similarly a contract cannot contain a provision allowing the creditor to freeze a line due to an insignificant decline in property value since the regulation allows that response only for a significant decline.

*Paragraph 5b(f)(3)(ii)*

1. *Substitution of index.* A creditor may change the index and margin used under the plan if the original index becomes unavailable, as long as historical fluctuations in the original and replacement indices were substantially similar, and as long as the replacement index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. If the replacement index is newly established and therefore does not have any rate history, it may be used if it produces a rate substantially similar to the rate in effect when the original index became unavailable.

*Paragraph 5b(f)(3)(iii)*

1. *Changes by written agreement.* A creditor may change the terms of a plan if the consumer expressly agrees in writing to the change at the time it is made. For example, a consumer and a creditor could agree in writing to change the repayment terms from interest-only payments to payments that reduce the principal balance. The provisions of any such agreement are governed by the limitations in §226.5b(f). For example, a mutual agreement could not provide for future annual percentage rate changes based on the movement of an index controlled by the creditor or for termination and acceleration under circumstances other than those specified in the regulation. By contrast, a consumer could agree to a new credit limit for the plan, although the agreement could not permit the creditor to later change the credit limit except by a subsequent written agreement or in the circumstances described in §226.5b(f)(3)(vi).

2. *Written agreement.* The change must be agreed to in writing by the consumer. Creditors are not permitted to assume consent because the consumer uses an account, even if use of an account would otherwise constitute acceptance of a proposed change under state law.

*Paragraph 5b(f)(3)(iv)*

1. *Beneficial changes.* After a plan is opened, a creditor may make changes that unequivocally benefit the consumer. Under this provision, a creditor may offer more options to consumers, as long as existing options remain. For example, a creditor may offer the consumer the option of making lower monthly payments or could increase the credit limit. Similarly, a creditor wishing to extend the length of the plan on the same terms may do so. Creditors are permitted to temporarily reduce the rate or fees charged during the plan (though a change in terms notice may be required under §226.9(c) when the rate or fees are returned to their original level). Creditors also may offer an additional means of access to the line, even if fees are associated with using the device, provided the consumer retains the ability to use prior access devices on the original terms.

*Paragraph 5b(f)(3)(v)*

1. *Insignificant changes.* A creditor is permitted to make insignificant changes after a plan is opened. This rule accommodates operational and similar problems, such as changing the address of the creditor for purposes of sending payments. It does not permit a creditor to change a term such as a fee charged for late payments.

2. *Examples of insignificant changes.* Creditors may make minor changes to features such as the billing cycle date, the payment due date (as long as the consumer does not have a diminished grace period if one is provided), and the day of the month on which index values are measured to determine changes to the rate for variable-rate plans. A creditor also may change its rounding practice in accordance with the tolerance rules set forth in § 226.14 (for example, stating an exact APR of 14.3333 percent as 14.3 percent, even if it had previously been stated as 14.33 percent). A creditor may change the balance computation method it uses only if the change produces an insignificant difference in the finance charge paid by the consumer. For example, a creditor may switch from using the average daily balance method (including new transactions) to the daily balance method (including new transactions).

*Paragraph 5b(f)(3)(vi)*

1. *Suspension of credit privileges or reduction of credit limit.* A creditor may prohibit additional extensions of credit or reduce the credit limit in the circumstances specified in this section of the regulation. In addition, as discussed under § 226.5b(f)(3)(i), a creditor may contractually reserve the right to take such actions when the maximum annual percentage rate is reached. A creditor may not take these actions under other circumstances, unless the creditor would be permitted to terminate the line and accelerate the balance as described in § 226.5b(f)(2). The creditor's right to reduce the credit limit does not permit reducing the limit below the amount of the outstanding balance if this would require the consumer to make a higher payment.

2. *Temporary nature of suspension or reduction.* Creditors are permitted to prohibit additional extensions of credit or reduce the credit limit only while one of the designated circumstances exists. When the circumstance justifying the creditor's action ceases to exist, credit privileges must be reinstated, assuming that no other circumstance permitting such action exists at that time.

3. *Imposition of fees.* If not prohibited by state law, a creditor may collect only bona fide and reasonable appraisal and credit report fees if such fees are actually incurred in investigating whether the condition permitting the freeze continues to exist. A creditor may not, in any circumstances, impose a fee to reinstate a credit line once the condition has been determined not to exist.

4. *Reinstatement of credit privileges.* Creditors are responsible for ensuring that credit privileges are restored as soon as reasonably possible after the condition that permitted the creditor's action ceases to exist. One way a creditor can meet this responsibility is to monitor the line on an ongoing basis to determine when the condition ceases to exist. The creditor must investigate the condition frequently enough to assure itself that the condition permitting the freeze continues to exist. The frequency with which the creditor must investigate to determine whether a condition continues to exist depends upon the specific condition permitting the freeze. As an alternative to such monitoring, the creditor may shift the duty to the consumer to request reinstatement of credit privileges by providing a notice in accordance with § 226.9(c)(3). A creditor may require a reinstatement request to be in writing if it notifies the consumer of this requirement on the notice provided under § 226.9(c)(3). Once the consumer requests reinstatement, the creditor must promptly investigate to determine whether the condition allowing the freeze continues to exist. Under this alternative, the creditor has a duty to investigate only upon the consumer's request.

5. *Suspension of credit privileges following request by consumer.* A creditor may honor a specific request by a consumer to suspend credit privileges. If the consumer later requests that the creditor reinstate credit privileges, the creditor must do so provided no other circumstance justifying a suspension exists at that time. If two or more consumers are obligated under a plan and each has the ability to take advances, the agreement may permit any of the consumers to direct the creditor not to make further advances. A creditor may require that all persons obligated under a plan request reinstatement.

6. *Significant decline defined.* What constitutes a significant decline for purposes of § 226.5b(f)(3)(vi)(A) will vary according to individual circumstances. In any event, if the value of the dwelling declines such that the initial difference between the credit limit and the available equity (based on the property's appraised value for purposes of the plan) is reduced by fifty percent, this constitutes a significant decline in the value of the dwelling for purposes of § 226.5b(f)(3)(vi)(A). For example, assume that a house with a first mortgage of $50,000 is appraised at $100,000 and the credit limit is $30,000. The difference between the credit limit and the available equity is $20,000, half of which is $10,000. The creditor could prohibit further advances or reduce the credit limit if the value of the property declines from $100,000 to $90,000. This provision does

not require a creditor to obtain an appraisal before suspending credit privileges although a significant decline must occur before suspension can occur.

7. *Material change in financial circumstances.* Two conditions must be met for §226.5b(f)(3)(vi)(B) to apply. First, there must be a ''material change'' in the consumer's financial circumstances, such as a significant decrease in the consumer's income. Second, as a result of this change, the creditor must have a reasonable belief that the consumer will be unable to fulfill the payment obligations of the plan. A creditor may, but does not have to, rely on specific evidence (such as the failure to pay other debts) in concluding that the second part of the test has been met. A creditor may prohibit further advances or reduce the credit limit under this section if a consumer files for or is placed in bankruptcy.

8. *Default of a material obligation.* Creditors may specify events that would qualify as a default of a material obligation under §226.5b(f)(3)(vi)(C). For example, a creditor may provide that default of a material obligation will exist if the consumer moves out of the dwelling or permits an intervening lien to be filed that would take priority over future advances made by the creditor.

9. *Government limits on the annual percentage rate.* Under §226.5b(f)(3)(vi)(D), a creditor may prohibit further advances or reduce the credit limit if, for example, a state usury law is enacted which prohibits a creditor from imposing the agreed-upon annual percentage rate.

### *5b(g) Refund of Fees*

1. *Refund of fees required.* If any disclosed term, including any term provided upon request pursuant to §226.5b(d), changes between the time the early disclosures are provided to the consumer and the time the plan is opened, and the consumer as a result decides to not enter into the plan, a creditor must refund all fees paid by the consumer in connection with the application. All fees, including credit report fees and appraisal fees, must be refunded whether such fees are paid to the creditor or directly to third parties. A consumer is entitled to a refund of fees under these circumstances whether or not terms are guaranteed by the creditor under §226.5b(d)(2)(i).

2. *Variable-rate plans.* The right to a refund of fees does not apply to changes in the annual percentage rate resulting from fluctuations in the index value in a variable-rate plan. Also, if the maximum annual percentage rate is expressed as an amount over the initial rate, the right to refund of fees would not apply to changes in the cap resulting from fluctuations in the index value.

3. *Changes in terms.* If a term, such as the maximum rate, is stated as a range in the early disclosures, and the term ultimately applicable to the plan falls within that range, a change does not occur for purposes of this section. If, however, no range is used and the term is changed (for example, a rate cap of 6 rather than 5 percentage points over the initial rate), the change would permit the consumer to obtain a refund of fees. If a fee imposed by the creditor is stated in the early disclosures as an estimate and the fee changes, the consumer could elect to not enter into the agreement and would be entitled to a refund of fees. On the other hand, if fees imposed by third parties are disclosed as estimates and those fees change, the consumer is not entitled to a refund of fees paid in connection with the application. Creditors must, however, use the best information reasonably available in providing disclosures about such fees.

4. *Timing of refunds and relation to other provisions.* The refund of fees must be made as soon as reasonably possible after the creditor is notified that the consumer is not entering into the plan because of the changed term, or that the consumer wants a refund of fees. The fact that an application fee may be refunded to some applicants under this provision does not render such fees finance charges under §226.4(c)(1) of the regulation.

### *5b(h) Imposition of Nonrefundable Fees*

1. *Collection of fees after consumer receives disclosures.* A fee may be collected after the consumer receives the disclosures and brochure and before the expiration of three days, although the fee must be refunded if, within three days of receiving the required information, the consumer decides to not enter into the agreement. In such a case, the consumer must be notified that the fee is refundable for three days. The notice must be clear and conspicuous and in writing, and may be included with the disclosures required under §226.5b(d) or as an attachment to them. If disclosures and brochure are mailed to the consumer, footnote 10d of the regulation provides that a nonrefundable fee may not be imposed until six business days after the mailing.

2. *Collection of fees before consumer receives disclosures.* An application fee may be collected before the consumer receives the disclosures and brochure (for example, when an application contained in a magazine is mailed in with an application fee) provided that it remains refundable until three business days after the consumer receives the §226.5b disclosures. No other fees except a refundable membership fee may be collected until after the consumer receives the disclosures required under §226.5b.

3. *Relation to other provisions.* A fee collected before disclosures are provided may become nonrefundable except that, under §226.5b(g), it must be refunded if the consumer elects to not enter into the plan because of a change in terms. (Of course, all

fees must be refunded if the consumer later rescinds under § 226.15.)

*Section 226.6 Initial Disclosure Statement*

1. *Consistent terminology*. Language on the initial and periodic disclosure statements must be close enough in meaning to enable the consumer to relate the 2 sets of disclosures; however, the language need not be identical. For example, in making the disclosure under § 226.6(a)(3), the creditor may refer to the ''outstanding balance at the end of the billing cycle,'' while the disclosure for § 226.7(i) refers to the ''ending balance'' or ''new balance.''

2. *Separate initial disclosures permitted*. In a certain open-end credit program involving more than one creditor—a card issuer of travel-and-entertainment cards and a financial institution—the consumer has the option to pay the card issuer directly or to transfer to the financial institution all or part of the amount owing. In this case, the creditors may send separate initial disclosure statements.

*6(a) Finance charge.*

*Paragraph 6(a)(1)*

1. *When finance charges accrue*. Creditors may provide a general explanation about finance charges beginning to run and need not disclose a specific date. For example, a disclosure that the consumer has 30 days from the closing date to pay the new balance before finance charges will accrue on the account would describe when finance charges begin to run.

2. *Free-ride periods*. In disclosing whether or not a free-ride period exists, the creditor need not use ''free period,'' ''free-ride period,'' or any other particular descriptive phrase or term. For example, a statement that ''the finance charge begins on the date the transaction is posted to your account'' adequately discloses that no free-ride period exists. In the same fashion, a statement that ''finance charges will be imposed on any new purchases only if they are not paid in full within 25 days after the close of the billing cycle'' indicates that a free-ride period exists in the interim.

*Paragraph 6(a)(2).*

1. *Range of balances*. The range of balances disclosure is inapplicable:

• If only one periodic rate may be applied to the entire account balance.

• If only one periodic rate may be applied to the entire balance for a feature (for example, cash advances), even though the balance for another feature (purchases) may be subject to 2 rates (a 1.5% periodic rate on purchase balances of $0–$500, while balances above $500 are subject to a 1% periodic rate). Of course, the creditor must give a range of balances disclosure for the purchase feature.

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

• Rate changes that are tied to the rate the creditor pays on its 6-month money market certificates.

• Rate changes that are tied to Treasury bill rates.

• Rate changes that are tied to changes in the creditor's commercial lending rate.

In contrast, the creditor's contract reservation to increase the rate without reference to such an index or formula (for example, a plan that simply provides that the creditor reserves the right to raise its rates) would not be considered a variable-rate plan for Truth in Lending disclosure purposes. (See the rule in § 226.5b(f)(1) applicable to home equity plans, however, which prohibits ''rate reservation'' clauses.) Moreover, an open-end credit plan in which the employee receives a lower rate contingent upon employment (that is, with the rate to be increased upon termination of employment) is not a variable-rate plan. (With regard to such employee preferential-rate plans, however, see comment 9(c)–1, which provides that if the specific change that would occur is disclosed on the initial disclosure statement, no notice of a change in terms need be given when the term later changes as disclosed.)

3. *Variable rate plan—rate(s) in effect*. In disclosing the rate(s) in effect at the time of the initial disclosures (as is required by § 226.6(a)(2)), the creditor may use an insert showing the current rate; may give the rate as of a specified date and then update the disclosure from time to time, for example, each calendar month; or may disclose an estimated rate under § 226.5(c).

4. *Variable rate plan—additional disclosures required*. In addition to disclosing the rates in effect at the time of the initial disclosures, the disclosures under footnote 12 also must be made.

5. *Variable rate plan—index*. The index to be used must be clearly identified; the creditor need not give, however, an explanation of how the index is determined or provide instructions for obtaining it.

6. *Variable rate plan—circumstances for increase*. Circumstances under which the rate(s) may increase include, for example:

• An increase in the Treasury bill rate.

• An increase in the Federal Reserve discount rate.

The creditor must disclose when the increase will take effect; for example,

• ''An increase will take effect on the day that the Treasury bill rate increases,'' or

• ''An increase in the Federal Reserve discount rate will take effect on the first day of the creditor's billing cycle.''

7. *Variable-rate plan—limitations on increase.* In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. (A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See §226.30 and the commentary to that section.) Legal limits such as usury or rate ceilings under State or Federal statutes or regulations need not be disclosed. Examples of limitations that must be disclosed include:

• ''The rate on the plan will not exceed 25% annual percentage rate.''

• ''Not more than ½% increase in the annual percentage rate per year will occur.''

8. *Variable rate plan—effects of increase.* Examples of effects that must be disclosed include:

• Any requirement for additional collateral if the annual percentage rate increases beyond a specified rate.

• Any increase in the scheduled minimum periodic payment amount.

9. *Variable rate plan—change-in-terms notice not required.* No notice of a change in terms is required for a rate increase under a variable rate plan as defined in Comment 6(a)(2)–2.

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

• For example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the current Treasury bill rate is 10 percent, the creditor may forego the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent, or the creditor may disregard the index or formula and set the initial rate at 9 percent.

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

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

11. *Increased penalty rates.* If the initial rate may increase upon the occurrence of one or more specific events, such as a late payment or an extension of credit that exceeds the credit limit, the creditor must disclose the initial rate and the increased penalty rate that may apply. If the penalty rate is based on an index and an increased margin, the issuer must disclose the index and the margin. The creditor must also disclose the specific event or events that may result in the increased rate, such as ''22% APR, if 60 days late.'' If the penalty rate cannot be determined at the time disclosures are given, the creditor must provide an explanation of the specific event or events that may result in the increased rate. At the creditor's option, the creditor may disclose the period for which the increased rate will remain in effect, such as ''until you make three timely payments.'' The creditor need not disclose an increased rate that is imposed when credit privileges are permanently terminated.

*Paragraph 6(a)(3).*

1. *Explanation of balance computation method.* A shorthand phrase such as ''previous balance method'' does not suffice in explaining the balance computation method. (See appendix G–1 for model clauses.)

2. *Allocation of payments.* Disclosure about the allocation of payments and other credits is not required. For example, the creditor need not disclose that payments are applied to late charges, overdue balances, and finance charges before being applied to the principal balance; or in a multifeatured plan, that payments are applied first to finance charges, then to purchases, and then to cash advances. (See Comment 7–1 for definition of multifeatured plan.)

*Paragraph 6(a)(4).*

1. *Finance charges.* In addition to disclosing the periodic rate(s) under §226.6(a)(2), disclosure is required of any other type of finance charge that may be imposed, such as minimum, fixed, transaction, and activity charges; required insurance; or appraisal or credit report fees (unless excluded from the finance charge under §226.4(c)(7)).

*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. A membership or participation fee 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 is not an ''other charge,'' even if membership is required to apply for credit. For the fee to be excluded from disclosure as an ''other charge,'' however, the package of services must have some substantive purpose other than access to the credit feature. For example, if the primary benefit of membership in an organization is the opportunity to apply for a credit card, and the other benefits offered (such as a newsletter or a member information hotline) are merely incidental to the credit feature, the membership fee would have to be disclosed as an ''other charge.''

vi. Automated teller machine (ATM) charges described in comment 4(a)–4 that are not finance charges.

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

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

i. Fees charged for documentary evidence of transactions for income tax purposes.

ii. Amounts payable by a consumer for collection activity after default; attorney's fees, whether or not automatically imposed; foreclosure costs; post-judgment interest rates imposed by law; and reinstatement or reissuance fees.

iii. Premiums for voluntary credit life or disability insurance, or for property insurance, that are not part of the finance charge.

iv. Application fees under § 226.4(c)(1).

v. A monthly service charge for a checking account with overdraft protection that is applied to all checking accounts, whether or not a credit feature is attached.

vi. Charges for submitting as payment a check that is later returned unpaid (*see* commentary to § 226.4(c)(2)).

vii. Charges imposed on a cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system. (*See* also comment 7(b)–2.)

viii. Taxes and filing or notary fees excluded from the finance charge under § 226.4(e).

ix. A fee to expedite delivery of a credit card, either at account opening or during the life of the account, provided delivery of the card is also available by standard mail service (or other means at least as fast) without paying a fee for delivery.

x. A fee charged for arranging a single payment on the credit account, upon the consumer's request (regardless of how frequently the consumer requests the service), if the credit plan provides that the consumer may make payments on the account by another reasonable means, such as by standard mail service, without paying a fee to the creditor.

*6(c) Security interests.*

1. *General*. Disclosure is not required about the type of security interest, or about the creditor's rights with respect to that collateral. In other words, the creditor need not expand on the term *security interest*. Also, since no specified terminology is required, the creditor may designate its interest by using, for example, *pledge, lien,* or *mortgage* (instead of *security interest*).

2. *Identification of property*. Identification of the collateral by type is satisfied by stating, for example, *motor vehicle* or *household appliances*. (Creditors should be aware, however, that the federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) The creditor may, at its option, provide a more specific identification (for example, a model and serial number).

3. *Spreader clause*. The fact that collateral for pre-existing credit extensions with the institution is being used to secure the present obligation constitutes a security interest and must be disclosed. (Such security interests may be known as *spreader* or *dragnet* clauses, or as *cross-collateralization* clauses.) A specific identification of that collateral is unnecessary, but a reminder of the interest arising from the prior indebtedness is required. This may be accomplished by using language such as ''collateral securing other loans with us may also secure this loan.'' At the creditor's option, a more specific description of the property involved may be given.

4. *Additional collateral*. If collateral is required when advances reach a certain amount, the creditor should disclose the information available at the time of the initial disclosures. For example, if the creditor knows that a security interest will be taken in household goods if the consumer's balance exceeds $1,000, the creditor should disclose accordingly. If the creditor knows that security will be required if the consumer's balance exceeds $1,000, but the creditor does not know what security will be required, the creditor must disclose on the initial disclosure statement that security will be required if the balance exceeds $1,000, and the creditor must provide a change-in-terms notice under § 226.9(c) at the time the security is taken. (See comment 6(c)–2.)

5. *Collateral from third party*. In certain situations, the consumer's obligation may be secured by collateral belonging to a third party. For example, an open-end credit plan may be secured by an interest in property owned by the consumer's parents. In such cases, the security interest is taken in connection with the plan and must be disclosed, even though the property encumbered is owned by someone other than the consumer.

*6(d) Statement of billing rights.*

See the commentary to appendix G–3.

*6(e) Home Equity Plan Information*

1. *Additional disclosures required.* For home equity plans, creditors must provide several of the disclosures set forth in §226.5b(d) along with the disclosures required under §226.6. Creditors also must disclose a list of the conditions that permit the creditor to terminate the plan, freeze or reduce the credit limit, and implement specified modifications to the original terms. (See comment 5b(d)(4)(iii)–1.)

2. *Form of disclosures.* The home equity disclosures provided under this section must be in a form the consumer can keep, and are governed by §226.5(a)(1). The segregation standard set forth in §226.5b(a) does not apply to home equity disclosures provided under §226.6.

3. *Disclosure of payment and variable-rate examples.* The payment example disclosure in §226.5b(d)(5)(iii) and the variable-rate information in §226.5b(d)(12) (viii), (x), (xi), and (xii) need not be provided with the disclosures under §226.6 if:

• The disclosures under §226.5b(d) were provided in a form the consumer could keep; and

• The disclosures of the payment example under §226.5b(d)(5)(iii), the maximum payment example under §226.5b(d)(12)(x) and the historical table under §226.5b(d)(12)(xi) included a representative payment example for the category of payment options the consumer has chosen.

For example, if a creditor offers three payment options (one for each of the categories described in the commentary to §226.5b(d)(5)), describes all three options in its early disclosures, and provides all of the disclosures in a retainable form, that creditor need not provide the §226.5b(d)(5)(iii) or (d)(12) disclosures again when the account is opened. If the creditor showed only one of the three options in the early disclosures (which would be the case with a separate disclosure form rather than a combined form, as discussed under §226.5b(a)), the disclosures under §226.5b(d)(5)(iii) and (d)(12) (viii), (x), (xi) and (xii) must be given to any consumer who chooses one of the other two options. If the §226.5b(d)(5)(iii) and (d)(12) disclosures are provided with the second set of disclosures, they need not be transaction-specific, but may be based on a representative example of the category of payment option chosen.

4. *Disclosures for the repayment period.* The creditor must provide disclosures about both the draw and repayment phases when giving the disclosures under §226.6. Specifically, the creditor must make the disclosures in §226.6(e), state the corresponding annual percentage rate (as required in §226.6(a)(2)) and provide the variable-rate information required in footnote 12 for the repayment phase. To the extent the corresponding annual percentage rate, the information in footnote 12, and any other required disclosures are the same for the draw and repayment phase, the creditor need not repeat such information, as long as it is clear that the information applies to both phases.

References

*Statute:* Section 127(a).

*Other sections:* Sections 226.4, 226.5, 226.7, 226.9, 226.14, and appendix G.

*Previous regulation:* Section 226.7(a) and Interpretation §226.706.

*1981 changes:* Section 226.6 implements the amended statute which requires disclosure of the fact that *no* free period exists. Disclosures about the minimum periodic payment and the Comparative Index of Credit Cost have been eliminated. The security interest disclosures have been simplified. *Other charges* no longer include voluntary credit life or disability insurance, required property insurance premiums, default charges, or fees for collection activity. Disclosures for variable rate plans are now required by the regulation, replacing Interpretation §226.707. The regulation no longer specifies the exact language to be used for the billing rights notice; creditors may use any version *substantially similar* to the one in appendix G.

*Section 226.7—Periodic Statement*

1. *Multifeatured plans.* Some plans involve a number of different features, such as purchases, cash advances, or overdraft checking. Groups of transactions subject to different finance charge terms because of the dates on which the transactions took place are treated like different features for purposes of disclosures on the periodic statements. The commentary includes some special rules for multifeatured plans.

2. *Separate periodic statements permitted.* In a certain open-end credit program involving more than one creditor—a card issuer of travel-and-entertainment cards and a financial institution—the consumer has the option to pay the card issuer directly or to transfer to the financial institution all or part of the amount owing. In this case, the creditors may send separate periodic statements that reflect the separate obligations owed to each.

3. *Deferred payment transactions.* Creditors offer a variety of payment plans for purchases that permit consumers to avoid finance charges if the purchase balance is paid in full by a certain date. The following provides guidance for one type of deferred payment plan where, for example, no finance charge is imposed on a $500 purchase made in January if the $500 balance is paid by March 31.

i. *Periodic rates.* Under §226.7(d), creditors must disclose each periodic rate that may be used to compute the finance charge. Under some plans with a deferred payment feature, if the deferred payment balance is not paid by the payment due date, finance charges attributable to periodic rates applicable to the billing cycles between the date of purchase and the payment due date (January through March in this example) may be imposed. Periodic rates that may apply to the deferred payment balance ($500 in this example) if the balance is not paid in full by the payment due date must appear on periodic statements for the billing cycles between the date of purchase and the payment due date. However, if the consumer does not pay the deferred payment balance by the due date, the creditor is not required to identify, on the periodic statement disclosing the finance charge for the deferred payment balance, periodic rates that have been disclosed in previous billing cycles between the date of purchase and the payment due date.

ii. *Balances subject to periodic rates.* Under §226.7(e), creditors must disclose the balances subject to periodic rates during a billing cycle. The deferred payment balance ($500 in this example) is not subject to a periodic rate for billing cycles between the date of purchase and the payment due date. Periodic statements sent for those billing cycles should not include the deferred payment balance in the balance disclosed under §226.7(e). At the creditor's option, this amount may be disclosed on periodic statements provided it is identified by a term other than the term used to identify the balance disclosed under §226.7(e) (such as ''deferred payment balance''). During any billing cycle in which a periodic rate finance charge on the deferred payment balance is debited to the account, the balance disclosed under §226.7(e) should include the deferred payment balance for that billing cycle.

iii. *Amount of finance charge.* Under §226.7(f), creditors must disclose finance charges imposed during a billing cycle. For some deferred payment purchases, the creditor may impose a finance charge from the date of purchase if the deferred payment balance ($500 in this example) is not paid in full by the due date, but otherwise will not impose finance charges for billing cycles between the date of purchase and the payment due date. Periodic statements for billing cycles preceding the payment due date should not include in the finance charge disclosed under §226.7(f) the amounts a consumer may owe if the deferred payment balance is not paid in full by the payment due date. In this example, the February periodic statement should not identify as finance charges interest attributable to the $500 January purchase. At the creditor's option, this amount may be disclosed on periodic statements provided it is identified by a term other than ''finance charge'' (such as ''contingent finance charge'' or ''deferred finance charge''). The finance charge on a deferred payment balance should be reflected on the periodic statement under §226.7(f) for the billing cycle in which the finance charge is debited to the account.

iv. *Free-ride period.* Assuming monthly billing cycles ending at month-end and a free-ride period ending on the 25th of the following month, here are four examples illustrating how a creditor may comply with the requirement to disclose the free-ride period applicable to a deferred payment balance ($500 in this example) and with the 14-day rule for mailing or delivering periodic statements before imposing finance charges (see §226.5):

A. The creditor could include the $500 purchase on the periodic statement reflecting account activity for February and sent on March 1 and identify March 31 as the payment due date for the $500 purchase. (The creditor could also identify March 31 as the payment due date for any other amounts that would normally be due on March 25.)

B. The creditor could include the $500 purchase on the periodic statement reflecting activity for March and sent on April 1 and identify April 25 as the payment due date for the $500 purchase, permitting the consumer to avoid finance charges if the $500 is paid in full by April 25.

C. The creditor could include the $500 purchase and its due date on each periodic statement sent during the deferred payment period (January, February, and March in this example).

D. If the due date for the deferred payment balance is March 7 (instead of March 31), the creditor could include the $500 purchase and its due date on the periodic statement reflecting activity for January and sent on February 1, the most recent statement sent at least 14 days prior to the due date.

*7(a) Previous balance.*

1. *Credit balances.* If the previous balance is a credit balance, it must be disclosed in such a way so as to inform the consumer that it is a credit balance, rather than a debit balance.

2. *Multifeatured plans.* In a multifeatured plan, the previous balance may be disclosed either as an aggregate balance for the account or as separate balances for each feature (for example, a previous balance for purchases and a previous balance for cash advances). If separate balances are disclosed, a total previous balance is optional.

3. *Accrued finance charges allocated from payments.* Some open-end credit plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and reflected as an increase in the obligation. In such a plan, the

previous balance need not reflect finance charges accrued since the last payment.

*7(b) Identification of transactions.*

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

2. *Automated teller machine (ATM) charges imposed by other institutions in shared or interchange systems.* A charge imposed on the cardholder by an institution other than the card issuer for the use of the other institution's ATM in a shared or interchange system and included by the terminal-operating institution in the amount of the transaction need not be separately disclosed on the periodic statement.

*7(c) Credits.*

1. *Identification—sufficiency.* The creditor need not describe each credit by type (returned merchandise, rebate of finance charge, etc.)—*credit* would suffice—except if the creditor is using the periodic statement to satisfy the billing error correction notice requirement. (See the commentary to §226.13 (e) and (f).)

2. *Format.* A creditor may list credits relating to credit extensions (payments, rebates, etc.) together with other types of credits (such as deposits to a checking account), as long as the entries are identified so as to inform the consumer which type of credit each entry represents.

3. *Date.* If only one date is disclosed (that is, the crediting date as required by the regulation), no further identification of that date is necessary. More than one date may be disclosed for a single entry, as long as it is clear which date represents the date on which credit was given.

4. *Totals.* Where the creditor lists the credits made to the account during the billing cycle, the creditor need not disclose total figures for the amounts credited.

*7(d) Periodic rates.*

1. *Disclosure of periodic rates—whether or not actually applied.* Any periodic rate that may be used to compute finance charges (and its corresponding annual percentage rate) must be disclosed whether or not it is applied during the billing cycle. For example:

• If the consumer's account has both a purchase feature and a cash advance feature, the creditor must disclose the rate for each, even if the consumer only makes purchases on the account during the billing cycle.

• If the rate varies (such as when it is tied to a particular index), the creditor must disclose each rate in effect during the cycle for which the statement was issued.

2. *Disclosure of periodic rates required only if imposition possible.* With regard to the periodic rate disclosure (and its corresponding annual percentage rate), only rates that *could have* been imposed during the billing cycle reflected on the periodic statement need to be disclosed. For example:

• If the creditor is changing rates effective during the next billing cycle (either because it is changing terms or because of a variable rate plan), the rates required to be disclosed under §226.7(d) are only those in effect during the billing cycle reflected on the periodic statement. For example, if the monthly rate applied during May was 1.5 percent, but the creditor will increase the rate to 1.8 percent effective June 1, 1.5 percent (and its corresponding annual percentage rate) is the only required disclosure under §226.7(d) for the periodic statement reflecting the May account activity.

• If the consumer has an overdraft line that might later be expanded upon the consumer's request to include secured advances, the rates for the secured advance feature need not be given until such time as the consumer has requested and received access to the additional feature.

• If rates applicable to a particular type of transaction changed after a certain date, and the old rate is only being applied to transactions that took place prior to that date, the creditor need not continue to disclose the old rate for those consumers that have no outstanding balances to which that rate could be applied.

3. *Multiple rates—same transaction.* If two or more periodic rates are applied to the *same* balance for the same type of transaction (for example, if the finance charge consists of a monthly periodic rate of 1.5% applied to the outstanding balance and a required credit life insurance component calculated at .1% per month on the same outstanding balance), the creditor may do either of the following:

• Disclose each periodic rate, the range of balances to which it is applicable, and the corresponding annual percentage rate for each. (For example, 1.5% monthly, 18% annual percentage rate; .1% monthly, 1.2% annual percentage rate.)

• Disclose one composite periodic rate (that is, 1.6% per month) along with the applicable range of balances and corresponding annual percentage rate.

4. *Corresponding annual percentage rate.* In disclosing the annual percentage rate that corresponds to each periodic rate, the creditor may use ''corresponding annual percentage rate,'' ''nominal annual percentage rate,'' ''corresponding nominal annual percentage rate,'' or similar phrases.

5. *Rate same as actual annual percentage rate.* When the corresponding rate is the same as the actual annual percentage rate (historical rate) required to be disclosed (§226.7(g)), the creditor need disclose only

one annual percentage rate, but must use the phrase ''annual percentage rate.''

6. *Ranges of balances.* See Comment 6(a)(2)–1.

7. *Deferred payment transactions.* See comment 7–3(i).

*7(e) Balance on which finance charge computed.*

1. *Limitation to periodic rates.* Section 226.7(e) only requires disclosure of the balance(s) to which a periodic rate was applied and does not apply to balances on which other kinds of finance charges (such as transaction charges) were imposed. For example, if a consumer obtains a $1,500 cash advance subject to both a 1% transaction fee and a 1% monthly periodic rate, the creditor need only disclose the balance subject to the monthly rate (which might include portions of earlier cash advances not paid off in previous cycles).

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

3. *Monthly rate on average daily balance.* If a creditor computes a finance charge on the average daily balance by application of a monthly periodic rate or rates, the balance is adequately disclosed if the statement gives the amount of the average daily balance on which the finance charge was computed, and also states how the balance is determined.

4. *Multifeatured plans.* In a multifeatured plan, the creditor must disclose a separate balance (or balances, as applicable) to which a periodic rate was applied for each feature or group of features subject to different periodic rates or different balance computation methods. Separate balances are not required, however, merely because a ''free-ride'' period is available for some features but not others. A total balance for the entire plan is optional. This does not affect how many balances the creditor must disclose—or may disclose—within each feature. (See, for example, comment 7(e)–5.)

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

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

—A balance for each day in the billing cycle

—A balance for each day in the billing cycle on which the balance in the account changes

—The sum of the daily balances during the billing cycle

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

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

—A balance for each day in the billing cycle

—A balance for each day in the billing cycle on which the balance in the account changes

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

6. *Explanation of balance computation method.* See the commentary to §226.6(a)(3).

7. *Information to compute balance.* In connection with disclosing the finance charge balance, the creditor need not give the consumer all of the information necessary to compute the balance if that information is not otherwise required to be disclosed. For example, if current purchases are included from the date they are posted to the account, the posting date need not be disclosed.

8. *Non-deduction of credits.* The creditor need not specifically identify the total dollar amount of credits not deducted in computing the finance charge balance. Disclosure of the amount of credits not deducted is accomplished by listing the credits (§226.7(c)) and indicating which credits will not be deducted in determining the balance (for example, ''credits after the 15th of the month are not deducted in computing the finance charge.'')

9. *Use of one balance computation method explanation when multiple balances disclosed.* Sometimes the creditor will disclose more than one balance to which a periodic rate was applied even though each balance was computed using the same balance computation method. For example, if a plan involves purchases and cash advances that are subject to different rates, more than one balance must be disclosed even though the same computation method is used for determining the balance for each feature. In these cases, one explanation of the balance computation method is sufficient. Sometimes the creditor separately discloses the portions of the balance that are subject to different rates because different portions of the balance fall within two or more balance ranges, even when a combined balance disclosure would be permitted under comment 7(e)–2. In these cases, one explanation of the balance computation method is also sufficient (assuming, of course, that all portions of the balance were computed using the same method).

10. *Deferred payment transactions.* See comment 7–3(ii).

*7(f) Amount of finance charge.*

1. *Total.* A total finance charge amount for the plan is not required.

2. *Itemization—types of finance charges.* Each type of finance charge (such as periodic rates, transaction charges, and minimum charges) imposed during the cycle must be separately itemized; for example, disclosure of only a combined finance charge attributable to both a minimum charge and transaction charges would not be permissible. Finance charges of the same type may be disclosed, however, individually or as a total. For example, 5 transaction charges of $1 may be listed separately or as $5.

3. *Itemization—different periodic rates.* Whether different periodic rates are applicable to different types of transactions or to different balance ranges, the creditor may give the finance charge attributable to each rate or may give a total finance charge amount. For example, if a creditor charges 1.5% per month on the first $500 of a balance and 1% per month on amounts over $500, the creditor may itemize the two components ($7.50 and $1.00) of the $8.50 charge, or may disclose $8.50.

4. *Multifeatured plans.* In a multifeatured plan, in disclosing the amount of the finance charge attributable to the application of periodic rates no total periodic rate disclosure for the entire plan need be given.

5. *Finance charges not added to account.* A finance charge that is not included in the new balance because it is payable to a third party (such as required life insurance) must still be shown on the periodic statement as a finance charge.

6. *Finance charges other than periodic rates.* See Comment 6(a)(4)–1 for examples.

7. *Accrued finance charges allocated from payments.* Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, no disclosure is required of finance charges that have accrued since the last payment.

8. *Start-up fees.* Points, loan fees, and similar finance charges relating to the opening of the account that are paid prior to the issuance of the first periodic statement need not be disclosed on the periodic statement. If, however, these charges are financed as part of the plan, including charges that are paid out of the first advance, the charges must be disclosed as part of the finance charge on the first periodic statement. However, they need not be factored into the annual percentage rate. (See footnote 33 in the regulation.)

9. *Deferred payment transactions.* See comment 7–3(iii).

*7(g) Annual percentage rate.*

1. *Rate same as corresponding annual percentage rate.* See Comment 7(d)–5.

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

*7(h) Other charges.*

1. *Identification.* In identifying any ''other charges'' actually imposed during the billing cycle, the type is adequately described as *late charge* or *membership fee,* for example. Similarly, *closing costs* or *settlement costs,* for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under §226.4(c)(7), if the same term (such as *closing costs*) was used in the initial disclosures and if the creditor chose to itemize and individually disclose the costs included in that term. Even though the taxes and filing or notary fees excluded from the finance charge under §226.4(e) are not required to be disclosed as *other charges* under §226.6(b), these charges may be included in the amount shown as *closing costs* or *settlement costs* on the periodic statement, if the charges were itemized and disclosed as part of the *closing costs* or *settlement costs* on the initial disclosure statement. (See comment 6(b)–1 for examples of *other charges.*)

2. *Date.* The date of imposing or debiting *other charges* need not be disclosed.

3. *Total.* Disclosure of the total amount of other charges is optional.

4. *Itemization—types of other charges.* Each type of *other charge* (such as late payment charges, over-the-credit-limit charges, ATM

fees that are not finance charges, and membership fees) imposed during the cycle must be separately itemized; for example, disclosure of only a total of *other charges* attributable to both an over-the-credit-limit charge and a late payment charge would not be permissible. *Other charges* of the same type may be disclosed, however, individually or as a total. For example, three ATM fees of $1 may be listed separately or as $3.

*7(i) Closing date of billing cycle; new balance.*

1. *Credit balances.* See Comment 7(a)–1.

2. *Multifeatured plans.* In a multifeatured plan, the new balance may be disclosed for each feature or for the plan as a whole. If separate new balances are disclosed, a total new balance is optional.

3. *Accrued finance charges allocated from payments.* Some plans provide that the amount of the finance charge that has accrued since the consumer's last payment is directly deducted from each new payment, rather than being separately added to each statement and therefore reflected as an increase in the obligation. In such a plan, the new balance need not reflect finance charges accrued since the last payment.

*7(j) Free-ride period.*

1. *Wording.* Although the creditor is required to indicate any time period the consumer may have to pay the balance outstanding without incurring additional finance charges, no specific wording is required, so long as the language used is consistent with that used on the initial disclosure statement. For example, ''To avoid additional finance charges, pay the new balance before _____'' would suffice.

2. *Deferred payment transactions.* See comment 7–3(iv).

*7(k) Address for notice of billing errors.*

1. *Wording.* The periodic statement must contain the address for consumers to use in asserting billing errors under §226.13. Since all disclosures must be ''clear,'' the statement should indicate the general purpose for the address, although no elaborate explanation or particular wording is required.

2. *Telephone number.* A telephone number may be included, but the address for billing error inquiries, which is the required disclosure, must be clear and conspicuous. One way to ensure that the address is clear and conspicuous is to include a precautionary instruction that telephoning will not preserve the consumer's billing error rights. Both of the billing rights statements in appendix G contain such a precautionary instruction, so that a creditor could, by including either of these statements with each periodic statement, ensure that the required address is provided in a clear and conspicuous manner.

References

*Statute:* Section 127(b).

*Previous regulation:* Section 226.7(b)(1) and Interpretation §§226.701, 226.703, 226.706, and 226.707.

*Other sections:* Sections 226.4 through 226.6, 226.8, 226.14, and appendix G.

*1981 changes:* Under §226.7, required terminology is no longer mandated except for the terms *finance charge* and *annual percentage rate*. The requirement in the previous regulation about the location of disclosures has been deleted.

Under the revised §226.7, disclosure of credits to the account no longer have to indicate the type of credit. A short disclosure for variable rate plans must be included on the periodic statement. Disclosures relating to multifeatured accounts have been clarified.

Section 226.7 now specifically requires a periodic statement disclosure of *other charges* (non-finance charges related to the plan) that are actually imposed during the billing cycle.

Disclosures about minimum charges that might be imposed on the account and about the Comparative Index of Credit Cost have been deleted.

*Section 226.8—Identification of Transactions*

1. *Application of identification rules.* Section 226.8 deals with the requirement (imposed by §226.7(b)) for identification of each credit transaction made during the billing cycle. The rules for identifying transactions on periodic statements vary, depending on whether:

• The transaction involves sale credit (purchases) or nonsale credit (cash advances, for example).

• An actual copy of the credit document reflecting the transaction accompanies the statement (this is the distinction between so-called *country club* and *descriptive* billing).

• The creditor and seller are the same or related persons.

2. *Sale credit.* The term *sale credit* refers to a purchase in which the consumer uses a credit card or otherwise directly accesses an open-end line of credit (see Comment 8–3 if access is by means of a check) to obtain goods or services from a merchant, whether or not the merchant is the card issuer. *Sale credit* even includes:

• Premiums for voluntary credit life insurance whether sold by the card issuer or another person.

• The purchase of funds-transfer services (such as telegrams) from an intermediary.

3. *Nonsale credit.* The term *nonsale credit* refers to any form of loan credit including, for example:

• Cash advances.

• Overdraft checking.

• The use of a *supplemental credit device* in the form of a check or draft or the use of the overdraft feature of a debit card, even if such

use is in connection with a purchase of goods or services.

• Miscellaneous debits to remedy mispostings, returned checks, and similar entries.

4. *Actual copy*. An actual copy does not include a recreated document. It includes, for example, a duplicate, carbon, or photographic copy, but does not include a so-called ''facsimile draft'' in which the required information is typed, printed, or otherwise recreated. If a facsimile draft is used, the creditor must follow the rules that apply when a copy of the credit document is not furnished.

5. *Same or related persons*. For purposes of identifying transactions, the term *same or related persons* refers to, for example:

• Franchised or licensed sellers of a creditor's product or service.

• Sellers who assign or sell open-end sales accounts to a creditor or arrange for such credit under a plan that allows the consumer to use the credit only in transactions with that seller.

A seller is not related to the creditor merely because the seller and the creditor have an agreement authorizing the seller to honor the creditor's credit card.

6. *Transactions resulting from promotional material*. In describing transactions with third-party sellers resulting from promotional material mailed by the creditor, creditors may use the rules either for *related* or for *non-related* sellers and creditors.

7. *Credit insurance offered through the creditor*. When credit insurance that is not part of the finance charge (for example, voluntary credit life insurance) is offered to the consumer through the creditor, but is actually provided by another company, the creditor has the option of identifying the premiums in one of two ways on the periodic statement. The creditor may describe the premiums using either the rule in § 226.8(a)(2) for *related* sellers and creditors, or the rule in § 226.8(a)(3) for *non-related* sellers and creditors. This means, therefore, that the creditor may identify the insurance either by providing, under § 226.8(a)(2), a brief identification of the services provided (for example, *credit life insurance*), or by disclosing, under § 226.8(a)(3), the name and address of the company providing the insurance (for example, ABC Insurance Company, New York, New York). In either event, the creditor would, of course, also provide the amount and the date of the transaction.

8. *Transactions involving creditors and sellers with corporate connections*. In a credit card plan established for use primarily with sellers that have no corporate connection with the creditor, the creditor may describe all transactions under the plan by using the rules in § 226.8(a)(3)—creditor and seller not same or related persons—including transactions involving a seller that has a corporate connection with the creditor. In other credit card plans, the creditor may describe transactions involving a seller that has a corporate connection with the creditor, such as subsidiary-parent, using the rules in § 226.8(a)(3) where it is unlikely that the consumer would know of the corporate connection between the creditor and the seller—for example, where the names of the creditor and the seller are not similar, and the periodic statement is issued in the name of the creditor only.

*8(a) Sale credit.*

1. *Date—disclosure of only one date*. If only the required date is disclosed for a transaction, the creditor need not identify it as the ''transaction date.'' If the creditor discloses more than one date (for example, the transaction date and the posting date), the creditor must identify each.

2. *Date—disclosure of month and day only*. The month and day are sufficient disclosure of the date on which the transaction took place, unless the posting of the transaction is delayed so long that the year is needed for a clear disclosure to the consumer.

3. *When transaction takes place*. If the consumer conducts the transaction in person, the date of the transaction is the calendar date on which the consumer made the purchase or order, or secured the advance. For transactions billed to the account on an ongoing basis (other than installments to pay a precomputed amount), the date of the transaction is the date on which the amount is debited to the account. This might include, for example, monthly insurance premiums. For mail or telephone orders, a creditor may disclose as the transaction date either the invoice date, the debiting date, or the date the order was placed by telephone.

4. *Transactions not billed in full*. If sale transactions are not billed in full on any single statement, but are billed periodically in precomputed installments, the first periodic statement reflecting the transaction must show either the full amount of the transaction together with the date the transaction actually took place; *or* the amount of the first installment that was debited to the account together with the date of the transaction or the date on which the first installment was debited to the account. In any event, subsequent periodic statements should reflect each installment due, together with either any other identifying information required by § 226.8(a) (such as the seller's name and address in a three-party situation) or other appropriate identifying information relating the transaction to the first billing. The debiting date for the particular installment, or the date the transaction took place, may be used as the date of the transaction on these subsequent statements.

*8(a)(1) Copy of credit document provided.*

1. *Format.* The information required by §226.8(a)(1) may appear either on the copy of the credit document reflecting the transaction or on the periodic statement.

*8(a)(2) Copy of credit document not provided—creditor and seller same or related person(s).*

1. *Property identification—sufficiency of description.* The ''brief identification'' provision in §226.8(a)(2) requires a designation that will enable the consumer to reconcile the periodic statement with the consumer's own records. In determining the sufficiency of the description, the following rules apply:

• While item-by-item descriptions are not necessary, reasonable precision is required. For example, *merchandise, miscellaneous, second-hand goods,* or *promotional items* would not suffice.

• A reference to a department in a sales establishment that accurately conveys the identification of the types of property or services available in the department is sufficient—for example, *jewelry, sporting goods.*

2. *Property identification—number or symbol.* The ''brief identification'' may be made by disclosing on the periodic statement a number or symbol that is related to an identification list printed elsewhere on the statement.

3. *Property identification—additional document.* In making the ''brief identification'' required by §226.8(a)(2), the creditor may identify the property by describing the transaction on a document accompanying the periodic statement (for example, on a facsimile draft). (See also footnote 17.)

4. *Small creditors.* Under footnote 18, which provides a further identification alternative to a creditor with fewer than 15,000 accounts, the creditor need count only its own accounts and not others serviced by the same data processor or other shared-service provider.

5. *Date of transaction—foreign transactions.* In a foreign transaction, the debiting date may be considered the transaction date.

*8(a)(3) Copy of credit document not provided—creditor and seller not same or related person(s).*

1. *Seller's name.* The requirement contemplates that the seller's name will appear on the periodic statement in essentially the same form as it appears on transaction documents provided to the consumer at the time of the sale. The seller's name may also be disclosed as, for example:

• A more complete spelling of the name that was alphabetically abbreviated on the receipt or other credit document.

• An alphabetical abbreviation of the name on the periodic statement even if the name appears in a more complete spelling on the receipt or other credit document. Terms that merely indicate the form of a business entity, such as *Inc.*, *Co.*, or *Ltd.*, may always be omitted.

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

3. *No fixed location.* When no meaningful address is available because the consumer did not make the purchase at any fixed location of the seller, the creditor:

• May omit the address.

• May provide some other identifying designation, such as *aboard plane, ABC Airways Flight, customer's home, telephone order,* or *mail order.*

4. *Date of transaction—foreign transactions.* See Comment 8(a)(2)–5.

*8(b) Nonsale credit.*

1. *Date of transaction.* If only one of the required dates is disclosed for a transaction, the creditor need not identify it. If the creditor discloses more than one date (for example, transaction date and debiting date), the creditor must identify each.

2. *Amount of transaction.* If credit is extended under an overdraft checking account plan or by means of a debit card with an overdraft feature, the amount to be disclosed is that of the credit extension, not the face amount of the check or the total amount of the debit/credit transaction.

3. *Amount—disclosure on cumulative basis.* If credit is extended under an overdraft checking account plan or by means of a debit card with an overdraft feature, the creditor may disclose the amount of the credit extensions on a cumulative daily basis, rather than the amount attributable to each check or each use of the debit/credit card.

4. *Identification of transaction type.* The creditor may identify a transaction by describing the type of advance it represents, such as cash advance, loan, overdraft loan, or any readily understandable trade name for the credit program.

References

*Statute:* Section 127(b)(2).

*Previous regulation:* Section 226.7(k).

*Other sections:* Section 226.7.

*1981 changes:* Section 226.8 has been streamlined and reorganized to facilitate its use. Technical detail has been deleted from the Regulation for inclusion in the commentary. The Regulation implements the amended section 127(b)(2) of the Act by providing for protection from civil liability under certain circumstances when required information is not provided and by reducing disclosure responsibilities for certain small creditors. For descriptive billing of nonsale transactions,

the regulation now permits the use of the debiting date in all cases.

*Section 226.9—Subsequent Disclosure Requirements*

9(a) Furnishing Statement of Billing Rights.

9(a)(1) Annual Statement

1. *General*. The creditor may provide the annual billing rights statement:

• By sending it in one billing period per year to each consumer that gets a periodic statement for that period; or

• By sending a copy to all of its account holders sometime during the calendar year but not necessarily all in one billing period (for example, sending the annual notice in connection with renewal cards or when imposing annual membership fees).

2. *Substantially similar*. See the commentary to appendix G–3.

9(a)(2) Alternative Summary Statement

1. *Changing from long-form to short-form statement and vice versa*. If the creditor has been sending the long-form annual statement, and subsequently decides to use the alternative summary statement, the first summary statement must be sent no later than 12 months after the last long-form statement was sent. Conversely, if the creditor wants to switch to the long-form, the first long-form statement must be sent no later than 12 months after the last summary statement.

2. *Substantially similar*. See the commentary to appendix G–4.

9(b) Disclosures for Supplemental Credit Devices and Additional Features

1. *Credit device—examples*. *Credit device* includes, for example, a blank check, payee-designated check, blank draft or order, or authorization form for issuance of a check; it does not include a check issued payable to a consumer representing loan proceeds or the disbursement of a cash advance.

2. *Credit feature—examples*. A new credit *feature* would include, for example:

• The addition of overdraft checking to an existing account (although the regular checks that could trigger the overdraft feature are not themselves *devices*).

• The option to use an existing credit card to secure cash advances, when previously the card could only be used for purchases.

Paragraph 9(b)(1)

1. *Same finance charge terms*. If the new means of accessing the account is subject to the same finance charge terms as those previously disclosed, the creditor:

• Need only provide a reminder that the new device or feature is covered by the earlier disclosures. (For example, in mailing special checks that directly access the credit line, the creditor might give a disclosure such as ''Use this as you would your XYZ card to obtain a cash advance from our bank''); or

• May remake the §226.6(a) finance charge disclosures.

Paragraph 9(b)(2)

1. *Different finance charge terms*. If the finance charge terms are different from those previously disclosed, the creditor may satisfy the requirement to give the finance charge terms either by giving a complete set of new initial disclosures reflecting the terms of the added device or feature or by giving only the finance charge disclosures for the added device or feature.

9(c) Change in Terms

1. *Changes* initially disclosed. No notice of a change in terms need be given if the specific change is set forth initially, such as: Rate increases under a properly disclosed variable-rate plan, a rate increase that occurs when an employee has been under a preferential rate agreement and terminates employment, or an increase that occurs when the consumer has been under an agreement to maintain a certain balance in a savings account in order to keep a particular rate and the account balance falls below the specified minimum. In contrast, notice must be given if the contract allows the creditor to increase the rate at its discretion but does not include specific terms for an increase (for example, when an increase may occur under the creditor's contract reservation right to increase the periodic rate). The rules in §226.5b(f) relating to home equity plans, however, limit the ability of a creditor to change the terms of such plans.

2. *State law issues*. Examples of issues not addressed by §226.9(c) because they are controlled by State or other applicable law include:

• The types of changes a creditor may make.

• How changed terms affect existing balances, such as when a periodic rate is changed and the consumer does not pay off the entire existing balance before the new rate takes effect.

3. *Change in billing cycle*. Whenever the creditor changes the consumer's billing cycle, it must give a change-in-terms notice if the change either affects any of the terms required to be disclosed under §226.6 or increases the minimum payment, unless an exception under §226.9(c)(2) applies; for example, the creditor must give advance notice if the creditor initially disclosed a 25-day free-ride period on purchases and the consumer will have fewer days during the billing cycle change.

9(c)(1) Written Notice Required

1. *Affected consumers.* Change-in-terms notices need only go to those consumers who may be affected by the change. For example, a change in the periodic rate for check overdraft credit need not be disclosed to consumers who do not have that feature on their accounts.

2. *Timing—effective date of change.* The rule that the notice of the change in terms be provided at least 15 days before the change takes effect permits mid-cycle changes when there is clearly no retroactive effect, such as the imposition of a transaction fee. Any change in the balance computation method, in contrast, would need to be disclosed at least 15 days prior to the billing cycle in which the change is to be implemented.

3. *Timing—advance notice not required.* Advance notice of 15 days is not necessary—that is, a notice of change in terms is required, but it may be mailed or delivered as late as the effective date of the change—in two circumstances:

- If there is an increased periodic rate or any other finance charge attributable to the consumer's delinquency or default.
- If the consumer agrees to the particular change. This provision is intended for use in the unusual instance when a consumer substitutes collateral or when the creditor can advance additional credit only if a change relatively unique to that consumer is made, such as the consumer's providing additional security or paying an increased minimum payment amount. Therefore, the following are not ''agreements'' between the consumer and the creditor for purposes of §226.9(c)(1): The consumer's general acceptance of the creditor's contract reservation of the right to change terms; the consumer's use of the account (which might imply acceptance of its terms under State law); and the consumer's acceptance of a unilateral term change that is not particular to that consumer, but rather is of general applicability to consumers with that type of account.

4. *Form of change-in-terms notice.* A complete new set of the initial disclosures containing the changed term complies with §226.9(c) if the change is highlighted in some way on the disclosure statement, or if the disclosure statement is accompanied by a letter or some other insert that indicates or draws attention to the term change.

5. *Security interest change—form of notice.* A copy of the security agreement that describes the collateral securing the consumer's account may be used as the notice, when the term change is the addition of a security interest or the addition or substitution of collateral.

6. *Changes to home equity plans entered into on or after November 7, 1989.* Section 226.9(c) applies when, by written agreement under §226.5b(f)(3)(iii), a creditor changes the terms of a home equity plan—entered into on or after November 7, 1989—at or before its scheduled expiration, for example, by renewing a plan on terms different from those of the original plan. In disclosing the change:

- If the index is changed, the maximum annual percentage rate is increased (to the limited extent permitted by §226.30), or a variable-rate feature is added to a fixed-rate plan, the creditor must include the disclosures required by §226.5b (d)(12)(x) and (d)(12)(xi), unless these disclosures are unchanged from those given earlier.
- If the minimum payment requirement is changed, the creditor must include the disclosures required by §226.5(d)(5)(iii) (and, in variable-rate plans, the disclosures required by §226.5b (d)(12)(x) and (d)(12)(xi)) unless the disclosures given earlier contained representative examples covering the new minimim payment requirement. (See the commentary to §226.5b (d)(5)(iii), (d)(12)(x) and (d)(12)(xi) for a discussion of representative examples.)

When the terms are changed pursuant to a written agreement as described in §226.5b(f)(3)(iii), the advance-notice requirement does not apply.

9(c)(2) Notice Not Required

1. *Changes not requiring notice.* The following are examples of changes that do not require a change-in-terms notice:

- A change in the consumer's credit limit.
- A change in the name of the credit card or credit card plan.
- The substitution of one insurer for another.
- A termination or suspension of credit privileges.
- Changes arising merely by operation of law; for example, if the creditor's security interest in a consumer's car automatically extends to the proceeds when the consumer sells the car.

2. *Skip features.* If a credit program allows consumers to skip or reduce one or more payments during the year, or involves temporary reductions in finance charges, no notice of the change in terms is required either prior to the reduction or upon resumption of the higher rates or payments if these features are explained on the initial disclosure statement (including an explanation of the terms upon resumption). For example, a merchant may allow consumers to skip the December payment to encourage holiday shopping, or a teachers' credit union may not require payments during summer vacation. Otherwise, the creditor must give notice prior to resuming the original schedule or rate, even though no notice is required prior to the reduction. The change-in-terms

notice may be combined with the notice offering the reduction. For example, the periodic statement reflecting the reduction or skip feature may also be used to notify the consumer of the resumption of the original schedule or rate, either by stating explicitly when the higher payment or charges resume, or by indicating the duration of the skip option. Language such as ''You may skip your October payment,'' or ''We will waive your finance charges for January,'' may serve as the change-in-terms notice.

*9(c)(3) Notice for Home Equity Plans*

1. *Written request for reinstatement.* If a creditor requires the request for reinstatement of credit privileges to be in writing, the notice under § 226.9(c)(3) must state that fact.

2. *Notice not required.* A creditor need not provide a notice under this paragraph if, pursuant to the commentary to § 226.5b(f)(2), a creditor freezes a line or reduces a credit line rather than terminating a plan and accelerating the balance.

*9(d) Finance Charge Imposed at Time of Transaction*

1. *Disclosure prior to imposition.* A person imposing a finance charge at the time of honoring a consumer's credit card must disclose the amount of the charge, or an explanation of how the charge will be determined, prior to its imposition. This must be disclosed before the consumer becomes obligated for property or services that may be paid for by use of a credit card. For example, disclosure must be given before the consumer has dinner at a restaurant, stays overnight at a hotel, or makes a deposit guaranteeing the purchase of property or services.

*9(e) Disclosures Upon Renewal of Credit or Charge Card*

1. *Coverage.* This paragraph applies to credit and charge card accounts of the type subject to 226.5a. (See § 226.5a(a)(3) and the accompanying commentary for discussion of the types of accounts subject to § 226.5a.) The disclosure requirements are triggered when a card issuer imposes any annual or other periodic fee on such an account, whether or not the card issuer originally was required to provide the application and solicitation disclosures described in § 226.5a.

2. *Form.* The disclosures under this paragraph must be clear and conspicuous, but need not appear in a tabular format or in a prominent location. The disclosures need not be in a form the cardholder can retain.

3. *Terms at renewal.* Renewal notices must reflect the terms actually in effect at the time of renewal. For example, a card issuer that offers a preferential annual percentage rate to employees during their employment must send a renewal notice to employees disclosing the lower rate actually charged to employees (although the card issuer also may show the rate charged to the general public).

4. *Variable rate.* If the card issuer cannot determine the rate that will be in effect if the cardholder chooses to renew a variable-rate account, the card issuer may disclose the rate in effect at the time of mailing or delivery of the renewal notice. Alternatively, the card issuer may use the rate as of a specified date (and then update the rate from time to time, for example, each calendar month) or use an estimated rate under § 226.5(c).

5. *Renewals more frequent than annual.* If a renewal fee is billed more often than annually, the renewal notice should be provided each time the fee is billed. In this instance, the fee need not be disclosed as an annualized amount. Alternatively, the card issuer may provide the notice no less than once every twelve months if the notice explains the amount and frequency of the fee that will be billed during the time period covered by the disclosure, and also discloses the fee as an annualized amount. The notice under this alternative also must state the consequences of a cardholder's decision to terminate the account after the renewal notice period has expired. For example, if a $2 fee is billed monthly but the notice is given annually, the notice must inform the cardholder that the monthly charge is $2, the annualized fee is $24, and $2 will be billed to the account each month for the coming year unless the cardholder notifies the card issuer. If the cardholder is obligated to pay an amount equal to the remaining unpaid monthly charges if the cardholder terminates the account during the coming year but after the first month, the notice must disclose that fact.

6. *Terminating credit availability.* Card issuers have some flexibility in determining the procedures for how and when an account may be terminated. However, the card issuer must clearly disclose the time by which the cardholder must act to terminate the account to avoid paying a renewal fee. State and other applicable law govern whether the card issuer may impose requirements such as specifying that the cardholder's response be in writing or that the outstanding balance be repaid in full upon termination.

7. *Timing of termination by cardholder.* When a card issuer provides notice under § 226.9(e)(1), a cardholder must be given at least 30 days or one billing cycle, whichever is less, from the date the notice is mailed or delivered to make a decision whether to terminate an account. When notice is given under § 226.9(e)(2), a cardholder has 30 days from mailing or delivery to decide to terminate an account.

8. *Timing of notices.* A renewal notice is deemed to be provided when mailed or delivered. Similarly, notice of termination is deemed to be given when mailed or delivered.

9. *Prompt reversal of renewal fee upon termination.* In a situation where a cardholder has provided timely notice of termination and a renewal fee has been billed to a cardholder's account, the card issuer must reverse or otherwise withdraw the fee promptly. Once a cardholder has terminated an account, no additional action by the cardholder may be required.

*9(e)(3) Notification on Periodic Statements*

1. *Combined disclosures.* If a single disclosure is used to comply with both §§226.9(e) and 226.7, the periodic statement must comply with the rules in §§226.5a and 226.7. For example, the words *grace period* must be used and the name of the balance calculation method must be identified (if listed in §226.5a(g)) to comply with the requirements of §226.5a, even though the use of those terms would not otherwise be required for periodic statements under §226.7. A card issuer may include some of the renewal disclosures on a periodic statement and others on a separate document so long as there is some reference indicating that they relate to one another. All renewal disclosures must be provided to a cardholder at the same time.

2. *Preprinted notices on periodic statements.* A card issuer may preprint the required information on its periodic statements. A card issuer that does so, however, using the advance notice option under §226.9(e)(1), must make clear on the periodic statement when the preprinted renewal disclosures are applicable. For example, the card issuer could include a special notice (not preprinted) at the appropriate time that the renewal fee will be billed in the following billing cycle, or could show the renewal date as a regular (preprinted) entry on all periodic statements.

*9(f) Change in Credit Card Account Insurance Provider*

1. *Coverage.* This paragraph applies to credit card accounts of the type subject to §226.5a if credit insurance (typically life, disability, and unemployment insurance) is offered on the outstanding balance of such an account. (Credit card accounts subject to §226.9(f) are the same as those subject to §226.9(e); see comment 9(e)–1.) Charge card accounts are not covered by this paragraph. In addition, the disclosure requirements of this paragraph apply only where the card issuer initiates the change in insurance providers. For example, if the card issuer's current insurance provider is merged into or acquired by another company, these disclosures would not be required. Disclosures also need not be given in cases where card issuers pay for credit insurance themselves and do not separately charge the cardholder.

2. *No increase in rate or decrease in coverage.* The requirement to provide the disclosure arises when the card issuer changes the provider of insurance, even if there will be no increase in the premium rate charged the consumer and no decrease in coverage under the insurance policy.

3. *Form of notice.* If a substantial decrease in coverage will result from the change in providers, the card issuer either must explain the decrease or refer to an accompanying copy of the policy or group certificate for details of the new terms of coverage. (See the commentary to appendix G–13.)

4. *Discontinuation of insurance.* In addition to stating that the cardholder may cancel the insurance, the card issuer may explain the effect the cancellation would have on the consumer's credit card plan.

5. *Mailing by third party.* Although the card issuer is responsible for the disclosures, the insurance provider or another third party may furnish the disclosures on the card issuer's behalf.

*9(f)(3) Substantial Decrease in Coverage*

1. *Determination.* Whether a substantial decrease in coverage will result from the change in providers is determined by the two-part test in §226.9(f)(3): First, whether the decrease is in a significant term of coverage; and second, whether the decrease might reasonably be expected to affect a cardholder's decision to continue the insurance. If both conditions are met, the decrease must be disclosed in the notice.

References

*Statute:* Section 127(a)(7).

*Other sections:* Sections 226.4 through 226.7 and appendix G.

*Previous regulation:* Section 226.7 (d) through (f) and (j) and Interpretation §§226.705 and 226.708.

*1981 changes:* Section 226.9(a) implements the statutory change that the long-form statement of billing rights be provided only once a year. The provision now permits two rather than one means of providing the long-form statement to consumers. The verbatim text of the annual statement is no longer required; creditors may use any version ''substantially similar'' to the one in appendix G. If the creditor elects to use the alternative summary statement, the new regulation no longer requires that the long-form statement be sent upon receiving a billing error notice and at the consumer's request. The rules in §226.708 on switching the type of billing rights statement used have been modified.

Under §226.9(b) disclosure requirements have been streamlined when supplemental credit devices or new credit features are added to an existing open-end plan.

Section 226.9(c) substantially changes the change-in-terms rules. Change-in-terms disclosures must now be made 15 days before the effective date of the change, rather than 15 days before the billing cycle in which the change will take effect. The kinds of changes that will trigger disclosures have been reduced: change-in-terms notices are no longer required for the types of changes described in § 226.9(c)(2). But the provision reverses Interpretation § 226.705, which indicated that certain changes in the balance computation method did not require disclosure because they could result in lowered finance charges; now, any change in the balance computation method requires disclosure.

When a finance charge is imposed at the time of a transaction, § 226.9(d) only requires disclosure of the finance charge at point of sale; the amount financed and annual percentage rate figured in accordance with the closed-end credit provisions need no longer be disclosed. Furthermore, the finance charge disclosure now may be made orally by the person honoring the card.

*Section 226.10—Prompt Crediting of Payments*

*10(a) General rule.*

1. *Crediting date.* Section 226.10(a) does not require the creditor to post the payment to the consumer's account on a particular date; the creditor is only required to credit the payment as of the date of receipt.

2. *Date of receipt.* The ''date of receipt'' is the date that the payment instrument or other means of completing the payment reaches the creditor. For example:

• Payment by check is received when the creditor gets it, not when the funds are collected.

• In a payroll deduction plan in which funds are deposited to an asset account held by the creditor, and from which payments are made periodically to an open-end credit account, payment is received on the date when it is debited to the asset account (rather than on the date of the deposit), provided the payroll deduction method is voluntary and the consumer retains use of the funds until the contractual payment date.

• If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the creditor gets the third-party payor's check or other transfer medium, such as an electronic fund transfer, as long as the payment meets the creditor's requirements as specified under § 226.10(b).

*10(b) Specific requirements for payments.*

1. *Payment requirements.* The creditor may specify requirements for making payments, such as:

• Requiring that payments be accompanied by the account number or the payment stub.

• Setting a cut-off hour for payment to be received, or set different hours for payment by mail and payments made in person.

• Specifying that only checks or money orders should be sent by mail.

• Specifying that payment is to be made in U.S. dollars.

• Specifying one particular address for receiving payments, such as a post office box.

The creditor may be prohibited, however, from specifying payment by preauthorized electronic fund transfer. (See section 913 of the Electronic Fund Transfer Act.)

2. *Payment requirements—limitations.* Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would not be reasonable to require that all payments be made in person between 10 a.m. and 11 a.m., since this would require consumers to take time off from their jobs to deliver payments.

3. *Acceptance of non-conforming payments.* If the creditor accepts a non-conforming payment (for example, payment at a branch office, when it had specified that payment be sent to headquarters), finance charges may accrue for the period between receipt and crediting of payments.

4. *Implied guidelines for payments.* In the absence of specified requirements for making payments (see § 226.10(b)):

• Payments may be made at any location where the creditor conducts business.

• Payments may be made any time during the creditor's normal business hours.

• Payments may be made by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the creditor and consumer have so agreed.

References

*Statute:* Section 164.

*Other sections:* Section 226.7.

*Previous regulation:* Section 226.7(g).

*1981 changes:* Much of the explanatory detail of the previous regulation is now in the commentary. The revised regulation gives the creditor 5 days in which to credit nonconforming payments, whereas the previous regulation required the crediting of such payments promptly, with an outside limit of 5 days. The 5 days in which to credit are available whenever the creditor accepts payment that does not conform to the creditor's disclosed specifications, in contrast to the previous regulation, which only allowed deferred crediting for payments made at the wrong location.

*Section 226.11—Treatment of Credit Balances*

1. *Timing of refund.* The creditor may also fulfill its obligations under § 226.11 by:

• Refunding any credit balance to the consumer immediately.

• Refunding any credit balance prior to receiving a written request (under §226.11(b)) from the consumer.

• Making a good faith effort to refund any credit balance before 6 months have passed. If that attempt is unsuccessful, the creditor need not try again to refund the credit balance at the end of the 6-month period.

2. *Amount of refund.* The phrase *any part of the credit balance remaining in the account* in §226.11(b) and (c) means the amount of the credit balance at the time the creditor is required to make the refund. The creditor may take into consideration intervening purchases or other debits to the consumer's account (including those that have not yet been reflected on a periodic statement) that decrease or eliminate the credit balance.

*Paragraph 11(b).*

1. *Written requests—standing orders.* The creditor is not required to honor standing orders requesting refunds of any credit balance that may be created on the consumer's account.

*Paragraph 11(c).*

1. *Good faith effort to refund.* The creditor must take positive steps to return any credit balance that has remained in the account for over 6 months. This includes, if necessary, attempts to trace the consumer through the consumer's last known address or telephone number, or both.

2. *Good faith effort unsuccessful.* Section 226.11 imposes no further duties on the creditor if a good faith effort to return the balance is unsuccessful. The ultimate disposition of the credit balance (or any credit balance of $1 or less) is to be determined under other applicable law.

References

*Statute:* Section 165.

*Previous regulation:* Section 226.7(h).

*1981 changes:* Under the previous regulation, the creditor's duty to refund credit balances applied only to ''excess payments''; §226.11 of the revised regulation implements the amendments to section 165 of the statute which impose refunding duties on the creditor whatever the source of the credit balance. The revised regulation permits the creditor, in computing the refund, to take account of intervening debits, not just the difference between the previous balance and the overpayment as is provided in the previous regulation. The revised regulation gives the creditor 7 business days in which to make the refund after receiving the consumer's written request, whereas the previous regulation required the creditor to make the refund promptly, with an outside limit of 5 business days. This provision also implements the amended statute by requiring a good faith effort to refund the credit balance after 6 months.

*Section 226.12—Special Credit Card Provisions*

1. *Scope.* Sections 226.12(a) and (b) deal with the issuance and liability rules for credit cards, whether the card is intended for consumer, business, or any other purposes. Sections 226.12(a) and (b) are exceptions to the general rule that the regulation applies only to consumer credit. (See §§226.1 and 226.3.)

*12(a) Issuance of credit cards.*

*Paragraph 12(a)(1)*

1. *Explicit request.* A request or application for a card must be explicit. For example, a request for overdraft privileges on a checking account does not constitute an application for a credit card with overdraft checking features.

2. *Addition of credit features.* If the consumer has a non-credit card, the addition of credit features to the card (for example, the granting of overdraft privileges on a checking account when the consumer already has a check guarantee card) constitutes issuance of a credit card.

3. *Variance of card from request.* The request or application need not correspond exactly to the card that is issued. For example:

• The name of the card requested may be different when issued.

• The card may have features in addition to those reflected in the request or application.

4. *Permissible form of request.* The request or application may be oral (in response to a telephone solicitation by a card issuer, for example) or written.

5. *Time of issuance.* A credit card may be issued in response to a request made before any cards are ready for issuance (for example, if a new program is established), even if there is some delay in issuance.

6. *Persons to whom cards may be issued.* A card issuer may issue a credit card to the person who requests it, and to anyone else for whom that person requests a card and who will be an authorized user on the requester's account. In other words, cards may be sent to consumer A on A's request, and also (on A's request) to consumers B and C, who will be authorized users on A's account. In these circumstances, the following rules apply:

• The additional cards may be imprinted in either A's name or in the names of B and C.

• No liability for unauthorized use (by persons other than B and C), not even the $50, may be imposed on B or C since they are merely users and not *cardholders* as that term is defined in §226.2 and used in §226.12(b); of course, liability of up to $50 for unauthorized use of B's and C's cards may be imposed on A.

• Whether B and C may be held liable for their own use, or on the account generally, is a matter of state or other applicable law.

7. *Issuance of non-credit cards.* i. *General.* Under §226.12(a)(1), a credit card cannot be issued except in response to a request or an application. (See comment 2(a)(15)–2 for examples of cards or devices that are and are not credit cards.) A non-credit card may be sent on an unsolicited basis by an issuer that does not propose to connect the card to any credit plan; a credit feature may be added to a previously issued non-credit card only upon the consumer's specific request.

ii. *Examples.* A purchase-price discount card may be sent on an unsolicited basis by an issuer that does not propose to connect the card to any credit plan. An issuer demonstrates that it proposes to connect the card to a credit plan by, for example, including promotional materials about credit features or account agreements and disclosures required by §226.6. The issuer will violate the rule against unsolicited issuance if, for example, at the time the card is sent a credit plan can be accessed by the card or the recipient of the unsolicited card has been preapproved for credit that the recipient can access by contacting the issuer and activating the card.

8. *Unsolicited issuance of PINs.* A card issuer may issue personal identification numbers (PINs) to existing credit cardholders without a specific request from the cardholders, provided the PINs cannot be used alone to obtain credit. For example, the PINs may be necessary if consumers wish to use their existing credit cards at automated teller machines or at merchant locations with point-of-sale terminals that require PINs.

*Paragraph 12(a)(2)*

1. *Renewal. Renewal* generally contemplates the regular replacement of existing cards because of, for example, security reasons or new technology or systems. It also includes the re-issuance of cards that have been suspended temporarily, but does not include the opening of a new account after a previous account was closed.

2. *Substitution—examples. Substitution* encompasses the replacement of one card with another because the underlying account relationship has changed in some way—such as when the card issuer has:

• Changed its name.

• Changed the name of the card.

• Changed the credit or other features available on the account. For example, the original card could be used to make purchases and obtain cash advances at teller windows. The substitute card might be usable, in addition, for obtaining cash advances through automated teller machines. (If the substitute card constitutes an access device, as defined in Regulation E, then the Regulation E issuance rules would have to be followed.) The *substitution* of one card with another on an unsolicited basis is not permissible, however, where in conjunction with the substitution an additional credit card account is opened and the consumer is able to make new purchases or advances under both the original and the new account with the new card. For example, if a retail card issuer replaces its credit card with a combined retailer/bank card, each of the creditors maintains a separate account, and both accounts can be accessed for new transactions by use of the new credit card, the card cannot be provided to a consumer without solicitation.

• Substituted a card user's name on the substitute card for the cardholder's name appearing on the original card.

• Changed the merchant base. However, the new card must be honored by at least one of the persons that honored the original card.

3. *Substitution—successor card issuer. Substitution* also occurs when a successor card issuer replaces the original card issuer (for example, when a new card issuer purchases the accounts of the original issuer and issues its own card to replace the original one). A permissible substitution exists even if the original issuer retains the existing receivables and the new card issuer acquires the right only to future receivables, provided use of the original card is cut off when use of the new card becomes possible.

4. *Substitution—non-credit-card plan.* A credit card that replaces a retailer's open-end credit plan *not* involving a credit card is not considered a substitute for the retailer's plan—even if the consumer used the retailer's plan. A credit card cannot be issued in these circumstances without a request or application.

5. *One-for-one rule.* An accepted card may be replaced by no more than one renewal or substitute card. For example, the card issuer may not replace a credit card permitting purchases and cash advances with two cards, one for the purchases and another for the cash advances.

6. *One-for-one rule—exceptions.* The regulation does not prohibit the card issuer from:

i. Replacing a debit/credit card with a credit card and another card with only debit functions (or debit functions plus an associated overdraft capability), since the latter card could be issued on an unsolicited basis under Regulation E.

ii. Replacing an accepted card with more than one renewal or substitute card, provided that:

A. No replacement card accesses any account not accessed by the accepted card;

B. For terms and conditions required to be disclosed under §226.6, all replacement cards are issued subject to the same terms and conditions, except that a creditor may vary terms for which no change in terms notice is required under §226.9(c); and

C. Under the account's terms the consumer's total liability for unauthorized use

with respect to the account does not increase.

7. *Methods of terminating replaced card.* The card issuer need not physically retrieve the original card, provided the old card is voided in some way; for example:

• The issuer includes with the new card a notification that the existing card is no longer valid and should be destroyed immediately.

• The original card contained an expiration date.

• The card issuer, in order to preclude use of the card, reprograms computers or issues instructions to authorization centers.

8. *Incomplete replacement.* If a consumer has duplicate credit cards on the same account (Card A—one type of bank credit card, for example), the card issuer may not replace the duplicate cards with one Card A and one Card B (Card B—another type of bank credit card) unless the consumer requests Card B.

9. *Multiple entities.* Where multiple entities share responsibilities with respect to a credit card issued by one of them, the entity that issued the card may replace it on an unsolicited basis, if that entity terminates the original card by voiding it in some way, as described in comment 12(a)(2)–7. The other entity or entities may not issue a card on an unsolicited basis in these circumstances.

*12(b) Liability of cardholder for unauthorized use.*

1. *Meaning of cardholder.* For purposes of this provision, *cardholder* includes any person (including organizations) to whom a credit card is issued for any purpose, including business. When a corporation is the cardholder, required disclosures should be provided to the corporation (as opposed to an employee user).

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. The card issuer may not automatically deny a claim based solely on the cardholder's failure or refusal to comply with a particular request; however, if the card issuer otherwise has no knowledge of facts confirming the unauthorized use, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation. The procedures involved in 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 documentation to assist in the verification of the claim.

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

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

viii. Requesting information regarding the cardholder's knowledge of the person who allegedly used the card or of that person's authority to do so.

*12(b)(1) Limitation on amount.*

1. *Meaning of authority.* Footnote 22 defines unauthorized use in terms of whether the user has *actual, implied, or apparent authority.* Whether such authority exists must be determined under state or other applicable law.

2. *Liability limits—dollar amounts.* As a general rule, the cardholder's liability for a series of unauthorized uses cannot exceed either $50 or the value obtained through the unauthorized use before the care issuer is notified, whichever is less.

*12(b)(2) Conditions of liability.*

1. *Issuer's option not to comply.* A card issuer that chooses not to impose any liability on cardholders for unauthorized use need not comply with the disclosure and identification requirements discussed below.

*Paragraph 12(b)(2)(ii).*

1. *Disclosure of liability and means of notifying issuer.* The disclosures referred to in §226.12(b)(2)(ii) may be given, for example, with the initial disclosures under §226.6, on the credit card itself, or on periodic statements. They may be given at any time preceding the unauthorized use of the card.

*Paragraph 12(b)(2)(iii).*

1. *Means of identifying cardholder or user.* To fulfill the condition set forth in §226.12(b)(2)(iii), the issuer must provide some method whereby the cardholder or the authorized user can be identified. This could include, for example, signature, photograph, or fingerprint on the card, or electronic or mechanical confirmation.

2. *Identification by magnetic strip.* Unless a magnetic strip (or similar device not readable without physical aids) must be used in conjunction with a secret code or the like, it would not constitute sufficient means of identification. Sufficient identification also

does not exist if a *pool* or group card, issued to a corporation and signed by a corporate agent who will not be a user of the card, is intended to be used by another employee for whom no means of identification is provided.

3. *Transactions not involving card.* The cardholder may not be held liable under §226.12(b) when the card itself (or some other sufficient means of identification of the cardholder) is not presented. Since the issuer has not provided a means to identify the user under these circumstances, the issuer has not fulfilled one of the conditions for imposing liability. For example, when merchandise is ordered by telephone by a person without authority to do so, using a credit card account number or other number only (which may be widely available), no liability may be imposed on the cardholder.

*12(b)(3) Notification to card issuer.*

1. *How notice must be provided.* Notice given in a normal business manner—for example, by mail, telephone, or personal visit—is effective even though it is not given to, or does not reach, some particular person within the issuer's organization. Notice also may be effective even though it is not given at the address or phone number disclosed by the card issuer under §226.12(b)(2)(ii).

2. *Who must provide notice.* Notice of loss, theft, or possible unauthorized use need not be initiated by the cardholder. Notice is sufficient so long as it gives the *pertinent information* which would include the name or card number of the cardholder and an indication that unauthorized use has or may have occurred.

3. *Relationship to §226.13.* The liability protections afforded to cardholders in §226.12 do not depend upon the cardholder's following the error resolution procedures in §226.13. For example, the written notification and time limit requirements of §226.13 do not affect the section 226.12 protections.

*12(b)(5) Business use of credit cards.*

1. *Agreement for higher liability for business use cards.* The card issuer may not rely on §226.12(b)(5) if the business is clearly not in a position to provide 10 or more cards to employees (for example, if the business has only 3 employees). On the other hand, the issuer need not monitor the personnel practices of the business to make sure that it has at least 10 employees at all times.

2. *Unauthorized use by employee.* The protection afforded to an employee against liability for unauthorized use in excess of the limits set in §226.12(b) applies only to unauthorized use by someone other then the employee. If the employee uses the card in an unauthorized manner, the regulation sets no restriction on the employee's potential liability for such use.

*12(c) Right of cardholder to assert claims or defenses against card issuer.*

1. *Relationship to §226.13.* The §226.12(c) credit card ''holder in due course'' provision deals with the consumer's right to assert against the card issuer a claim or defense concerning property or services purchased with a credit card, if the merchant has been unwilling to resolve the dispute. Even though certain merchandise disputes, such as non-delivery of goods, may also constitute ''billing errors'' under §226.13, that section operates independently of §226.12(c). The cardholder whose asserted billing error involves undelivered goods may institute the error resolution procedures of §226.13; but whether or not the cardholder has done so, the cardholder may assert claims or defenses under §226.12(c). Conversely, the consumer may pay a disputed balance and thus have no further right to assert claims and defenses, but still may assert a billing error if notice of that billing error is given in the proper time and manner. An assertion that a particular transaction resulted from unauthorized use of the card could also be both a ''defense'' and a billing error.

2. *Claims and defenses assertible.* Section 226.12(c) merely preserves the consumer's right to assert against the card issuer any claims or defenses that can be asserted against the merchant. It does not determine what claims or defenses are valid as to the merchant; this determination must be made under state or other applicable law.

*12(c)(1) General rule.*

1. *Situations excluded and included.* The consumer may assert claims or defenses only when the goods or services are ''purchased with the credit card.'' This could include:

• Mail or telephone orders, if the purchase is charged to the credit card account.

But it would exclude:

• Use of a credit card to obtain a cash advance, even if the consumer then uses the money to purchase goods or services. Such a transaction would not involve ''property or services purchased with the credit card.''

• The purchase of goods or services by use of a check accessing an overdraft account and a credit card used solely for identification of the consumer. (On the other hand, if the credit card is used to make partial payment for the purchase and not merely for identification, the right to assert claims or defenses would apply to credit extended via the credit card, although not to the credit extended on the overdraft line.)

• Purchases made by use of a check guarantee card in conjunction with a cash advance check (or by cash advance checks alone). See footnote 24. A cash advance check is a check that, when written, does not draw on an asset account; instead, it is charged entirely to an open-end credit account.

• Purchases effected by use of either a check guarantee card or a debit card when used to draw on overdraft credit lines (see

footnote 24). The debit card exemption applies whether the card accesses an asset account via point-of-sale terminals, automated teller machines, or in any other way, and whether the card qualifies as an ''access device'' under Regulation E or is only a paper-based debit card. If a card serves both as an ordinary credit card and also as check guarantee or debit card, a transaction will be subject to this rule on asserting claims and defenses when used as an ordinary credit card, but not when used as a check guarantee or debit card.

*12(c)(2) Adverse credit reports prohibited.*

1. *Scope of prohibition.* Although an amount in dispute may not be reported as delinquent until the matter is resolved:

i. That amount may be reported as disputed.

ii. Nothing in this provision prohibits the card issuer from undertaking its normal collection activities for the delinquent and undisputed portion of the account.

2. *Settlement of dispute.* A card issuer may not consider a dispute settled and report an amount disputed as delinquent or begin collection of the disputed amount until it has completed a reasonable investigation of the cardholder's claim. A reasonable investigation requires an independent assessment of the cardholder's claim based on information obtained from both the cardholder and the merchant, if possible. In conducting an investigation, the card issuer may request the cardholder's reasonable cooperation. The card issuer may not automatically consider a dispute settled if the cardholder fails or refuses to comply with a particular request. However, if the card issuer otherwise has no means of obtaining information necessary to resolve the dispute, the lack of information resulting from the cardholder's failure or refusal to comply with a particular request may lead the card issuer reasonably to terminate the investigation.

*12(c)(3) Limitations.*

*Paragraph 12(c)(3)(i).*

1. *Resolution with merchant.* The consumer must have tried to resolve the dispute with the merchant. This does not require any special procedures or correspondence between them, and is a matter for factual determination in each case. The consumer is not required to seek satisfaction from the manufacturer of the goods involved. When the merchant is in bankruptcy proceedings, the consumer is not required to file a claim in those proceedings.

*Paragraph 12(c)(3)(ii).*

1. *Geographic limitation.* The question of where as transaction occurs (as in the case of mail or telephone orders, for example) is to be determined under state or other applicable law.

2. *Merchant honoring card.* The exceptions (stated in footnote 26) to the amount and geographic limitations do not apply if the merchant merely honors, or indicates through signs or advertising that it honors, a particular credit card.

*12(d) Offsets by card issuer prohibited.*

*Paragraph 12(d)(1).*

1. *Holds* on accounts. ''Freezing'' or placing a hold on funds in the cardholder's deposit account is the functional equivalent of an offset and would contravene the prohibition in §226.12(d)(1), unless done in the context of one of the exceptions specified in §226.12(d)(2). For example, if the terms of a security agreement permitted the card issuer to place a hold on the funds, the hold would not violate the offset prohibition. Similarly, if an order of a bankruptcy court required the card issuer to turn over deposit account funds to the trustee in bankruptcy, the issuer would not violate the regulation by placing a hold on the funds in order to comply with the court order.

2. *Funds intended as deposits.* If the consumer tenders funds as a deposit (to a checking account, for example), the card issuer may not apply the funds to repay indebtedness on the consumer's credit card account.

3. *Types of indebtedness; overdraft accounts.* The offset prohibition applies to any indebtedness arising from transactions under a credit card plan, including accrued finance charges and other charges on the account. The prohibition also applies to balances arising from transactions not using the credit card itself but taking place under plans that involve credit cards. For example, if the consumer writes a check that accesses an overdraft line of credit, the resulting indebtedness is subject to the offset prohibition since it is incurred through a credit card plan, even though the consumer did not use an associated check guarantee or debit card.

4. *When prohibition applies in case of termination of account.* The offset prohibition applies even after the card issuer terminates the cardholder's credit card privileges, if the indebtedness was incurred prior to termination. If the indebtedness was incurred after termination, the prohibition does not apply.

*Paragraph 12(d)(2).*

1. *Security interest—limitations.* In order to qualify for the exception stated in §226.12(d)(2), a security interest must be affirmatively agreed to by the consumer and must be disclosed in the issuer's initial disclosures under §226.6. The security interest must not be the functional equivalent of a right of offset; as a result, routinely including in agreements contract language indicating that consumers are giving a security interest in any deposit accounts maintained with the issuer does not result in a security interest that falls within the exception in §226.12(d)(2). For a security interest to qualify for the exception under §226.12(d)(2) the following conditions must be met:

• The consumer must be aware that granting a security interest is a condition for the credit card account (or for more favorable account terms) and must specifically intend to grant a security interest in a deposit account. Indicia of the consumer's awareness and intent could include, for example:

—Separate signature or initials on the agreement indicating that a security interest is being given
—Placement of the security agreement on a separate page, or otherwise separating the security interest provisions from other contract and disclosure provisions
—Reference to a specific amount of deposited funds or to a specific deposit account number

• The security interest must be obtainable and enforceable by creditors generally. If other creditors could not obtain a security interest in the consumer's deposit accounts to the same extent as the card issuer, the security interest is prohibited by §226.12(d)(2).

2. *Security interest—after-acquired property.* As used in §226.12(d), the term *security interest* does not exclude (as it does for other Regulation Z purposes) interests in after-acquired property. Thus, a consensual security interest in deposit-account funds, including funds deposited after the granting of the security interest, would constitute a permissible exception to the prohibition on offsets.

3. *Court order.* If the card issuer obtains a judgment against the cardholder, and if State and other applicable law and the terms of the judgment do not so prohibit, the card issuer may offset the indebtedness against the cardholder's deposit account.

*Paragraph 12(d)(3).*

1. *Automatic payment plans—scope of exception.* With regard to automatic debit plans under §226.12(d)(3), the following rules apply:

• The cardholder's authorization must be in writing and signed or initialed by the cardholder.

• The authorizing language need not appear directly above or next to the cardholder's signature or initials, provided it appears on the same document and that it clearly spells out the terms of the automatic debit plan.

• If the cardholder has the option to accept or reject the automatic debit feature (such option may be required under section 913 of the Electronic Fund Transfer Act), the fact that the option exists should be clearly indicated.

2. *Automatic payment plans—additional exceptions.* The following practices are not prohibited by §226.12(d)(1):

• Automatically deducting charges for participation in a program of banking services (one aspect of which may be a credit card plan).

• Debiting the cardholder's deposit account on the cardholder's *specific* request rather than on an *automatic* periodic basis (for example, a cardholder might check a box on the credit card bill stub, requesting the issuer to debit the cardholder's account to pay that bill).

*12(e) Prompt notification of returns and crediting of refunds.*

*Paragraph 12(e)(1).*

1. *Normal channels.* The term *normal channels* refers to any network or interchange system used for the processing of the original charge slips (or equivalent information concerning the transaction).

*Paragraph 12(e)(2).*

1. *Crediting account.* The card issuer need not actually post the refund to the consumer's account within 3 business days after receiving the credit statement, provided that it credits the account as of a date within that time period.

References

*Statute:* Sections 103(1), 132, 133, 135, 162, 166, 167, 169, and 170.

*Other sections:* Section 226.13.

*Other regulations:* Regulation E (12 CFR 205).

*Previous regulation:* Section 226.13.

*1981 changes:* The issuance rules in §226.12(a) make clear that cards may be sent to the person making the request and also to any other person for whom a card is requested, except that no liability for unauthorized use may be imposed on persons who are only authorized users.

The principal differences in §226.12(b) about conditions of liability are as follows: the requirement that the cardholder be given a postage-paid, preaddressed card or envelope for notification of loss or theft has been deleted (corresponding to an amendment to the act); the required disclosures of maximum liability and of means of notification have been simplified; and the required provision of a means of identification has been changed in that the issuer now may provide a means to identify either the cardholder or the authorized user. Finally, anyone may provide the notification to the card issuer, not just the cardholder.

Section 226.12(d) on offsets clarifies that the offset prohibition does not apply to consensual security interests. The separate promptness standard which used to apply in addition to the 7-business-day and 3-business-day standards has been deleted from §226.12(e) on prompt notification of returns. Section 226.12(f) now clarifies rules on clearing accounts.

Section 226.12(g), dealing with the relationship of the regulation to Regulation E (Electronic Fund Transfers), has been added.

*Section 226.13—Billing Error Resolution*

1. *General prohibitions.* Footnote 27 prohibits a creditor from responding to a consumer's billing error allegation by accelerating the debt or closing the account, and reflects protections authorized by section 161(d) of the Truth in Lending Act and section 701 of the Equal Credit Opportunity Act. The footnote also alerts creditors that failure to comply with the error resolution procedures may result in the forfeiture of disputed amounts as prescribed in section 161(e) of the Act. (Any failure to comply may also be a violation subject to the liability provisions of section 130 of the Act.)

2. *Charges for error resolution.* If a billing error occurred, whether as alleged or in a different amount or manner, the creditor may not impose a charge related to any aspect of the error resolution process (including charges for documentation or investigation) and must credit the consumer's account if such a charge was assessed pending resolution. Since the Act grants the consumer error resolution rights, the creditor should avoid any chilling effect on the good faith assertion of errors that might result if charges are assessed when no billing error has occurred.

*13(a) Definition of billing error.*

1. *Actual, implied, or apparent authority.* Whether use of a credit card or open-end credit plan is authorized is determined by state or other applicable law.

*Paragraph 13(a)(3).*

1. *Coverage.* Section 226.13(a)(3) covers disputes about goods or services that are ''not accepted'' or ''not delivered . . . as agreed''; for example:

- The appearance on a periodic statement of a purchase, when the consumer refused to take delivery of goods because they did not comply with the contract.
- Delivery of property or services different from that agreed upon.
- Delivery of the wrong quantity.
- Late delivery.
- Delivery to the wrong location.

Section 226.13(a)(3) does not apply to a dispute relating to the quality of property or services that the consumer accepts. Whether acceptance occurred is determined by state or other applicable law.

*Paragraph 13(a)(5).*

1. *Computational errors.* In periodic statements that are combined with other information, the error resolution procedures are triggered only if the consumer asserts a computational billing error in the credit-related portion of the periodic statement. For example:

- If a bank combines a periodic statement reflecting the consumer's credit card transactions with the consumer's monthly checking statement, a computational error in the checking account portion of the combined statement is not a billing error.

*Paragraph 13(a)(6).*

1. *Documentation requests.* A request for documentation such as receipts or sales slips, unaccompanied by an allegation of an error under §226.13(a) or a request for additional clarification under §226.13(a)(6), does not trigger the error resolution procedures. For example, a request for documentation merely for purposes such as tax preparation or recordkeeping does not trigger the error resolution procedures.

*13(b) Billing error notice.*

1. *Withdrawal.* The consumer's withdrawal of a billing error notice may be oral or written.

*Paragraph 13(b)(1).*

1. *Failure to send periodic statement—timing.* If the creditor has failed to send a periodic statement, the 60-day period runs from the time the statement should have been sent. Once the statement is provided, the consumer has another 60 days to assert any billing errors reflected on it.

2. *Failure to reflect credit—timing.* If the periodic statement fails to reflect a credit to the account, the 60-day period runs from transmittal of the statement on which the credit should have appeared.

3. *Transmittal.* If a consumer has arranged for periodic statements to be held at the financial institution until called for, the statement is ''transmitted'' when it is first made available to the consumer.

*Paragraph 13(b)(2).*

1. *Identity of the consumer.* The billing error notice need not specify both the name and the account number if the information supplied enables the creditor to identify the consumer's name and account.

*13(c) Time for resolution; general procedures.*

1. *Temporary or provisional corrections.* A creditor may temporarily correct the consumer's account in response to a billing error notice, but is not excused from complying with the remaining error resolution procedures within the time limits for resolution.

2. *Correction without investigation.* A creditor may correct a billing error in the manner and amount asserted by the consumer without the investigation or the determination normally required. The creditor must comply, however, with all other applicable provisions. If a creditor follows this procedure, no presumption is created that a billing error occurred.

*Paragraph 13(c)(2).*

1. *Time for resolution.* The phrase *two complete billing cycles* means 2 actual billing cycles occurring after receipt of the billing error notice, not a measure of time equal to 2 billing cycles. For example, if a creditor on a monthly billing cycle receives a billing error notice mid-cycle, it has the remainder

of that cycle plus the next 2 full billing cycles to resolve the error.

*13(d) Rules pending resolution.*

1. *Disputed amount. Disputed amount* is the dollar amount alleged by the consumer to be in error. When the allegation concerns the description or identification of the transaction (such as the date or the seller's name) rather than a dollar amount, the disputed amount is the amount of the transaction or charge that corresponds to the disputed transaction identification. If the consumer alleges a failure to send a periodic statement under §226.13(a)(7),the disputed amount is the entire balance owing.

*13(d)(1) Consumer's right to withhold disputed amount; collection action prohibited.*

1. *Prohibited collection actions.* During the error resolution period, the creditor is prohibited from trying to collect the disputed amount from the consumer. Prohibited collection actions include, for example, instituting court action, taking a lien, or instituting attachment proceedings.

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

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

4. *Automatic payment plans—coverage.* The coverage of this provision is limited to the card issuer's intra-institutional payment plans. It does not apply to:

- Inter-institutional payment plans that permit a cardholder to pay automatically any credit card indebtedness from an asset account not held by the card issuer receiving payment.
- Intra-institutional automatic payment plans offered by financial institutions that are not credit card issuers.

5. *Automatic payment plans—time of notice.* While the card issuer does not have to restore or prevent the debiting of a disputed amount if the billing error notice arrives after the 3-business-day cut-off, the card issuer must, however, prevent the automatic debit of any part of the disputed amount that is still outstanding and unresolved at the time of the next scheduled debit date.

*13(d)(2) Adverse credit reports prohibited.*

1. *Report of dispute.* Although the creditor must not issue an adverse credit report because the consumer fails to pay the disputed amount or any related charges, the creditor may report that the amount or the account is in dispute. Also, the creditor may report the account as delinquent if undisputed amounts remain unpaid.

2. *Person.* During the error resolution period, the creditor is prohibited from making an adverse credit report about the disputed amount to any person—including employers, insurance companies, other creditors, and credit bureaus.

3. *Creditor's agent.* Whether an agency relationship exists between a creditor and an issuer of an adverse credit report is determined by State or other applicable law.

*13(e) Procedures if billing error occurred as asserted.*

1. *Correction of error.* The phrase *as applicable* means that the necessary corrections vary with the type of billing error that occurred. For example, a misidentified transaction (or a transaction that is identified by one of the alternative methods in §226.8) is cured by properly identifying the transaction and crediting related finance and any other charges imposed. The creditor is not required to cancel the amount of the underlying obligation incurred by the consumer.

2. *Form of correction notice.* The written correction notice may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the periodic statement is used, the amount of the billing error must be specifically identified.

If a separate billing error correction notice is provided, the accompanying or subsequent periodic statement reflecting the corrected amount may simply identify it as *credit.*

*13(f) Procedures if different billing error or no billing error occurred.*

1. *Different billing error.* Examples of a *different billing error* include:

• Differences in the amount of an error (for example, the customer asserts a $55.00 error but the error was only $53.00).

• Differences in other particulars asserted by the consumer (such as when a consumer asserts that a particular transaction never occurred, but the creditor determines that only the seller's name was disclosed incorrectly).

2. *Form of creditor's explanation.* The written explanation (which also may notify the consumer of corrections to the account) may take a variety of forms. It may be sent separately, or it may be included on or with a periodic statement that is mailed within the time for resolution. If the creditor uses the periodic statement for the explanation and correction(s), the corrections must be specifically identified. If a separate explanation, including the correction notice, is provided, the enclosed or subsequent periodic statement reflecting the corrected amount may simply identify it as a *credit.* The explanation may be combined with the creditor's notice to the consumer of amounts still owing, which is required under §226.13(g)(1), provided it is sent within the time limit for resolution. (See Commentary to §226.13(e).)

*13(g) Creditor's rights and duties after resolution.*

*Paragraph 13(g)(1).*

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

2. *Time of notice.* The creditor need not send the notice of amount owed within the time period for resolution, although it is under a duty to send the notice promptly after resolution of the alleged error. If the creditor combines the notice of the amount owed with the explanation required under §226.13(f)(1), the combined notice must be provided within the time limit for resolution.

*Paragraph 13(g)(2).*

1. The creditor need not allow any free-ride period disclosed under §§226.6(a)(1) and 226.7(j) to pay the amount due under §226.13(g)(1) if no error occurred and the consumer was not entitled to a free-ride period at the time the consumer asserted the error.

*Paragraph 13(g)(3).*

1. *Time for payment.* The consumer has a minimum of 10 days to pay (measured from the time the consumer could reasonably be expected to have received notice of the amount owed) before the creditor may issue an adverse credit report; if an initially disclosed free-ride period allows the consumer a longer time in which to pay, the consumer has the benefit of that longer period.

*Paragraph 13(g)(4).*

1. *Credit reporting.* Under §226.13(g)(4)(i) and (iii) the creditor's additional credit reporting responsibilities must be accomplished promptly. The creditor need not establish costly procedures to fulfill this requirement. For example, a creditor that reports to a credit bureau on scheduled updates need not transmit corrective information by an unscheduled computer or magnetic tape; it may provide the credit bureau with the correct information by letter or other commercially reasonable means when using the scheduled update would not be ''prompt.'' The creditor is not responsible for ensuring that the credit bureau corrects its information immediately.

2. *Adverse report to credit bureau.* If a creditor made an adverse report to a credit bureau that disseminated the information to other creditors, the creditor fulfills its §226.13(g)(4)(ii) obligations by providing the consumer with the name and address of the credit bureau.

*13(i) Relation to Electronic Fund Transfer Act and Regulation E.*

1. *Coverage.* Credit extended directly from a non-overdraft credit line is governed solely by Regulation Z, even though a combined credit card/access device is used to obtain the extension.

2. *Incidental credit under agreement.* Credit extended incident to an electronic fund transfer under an agreement between the consumer and the financial institution is governed by §226.13(i), which provides that certain error resolution procedures in both this regulation and Regulation E apply. Incidental credit that is not extended under an agreement between the consumer and the financial institution is governed *solely* by the error resolution procedures in Regulation E. For example:

• Credit inadvertently extended incident to an electronic fund transfer is governed solely by the Regulation E error resolution procedures, if the bank and the consumer do not have an agreement to extend credit when the consumer's account is overdrawn.

3. *Application to debit/credit transactions-examples.* If a consumer withdraws money at an automated teller machine and activates an overdraft credit feature on the checking account:

i. An error asserted with respect to the transaction is subject, for error resolution

purposes, to the applicable Regulation E provisions (such as timing and notice) for the entire transaction.

ii. The creditor need not provisionally credit the consumer's account, under §205.11(c)(2)(i) of Regulation E, for any portion of the unpaid extension of credit.

iii. The creditor must credit the consumer's account under §205.11(c) with any finance or other charges incurred as a result of the alleged error.

iv. The provisions of §226.13(d) and (g) apply only to the credit portion of the transaction.

References

*Statute:* Sections 161 and 162.

*Other sections:* Sections 226.6 through 226.8.

*Other regulations:* Regulation E (12 CFR 205).

*Previous regulation:* Sections 226.2(j) and (cc), and 226.14.

*1981 changes:* Section 226.13 reflects several substantive changes from the previous regulation and a complete restructuring of the error resolution provisions. The new organization, for example, arranges the creditor's responsibilities in chronological sequence.

Section 226.13(a)(7) implements amended §161(b) of the act, and provides that the creditor's failure to send a periodic statement to the consumer's current address is a billing error, unless the creditor received written notice of the address change fewer than 20 days (instead of 10 days) before the end of the billing cycle.

Several provisions regarding the creditor's duties after a billing error is alleged have been revised. The previous regulation immunized a creditor from liability for inadvertently taking collection action or making an adverse credit report within 2 days after receiving a billing error notice; these provisions are deleted from the revised regulation. The revised regulation no longer requires placement ''on the face'' of the periodic statment of the disclosure about payment of disputed amounts.

The revised regulation changes the rule in the previous regulation that a card issuer must prevent or restore an automatic debit of a disputed amount if it receives a billing error notice within 16 days after transmitting the periodic statement that reflects the alleged error. Under the revised regulation, the card issuer must prevent an automatic debit if it receives a billing error notice up to 3 days before the scheduled payment date (provided that the notice is received within the 60 days for the consumer to assert the error).

*Section 226.14—Determination of Annual Percentage Rate*

*14(a) General rule.*

1. *Tolerance.* The tolerance of ⅛ of 1 percentage point above or below the annual percentage rate applies to any required disclosure of the annual percentage rate. The disclosure of the annual percentage rate is required in §§226.6, 226.7, 226.9, 226.15, 226.16, and 226.26.

2. *Rounding.* The regulation does not require that the annual percentage rate be calculated to any particular number of decimal places; rounding is permissible within the ⅛ of 1 percent tolerance. For example, an exact annual percentage rate of 14.33333% may be stated as 14.33% or as 14.3%, or even as 14¼%; but it could not be stated as 14.2% or 14%, since each varies by more than the permitted tolerance.

3. *Periodic rates.* No explicit tolerance exists for any periodic rate as such; a disclosed periodic rate may vary from precise accuracy (for example, due to rounding) only to the extent that its annualized equivalent is within the tolerance permitted by §226.14(a). Further, a periodic rate need not be calculated to any particular number of decimal places.

4. *Finance charges.* The regulation does not prohibit creditors from assessing finance charges on balances that include prior, unpaid finance charges; state or other applicable law may do so, however.

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

*14(b) Annual Percentage Rate for §§226.5a and 226.5b Disclosures, for Initial Disclosures and for Advertising Purposes*

1. *Corresponding annual percentage rate computation.* For purposes of §§226.5a, 226.5b, 226.6 and 226.16, the annual percentage rate is determined by multiplying the periodic rate by the number of periods in the year. This computation reflects the fact that, in such disclosures, the rate (known as the corresponding annual percentage rate) is prospective and does not involve any particular finance charge or periodic balance. This computation also is used to determine any annual percentage rate for oral disclosures under §226.26(a).

*14(c) Annual percentage rate for periodic statements.*

1. *General rule.* Section 226.14(c) requires disclosure of the corresponding annual percentage rate for each periodic rate (under §226.7(d)). It is figured by multiplying each periodic rate by the number of periods per year. This disclosure is like that provided on the initial disclosure statement. The periodic statement also must reflect (under §226.7(g)) the annualized equivalent of the rate actually applied during a particular cycle (the historical rate); this rate may differ from the corresponding annual percentage rate because of the inclusion of fixed, minimum, or transaction charges. Sections 226.14 (c)(1) through (c)(4) state the computation rules for the historical rate.

2. *Periodic rates.* Section 226.14(c)(1) applies if the only finance charge imposed is due to the application of a periodic rate to a balance. The creditor may compute the annual percentage rate either:

• By multiplying each periodic rate by the number of periods in the year; or

• By the ''quotient'' method. This method refers to a composite annual percentage rate when different periodic rates apply to different balances. For example, a particular plan may involve a periodic rate of 1½% on balances up to $500, and 1% on balances over $500. If, in a given cycle, the consumer has a balance of $800, the finance charge would consist of $7.50 (500×.015) plus $3.00 (300×.01), for a total finance charge of $10.50. The annual percentage rate for this period may be disclosed either as 18% on $500 and 12% on $300, or as 15.75% on a balance of $800 (the quotient of $10.50 divided by $800, multiplied by 12).

3. *Charges not based on periodic rates.* Section 226.14(c)(2) applies if the finance charge imposed includes a charge not due to the application of a periodic rate (other than a charge relating to a specific transaction). For example, if the creditor imposes a minimum $1 finance charge on all balances below $50, and the consumer's balance was $40 in a particular cycle, the creditor would disclose an annual percentage rate of 30% (1/40×12).

4. *No balance.* Footnote 32 to §226.14(c)(2) would apply not only when minimum charges are imposed on an account with no balance, but also to a plan in which a periodic rate is applied to advances from the date of the transaction. For example, if on May 19 the consumer pays the new balance in full from a statement dated May 1, and has no further transactions reflected on the June 1 statement, that statement would reflect a finance charge with no account balance.

5. *Transaction charges.* i. Section 226.14(c)(3) transaction charges include, for example:

A. A loan fee of $10 imposed on a particular advance.

B. A charge of 3% of the amount of each transaction.

ii. The reference to avoiding duplication in the computation requires that the amounts of transactions on which transaction charges were imposed not be included both in the amount of total balances and in the ''other amounts on which a finance charge was imposed'' figure. In a multifeatured plan, creditors may consider each bona fide feature separately in the calculation of the denominator. A creditor has considerable flexibility in defining features for open-end plans, as long as the creditor has a reasonable basis for the distinctions. For further explanation and examples of how to determine the components of this formula, see appendix F.

6. *Daily rate with specific transaction charge.* Section 226.14(c)(3) sets forth an acceptable method for calculating the annual percentage rate if the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate. This section includes the requirement that the creditor follow the rules in appendix F in calculating the annual percentage rate, especially footnote 1 to appendix F which addresses the daily rate/transaction charge situation by providing that the ''average of daily balances'' shall be used instead of the ''sum of the balances.''

7. *Charges related to opening, renewing, or continuing an account.* Footnote 33 is applicable to §226.14 (c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to specific activity on the account, but relate solely to the opening, renewing, or continuing of the account. For example, an annual fee to renew an open-end credit account that is a percentage of the credit limit on the account, or that is charged only to consumers that have not used their credit card for a certain dollar amount in transactions during the preceding year, would not be included in the calculation of the annual percentage rate, even though the fee may not be excluded from the finance charge under §226.4(c)(4). (See comment 4(c)(4)–2.) Inclusion of these charges in the annual percentage rate calculation results in significant distortions of the annual percentage rate and delivery of a possibly misleading disclosure to consumers. The rule in footnote 33 applies even if the loan fee, points, or similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

8. *Classification of charges.* If the finance charge includes a charge not due to the application of a periodic rate, the creditor must determine the proper annual percentage rate computation method according to the type of charge imposed. If the charge is tied to a specific transaction (for example, 3% of the amount of each transaction), then

the method in §226.14(c)(3) must be used. If a fixed or minimum charge is applied, that is, one not tied to any specific transaction, then the formula in §226.14(c)(2) is appropriate.

9. *Small finance charges.* Section 226.14(c)(4) gives the creditor an alternative to §226.14(c)(2) and (c)(3) if small finance charges (50 cents or less) are involved; that is, if the finance charge includes minimum or fixed fees not due to the application of a periodic rate and the total finance charge for the cycle does not exceed 50 cents. For example, while a monthly activity fee of 50 cents on a balance of $20 would produce an annual percentage rate of 30 percent under the rule in §226.14(c)(2), the creditor may disclose an annual percentage rate of 18 percent if the periodic rate generally applicable to all balances is 1½ percent per month. This option is consistent with the provision in footnote 11 to §§226.6 and 226.7 permitting the creditor to disregard the effect of minimum charges in disclosing the ranges of balances to which periodic rates apply.

10. *Prior-cycle adjustments.* i. The annual percentage rate reflects the finance charges imposed during the billing cycle. However, finance charges imposed during the billing cycle may relate to activity in a prior cycle. Examples of circumstances when this may occur are:

A. A cash advance occurs on the last day of a billing cycle on an account that uses the transaction date to figure finance charges, and it is impracticable to post the transaction until the following cycle.

B. An adjustment to the finance charge is made following the resolution of a billing error dispute.

C. A consumer fails to pay the purchase balance under a deferred payment feature by the payment due date, and finance charges are imposed from the date of purchase.

ii. Finance charges relating to activity in prior cycles should be reflected on the periodic statement as follows:

A. If a finance charge imposed in the current billing cycle is attributable to periodic rates applicable to prior billing cycles (such as when a deferred payment balance was not paid in full by the payment due date and finance charges from the date of purchase are now being debited to the account, or when a cash advance occurs on the last day of a billing cycle on an account that uses the transaction date to figure finance charges and it is impracticable to post the transaction until the following cycle), and the creditor uses the quotient method to calculate the annual percentage rate, the numerator would include the amount of any transaction charges plus any other finance charges posted during the billing cycle. At the creditor's option, balances relating to the finance charge adjustment may be included in the denominator if permitted by the legal obligation, if it was impracticable to post the transaction in the previous cycle because of timing, or if the adjustment is covered by comment 14(c)10.ii.B.

B. If a finance charge that is posted to the account relates to activity for which a finance charge was debited or credited to the account in a previous billing cycle (for example, if the finance charge relates to an adjustment such as the resolution of a billing error dispute, or an unintentional posting error, or a payment by check that was later returned unpaid for insufficient funds or other reasons), the creditor shall at its option:

1. Calculate the annual percentage rate in accord with ii.A. of this paragraph, or

2. Disclose the finance charge adjustment on the periodic statement and calculate the annual percentage rate for the current billing cycle without including the finance charge adjustment in the numerator and balances associated with the finance charge adjustment in the denominator.

*14(d) Calculations where daily periodic rate applied.*

1. *Quotient Method.* Section 226.14(d) addresses use of a daily periodic rate(s) to determine some or all of the finance charge and use of the quotient method to determine the annual percentage rate. Since the quotient formula in §226.14(c)(1)(ii) does not work when a daily rate is being applied to a series of daily balances, §226.14(d) gives the creditor 2 alternative ways to figure the annual percentage rate—either of which satisfies the requirement in §226.7(g).

2. *Daily rate with specific transaction charge.* If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(c)–6 for guidance on an appropriate calculation method.

References

*Statute:* Section 107.

*Other sections:* Sections 226.6, 226.7, 226.9, 226.15, 226.16, and 226.26.

*Previous regulation:* Section 226.5(a) and Interpretation §§226.501 and 226.506.

*1981 changes:* Section 226.14 reflects the statutory amendment permitting a ⅛ of 1 percent tolerance for annual percentage rates. The revised regulation no longer reflects the provision dealing with finance charges imposed on specified ranges or brackets of balances. The revised regulation includes a footnote providing that loan fees, points, or similar charges unrelated to any specific transaction are not figured into the annual percentage rate computation.

*Section 226.15—Right of Rescission*

1. *Transactions not covered.* Credit extensions that are not subject to the regulation are not covered by §226.15 even if the customer's principal dwelling is the collateral

securing the credit. For this purpose, *credit extensions* also would include the occurrences listed in Comment 15(a)(1)–1. For example, the right of rescission does not apply to the opening of a business-purpose credit line, even though the loan is secured by the customer's principal dwelling.

*15(a) Consumer's right to rescind.*

*Paragraph 15(a)(1).*

1. *Occurrences subject to right.* Under an open-end credit plan secured by the consumer's principal dwelling, the right of rescission generally arises with each of the following occurrences:

• Opening the account.
• Each credit extension.
• Increasing the credit limit.
• Adding to an existing account a security interest in the consumer's principal dwelling.
• Increasing the dollar amount of the security interest taken in the dwelling to secure the plan. For example, a consumer may open an account with a $10,000 credit limit, $5,000 of which is initially secured by the consumer's principal dwelling. The consumer has the right to rescind at that time and (except as noted in §226.15(a)(1)(ii)) with each extension on the account. Later, if the creditor decides that it wants the credit line fully secured, and increases the amount of its interest in the consumer's dwelling, the consumer has the right to rescind the increase.

2. *Exceptions.* Although the consumer generally has the right to rescind with each transaction on the account, section 125(e) of the Act provides an exception: the creditor need not provide the right to rescind at the time of each credit extension made under an open-end credit plan secured by the consumer's principal dwelling to the extent that the credit extended is in accordance with a previously established credit limit for the plan. This limited rescission option is available whether or not the plan existed prior to the effective date of the Act.

3. *Security interest arising from transaction.* In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

• A security interest that is acquired by a contractor who is also extending the credit in the transaction.
• A mechanic's or materialman's lien that is retained by a subcontractor or supplier of a contractor-creditor, even when the latter has waived its own security interest in the consumer's home.

The security interest is not part of the credit transaction, and therefore the transaction is not subject to the right of rescission when, for example:

• A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but merely is paid with the proceeds of the consumer's cash advance.
• All security interests that may arise in connection with the credit transaction are validly waived.
• The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

Although liens arising by operation of law are not considered security interests for purposes of disclosure under §226.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under §226.6(c), it may still give rise to the right of rescission.

4. *Consumer.* To be a consumer within the meaning of §226.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse enters into a secured plan, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

5. *Principal dwelling.* A consumer can only have one principal dwelling at a time. (But see comment 15(a)(1)–6.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. 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 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. Dwelling, as defined in §226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

6. *Special rule for principal dwelling.* Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, a credit plan or extension that is subject to Regulation Z and is secured by the equity in the consumer's current principal dwelling is subject to the right of rescission regardless of

the purpose of that loan (for example, an advance to be used as a bridge 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 loan to finance B and secured by A is subject to the right of rescission. Moreover, a loan secured by both A and B is, likewise, rescindable.

*Paragraph 15(a)(2).*

1. *Consumer's exercise of right.* The consumer must exercise the right of rescission in writing but not necessarily on the notice supplied under §226.15(b). Whatever the means of sending the notification of rescission—mail, telegram or other written means—the time period for the creditor's performance under §226.15(d)(2) does not begin to run until the notification has been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under §226.15(b). Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission, delivery of the notification to the person or address to which the consumer has been directed to send payments constitutes delivery to the creditor or assignee. State law determines whether delivery of the notification to a third party other than the person to whom payments are made is delivery to the creditor or assignee, in the case where the creditor fails to designate an address for sending the notification of rescission.

*Paragraph 15 (a)(3).*

1. *Rescission period.* the period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:

• The occurrence that gives rise to the right of rescission.

• Delivery of *all* material disclosures that are relevant to the plan.

• Delivery to the consumer of the required rescission notice.

For example, an account is opened on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31; the rescission period will expire at midnight of the third business day after June 1—that is, Tuesday June 5. In another example, if the disclosures are given and the account is opened on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4—that is Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.

2. *Material disclosures.* Footnote 36 sets forth the material disclosures that must be provided before the rescission period can begin to run. The creditor must provide sufficient information to satisfy the requirements of §226.6 for these disclosures. A creditor may satisfy this requirement by giving an initial disclosure statement that complies with the regulation. Failure to give the other required initial disclosures (such as the billing rights statement) or the information required under section 226.5b. does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions. The payment terms set forth in footnote 36 apply to any repayment phase set forth in the agreement. Thus, the payment terms described in §226.6(e)(2) for any repayment phase as well as for the draw period are ''material disclosures.''

3. *Material disclosures—variable rate program.* For a variable rate program, the material disclosures also include the disclosures listed in footnote 12 to §226.6(a)(2): the circumstances under which the rate may increase; the limitations on the increase; and the effect of an increase. The disclosures listed in footnote 12 to section 226.6(a)(2) for any repayment phase also are material disclosures for variable-rate programs.

4. *Unexpired right of rescission.* When the creditor has failed to take the action necessary to start the three-day rescission period running the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

• The expiration of three years after the occurrence giving rise to the right of rescission.

• Transfer of all the consumer's interest in the property.

• Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.

Transfer of all the consumer's interest includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in section 125 of the act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of §226.15. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

*Paragraph 15(a)(4).*

1. *Joint owners.* When more than one consumer has the right to rescind a transaction, any one of them may exercise that right and cancel the transaction on behalf of all. For example, if both a husband and wife have the right to rescind a transaction, either spouse

acting alone may exercise the right and both are bound by the rescission.

*15(b) Notice of right to rescind.*

1. *Who receives notice.* Each consumer entitled to rescind must be given:

• Two copies of the rescission notice.

• The material disclosures.

In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive two copies of the rescission notice (one copy to each if the notice is provided in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act) and one copy of the disclosures.

2. *Format.* The rescission notice may be physically separated from the material disclosures or combined with the material disclosures, so long as the information required to be included on the notice is set forth in a clear and conspicuous manner. See the model notices in appendix G.

3. *Content.* The notice must include all of the information outlined in §226.15(b)(1) through (5). The requirement in §226.15(b) that the transaction or occurrence be identified may be met by providing the date of the transaction or occurrence. The notice may include additional information related to the required information, such as:

• A description of the property subject to the security interest.

• A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.

• The name and address of an agent of the creditor to receive notice of rescission.

4. *Time of providing notice.* The notice required by §226.15(b) need not be given before the occurrence giving rise to the right of rescission. The creditor may deliver the notice after the occurrence, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the credit limit was raised on May 10, the 3-business-day rescission period will run from May 15.

*15(c) Delay of creditor's performance.*

1. *General rule.* Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

• Disburse advances to the consumer.

• Begin performing services for the consumer.

• Deliver materials to the consumer.

A creditor may, however, continue to allow transactions under an existing open-end credit plan during a rescission period that results solely from the addition of a security interest in the consumer's principal dwelling. (See comment 15(c)–3 for other actions that may be taken during the delay period.)

2. *Escrow.* The creditor may disburse advances during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as ''trustee'' or ''escrow agent'' and distribute funds to the consumer in that capacity during the delay period.

3. *Actions during the delay period.* Section 226.15(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

• Prepare the cash advance check.

• Perfect the security interest.

• Accrue finance charges during the delay period.

4. *Performance by third party.* The creditor is relieved from liability for failure to delay performance if a third party with no knowledge that the rescission right has been activated provides materials or services, as long as any debt incurred for materials or services obtained by the consumer during the rescission period is not secured by the security interest in the consumer's dwelling. For example, if a consumer uses a bank credit card to purchase materials from a merchant in an amount below the floor limit, the merchant might not contact the card issuer for authorization and therefore would not know that materials should not be provided.

5. *Delay beyond rescission period.* The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

• Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.

• Obtaining a written statement from the consumer that the right has not been exercised.

When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

*15(d) Effects of rescission.*

*Paragraph 15(d)(1).*

1. *Termination of security interest.* Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated, regardless of its status and whether or not it was recorded or perfected. Under §226.15(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

2. *Extent of termination.* The creditor's security interest is void to the extent that it is related to the occurrence giving rise to the

right of rescission. For example, upon rescission:

• If the consumer's right to rescind is activated by the opening of a plan, any security interest in the principal dwelling is void.

• If the right arises due to an increase in the credit limit, the security interest is void as to the amount of credit extensions over the prior limit, but the security interest in amounts up to the original credit limit is unaffected.

• If the right arises with each individual credit extension, then the interest is void as to that extension, and other extensions are unaffected.

*Paragraph 15(d)(2).*

1. *Refunds to consumer.* The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the occurrence subject to the right of rescission. Any amounts of this nature already paid by the consumer must be refunded. ''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 by the consumer directly to a third party, or passed on from the creditor to the third party. It is irrelevant that these amounts may not represent profit to the creditor. For example:

• If the occurrence is the opening of the plan, the creditor must return any membership or application fee paid.

• If the occurrence is the increase in a credit limit or the addition of a security interest, the creditor must return any fee imposed for a new credit report or filing fees.

• If the occurrence is a credit extension, the creditors must return fees such as application, title, and appraisal or survey fees, as well as any finance charges related to the credit extension.

2. *Amounts not refundable to consumer.* Creditors need not return any money given by the consumer to a third party outside of the occurrence, such as costs incurred for a building permit or for a zoning variance. Similarly, the term *any amount* does not apply to money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under §226.15(d)(3).

3. *Reflection of security interest termination.* The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the occurrence rescinded by the consumer, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.

*Paragraph 15(d)(3).*

1. *Property exchange.* Once the creditor has fulfilled its obligation under §226.15(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if fixtures or furniture have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer *must* be tendered at the creditor's place of business. For purpose of property exchange, the following additional rules apply:

• A cash advance is considered money for purposes of this section even if the creditor knows what the consumer intends to purchase with the money.

• In a 3-party open-end credit plan (that is, if the creditor and seller are not the same or related persons), extensions by the creditor that are used by the consumer for purchases from third-party sellers are considered to be the same as cash advances for purposes of tendering value to the creditor, even though the transaction is a purchase for other purposes under the regulation. For example, if a consumer exercises the unexpired right to rescind after using a 3-party credit card for one year, the consumer would tender the amount of the purchase price for the items charged to the account, rather than tendering the items themselves to the creditor.

2. *Reasonable value.* If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.

*Paragraph 15(d)(4).*

1. *Modifications.* The procedures outlined in §226.15(d)(2) and (3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The sequence of procedures under §226.15(d)(2) and (3), or a court's modification of those procedures under §226.15(d)(4), does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly. Where the consumer's right to rescind is contested by the creditor, a court would normally determine whether

the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.

*15(e) Consumer's waiver of right to rescind.*

1. *Need for waiver.* To waive the right to rescind, the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.

2. *Procedure.* To waive or modify the right to rescind, the consumer must give a written statement that specifically waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.

*15(f) Exempt transactions.*

1. *Residential mortgage transaction.* Although residential mortgage transactions would seldom be made on bona fide open-end credit plans (under which repeated transactions must be reasonably contemplated), an advance on an open-end plan could be for a downpayment for the purchase of a dwelling that would then secure the remainder of the line. In such a case, only the particular advance for the downpayment would be exempt from the rescission right.

2. *State creditors.* Cities and other political subdivisions of states acting as creditors are not exempt from § 226.15.

3. *Spreader clause.* When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a ''spreader clause'' (also known as a ''dragnet'' or cross-collateralization clause), subsequent occurrences such as the opening of a plan or individual credit extensions are subject to the right of rescission to the same degree as if the security interest were taken directly to secure the open-end plan, unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent open-end credit extensions.

References

*Statute:* Sections 113, 125, 130, and the Housing and Community Development Technical Amendments Act of 1984, Sec. 205 (Pub. L. 98–479).

*Other sections:* Section 226.2 and appendix G.

*Previous regulation:* Section 226.9.

*1981 Changes:* Section 226.15 reflects the statutory amendments of 1980, providing for a limited right of rescission when individual credit extensions are made in accordance with a previously established credit limit for an open-end credit plan. The 1980 amendments provided that this limited rescission right be available for a three-year trial period. However, Pub. L. 98–479 now permanently exempts such individual credit extensions from the right of rescission.

The right to rescind applies not only to real property used as the consumer's principal dwelling, but to personal property as well. The regulation provides no specific text or format for the rescission notice.

When a consumer exercises the right to rescind, the creditor now has 20 days to return a consumer's money or property and take the necessary action to terminate the security interest. The creditor has 20 days to take possession of the money or property after the consumer's tender before the consumer may keep it without further obligation.

Under the revised regulation, the waiver provision has been relaxed. The lien status of the mortgage is irrelevant for purposes of the residential mortgage transaction exemption. The exemption for agricultural loans from the right to rescind has been deleted.

*Section 226.16—Advertising*

1. *Clear and conspicuous standard.* Section 226.16 is subject to the general ''clear and conspicuous'' standard for subpart B (see § 226.5(a)(1)) but prescribes no specific rules for the format of the necessary disclosures. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement.

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

*16(a) Actually available terms.*

1. *General rule.* To the extent that an advertisement mentions specific credit terms, it may state only those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low annual percentage rate that will not in fact be available at any time. Section 226.16(a) is not intended to inhibit the promotion of new credit programs, but to bar the advertising of terms that are not and will not be available. For example, a creditor may advertise terms that will be offered for only a limited period, or terms that will become available at a future date.

2. *Specific credit terms. Specific credit terms* is not limited to the disclosures required by the regulation but would include any specific components of a credit plan, such as the minimum periodic payment amount or seller's points in a plan secured by real estate.

*16(b) Advertisement of terms that require additional disclosures.*

1. *Terms requiring additional disclosures.* In § 226.16(b) the phrase *the terms required to be*

*disclosed under § 226.6* refers to the terms in § 226.6(a) and § 226.6(b).

2. *Use of positive terms.* An advertisement must state a credit term as a positive number in order to trigger additional disclosures. For example, *no annual membership fee* would not trigger the additional disclosures required by § 226.16(b). (See, however, the rules in § 226.16(d) relating to advertisements for home equity plans.)

3. *Implicit terms.* Section 226.16(b) applies even if the triggering term is not stated explicitly, but may be readily determined from the advertisement.

4. *Membership fees.* A membership fee is not a triggering term nor need it be disclosed under § 226.16(b)(3) if it is required for participation in the plan whether or not an open-end credit feature is attached. (See Comment 6(b)–1.)

5. *Variable-rate plans.* In disclosing the annual percentage rate in an advertisement for a variable-rate plan, as required by § 226.16(b)(2), the creditor may use an insert showing the current rate; may give the rate as of a specified recent date; or may disclose an estimated rate under § 226.5(c). The additional requirement in § 226.16(b)(2) to disclose the variable-rate feature may be satisfied by disclosing that *the annual percentage rate may vary* or a similar statement, but the advertisement need not include the information required by footnote 12 to § 226.6(a)(2).

6. *Discounted variable-rate plans—disclosure of the annual percentage rates.* The advertised annual percentage rates for discounted variable-rate plans must, in accordance with comment 6(a)(2)–10, include both the initial rate (with the statement of how long it will remain in effect) and the current indexed rate (with the statement that this second rate may vary). The options listed in comment I6(b)–5 may be used in disclosing the current indexed rate.

7. *Triggering terms.* The following are examples of terms that trigger additional disclosures:

• *Small monthly service charge on the remaining balance, which describes how the amount of a finance charge will be determined.*

• *12 percent Annual Percentage Rate* or *A $15 annual membership fee buys you $2,000 in credit,* which describe required disclosures using positive numbers.

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

9. *Deferred billing and deferred payment programs.* Statements such as ''Charge it—you won't be billed until May'' or ''You may skip your January payment'' are not in themselves triggering terms, since the timing for initial billing or for monthly payments are not terms required to be disclosed under § 226.6. However, a statement such as ''No finance charge until May'' or any other statement regarding when finance charges begin to accrue is a triggering term, whether appearing alone or in conjunction with a description of a deferred billing or deferred payment program such as the examples above.

*16(c) Catalogs or Other Multiple-page Advertisements; Electronic Advertisements*

1. *Definition.* The multiple-page advertisements to which § 226.16(c) refers are advertisements consisting of a series of sequentially numbered pages—for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.16(c).

*Paragraph 16(c)(1).*

1. *General.* Section 226.16(c)(1) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement or an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.16(b).

2. *Electronic advertisement.* If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.16(c)(1), any statement of terms set forth in § 226.6 appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

*Paragraph 16(c)(2).*

1. *Table or schedule if credit terms depend on outstanding balance.* If the credit terms of a plan vary depending on the amount of the balance outstanding, rather than the amount of any property purchased, a table or schedule complies with § 226.16(c)(2) if it includes the required disclosures for representative balances. For example, a creditor would disclose that a periodic rate of 1.5% is applied to balances of $500 or less, and a 1% rate is applied to balances greater than $500.

*16(d) Additional Requirements for Home Equity Plans*

1. *Trigger terms.* Negative as well as affirmative references trigger the requirement for additional information. For example, if a creditor states *no annual fee, no points,* or *we waive closing costs* in an advertisement, additional information must be provided. (See comment 16(d)–4 regarding the use of a phrase such as *no closing costs.*) Inclusion of a statement such as *low fees,* however, would not trigger the need to state additional information. References to payment terms include references to the draw period or any repayment period, to the length of the plan,

to how the minimum payments are determined and to the timing of such payments.

2. *Fees to open the plan.* Section 226.16(d)(1)(i) requires a disclosure of any fees imposed by the creditor or a third party to open the plan. In providing the fee information required under this paragraph, the corresponding rules for disclosure of this information apply. For example, fees to open the plan may be stated as a range. Similarly, if property insurance is required to open the plan, a creditor either may estimate the cost of the insurance or provide a statement that such insurance is required. (See the commentary to § 226.5b(d)(7) and (8).)

3. *Statements of tax deductibility.* An advertisement referring to deductibility for tax purposes is not misleading if it includes a statement such as ''consult a tax advisor regarding the deductibility of interest.''

4. *Misleading terms prohibited.* Under § 226.16(d)(5), advertisements may not refer to home equity plans as *free money* or use other misleading terms. For example, an advertisement could not state ''no closing costs'' or ''we waive closing costs'' if consumers may be required to pay any closing costs, such as recordation fees. In the case of property insurance, however, a creditor may state, for example, ''no closing costs'' even if property insurance may be required, as long as the creditor also provides a statement that such insurance may be required. (See the commentary to this section regarding fees to open a plan.)

5. *Relation to other sections.* Advertisements for home equity plans must comply with all provisions in § 226.16, not solely the rules in § 226.16(d). If an advertisement contains information (such as the payment terms) that triggers the duty under § 226.16(d) to state the annual percentage rate, the additional disclosures in § 226.16(b) must be provided in the advertisement. While § 226.16(d) does not require a statement of fees to use or maintain the plan (such as membership fees and transaction charges), such fees must be disclosed under § 226.16(b) (1) and (3).

6. *Inapplicability of closed-end rules.* Advertisements for home equity plans are governed solely by the requirements in § 226.16, and not by the closed-end advertising rules in § 226.24. Thus, if a creditor states payment information about the repayment phase, this will trigger the duty to provide additional information under § 226.16, but not under § 226.24.

7. *Balloon payment.* In some programs, a balloon payment will occur if only the minimum payments under the plan are made. If an advertisement for such a program contains any statement about a minimum periodic payment, the advertisement must also state that a balloon payment will result (not merely that a balloon payment ''may'' result). (See comment 5b(d)(5)(ii)–3 for guidance on items not required to be stated in the advertisement, and on situations in which the balloon payment requirement does not apply.)

References

*Statute:* Sections 141 and 143.

*Previous regulation:* Section 226.10 (a) through (c) and Interpretation § 226.1002.

*Other sections:* Sections 226.2 and 226.6.

*1981 changes:* Section 226.16 reflects the statutory changes to section 143 of the act which reduce both the number of triggering terms and the additional disclosures required by the use of those terms. Membership or participation fees are included among the additional disclosures required when a triggering term is used. The substance of Interpretation § 226.1002, requiring disclosure of representative amounts of credit in catalogs and multiple-page advertisements, has been incorporated in simplified form in paragraph (c).

SUBPART C—CLOSED-END CREDIT

*Section 226.17—General Disclosure Requirements*

*17(a) Form of disclosures.*

*Paragraph 17(a)(1).*

1. *Clear and conspicuous.* This standard requires that disclosures be in a reasonably understandable form. For example, while the regulation requires no mathematical progression or format, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other. In addition, although no minimum type size is mandated, the disclosures must be legible, whether typewritten, handwritten, or printed by computer.

2. *Segregation of disclosures.* The disclosures may be grouped together and segregated from other information in a variety of ways. For example, the disclosures may appear on a separate sheet of paper or may be set off from other information on the contract or other documents:

- By outlining them in a box
- By bold print dividing lines
- By a different color background
- By a different type style

(The general segregation requirement described in this subparagraph does not apply to the disclosures required under §§ 226.19(b) and 226.20(c) although the disclosures must be clear and conspicuous.)

3. *Location.* The regulation imposes no specific location requirements on the segregated disclosures. For example:

- They may appear on a disclosure statement separate from all other material.
- They may be placed on the same document with the credit contract or other information, so long as they are segregated from that information.
- They may be shown on the front or back of a document.

• They need not begin at the top of a page.
• They may be continued from one page to another.

4. *Content of segregated disclosures.* Footnotes 37 and 38 contain exceptions to the requirement that the disclosures under § 226.18 be segregated from material that is not directly related to those disclosures. Footnote 37 lists the items that may be added to the segregated disclosures, even though not directly related to those disclosures. Footnote 38 lists the items required under § 226.18 that may be deleted from the segregated disclosures and appear elsewhere. Any one or more of these additions or deletions may be combined and appear either together with or separate from the segregated disclosures. The itemization of the amount financed under § 226.18(c), however, must be separate from the other segregated disclosures under § 226.18. If a creditor chooses to include the security interest charges required to be itemized under § 226.4(e) and § 226.18(o) in the amount financed itemization, it need not list these charges elsewhere.

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

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 event 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 of 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.

6. *Multiple-purpose forms.* The creditor may design a disclosure statement that can be used for more than one type of transaction, so long as the required disclosures for individual transactions are clear and conspicuous. (See the Commentary to appendices G and H for a discussion of the treatment of disclosures that do not apply to specific transactions.) Any disclosure listed in § 226.18 (except the itemization of the amount financed under § 226.18(c)) may be included on a standard disclosure statement even though

not all of the creditor's transactions include those features. For example, the statement may include:

• The variable rate disclosure under § 226.18(f).

• The demand feature disclosure under § 226.18(i).

• A reference to the possibility of a security interest arising from a spreader clause, under § 226.18(m).

• The assumption policy disclosure under § 226.18(q).

• The required deposit disclosure under § 226.18(r).

7. *Balloon payment financing with leasing characteristics.* In certain credit sale or loan transactions, a consumer may reduce the dollar amount of the payments to be made during the course of the transaction by agreeing to make, at the end of the loan term, a large final payment based on the expected residual value of the property. The consumer may have a number of options with respect to the final payment, including, among other things, retaining the property and making the final payment, refinancing the final payment, or transferring the property to the creditor in lieu of the final payment. Such transactions may have some of the characteristics of lease transactions subject to Regulation M, but are considered credit transactions where the consumer assumes the indicia of ownership, including the risks, burdens and benefits of ownership upon consummation. These transactions are governed by the disclosure requirements of this regulation instead of Regulation M. Creditors should not include in the segregated Truth in Lending disclosures additional information. Thus, disclosures should show the large final payment in the payment schedule and should not, for example, reflect the other options available to the consumer at maturity.

*Paragraph 17(a)(2).*

1. *When disclosures must be more conspicuous.* The following rules apply to the requirement that the terms *annual percentage rate* and *finance charge* be shown more conspicuously:

• The terms must be more conspicuous only in relation to the other required disclosures under § 226.18. For example, when the disclosures are included on the contract document, those 2 terms need not be more conspicuous as compared to the heading on the contract document or information required by state law.

• The terms need not be more conspicuous except as part of the finance charge and annual percentage rate disclosures under § 226.18 (d) and (e), although they may, at the creditor's option, be highlighted wherever used in the required disclosures. For example, the terms may, but need not, be highlighted when used in disclosing a prepayment penalty under § 226.18(k) or a required deposit under § 226.18(r).

• The creditor's identity under § 226.18(a) may, but need not, be more prominently displayed than the finance charge and annual percentage rate.

• The terms need not be more conspicuous than figures (including, for example, numbers, percentages, and dollar signs)

2. *Making disclosures more conspicuous.* The terms *finance charge* and *annual percentage rate* may be made more conspicuous in any way that highlights them in relation to the other required disclosures. For example, they may be:

• Capitalized when other disclosures are printed in capital and lower case.

• Printed in larger type, bold print or different type face.

• Printed in a contrasting color.

• Underlined.

• Set off with asterisks.

*17(b) Time of disclosures.*

1. *Consummation.* As a general rule, disclosures must be made before ''consummation'' of the transaction. The disclosures need not be given by any particular time before consummation, except in certain mortgage transactions and variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year under § 226.19. (See the commentary to § 226.2(a)(13) regarding the definition of consummation.)

2. *Converting open-end to closed-end credit.* Except for home equity plans subject to § 226.5b in which the agreement provides for a repayment phase, if an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. (See the commentary to § 226.19(b) for the timing rules for additional disclosures required upon the conversion to a variable-rate transaction secured by a consumer's principal dwelling with a term greater than one year.) If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to § 226.5 regarding conversion of closed-end to open-end credit.)

3. *Disclosures provided on credit contracts.* Creditors must give the required disclosures to the consumer in writing, in a form that the consumer may keep, before consummation of the transaction. *See* § 226.17(a)(1) and (b). Sometimes the disclosures are placed on the same document with the credit contract.

Creditors are not required to give the consumer two separate copies of the document before consummation, one for the consumer to keep and a second copy for the consumer to execute. The disclosure requirement is satisfied if the creditor gives a copy of the document containing the unexecuted credit contract and disclosures to the consumer to read and sign; and the consumer receives a copy to keep at the time the consumer becomes obligated. It is not sufficient for the creditor merely to show the consumer the document containing the disclosures before the consumer signs and becomes obligated. The consumer must be free to take possession of and review the document in its entirety before signing.

i. *Example*. To illustrate:

A. A creditor gives a consumer a multiple-copy form containing a credit agreement and TILA disclosures. The consumer reviews and signs the form and returns it to the creditor, who separates the copies and gives one copy to the consumer to keep. The creditor has satisfied the disclosure requirement.

*17(c) Basis of disclosures and use of estimates. Paragraph 17(c)(1).*

1. *Legal obligation*. The disclosures shall reflect the credit terms to which the parties are legally bound as of the outset of the transaction. In the case of disclosures required under §226.20(c), the disclosures shall reflect the credit terms to which the parties are legally bound when the disclosures are provided. The legal obligation is determined by applicable state law or other law. (Certain transactions are specifically addressed in this commentary. See, for example, the discussion of buydown transactions elsewhere in the commentary to §226.17(c).)

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

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

• If the creditor offers a preferential rate, such as an employee preferred rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to §226.19(b) for an example of a preferred-rate transaction that is a variable-rate transaction.)

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

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

3. *Third-party buydowns*. In certain transactions, a seller or other third party may pay an amount, either to the creditor or to the consumer, in order to reduce the consumer's payments or buy down the interest rate for all or a portion of the credit term. For example, a consumer and a bank agree to a mortgage with an interest rate of 15% and level payments over 25 years. By a separate agreement, the seller of the property agrees to subsidize the consumer's payments for the first 2 years of the mortgage, giving the consumer an effective rate of 12% for that period.

• If the lower rate is reflected in the credit contract between the consumer and the bank, the disclosures must take the buydown into account. For example, the annual percentage rate must be a composite rate that takes account of both the lower initial rate and the higher subsequent rate, and the payment schedule disclosures must reflect the 2 payment levels. However, the amount paid by the seller would not be specifically reflected in the disclosures given by the bank, since that amount constitutes seller's points and thus is not part of the finance charge.

• If the lower rate is not reflected in the credit contract between the consumer and the bank and the consumer is legally bound to the 15% rate from the outset, the disclosures given by the bank must not reflect the seller buydown in any way. For example, the annual percentage rate and payment schedule would not take into account the reduction in the interest rate and payment level for the first 2 years resulting from the buydown.

4. *Consumer buydowns*. In certain transactions, the consumer may pay an amount to the creditor to reduce the payments or obtain a lower interest rate on the transaction. Consumer buydowns must be reflected in the disclosures given for that transaction. To illustrate, in a mortgage transaction, the creditor and consumer agree to a note specifying a 14 percent interest rate. However, in a separate document, the consumer agrees to pay an amount to the creditor at consummation in return for a reduction in the interest rate to 12 percent for a portion of the mortgage term. The amount paid by the consumer may be deposited in an escrow account or may be retained by the creditor.

Depending upon the buydown plan, the consumer's prepayment of the obligation may or may not result in a portion of the amount being credited or refunded to the consumer. In the disclosures given for the mortgage, the creditor must reflect the terms of the buydown agreement. For example:

• The amount paid by the consumer is a prepaid finance charge (even if deposited in an escrow account).

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

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

The rules regarding consumer buydowns do not apply to transactions known as ''lender buydowns,'' In lender buydowns. a creditor pays an amount (either into an account or to the party to whom the obligation is sold) to reduce the consumer's payments or interest rate for all or a portion of the credit term. Typically, these transactions are structured as a buydown of the interest rate during an initial period of the transaction with a higher than usual rate for the remainder of the term. The disclosures for lender buydowns should be based on the terms of the legal obligation between the consumer and the creditor. (See comment 17(c)(1)–3 for the analogous rules concerning third-party buydowns.)

5. *Split buydowns*. In certain transactions, a third party (such as a seller) and a consumer both pay an amount to the creditor to reduce the interest rate. The creditor must include the portion paid by the consumer in the finance charge and disclose the corresponding multiple payment levels and composite annual percentage rate. The portion paid by the third party and the corresponding reduction in interest rate, however, should not be reflected in the disclosures unless the lower rate is reflected in the credit contract. (See the discussion on third-party and consumer buydown transactions elsewhere in the commentary to §226.17(c).)

6. *Wrap-around financing*. Wrap-around transactions, usually loans, involve the creditor's wrapping the outstanding balance on an existing loan and advancing additional funds to the consumer. The pre-existing loan, which is wrapped, may be to the same consumer or to a different consumer. In either case, the consumer makes a single payment to the new creditor, who makes the payments on the pre-existing loan to the original creditor. Wrap-around loans or sales are considered new single-advance transactions, with an amount financed equalling the sum of the new funds advanced by the wrap creditor and the remaining principal owed to the original creditor on the pre-existing loan. In disclosing the itemization of the amount financed, the creditor may use a label such as ''the amount that will be paid to creditor X'' to describe the remaining principal balance on the pre-existing loan. This approach to Truth in Lending calculations has no effect on calculations required by other statutes, such as state usury laws.

7. *Wrap-around financing with balloon payments*. For wrap-around transactions involving a large final payment of the new funds before the maturity of the pre-existing loan, the amount financed is the sum of the new funds and the remaining principal on the pre-existing loan. The disclosures should be based on the shorter term of the wrap loan, with a large final payment of both the new funds and the total remaining principal on the pre-existing loan (although only the wrap loan will actually be paid off at that time).

8. *Basis of disclosures in variable-rate transactions*. The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer buydown, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to §226.17(c) for a discussion of buydown, discounted, and premium transactions and the commentary to section 226.19(a)(2) for a discussion of the redisclosure in certain residential mortgage transactions with a variable-rate feature).

9. *Use of estimates in variable-rate transactions*. The variable-rate feature does not, by itself, make the disclosures estimates.

10. *Discounted and premium variable-rate transactions*. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor

may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

i. When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use any index value in effect during the 45 day period before consummation in calculating a composite annual percentage rate.

ii. The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.

iii. If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.

iv. Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of ¼ of 1 percent applies, in accordance with § 226.22(a)(3).

v. Examples of discounted variable-rate transactions include:

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

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

C. Same loan as above, except with a 7½ percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

vi. A loan in which the initial interest rate is set according to the index or formula used for later adjustments but is not set at the value of the index or formula at consummation is not a discounted variable-rate loan. For example, if a creditor commits to an initial rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor should base its disclosures on the initial rate.

11. *Examples of variable-rate transactions.* Variable-rate transactions include:

• 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. Disclosures must be based on the payment amortization (unless the specified term of the obligation with renewals is shorter) and on the rate in effect at the time of consummation of the transaction. (Examples of conditions within a consumer's control include requirements that a consumer be current in payments or continue to reside in the mortgaged property. In contrast, setting a limit on the rate at which the creditor would be obligated to renew or reserving the right to change the credit standards at the time of renewal are examples of conditions outside a consumer's control.) If, however, a creditor is not obligated to renew as described above, disclosures must be based on the term of the balloon-payment loan. Disclosures also must be based on the term of the balloon-payment loan in balloon-payment instruments in which the legal obligation provides that the loan will be renewed by a ''refinancing'' of the obligation, as that term is defined by § 226.20(a). If it cannot be determined from the legal obligation that the loan will be renewed by a ''refinancing,'' disclosures must be based either on the term of the balloon-payment loan or on the payment amortization, depending on whether the creditor is unconditionally obligated to renew the loan as described above. (This discussion does not apply to construction loans subject to § 226.17(c)(6).)

• ''Shared-equity'' or ''shared-appreciation'' mortgages that have a fixed rate of interest and an appreciation share based on the consumer's equity in the mortgaged property. The appreciation share is payable in a lump sum at a specified time. Disclosures must be based on the fixed interest rate. (As discussed in the commentary to §226.2, other types of shared-equity arrangements are not considered ''credit'' and are not subject to Regulation Z.)

• 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 are to be based on the preferred rate.

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

• ''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. Disclosures are to be based on the fixed interest rate.

12. *Graduated payment adjustable rate mortgages.* These mortgages involve both a variable interest rate and scheduled variations in payment amounts during the loan term. For example, under these plans, a series of graduated payments may be scheduled before rate adjustments affect payment amounts, or the initial scheduled payment may remain constant for a set period before rate adjustments affect the payment amount. In any case, the initial payment amount may be insufficient to cover the scheduled interest, causing negative amortization from the outset of the transaction. In these transactions, the disclosures should treat these features as follows:

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

• The amount financed does not include the amount of negative amortization.

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

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

13. *Growth-equity mortgages.* Also referred to as payment-escalated mortgages, these mortgage plans involve scheduled payment increases to prematurely amortize the loan. The initial payment amount is determined as for a long-term loan with a fixed interest rate. Payment increases are scheduled periodically, based on changes in an index. The larger payments result in accelerated amortization of the loan. In disclosing these mortgage plans, creditors may either:

• Estimate the amount of payment increases, based on the best information reasonably available; or

• Disclose by analogy to the variable-rate disclosures in 226.18(f)(1).

(This discussion does not apply to growth-equity mortgages in which the amount of payment increases can be accurately determined at the time of disclosure. For these mortgages, as for graduated-payment mortgages, disclosures should reflect the scheduled increases in payments.)

14. *Reverse mortgages.* Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, typically involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer's death. Repayment of the loan (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these transactions, creditors must apply the following rules, as applicable:

• If the reverse mortgage has a specified period for disbursements but repayment is due only upon the occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as ''The disclosures assume that you will repay the loan at the time our payments to you end. As provided in your agreement, your repayment may be required at a different time.''

• If the reverse mortgage has neither a specified period for disbursements nor a specified repayment date and these terms will be determined solely by reference to future events including the consumer's death, the creditor may assume that the disbursements will end upon the consumer's death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval

for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures upon the occurence of the event estimated to be most likely to occur first.)

• In making the disclosures, the creditor must assume that all disbursements and accrued interest will be paid by the consumer. For example, if the note has a nonrecourse provision providing that the consumer is not obligated for an amount greater than the value of the house, the creditor must nonetheless assume that the full amount to be disbursed will be repaid. In this case, however, the creditor may include a statement such as ''The disclosures assume full repayment of the amount advanced plus accrued interest, although the amount you may be required to pay is limited by your agreement.''

• Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. Such loans are considered variable-rate mortgages, as described in comment 17(c)(1)–11, and the appreciation feature must be disclosed in accordance with §226.18(f)(1). If the reverse mortgage has a variable interest rate, is written for a term greater than one year, and is secured by the consumer's principal dwelling, the shared appreciation feature must be described under §226.19(b)(2)(vii).

15. *Morris Plan transactions.* When a deposit account is created for the sole purpose of accumulating payments and then is applied to satisfy entirely the consumer's obligation in the transaction, each deposit made into the account is considered the same as a payment on a loan for purposes of making disclosures.

16. *Number of transactions.* Creditors have flexibility in handling credit extensions that may be viewed as multiple transactions. For example:

• When a creditor finances the credit sale of a radio and a television on the same day, the creditor may disclose the sales as either 1 or 2 credit sale transactions.

• When a creditor finances a loan along with a credit sale of health insurance, the creditor may disclose in one of several ways: a single credit sale transaction, a single loan transaction, or a loan and a credit sale transaction.

• The separate financing of a downpayment in a credit sale transaction may, but need not, be disclosed as 2 transactions (a credit sale and a separate transaction for the financing of the downpayment).

17. *Special rules for tax refund anticipation loans.* Tax refund loans, also known as refund anticipation loans (RALs), are transactions in which a creditor will lend up to the amount of a consumer's expected tax refund. RAL agreements typically require repayment upon demand, but also may provide that repayment is required when the refund is made. The agreements also typically provide that if the amount of the refund is less than the payment due, the consumer must pay the difference. Repayment often is made by a preauthorized offset to a consumer's account held with the creditor when the refund has been deposited by electronic transfer. Creditors may charge fees for RALs in addition to fees for filing the consumer's tax return electronically. In RAL transactions subject to the regulation the following special rules apply:

• If, under the terms of the legal obligation, repayment of the loan is required when the refund is received by the consumer (such as by deposit into the consumer's account), the disclosures should be based on the creditor's estimate of the time the refund will be delivered even if the loan also contains a demand clause. The practice of a creditor to demand repayment upon delivery of refunds does not determine whether the legal obligation requires that repayment be made at that time; this determination must be made according to applicable state or other law. (See comment 17(c)(5)–1 for the rules regarding disclosures if the loan is payable solely on demand or is payable either on demand or on an alternate maturity date.)

• If the consumer is required to repay more than the amount borrowed, the difference is a finance charge unless excluded under §226.4. In addition, to the extent that any fees charged in connection with the loan (such as for filing the tax return electronically) exceed those fees for a comparable cash transaction (that is, filing the tax return electronically without a loan), the difference must be included in the finance charge.

18. *Pawn Transactions.* When, in connection with an extension of credit, a consumer pledges or sells an item to a pawnbroker creditor in return for a sum of money and retains the right to redeem the item for a greater sum (the redemption price) within a specified period of time, disclosures are required. In addition to other disclosure requirements that may be applicable under §226.18, for purposes of pawn transactions:

i. The amount financed is the initial sum paid to the consumer. The pawnbroker creditor need not provide a separate itemization of the amount financed if that entire amount is paid directly to the consumer and the disclosed description of the amount financed is ''the amount of cash given directly to you'' or a similar phrase.

ii. The finance charge is the difference between the initial sum paid to the consumer

and the redemption price plus any other finance charges paid in connection with the transaction. (See § 226.4.)

iii. The term of the transaction, for calculating the annual percentage rate, is the period of time agreed to by the pawnbroker creditor and the consumer. The term of the transaction does not include a grace period (including any statutory grace period) after the agreed redemption date.

*Paragraph 17(c)(2)(i).*

1. *Basis for estimates.* Disclosures may be estimated when the exact information is unknown at the time disclosures are made. Information is unknown if it is not reasonably available to the creditor at the time the disclosures are made. The ''reasonably available'' standard requires that the creditor, acting in good faith, exercise due diligence in obtaining information. For example, the creditor must at a minimum utilize generally accepted calculation tools, but need not invest in the most sophisticated computer program to make a particular type of calculation. The creditor normally may rely on the representations of other parties in obtaining information. For example, the creditor might look to the consumer for the time of consummation, to insurance companies for the cost of insurance, or to realtors for taxes and escrow fees. The creditor may utilize estimates in making disclosures even though the creditor knows that more precise information will be available by the point of consummation. However, new disclosures may be required under § 226.17(f) or § 226.19.

2. *Labelling estimates.* Estimates must be designated as such in the segregated disclosures. Even though other disclosures are based on the same assumption on which a specific estimated disclosure was based, the creditor has some flexibility in labelling the estimates. Generally, only the particular disclosure for which the exact information is unknown is labelled as an estimate. However, when several disclosures are affected because of the unknown information, the creditor has the option of labelling either every affected disclosure or only the disclosure primarily affected. For example, when the finance charge is unknown because the date of consummation is unknown, the creditor must label the finance charge as an estimate and may also label as estimates the total of payments and the payment schedule. When many disclosures are estimates, the creditor may use a general statement, such as ''all numerical disclosures except the late payment disclosure are estimates,'' as a method to label those disclosures as estimates.

3. *Simple-interest transactions.* If consumers do not make timely payments in a simple-interest transaction, some of the amounts calculated for Truth in Lending disclosures will differ from amounts that consumers will actually pay over the term of the transaction. Creditors may label disclosures as estimates in these transactions. For example, because the finance charge and total of payments may be larger than disclosed if consumers make late payments, creditors may label the finance charge and total of payments as estimates. On the other hand, creditors may choose not to label disclosures as estimates and may base all disclosures on the assumption that payments will be made on time, disregarding any possible inaccuracies resulting from consumers' payment patterns.

*Paragraph 17(c)(2)(ii).*

1. *Per-diem interest.* This paragraph applies to any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures are not labeled as estimates. For example, if the amount of per-diem interest used to prepare disclosures is less than the amount of per-diem interest charged at consummation, and as a result the finance charge is understated by $200, the disclosed finance charge is considered accurate even though the understatement is not within the $100 tolerance of § 226.18(d)(1), and the finance charge was not labeled as an estimate. In this example, if in addition to the understatement related to the per-diem interest, a $90 fee is incorrectly omitted from the finance charge, causing it to be understated by a total of $290, the finance charge is considered accurate because the $90 fee is within the tolerance in § 226.18(d)(1).

*Paragraph 17(c)(3)*

1. *Minor variations.* Section 226.17(c)(3) allows creditors to disregard certain factors in calculating and making disclosures. For example:

• Creditors may ignore the effects of collecting payments in whole cents. Because payments cannot be collected in fractional cents, it is often difficult to amortize exactly an obligation with equal payments; the amount of the last payment may require adjustment to account for the rounding of the other payments to whole cents.

• Creditors may base their disclosures on calculation tools that assume that all months have an equal number of days, even if their practice is to take account of the variations in months for purposes of collecting interest. For example, a creditor may use a calculation tool based on a 360-day year, when it in fact collects interest by applying a factor of 1/365 of the annual rate to 365 days. This rule does not, however, authorize creditors to ignore, for disclosure

purposes, the effects of applying 1/360 of an annual rate to 365 days.

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

*Paragraph 17(c)(4).*

1. *Payment schedule irregularities.* When one or more payments in a transaction differ from the others because of a long or short first period, the variations may be ignored in disclosing the payment schedule, finance charge, annual percentage rate, and other terms. For example:

• A 36-month auto loan might be consummated on June 8 with payments due on July 1 and the first of each succeeding month. The creditor may base its calculations on a payment schedule that assumes 36 equal intervals and 36 equal installment payments, even though a precise computation would produce slightly different amounts because of the shorter first period.

• By contrast, in the same example, if the first payment were not scheduled until August 1, the irregular first period would exceed the limits in §226.17(c)(4); the creditor could not use the special rule and could not ignore the extra days in the first period in calculating its disclosures.

2. *Measuring odd periods.* In determining whether a transaction may take advantage of the rule in §226.17(c)(4), the creditor must measure the variation against a regular period. For purposes of that rule:

• The first period is the period from the date on which the finance charge begins to be earned to the date of the first payment.

• The term is the period from the date on which the finance charge begins to be earned to the date of the final payment.

• The regular period is the most common interval between payments in the transaction.

In transactions involving regular periods that are monthly, semimonthly or multiples of a month, the length of the irregular and regular periods may be calculated on the basis of either the actual number of days or an assumed 30-day month. In other transactions, the length of the periods is based on the actual number of days.

3. *Use of special rules.* A creditor may utilize the special rules in §226.17(c)(4) for purposes of calculating and making some disclosures but may elect not to do so for all of the disclosures. For example, the variations may be ignored in calculating and disclosing the annual percentage rate but taken into account in calculating and disclosing the finance charge and payment schedule.

4. *Relation to prepaid finance charges.* Prepaid finance charges, including ''odd-days'' or ''per-diem'' interest, paid prior to or at closing may not be treated as the first payment on a loan. Thus, creditors may not disregard an irregularity in disclosing such finance charges.

*Paragraph 17(c)(5).*

1. *Demand disclosures.* Disclosures for demand obligations are based on an assumed 1-year term, unless an alternate maturity date is stated in the legal obligation. Whether an alternate maturity date is stated in the legal obligation is determined by applicable law. An alternate maturity date is not inferred from an informal principal reduction agreement or a similar understanding between the parties. However, when the note itself specifies a principal reduction schedule (for example, ''payable on demand or $2,000 plus interest quarterly''), an alternate maturity is stated and the disclosures must reflect that date.

2. *Future event as maturity date.* An obligation whose maturity date is determined solely by a future event, as for example, a loan payable only on the sale of property, is not a demand obligation. Because no demand feature is contained in the obligation, demand disclosures under §226.18(i) are inapplicable. The disclosures should be based on the creditor's estimate of the time at which the specified event will occur, and may indicate the basis for the creditor's estimate, as noted in the commentary to §226.17(a).

3. *Demand after stated period.* Most demand transactions contain a demand feature that may be exercised at any point during the term, but certain transactions convert to demand status only after a fixed period. For example, in States prohibiting due-on-sale clauses, the Federal National Mortgage Association (FNMA) requires mortgages that it purchases to include a call option rider that may be exercised after 7 years. These mortgages are generally written as long-term obligations, but contain a demand feature that may be exercised only within a 30-day period at 7 years. The disclosures for these transactions should be based upon the legally agreed-upon maturity date. Thus, if a mortgage containing the 7-year FNMA call option is written as a 20-year obligation, the disclosures should be based on the 20-year term, with the demand feature disclosed under §226.18(i).

4. *Balloon mortgages.* Balloon payment mortgages, with payments based on a long-term amortization schedule and a large final payment due after a shorter term, are not demand obligations unless a demand feature is specifically contained in the contract. For example, a mortgage with a term of 5 years and a payment schedule based on 20 years would not be treated as a mortgage with a demand feature, in the absence of any contractual demand provisions. In this type of mortgage, disclosures should be based on the 5-year term.

*Paragraph 17(c)(6).*

1. *Series of advances.* Section 226.17(c)(6)(i) deals with a series of advances under an agreement to extend credit up to a certain amount. A creditor may treat all of the advances as a single transaction or disclose each advance as a separate transaction. If these advances are treated as 1 transaction and the timing and amounts of advances are unknown, creditors must make disclosures based on estimates, as provided in §226.17(c)(2). If the advances are disclosed separately, disclosures must be provided before each advance occurs, with the disclosures for the first advance provided by consummation.

2. *Construction loans.* Section 226.17(c)(6)(ii) provides a flexible rule for disclosure of construction loans that may be permanently financed. These transactions have 2 distinct phases, similar to 2 separate transactions. The construction loan may be for initial construction or subsequent construction, such as rehabilitation or remodelling. The construction period usually involves several disbursements of funds at times and in amounts that are unknown at the beginning of that period, with the consumer paying only accrued interest until construction is completed. Unless the obligation is paid at that time, the loan then converts to permanent financing in which the loan amount is amortized just as in a standard mortgage transaction. Section 226.17(c)(6)(ii) permits the creditor to give either one combined disclosure for both the construction financing and the permanent financing, or a separate set of disclosures for the 2 phases. This rule is available whether the consumer is initially obligated to accept construction financing only or is obligated to accept both construction and permanent financing from the outset. If the consumer is obligated on both phases and the creditor chooses to give 2 sets of disclosures, both sets must be given to the consumer initially, because both transactions would be consummated at that time. (appendix D provides a method of calculating the annual percentage rate and other disclosures for construction loans, which may be used, at the creditor's option, in disclosing construction financing.)

3. *Multiple-advance construction loans.* Section 226.17(c)(6)(i) and (ii) are not mutually exclusive. For example, in a transaction that finances the construction of a dwelling that may be permanently financed by the same creditor, the construction phase may consist of a series of advances under an agreement to extend credit up to a certain amount. In these cases, the creditor may disclose the construction phase as either 1 or more than 1 transaction and also disclose the permanent financing as a separate transaction.

4. *Residential mortgage transaction.* See the commentary to §226.2(a)(24) for a discussion of the effect of §226.17(c)(6) on the definition of a residential mortgage transaction.

5. *Allocation of points.* When a creditor utilizes the special rule in §226.17(c)(6) to disclose credit extensions as multiple transactions, buyers points or similar amounts imposed on the consumer must be allocated for purposes of calculating disclosures. While such amounts should not be taken into account more than once in making calculations, they may be allocated between the transactions in any manner the creditor chooses. For example, if a construction-permanent loan is subject to 5 points imposed on the consumer and the creditor chooses to disclose the 2 phases separately, the 5 points may be allocated entirely to the construction loan, entirely to the permanent loan, or divided in any manner between the two. However, the entire 5 points may not be applied twice, that is, to both the construction and the permanent phases.

*17(d) Multiple creditors; multiple consumers.*

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

- The creditors must choose which of them will make the disclosures.
- A single, complete set of disclosures must be provided, rather than partial disclosures from several creditors.
- All disclosures for the transaction must be given, even if the disclosing creditor would not otherwise have been obligated to make a particular disclosure. For example, if one of the creditors is the seller, the total sale price disclosure under §226.18(j) must be made, even though the disclosing creditor is not the seller.

2. *Multiple consumers.* When two consumers are joint obligors with primary liability on an obligation, the disclosures may be given to either one of them. If one consumer is merely a surety or guarantor, the disclosures must be given to the principal debtor. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under §226.23, although the disclosures required under §226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program.

*17(e) Effect of subsequent events.*

1. *Events causing inaccuracies.* Inaccuracies in disclosures are not violations if attributable to events occurring after the disclosures are made. For example, when the consumer fails to fulfill a prior commitment to keep the collateral insured and the creditor then provides the coverage and charges the consumer for it, such a change does not make the original disclosures inaccurate. The creditor may, however, be required to make new disclosures under §226.17(f) or §226.19 if the events occurred between disclosure and consummation or under §226.20 if the events occurred after consummation.

*17(f) Early disclosures.*

1. *Change in rate or other terms.* Redisclosure is required for changes that occur between the time disclosures are made and consummation if the annual percentage rate in the consummated transaction exceeds the limits prescribed in this section, even if the initial disclosures would be considered accurate under the tolerances in §226.18(d) or 226.22(a). To illustrate:

i. *General.* A. If disclosures are made in a regular transaction on July 1, the transaction is consummated on July 15, and the actual annual percentage rate varies by more than ⅛ 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.

B. In a regular transaction, if early disclosures are marked as estimates and the disclosed annual percentage rate is within ⅛ of 1 percentage point of the rate at consummation, the creditor need not redisclose the changed terms (including the annual percentage rate).

ii. *Nonmortgage loan.* If disclosures are made on July 1, the transaction is consummated on July 15, 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 that were not marked as estimates. (See §226.18(d)(2) of this part.)

iii. *Mortgage loan.* At the time TILA disclosures are prepared in July, the loan closing is scheduled for July 31 and the creditor does not plan to collect per-diem interest at consummation. Consummation actually occurs on August 5, and per-diem interest for the remainder of August is collected as a prepaid finance charge. Assuming there were no other changes requiring redisclosure, the creditor may rely on the disclosures prepared in July that were accurate when they were prepared. However, if the creditor prepares new disclosures in August that will be provided at consummation, the new disclosures must take into account the amount of the per-diem interest known to the creditor at that time.

2. *Variable rate.* The addition of a variable rate feature to the credit terms, after early disclosures are given, requires new disclosures.

3. *Content of new disclosures.* If redisclosure is required, the creditor has the option of either providing a complete set of new disclosures, or providing disclosures of only the terms that vary from those originally disclosed. (See the commentary to §226.19(a)(2).)

4. *Special rules.* In residential mortgage transactions subject to §226.19, the creditor must redisclose if, between the delivery of the required early disclosures and consummation, the annual percentage rate changes by more than a stated tolerance. When subsequent events occur *after* consummation, new disclosures are required only if there is a refinancing or an assumption within the meaning of §226.20.

*Paragraph 17(f)(2).*

1. *Irregular transactions.* For purposes of this paragraph, a transaction is deemed to be ''irregular'' according to the definition in footnote 46 of §226.22(a)(3).

*17(g) Mail or telephone orders—delay in disclosures.*

1. *Conditions for use.* When the creditor receives a mail or telephone request for credit, the creditor may delay making the disclosures until the first payment is due if the following conditions are met:

- The credit request is initiated without face-to-face or direct telephone solicitation. (Creditors may, however, use the special rule when credit requests are solicited by mail.)
- The creditor has supplied the specified credit information about its credit terms either to the individual consumer or to the public generally. That information may be distributed through advertisements, catalogs, brochures, special mailers, or similar means.

2. *Insurance.* The location requirements for the insurance disclosures under §226.18(n) permit them to appear apart from the other disclosures. Therefore, a creditor may mail an insurance authorization to the consumer and then prepare the other disclosures to reflect whether or not the authorization is completed by the consumer. Creditors may also disclose the insurance cost on a unit-cost basis, if the transaction meets the requirements of §226.17(g).

*17(h) Series of sales—delay in disclosures.*

1. *Applicability.* The creditor may delay the disclosures for individual credit sales in a series of such sales until the first payment is due on the current sale, assuming the 2 conditions in this paragraph are met. If those conditions are not met, the general timing rules in §266.17(b) apply.

2. *Basis of disclosures.* Creditors structuring disclosures for a series of sales under §226.17(h) may compute the total sale price as either:

- The cash price for the sale plus that portion of the finance charge and other charges applicable to that sale; or
- The cash price for the sale, other charges applicable to the sale, and the total finance charge and outstanding principal.

*17(i) Interim student credit extensions.*

1. *Definition.* Student credit plans involve extensions of credit for education purposes where the repayment amount and schedule are not known at the time credit is advanced. These plans include loans made

under any student credit plan, whether government or private, where the repayment period does not begin immediately. (Certain student credit plans that meet this definition are exempt from Regulation Z. See §226.3(f).) Creditors in interim student credit extensions need not disclose the terms set forth in this paragraph at the time the credit is actually extended but must make complete disclosures at the time the creditor and consumer agree upon the repayment schedule for the total obligation. At that time, a new set of disclosures must be made of all applicable items under §226.18.

2. *Basis of disclosures*. The disclosures given at the time of execution of the interim note should reflect two annual percentage rates, one for the interim period and one for the repayment period. The use of §226.17(i) in making disclosures does not, by itself, make those disclosures estimates. Any portion of the finance charge, such as statutory interest, that is attributable to the interim period and is paid by the student (either as a prepaid finance charge, periodically during the interim period, in one payment at the end of the interim period, or capitalized at the beginning of the repayment period) must be reflected in the interim annual percentage rate. Interest subsidies, such as payments made by either a state or the Federal government on an interim loan, must be excluded in computing the annual percentage rate on the interim obligation, when the consumer has no contingent liability for payment of those amounts. Any finance charges that are paid separately by the student at the outset or withheld from the proceeds of the loan are prepaid finance charges. An example of this type of charge is the loan guarantee fee. The sum of the prepaid finance charges is deducted from the loan proceeds to determine the amount financed and included in the calculation of the finance charge.

3. *Consolidation*. Consolidation of the interim student credit extensions through a renewal note with a set repayment schedule is treated as a new transaction with disclosures made as they would be for a refinancing. Any unearned portion of the finance charge must be reflected in the new finance charge and annual percentage rate, and is not added to the new amount financed. In itemizing the amount financed under §226.18(c), the creditor may combine the principal balances remaining on the interim extensions at the time of consolidation and categorize them as the amount paid on the consumer's account.

4. *Approved student credit forms*. See the commentary to appendix H regarding disclosure forms approved for use in certain student credit programs.

References

*Statute:* Sections 121, 122, 124, and 128, and the Higher Education Act of 1965 (20 U.S.C. 1071) as amended by Pub. L. 97–35, August 13, 1981.

*Other sections:* Section 226.2 and appendix H.

*Previous regulation:* Sections 226.6 and 226.8.

*1981 changes:* With few exceptions, the disclosures must now appear apart from all other information, and may not be interspersed with that information. The disclosures must be based on the legal obligation between the parties, rather than any side agreement.

The assumed maturity period for demand loans has been increased from 6 months to 1 year. Any alternate maturity date must be stated in the legal obligation rather than inferred from the documents, in order to form a basis for disclosures.

In multiple-advance transactions, a series of advances up to a certain amount and construction loans that may be permanently financed may be disclosed, at the creditor's option, as either a single transaction or several transactions. Appendix D is applicable only to multiple advances for the construction of a dwelling, whereas its predecessor, Interpretation §226.813, could be used for all multiple-advance transactions.

If disclosures are made before the date of consummation, the creditor need not provide updated disclosures at consummation unless the annual percentage rate has changed beyond certain limits or a variable rate feature has been added.

*Section 226.18—Content of Disclosures*

1. *As applicable*. The disclosures required by this section need be made only as applicable. Any disclosure not relevant to a particular transaction may be eliminated entirely. For example:

• In a loan transaction, the creditor may delete disclosure of the total sale price.

• In a credit sale requiring disclosure of the total sale price under §226.18(j), the creditor may delete any reference to a downpayment where no downpayment is involved.

Where the amounts of several numerical disclosures are the same, the ''as applicable'' language also permits creditors to combine the terms, so long as it is done in a clear and conspicuous manner. For example:

• In a transaction in which the amount financed equals the total of payments, the creditor may disclose ''amount financed/total of payments,'' together with descriptive language, followed by a single amount.

• However, if the terms are separated on the disclosure statement and separate space is provided for each amount, both disclosures must be completed, even though the same amount is entered in each space.

2. *Format*. See the commentary to §226.17 and appendix H for a discussion of the format to be used in making these disclosures, as well as acceptable modifications.

*18(a) Creditor.*

1. *Identification of creditor.* The creditor making the disclosures must be identified. This disclosure may, at the creditor's option, appear apart from the other disclosures. Use of the creditor's name is sufficient, but the creditor may also include an address and/or telephone number. In transactions with multiple creditors, any one of them may make the disclosures; the one doing so must be identified.

*18(b) Amount financed.*

1. *Disclosure required.* The net amount of credit extended must be disclosed using the term *amount financed* and a descriptive explanation similar to the phrase in the regulation.

2. *Rebates and loan premiums.* In a loan transaction, the creditor may offer a premium in the form of cash or merchandise to prospective borrowers. Similarly, in a credit sale transaction, a seller's or manufacturer's rebate may be offered to prospective purchasers of the creditor's goods or services. At the creditor's option, these amounts may be either reflected in the Truth in Lending disclosures or disregarded in the disclosures. If the creditor chooses to reflect them in the § 226.18 disclosures, rather than disregard them, they may be taken into account in any manner as part of those disclosures.

*Paragraph 18(b)(1).*

1. *Downpayments.* A downpayment is defined in § 226.2(a)(18) to include, at the creditor's option, certain deferred downpayments or pick-up payments. A deferred downpayment that meets the criteria set forth in the definition may be treated as part of the downpayment, at the creditor's option.

• Deferred downpayments that are not treated as part of the downpayment (either because they do not meet the definition or because the creditor simply chooses not to treat them as downpayments) are included in the amount financed.

• Deferred downpayments that are treated as part of the downpayment are not part of the amount financed under § 226.18(b)(1).

*Paragraph 18(b)(2).*

1. *Adding other amounts.* Fees or other charges that are not part of the finance charge and that are financed rather than paid separately at consummation of the transaction are included in the amount financed. Typical examples are real estate settlement charges and premiums for voluntary credit life and disability insurance excluded from the finance charge under § 226.4. This paragraph does not include any amounts already accounted for under § 226.18(b)(1), such as taxes, tag and title fees, or the costs of accessories or service policies that the creditor includes in the cash price.

*Paragraph 18(b)(3).*

1. *Prepaid finance charges.* Prepaid finance charges that are paid separately in cash or by check should be deducted under § 226.18(b)(3) in calculating the amount financed. To illustrate:

• A consumer applies for a loan of $2,500 with a $40 loan fee. The face amount of the note is $2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of § 226.18(b)(1) is $2,500 and $40 should be deducted under § 226.18(b(3), thereby yielding an amount financed of $2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the note. Creditors have the option, when the charges are not add-on or discount charges, of determining a principal loan amount under § 226.18(b)(1) that either includes or does not include the amount of the finance charges. (Thus the principal loan amount may, but need not, be determined to equal the face amount of the note.) When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under § 226.18(b)(3). When the finance charges are not included in the principal loan amount, they should not be deducted under § 226.18(b)(3). The following examples illustrate the application of § 226.18(b) to this type of transaction. Each example assumes a loan request of $2,500 with a loan fee of $40; the creditor assesses the loan fee by increasing the face amount of the note to $2,540.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,540, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of $2,500.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,500.

The same rules apply when the creditor does not increase the face amount of the note by the amount of the charge but collects the charge by withholding it from the amount advanced to the consumer. To illustrate, the following examples assume a loan request of $2,500 with a loan fee of $40; the creditor prepares a note for $2,500 and advances $2,460 to the consumer.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of $2,460.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,460, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,460.

Thus in the examples where the creditor derives the net amount of credit by determining a principal loan amount that does not include the amount of the finance charge, no subtraction is appropriate. Creditors should note, however, that although the charges are not subtracted as *prepaid* finance charges in those examples, they are nonetheless finance charges and must be treated as such.

2. *Add-on or discount charges.* All finance charges must be deducted from the amount of credit in calculating the amount financed. If the principal loan amount reflects finance charges that meet the definition of a prepaid finance charge in § 226.2, those charges are included in the § 226.18(b)(1) amount and deducted under § 226.18(b)(3). However, if the principal loan amount includes finance charges that do not meet the definition of a prepaid finance charge, the § 226.18(b)(1) amount must exclude those finance charges. The following examples illustrate the application of § 226.18(b) to these types of transactions. Each example assumes a loan request of $1000 for 1 year, subject to a 6 percent precomputed interest rate, with a $10 loan fee paid separately at consummation.

• The creditor assesses add-on interest of $60 which is added to the $1000 in loan proceeds for an obligation with a face amount of $1060. The principal for purposes of § 226.18(b)(1) is $1000, no amounts are added under § 226.18(b)(2), and the $10 loan fee is a prepaid finance charge to be deducted under § 226.18(b)(3). The amount financed is $990.

• The creditor assesses discount interest of $60 and distributes $940 to the consumer, who is liable for an obligation with a face amount of $1000. The principal under § 226.18(b)(1) is $940, which results in an amount financed of $930, after deduction of the $10 prepaid finance charge under § 226.18(b)(3).

• The creditor assesses $60 in discount interest by increasing the face amount of the obligation to $1060, with the consumer receiving $1000. The principal under § 226.18(b)(1) is thus $1000 and the amount financed $990, after deducting the $10 prepaid finance charge under § 226.18(b)(3).

*18(c) Itemization of amount financed.*

1. *Disclosure required.* The creditor has 2 alternatives in complying with § 226.18(c):

• The creditor may inform the consumer, on the segregated disclosures, that a written itemization of the amount financed will be provided on request, furnishing the itemization only if the customer in fact requests it.

• The creditor may provide an itemization as a matter of course, without notifying the consumer of the right to receive it or waiting for a request.

Whether given as a matter of course or only on request, the itemization must be provided at the same time as the other disclosures required by § 226.18, although separate from those disclosures.

2. *Additional information.* Section 226.18(c) establishes only a minimum standard for the material to be included in the itemization of the amount financed. Creditors have considerable flexibility in revising or supplementing the information listed in § 226.18(c) and shown in model form H–3, although no changes are required. The creditor may, for example, do one or more of the following:

i. Include amounts that reflect payments not part of the amount financed. For example, escrow items and certain insurance premiums may be included, as discussed in the commentary to § 226.18(g).

ii. Organize the categories in any order. For example, the creditor may rearrange the terms in a mathematical progression that depicts the arithmetic relationship of the terms.

iii. Add categories. For example, in a credit sale, the creditor may include the cash price and the downpayment. If the credit sale involves a trade-in of the consumer's car and an existing lien on that car exceeds the value of the trade-in amount, the creditor may disclose the consumer's trade-in value, the creditor's payoff of the existing lien, and the resulting additional amount financed.

iv. Further itemize each category. For example, the amount paid directly to the consumer may be subdivided into the amount given by check and the amount credited to the consumer's savings account.

v. Label categories with different language from that shown in § 226.18(c). For example, an amount paid on the consumer's account may be revised to specifically identify the account as ''your auto loan with us.''

vi. Delete, leave blank, mark ''N/A'' or otherwise not inapplicable categories in the itemization. For example, in a credit sale with no prepaid finance charges or amounts paid to others, the amount financed may consist of only the cash price less downpayment. In this case, the itemization may be composed of only a single category and all other categories may be eliminated.

3. *Amounts appropriate to more than one category.* When an amount may appropriately be placed in any of several categories and the creditor does not wish to revise the categories shown in § 226.18(c), the creditor has considerable flexibility in determining where to show the amount. For example:

• In a credit sale, the portion of the purchase price being financed by the creditor may be viewed as either an amount paid to the consumer or an amount paid on the consumer's account.

4. *RESPA transactions.* The Real Estate Settlement Procedures Act (RESPA) requires creditors to provide a good faith estimate of closing costs and a settlement statement

listing the amounts paid by the consumer. Transactions subject to RESPA are exempt from the requirements of §226.18(c) if the creditor complies with RESPA's requirements for a good faith estimate and settlement statement. The itemization of the amount financed need not be given, even though the content and timing of the good faith estimate and settlement statement under RESPA differ from the requirements of §§226.18(c) and 226.19(a)(2). If a creditor chooses to substitute RESPA's settlement statement for the itemization when redisclosure is required under §226.19(a)(2), the statement must be delivered to the consumer at or prior to consummation. The disclosures required by §§226.18(c) and 226.19(a)(2) may appear on the same page or on the same document as the good faith estimate or the settlement statement, so long as the requirements of §226.17(a) are met.

*Paragraph 18(c)(1)(i).*

1. *Amounts paid to consumer.* This encompasses funds given to the consumer in the form of cash or a check, including joint proceeds checks, as well as funds placed in an asset account. It may include money in an interest-bearing account even if that amount is considered a required deposit under §226.18(r). For example, in a transaction with total loan proceeds of $500, the consumer receives a check for $300 and $200 is required by the creditor to be put into an interest-bearing account. Whether or not the $200 is a required deposit, it is part of the amount financed. At the creditor's option, it may be broken out and labeled in the itemization of the amount financed.

*Paragraph 18(c)(1)(ii).*

1. *Amounts credited to consumer's account.* The term *consumer's account* refers to an account in the nature of a debt with that creditor. It may include, for example, an unpaid balance on a prior loan, a credit sale balance or other amounts owing to that creditor. It does not include asset accounts of the consumer such as savings or checking accounts.

*Paragraph 18(c)(1)(iii).*

1. *Amounts paid to others.* This includes, for example, tag and title fees; amounts paid to insurance companies for insurance premiums; security interest fees, and amounts paid to credit bureaus, appraisers or public officials. When several types of insurance premiums are financed, they may, at the creditor's option, be combined and listed in one sum, labeled ''insurance'' or similar term. This includes, but is not limited to, different types of insurance premiums paid to one company and different types of insurance premiums paid to different companies. Except for insurance companies and other categories noted in footnote 41, third parties must be identified by name.

2. *Charges added to amounts paid to others.* A sum is sometimes added to the amount of a fee charged to a consumer for a service provided by a third party (such as for an extended warranty or a service contract) that is payable in the same amount in comparable cash and credit transactions. In the credit transaction, the amount is retained by the creditor. Given the flexibility permitted in meeting the requirements of the amount financed itemization (see the commentary to §226.18(c)), the creditor in such cases may reflect that the creditor has retained a portion of the amount paid to others. For example, the creditor could add to the category ''amount paid to others'' language such as ''(we may be retaining a portion of this amount).''

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

1. *Prepaid finance charge.* Prepaid finance charges that are deducted under §226.18(b)(3) must be disclosed under this section. The prepaid finance charges must be shown as a total amount but may, at the creditor's option, also be further itemized and described. All amounts must be reflected in this total, even if portions of the prepaid finance charge are also reflected elsewhere. For example, if at consummation the creditor collects interim interest of $30 and a credit report fee of $10, a total prepaid finance charge of $40 must be shown. At the creditor's option, the credit report fee paid to a third party may also be shown elsewhere as an amount included in §226.18(c)(1)(iii). The creditor may also further describe the 2 components of the prepaid finance charge, although no itemization of this element is required by §226.18(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 listed on the line for mortgage insurance on the settlement statement (line 1002 on HUD–1 or HUD 1–A), without adjustment, even if the actual amount collected at settlement may vary because of RESPA's escrow accounting rules. Figures for mortgage insurance disclosed in conformance with RESPA shall be deemed to be accurate for purposes of Regulation Z.

*18(d) Finance charge.*

1. *Disclosure required.* The creditor must disclose the finance charge as a dollar amount, using the term *finance charge*, and must include a brief description similar to that in §226.18(d). The creditor may, but need not, further modify the descriptor for variable rate transactions with a phrase such as *which is subject to change*. The finance charge must be shown on the disclosures only as a total amount; the elements of the finance

charge must not be itemized in the segregated disclosures, although the regulation does not prohibit their itemization elsewhere.

2. [Reserved]

*18(d)(2) Other credit.*

1. *Tolerance.* When a finance charge error results in a misstatement of the amount financed, or some other dollar amount for which the regulation provides no specific tolerance, the misstated disclosure does not violate the act or the regulation if the finance charge error is within the permissible tolerance under this paragraph.

*18(e) Annual percentage rate.*

1. *Disclosure required.* The creditor must disclose the cost of the credit as an annual rate, using the term *annual percentage rate,* plus a brief descriptive phrase comparable to that used in §226.18(e). For variable rate transactions, the descriptor may be further modified with a phrase such as *which is subject to change.* Under §226.17(a), the terms *annual percentage rate* and *finance charge* must be more conspicuous than the other required disclosures.

2. *Exception.* Footnote 42 provides an exception for certain transactions in which no annual percentage rate disclosure is required.

*18(f) Variable rate.*

1. *Coverage.* The requirements of §226.18(f) apply to all transactions in which the terms of the legal obligation allow the creditor to increase the rate originally disclosed to the consumer. It includes not only increases in the interest rate but also increases in other components, such as the rate of required credit life insurance. The provisions, however, do not apply to increases resulting from delinquency (including late payment), default, assumption, acceleration or transfer of the collateral. Section 226.18(f)(1) applies to variable-rate transactions that are not secured by the consumer's principal dwelling and to those that are secured by the principal dwelling but have a term of one year or less. Section 226.18(f)(2) applies to variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. Moreover, transactions subject to §226.18(f)(2) are subject to the special early disclosure requirements of §226.19(b). (However, ''shared-equity'' or ''shared-appreciation'' mortgages are subject to the disclosure requirements of §226.18(f)(1) and not to the requirements of §§226.18(f)(2) and 226.19(b) regardless of the general coverage of those sections.) Creditors are permitted under footnote 43 to substitute in any variable-rate transaction the disclosures required under §226.19(b) for those disclosures ordinarily required under 226.18(f)(1). Creditors who provide variable-rate disclosures under §226.19(b) must comply with all of the requirements of that section, including the timing of disclosures, and must also provide the disclosures required under §226.18(f)(2). Creditors utilizing footnote 43 may, but need not, also provide disclosures pursuant to §226.20(c). (Substitution of disclosures under §226.18(f)(1) in transactions subject to §226.19(b) is not permitted under the footnote.)

*Paragraph 18(f)(1).*

1. *Terms used in disclosure.* In describing the variable rate feature, the creditor need not use any prescribed terminology. For example, limitations and hypothetical examples may be described in terms of interest rates rather than annual percentage rates. The model forms in appendix H provide examples of ways in which the variable rate disclosures may be made.

2. *Conversion feature.* In variable-rate transactions with an option permitting consumers to convert to a fixed-rate transaction, the conversion option is a variable-rate feature that must be disclosed. In making disclosures under §226.18(f)(1), creditors should disclose the fact that the rate may increase upon conversion; identify the index or formula used to set the fixed rate; and state any limitations on and effects of an increase resulting from conversion that differ from other variable-rate features. Because §226.18(f)(1)(iv) requires only one hypothetical example (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example need not be given.

*Paragraph 18(f)(1)(i).*

1. *Circumstances.* The circumstances under which the rate may increase include identification of any index to which the rate is tied, as well as any conditions or events on which the increase is contingent.

- When no specific index is used, any identifiable factors used to determine whether to increase the rate must be disclosed.
- When the increase in the rate is purely discretionary, the fact that any increase is within the creditor's discretion must be disclosed.
- When the index is internally defined (for example, by that creditor's prime rate), the creditor may comply with this requirement by either a brief description of that index or a statement that any increase is in the discretion of the creditor. An externally defined index, however, must be identified.

*Paragraph 18(f)(1)(ii).*

1. *Limitations.* This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. When there are no limitations, the creditor may, but need not, disclose that fact. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See §226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

*Paragraph 18(f)(1)(iii).*

1. *Effects.* Disclosure of the effect of an increase refers to an increase in the number or amount of payments or an increase in the final payment. In addition, the creditor may make a brief reference to negative amortization that may result from a rate increase. (See the commentary to § 226.17(a)(1) regarding directly related information.) If the effect cannot be determined, the creditor must provide a statement of the possible effects. For example, if the exercise of the variable-rate feature may result in either more or larger payments, both possibilities must be noted.

*Paragraph 18(f)(1)(iv).*

1. *Hypothetical example.* The example may, at the creditor's option appear apart from the other disclosures. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. In transactions with more than one variable-rate feature, only one hypothetical example need be provided. (See the commentary to section 226.17(a)(1) regarding disclosure of more than one hypothetical example as directly related information.)

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

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

*Paragraph 18(f)(2).*

1. *Disclosure required.* In variable-rate transactions that have a term greater than one year and are secured by the consumer's principal dwelling, the creditor must give special early disclosures under § 226.19(b) in addition to the later disclosures required under § 226.18(f)(2). The disclosures under § 226.18(f)(2) must state that the transaction has a variable-rate feature and that variable-rate disclosures have been provided earlier. (See the commentary to § 226.17(a)(1) regarding the disclosure of certain directly related information in addition to the variable-rate disclosures required under § 226.18(f)(2).)

*18(g) Payment schedule.*

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

2. *Deferred downpayments.* As discussed in the commentary to § 226.2(a)(18), deferred downpayments or pick-up payments that meet the conditions set forth in the definition of downpayment may be treated as part of the downpayment. Even if treated as a downpayment, that amount may nevertheless be disclosed as part of the payment schedule, at the creditor's option.

3. *Total number of payments.* In disclosing the number of payments for transactions with more than one payment level, creditors may but need not disclose as a single figure the total number of payments for all levels. For example, in a transaction calling for 108 payments of $350, 240 payments of $335, and 12 payments of $330, the creditor need not state that there will be a total of 360 payments.

4. *Timing of payments.* i. *General rule.* Section 226.18(g) requires creditors to disclose the timing of payments. To meet this requirement, creditors may list all of the payment due dates. They also have the option of specifying the ''period of payments'' scheduled to repay the obligation. As a general rule, creditors that choose this option must disclose the payment intervals or frequency, such as ''monthly''or ''bi-weekly,'' and the calendar date that the beginning payment is due. For example, a creditor may disclose that payments are due ''monthly beginning on July 1, 1998.'' This information, when combined with the number of payments, is necessary to define the repayment period and enable a consumer to determine all of the payment due dates.

ii. *Exception.* In a limited number of circumstances, the beginning-payment date is unknown and difficult to determine at the time disclosures are made. For example, a consumer may become obligated on a credit contract that contemplates the delayed disbursement of funds based on a contingent event, such as the completion of home repairs. Disclosures may also accompany loan checks that are sent by mail, in which case the initial disbursement and repayment dates are solely within the consumer's control. In such cases, if the beginning-payment date is unknown the creditor may use an estimated date and label the disclosure as an estimate pursuant to § 226.17(c). Alternatively, the disclosure may refer to the occurrence of a particular event, for example, by disclosing that the beginning payment is due ''30 days after the first loan disbursement.'' This information also may be included with an estimated date to explain the basis for the creditor's estimate. See Comment 17(a)(1)–5(iii).

5. *Mortgage insurance.* The payment schedule should reflect the consumer's mortgage

insurance payments until the date on which the creditor must automatically terminate coverage under applicable law, even though the consumer may have a right to request that the insurance be cancelled earlier. The payment schedule must reflect the legal obligation, as determined by applicable state or other law. For example, assume that under applicable law, mortgage insurance must terminate after the 130th scheduled monthly payment, and the creditor collects at closing and places in escrow two months of premiums. If, under the legal obligation, the creditor will include mortgage insurance premiums in 130 payments and refund the escrowed payments when the insurance is terminated, the payment schedule should reflect 130 premium payments. If, under the legal obligation, the creditor will apply the amount escrowed to the two final insurance payments, the payment schedule should reflect 128 monthly premium payments. (For assumptions in calculating a payment schedule that includes mortgage insurance that must be automatically terminated, see comments 17(c)(1)–8 and 17(c)(1)–10.)

*Paragraph 18(g)(1).*

1. *Demand obligations.* In demand obligations with no alternate maturity date, the creditor has the option of disclosing only the due dates or periods of scheduled interest payments in the first year (for example, ''interest payable quarterly'' or ''interest due the first of each month''). The amounts of the interest payments need not be shown.

*Paragraph 18(g)(2).*

1. *Abbreviated disclosure.* The creditor may disclose an abbreviated payment schedule when the amount of each regularly scheduled payment (other than the first or last payment) includes an equal amount to be applied on principal and a finance charge computed by application of a rate to the decreasing unpaid balance. This option is also available when mortgage-guarantee insurance premiums, paid either monthly or annually, cause variations in the amount of the scheduled payments, reflecting the continual decrease or increase in the premium due. In addition, in transactions where payments vary because interest and principal are paid at different intervals, the two series of payments may be disclosed separately and the abbreviated payment schedule may be used for the interest payments. For example, in transactions with fixed quarterly principal payments and monthly interest payments based on the outstanding principal balance, the amount of the interest payments will change quarterly as principal declines. In such cases the creditor may treat the interest and principal payments as two separate series of payments, separately disclosing the number, amount, and due dates of principal payments, and, using the abbreviated payment schedule, the number, amount, and due dates of interest payments. This option may be used when interest and principal are scheduled to be paid on the same date of the month as well as on different dates of the month. The creditor using this alternative must disclose the dollar amount of the highest and lowest payments and make reference to the variation in payments.

2. *Combined payment schedule disclosures.* Creditors may combine the option in this paragraph with the general payment schedule requirements in transactions where only a portion of the payment schedule meets the conditions of § 226.18(g)(2). For example, in a graduated payment mortgage where payments rise sharply for 5 years and then decline over the next 25 years because of decreasing mortgage insurance premiums, the first 5 years would be disclosed under the general rule in § 226.18(g) and the next 25 years according to the abbreviated schedule in § 226.18(g)(2).

3. *Effect on other disclosures.* Section 226.18(g)(2) applies only to the payment schedule disclosure. The actual amounts of payments must be taken into account in calculating and disclosing the finance charge and the annual percentage rate.

*Paragraph 18(h) Total of payments.*

1. *Disclosure required.* The total of payments must be disclosed using that term, along with a descriptive phrase similar to the one in the regulation. The descriptive explanation may be revised to reflect a variable rate feature with a brief phrase such as ''based on the current annual percentage rate which may change.''

2. *Calculation of total of payments.* The total of payments is the sum of the payments disclosed under § 226.18(g). For example, if the creditor disclosed a deferred portion of the downpayment as part of the payment schedule, that payment must be reflected in the total disclosed under this paragraph.

3. *Exception.* Footnote 44 permits creditors to omit disclosure of the total of payments in single-payment transactions. This exception does not apply to a transaction calling for a single payment of principal combined with periodic payments of interest.

4. *Demand obligations.* In demand obligations with no alternate maturity date, the creditor may omit disclosure of payment amounts under § 226.18(g)(1). In those transactions, the creditor need not disclose the total of payments.

*Paragraph 18(i) Demand feature.*

1. *Disclosure requirements.* The disclosure requirements of this provision apply not only to transactions payable on demand from the outset, but also to transactions that are not payable on demand at the time of consummation but convert to a demand status after a stated period. In demand obligations in which the disclosures are based on an assumed maturity of 1 year under § 226.17(c)(5), that fact must also be stated. Appendix H

contains model clauses that may be used in making this disclosure.

2. *Covered demand features.* The type of demand feature triggering the disclosures required by §226.18(i) includes only those demand features contemplated by the parties as part of the legal obligation. For example, this provision does not apply to transactions that covert to a demand status as a result of the consumer's default. A due-on-sale clause is not considered a demand feature. A creditor may, but need not, treat its contractual right to demand payment of a loan made to its executive officers as a demand feature to the extent that the contractual right is required by Regulation O (12 CFR 215.5) or other federal law.

3. *Relationship to payment schedule disclosures.* As provided in §226.18(g)(1), in demand obligations with no alternate maturity date, the creditor need only disclose the due dates or payment periods of any scheduled interest payments for the first year. If the demand obligation states an alternate maturity, however, the disclosed payment schedule must reflect that stated term; the special rule in §226.18(g)(1) is not available.

*Paragraph 18(j) Total sale price.*

1. *Disclosure required.* In a credit sale transaction, the *total sale price* must be disclosed using that term, along with a descriptive explanation similar to the one in the regulation. For variable rate transactions, the descriptive phrase may, at the creditor's option, be modified to reflect the variable rate feature. For example, the descriptor may read: ''The total cost of your purchase on credit, which is subject to change, including your downpayment of * * *.'' The reference to a downpayment may be eliminated in transactions calling for no downpayment.

2. *Calculation of total sale price.* The figure to be disclosed is the sum of the cash price, other charges added under §226.18(b)(2), and the finance charge disclosed under §226.18(d).

3. *Effect of existing liens.* When a credit sale transaction involves property that is being used as a trade-in (an automobile, for example) and that has a lien exceeding the value of the trade-in, the total sale price is affected by the amount of any cash provided. (See comment 2(a)(18)–3.) To illustrate, assume a consumer finances the purchase of an automobile with a cash price of $20,000. Another vehicle used as a trade-in has a value of $8,000 but has an existing lien of $10,000, leaving a $2,000 deficit that the consumer must finance.

i. If the consumer pays $1,500 in cash, the creditor may apply the cash first to the lien, leaving a $500 deficit, and reflect a downpayment of $0. The total sale price would include the $20,000 cash price, an additional $500 financed under §226.18(b)(2), and the amount of the finance charge. Alternatively, the creditor may reflect a downpayment of $1,500 and finance the $2,000 deficit. In that case, the total sale price would include the sum of the $20,000 cash price, the $2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.

ii. If the consumer pays $3,000 in cash, the creditor may apply the cash first to extinguish the lien and reflect the remainder as a downpayment of $1,000. The total sale price would reflect the $20,000 cash price and the amount of the finance charge. (The cash payment extinguishes the trade-in deficit and no charges are added under §226.18(b)(2).) Alternatively, the creditor may elect to reflect a downpayment of $3,000 and finance the $2,000 deficit. In that case, the total sale price would include the sum of the $20,000 cash price, the $2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.

*Paragraph 18(k) Prepayment.*

1. *Disclosure required.* The creditor must give a definitive statement of whether or not a penalty will be imposed or a rebate will be given.

- The fact that no penalty will be imposed may not simply be inferred from the absence of a penalty disclosure; the creditor must indicate that prepayment will not result in a penalty.
- If a penalty or refund is possible for one type of prepayment, even though not for all, a positive disclosure is required. This applies to any type of prepayment, whether voluntary or involuntary as in the case of prepayments resulting from acceleration.
- Any difference in rebate or penalty policy, depending on whether prepayment is voluntary or not, must not be disclosed with the segregated disclosures.

2. *Rebate-penalty disclosure.* A single transaction may involve both a precomputed finance charge and a finance charge computed by application of a rate to the unpaid balance (for example, mortgages with mortgage-guarantee insurance). In these cases, disclosures about both prepayment rebates and penalties are required. Sample form H–15 in appendix H illustrates a mortgage transaction in which both rebate and penalty disclosures are necessary.

3. *Prepaid finance charge.* The existence of a prepaid finance charge in a transaction does not, by itself, require a disclosure under §226.18(k). A prepaid finance charge is not considered a penalty under §226.18(k)(1), nor does it require a disclosure under §226.18(k)(2). At its option, however, a creditor may consider a prepaid finance charge to be under §226.18(k)(2). If a disclosure is made under §226.18(k)(2) with respect to a prepaid finance charge or other finance charge, the creditor may further identify that finance charge. For example, the disclosure may state that the borrower ''will not be entitled to a refund of the prepaid finance

charge'' or some other term that describes the finance charge.

*Paragraph 18(k)(1).*

1. *Penalty*. This applies only to those transactions in which the interest calculation takes account of all scheduled reductions in principal, as well as transactions in which interest calculations are made daily. The term *penalty* as used here encompasses only those charges that are assessed strictly because of the prepayment in full of a simple-interest obligation, as an addition to all other amounts. Items which are penalties include, for example:

• Interest charges for any period after prepayment in full is made. (See the commentary to §226.17(a)(1) regarding disclosure of interest charges assessed for periods after prepayment in full as directly related information.)

• A minimum finance charge in a simple-interest transaction. (See the commentary to §226.17(a)(1) regarding the disclosure of a minimum finance charge as directly related information.) Items which are not penalties include, for example:

• Loan guarantee fees

• Interim interest on a student loan

*Paragraph 18(k)(2).*

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

• Precomputed finance charges such as add-on charges.

• Charges that take account of some but not all reductions in principal, such as mortgage guarantee insurance assessed on the basis of an annual declining balance, when the principal is reduced on a monthly basis.

No description of the method of computing earned or unearned finance charges is required or permitted as part of the segregated disclosures under this section.

*Paragraph 18(l) Late payment.*

1. *Definition*. This paragraph requires a disclosure only if charges are added to individual delinquent installments by a creditor who otherwise considers the transaction ongoing on its original terms. Late payment charges do not include:

• The right of acceleration.

• Fees imposed for actual collection costs, such as repossession charges or attorney's fees.

• Deferral and extension charges.

• The continued accrual of simple interest at the contract rate after the payment due date. However, an increase in the interest rate is a late payment charge to the extent of the increase.

2. *Content of disclosure*. Many state laws authorize the calculation of late charges on the basis of either a percentage or a specified dollar amount, and permit imposition of the lesser or greater of the 2 charges. The disclosure made under §226.18(l) may reflect this alternative. For example, stating that the charge in the event of a late payment is 5% of the late amount, not to exceed $5.00, is sufficient. Many creditors also permit a grace period during which no late charge will be assessed; this fact may be disclosed as directly related information. (See the commentary to §226.17(a).)

*Paragraph 18(m) Security interest.*

1. *Purchase money transactions*. When the collateral is the item purchased as part of, or with the proceeds of, the credit transaction, section 226.18(m) requires only a general identification such as ''the property purchased in this transaction.'' However, the creditor may identify the property by item or type instead of identifying it more generally with a phrase such as ''the property purchased in this transaction.'' For example, a creditor may identify collateral as ''a motor vehicle,'' or as ''the property purchased in this transaction.'' Any transaction in which the credit is being used to purchase the collateral is considered a purchase money transaction and the abbreviated identification may be used, whether the obligation is treated as a loan or a credit sale.

2. *Nonpurchase money transactions*. In nonpurchase money transactions, the property subject to the security interest must be identified by item or type. This disclosure is satisfied by a general disclosure of the category of property subject to the security interest, such as ''motor vehicles,'' ''securities,'' ''certain household items,'' or ''household goods.'' (Creditors should be aware, however, that the Federal credit practices rules, as well as some state laws, prohibit certain security interests in household goods.) At the creditor's option, however, a more precise identification of the property or goods may be provided.

3. *Mixed collateral*. In some transactions in which the credit is used to purchase the collateral, the creditor may also take other property of the consumer as security. In those cases, a combined disclosure must be provided, consisting of an identification of the purchase money collateral consistent with comment 18(m)–1 and a specific identification of the other collateral consistent with comment 18(m)–2.

4. *After-acquired property*. An after-acquired property clause is not a security interest to be disclosed under §226.18(m).

5. *Spreader clause*. The fact that collateral for pre-existing credit with the institution is being used to secure the present obligation constitutes a security interest and must be disclosed. (Such security interests may be known as ''spreader'' or ''dragnet'' clauses, or as ''cross-collateralization'' clauses.) A specific identification of that collateral is unnecessary but a reminder of the interest

arising from the prior indebtedness is required. The disclosure may be made by using language such as ''collateral securing other loans with us may also secure this loan.'' At the creditor's option, a more specific description of the property involved may be given.

6. *Terms used in disclosure.* No specified terminology is required in disclosing a security interest. Although the disclosure may, at the creditor's option, use the term *security interest,* the creditor may designate its interest by using, for example, *pledge, lien,* or *mortgage.*

7. *Collateral from third party.* In certain transactions, the consumer's obligation may be secured by collateral belonging to a third party. For example, a loan to a student may be secured by an interest in the property of the student's parents. In such cases, the security interest is taken in connection with the transaction and must be disclosed, even though the property encumbered is owned by someone other than the consumer.

*18(n) Insurance and debt cancellation.*

1. *Location.* This disclosure may, at the creditor's option, appear apart from the other disclosures. It may appear with any other information, including the amount financed itemization, any information prescribed by state law, or other supplementary material. When this information is disclosed with the other segregated disclosures, however, no additional explanatory material may be included.

2. *Debt cancellation.* Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law. Otherwise, they may provide a parallel disclosure that refers to debt cancellation coverage.

*Paragraph 18(o) Certain security interest charges.*

1. *Format.* No special format is required for these disclosures; under §226.4(e), taxes and fees paid to government officials with respect to a security interest may be aggregated, or may be broken down by individual charge. For example, the disclosure could be labelled ''filing fees and taxes'' and all funds disbursed for such purposes may be aggregated in a single disclosure. This disclosure may appear, at the creditor's option, apart from the other required disclosures. The inclusion of this information on a statement required under the Real Estate Settlement Procedures Act is sufficient disclosure for purposes of Truth in Lending.

*Paragraph 18(p) Contract reference.*

1. *Content.* Creditors may substitute, for the phrase ''appropriate contract document,'' a reference to specific transaction documents in which the additional information is found, such as ''promissory note'' or ''retail installment sale contract.'' A creditor may, at its option, delete inapplicable items in the contract reference, as for example when the contract documents contain no information regarding the right of acceleration.

*Paragraph 18(q) Assumption policy.*

1. *Policy statement.* In many mortgages, the creditor cannot determine, at the time disclosure must be made, whether a loan may be assumable at a future date on its original terms. For example, the assumption clause commonly used in mortgages sold to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation conditions an assumption on a variety of factors such as the creditworthiness of the subsequent borrower, the potential for impairment of the lender's security, and execution of an assumption agreement by the subsequent borrower. In cases where uncertainty exists as to the future assumability of a mortgage, the disclosure under §226.18(q) should reflect that fact. In making disclosures in such cases, the creditor may use phrases such as ''subject to conditions,'' ''under certain circumstances,'' or ''depending on future conditions.'' The creditor may provide a brief reference to more specific criteria such as a due-on-sale clause, although a complete explanation of all conditions is not appropriate. For example, the disclosure may state, ''Someone buying your home may be allowed to assume the mortgage on its original terms, subject to certain conditions, such as payment of an assumption fee.'' See comment 17(a)(1)–5 for an example for a reference to a due-on-sale clause.

2. *Original terms.* The phrase *original terms* for purposes of §226.18(q) does not preclude the imposition of an assumption fee, but a modification of the basic credit agreement, such as a change in the contract interest rate, represents different terms.

*Paragraph 18(r) Required deposit.*

1. *Disclosure required.* The creditor must inform the consumer of the existence of a required deposit. (appendix H provides a model clause that may be used in making that disclosure.) Footnote 45 describes 3 types of deposits that need not be considered required deposits. Use of the phrase ''need not'' permits creditors to include the disclosure even in cases where there is doubt as to whether the deposit constitutes a required deposit.

2. *Pledged account mortgages.* In these transactions, a consumer pledges as collateral funds that the consumer deposits in an account held by the creditor. The creditor withdraws sums from that account to supplement the consumer's periodic payments. Creditors may treat these pledged accounts as required deposits or they may treat them as consumer buydowns in accordance with the commentary to §226.17(c)(1).

3. *Escrow accounts.* The escrow exception in footnote 45 applies, for example, to accounts for such items as maintenance fees, repairs, or improvements, whether in a realty or a nonrealty transaction. (See the commentary to §226.17(c)(1) regarding the use of escrow

accounts in consumer buydown transactions.)

4. *Interest-bearing accounts*. When a deposit earns at least 5 percent interest per year, no disclosure is required under §226.18(r). This exception applies whether the deposit is held by the creditor or by a third party.

5. *Morris Plan transactions*. A deposit under a Morris Plan, in which a deposit account is created for the sole purpose of accumulating payments and this is applied to satisfy entirely the consumer's obligation in the transaction, is not a required deposit.

6. *Examples of amounts excluded*. The following are among the types of deposits that need not be treated as required deposits:

• Requirement that a borrower be a customer or a member even if that involves a fee or a minimum balance.

• Required property insurance escrow on a mobile home transaction.

• Refund of interest when the obligation is paid in full.

• Deposits that are immediately available to the consumer.

• Funds deposited with the creditor to be disbursed (for example, for construction) before the loan proceeds are advanced.

• Escrow of condominium fees.

• Escrow of loan proceeds to be released when the repairs are completed.

References

*Statute:* Section 128, the Garn-St Germain Depository Institutions Act of 1982 (Pub. L. 97–320) and the Real Estate Settlement Procedures Act (12 U.S.C. 2602).

*Other sections:* Sections 226.2, 226.17, and appendix H.

*Other regulations:* 12 CFR 545.6–2(a) and 12 CFR Part 29.

*Previous regulation:* Sections 226.4 and 226.8.

*1981 changes:* Five of the required disclosures must be explained to the consumer in a manner similar to the descriptive phrases shown in the regulation. A written itemization of the amount financed need not be provided unless the consumer requests it. The finance charge must be provided in all transactions, including real estate transactions, but must be shown only as a total amount. The disclosed finance charge is considered accurate if it is within a specified range.

The variable rate hypothetical is required in all variable rate transactions and may be either general or transaction-specific. The penalty and rebate disclosures in the event of prepayment have been modified and combined. The requirement of an explanation of how the rebates or penalties are computed has been eliminated. The late payment disclosure has also been narrowed to include only charges imposed before maturity for late payments.

The information required in the security interest disclosure has been decreased by the deletion of the type of security interest and a reduction in the property description requirement. The disclosure of the required deposit is limited to a statement that the annual percentage rate does not reflect the required deposit; the presence of a required deposit has no effect on the annual percentage rate.

Two disclosure requirements have been added: A reference to the contract documents for additional information and, in a residential mortgage transaction, a statement of the creditor's assumption policy.

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

*Paragraph 19(a)(1) Time of disclosure.*

1. *Coverage*. This section requires early disclosure of credit terms in residential mortgage transactions that are also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by this section, a transaction must be both a residential mortgage transaction under §226.2(a) and a federally related mortgage loan under RESPA. ''Federally related mortgage loan'' is defined under RESPA (12 USC 2602) and Regulation X (24 CFR 3500.5(b)), and is subject to any interpretations by HUD.

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

3. *Written application*. Creditors may rely on RESPA and Regulation X (including any interpretations issued by HUD) in deciding

whether a ''written application'' has been received. In general, Regulation X requires disclosures ''to every person from whom the Lender receives or for whom it prepares a written application on an application form or forms normally used by the Lender for a Federally Related Mortgage Loan'' (24 CFR 3500.6(a)). An application is received when it reaches the creditor in any of the ways applications are normally transmitted—by mail, hand delivery, or through an intermediary agent or broker. (See comment 19(b)–3 for guidance in determining whether or not the transaction involves an intermediary agent or broker.) If an application reaches the creditor through an intermediary agent or broker, the application is received when it reaches the creditor, rather than when it reaches the agent or broker.

4. *Exceptions.* The creditor may determine within the 3-day period that the application will not or cannot be approved on the terms requested, as, for example, when a consumer applies for a type or amount of credit that the creditor does not offer, or the consumer's application cannot be approved for some other reason. In that case, the creditor need not make the disclosures under this section. If the creditor fails to provide early disclosures and the transaction is later consummated on the original terms, the creditor will be in violation of this provision. If, however, the consumer amends the application because of the creditor's unwillingness to approve it on its original terms, no violation occurs for not providing disclosures based on the original terms. But the amended application is a new application subject to this section.

5. *Itemization of amount financed.* In many residential mortgage transactions, the itemization of the amount financed required by §226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed, either with the disclosures provided within 3 days after application or with the disclosures given at consummation or settlement.

*Paragraph 19(a)(2) Redisclosure required.*

1. *Conditions for redisclosure.* Creditors must make new disclosures if the annual percentage rate at consummation differs from the estimate originally disclosed by more than ⅛ of 1 percentage point in regular transactions or ¼ of 1 percentage point in irregular transactions, as defined in footnote 46 of §226.22(a)(3). The creditor must also redisclose if a variable rate feature is added to the credit terms after the original disclosures have been made. The creditor has the option of redisclosing information under other circumstances, if it wishes to do so.

2. *Content of new disclosures.* If redisclosure is required, the creditor may provide a complete set of new disclosures, or may redisclose only the terms that vary from those originally disclosed. If the creditor chooses to provide a complete set of new disclosures, the creditor may but need not highlight the new terms, provided that the disclosures comply with the format requirements of §226.17(a). If the creditor chooses to disclose only the new terms, all the new terms must be disclosed. For example, a different annual percentage rate will almost always produce a different finance charge, and often a new schedule of payments; all of these changes would have to be disclosed. If, in addition, unrelated terms such as the amount financed or prepayment penalty vary from those originally disclosed, the accurate terms must be disclosed. However, no new disclosures are required if the *only* inaccuracies involve estimates other than the annual percentage rate, and no variable rate feature has been added.

3. *Timing.* Redisclosures, when necessary, must be given no later than ''consummation or settlement.'' ''Consummation'' is defined in §226.2(a). ''Date of settlement'' is defined in Regulation X (24 CFR 3500.2(a)) and is subject to any interpretations issued under RESPA and Regulation X.

4. *Basis of disclosures.* In some cases, a creditor may delay redisclosure until settlement, which may be at a time later than consummation. If a creditor chooses to redisclose at settlement, disclosures may be based on the terms in effect at settlement, rather than at consummation. For example, in a variable-rate transaction, a creditor may choose to base disclosures on the terms in effect at settlement despite the general rule in the commentary to section 18(f) that variable-rate disclosures should be based on the terms in effect at consummation.

*19(b) Certain variable-rate transactions.*

1. *Coverage.* Section 226.19(b) applies to all closed-end variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. The requirements of this section apply not only to transactions financing the initial acquisition of the consumer's principal dwelling, but also to any other closed-end variable-rate transaction secured by the principal dwelling. Closed-end variable-rate transactions that are not secured by the principal dwelling, or are secured by the principal dwelling but have a term of one year or less, are subject to the disclosure requirements of §226.18(f)(1) rather than those of §226.19(b). (Furthermore, ''shared-equity'' or ''shared-appreciation'' mortgages are subject to the disclosure requirements of §226.18(f)(1) rather than those of §226.19(b) regardless of the general coverage of those sections.) For purposes of this section, the term of a variable-rate demand loan is determined

in accordance with the commentary to §226.17(c)(5). In determining whether a construction loan that may be permanently financed by the same creditor is covered under this section, the creditor may treat the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction. For purposes of the disclosures required under §226.18, the creditor may nevertheless treat the two phases either as separate transactions or as a single combined transaction in accordance with §226.17(c)(6). Finally, in any assumption of a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year, disclosures need not be provided under §§226.18(f)(2)(ii) or 226.19(b).

2. *Timing*. A creditor must give the disclosures required under this section at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier.

i. *Intermediary agent or broker*. In cases where a creditor receives a written application through an intermediary agent or broker, however, footnote 45b provides a substitute timing rule requiring the creditor to deliver the disclosures or place them in the mail not later than three business days after the creditor receives the consumer's written application. (See comment 19(b)–3 for guidance in determining whether or not the transaction involves an intermediary agent or broker.) This three-day rule also applies where the creditor takes an application over the telephone.

ii. *Telephone request*. In cases where the consumer merely requests an application over the telephone, the creditor must include the early disclosures required under this section with the application that is sent to the consumer.

iii. *Mail solicitations*. In cases where the creditor solicits applications through the mail, the creditor must also send the disclosures required under this section if an application form is included with the solicitation.

iv. *Conversion*. In cases where an open-end credit account will convert to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section may be given at the time of conversion. (See the commentary to §226.20(a) for information on the timing requirements for §226.19(b)(2) disclosures when a variable-rate feature is later added to a transaction.)

v. *Form of electronic disclosures provided on or with electronic applications*. Creditors must provide the disclosures required by this section (including the brochure) on or with a blank application that is made available to the consumer in electronic form, such as on a creditor's Internet Web site. Creditors have flexibility in satisfying this requirement. Methods creditors could use to satisfy the requirement include, but are not limited to, the following examples:

A. The disclosures could automatically appear on the screen when the application appears;

B. The disclosures could be located on the same web page as the application (whether or not they appear on the initial screen), if the application contains a clear and conspicuous reference to the location of the disclosures and indicates that the disclosures contain rate, fee, and other cost information, as applicable;

C. Creditors could provide a link to the electronic disclosures on or with the application as long as consumers cannot bypass the disclosures before submitting the application. The link would take the consumer to the disclosures, but the consumer need not be required to scroll completely through the disclosures; or

D. The disclosures could be located on the same web page as the application without necessarily appearing on the initial screen, immediately preceding the button that the consumer will click to submit the application.

Whatever method is used, a creditor need not confirm that the consumer has read the disclosures.

3. *Intermediary agent or broker*. In certain transactions involving an ''intermediary agent or broker,'' a creditor may delay providing disclosures. A creditor may not delay providing disclosures in transactions involving either a legal agent (as determined by applicable law) or any other third party that is not an ''intermediary agent or broker.'' In determining whether or not a transaction involves an ''intermediary agent or broker'' the following factors should be considered:

• The number of applications submitted by the broker to the creditor as compared to the total number of applications received by the creditor. The greater the percentage of total loan applications submitted by the broker in any given period of time, the less likely it is that the broker would be considered an ''intermediary agent or broker'' of the creditor during the next period.

• The number of applications submitted by the broker to the creditor as compared to the total number of applications received by the broker. (This factor is applicable only if the creditor has such information.) The greater the percentage of total loan applications received by the broker that is submitted to a creditor in any given period of time, the less likely it is that the broker would be considered an ''intermediary agent or broker'' of the creditor during the next period.

• The amount of work (such as document preparation) the creditor expects to be done by the broker on an application based on the creditor's prior dealings with the broker and on the creditor's requirements for accepting

applications, taking into consideration the customary practice of brokers in a particular area. The more work that the creditor expects the broker to do on an application, in excess of what is usually expected of a broker in that area, the less likely it is that the broker would be considered an ''intermediary agent or broker'' of the creditor.

An example of an ''intermediary agent or broker'' is a broker who, customarily within a brief period of time after receiving an application, inquires about the credit terms of several creditors with whom the broker does business and submits the application to one of them. The broker is responsible for only a small percentage of the applications received by that creditor. During the time the broker has the application, it might request a credit report and an appraisal (or even prepare an entire loan package if customary in that particular area).

4. *Other variable-rate regulations.* Transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other Federal agencies are exempt from the requirements of §226.19(b), by virtue of footnote 45a, and are exempt from the requirements of §226.20(c), by virtue of footnote 45c. Those variable-rate regulations include the regulations issued by the Federal Home Loan Bank Board and those issued by the Department of Housing and Urban Development. The exception in footnotes 45a and 45c is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (12 U.S.C. 3801 *et seq.*) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

5. *Examples of variable-rate transactions.*

(i) 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).

(A) 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.)

(B) 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), and (xii) are not applicable to such loans.

(C) ''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). (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.)

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

*Paragraph 19(b)(1).*

1. *Substitute.* Creditors who wish to use publications other than the *Consumer Handbook on Adjustable Rate Mortgages* must make a good faith determination that their brochures are suitable substitutes to the *Consumer Handbook*. A substitute is suitable if it is, at a minimum, comparable to the Consumer Handbook in substance and comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the *Consumer Handbook*.

2. *Applicability.* The *Consumer Handbook* need not be given for variable-rate transactions subject to this section in which the underlying interest rate is fixed. (See comment 19(b)–5 for an example of a variable-rate transaction where the underlying interest rate is fixed.)

*Paragraph 19(b)(2).*

1. *Disclosure for each variable-rate program.* A creditor must provide disclosures to the consumer that fully describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers who express a general interest in a creditor's ARM programs. Disclosures must be given at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. If program disclosures cannot be provided because a consumer expresses an interest in individually negotiating loan terms that are not generally offered, disclosures reflecting those terms may be provided as soon as reasonably possible after the terms have been decided upon, but not later than the

time a non-refundable fee is paid. If a consumer who has received program disclosures subsequently expresses an interest in other available variable-rate programs subject to 226.19(b)(2), or the creditor and consumer decide on a program for which the consumer has not received disclosures, the creditor must provide appropriate disclosures as soon as reasonably possible. The creditor, of course, is permitted to give the consumer information about additional programs subject to § 226.19(b) initially.

2. *Variable-rate loan program defined.* i. Generally, if the identification, the presence or absence, or the exact value of a loan feature must be disclosed under this section, variable-rate loans that differ as to such features constitute separate loan programs. For example, separate loan programs would exist based on differences in any of the following loan features:

A. The index or other formula used to calculate interest rate adjustments.

B. The rules relating to changes in the index value, interest rate, payments, and loan balance.

C. The presence or absence of, and the amount of, rate or payment caps.

D. The presence of a demand feature.

E. The possibility of negative amortization.

F. The possibility of interest rate carryover.

G. The frequency of interest rate and payment adjustments.

H. The presence of a discount feature.

I. In addition, if a loan feature must be taken into account in preparing the disclosures required by § 226.19(b)(2)(viii), variable-rate loans that differ as to that feature constitute separate programs under § 226.19(b)(2).

ii. If, however, a representative value may be given for a loan feature or the feature need not be disclosed under § 226.19(b)(2), variable-rate loans that differ as to such features do not constitute separate loan programs. For example, separate programs would not exist based on differences in the following loan features:

A. The amount of a discount.

B. The amount of a margin.

3. *Form of program disclosures.* A creditor may provide separate program disclosure forms for each ARM program it offers or a single disclosure form that describes multiple programs. A disclosure form may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for a particular program. A disclosure form describing more than one program need not repeat information applicable to each program that is described. For example, a form describing multiple programs may disclose the information applicable to all of the programs in one place with the various program features (such as options permitting conversion to a fixed rate) disclosed separately. The form, however, must state if any program feature that is described is available only in conjunction with certain other program features. Both the separate and multiple program disclosures may illustrate more than one loan maturity or payment amortization—for example, by including multiple payment and loan balance columns in the historical payment example. Disclosures may be inserted or printed in the *Consumer Handbook* (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

4. *As applicable.* The disclosures required by this section need only be made as applicable. Any disclosure not relevant to a particular transaction may be eliminated. For example, if the transaction does not contain a demand feature, the disclosure required under § 226.19(b)(2)(x) need not be given. As used in this section, *payment* refers only to a payment based on the interest rate, loan balance and loan term, and does not refer to payment of other elements such as mortgage insurance premiums.

5. *Revisions.* A creditor must revise the disclosures required under this section once a year as soon as reasonably possible after the new index value becomes available. Revisions to the disclosures also are required when the loan program changes.

*Paragraph 19(b)(2)(i).*

1. *Change in interest rate, payment, or term.* A creditor must disclose the fact that the terms of the legal obligation permit the creditor, after consummation of the transaction, to increase (or decrease) the interest rate, payment, or term of the loan initially disclosed to the consumer. For example, the disclosures for a variable-rate program in which the interest rate and payment (but not loan term) can change might read, ''Your interest rate and payment can change yearly.'' In transactions where the term of the loan may change due to rate fluctuations, the creditor must state that fact.

*Paragraph 19(b)(2)(ii).*

1. *Identification of index or formula.* If a creditor ties interest rate changes to a particular index, this fact must be disclosed, along with a source of information about the index. For example, if a creditor uses the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity as its index, the disclosure might read, ''Your index is the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year published weekly in the *Wall Street Journal.*'' If no particular index is used, the creditor must briefly describe the formula used to calculate interest rate changes.

2. *Changes at creditor's discretion.* If interest rate changes are at the creditor's discretion, this fact must be disclosed. If an index is internally defined, such as by a creditor's

prime rate, the creditor should either briefly describe that index or state that interest rate changes are at the creditor's discretion.

*Paragraph 19(b)(2)(iii).*

1. *Determination of interest rate and payment.* This provision requires an explanation of how the creditor will determine the consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, ''Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term.'' In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor must disclose this fact. For example, the disclosure might read, ''Your periodic payments will not fully amortize your loan and you will be required to make a single payment of the periodic payment plus the remaining unpaid balance at the end of the loan term.'' The creditor, however, need not reflect any irregular final payment in the historical example or in the disclosure of the initial and maximum rates and payments. If applicable, the creditor should also disclose that the rate and payment will be rounded.

*Paragraph 19(b)(2)(iv).*

1. *Current margin value and interest rate.* Because the disclosures can be prepared in advance, the interest rate and margin may be several months old when the disclosures are delivered. A statement, therefore, is required alerting consumers to the fact that they should inquire about the current margin value applied to the index and the current interest rate. For example, the disclosure might state, ''Ask us for our current interest rate and margin.''

*Paragraph 19(b)(2)(v).*

1. *Discounted and premium interest rate.* In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact. For example, if a creditor discounted a consumer's initial rate, the disclosure might state, ''Your initial interest rate is not based on the index used to make later adjustments.'' (See the commentary to § 226.17(c)(1) for a further discussion of discounted and premium variable-rate transactions.) In addition, the disclosure must suggest that consumers inquire about the amount that the program is currently discounted. For example, the disclosure might state, ''Ask us for the amount our adjustable rate mortgages are currently discounted.'' In a transaction with a consumer buydown or with a third-party buydown that will be incorporated in the legal obligation, the creditor should disclose the program as a discounted variable-rate transaction, but need not disclose additional information regarding the buydown in its program disclosures. (See the commentary to § 226.19(b)(2)(viii) for a discussion of how to reflect the discount or premium in the historical example or the maximum rate and payment disclosure).

*Paragraph 19(b)(2)(vi).*

1. *Frequency.* The frequency of interest rate and payment adjustments must be disclosed. If interest rate changes will be imposed more frequently or at different intervals than payment changes, a creditor must disclose the frequency and timing of both types of changes. For example, in a variable-rate transaction where interest rate changes are made monthly, but payment changes occur on an annual basis, this fact must be disclosed. In certain ARM transactions, the interval between loan closing and the initial adjustment is not known and may be different from the regular interval for adjustments. In such cases, the creditor may disclose the initial adjustment period as a range of the minimum and maximum amount of time from consummation or closing. For example, the creditor might state: ''The first adjustment to your interest rate and payment will occur no sooner than 6 months and no later than 18 months after closing. Subsequent adjustments may occur once each year after the first adjustment.'' (See comments 19(b)(2)(viii)(A)–7 and 19(b)(2)(viii)(B)–4 for guidance on other disclosures when this alternative disclosure rule is used.)

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

1. *Rate and payment caps.* The creditor must disclose limits on changes (increases or decreases) in the interest rate or payment. If an initial discount is not taken into account in applying overall or periodic rate limitations, that fact must be disclosed. If separate overall or periodic limitations apply to interest rate increases resulting from other events, such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations must also be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or Federal statutes or regulations. (See § 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.) The creditor need not disclose each periodic or overall rate limitation that is currently available. As an alternative, the creditor may disclose the range of the lowest and highest periodic and overall rate limitations that may be applicable to the creditor's ARM transactions.

For example, the creditor might state: ''The limitation on increases to your interest rate at each adjustment will be set at an amount in the following range: Between 1 and 2 percentage points at each adjustment. The limitation on increases to your interest rate over the term of the loan will be set at an amount in the following range: Between 4 and 7 percentage points above the initial interest rate.'' A creditor using this alternative rule must include a statement in its program disclosures suggesting that the consumer ask about the overall rate limitations currently offered for the creditor's ARM programs. (See comments 19(b)(2)(viii)(A)–6 and 19(b)(2)(viii)(B)–3 for an explanation of the additional requirements for a creditor using this alternative rule for disclosure of periodic and overall rate limitations.)

2. *Negative amortization and interest rate carryover*. A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, ''If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount.'' 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) for a discussion on the definition of a variable-rate loan program 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.

3. *Conversion option*. If a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the creditor must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The creditor must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined. The creditor should identify any index or other measure or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the creditor may use information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the creditor. The information may be used until the program disclosures are otherwise revised. Although the rules relating to the conversion option must be disclosed, the effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rate and payments.

4. *Preferred-rate loans*. Section 226.19(b) applies to preferred-rate loans, where the rate will increase upon the occurrence of some event, such as an employee leaving the creditor's employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose the event that would allow the creditor to increase the rate such as that the rate may increase if the employee leaves the creditor's employ. The creditor must also disclose the rules relating to termination of the preferred rate, such as that fees may be charged when the rate is changed and how the new rate will be determined.

*Paragraph 19(b)(2)(viii)*.

1. *Historical example and initial and maximum interest rates and payments*. A creditor may disclose both the historical example and the initial and maximum interest rates and payments.

*Paragraph 19(b)(2)(viii)(A)*.

1. *Index movement*. This section requires a creditor to provide an historical example, based on a $10,000 loan amount originating in 1977, showing how interest rate changes implemented according to the terms of the loan program would have affected payments and the loan balance at the end of each year during a 15-year period. (In all cases, the creditor need only calculate the payments and loan balance for the term of the loan. For example, in a five-year loan, a creditor would show the payments and loan balance for the five-year term, from 1977 to 1981, with a zero loan balance reflected for 1981. For the remaining ten years, 1982–1991, the creditor need only show the remaining index values, margin and interest rate and must continue to reflect all significant loan program terms such as rate limitations affecting them.) Pursuant to this section, the creditor must provide a history of index values for the preceding 15 years. Initially, the disclosures would give the index values from 1977 to the present. Each year thereafter, the revised program disclosures should include an additional year's index value until 15 years of values are shown. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values are available in giving a history and payment example. In all cases, only one index value per year need be shown. Thus, in transactions where interest rate adjustments are implemented more frequently than once per year, a creditor may assume that the interest rate and payment resulting from the index value chosen will stay in effect for the entire year for purposes of calculating the loan balance as of the end of the year and for reflecting other loan program terms. In cases

where interest rate changes are at the creditor's discretion (see the commentary to §226.19(b)(2)(ii)), the creditor must provide a history of the rates imposed for the preceding 15 years, beginning with the rates in 1977. In giving this history, the creditor need only go back as far as the creditor's rates can reasonably be determined.

2. *Selection of index values.* The historical example must reflect the method by which index values are determined under the program. If a creditor uses an average of index values or any other index formula, the history given should reflect those values. The creditor should select one date or, when an average of single values is used as an index, one period and should base the example on index values measured as of that same date or period for each year shown in the history. A date or period at any time during the year may be selected, but the same date or period must be used for each year in the historical example. For example, a creditor could use values for the first business day in July or for the first week ending in July for each of the 15 years shown in the example.

3. *Selection of margin.* For purposes of the disclosure required under §226.19(b)(2)(viii)(A), a creditor may select a representative margin that has been used during the six months preceding preparation of the disclosures, and should disclose that the margin is one that the creditor has used recently. The margin selected may be used until a creditor revises the disclosure form.

4. *Amount of discount or premium.* For purposes of the disclosure required under §226.19(b)(2)(viii)(A), a creditor may select a discount or premium (amount and term) that has been used during the six months preceding preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the historical example for as long as the discount or premium is in effect. A creditor may assume that a discount that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example. For example, a 3-month discount may be treated as being in effect for the entire first year of the example; a 15-month discount may be treated as being in effect for the first two years of the example. In illustrating the effect of the discount or premium, creditors should adjust the value of the interest rate in the historical example, and should not adjust the margin or index values. For example, if during the six months preceding preparation of the disclosures the fully indexed rate would have been 10% but the first year's rate under the program was 8%, the creditor would discount the first interest rate in the historical example by 2 percentage points.

5. *Term of the loan.* In calculating the payments and loan balances in the historical example, a creditor need not base the disclosures on each term to maturity or payment amortization that it offers. Instead, disclosures for ARMs may be based upon terms to maturity or payment amortizations of 5, 15 and 30 years, as follows: ARMs with terms or amortizations from over 1 year to 10 years may be based on a 5-year term or amortization; ARMs with terms or amortizations from over 10 years to 20 years may be based on a 15-year term or amortization; and ARMs with terms or amortizations over 20 years may be based on a 30-year term or amortization. Thus, disclosures for ARMs offered with any term from over 1 year to 40 years may be based solely on terms of 5, 15 and 30 years. Of course, a creditor may always base the disclosures on the actual terms or amortizations offered. If the creditor bases the disclosures on 5-, 15- or 30-year terms or payment amortization as provided above, the term or payment amortization used in making the disclosure must be stated.

6. *Rate caps.* A creditor using the alternative rule described in comment 19(b)(2)(vii)–1 for disclosure of rate limitations must base the historical example upon the highest periodic and overall rate limitations disclosed under section 226.19(b)(2)(vii). In addition, the creditor must state the limitations used in the historical example. (See comment 19(b)(2)(viii)(B)–3 for an explanation of the use of the highest rate limitation in other disclosures.)

7. *Frequency of adjustments.* In certain transactions, creditors may use the alternative rule described in comment 19(b)(2)(vi)–1 for disclosure of the frequency of rate and payment adjustments. In such cases, the creditor may assume for purposes of the historical example that the first adjustment occurred at the end of the first full year in which the adjustment could occur. For example, in an ARM in which the first adjustment may occur between 6 and 18 months after closing and annually thereafter, the creditor may assume that the first adjustment occurred at the end of the first year in the historical example. (See comment 19(b)(2)(viii)(B)–4 for an explanation of how to compute the maximum interest rate and payment when the initial adjustment period is not known.)

*Paragraph 19(b)(2)(viii)(B).*

1. *Initial and maximum interest rates and payments.* The disclosure form must state the initial and maximum interest rates and payments for a $10,000 loan originated at an initial interest rate (index value plus margin adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure. (See comment 19(b)(2)–5 on revisions to the loan program disclosure.) In calculating the maximum payment under this paragraph, a creditor should assume that the interest rate increases as rapidly as possible under the

loan program, and the maximum payment disclosed should reflect the amortization of the loan during this period. Thus, in a loan with 2 percentage point annual (and 5 percentage point overall) interest rate limitations or ''caps,'' the maximum interest rate would be 5 percentage points higher than the initial interest rate disclosed. Moreover, the loan would not reach the maximum interest rate until the fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed would reflect the amortization of the loan during this period. If the loan program includes a discounted or premium initial interest rate, the initial interest rate should be adjusted by the amount of the discount or premium.

2. *Term of the loan.* In calculating the initial and maximum payments, the creditor need not base the disclosures on each term to maturity or payment amortization offered under the program. Instead, the creditor may follow the rules set out in comment 19(b)(2)(viii)(A)–5.

If a historical example is provided under §226.19(b)(2)(viii)(A), the terms to maturity or payment amortization used in the historical example must be used in calculating the initial and maximum payment. In addition, creditors must state the term or payment amortization used in making the disclosures under this section.

3. *Rate caps.* A creditor using the alternative rule for disclosure of interest rate limitations described in comment 19(b)(2)(vii)–1 must calculate the maximum interest rate and payment based upon the highest periodic and overall rate limitations disclosed under §226.19(b)(2)(vii). In addition, the creditor must state the rate limitations used in calculating the maximum interest rate and payment. (See comment 19(b)(2)(viii)(A)–6 for an explanation of the use of the highest rate limitation in other disclosures.)

4. *Frequency of adjustments.* In certain transactions, a creditor may use the alternative rule for disclosure of the frequency of rate and payment adjustments described in comment 19(b)(2)(vi)–1. In such cases, the creditor must base the calculations of the initial and maximum rates and payments upon the earliest possible first adjustment disclosed under §226.19(b)(2)(vi). (See comment 19(b)(2)(viii)(A)–7 for an explanation of how to disclose the historical example when the initial adjustment period is not known.)

5. *Periodic payment statement.* The statement that the periodic payment may increase or decrease substantially may be satisfied by the disclosure in paragraph 19(b)(2)(vi) if it states for example, ''your monthly payment can increase or decrease substantially based on annual changes in the interest rate.''

*Paragraph 19(b)(2)(ix).*

1. *Calculation of payments.* A creditor is required to include a statement on the disclosure form that explains how a consumer may calculate his or her actual monthly payments for a loan amount other than $10,000. The example should be based upon the most recent payment shown in the historical example or upon the initial interest rate reflected in the maximum rate and payment disclosure. In transactions in which the latest payment shown in the historical example is not for the latest year of index values shown (such as in a five-year loan), a creditor may provide additional examples based on the initial and maximum payments disclosed under §226.19(b)(2)(viii)(B). The creditor, however, is not required to calculate the consumer's payments. (See the model clauses in appendix H–4(C).)

*Paragraph 19(b)(2)(x).*

1. *Demand feature.* If a variable-rate loan subject to §226.19(b) requirements contains a demand feature as discussed in the commentary to §226.18(i), this fact must be disclosed. (Pursuant to §226.18(i), creditors would also disclose the demand feature in the standard disclosures given later.)

*Paragraph 19(b)(2)(xi).*

1. *Adjustment notices.* A creditor must disclose to the consumer the type of information that will be contained in subsequent notices of adjustments and when such notices will be provided. (See the commentary to §226.20(c) regarding notices of adjustments.) For example, the disclosure might state, ''You will be notified at least 25, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the index and interest rates, payment amount, and loan balance.'' In transactions where there may be interest rate adjustments without accompanying payment adjustments in a year, the disclosure might read, ''You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance.''

*Paragraph 19(b)(2)(xii).*

1. *Multiple loan programs.* A creditor that offers multiple variable-rate loan programs is required to have disclosures for each variable-rate loan program subject to §226.19(b)(2). Unless disclosures for all of its variable-rate programs are provided initially, the creditor must inform the consumer that other closed-end variable-rate programs exist, and that disclosure forms are available for these additional loan programs. For example, the disclosure form might state, ''Information on other adjustable rate mortgage programs is available upon request.''

*19(c) Electronic disclosures.*

1. *Form of disclosures.* Whether disclosures must be in electronic form depends upon the following:

i. If a consumer accesses an ARM loan application electronically (other than as described under ii. below), such as online at a home computer, the creditor must provide the disclosures in electronic form (such as with the application form on its Web site) in order to meet the requirement to provide disclosures in a timely manner on or with the application. If the creditor instead mailed paper disclosures to the consumer, this requirement would not be met.

ii. In contrast, if a consumer is physically present in the creditor's office, and accesses an ARM loan application electronically, such as via a terminal or kiosk (or if the consumer uses a terminal or kiosk located on the premises of an affiliate or third party that has arranged with the creditor to provide applications to consumers), the creditor may provide disclosures in either electronic or paper form, provided the creditor complies with the timing, delivery, and retainability requirements of the regulation.

References

*Statute:* Section 128(b)(2) and the Real Estate Settlement Procedures Act (12 U.S.C. 2602).

*Other sections:* Sections 226.2, 226.17, and 226.22.

*Other regulations:* Regulation X (24 CFR 3500.2(a), 3500.5(b), and 3500.6(a)).

*Previous regulation:* None.

*1981 changes:* This section implements section 128(b)(2), a new provision that requires early disclosure of credit terms in certain mortgage transactions.

*Section 226.20 Subsequent Disclosure Requirements*

*Paragraph 20(a) Refinancings.*

1. *Definition.* A refinancing is a new transaction requiring a complete new set of disclosures. Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation, based on the parties' contract and applicable law. The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.

• Changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation.

• A substitution of agreements that meets the refinancing definition will require new disclosures, even if the substitution does not substantially alter the prior credit terms.

2. *Exceptions.* A transaction is subject to §226.20(a) only if it meets the general definition of a refinancing. Section 226.20(a) (1) through (5) lists 5 events that are not treated as refinancings, even if they are accomplished by cancellation of the old obligation and substitution of a new one.

3. *Variable-rate.*

i. If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, no new disclosures are required when the variable-rate feature is invoked on a renewable balloon-payment mortgage that was previously disclosed as a variable-rate transaction.

ii. Even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosures results if the creditor either:

A. Increases the rate based on a variable-rate feature that was not previously disclosed; or

B. Adds a variable-rate feature to the obligation. A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists.

iii. If either of the events in paragraph 20(a)3.ii.A. or ii.B. occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under §226.19(b) also must be given at that time.

4. *Unearned finance charge.* In a transaction involving precomputed finance charges, the creditor must include in the finance charge on the refinanced obligation any unearned portion of the original finance charge that is not rebated to the consumer or credited against the underlying obligation. For example, in a transaction with an add-on finance charge, a creditor advances new money to a consumer in a fashion that extinguishes the original obligation and replaces it with a new one. The creditor neither refunds the unearned finance charge on the original obligation to the consumer nor credits it to the remaining balance on the old obligation. Under these circumstances, the unearned finance charge must be included in the finance charge on the new obligation and reflected in the annual percentage rate disclosed on refinancing. Accrued but unpaid finance charges are included in the amount financed in the new obligation.

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

*Paragraph 20(a)(1).*

1. *Renewal.* This exception applies both to obligations with a single payment of principal and interest and to obligations with periodic payments of interest and a final payment of principal. In determining whether a new obligation replacing an old one is a renewal of the original terms or a refinancing, the creditor may consider it a renewal even if:

• Accrued unpaid interest is added to the principal balance.

• Changes are made in the terms of renewal resulting from the factors listed in §226.17(c)(3).

• The principal at renewal is reduced by a curtailment of the obligation.

*Paragraph 20(a)(2).*

1. *Annual percentage rate reduction.* A reduction in the annual percentage rate with a corresponding change in the payment schedule is not a refinancing. If the annual percentage rate is subsequently increased (even though it remains below its original level) and the increase is effected in such a way that the old obligation is satisfied and replaced, new disclosures must then be made.

2. *Corresponding change.* A corresponding change in the payment schedule to implement a lower annual percentage rate would be a shortening of the maturity, or a reduction in the payment amount or the number of payments of an obligation. The exception in §226.20(a)(2) does not apply if the maturity is lengthened, or if the payment amount or number of payments is increased beyond that remaining on the existing transaction.

*Paragraph 20(a)(3).*

1. *Court agreements.* This exception includes, for example, agreements such as reaffirmations of debts discharged in bankruptcy, settlement agreements, and post-judgment agreements. (See the commentary to §226.2(a)(14) for a discussion of court-approved agreements that are not considered ''credit.'')

*Paragraph 20(a)(4).*

1. *Workout agreements.* A workout agreement is not a refinancing unless the annual percentage rate is increased or additional credit is advanced beyond amounts already accrued plus insurance premiums.

*Paragraph 20(a)(5).*

1. *Insurance renewal.* The renewal of optional insurance added to an existing credit transaction is not a refinancing, assuming that appropriate Truth in Lending disclosures were provided for the initial purchase of the insurance.

*Paragraph 20(b) Assumptions.*

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

• A residential mortgage transaction.

• An express acceptance of the subsequent consumer by the creditor.

• A written agreement.

The assumption of a nonexempt consumer credit obligation requires no disclosures unless all three elements are present. For example, an automobile dealer need not provide Truth in Lending disclosures to a customer who assumes an existing obligation secured by an automobile. However, a residential mortgage transaction with the elements described in §226.20(b) is an assumption that calls for new disclosures; the disclosures must be given whether or not the assumption is accompanied by changes in the terms of the obligation. (See comment 2(a)(24)–5 for a discussion of assumptions that are not considered residential mortgage transactions.)

2. *Existing residential mortgage transaction.* A transaction may be a residential mortgage transaction as to one consumer and not to the other consumer. In that case, the creditor must look to the assuming consumer in determining whether a residential mortgage transaction exists. To illustrate:

• The original consumer obtained a mortgage to purchase a home for vacation purposes. The loan was not a residential mortgage transaction as to that consumer. The mortgage is assumed by a consumer who will use the home as a principal dwelling. As to that consumer, the loan is a residential mortgage transaction. For purposes of §226.20(b), the assumed loan is an ''existing residential mortgage transaction'' requiring disclosures, if the other criteria for an assumption are met.

3. *Express agreement. Expressly agrees* means that the creditor's agreement must relate specifically to the new debtor and must unequivocally accept that debtor as a primary obligor. The following events are not construed to be express agreements between the creditor and the subsequent consumer:

• Approval of creditworthiness.

• Notification of a change in records.

• Mailing of a coupon book to the subsequent consumer.

• Acceptance of payments from the new consumer.

4. *Retention of original consumer.* The retention of the original consumer as an obligor in some capacity does not prevent the change from being an assumption, provided the new consumer becomes a primary obligor. But the mere addition of a guarantor to an obligation for which the original consumer remains primarily liable does not give rise to an assumption. However, if neither party is designated as the primary obligor but the creditor accepts payment from the subsequent consumer, an assumption exists for purposes of §226.20(b).

5. *Status of parties.* Section 226.20(b) applies only if the previous debtor was a consumer and the obligation is assumed by another consumer. It does not apply, for example, when an individual takes over the obligation of a corporation.

6. *Disclosures.* For transactions that are assumptions within this provision, the creditor must make disclosures based on the ''remaining obligation.'' For example:

• The amount financed is the remaining principal balance plus any arrearages or other accrued charges from the original transaction.

• If the finance charge is computed from time to time by application of a percentage rate to an unpaid balance, in determining the amount of the finance charge and the annual percentage rate to be disclosed, the creditor should disregard any prepaid finance charges paid by the original obligor, but must include in the finance charge any prepaid finance charge imposed in connection with the assumption.

• If the creditor requires the assuming consumer to pay any charges as a condition of the assumption, those sums are prepaid finance charges as to that consumer, unless exempt from the finance charge under §226.4. If a transaction involves add-on or discount finance charges, the creditor may make abbreviated disclosures, as outlined in §226.20(b) (1) through (5). Creditors providing disclosures pursuant to this section for assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term longer than one year need not provide new disclosures under §226.18(f)(2)(ii) or §226.19(b). In such transactions, a creditor may disclose the variable-rate feature solely in accordance with §226.18(f)(1).

7. *Abbreviated disclosures.* The abbreviated disclosures permitted for assumptions of transactions involving add-on or discount finance charges must be made clearly and conspicuously in writing in a form that the consumer may keep. However, the creditor need not comply with the segregation requirement of §226.17(a)(1). The terms *annual percentage rate* and *total of payments,* when disclosed according to §226.20(b) (4) and (5), are not subject to the description requirements of §226.18 (e) and (h). The term *annual percentage rate* disclosed under §226.20(b)(4) need not be more conspicuous than other disclosures.

*Paragraph 20(c) Variable-rate adjustments.*

1. *Timing of adjustment notices.* This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to §226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to §226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to §226.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

2. *Exceptions.* Section 226.20(c) does not apply to ''shared-equity,'' ''shared-appreciation,'' or ''price level adjusted'' or similar mortgages.

3. *Basis of disclosures.* The disclosures required under this section shall reflect the terms of the parties' legal obligation, as required under §226.17(c)(1).

*Paragraph 20(c)(1).*

1. *Current and prior interest rates.* The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount (''current rate'') and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice (''prior rates''). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.

*Paragraph 20(c)(2).*

1. *Current and prior index values.* This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in §226.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.

*Paragraph 20(c)(3).*

1. *Unapplied index increases.* The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate is

applicable only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

*Paragraph 20(c)(4).*

1. *Contractual effects of the adjustment.* The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the amount of the adjusted payment must be disclosed if such payment has changed as a result of the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under §226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

*Paragraph 20(c)(5).*

1. *Fully-amortizing payment.* This paragraph requires a disclosure only when negative amortization occurs as a result of the adjustment. A disclosure is not required simply because a loan calls for non-amortizing or partially amortizing payments. For example, in a transaction with a five-year term and payments based on a longer amortization schedule, and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is required, however, if the payment disclosed under §226.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in §226.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.)

References

*Statute:* None.

*Other sections:* Section 226.2.

*Previous regulation:* Section 226.8(j) through (l), and Interpretation Sections 226.807, 226.811, 226.814, and 226.817.

*1981 changes:* While the previous regulation treated virtually any change in terms as a refinancing requiring new disclosures, this regulation limits refinancings to transactions in which the entire original obligation is extinguished and replaced by a new one. Redisclosure is no longer required for deferrals or extensions.

The assumption provision retains the substance of §226.8(k) and Interpretation §226.807 of the previous regulation, but limits its scope to residential mortgage transactions.

*Section 226.21—Treatment of Credit Balances*

*Paragraph 21(a).*

1. *Credit balance.* A credit balance arises whenever the creditor receives or holds funds in an account in excess of the total balance due from the consumer on that account. A balance might result, for example, from the debtor's paying off a loan by transmitting funds in excess of the total balance owed on the account, or from the early payoff of a loan entitling the consumer to a rebate of insurance premiums and finance charges. However, §226.21 does not determine whether the creditor in fact owes or holds sums for the consumer. For example, if a creditor has no obligation to rebate any portion of precomputed finance charges on prepayment, the consumer's early payoff would not create a credit balance with respect to those charges. Similarly, nothing in this provision interferes with any rights the creditor may have under the contract or under state law with respect to set-off, cross collateralization, or similar provisions.

2. *Total balance due.* The phrase *total balance due* refers to the total outstanding balance. Thus, this provision does not apply where the consumer has simply paid an amount in excess of the payment due for a given period.

3. *Timing of refund.* The creditor may also fulfill its obligation under this section by:

- Refunding any credit balance to the consumer immediately.
- Refunding any credit balance prior to a written request from the consumer.
- Making a good faith effort to refund any credit balance before 6 months have passed. If that attempt is unsuccessful, the creditor need not try again to refund the credit balance at the end of the 6-month period.

*Paragraph 21(b).*

1. *Written requests—standing orders.* The creditor is not required to honor standing orders requesting refunds of any credit balance that may be created on the consumer's account.

*Paragraph 21(c).*

1. *Good faith effort to refund.* The creditor must take positive steps to return any credit balance that has remained in the account for over 6 months. This includes, if necessary,

attempts to trace the consumer through the consumer's last known address or telephone number, or both.

2. *Good faith effort unsuccessful.* Section 226.21 imposes no further duties on the creditor if a good faith effort to return the balance is unsuccessful. The ultimate disposition of the credit balance (or any credit balance of $1 or less) is to be determined under other applicable law.

References

*Statute:* Section 165.

*Other sections:* None.

*Previous regulation:* None.

*1981 changes:* This section implements section 165 of the Act, which was expanded by the 1980 statutory amendments to apply to closed-end as well as open-end credit.

*Section 226.22—Determination of the Annual Percentage Rate*

*22(a) Accuracy of the annual percentage rate.*

*Paragraph 22(a)(1).*

1. *Calculation method.* The regulation recognizes both the actuarial method and the United States Rule Method (U.S. Rule) as measures of an exact annual percentage rate. Both methods yield the same annual percentage rate when payment intervals are equal. They differ in their treatment of unpaid accrued interest.

2. *Actuarial method.* When no payment is made, or when the payment is insufficient to pay the accumulated finance charge, the actuarial method requires that the unpaid finance charge be added to the amount financed and thereby capitalized. Interest is computed on interest since in succeeding periods the interest rate is applied to the unpaid balance including the unpaid finance charge. Appendix J provides instructions and examples for calculating the annual percentage rate using the actuarial method.

3. *U.S. Rule.* The U.S. Rule produces no compounding of interest in that any unpaid accrued interest is accumulated separately and is not added to principal. In addition, under the U.S. Rule, no interest calculation is made until a payment is received.

4. *Basis for calculations.* When a transaction involves ''step rates'' or ''split rates''—that is, different rates applied at different times or to different portions of the principal balance—a single composite annual percentage rate must be calculated and disclosed for the entire transaction. Assume, for example, a step-rate transaction in which a $10,000 loan is repayable in 5 years at 10 percent interest for the first 2 years, 12 percent for years 3 and 4, and 14 percent for year 5. The monthly payments are $210.71 during the first 2 years of the term, $220.25 for years 3 and 4, and $222.59 for year 5. The composite annual percentage rate, using a calculator with a ''discounted cash flow analysis'' or ''internal rate of return'' function, is 10.75 percent.

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

*Paragraph 22(a)(2).*

1. *Regular transactions.* The annual percentage rate for a regular transaction is considered accurate if it varies in either direction by not more than ⅛ of 1 percentage point from the actual annual percentage rate. For example, when the exact annual percentage rate is determined to be 10⅛%, a disclosed annual percentage rate from 10% to 10¼%, or the decimal equivalent, is deemed to comply with the regulation.

*Paragraph 22(a)(3).*

1. *Irregular transactions.* The annual percentage rate for an irregular transaction is considered accurate if it varies in either direction by not more than ¼ of 1 percentage point from the actual annual percentage rate. This tolerance is intended for more complex transactions that do not call for a single advance and a regular series of equal payments at equal intervals. The ¼ of 1 percentage point tolerance may be used, for example, in a construction loan where advances are made as construction progresses, or in a transaction where payments vary to reflect the consumer's seasonal income. It may also be used in transactions with graduated payment schedules where the contract commits the consumer to several series of payments in different amounts. It does not apply, however, to loans with variable rate features where the initial disclosures are based on a regular amortization schedule over the life of the loan, even though payments may later change because of the variable rate feature.

*22(a)(4) Mortgage loans.*

1. *Example.* If a creditor improperly omits a $75 fee from the finance charge on a regular transaction, the understated finance charge is considered accurate under §226.18(d)(1), and the annual percentage rate corresponding to that understated finance charge also is considered accurate even if it

falls outside the tolerance of ⅛ of 1 percentage point provided under §226.22(a)(2). Because a $75 error was made, an annual percentage rate corresponding to a $100 understatement of the finance charge would not be considered accurate.

*22(a)(5) Additional tolerance for mortgage loans.*

1. *Example.* This paragraph contains an additional tolerance for a disclosed annual percentage rate that is incorrect but is closer to the actual annual percentage rate than the rate that would be considered accurate under the tolerance in §226.22(a)(4). To illustrate: in an irregular transaction subject to a ¼ of 1 percentage point tolerance, if the actual annual percentage rate is 9.00 percent and a $75 omission from the finance charge corresponds to a rate of 8.50 percent that is considered accurate under §226.22(a)(4), a disclosed APR of 8.65 percent is within the tolerance in §226.22(a)(5). In this example of an understated finance charge, a disclosed annual percentage rate below 8.50 or above 9.25 percent will not be considered accurate.

*22(b) Computation tools.*

*Paragraph 22(b)(1).*

1. *Board tables.* Volumes I and II of the Board's Annual Percentage Rate Tables provide a means of calculating annual percentage rates for regular and irregular transactions, respectively. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation, even where use of the tables produces a rate that falls outside the general standard of accuracy. To illustrate:

• Volume I may be used for single advance transactions with completely regular payment schedules or with payment schedules that are regular except for an odd first payment, odd first period or odd final payment. When used for a transaction with a large final balloon payment, Volume I may produce a rate that is considerably higher than the exact rate produced using a computer program based directly on appendix J. However, the Volume I rate—produced using certain adjustments in that volume—is considered to be in compliance.

*Paragraph 22(b)(2).*

1. *Other calculation tools.* Creditors need not use the Board tables in calculating the annual percentage rates. Any computation tools may be used, so long as they produce annual percentage rates within ⅛ or ¼ of 1 percentage point, as applicable, of the precise actuarial or U.S. Rule annual percentage rate.

*22(c) Single add-on rate transactions.*

1. *General rule.* Creditors applying a single add-on rate to all transactions up to 60 months in length may disclose the same annual percentage rate for all those transactions, although the actual annual percentage rate varies according to the length of the transaction. Creditors utilizing this provision must show the highest of those rates. For example:

• An add-on rate of 10 percent converted to an annual percentage rate produce the following actual annual percentage rates at various maturities: at 3 months, 14.94 percent; at 21 months, 18.18 percent; and at 60 months, 17.27 percent. The creditor must disclose an annual percentage rate of 18.18 percent (the highest annual percentage rate) for any transaction up to 5 years, even though that rate is precise only for a transaction of 21 months.

*22(d) Certain transactions involving ranges of balances.*

1. *General rule.* Creditors applying a fixed dollar finance charge to all balances within a specified range of balances may understate the annual percentage rate by up to 8 percent of that rate, by disclosing for all those balances the annual percentage rate computed on the median balance within that range. For example:

• If a finance charge of $9 applies to all balances between $91 and $100, an annual percentage rate of 10 percent (the rate on the median balance) may be disclosed as the annual percentage rate for all balances, even though a $9 finance charge applied to the lowest balance ($91) would actually produce an annual percentage rate of 10.7 percent.

References

*Statute:* Section 107.

*Other sections:* Section 226.17(c)(4) and appendix J.

*Previous regulation: Section 226.5(b) through (e).*

*1981 changes:* The section now provides a larger tolerance (¼ of 1 percentage point) for irregular transactions.

*Section 226.23—Right of Rescission*

1. *Transactions not covered.* Credit extensions that are not subject to the regulation are not covered by §226.23 even if a customer's principal dwelling is the collateral securing the credit. For example, the right of rescission does not apply to a business purpose loan, even though the loan is secured by the customer's principal dwelling.

*23(a) Consumer's right to rescind.*

*Paragraph 23(a)(1).*

1. *Security interest arising from transaction.* In order for the right of rescission to apply, the security interest must be retained as part of the credit transaction. For example:

• A security interest that is acquired by a contractor who is also extending the credit in the transaction.

• A mechanic's or materialman's lien that is retained by a subcontractor or supplier of the contractor-creditor, even when the latter

has waived its own security interest in the consumer's home.

The security interest is not part of the credit transaction and therefore the transaction is not subject to the right of rescission when, for example:

• A mechanic's or materialman's lien is obtained by a contractor who is not a party to the credit transaction but is merely paid with the proceeds of the consumer's unsecured bank loan.

• All security interests that may arise in connection with the credit transaction are validly waived.

• The creditor obtains a lien and completion bond that in effect satisfies all liens against the consumer's principal dwelling as a result of the credit transaction.

Although liens arising by operation of law are not considered security interests for purposes of disclosure under §226.2, that section specifically includes them in the definition for purposes of the right of rescission. Thus, even though an interest in the consumer's principal dwelling is not a required disclosure under §226.18(m), it may still give rise to the right of rescission.

2. *Consumer*. To be a consumer within the meaning of §226.2, that person must at least have an ownership interest in the dwelling that is encumbered by the creditor's security interest, although that person need not be a signatory to the credit agreement. For example, if only one spouse signs a credit contract, the other spouse is a consumer if the ownership interest of that spouse is subject to the security interest.

3. *Principal dwelling*. A consumer can only have one principal dwelling at a time. (But see comment 23(a)(1)–4.) A vacation or other second home would not be a principal dwelling. A transaction secured by a second home (such as a vacation home) that is not currently being used as the consumer's principal dwelling is not rescindable, even if the consumer intends to reside there in the future. 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 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, a construction loan to finance B and secured by B is a residential mortgage transaction. Dwelling, as defined in §226.2, includes structures that are classified as personalty under state law. For example, a transaction secured by a mobile home, trailer, or houseboat used as the consumer's principal dwelling may be rescindable.

4. *Special rule for principal dwelling*. Notwithstanding the general rule that consumers may have only one principal dwelling, when the consumer is acquiring or constructing a new principal dwelling, any loan subject to Regulation Z and secured by the equity in the consumer's current principal dwelling (for example, a bridge loan) is 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. A loan secured by both A and B is, likewise, rescindable.

5. *Addition of a security interest*. Under footnote 47, the addition of a security interest in a consumer's principal dwelling to an existing obligation is rescindable even if the existing obligation is not satisfied and replaced by a new obligation, and even if the existing obligation was previously exempt (because it was credit over $25,000 not secured by real property or a consumer's principal dwelling). The right of rescission applies only to the added security interest, however, and not to the original obligation. In those situations, only the §226.23(b) notice need be delivered, not new material disclosures; the rescission period will begin to run from the delivery of the notice.

*Paragraph 23(a)(2)*.

1. *Consumer's exercise of right*. The consumer must exercise the right of rescission in writing but not necessarily on the notice supplied under §226.23(b). Whatever the means of sending the notification of rescission—mail, telegram or other written means—the time period for the creditor's performance under §226.23(d)(2) does not begin to run until the notification has been received. The creditor may designate an agent to receive the notification so long as the agent's name and address appear on the notice provided to the consumer under §226.23(b). Where the creditor fails to provide the consumer with a designated address for sending the notification of rescission, delivering notification to the person or address to which the consumer has been directed to send, payments constitutes delivery to the creditor or assignee. State law determines whether delivery of the notification to a third party other than the person to whom payments are made is delivery to the creditor or assignee, in the case where the creditor fails to designate an address for sending the notification of rescission.

*Paragraph 23(a)(3)*.

1. *Rescission period*. The period within which the consumer may exercise the right to rescind runs for 3 business days from the last of 3 events:

• Consummation of the transaction.

• Delivery of all material disclosures.

• Delivery to the consumer of the required rescission notice.

For example, if a transaction is consummated on Friday, June 1, and the disclosures and notice of the right to rescind were given on Thursday, May 31, the rescission period will expire at midnight of the third business day after June 1—that is, Tuesday, June 5. In another example, if the disclosures are given and the transaction consummated on Friday, June 1, and the rescission notice is given on Monday, June 4, the rescission period expires at midnight of the third business day after June 4—that is, Thursday, June 7. The consumer must place the rescission notice in the mail, file it for telegraphic transmission, or deliver it to the creditor's place of business within that period in order to exercise the right.

2. *Material disclosures*. Footnote 48 sets forth the material disclosures that must be provided before the rescission period can begin to run. Failure to provide information regarding the annual pecentage rate also includes failure to inform the consumer of the existence of a variable rate feature. Failure to give the other required disclosures does not prevent the running of the rescission period, although that failure may result in civil liability or administrative sanctions.

3. *Unexpired right of rescission*. When the creditor has failed to take the action necessary to start the three-business day rescission period running, the right to rescind automatically lapses on the occurrence of the earliest of the following three events:

• The expiration of three years after consummation of the transaction.
• Transfer of all the consumer's interest in the property.
• Sale of the consumer's interest in the property, including a transaction in which the consumer sells the dwelling and takes back a purchase money note and mortgage or retains legal title through a device such as an installment sale contract.

Transfer of all the consumers' interest includes such transfers as bequests and gifts. A sale or transfer of the property need not be voluntary to terminate the right to rescind. For example, a foreclosure sale would terminate an unexpired right to rescind. As provided in section 125 of the Act, the three-year limit may be extended by an administrative proceeding to enforce the provisions of this section. A partial transfer of the consumer's interest, such as a transfer bestowing co-ownership on a spouse, does not terminate the right of rescission.

*Paragraph 23(a)(4)*.

1. *Joint owners*. When more than one consumer has the right to rescind a transaction, any of them may exercise that right and cancel the transaction on behalf of all. For example, if both husband and wife have the right to rescind a transaction, either spouse acting alone may exercise the right and both are bound by the rescission.

*23(b) Notice of right to rescind*.

1. *Who receives notice*. Each consumer entitled to rescind must be given:

• Two copies of the rescission notice.
• The material disclosures.

In a transaction involving joint owners, both of whom are entitled to rescind, both must receive the notice of the right to rescind and disclosures. For example, if both spouses are entitled to rescind a transaction, each must receive two copies of the rescission notice (one copy to each if the notice is provided in electronic form in accordance with the consumer consent and other applicable provisions of the E-Sign Act) and one copy of the disclosures.

2. *Format*. The notice must be on a separate piece of paper, but may appear with other information such as the itemization of the amount financed. The material must be clear and conspicuous, but no minimum type size or other technical requirements are imposed. The notices in appendix H provide models that creditors may use in giving the notice.

3. *Content*. The notice must include all of the information outlined in Section 226.23(b)(1)(i) through (v). The requirement in §226.23(b) that the transaction be identified may be met by providing the date of the transaction. The creditor may provide a separate form that the consumer may use to exercise the right of rescission, or that form may be combined with the other rescission disclosures, as illustrated in appendix H. The notice may include additional information related to the required information, such as:

• A description of the property subject to the security interest.
• A statement that joint owners may have the right to rescind and that a rescission by one is effective for all.
• The name and address of an agent of the creditor to receive notice of rescission.

4. *Time of providing notice*. The notice required by §226.23(b) need not be given before consummation of the transaction. The creditor may deliver the notice after the transaction is consummated, but the rescission period will not begin to run until the notice is given. For example, if the creditor provides the notice on May 15, but disclosures were given and the transaction was consummated on May 10, the 3-business day rescission period will run from May 15.

*23(c) Delay of creditor's performance*.

1. *General rule*. Until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded, the creditor must not, either directly or through a third party:

• Disburse loan proceeds to the consumer.
• Begin performing services for the consumer.
• Deliver materials to the consumer.

2. *Escrow*. The creditor may disburse loan proceeds during the rescission period in a valid escrow arrangement. The creditor may not, however, appoint the consumer as ''trustee'' or ''escrow agent'' and distribute funds to the consumer in that capacity during the delay period.

3. *Actions during the delay period*. Section 226.23(c) does not prevent the creditor from taking other steps during the delay, short of beginning actual performance. Unless otherwise prohibited, such as by state law, the creditor may, for example:

• Prepare the loan check.

• Perfect the security interest.

• Prepare to discount or assign the contract to a third party.

• Accrue finance charges during the delay period.

4. *Delay beyond rescission period*. The creditor must wait until it is reasonably satisfied that the consumer has not rescinded. For example, the creditor may satisfy itself by doing one of the following:

• Waiting a reasonable time after expiration of the rescission period to allow for delivery of a mailed notice.

• Obtaining a written statement from the consumer that the right has not been exercised.

When more than one consumer has the right to rescind, the creditor cannot reasonably rely on the assurance of only one consumer, because other consumers may exercise the right.

*23(d) Effects of rescission.*

*Paragraph 23(d)(1).*

1. *Termination of security interest*. Any security interest giving rise to the right of rescission becomes void when the consumer exercises the right of rescission. The security interest is automatically negated regardless of its status and whether or not it was recorded or perfected. Under §226.23(d)(2), however, the creditor must take any action necessary to reflect the fact that the security interest no longer exists.

*Paragraph 23(d)(2).*

1. *Refunds to consumer*. The consumer cannot be required to pay any amount in the form of money or property either to the creditor or to a third party as part of the credit transaction. Any amounts of this nature already paid by the consumer must be refunded. ''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. It is irrelevant that these amounts may not represent profit to the creditor.

2. *Amounts not refundable to consumer*. Creditors need not return any money given by the consumer to a third party outside of the credit transaction, such as costs incurred for a building permit or for a zoning variance. Similarly, the term *any amount* does not apply to any money or property given by the creditor to the consumer; those amounts must be tendered by the consumer to the creditor under §226.23(d)(3).

3. *Reflection of security interest termination*. The creditor must take whatever steps are necessary to indicate that the security interest is terminated. Those steps include the cancellation of documents creating the security interest, and the filing of release or termination statements in the public record. In a transaction involving subcontractors or suppliers that also hold security interests related to the credit transaction, the creditor must insure that the termination of their security interests is also reflected. The 20-day period for the creditor's action refers to the time within which the creditor must begin the process. It does not require all necessary steps to have been completed within that time, but the creditor is responsible for seeing the process through to completion.

*Paragraph 23(d)(3).*

1. *Property exchange*. Once the creditor has fulfilled its obligations under §226.23(d)(2), the consumer must tender to the creditor any property or money the creditor has already delivered to the consumer. At the consumer's option, property may be tendered at the location of the property. For example, if lumber or fixtures have been delivered to the consumer's home, the consumer may tender them to the creditor by making them available for pick-up at the home, rather than physically returning them to the creditor's premises. Money already given to the consumer *must* be tendered at the creditor's place of business.

2. *Reasonable value*. If returning the property would be extremely burdensome to the consumer, the consumer may offer the creditor its reasonable value rather than returning the property itself. For example, if building materials have already been incorporated into the consumer's dwelling, the consumer may pay their reasonable value.

*Paragraph 23(d)(4).*

1. *Modifications*. The procedures outlined in §226.23(d)(2) and (3) may be modified by a court. For example, when a consumer is in bankruptcy proceedings and prohibited from returning anything to the creditor, or when the equities dictate, a modification might be made. The sequence of procedures under §226.23(d)(2) and (3), or a court's modification of those procedures under §226.23(d)(4), does not affect a consumer's substantive right to rescind and to have the loan amount adjusted accordingly. Where the consumer's right to rescind is contested by the creditor, a court would normally determine whether

the consumer has a right to rescind and determine the amounts owed before establishing the procedures for the parties to tender any money or property.

*23(e) Consumer's waiver of right to rescind.*

1. *Need for waiver.* To waive the right to rescind, the consumer must have a bona fide personal financial emergency that must be met before the end of the rescission period. The existence of the consumer's waiver will not, of itself, automatically insulate the creditor from liability for failing to provide the right of rescission.

2. *Procedure.* To waive or modify the right to rescind, the consumer must give a written statement that specifically waives or modifies the right, and also includes a brief description of the emergency. Each consumer entitled to rescind must sign the waiver statement. In a transaction involving multiple consumers, such as a husband and wife using their home as collateral, the waiver must bear the signatures of both spouses.

*23(f) Exempt transactions.*

1. *Residential mortgage transaction.* Any transaction to construct or acquire a principal dwelling, whether considered real or personal property, is exempt. (See the commentary to §226.23(a).) For example, a credit transaction to acquire a mobile home or houseboat to be used as the consumer's principal dwelling would not be rescindable.

2. *Lien status.* The lien status of the mortgage is irrelevant for purposes of the exemption in §226.23(f)(1); the fact that a loan has junior lien status does not by itself preclude application of this exemption. For example, a home buyer may assume the existing first mortgage and create a second mortgage to finance the balance of the purchase price. Such a transaction would not be rescindable.

3. *Combined-purpose transaction.* A loan to acquire a principal dwelling and make improvements to that dwelling is exempt if treated as one transaction. If, on the other hand, the loan for the acquisition of the principal dwelling and the subsequent advances for improvements are treated as more than one transaction, then only the transaction that finances the acquisition of that dwelling is exempt.

4. *New advances.* The exemption in §226.23(f)(2) applies only to refinancings (including consolidations) by the original creditor. The original creditor is the creditor to whom the written agreement was initially made payable. In a merger, consolidation or acquisition, the successor institution is considered the original creditor for purposes of the exemption in §226.23(f)(2). If the refinancing involves a new advance of money, the amount of the new advance is rescindable. In determining whether there is a new advance, a creditor may rely on the amount financed, refinancing costs, and other figures stated in the latest Truth in Lending disclosures provided to the consumer and is not required to use, for example, more precise information that may only become available when the loan is closed. For purposes of the right of rescission, a new advance does not include amounts attributed solely to the costs of the refinancing. These amounts would include §226.4(c)(7) charges (such as attorneys fees and title examination and insurance fees, if bona fide and reasonable in amount), as well as insurance premiums and other charges that are not finance charges. (Finance charges on the new transaction—points, for example—would not be considered in determining whether there is a new advance of money in a refinancing since finance charges are not part of the amount financed.) To illustrate, if the sum of the outstanding principal balance plus the earned unpaid finance charge is $50,000 and the new amount financed is $51,000, then the refinancing would be exempt if the extra $1,000 is attributed solely to costs financed in connection with the refinancing that are not finance charges. Of course, if new advances of money are made (for example, to pay for home improvements) and the consumer exercises the right of rescission, the consumer must be placed in the same position as he or she was in prior to entering into the new credit transaction. Thus, all amounts of money (which would include all the costs of the refinancing) already paid by the consumer to the creditor or to a third party as part of the refinancing would have to be refunded to the consumer. (See the commentary to §226.23(d)(2) for a discussion of refunds to consumers.) A model rescission notice applicable to transactions involving new advances appears in appendix H. The general rescission notice (model form H–8) is the appropriate form for use by creditors not considered original creditors in refinancing transactions.

5. *State creditors.* Cities and other political subdivisions of states acting as creditors are not exempted from this section.

6. *Multiple advances.* Just as new disclosures need not be made for subsequent advances when treated as one transaction, no new rescission rights arise so long as the appropriate notice and disclosures are given at the outset of the transaction. For example, the creditor extends credit for home improvements secured by the consumer's principal dwelling, with advances made as repairs progress. As permitted by §226.17(c)(6), the creditor makes a single set of disclosures at the beginning of the construction period, rather than separate disclosures for each advance. The right of rescission does not arise with each advance. However, if the advances are treated as separate transactions, the right of rescission applies to each advance.

7. *Spreader clauses.* When the creditor holds a mortgage or deed of trust on the consumer's principal dwelling and that mortgage or deed of trust contains a ''spreader

clause,'' subsequent loans made are separate transactions and are subject to the right of rescission. Those loans are rescindable unless the creditor effectively waives its security interest under the spreader clause with respect to the subsequent transactions.

8. *Converting open-end to closed-end credit.* Under certain state laws, consummation of a closed-end credit transaction may occur at the time a consumer enters into the intitial open-end credit agreement. As provided in the commentary to §226.17(b), closed-end credit disclosures may be delayed under these circumstances until the conversion of the open-end account to a closed-end transaction. In accounts secured by the consumer's principal dwelling, no new right of rescission arises at the time of conversion. Rescission rights under §226.15 are unaffected.

*23(g) Tolerances for accuracy.*

*23(g)(2) One percent tolerance.*

1. *New advance.* The phrase ''new advance'' has the same meaning as in comment 23(f)–4.

*23(h) Special Rules for Foreclosures.*

1. *Rescission.* Section 226.23(h) applies only to transactions that are subject to rescission under §226.23(a)(1).

*Paragraph 23(h)(1)(i).*

1. *Mortgage broker fees.* A consumer may rescind a loan in foreclosure if a mortgage broker fee that should have been included in the finance charge was omitted, without regard to the dollar amount involved. If the amount of the mortgage broker fee is included but misstated the rule in §226.23(h)(2) applies.

*23(h)(2) Tolerance for disclosures.*

1. *General.* This section is based on the accuracy of the total finance charge rather than its component charges.

References

*Statute:* Sections 113, 125, and 130.

*Other sections:* Section 226.2 and appendix H.

*Previous regulation:* Section 226.9.

*1981 changes:* The right to rescind applies not only to real property used as the consumer's principal dwelling, but to personal property as well. The regulation provides no specific text or format for the notice of the right to rescind.

*Section 226.24—Advertising*

1. *Clear and conspicuous standard.* This section is subject to the general ''clear and conspicous'' standard for this subpart but prescribes no specific rules for the format of the necessary disclosures. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisment. For example, a merchandise tag that is an advertisement under the regulation complies with this section if the necessary credit terms are on both sides of the tag, so long as each side is accessible.

*24(a) Actually available terms.*

1. *General rule.* To the extent that an advertisement mentions specific credit terms, it may state only those terms that the creditor is actually prepared to offer. For example, a creditor may not advertise a very low annual percentage rate that will not in fact be available at any time. This provision is not intended to inhibit the promotion of new credit programs, but to bar the advertising of terms that are not and will not be available. For example, a creditor may advertise terms that will be offered for only a limited period, or terms that will become available at a future date.

*24(b) Advertisment of rate of finance charge.*

1. *Annual percentage rate.* Advertised rates must be stated in terms of an *annual percentage rate,* as defined in §226.22. Even though state or local law permits the use of add-on, discount, time-price differential, or other methods of stating rates, advertisements must state them as annual percentage rates. Unlike the transactional disclosure of an annual percentage rate under §226.18(e), the advertised annual percentage rate need not include a descriptive explanation of the term and may be expressed using the abbreviation *APR.* The advertisement must state that the rate is subject to increase after consummation if that is the case, but the advertisement need not describe the rate increase, its limits, or how it would affect the payment schedule. As under §226.18(f), relating to disclosure of a variable rate, the rate increase disclosure requirement in this provision does not apply to any rate increase due to delinquency (including late payment), default, acceleration, assumption, or transfer of collateral.

2. *Simple or periodic rates.* The advertisement may not simultaneously state any other rate, except that a simple annual rate or periodic rate applicable to an unpaid balance may appear along with (but not more conspicuously than) the annual percentage rate. For example:

• In an advertisement for real estate, a simple interest rate may be shown in the same type size as the annual percentage rate for the advertised credit.

3. *Buydowns.* When a third party (such as a seller) or a creditor wishes to promote the availability of reduced interest rates (consumer or seller buydowns), the advertised annual percentage rate must be determined in accordance with the rules in the commentary to §226.17(c) regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the

term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period without triggering the additional disclosures under §226.24(c)(2). For example, the advertisement may state that ''with this buydown arrangement, your monthly payments for the first 3 years of the mortgage term will be only $350'' or ''this buydown arrangement will reduce your monthly payments for the first 3 years of the mortgage term by $150.''

4. *Effective rates.* In some transactions the consumer's payments may be based upon an interest rate lower than the rate at which interest is accruing. The lower rate may be referred to as the effective rate, payment rate or qualifying rate. A creditor or seller may advertise such rates by stating: The term of the reduced payment schedule, the interest rate upon which the reduced payments are calculated, the rate at which the interest is in fact accruing, and the annual percentage rate. The advertised annual percentage rate that must accompany this rate must take into account the interest that will accrue but will not be paid during this period. For example, an advertisement may state ''An effective first year interest rate of 10 percent. Interest being earned at 14 percent. Annual percentage rate 15 percent.''

5. *Discounted variable-rate transactions.* The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 17(c)(1)–10 regarding the basis of transactional disclosures for such financing. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced initial rate, provided the advertisement shows the limited term to which the reduced rate applies.

• Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 17(c)(1)–10, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.

• The advertisement may also show the effect of the discount on the payment schedule for the discount period without triggering the additional disclosures under §226.24(c). For example, the advertisement may state that ''with this discount, your monthly payments for the first year of the mortgage term will be only $577'' or ''this discount will reduce your monthly payments for the first year of the mortgage term by $223.''

*24(c) Advertisement of terms that require additional disclosures.*

1. *General rule.* Under §226.24(c)(1), whenever certain triggering terms appear in credit advertisements, the additional credit terms enumerated in §226.24(c)(2) must also appear. These provisions apply even if the triggering term is not stated explicitly, but may be readily determined from the advertisement. For example, an advertisement may state ''80% financing available,'' which is in fact indicating that a 20% downpayment is required.

*Paragraph 24(c)(1).*

1. *Downpayment.* The dollar amount of a downpayment or a statement of the downpayment as a percentage of the price requires further information. By virtue of the definition of *downpayment* in §226.2, this triggering term is limited to credit sale transactions. It includes such statements as:

• *Only 5% down.*
• *As low as $100 down.*
• *Total move-in costs of $800.*

This provision applies only if a downpayment is actually required; statements such as *no downpayment* or *no trade-in required* do not trigger the additional disclosures under this paragraph.

2. *Payment period.* The number of payments required or the total period of repayment includes such statements as:

• *48-month payment terms.*
• *30-year mortgage.*
• *Repayment in as many as 36 monthly installments.*

But it does not include such statements as ''pay weekly,'' ''monthly payment terms arranged,'' or ''take years to repay,'' since these statements do not indicate a time period over which a loan may be financed.

3. *Payment amount.* The dollar amount of any payment includes statements such as:

• ''Payable in installments of $103.''
• ''$25 weekly.''
• ''$1,200 balance payable in 10 equal installments.''

In the last example, the amount of each payment is readily determinable, even though not explicitly stated. But statements such as ''monthly payments to suit your needs'' or ''regular monthly payments'' are not covered.

4. *Finance charge.* The dollar amount of the finance charge or any portion of it includes statements such as:

• ''$500 total cost of credit.''
• ''$2 monthly carrying charge.''
• ''$50,000 mortgages, 2 points to the borrower.''

In the last example, the $1,000 prepaid finance charge can be readily determined from the information given. Statements of the annual percentage rate or statements that there is no particular charge for credit (such as ''no closing costs'') are not triggering terms under this paragraph.

*Paragraph 24(c)(2).*

1. *Disclosure of downpayment.* The total downpayment as a dollar amount or percentage must be shown, but the word ''downpayment'' need not be used in making this disclosure. For example, ''10% cash required

from buyer'' or ''credit terms require minimum $100 trade-in'' would suffice.

2. *Disclosure of repayment terms.* While the phrase *terms of repayment* generally has the same meaning as the *payment schedule* required to be disclosed under § 226.18(g), § 226.24(c)(2)(ii) provides greater flexibility to creditors in making this disclosure for advertising purposes. Repayment terms may be expressed in a variety of ways in addition to an exact repayment schedule; this is particularly true for advertisements that do not contemplate a single specific transaction. For example:

• A creditor may use a unit-cost approach in making the required disclosure, such as ''48 monthly payments of $27.83 per $1,000 borrowed.''

• In an advertisement for credit secured by a dwelling, when any series of payments varies because of a graduated payment feature or because of the inclusion of mortgage insurance premiums, a creditor may state the number and timing of payments, the amounts of the largest and smallest of those payments, and the fact that other payments will vary between those amounts.

3. *Annual percentage rate.* The advertised annual percentage rate may be expressed using the abbreviation ''APR.'' The advertisement must also state, if applicable, that the annual percentage rate is subject to increase after consummation.

4. *Use of examples.* Footnote 49 authorizes the use of illustrative credit transactions to make the necessary disclosures under § 226.24(c)(2). That is, where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions, so long as each example contains all of the applicable terms required by § 226.24(c). The examples must be labelled as such and must reflect representative credit terms that are made available by the creditor to present and prospective customers.

*24(d) Catalogs or Other Multiple-page Advertisements; Electronic Advertisements*

1. *Definition.* The multiple-page advertisements to which this section refers are advertisements consisting of a series of sequentially numbered pages—for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.24(d).

2. *General.* Section 226.24(d) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement, or in an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.24(c)(1). A list of different annual percentage rates applicable to different balances, for example, does not trigger further disclosures under § 226.24(c)(2) and so is not covered by § 226.24(d).

3. *Representative examples.* The table or schedule must state all the necessary information for a representative sampling of amounts of credit. This must reflect amounts of credit the creditor actually offers, up to and including the higher-priced items. This does not mean that the chart must make the disclosures for the single most expensive item the seller offers, but only that the chart cannot be limited to information about less expensive sales when the seller commonly offers a distinct level of more expensive goods or services. The range of transactions shown in the table or schedule in a particular catalog or multiple-page advertisement need not exceed the range of transactions actually offered in that advertisement.

4. *Electronic advertisement.* If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.24(d)(1), any statement of terms set forth in § 226.24(c)(1) appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

References

*Statute:* Sections 141, 142, and 144.

*Other sections:* Sections 226.2, 226.4, and 226.22.

*Previous regulation:* Section 226.10 (a), (b), and (d).

*1981 changes:* This section retains the advertising rules in a form very similar to the previous regulation, but with certain changes to reflect the 1980 statutory amendments. For example, if triggering terms appear in any advertisement, the additional disclosures required no longer include the cash price. The special rule for FHA section 235 financing has been eliminated, as well as the rule for advertising credit payable in more than four installments with no identified finance charge. Interpretation § 226.1002, requiring disclosure of representative amounts of credit in catalogs and multiple-page advertisements, has been incorporated in simplified form in § 226.24(d).

Unlike the previous regulation, if the advertised annual percentage rate is subject to increase, that fact must now be disclosed.

SUBPART D—MISCELLANEOUS

*Section 226.25—Record Retention*

*25(a) General rule.*

1. *Evidence of required actions.* The creditor must retain evidence that it performed the required actions as well as made the required

disclosures. This includes, for example, evidence that the creditor properly handled adverse credit reports in connection with amounts subject to a billing dispute under § 226.13, and properly handled the refunding of credit balances under §§ 226.11 and 226.21.

2. *Methods of retaining evidence.* Adequate evidence of compliance does not necessarily mean actual paper copies of disclosure statements or other business records. The evidence may be retained on microfilm, microfiche, or by any other method that reproduces records accurately (including computer programs). The creditor need retain only enough information to reconstruct the required disclosures or other records. Thus, for example, the creditor need not retain each open-end periodic statement, so long as the specific information on each statement can be retrieved.

3. *Certain variable-rate transactions.* In variable-rate transactions that are subject to the disclosure requirements of § 226.19(b), written procedures for compliance with those requirements as well as a sample disclosure form for each loan program represent adequate evidence of compliance. (See comment 25(a)–2 pertaining to permissible methods of retaining the required disclosures.)

4. *Home equity plans.* In home equity plans that are subject to the requirements of § 226.5b, written procedures for compliance with those requirements as well as a sample disclosure form and contract for each home equity program represent adequate evidence of compliance. (See comment 25(a)–2 pertaining to permissible methods of retaining the required disclosures.)

References

*Statute:* Sections 105 and 108.
*Other sections:* Appendix I.
*Previous regulation:* Section 226.6(i).
*1981 changes:* Section 226.25 substitutes a uniform 2-year record-retention rule for the previous requirement that certain creditors retain records through at least one compliance examination. It also states more explicitly that the record-retention requirements apply to evidence of required actions.

*Section 226.26—Use of Annual Percentage Rate in Oral Disclosures*

1. *Application of rules.* The restrictions of § 226.26 apply only if the creditor chooses to respond orally to the consumer's request for credit cost information. Nothing in the regulation requires the creditor to supply rate information orally. If the creditor volunteers information (including rate information) through oral solicitations directed generally to prospective customers, as through a telephone solicitation, those communications may be advertisements subject to the rules in §§ 226.16 and 226.24.

*26(a) Open-end credit.*

1. *Information that may be given.* The creditor may state periodic rates in addition to the required annual percentage rate, but it need not do so. If the annual percentage rate is unknown because transaction charges, loan fees, or similar finance charges may be imposed, the creditor must give the corresponding annual percentage rate (that is, the periodic rate multiplied by the number of periods in a year, as described in §§ 226.6(a)(2) and 226.7(d)). In such cases, the creditor may, but need not, also give the consumer information about other finance charges and other charges.

*26(b) Closed-end credit.*

1. *Information that may be given.* The creditor may state other annual or periodic rates that are applied to an unpaid balance, along with the required annual percentage rate. This rule permits disclosure of a simple interest rate, for example, but not an add-on, discount, or similar rate. If the creditor cannot give a precise annual percentage rate in its oral response because of variables in the transaction, it must give the annual percentage rate for a comparable sample transaction; in this case, other cost information may, but need not, be given. For example, the creditor may be unable to state a precise annual percentage rate for a mortgage loan without knowing the exact amount to be financed, the amount of loan fees or mortgage insurance premiums, or similar factors. In this situation, the creditor should state an annual percentage rate for a sample transaction; it may also provide information about the consumer's specific case, such as the contract interest rate, points, other finance charges, and other charges.

References

*Statute:* Section 146.
*Other sections:* Sections 226.6(a)(2) and 226.7(d).
*Previous regulation:* Interpretation § 226.101.
*1981 changes:* This section implements amended section 146 of the Act, which added a provision dealing with oral disclosures, and incorporates Interpretation § 226.101.

*Section 226.27—Language of Disclosures*

1. *Subsequent disclosures.* If a creditor provides initial disclosures in a language other than English, subsequent disclosures need not be in that other language. For example, if the creditor gave Spanish-language initial disclosures, periodic statements and change-in-terms notices may be made in English.

2. [Reserved]

References

*Statute:* None.
*Other sections:* None.
*Previous regulation:* Section 226.6(a).
*1981 changes:* No substantive change.

*Section 226.28—Effect on State Laws*

*28(a) Inconsistent disclosure requirements*

1. *General.* There are 3 sets of preemption criteria: 1 applies to the general disclosure and advertising rules of the regulation, and 2 apply to the credit billing provisions. Section 226.28 also provides for Board determinations of preemption.

2. *Rules for chapters 1, 2, and 3.* The standard for judging whether State laws that cover the types of requirements in chapters 1 (General provisions), 2 (Credit transactions), and 3 (Credit advertising) of the Act are inconsistent and therefore preempted, is contradiction of the Federal law. Examples of laws that would be preempted include:

• A State law that requires use of the term *finance charge,* but defines the term to include fees that the Federal law excludes, or to exclude fees the Federal law includes.

• A State law that requires a label such as *nominal annual interest rate* to be used for what the Federal law calls the *annual percentage rate.*

3. *Laws not contradictory to chapters 1, 2, and 3.* Generally, State law requirements that call for the disclosure of items of information not covered by the Federal law, or that require more detailed disclosures, do not contradict the Federal requirements. Examples of laws that are not preempted include:

• A State law that requires disclosure of the minimum periodic payment for open-end credit, even though not required by §226.7.

• A State law that requires contracts to contain warnings such as: ''Read this contract before you sign. Do not sign if any spaces are left blank. You are entitled to a copy of this contract.''

Similarly, a State law that requires itemization of the amount financed does not automatically contradict the permissive itemization under §226.18(c). However, a State law requirement that the itemization appear with the disclosure of the amount financed in the segregated closed-end credit disclosures is inconsistent, and this location requirement would be preempted.

4. *Creditor's options.* Before the Board makes a determination about a specific State law, the creditor has certain options. Since the prohibition against giving the State disclosures does not apply until the Board makes its determination, the creditor may choose to give State disclosures until the Board formally determines that the State law is inconsistent. (The Board will provide sufficient time for creditors to revise forms and procedures as necessary to conform to its determinations.)

• Under this first approach, as in all cases, the Federal disclosures must be clear and conspicuous, and the closed-end disclosures must be properly segregated in accordance with §226.17(a)(1).

• This ability to give State disclosures relieves any uncertainty that the creditor might have prior to Board determinations of inconsistency.

As a second option, the creditor may apply the preemption standards to a State law, conclude that it is inconsistent, and choose not to give the state-required disclosures. However, nothing in §226.28(a) provides the creditor with immunity for violations of State law if the creditor chooses *not* to make State disclosures and the Board later determines that the State law is not preempted.

5. *Rules for correction of billing errors and regulation of credit reports.* The preemption criteria for the fair credit billing provisions set forth in §226.28 have 2 parts. With respect to the rules on correction of billing errors and regulation of credit reports (which are in §226.13), §226.28(a)(2)(i) provides that a State law is inconsistent and preempted if its requirements are different from the Federal law. An exception is made, however, for State laws that allow the consumer to inquire about an account and require the creditor to respond to such inquiries beyond the time limits in the Federal law. Such a State law is not preempted with respect to the extra time period. For example, §226.13 requires the consumer to submit a written notice of billing error within 60 days after transmittal of the periodic statement showing the alleged error. If a State law allows the consumer 90 days to submit a notice, the State law remains in effect to provide the extra 30 days. Any State law disclosures concerning this extended state time limit must reflect the qualifications and conform to the format specified in §226.28(a)(2)(i). Examples of laws that would be preempted include:

• A State law that has a narrower or broader definition of *billing error.*

• A State law that requires the creditor to take different steps to resolve errors.

• A State law that provides different timing rules for error resolution (subject to the exception discussed above).

6. *Rules for other fair credit billing provisions.* The second part of the criteria for fair credit billing relates to the other rules implementing chapter 4 of the Act (addressed in §§226.4(c)(8), 226.5(b)(2)(ii), 226.6(d), 226.7(k), 226.9(a), 226.10, 226.11, 226.12 (c) through (f), 226.13, and 226.21). Section 226.28(a)(2)(ii) provides that the test of inconsistency is whether the creditor can comply with State law without violating Federal law. For example:

• A State law that allows the card issuer to offset the consumer's credit-card indebtedness against funds held by the card issuer would be preempted, since §226.12(d) prohibits such action.

• A State law that requires periodic statements to be sent *more* than 14 days before the

end of a free-ride period would not be preempted.

• A State law that permits consumers to assert claims and defenses against the card issuer without regard to the $50 and 100-mile limitations of §226.12(c)(3)(ii) would not be preempted.

In the last 2 cases, compliance with State law would involve no violation of the Federal law.

7. *Who may receive a chapter 4 determination.* Only states (through their authorized officials) may request and receive determinations on inconsistency with respect to the fair credit billing provisions.

8. *Preemption determination—Arizona.* Effective October 1, 1983, the Board has determined that the following provisions in the State law of Arizona are preempted by the Federal law:

- Section 44–287 B.5—Disclosure of final cash price balance. This provision is preempted in those transactions in which the amount of the final cash price balance is the same as the Federal amount financed, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.
- Section 44–287 B.6—Disclosure of finance charge. This provision is preempted in those transactions in which the amount of the finance charge is different from the amount of the Federal finance charge, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount.
- Section 44–287 B.7—Disclosure of the time balance. The time balance disclosure provision is preempted in those transactions in which the amount is the same as the amount of the Federal total of payments, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.

9. *Preemption determination—Florida.* Effective October 1, 1983, the Board has determined that the following provisions in the State law of Florida are preempted by the Federal law:

- Sections 520.07(2)(f) and 520.34(2)(f)—Disclosure of amount financed. This disclosure is preempted in those transactions in which the amount is different from the Federal amount financed, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount.
- Sections 520.07(2)(g), 520.34(2)(g), and 520.35(2)(d)—Disclosure of finance charge and a description of its components. The finance charge disclosure is preempted in those transactions in which the amount of the finance charge is different from the Federal amount, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount. The requirement to describe or itemize the components of the finance charge, which is also included in these provisions, is not preempted.
- Sections 520.07(2)(h) and 520.34(2)(h)—Disclosure of total of payments. The total of payments disclosure is preempted in those transactions in which the amount differs from the amount of the Federal total of payments, since in such transactions the State law requires the use of the same term as the Federal law to represent a different amount than the Federal law.
- Sections 520.07(2)(i) and 520.34(2)(i)—Disclosure of deferred payment price. This disclosure is preempted in those transactions in which the amount is the same as the Federal total sale price, since in such transactions the State law requires the use of a different term than the Federal law to represent the same amount as the Federal law.

10. *Preemption determination—Missouri.* Effective October 1, 1983, the Board has determined that the following provisions in the State law of Missouri are preempted by the Federal law:

- Sections 365.070–6(9) and 408.260–5(6)—Disclosure of principal balance. This disclosure is preempted in those transactions in which the amount of the principal balance is the same as the Federal amount financed, since in such transactions the State law requires the use of a term different from the Federal term to represent the same amount.
- Sections 365.070–6(10) and 408.260–5(7)—Disclosure of time price differential and time charge, respectively. These disclosures are preempted in those transactions in which the amount is the same as the Federal finance charge, since in such transactions the State law requires the use of a term different from the Federal law to represent the same amount.
- Sections 365.070–2 and 408.260–2—Use of the terms *time price differential* and *time charge* in certain notices to the buyer. In those transactions in which the State disclosure of the time price differential or time charge is preempted, the use of the terms in this notice also is preempted. The notice itself is not preempted.
- Sections 365.070–6(11) and 408.260–5(8)—Disclosure of time balance. The time balance disclosure is preempted in those transactions in which the amount is the same as the amount of the Federal total of payments, since in such transactions the State law requires the use of a different term than the Federal law to represent the same amount.
- Sections 365.070–6(12) and 408.260–5(9)—Disclosure of time sale price. This disclosure

is preempted in those transactions in which the amount is the same as the Federal total sale price, since in such transactions the State law requires the use of a different term from the Federal law to represent the same amount.

11. *Preemption determination—Mississippi.* Effective October 1, 1984, the Board has determined that the following provision in the State law of Mississippi is preempted by the Federal law:

• Section 63–19–31(2)(g)—Disclosure of finance charge. This disclosure is preempted in those cases in which the term *finance charge* would be used under State law to describe a different amount than the finance charge disclosed under Federal law.

12. *Preemption determination—South Carolina.* Effective October 1, 1984, the Board has determined that the following provision in the State law of South Carolina is preempted by the Federal law.

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

13. *Preemption determination—Arizona.* Effective October 1, 1986, the Board has determined that the following provision in the State law of Arizona is preempted by the Federal law:

• Section 6–621A.2—Use of the term *the total sum of* $_____ in certain notices provided to borrowers. This term describes the same item that is disclosed under Federal law as the *total of payments*. Since the State law requires the use of a different term than Federal law to describe the same item, the State-required term is preempted. The notice itself is not preempted.

NOTE: The State disclosure notice that incorporated the above preempted term was amended on May 4, 1987, to provide that disclosures must now be made pursuant to the Federal disclosure provisions.)

14. *Preemption determination—Indiana.* Effective October 1, 1988, the Board has determined that the following provision in the State law of Indiana is preempted by the Federal law:

• Section 23–2–5–8—Inclusion of the loan broker's fees and charges in the calculation of, among other items, the finance charge and annual percentage rate disclosed to potential borrowers. This disclosure is inconsistent with sections 106(a) and §226.4(a) of the Federal statute and regulation, respectively, and is preempted in those instances where the use of the same term would disclose a different amount than that required to be disclosed under Federal law.

15. *Preemption determination—Wisconsin.* Effective October 1, 1991, the Board has determined that the following provisions in the state law of Wisconsin are preempted by the federal law:

• Section 422.308(1)—the disclosure of the annual percentage rate in cases where the amount of the annual percentage rate disclosed to consumers under the state law differs from the amount that would be disclosed under federal law, since in those cases the state law requires the use of the same term as the federal law to represent a different amount than the federal law.

• Section 766.565(5)—the provision permitting a creditor to include in an open-end home equity agreement authorization to declare the account balance due and payable upon receiving notice of termination from a non-obligor spouse, since such provision is inconsistent with the purpose of the federal law.

*28(b) Equivalent disclosure requirements.*

1. *General.* A state disclosure may be substituted for a Federal disclosure only *after* the Board has made a finding of substantial similarity. Thus, the creditor may not unilaterally choose to make a state disclosure in place of a Federal disclosure, even if it believes that the state disclosure is substantially similar. Since the rule stated in §226.28(b) does not extend to any requirement relating to the finance charge or annual percentage rate, no state provision on computation, description, or disclosure of these terms may be substituted for the Federal provision.

*28(d) Special Rule for Credit and Charge Cards*

1. *General.* The standard that applies to preemption of state laws as they affect transactions of the type subject to §§226.5a and 226.9(e) differs from the preemption standards generally applicable under the Truth in Lending Act. The Fair Credit and Charge Card Disclosure Act fully preempts state laws relating to the disclosure of credit information in consumer credit or charge card applications or solicitations. (For purposes of this section, a single credit or charge card application or solicitation that may be used to open either an account for consumer purposes or an account for business purposes is deemed to be a ''consumer credit or charge card application or solicitation.'') For example, a state law requiring disclosure of credit terms in direct mail solicitations for consumer credit card accounts is preempted. A state law requiring disclosures in telephone applications for consumer credit card accounts also is preempted, even if it applies to applications initiated by the consumer rather than the issuer, because the state law relates to the disclosure of credit information in applications or solicitations within the general field of preemption, that is, consumer credit and charge cards.

2. *Limitations on field of preemption.* Preemption under the Fair Credit and Charge Card Disclosure Act does not extend to state laws applying to types of credit other than open-end consumer credit and charge card accounts. Thus, for example, a state law is not preempted as it applies to disclosures in credit and charge card applications and solicitations solely for business-purpose accounts. On the other hand, state credit disclosure laws will not apply to a single application or solicitation to open either an account for consumer purposes or an account for business purposes. Such ''dual purpose'' applications and solicitations are treated as ''consumer credit or charge card applications or solicitations'' under this section and state credit disclosure laws applicable to them are preempted. Preemption under this statute does not extend to state laws applicable to home equity plans; preemption determinations in this area are based on the Home Equity Loan Consumer Protection Act, as implemented in §226.5b of the regulation.

3. *Laws not preempted.* State laws relating to disclosures concerning credit and charge cards other than in applications, solicitations, or renewal notices are not preempted under §226.28(d). In addition, state laws regulating the terms of credit and charge card accounts are not preempted, nor are laws preempted that regulate the form or content of information unrelated to the information required to be disclosed under §§226.5a and 226.9(e). Finally, state laws concerning the enforcement of the requirements of §§226.5a and 226.9(e) and state laws prohibiting unfair or deceptive acts or practices concerning credit and charge card applications, solicitations and renewals are not preempted. Examples of laws that are not preempted include:

• A state law that requires card issuers to offer a grace period or that prohibits certain fees in credit and charge card transactions.

• A state retail installment sales law or a state plain language law, except to the extent that it regulates the disclosure of credit information in applications, solicitations and renewals of accounts of the type subject to §§226.5a and 226.9(e).

• A state law requiring notice of a consumer's rights under antidiscrimination or similar laws or a state law requiring notice about credit information available from state authorities.

References

*Statute:* Sections 111 and 171 (a) and (c).

*Other sections:* Appendix A.

*Previous regulation:* Section 226.6 (b) and (c), and Interpretation §226.604.

*1981 changes:* Section 226.28 implements amended section 111 of the Act. The test for preemption of state laws relating to disclosure and advertising is now whether the state law ''contradicts'' the Federal, rather than whether state requirements are ''different.''

The revised regulation contains no counterpart to §226.6(c) of the previous regulation concerning placement of inconsistent disclosures. It also reflects the statutory amendment providing that once the Board determines that a state-required disclosure is inconsistent with Federal law, the creditor may not make the state disclosure.

*Section 226.29—State Exemptions*

*29(a) General rule.*

1. *Classes eligible.* The state determines the classes of transactions for which it will request an exemption, and makes its application for those classes. Classes might be, for example, all open-end credit transactions, all open-end and closed-end transactions, or all transactions in which the creditor is a bank.

2. *Substantial similarity.* The ''substantially similar'' standard requires that state statutory or regulatory provisions and state interpretations of those provisions be generally the same as the Federal Act and Regulation Z. This includes the requirement that state provisions for reimbursement to consumers for overcharges be at least equivalent to those required in section 108 of the act. A State will be eligible for an exemption even if its law covers classes of transactions not covered by the Federal law. For example, if a state's law covers agricultural credit, this will not prevent the Board from granting an exemption for consumer credit, even though agricultural credit is not covered by the Federal law.

3. *Adequate enforcement.* The standard requiring adequate provision for enforcement generally means that appropriate state officials must be authorized to enforce the state law through procedures and sanctions comparable to those available to Federal enforcement agencies. Furthermore, state law must make adequate provision for enforcement of the reimbursement rules.

4. *Exemptions granted.* Effective October 1, 1982, the Board has granted the following exemptions from portions of the revised Truth in Lending Act:

• *Maine.* Credit or lease transactions subject to the Maine Consumer Credit Code and its implementing regulations are exempt from chapters 2, 4 and 5 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor or lessor.)

• *Connecticut.* Credit transactions subject to the Connecticut Truth in Lending Act are exempt from chapters 2 and 4 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

• *Massachusetts.* Credit transactions subject to the Massachusetts Truth in Lending Act are exempt from chapters 2 and 4 of the

Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

• *Oklahoma*. Credit or lease transactions subject to the Oklahoma Consumer Credit Code are exempt from chapters 2 and 5 of the Federal Act. (The exemption does not apply to sections 132 through 135 of the Federal Act, nor does it apply to transactions in which a federally chartered institution is a creditor or lessor.)

• *Wyoming*. Credit transactions subject to the Wyoming Consumer Credit Code are exempt from chapter 2 of the Federal Act. (The exemption does not apply to transactions in which a federally chartered institution is a creditor.)

*29(b) Civil liability*.

1. *Not eligible for exemption*. The provision that an exemption may not extend to sections 130 and 131 of the Act assures that consumers retain access to both Federal and State courts in seeking damages or civil penalties for violations, while creditors retain the defenses specified in those sections.

References

*Statute:* Sections 108, 123, and 171(b).

*Other sections:* Appendix B.

*Previous regulation:* Section 226.12.

*1981 changes:* The procedures that states must follow to seek exemptions are now located in an appendix. Exemptions under the previous regulation will be automatically revoked on April 1, 1982, when compliance with the new regulation is mandatory.

*Section 226.30—Limitation on Rates*

1. *Scope of coverage*. The requirement of this section applies to consumer credit obligations secured by a dwelling (as dwelling is defined in § 226.2(a)(19)) in which the annual percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge—whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of credit obligations subject to this section include:

• Dwelling-secured credit obligations that require variable-rate disclosures under the regulation because the interest rate may increase during the term of the obligation.

• Dwelling-secured open-end credit plans entered into before November 7, 1989 (the effective date of the home equity rules) that are not considered variable-rate obligations for purposes of disclosure under the regulation but where the creditor reserves the contractual right to increase the interest rate—periodic rate and corresponding annual percentage rate—during the term of the plan.

In contrast, credit obligations in which there is no contractual right to increase the interest rate during the term of the obligation are not subject to this section. Examples include:

• ''Shared-equity'' or ''shared-appreciation'' mortgage loans that have a fixed rate of interest and a shared-appreciation feature based on the consumer's equity in the mortgaged property. (The appreciation share is payable in a lump sum at a specified time.)

• Dwelling-secured fixed-rate closed-end balloon-payment mortgage loans and dwelling-secured fixed-rate open-end plans with a stated term that the creditor may renew at maturity. (Contrast with the renewable balloon-payment mortgage instrument described in comment 17(c)(1)–11.)

• Dwelling-secured fixed rate closed-end multiple advance transactions in which each advance is disclosed as a separate transaction.

• ''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 requirement of this section does not apply to credit obligations entered into prior to December 9, 1987. Consequently, new advances under open-end credit plans existing prior to December 9, 1987, are not subject to this section.

2. *Refinanced obligations*. On or after December 9, 1987, when a credit obligation is refinanced, as defined in § 226.20(a), the new obligation is subject to this section if it is dwelling-secured and allows for increases in the interest rate.

3. *Assumptions*. On or after December 9, 1987, when a credit obligation is assumed, as defined in § 226.20(b), the obligation becomes subject to this section if it is dwelling-secured and allows for increases in the interest rate.

4. *Modifications of obligations*. The modification of an obligation, regardless of when the obligation was entered into, is generally not covered by this section. For example, increasing the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective date of the rule does not make the obligation subject to this section. If, however, a security interest in a dwelling is added on or after December 9, 1987, to a credit obligation that allows for interest rate increases, the obligation becomes subject to this section. Similarly, if a variable interest rate feature is added to a dwelling-secured credit obligation, the obligation becomes subject to this section.

5. *Land trusts*. In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)–8).)

If a consumer-purpose loan that allows for interest rate increases is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to this section.

6. *Relationship to other sections.* Unless otherwise provided for in the commentary to this section, other provisions of the regulation such as definitions, exemptions, rules and interpretations also apply to this section where appropriate. To illustrate:

• An adjustable interest rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally §226.3(a).)

• Creditors subject to this section are only those that fall within the definition of a creditor in §226.2(a)(17).

7. *Consumer credit contract.* Creditors are required to specify a lifetime maximum interest rate in their credit contracts—the instrument that creates personal liability and generally contains the terms and conditions of the agreement (for example, a promissory note or home-equity line of credit agreement). In some states, the signing of a commitment letter may create a binding obligation, for example, constituting *consummation* as defined in §226.2(a)(13). The maximum interest rate must be included in the credit contract, but a creditor may include the rate ceiling in the commitment instrument as well.

8. *Manner of stating the maximum interest rate.* The maximum interest rate must be stated in the credit contract either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the rate ceiling will be over the term of the obligation. For example, the following statements would be sufficiently specific:

• The maximum interest rate will not exceed X%.

• The interest rate will never be higher than X percentage points above the initial rate of Y%.

• The interest rate will not exceed X%, or X percentage points about [a rate to be determined at some future point in time], whichever is less.

• The maximum interest rate will not exceed X%, or the state usury ceiling, whichever is less.

The following statements would not comply with this section:

• The interest rate will never be higher than X percentage points over the prevailing market rate.

• The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].

• The interest rate will not exceed the state usury ceiling which is currently X%.

A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under an open-end credit plan, this normally would be the corresponding annual percentage rate. (See generally §226.6(a)(2).)

9. *Multiple interest rate ceilings.* Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable-rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable-rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable-rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. *Interest rate charged after default.* State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default is subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. *Increasing the maximum interest rate—general rule.* Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation subject to this section unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan, a creditor may not increase the rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan has a fixed maturity and a creditor renews the plan at maturity, or enters into a closed-end credit transaction, a new maximum interest rate may be set at that time. If the open-end plan provides for a repayment phase, the maximum interest rate cannot be increased when the repayment phase begins unless the agreement provided for such an increase. For a closed-end credit transaction, a new maximum interest rate may be set only if the transaction is satisfied and replaced by a new obligation. (The exceptions in §226.20(a)(1)–(5) which limit what transactions are considered refinancings for purposes of disclosure do not apply with respect to increasing a rate ceiling that has been imposed; if a transaction is satisfied and replaced, the rate ceiling may be increased.)

12. *Increasing the maximum interest rate—assumption of an obligation.* If an obligation subject to this section is assumed by a new obligor and the original obligor is released from liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule

applies whether or not the transaction constitutes an assumption as defined in §226.20(b).)

13. *Transition rules.* Under footnote 50, if creditors properly include the maximum rate in their credit contracts, creditors need not revise their Truth in Lending disclosure statement forms to add the disclosures about limitations on rate increases as part of the variable-rate disclosures, until October 1, 1988. On or after that date, creditors must have the maximum rate set forth in their credit contracts and, where applicable, as part of their truth in lending disclosures in the manner prescribed in the applicable sections of the regulation.

References

*Statute:* Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552

*Other sections:* Sections 226.6, 226.18, and 226.19

*Previous regulation:* None

*1987 changes:* This section implements section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552 which provides that, effective December 9, 1987, adjustable-rate mortgages must include a limitation on the interest rate that may apply during the term of the mortgage loan. An adjustable-rate mortgage loan is defined in section 1204 as ''any loan secured by a lien on a one-to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time, adjust the rate of interest.'' The rule in this section incorporates section 1204 into Regulation Z and limits the scope of section 1204 to dwelling-secured consumer credit subject to the Truth in Lending Act, in which a creditor has the contractual right to increase the interest rate during the term of the credit obligation.

SUBPART E—SPECIAL RULES FOR CERTAIN HOME MORTGAGE TRANSACTIONS

*Section 226.31—General Rules*

*31(c) Timing of disclosure.*

1. *Furnishing disclosures.* Disclosures are considered furnished when received by the consumer.

*Paragraph 31(c)(1) Disclosures for certain closed-end home mortgages.*

1. *Pre-consummation waiting period.* A creditor must furnish §226.32 disclosures at least three business days prior to consummation. Under §226.32, ''business day'' has the same meaning as the rescission rule in comment 2(a)(6)-2—all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a). However, while the disclosure rule under §§226.15 and 226.23 extends to midnight of the third business day, the rule under §226.32 does not. For example, under §226.32, if disclosures were provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures. If the timing of the rescission rule were to be used, consummation could not occur until after midnight on Tuesday.

*Paragraph 31(c)(1)(i) Change in terms.*

1. *Redisclosure required.* Creditors must provide new disclosures when a change in terms makes disclosures previously provided under §226.32(c) inaccurate, including disclosures based on and labeled as an estimate. A change in terms may result from a formal written agreement or otherwise.

2. *Sale of optional products at consummation.* If the consumer finances the purchase of optional products such as credit insurance and as a result the monthly payment differs from what was previously disclosed under §226.32, redisclosure is required and a new three-day waiting period applies. (See comment 32(c)(3)–1 on when optional items may be included in the regular payment disclosure.)

*Paragraph 31(c)(1)(ii) Telephone disclosures.*

1. *Telephone disclosures.* Disclosures by telephone must be furnished at least three business days prior to consummation, calculated in accord with the timing rules under §226.31(c)(1).

*Paragraph 31(c)(1)(iii) Consumer's waiver of waiting period before consummation.*

1. *Modification or waiver.* A consumer may modify or waive the right to the three-day waiting period only after receiving the disclosures required by §226.32 and only if the circumstances meet the criteria for establishing a bona fide personal financial emergency under §226.23(e). Whether these criteria are met is determined by the facts surrounding individual situations. The imminent sale of the consumer's home at foreclosure during the three-day period is one example of a bona fide personal financial emergency. Each consumer entitled to the three-day waiting period must sign the handwritten statement for the waiver to be effective.

*Paragraph 31(c)(2) Disclosures for reverse mortgages.*

1. *Business days.* For purposes of providing reverse mortgage disclosures, ''business day'' has the same meaning as in comment 31(c)(1)-2—all calendar days except Sundays and the federal legal holidays listed in 5 USC 6103(a). This means if disclosures are provided on a Friday, consummation could occur any time on Tuesday, the third business day following receipt of the disclosures.

2. *Open-end plans.* Disclosures for open-end reverse mortgages must be provided at least three business days before the first transaction under the plan (see §226.5(b)(1)).

*31(d) Basis of disclosures and use of estimates.*

1. *Redisclosure.* Section 226.31(d) allows the use of estimates when information necessary

for an accurate disclosure is unknown to the creditor, provided that the disclosure is clearly identified as an estimate. For purposes of Subpart E, the rule in §226.31(c)(1)(i) requiring new disclosures when the creditor changes terms also applies to disclosures labeled as estimates.

*31(d)(3) Per-diem interest.*

1. *Per-diem interest.* This paragraph applies to the disclosure of any numerical amount (such as the finance charge, annual percentage rate, or payment amount) that is affected by the amount of the per-diem interest charge that will be collected at consummation. If the amount of per-diem interest used in preparing the disclosures for consummation is based on the information known to the creditor at the time the disclosure document is prepared, the disclosures are considered accurate under this rule, and affected disclosures are also considered accurate, even if the disclosures were not labeled as estimates. (See comment 17(c)(2)(ii)–1 generally.)

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

*32(a) Coverage.*

*Paragraph 32(a)(1)(i).*

1. *Application date.* An application is deemed received when it reaches the creditor in any of the ways applications are normally transmitted. (See §226.19(a).) For example, if a borrower applies for a 10-year loan on September 30 and the creditor counteroffers with a 7-year loan on October 10, the application is deemed received in September and the creditor must measure the annual percentage rate against the appropriate Treasury security yield as of August 15. An application transmitted through an intermediary agent or broker is received when it reaches the creditor, rather than when it reaches the agent or broker. (See comment 19(b)-3 to determine whether a transaction involves an intermediary agent or broker.)

2. *When fifteenth not a business day.* If the 15th day of the month immediately preceding the application date is not a business day, the creditor must use the yield as of the business day immediately preceding the 15th.

3. *Calculating annual percentage rates for variable-rate loans and discount loans.* Creditors must use the rules set out in the commentary to §226.17(c)(1) in calculating the annual percentage rate for variable-rate loans (assume the rate in effect at the time of disclosure remains unchanged) and for discount, premium, and stepped-rate transactions (which must reflect composite annual percentage rates).

4. *Treasury securities.* To determine the yield on comparable Treasury securities for the annual percentage rate test, creditors may use the yield on actively traded issues adjusted to constant maturities published in the Board's ''Selected Interest Rates'' (statistical release H–15). Creditors must use the yield corresponding to the constant maturity that is closest to the loan's maturity. If the loan's maturity is exactly halfway between security maturities, the annual percentage rate on the loan should be compared with the yield for Treasury securities having the lower yield. In determining the loan's maturity, creditors may rely on the rules in §226.17(c)(4) regarding irregular first payment periods. For example:

i. If the H–15 contains a yield for Treasury securities with constant maturities of 7 years and 10 years and no maturity in between, the annual percentage rate for an 8-year mortgage loan is compared with the yield of securities having a 7-year maturity, and the annual percentage rate for a 9-year mortgage loan is compared with the yield of securities having a 10-year maturity.

ii. If a mortgage loan has a term of 15 years, and the H–15 contains a yield of 5.21 percent for constant maturities of 10 years, and also contains a yield of 6.33 percent for constant maturities of 20 years, then the creditor compares the annual percentage rate for a 15-year mortgage loan with the yield for constant maturities of 10 years.

iii. If a mortgage loan has a term of 30 years, and the H–15 does not contain a yield for 30-year constant maturities, but contains a yield for 20-year constant maturities, and an average yield for securities with remaining terms to maturity of 25 years and over, then the annual percentage rate on the loan is compared with the yield for 20-year constant maturities.

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

1. *Total loan amount.* For purposes of the ''points and fees'' test, the total loan amount is calculated by taking the amount financed, as determined according to §226.18(b), and deducting any cost listed in §226.32(b)(1)(iii) and §226.32(b)(1)(iv) that is both included as points and fees under §226.32(b)(1) and financed by the creditor. Some examples follow, each using a $10,000 amount borrowed, a $300 appraisal fee, and $400 in points. A $500 premium for optional credit life insurance is used in one example.

i. If the consumer finances a $300 fee for a creditor-conducted appraisal and pays $400 in points at closing, the amount financed under §226.18(b) is $9,900 ($10,000 plus the $300 appraisal fee that is paid to and financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under §226.32(b)(1)(iii). It is deducted from the amount financed ($9,900) to derive a total loan amount of $9,600.

ii. If the consumer pays the $300 fee for the creditor-conducted appraisal in cash at closing, the $300 is included in the points and fees calculation because it is paid to the creditor. However, because the $300 is not financed by the creditor, the fee is not part of

the amount financed under §226.18(b). In this case, the amount financed is the same as the total loan amount: $9,600 ($10,000, less $400 in prepaid finance charges).

iii. If the consumer finances a $300 fee for an appraisal conducted by someone other than the creditor or an affiliate, the $300 fee is not included with other points and fees under §226.32(b)(1)(iii). The amount financed under §226.18(b) is $9,900 ($10,000 plus the $300 fee for an independently-conducted appraisal that is financed by the creditor, less the $400 paid in cash and deducted as prepaid finance charges).

iv. If the consumer finances a $300 fee for a creditor-conducted appraisal and a $500 single premium for optional credit life insurance, and pays $400 in points at closing, the amount financed under §226.18(b) is $10,400 ($10,000, plus the $300 appraisal fee that is paid to and financed by the creditor, plus the $500 insurance premium that is financed by the creditor, less $400 in prepaid finance charges). The $300 appraisal fee paid to the creditor is added to other points and fees under §226.32(b)(1)(iii), and the $500 insurance premium is added under 226.32(b)(1)(iv). The $300 and $500 costs are deducted from the amount financed ($10,400) to derive a total loan amount of $9,600.

2. *Annual adjustment of $400 amount.* A mortgage loan is covered by §226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. The $400 figure is adjusted annually on January 1 by the annual percentage change in the CPI that was in effect on the preceding June 1. The Board will publish adjustments after the June figures become available each year. The adjustment for the upcoming year will be included in any proposed commentary published in the fall, and incorporated into the commentary the following spring. The adjusted figures are:

i. For 1996, $412, reflecting a 3.00 percent increase in the CPI-U from June 1994 to June 1995, rounded to the nearest whole dollar.

ii. For 1997, $424, reflecting a 2.9 percent increase in the CPI-U from June 1995 to June 1996, rounded to the nearest whole dollar.

iii. For 1998, $435, reflecting a 2.5 percent increase in the CPI-U from June 1996 to June 1997, rounded to the nearest whole dollar.

iv. For 1999, $441, reflecting a 1.4 percent increase in the CPI-U from June 1997 to June 1998, rounded to the nearest whole dollar.

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.

vi. For 2001, $465, reflecting a 3.1 percent increase in the CPI-U from June 1999 to June 2000, rounded to the nearest whole dollar.

vii. For 2002, $480, reflecting a 3.27 percent increase in the CPI-U from June 2000 to June 2001, rounded to the nearest whole dollar.

viii. For 2003, $488, reflecting a 1.64 percent increase in the CPI-U from June 2001 to June 2002, rounded to the nearest whole dollar.

ix. For 2004, $499, reflecting a 2.22 percent increase in the CPI-U from June 2002 to June 2003, rounded to the nearest whole dollar.

x. For 2005, $510, reflecting a 2. 29 percent increase in the CPI–U from June 2003 to June 2004, rounded to the nearest whole dollar.

xi. For 2006, $528, reflecting a 3.51 percent increase in the CPI–U from June 2004 to June 2005, rounded to the nearest whole dollar.

xii. For 2007, $547, reflecting a 3.55 percent increase in the CPI–U from June 2005 to June 2006, rounded to the nearest whole dollar.

xiii. For 2008, $561, reflecting a 2.56 percent increase in the CPI–U from June 2006 to June 2007, rounded to the nearest whole dollar.

xiv. For 2009, $583, reflecting a 3.94 percent increase in the CPI–U from June 2007 to June 2008, rounded to the nearest whole dollar.

*32(b) Definitions*

*Paragraph 32(b)(1)(i).*

1. *General.* Section 226.32(b)(1)(i) includes in the total ''points and fees'' items defined as finance charges under §§226.4(a) and 226.(4)(b). Items excluded from the finance charge under other provisions of §226.4 are not included in the total ''points and fees'' under paragraph 32(b)(1)(i), but may be included in ''points and fees'' under paragraphs 32(b)(1)(ii) and 32(b)(1)(iii). Interest, including per-diem interest, is excluded from ''points and fees'' under §226.32(b)(1).

*Paragraph 32(b)(1)(ii).*

1. *Mortgage broker fees.* In determining ''points and fees'' for purposes of this section, compensation paid by a consumer to a mortgage broker (directly or through the creditor for delivery to the broker) is included in the calculation whether or not the amount is disclosed as a finance charge. Mortgage broker fees that are not paid by the consumer are not included. Mortgage broker fees already included in the calculation as finance charges under §226.32(b)(1)(i) need not be counted again under §226.32(b)(1)(ii).

2. *Example.* Section 226.32(b)(1)(iii) defines ''points and fees'' to include all items listed in §226.4(c)(7), other than amounts held for the future payment of taxes. An item listed in §226.4(c)(7) may be excluded from the ''points and fees'' calculation, however, if the charge is reasonable, the creditor receives no direct or indirect compensation from the charge, and the charge is not paid to an affiliate of the creditor. For example, a reasonable fee paid by the consumer to an independent, third-party appraiser may be excluded from the ''points and fees'' calculation (assuming no compensation is paid to the creditor). A fee paid by the consumer for an appraisal performed by the creditor must be included in the calculation, even though the fee may be excluded from the finance

charge if it is bona fide and reasonable in amount.

*Paragraph 32(b)(1)(iv).*

1. *Premium amount.* In determining ''points and fees'' for purposes of this section, premiums paid at or before closing for credit insurance are included whether they are paid in cash or financed, and whether the amount represents the entire premium for the coverage or an initial payment.

*32(c) Disclosures.*

1. *Format.* The disclosures must be clear and conspicuous but need not be in any particular type size or typeface, nor presented in any particular manner. The disclosures need not be a part of the note or mortgage document.

*Paragraph 32(c)(3) Regular payment; balloon payment.*

1. *General.* The regular payment is the amount due from the borrower at regular intervals, such as monthly, bimonthly, quarterly, or annually. There must be at least two payments, and the payments must be in an amount and at such intervals that they fully amortize the amount owed. In disclosing the regular payment, creditors may rely on the rules set forth in §226.18(g); however, the amounts for voluntary items, such as credit life insurance, may be included in the regular payment disclosure only if the consumer has previously agreed to the amounts.

i. If the loan has more than one payment level, the regular payment for each level must be disclosed. For example:

A. In a 30-year graduated payment mortgage where there will be payments of $300 for the first 120 months, $400 for the next 120 months, and $500 for the last 120 months, each payment amount must be disclosed, along with the length of time that the payment will be in effect.

B. If interest and principal are paid at different times, the regular amount for each must be disclosed.

C. In discounted or premium variable-rate transactions where the creditor sets the initial interest rate and later rate adjustments are determined by an index or formula, the creditor must disclose both the initial payment based on the discount or premium and the payment that will be in effect thereafter. Additional explanatory material which does not detract from the required disclosures may accompany the disclosed amounts. For example, if a monthly payment is $250 for the first six months and then increases based on an index and margin, the creditor could use language such as the following: ''Your regular monthly payment will be $250 for six months. After six months your regular monthly payment will be based on an index and margin, which currently would make your payment $350. Your actual payment at that time may be higher or lower.''

*Paragraph 32(c)(4) Variable-rate.*

1. *Calculating ''worst-case'' payment example.* Creditors may rely on instructions in §226.19(b)(2)(viii)(B) for calculating the maximum possible increases in rates in the shortest possible timeframe, based on the face amount of the note (not the hypothetical loan amount of $10,000 required by §226.19(b)(2)(viii)(B)). The creditor must provide a maximum payment for each payment level, where a payment schedule provides for more than one payment level and more than one maximum payment amount is possible.

*Paragraph 32(c)(5) Amount borrowed.*

1. *Optional insurance; debt-cancellation coverage.* This disclosure is required when the amount borrowed in a refinancing includes premiums or other charges for credit life, accident, health, or loss-of-income insurance, or debt-cancellation coverage (whether or not the debt-cancellation coverage is insurance under applicable law) that provides for cancellation of all or part of the consumer's liability in the event of the loss of life, health, or income or in the case of accident. See comment 4(d)(3)–2 and comment app. G and H–2 regarding terminology for debt-cancellation coverage.

*32(d) Limitations.*

*32(d) Limitations*

*Paragraph 32(d)(1)(i) Balloon payment.*

1. *Regular periodic payments.* The repayment schedule for a §226.32 mortgage loan with a term of less than five years must fully amortize the outstanding principal balance through ''regular periodic payments.'' A payment is a ''regular periodic payment'' if it is not more than twice the amount of other payments.

*Paragraph 32(d)(2) Negative amortization.*

1. *Negative amortization.* The prohibition against negative amortization in a mortgage covered by §226.32 does not preclude reasonable increases in the principal balance that result from events permitted by the legal obligation unrelated to the payment schedule. For example, when a consumer fails to obtain property insurance and the creditor purchases insurance, the creditor may add a reasonable premium to the consumer's principal balance, to the extent permitted by the legal obligation.

*Paragraph 32(d)(4) Increased interest rate.*

1. *Variable-rate transactions.* The limitation on interest rate increases does not apply to rate increases resulting from changes in accordance with the legal obligation in a variable-rate transaction, even if the increase occurs after default by the consumer.

*Paragraph 32(d)(5) Rebates.*

1. *Calculation of refunds.* The limitation applies only to refunds of precomputed (such as add-on) interest and not to any other charges that are considered finance charges under §226.4 (for example, points and fees

paid at closing). The calculation of the refund of interest includes odd-days interest, whether paid at or after consummation.

*Paragraph 32(d)(6) Prepayment penalties.*

1. *State law.* For purposes of computing a refund of unearned interest, if using the actuarial method defined by applicable state law results in a refund that is greater than the refund calculated by using the method described in section 933(d) of the Housing and Community Development Act of 1992, creditors should use the state law definition in determining if a refund is a prepayment penalty.

*32(d)(7) Prepayment penalty exception.*

*Paragraph 32(d)(7)(iii).*

1. *Calculating debt-to-income ratio.* ''Debt'' does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants.

2. *Verification.* Verification of employment satisfies the requirement for payment records for employment income.

*32(d)(8) Due-on-demand clause.*

*Paragraph 32(d)(8)(ii).*

1. *Failure to meet repayment terms.* A creditor may terminate a loan and accelerate the balance when the consumer fails to meet the repayment terms provided for in the agreement; a creditor may do so, however, only if the consumer actually fails to make payments. For example, a creditor may not terminate and accelerate if the consumer, in error, sends a payment to the wrong location, such as a branch rather than the main office of the creditor. If a consumer files for or is placed in bankruptcy, the creditor may terminate and accelerate under this provision if the consumer fails to meet the repayment terms of the agreement. Section 226.32(d)(8)(ii) does not override any state or other law that requires a creditor to notify a borrower of a right to cure, or otherwise places a duty on the creditor before it can terminate a loan and accelerate the balance.

*Paragraph 32(d)(8)(iii).*

1. *Impairment of security.* A creditor may terminate a loan and accelerate the balance if the consumer's action or inaction adversely affects the creditor's security for the loan, or any right of the creditor in that security. Action or inaction by third parties does not, in itself, permit the creditor to terminate and accelerate.

2. *Examples.* i. A creditor may terminate and accelerate, for example, if:

A. The consumer transfers title to the property or sells the property without the permission of the creditor.

B. The consumer fails to maintain required insurance on the dwelling.

C. The consumer fails to pay taxes on the property.

D. The consumer permits the filing of a lien senior to that held by the creditor.

E. The sole consumer obligated on the credit dies.

F. The property is taken through eminent domain.

G. A prior lienholder forecloses.

ii. By contrast, the filing of a judgment against the consumer would permit termination and acceleration only if the amount of the judgment and collateral subject to the judgment is such that the creditor's security is adversely affected. If the consumer commits waste or otherwise destructively uses or fails to maintain the property such that the action adversely affects the security, the loan may be terminated and the balance accelerated. Illegal use of the property by the consumer would permit termination and acceleration if it subjects the property to seizure. If one of two consumers obligated on a loan dies, the creditor may terminate the loan and accelerate the balance if the security is adversely affected. If the consumer moves out of the dwelling that secures the loan and that action adversely affects the security, the creditor may terminate a loan and accelerate the balance.

*Paragraph 32(e)(1) Repayment ability.*

1. *Determining repayment ability.* The information provided to the creditor in connection with §226.32(d)(7) may be used to show that the creditor considered the consumer's income and obligations before extending the credit. Any expected income can be considered by the creditor, except equity income that the consumer would obtain through the foreclosure of a mortgage covered by §226.32. For example, a creditor may use information about income other than regular salary or wages such as gifts, expected retirement payments, or income from housecleaning or childcare. The creditor also may use unverified income, as long as the creditor has a reasonable basis for believing that the income exists and will support the loan.

*Paragraph 32(e)(2) Home-Improvement Contracts.*

*Paragraph 32(e)(2)(i).*

1. *Joint payees.* If a creditor pays a contractor with an instrument jointly payable to the contractor and the consumer, the instrument must name as payee each consumer who is primarily obligated on the note.

*Paragraph 32(e)(3) Notice to Assignee.*

1. *Subsequent sellers or assignors.* Any person, whether or not the original creditor, that sells or assigns a mortgage subject to this section must furnish the notice of potential liability to the purchaser or assignee.

2. *Format.* While the notice of potential liability need not be in any particular format, the notice must be prominent. Placing it on the face of the note, such as with a stamp, is one means of satisfying the prominence requirement.

*Section 226.33—Requirements for Reverse Mortgages*

*33(a) Definition.*

1. *Nonrecourse transaction.* A nonrecourse reverse mortgage transaction limits the homeowner's liability to the proceeds of the sale of the home (or any lesser amount specified in the credit obligation). If a transaction structured as a closed-end reverse mortgage transaction allows recourse against the consumer, and the annual percentage rate or the points and fees exceed those specified under § 226.32(a)(1), the transaction is subject to all the requirements of § 226.32, including the limitations concerning balloon payments and negative amortization.

*Paragraph 33(a)(2).*

1. *Default.* Default is not defined by the statute or regulation, but rather by the legal obligation between the parties and state or other law.

2. *Definite term or maturity date.* To meet the definition of a reverse mortgage transaction, a creditor cannot require any principal, interest, or shared appreciation or equity to be due and payable (other than in the case of default) until after the consumer's death, transfer of the dwelling, or the consumer ceases to occupy the dwelling as a principal dwelling. Some state laws require legal obligations secured by a mortgage to specify a definite maturity date or term of repayment in the instrument. An obligation may state a definite maturity date or term of repayment and still meet the definition of a reverse-mortgage transaction if the maturity date or term of repayment used would not operate to cause maturity prior to the occurrence of any of the maturity events recognized in the regulation. For example, some reverse mortgage programs specify that the final maturity date is the borrower's 150th birthday; other programs include a shorter term but provide that the term is automatically extended for consecutive periods if none of the other maturity events has yet occurred. These programs would be permissible.

*33(c) Projected total cost of credit.*

*Paragraph 33(c)(1) Costs to consumer.*

1. *Costs and charges to consumer—relation to finance charge.* All costs and charges to the consumer that are incurred in a reverse mortgage transaction are included in the projected total cost of credit, and thus in the total annual loan cost rates, whether or not the cost or charge is a finance charge under § 226.4.

2. *Annuity costs.* As part of the credit transaction, some creditors require or permit a consumer to purchase an annuity that immediately—or at some future time—supplements or replaces the creditor's payments. The amount paid by the consumer for the annuity is a cost to the consumer under this section, regardless of whether the annuity is purchased through the creditor or a third party, or whether the purchase is mandatory or voluntary. For example, this includes the costs of an annuity that a creditor offers, arranges, assists the consumer in purchasing, or that the creditor is aware the consumer is purchasing as a part of the transaction.

3. *Disposition costs excluded.* Disposition costs incurred in connection with the sale or transfer of the property subject to the reverse mortgage are not included in the costs to the consumer under this paragraph. (However, see the definition of $Val_n$ in appendix K to the regulation to determine the effect certain disposition costs may have on the total annual loan cost rates.)

*Paragraph 33(c)(2) Payments to consumer.*

1. *Payments upon a specified event.* The projected total cost of credit should not reflect contingent payments in which a credit to the outstanding loan balance or a payment to the consumer's estate is made upon the occurrence of an event (for example, a ''death benefit'' payable if the consumer's death occurs within a certain period of time). Thus, the table of total annual loan cost rates required under § 226.33(b)(2) would not reflect such payments. At its option, however, a creditor may put an asterisk, footnote, or similar type of notation in the table next to the applicable total annual loan cost rate, and state in the body of the note, apart from the table, the assumption upon which the total annual loan cost is made and any different rate that would apply if the contingent benefit were paid.

*Paragraph 33(c)(3) Additional creditor compensation.*

1. *Shared appreciation or equity.* Any shared appreciation or equity that the creditor is entitled to receive pursuant to the legal obligation must be included in the total cost of a reverse mortgage loan. For example, if a creditor agrees to a reduced interest rate on the transaction in exchange for a portion of the appreciation or equity that may be realized when the dwelling is sold, that portion is included in the projected total cost of credit.

*Paragraph 33(c)(4) Limitations on consumer liability.*

1. *In general.* Creditors must include any limitation on the consumer's liability (such as a nonrecourse limit or an equity conservation agreement) in the projected total cost of credit. These limits and agreements protect a portion of the equity in the dwelling for the consumer or the consumer's estate. For example, the following are limitations on the consumer's liability that must be included in the projected total cost of credit:

i. A limit on the consumer's liability to a certain percentage of the projected value of the home.

ii. A limit on the consumer's liability to the net proceeds from the sale of the property subject to the reverse mortgage.

2. *Uniform assumption for ''net proceeds'' recourse limitations*. If the legal obligation between the parties does not specify a percentage for the ''net proceeds'' liability of the consumer, for purposes of the disclosures required by §226.33, a creditor must assume that the costs associated with selling the property will equal 7 percent of the projected sale price (see the definition of the $Val_n$ symbol under appendix K(b)(6)).

*Section 226.34—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer s Dwelling; Open-end Credit*

*34(a) Prohibited acts or practices for loans subject to §226.32.*

*Paragraph 34(a)(1) Home-improvement contracts.*

*Paragraph 34(a)(1)(i).*

1. *Joint payees*. If a creditor pays a contractor with an instrument jointly payable to the contractor and the consumer, the instrument must name as payee each consumer who is primarily obligated on the note.

*Paragraph 34(a)(2) Notice to Assignee.*

1. *Subsequent sellers or assignors*. Any person, whether or not the original creditor, that sells or assigns a mortgage subject to §226.32 must furnish the notice of potential liability to the purchaser or assignee.

2. *Format*. While the notice of potential liability need not be in any particular format, the notice must be prominent. Placing it on the face of the note, such as with a stamp, is one means of satisfying the prominence requirement.

3. *Assignee liability*. Pursuant to section 131(d) of the act, the act's general holder-in-due course protections do not apply to purchasers and assignees of loans covered by §226.32. For such loans, a purchaser's or other assignee's liability for all claims and defenses that the consumer could assert against the creditor is not limited to violations of the act.

*Paragraph 34(a)(3) Refinancings within one-year period.*

1. *In the borrower's interest*. The determination of whether or not a refinancing covered by §226.34(a)(3) is in the borrower's interest is based on the totality of the circumstances, at the time the credit is extended. A written statement by the borrower that ''this loan is in my interest'' alone does not meet this standard.

i. A refinancing would be in the borrower's interest if needed to meet the borrower's ''bona fide personal financial emergency'' (see generally §226.23(e) and §226.31(c)(1)(iii)).

ii. In connection with a refinancing that provides additional funds to the borrower, in determining whether a loan is in the borrower's interest consideration should be given to whether the loan fees and charges are commensurate with the amount of new funds advanced, and whether the real estate-related charges are bona fide and reasonable in amount (see generally §226.4(c)(7)).

2. *Application of the one-year refinancing prohibition to creditors and assignees*. The prohibition in §226.34(a)(3) applies where an extension of credit subject to §226.32 is refinanced into another loan subject to §226.32. The prohibition is illustrated by the following examples. Assume that Creditor A makes a loan subject to §226.32 on January 15, 2003, secured by a first lien; this loan is assigned to Creditor B on February 15, 2003:

i. Creditor A is prohibited from refinancing the January 2003 loan (or any other loan subject to §226.32 to the same borrower) into a loan subject to §226.32, until January 15, 2004. Creditor B is restricted until January 15, 2004, or such date prior to January 15, 2004 that Creditor B ceases to hold or service the loan. During the prohibition period, Creditors A and B may make a subordinate lien loan that does not refinance a loan subject to §226.32. Assume that on April 1, 2003, Creditor A makes but does not assign a second-lien loan subject to §226.32. In that case, Creditor A would be prohibited from refinancing either the first-lien or second-lien loans (or any other loans to that borrower subject to §226.32) into another loan subject to §226.32 until April 1, 2004.

ii. The loan made by Creditor A on January 15, 2003 (and assigned to Creditor B) may be refinanced by Creditor C at any time. If Creditor C refinances this loan on March 1, 2003 into a new loan subject to §226.32, Creditor A is prohibited from refinancing the loan made by Creditor C (or any other loan subject to §226.32 to the same borrower) into another loan subject to §226.32 until January 15, 2004. Creditor C is similarly prohibited from refinancing any loan subject to §226.32 to that borrower into another until March 1, 2004. (The limitations of §226.34(a)(3) no longer apply to Creditor B after Creditor C refinanced the January 2003 loan and Creditor B ceased to hold or service the loan.)

*Paragraph 34(a)(4) Repayment ability.*

1. *Income*. Any expected income can be considered by the creditor, except equity income that would be realized from collateral. For example, a creditor may use information about income other than regular salary or wages such as gifts, expected retirement payments, or income from self-employment, such as housecleaning or childcare.

2. *Pattern or practice of extending credit—repayment ability*. Whether a creditor is engaging or has engaged in a pattern or practice of violations of this section depends on the totality of the circumstances in the particular case. While a pattern or practice is not established by isolated, random, or accidental acts, it can be established without the use of a statistical process. In addition, a creditor might act under a lending policy (whether written or unwritten) and that action alone

could establish a pattern or practice of making loans in violation of this section.

3. *Discounted introductory rates.* In transactions where the creditor sets an initial interest rate to be adjusted later (whether fixed or to be determined by an index or formula), in determining repayment ability the creditor must consider the consumer's ability to make loan payments based on the nondiscounted or fully-indexed rate at the time of consummation.

4. *Verifying and documenting income and obligations.* Creditors may verify and document a consumer's repayment ability in various ways. A creditor may verify and document a consumer's income and current obligations through any reliable source that provides the creditor with a reasonable basis for believing that there are sufficient funds to support the loan. Reliable sources include, but are not limited to, a credit report, tax returns, pension statements, and payment records for employment income.

*Paragraph 34(b) Prohibited acts or practices for dwelling-secured loans; open-end credit.*

1. *Amount of credit extended.* Where a loan is documented as open-end credit but the features and terms or other circumstances demonstrate that it does not meet the definition of open-end credit, the loan is subject to the rules for closed-end credit, including §226.32 if the rate or fee trigger is met. In applying the triggers under §226.32, the ''amount financed,'' including the ''principal loan amount'' must be determined. In making the determination, the amount of credit that would have been extended if the loan had been documented as a closed-end loan is a factual determination to be made in each case. Factors to be considered include the amount of money the consumer originally requested, the amount of the first advance or the highest outstanding balance, or the amount of the credit line. The full amount of the credit line is considered only to the extent that it is reasonable to expect that the consumer might use the full amount of credit.

## APPENDIX A—EFFECT ON STATE LAWS

1. *Who may make requests.* Appendix A sets forth the procedures for preemption determinations. As discussed in §226.28, which contains the standards for preemption, a request for a determination of whether a state law is inconsistent with the requirements of chapters 1, 2, or 3 may be made by creditors, states, or any interested party. However, only states may request and receive determinations in connection with the fair credit billing provisions of chapter 4.

### References

*Statute:* Sections 111 and 171(a).
*Other sections:* Section 226.28.
*Previous regulation:* Sections 226.6(b) and 226.70 (Supplement V, Section II).
*1981 changes:* The procedures in appendix A were largely adapted from Supplement V, Section II of the previous regulation (§226.70), with changes made to streamline the procedures.

## APPENDIX B—STATE EXEMPTIONS

1. *General.* Appendix B sets forth the procedures for exemption applications. The exemption standards are found in §226.29 and are discussed in the commentary to that section.

### References

*Statute:* Sections 123 and 171(b).
*Other sections:* Section 226.29.
*Previous regulation:* Sections 226.12, 226.50 (Supplement II), 226.60 (Supplement IV), and 226.70 (Supplement V, Section I).
*1981 changes:* The procedures in appendix B represent a combination and streamlining of the procedures set forth in the supplements to the previous regulation.

## APPENDIX C—ISSUANCE OF STAFF INTERPRETATIONS

1. *General.* This commentary is the vehicle for providing official staff interpretations. Individual interpretations generally will not be issued separately from the commentary.

### References

*Statute:* Sections 105 and 130(f).
*Other sections:* None.
*Previous regulation:* Section 226.1(d).
*1981 changes:* Appendix C reflects the Board's intention that this commentary serve as the vehicle for interpreting the regulation, rather than individual interpretive letters.

## APPENDIX D—MULTIPLE-ADVANCE CONSTRUCTION LOANS

1. *General rule.* Appendix D provides a special procedure that creditors may use, at their option, to estimate and disclose the terms of multiple-advance construction loans when the amounts or timing of advances is unknown at consummation of the transaction. This appendix reflects the approach taken in §226.17(c)(6)(ii), which permits creditors to provide separate or combined disclosures for the construction period and for the permanent financing, if any; i.e., the construction phase and the permanent phase may be treated as one transaction or more than one transaction. Appendix D may also be used in multiple-advance transactions other than construction loans, when the amounts or timing of advances is unknown at consummation.

2. *Variable-rate multiple-advance loans.* The hypothetical disclosure required in variable-

rate transactions by § 226.18(f)(1)(iv) is not required for multiple-advance loans disclosed pursuant to appendix D, part I.

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

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

5. *Interest reserves.* In a multiple-advance construction loan, a creditor may establish an ''interest reserve'' to ensure that interest is paid as it accrues by designating a portion of the loan to be used for paying the interest that accrues on the loan. An interest reserve is not treated as a prepaid finance charge, whether the interest reserve is the same as or different from the estimated interest figure calculated under appendix D.

• If a creditor permits a consumer to make interest payments as they become due, the interest reserve should be disregarded in the disclosures and calculations under appendix D.

• If a creditor requires the establishment of an interest reserve and automatically deducts interest payments from the reserve amount rather than allow the consumer to make interest payments as they become due, the fact that interest will accrue on those interest payments as well as the other loan proceeds must be reflected in the calculations and disclosures. To reflect the effects of such compounding, a creditor should first calculate interest on the commitment amount (exclusive of the interest reserve) and then add the figure obtained by assuming that one-half of that interest is outstanding at the contract interest rate for the entire construction period. For example, using the example shown under paragraph A, part I of appendix D, the estimated interest would be $1,117.68 ($1093.75 plus an additional $23.93 calculated by assuming half of $1093.75 is outstanding at the contract interest rate for the entire construction period), and the estimated annual percentage rate would be 21.18%.

References

*Statute:* None.

*Other sections:* Sections 226.17 and 226.22.

*Previous regulation:* Interpretation § 226.813.

*1981 Changes:* The use of appendix D is limited to multiple-advance loans for construction purposes or analogous types of transactions.

APPENDIX E—RULES FOR CARD ISSUERS THAT BILL ON A TRANSACTION-BY-TRANSACTION BASIS

*Statute:* None.

*Previous regulation:* Interpretation § 226.709.

*Other sections:* Sections 226.6 through 226.13, and 226.15.

*1981 changes:* The rules in this appendix have been streamlined and clarified to indicate how certain card issuers that bill on a transaction basis may comply with the requirements of Subpart B.

APPENDIX F—ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CERTAIN OPEN-END CREDIT PLANS

1. *Daily rate with specific transaction charge.* If the finance charge results from a charge relating to a specific transaction and the application of a daily periodic rate, see comment 14(c)–6 for guidance on an appropriate calculation method.

References

*Statute:* Section 107.

*Previous regulation:* Section 226.5(a)(3)(ii), footnote 5(a).

*Other sections:* Section 226.14.

*1981 changes:* This appendix incorporates a sixth example in which the transaction amount exceeds the amount of the balance subject to the periodic rate.

APPENDIXES G AND H—OPEN-END AND CLOSED-END MODEL FORMS AND CLAUSES

1. *Permissible changes.* Although use of the model forms and clauses is not required, creditors using them properly will be deemed to be in compliance with the regulation with regard to those disclosures. Creditors may make certain changes in the format or content of the forms and clauses and may delete any disclosures that are inapplicable to a transaction or a plan without losing the act's protection from liability. (But see appendix G comment 5 for special rules concerning certain disclosures required under § 226.5a for credit and charge card applications and solicitations). The rearrangement of the model forms and clauses may not be so extensive as to affect the substance, clarity, or meaningful sequence of the forms and clauses. Creditors making revisions with that effect will lose their protection from civil liability. Acceptable changes include, for example:

• Using the first person, instead of the second person, in referring to the borrower.

• Using ''borrower'' and ''creditor'' instead of pronouns.

• Rearranging the sequence of the disclosures.

• Not using bold type for headings.

• Incorporating certain state ''plain English'' requirements.

• Deleting inapplicable disclosures by whiting out, blocking out, filling in ''N/A'' (not applicable) or ''0'', crossing out, leaving blanks, checking a box for applicable items, or circling applicable items. (This should permit use of multi-purpose standard forms.)

• Substituting appropriate references, such as ''bank,'' ''we,'' or a specific name, for ''creditor'' in the initial open-end disclosures.

• Using a vertical, rather than a horizontal, format for the boxes in the closed-end disclosures.

2. *Debt cancellation coverage.* This regulation does not authorize creditors to characterize debt cancellation fees as insurance premiums for purposes of this regulation. Creditors may provide a disclosure that refers to debt cancellation coverage whether or not the coverage is considered insurance. Creditors may use the model credit insurance disclosures only if the debt cancellation coverage constitutes insurance under state law.

## APPENDIX G—OPEN-END MODEL FORMS AND CLAUSES

1. *Model G–1.* The model disclosures in G–1 (different balance computation methods) may be used in both the initial disclosures under §226.6 and the periodic disclosures under §226.7. As is clear from the models given, ''short-hand'' descriptions of the balance computation methods are not sufficient. The phrase ''a portion of'' the finance charge should be included if the total finance charge includes other amounts, such as transaction charges, that are not due to the application of a periodic rate. In addition, if unpaid finance charges are subtracted in calculating the balance, that fact must be stated so that the disclosure of the computation method is accurate. Only Model G–1(b) contains a final sentence appearing in brackets which reflects the total dollar amount of payments and credits received during the billing cycle. The other models do not contain this language because they reflect plans in which payments and credits received during the billing cycle are subtracted. If this is not the case, however, the language relating to payments and credits should be changed, and the creditor should add either the disclosure of the dollar amount as in Model G–1(b) or an indication of which credits (disclosed elsewhere on the periodic statement) will not be deducted in determining the balance. (Such an indication may also substitute for the bracketed sentence in Model G–1(b)). See the commentary to §226.7(e).

2. *Model G–2.* This model contains the notice of liability for unauthorized use of a credit card.

3. *Models G–3 and G–4.* These set out models for the long form billing error rights statement (for use with the initial disclosures and as an annual disclosure or, at the creditor's option, with each periodic statement) and the alternative billing error rights statement (for use with each periodic statement), respectively. Creditors must provide the billing error rights statements in a form substantially similar to the models in order to comply with the regulation. The model billing rights statements may be modified in any of the ways set forth in the first paragraph to the commentary on appendices G and H. The models may, furthermore, be modified by deleting inapplicable information, such as:

• The paragraph concerning stopping a debit in relation to a disputed amount, if the creditor does not have the ability to debit automatically the consumer's saving or checking account for payment.

• The rights stated in the special rule for credit card purchases and any limitations on those rights.

The model billing rights statements also contain optional language that creditors may use. For example, the creditor may:

• Include a statement to the effect that notice of a billing error must be submitted on something other than the payment ticket or other material accompanying the periodic disclosures.

• Insert its address or refer to the address that appears elsewhere on the bill.

Additional information may be included on the statements as long as it does not detract from the required disclosures. For instance, information concerning the reporting of errors in connection with a checking account may be included on a combined statement as long as the disclosures required by the regulation remain clear and conspicuous.

4. *Models G–5 through G–9.* These models set out notices of the right to rescind that would be used at different times in an open-end plan. The last paragraph of each of the rescission model forms contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, when the notice or material disclosures are delivered late or when the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional. See the commentary to section 226.2(a)(25) regarding the specificity of the security interest disclosure for model form G-7.

5. Model G–10(A), Sample G–10(B) and Model G–10(C). i. Model G–10(A) and Sample G–10(B) illustrate, in the tabular format, all of the disclosures required under §226.5a for applications and solicitations for credit cards other than charge cards. Model G–10(B) is a sample disclosure illustrating an account with a lower introductory rate and

penalty rate. Model G–10(C) illustrates the tabular format disclosure for charge card applications and solicitations and reflects all of the disclosures in the table.

ii. Except as otherwise permitted, disclosures must be substantially similar in sequence and format to model forms G–10(A) and (C). The disclosures may, however, be arranged vertically or horizontally and need not be highlighted aside from being included in the table. While proper use of the model forms will be deemed in compliance with the regulation, card issuers are permitted to use headings and disclosures other than those in the forms (with an exception relating to the use of ''grace period'') if they are clear and concise and are substantially similar to the headings and disclosures contained in model forms. For further discussion of requirements relating to form, see the commentary to § 226.5a(a)(2).

6. *Models G–11 and G–12.* Model G–11 contains clauses that illustrate the general disclosures required under § 226.5a(e) in applications and solicitations made available to the general public. Model G–12 is a model clause for the disclosure required under § 226.5a(f) when a charge card accesses an open-end plan offered by another creditor.

7. *Models G–13(A) and G–13(B).* These model forms illustrate the disclosures required under § 226.9(f) when the card issuer changes the entity providing insurance on a credit card account. Model G–13(A) contains the items set forth in § 226.9(f)(3) as examples of significant terms of coverage that may be affected by the change in insurance provider. The card issuer may either list all of these potential changes in coverage and place a check mark by the applicable changes, or list only the actual changes in coverage. Under either approach, the card issuer must either explain the changes or refer to an accompanying copy of the policy or group certificate for details of the new terms of coverage. Model G–13(A) also illustrates the permissible combination of the two notices required by § 226.9(f)—the notice required for a planned change in provider and the notice required once a change has occurred. This form may be modified for use in providing only the disclosures required before the change if the card issuer chooses to send two separate notices. Thus, for example, the references to the attached policy or certificate would not be required in a separate notice prior to a change in the insurance provider since the policy or certificate need not be provided at that time. Model G–13(B) illustrates the disclosures required under § 226.9(f)(2) when the insurance provider is changed.

## APPENDIX H—CLOSED-END MODEL FORMS AND CLAUSES

1. *Models H–1 and H–2.* Creditors may make several types of changes to closed-end model forms H–1 (credit sale) and H–2 (loan) and still be deemed to be in compliance with the regulation, provided that the required disclosures are made clearly and conspicuously. Permissible changes include the addition of the information permitted by footnote 37 to § 226.17 and ''directly related'' information as set forth in the commentary to § 226.17(a).

The creditor may also delete or, on multipurpose forms, indicate inapplicable disclosures, such as:

- The itemization of the amount financed option. (See Samples H–12 through H–15.)
- The credit life and disability insurance disclosures. (See Samples H–11 and H–12.)
- The property insurance disclosures. (See Samples H–10 through H–12, and H–14.)
- The ''filing fees'' and ''non-filing insurance'' disclosures. (See Samples H–11 and H–12.)
- The prepayment penalty or rebate disclosures. (See Samples H–12 and H–14.)
- The total sale price. (See Samples H–11 through H–15.)

Other permissible changes include:

- Adding the creditor's address or telephone number. (See the commentary to § 226.18(a).)
- Combining required terms where several numerical disclosures are the same, for instance, if the ''total of payments'' equals the ''total sale price.'' (See the commentary to § 226.18.)
- Rearranging the sequence or location of the disclosures—for instance, by placing the descriptive phrases outside the boxes containing the corresponding disclosures, or by grouping the descriptors together as a glossary of terms in a separate section of the segregated disclosures; by placing the payment schedule at the top of the form; or by changing the order of the disclosures in the boxes, including the annual percentage rate and finance charge boxes.
- Using brackets, instead of checkboxes, to indicate inapplicable disclosures.
- Using a line for the consumer to initial, rather than a checkbox, to indicate an election to receive an itemization of the amount financed.
- Deleting captions for disclosures.
- Using a symbol, such as an asterisk, for estimated disclosures, instead of an ''e.''
- Adding a signature line to the insurance disclosures to reflect joint policies.
- Separately itemizing the filing fees.
- Revising the late charge disclosure in accordance with the commentary to § 226.18(l).

2. *Model H–3.* Creditors have considerable flexibility in filling out Model H–3 (itemization of the amount financed). Appropriate revisions, such as those set out in the commentary to § 226.18(c), may be made to this form without loss of protection from civil liability for proper use of the model forms.

3. *Models H–4 through H–7.* The model clauses are not included in the model forms

although they are mandatory for certain transactions. Creditors using the model clauses when applicable to a transaction are deemed to be in compliance with the regulation with regard to that disclosure.

4. *Model H–4(A)*. This model contains the variable rate model clauses applicable to transactions subject to § 226.18(f)(1) and is intended to give creditors considerable flexibility in structuring variable rate disclosures to fit individual plans. The information about circumstances, limitations, and effects of an increase may be given in terms of the contract interest rate or the annual percentage rate. Clauses are shown for hypothetical examples based on the specific amount of the transaction and based on a representative amount. Creditors may preprint the variable rate disclosures based on a representative amount for similar types of transactions, instead of constructing an individualized example for each transaction. In both representative examples and transaction-specific examples, creditors may refer either to the incremental change in rate, payment amount, or number of payments, or to the resulting rate, payment amount, or number of payments. For example, creditors may state that the rate will increase by 2%, with a corresponding $150 increase in the payment, or creditors may state that the rate will increase to 16%, with a corresponding payment of $850.

5. *Model H–4(B)*. This model clause illustrates the variable-rate disclosure required under § 226.18(f)(2), which would alert consumers to the fact that the transaction contains a variable-rate feature and that disclosures were provided earlier.

6. *Model H–4(C)*. This model clause illustrates the early disclosures required generally under § 226.19(b). It includes information on how the consumer's interest rate is determined and how it can change over the term of the loan, and explains changes that may occur in the borrower's monthly payment. It contains an example of how to disclose historical changes in the index or formula values used to compute interest rates for the preceding 15 years. The model clause also illustrates the disclosure of the initial and maximum interest rates and payments based on an initial interest rate (index value plus margin, adjusted by the amount of any discount or premium) in effect as of an identified month and year for the loan program disclosure and illustrates how to provide consumers with a method for calculating the monthly payment for the loan amount to be borrowed.

7. *Model H–4(D)*. This model clause illustrates the adjustment notice required under § 226.20(c), and provides examples of payment change notices and annual notices of interest rate changes.

8. *Model H–5*. This contains the demand feature clause.

9. *Model H–6*. This contains the assumption clause.

10. *Model H–7*. This contains the required deposit clause.

11. *Models H–8 and H–9*. These models contain the rescission notices for a typical closed-end transaction and a refinancing, respectively. The last paragraph of each model form contains a blank for the date by which the consumer's notice of cancellation must be sent or delivered. A parenthetical is included to address the situation in which the consumer's right to rescind the transaction exists beyond 3 business days following the date of the transaction, for example, where the notice or material disclosures are delivered late or where the date of the transaction in paragraph 1 of the notice is an estimate. The language of the parenthetical is not optional. See the commentary to section 226.2(a)(25) regarding the specificity of the security interest disclosure for model form H-9. The prior version of model form H–9 is substantially similar to the current version and creditors may continue to use it, as appropriate. Creditors are encouraged, however, to use the current version when reordering or reprinting forms.

12. *Sample forms*. The sample forms (H–10 through H–15) serve a different purpose than the model forms. The samples illustrate various ways of adapting the model forms to the individual transactions described in the commentary to appendix H. The deletions and rearrangments shown relate only to the specific transactions described. As a result, the samples do not provide the general protection from civil liability provided by the model forms and clauses.

13. *Sample H–10*. This sample illustrates an automobile credit sale. The cash price is $7,500 with a downpayment of $1,500. There is an 8% add-on interest rate and a term of 3 years, with 36 equal monthly payments. The credit life insurance premium and the filing fees are financed by the creditor. There is a $25 credit report fee paid by the consumer before consummation, which is a prepaid finance charge.

14. *Sample H–11*. This sample illustrates an installment loan. The amount of the loan is $5,000. There is a 12% simple interest rate and a term of 2 years. The date of the transaction is expected to be April 15, 1981, with the first payment due on June 1, 1981. The first payment amount is labelled as an estimate since the transaction date is uncertain. The odd days' interest ($26.67) is collected with the first payment. The remaining 23 monthly payments are equal.

15. *Sample H–12*. This sample illustrates a refinancing and consolidation loan. The amount of the loan is $5,000. There is a 15% simple interest rate and a term of 3 years. The date of the transaction is April 1, 1981, with the first payment due on May 1, 1981. The first 35 monthly payments are equal,

with an odd final payment. The credit disability insurance premium is financed. In calculating the annual percentage rate, the U.S. Rule has been used. Since an itemization of the amount financed is included with the disclosures, the statement regarding the consumer's option to receive an itemization is deleted.

16. *Samples H–13 through H–15.* These samples illustrate various mortgage transactions. They assume that the mortgages are subject to the Real Estate Settlement Procedures Act (RESPA). As a result, no option regarding the itemization of the amount financed has been included in the samples, because providing the good faith estimates of settlement costs required by RESPA satisfies Truth in Lending's amount financed itemization requirement. (See footnote 39 to §226.18(c).)

17. *Sample H–13.* This sample illustrates a mortgage with a demand feature. The loan amount is $44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. The 15 days of interim interest ($294.34) is collected as a prepaid finance charge at the time of consummation of the loan (April 15, 1981). In calculating the disclosure amounts, the minor irregularities provision in §226.17(c)(4) has been used. The property insurance premiums are not included in the payment schedule. This disclosure statement could be used for notes with the 7-year call option required by the Federal National Mortgage Association (FNMA) in states where due-on-sale clauses are prohibited.

18. *Sample H–14.* This sample disclosure form illustrates the disclosures under §226.19(b) for a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year. The sample form shows a creditor how to adapt the model clauses in appendix H–4(C) to the creditor's own particular variable-rate program. The sample disclosure form describes the features of a specific variable-rate mortgage program and alerts the consumer to the fact that information on the creditor's other closed-end variable-rate programs is available upon request. It includes information on how the interest rate is determined and how it can change over time. Section 226.19(b)(2)(viii) permits creditors the option to provide either a historical example or an initial and maximum interest rates and payments disclosure; both are illustrated in the sample disclosure. The historical example explains how the monthly payment can change based on a $10,000 loan amount, payable in 360 monthly installments, based on historical changes in the values for the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. Index values are measured for 15 years, as of the first week ending in July. This reflects the requirement that the index history be based on values for the same date or period each year in the example. The sample disclosure also illustrates the alternative disclosure under §226.19(b)(2)(viii)(B) that the initial and the maximum interest rates and payments be shown for a $10,000 loan originated at an initial interest rate of 12.41 percent (which was in effect July 1996) and to have 2 percentage point annual (and 5 percentage point overall) interest rate limitations or caps. Thus, the maximum amount that the interest rate could rise under this program is 5 percentage points higher than the 12.41 percent initial rate to 17.41 percent, and the monthly payment could rise from $106.03 to a maximum of $145.34. The loan would not reach the maximum interest rate until its fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

19. *Sample H–15.* This sample illustrates a graduated payment mortgage with a 5-year graduation period and a 7½ percent yearly increase in payments. The loan amount is $44,900, payable in 360 monthly installments at a simple interest rate of 14.75%. Two points ($898), as well as an initial mortgage guarantee insurance premium of $225.00, are included in the prepaid finance charge. The mortgage guarantee insurance premiums are calculated on the basis of ¼ of 1% of the outstanding principal balance under an annual reduction plan. The abbreviated disclosure permitted under §226.18(g)(2) is used for the payment schedule for years 6 through 30. The prepayment disclosure refers to both penalties and rebates because information about penalties is required for the simple interest portion of the obligation and information about rebates is required for the mortgage insurance portion of the obligation.

20. *Sample H–16.* This sample illustrates the disclosures required under §226.32(c). The sample illustrates the amount borrowed and the disclosures about optional insurance that are required for mortgage refinancings under §226.32(c)(5). Creditors may, at their option, include these disclosures for all loans subject to §226.32. The sample also includes disclosures required under §226.32(c)(3) when the legal obligation includes a balloon payment.

21. *HRSA–500–1 9–82.* Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–500–1 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all Health Education Assistance Loans (HEAL) with a variable interest rate that are interim student credit extensions as defined in Regulation Z.

22. *HRSA–500–2 9–82*. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–500–2 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a fixed interest rate that are interim student credit extensions as defined in Regulation Z.

23. *HRSA–502–1 9–82*. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–502–1 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a variable interest rate in which the borrower has reached repayment status and is making payments of both interest and principal.

24. *HRSA–502–2 9–82*. Pursuant to section 113(a) of the Truth in Lending Act, Form HRSA–502–2 9–82 issued by the U.S. Department of Health and Human Services for certain student loans has been approved. The form may be used for all HEAL loans with a fixed interest rate in which the borrower has reached repayment status and is making payments of both interest and principal.

References

*Statute:* Sections 105 and 130.
*Other sections:* Sections 226.6, 226.7, 226.9, 226.12, 226.15, 226.18, and 226.23.
*Previous regulation:* None.
*1981 changes:* The model forms and clauses have no counterpart in the previous regulation.

## APPENDIX I—FEDERAL ENFORCEMENT AGENCIES

*Statute:* Section 108.
*Other sections:* None.
*Previous regulation:* Section 226.1(b).
*1981 changes:* None.

## APPENDIX J—ANNUAL PERCENTAGE RATE COMPUTATIONS FOR CLOSED-END CREDIT TRANSACTIONS

1. *Use of appendix J*. Appendix J sets forth the actuarial equations and instructions for calculating the annual percentage rate in closed-end credit transactions. While the formulas contained in this appendix may be directly applied to calculate the annual percentage rate for an individual transaction, they may also be utilized to program calculators and computers to perform the calculations.

2. *Relation to Board tables*. The Board's Annual Percentage Rate Tables also provide creditors with a calculation tool that applies the technical information in appendix J. An annual percentage rate computed in accordance with the instructions in the tables is deemed to comply with the regulation. Volume I of the tables may be used for credit transactions involving equal payment amounts and periods, as well as for transactions involving any of the following irregularities: odd first period, odd first payment and odd last payment. Volume II of the tables may be used for transactions that involve any type of irregularities. These tables may be obtained from any Federal Reserve Bank or from the Board in Washington, DC 20551, upon request.

References

*Statute:* Section 107.
*Other sections:* Section 226.22.
*Previous regulation:* Section 226.40 (Supplement I).
*1981 changes:* Paragraph (b)(2) has been revised to clarify that the term of the transaction never begins earlier than consummation of the transaction. 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, to use either the 12-month method or the 365-day method to compute the number of unit-periods per year.

## APPENDIX K—TOTAL ANNUAL LOAN COST RATE COMPUTATIONS FOR REVERSE MORTGAGE TRANSACTIONS

1. *General*. The calculation of total annual loan cost rates under appendix K is based on the principles set forth and the estimation or ''iteration'' procedure used to compute annual percentage rates under appendix J. Rather than restate this iteration process in full, the regulation cross-references the procedures found in appendix J. In other aspects the appendix reflects the special nature of reverse mortgage transactions. Special definitions and instructions are included where appropriate.

*(b) Instructions and equations for the total annual loan cost rate.*

*(b)(5) Number of unit-periods between two given dates.*

1. *Assumption as to when transaction begins*. The computation of the total annual loan cost rate is based on the assumption that the reverse mortgage transaction begins on the first day of the month in which consummation is estimated to occur. Therefore, fractional unit-periods (used under appendix J for calculating annual percentage rates) are not used.

*(b)(9) Assumption for discretionary cash advances.*

1. *Amount of credit*. Creditors should compute the total annual loan cost rates for transactions involving discretionary cash advances by assuming that 50 percent of the initial amount of the credit available under the transaction is advanced at closing or, in an open-end transaction, when the consumer becomes obligated under the plan. (For the purposes of this assumption, the initial amount of the credit is the principal loan

amount less any costs to the consumer under section 226.33(c)(1).)

*(b)(10) Assumption for variable-rate reverse mortgage transactions.*

1. *Initial discount or premium rate.* Where a variable-rate reverse mortgage transaction includes an initial discount or premium rate, the creditor should apply the same rules for calculating the total annual loan cost rate as are applied when calculating the annual percentage rate for a loan with an initial discount or premium rate (see the commentary to § 226.17(c)).

*(d) Reverse mortgage model form and sample form.*

*(d)(2) Sample form.*

1. *General.* The ''clear and conspicuous'' standard for reverse mortgage disclosures does not require disclosures to be printed in any particular type size. Disclosures may be made on more than one page, and use both the front and the reverse sides, as long as the pages constitute an integrated document and the table disclosing the total annual loan cost rates is on a single page.

APPENDIX L—ASSUMED LOAN PERIODS FOR COMPUTATIONS OF TOTAL ANNUAL LOAN COST RATES

1. *General.* The life expectancy figures used in appendix L are those found in the U.S. Decennial Life Tables for women, as rounded to the nearest whole year and as published by the U. S. Department of Health and Human Services. The figures contained in appendix L must be used by creditors for all consumers (men and women). Appendix L will be revised periodically by the Board to incorporate revisions to the figures made in the Decennial Tables.

[46 FR 50288, Oct. 9, 1981]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting supplement I of part 226, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

EFFECTIVE DATE NOTE: At 73 FR 44604 through 44613, July 30, 2008, supplement I of part 226 was amended accordingly: under *Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability*, new headings *1(d) Organization* and *Paragraph 1(d)(5)*, and new paragraph 1(d)(5)–1 were added; under *Section 226.2—Definitions and Rules of Construction, 2(a) Definitions, 2(a)(6) Business day*, paragraph 2(a)(6)–2 was revised, and under *2(a)(24) Residential mortgage transaction*, paragraphs 2(a)(24)–1 and 2(a)(24)–5.ii were revised; under *Section 226.16—Advertising*, paragraph 16–1 was revised, paragraph 16–2 was redesignated as paragraph 16–6, and new paragraphs 16–2 through 16–5 and 16–7 were added; under *16(d) Additional requirements for home-equity plans*, paragraph 16(d)–3 was revised, paragraphs 16(d)–5, 16(d)–6, and 16(d)–7 were redesignated as paragraphs 16(d)–7, 16(d)–8, and 16(d)–9, respectively, new paragraphs 16(d)–5 and 16(d)–6 were added, and newly designated paragraphs 16(d)–7 and 16(d)–9 were revised; and new heading *16(e) Alternative disclosures—television or radio advertisements* was added, and new paragraphs 16(e)–1 and 16(e)–2 were added; under *Section 226.17—General Disclosure Requirements, 17(c) Basis of disclosures and use of estimates, Paragraph 17(c)(1)*, paragraph 17(c)(1)–8 was revised, and under *17(f) Early disclosures*, paragraph 17(f)–4 was revised; under *Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions*, the heading was revised, heading *19(a)(1) Time of disclosure* was redesignated as heading *19(a)(1)(i) Time of disclosure*, paragraphs 19(a)(1)(i)–1 and 19(a)(1)(i)–5 were revised, new heading *19(a)(1)(ii) Imposition of fees* and new paragraphs 19(a)(1)(ii)–1 through 19(a)(1)(ii)–3 were added, and new heading *19(a)(1)(iii) Exception to fee restriction* and new paragraph 19(a)(1)(iii)–1 were added; under *Section 226.24—Advertising*, paragraph 24–1 is revised; heading *24(d) Catalogs or other multiple-page advertisements; electronic advertisements* and paragraphs 24(d)–1 through 24(d)–4 were redesignated as heading *24(e) Catalogs or other multiple-page advertisements; electronic advertisements* and paragraphs 24(e)–1 through 24(e)–4, respectively; headings *24(c) Advertisements of terms that require additional disclosures, Paragraph 24(c)(1)*, and *Paragraph 24(c)(2)* and paragraphs 24(c)–1, 24(c)(1)–1 through 24(c)(1)–4, and 24(c)(2)–1 through 24(c)(2)–4 were redesignated as headings 24(d) *Advertisements of terms that require additional disclosures, Paragraph 24(d)(1)*, and *Paragraph 24(d)(2)* and paragraphs 24(d)–1, 24(d)(1)–1 through 24(d)(1)–4, and 24(d)(2)–1 through 24(d)(2)–4, respectively; heading *24(b) Advertisement of rate of finance charge* and paragraphs 24(b)–1 through 24(b)–5 were redesignated as heading *24(c) Advertisement of rate of finance charge* and paragraphs 24(c)–1 through 24(c)–5, respectively; new heading *24(b) Clear and conspicuous standard* and new paragraphs 24(b)–1 through 24(b)–5 were added; newly designated paragraphs 24(c)–2 and 24(c)–3 were revised, newly designated paragraph 24(c)–4 was removed, and newly designated paragraph 24(c)–5 was further redesignated as 24(c)–4 and revised; newly designated paragraphs 24(d)–1, 24(d)(1)–3, and 24(d)(2)–2 were revised, newly designated paragraphs 24(d)(2)–3 and 24(d)(2)–4 were further redesignated as 24(d)(2)–4 and 24(d)(2)–5, respectively, new paragraph 24(d)(2)–3 was added, and newly designated paragraph 24(d)(2)–5 was revised; newly designated paragraph 24(e)–1, 24(e)–2, and 24(e)–4 were revised; and new headings *24(f) Disclosure of rates and payments in advertisements for credit secured by a dwelling*, *24(f)(3) Disclosure of payments*, *24(g)*

*Alternative disclosures—television or radio advertisements*, and *24(i) Prohibited acts or practices in advertisements for credit secured by a dwelling* and new paragraphs 24(f)–1 through 24(f)–6, 24(f)(3)–1, 24(f)(3)–2, 24(g)–1, 24(g)–2, and 24(i)–1 through 24(i)–3 were added; under *Section 226.32–Requirements for Certain Closed-End Home Mortgages, 32(a) Coverage*, new heading *Paragraph 32(a)(2)* and new paragraph 32(a)(2)–1 were added, under *32(d) Limitations*, new paragraphs 32(d)–1 and 32(d)–2 were added, and under *32(d)(7) Prepayment penalty exception, Paragraph 32(d)(7)(iii)*, paragraphs 32(d)(7)(iii)–1 and 32(d)(7)(iii)–2 were removed and new paragraphs 32(d)(7)(iii)–1 through 32(d)(7)(iii)–3 were added, and new heading *Paragraph 32(d)(7)(iv)* and new paragraphs 32(d)(7)(iv)–1 and 32(d)(7)(iv)–2 were added; under *Section 226.34—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Dwelling; Open-end Credit*, the heading was revised, and under *34(a) Prohibited acts or practices for loans subject to § 226.32, 34(a)(4) Repayment ability*, paragraphs 34(a)(4)–1 through 34(a)(4)–4 were removed, and new paragraphs 34(a)(4)–1 through 34(a)(4)–7, new heading *34(a)(4)(i) Mortgage-related obligations* and new paragraph 34(a)(4)(i)–1, new heading *34(a)(4)(ii) Verification of repayment ability* and new paragraphs 34(a)(4)(ii)–1 through 34(a)(4)(ii)–3, new heading *Paragraph 34(a)(4)(ii)(A)* and new paragraphs 34(a)(4)(ii)(A)–1 through 34(a)(4)(ii)(A)–5, new heading *Paragraph 34(a)(4)(ii)(B)* and new paragraphs 34(a)(4)(ii)(B)–1 and 34(a)(4)(ii)(B)–2, new heading *Paragraph 34(a)(4)(ii)(C)* and new paragraph 34(a)(4)(ii)(C)–1, new heading *34(a)(4)(iii) Presumption of compliance* and new paragraph 34(a)(4)(iii)–1, new heading *Paragraph 34(a)(4)(iii)(B)* and new paragraph 34(a)(4)(iii)(B)–1, new heading Paragraph *34(a)(4)(iii)(C)* and new paragraph 34(a)(4)(iii)(C)–1, and new heading *34(a)(4)(iv) Exclusions from the presumption of compliance* and new paragraphs 34(a)(4)(iv)–1 and 34(a)(4)(iv)–2 were added; a new *Section 226.35—Prohibited Acts or Practices in Connection with Higher-priced Mortgage Loans* was added; *Section 226.36—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Principal Dwelling* was added, effective Oct. 1, 2009. For the convenience of the user, the added and revised text is set forth as follows:

## SUPPLEMENT I TO PART 226—OFFICIAL STAFF INTERPRETATIONS

* * * * *

*Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability*

* * * * *

*1(d) Organization.*

*Paragraph 1(d)(5).*

1. *Effective dates.* The Board's revisions to Regulation Z published on July 30, 2008 (the ''final rules''), apply to covered loans (including refinance loans and assumptions considered new transactions under § 226.20), for which the creditor receives an application on or after October 1, 2009, except for the final rules on advertising, escrows, and loan servicing. The final rules on escrows in § 226.35(b)(3) are effective for covered loans, (including refinancings and assumptions in § 226.20) for which the creditor receives an application on or after April 1, 2010; but for such loans secured by manufactured housing on or after October 1, 2010. The final rules applicable to servicers in § 226.36(c) apply to all covered loans serviced on or after October 1, 2009. The final rules on advertising apply to advertisements occurring on or after October 1, 2009. For example, a radio ad occurs on the date it is first broadcast; a solicitation occurs on the date it is mailed to the consumer. The following examples illustrate the application of the effective dates for the final rules.

i. *General.* A refinancing or assumption as defined in § 226.20(a) or (b) is a new transaction and is covered by a provision of the final rule if the creditor receives an application for the transaction on or after that provision's effective date. For example, if a creditor receives an application for a refinance loan covered by § 226.35(a) on or after October 1, 2009, and the refinance loan is consummated on October 15, 2009, the provision restricting prepayment penalties in § 226.35(b)(2) applies. However, If the transaction were a modification of an existing obligation's terms that does not constitute a refinance loan under § 226.20(a), the final rules, including for example the restriction on prepayment penalties would not apply.

ii. *Escrows.* Assume a consumer applies for a refinance loan to be secured by a dwelling (that is not a manufactured home) on March 15, 2010, and the loan is consummated on April 2, 2010, the escrow rule in § 226.35(b)(3) does not apply.

iii. *Servicing.* Assume that a consumer applies for a new loan on August 1, 2009. The loan is consummated on September 1, 2009. The servicing rules in § 226.36(c) apply to the servicing of that loan as of October 1, 2009.

* * * * *

*Section 226.2—Definitions and Rules of Construction*

*2(a) Definitions.*

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*2(a)(6) Business day.*

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2. *Recission rule.* A more precise rule for what is a business day (all calendar days except Sundays and the federal legal holidays listed in 5 U.S.C. 6103(a)) applies when the right of rescission, the receipt of disclosures for certain mortgage transactions under section 226.19(a)(1)(ii), or mortgages subject to section 226.32 are involved. (See also comment 31(c)(1)–1.) Four federal legal holidays are identified in 5 U.S.C. 6103(a) by a specific date: New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25. When one of these holidays (July 4, for example) falls on a Saturday, federal offices and other entities might observe the holiday on the preceding Friday (July 3). The observed holiday (in the example, July 3) is a business day for purposes of rescission, the receipt of disclosures for certain mortgage transactions under section 226.19(a)(1)(ii), or the delivery of disclosures for certain high-cost mortgages covered by section 226.32.

* * * * *

*2(a)(24) Residential mortgage transaction.*

1. *Relation to other sections.* This term is important in five provisions in the regulation:

i. §226.4(c)(7)—exclusions from the finance charge.

ii. §226.15(f)—exemption from the right of rescission.

iii. §226.18(q)—whether or not the obligation is assumable.

iv. §226.20(b)—disclosure requirements for assumptions.

v. §226.23(f)—exemption from the right of rescission.

* * * * *

5. *Acquisition.* * * *

* * * * *

ii. Examples of new transactions involving a previously acquired dwelling include the financing of a balloon payment due under a land sale contract and an extension of credit made to a joint owner of property to buy out the other joint owner's interest. In these instances, disclosures are not required under §226.18(q) (assumability policies). However, the rescission rules of §§226.15 and 226.23 do apply to these new transactions.

* * * * *

*Section 226.16—Advertising*

1. *Clear and conspicuous standard—general.* Section 226.16 is subject to the general ''clear and conspicuous'' standard for subpart B (*see* §226.5(a)(1)) but prescribes no specific rules for the format of the necessary disclosures, aside from the format requirements related to the disclosure of a promotional rate under §226.16(d)(6). Aside from the terms described in §226.16(d)(6), the credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement.

2. *Clear and conspicuous standard—promotional rates or payments for home-equity plans.* For purposes of §226.16(d)(6), a clear and conspicuous disclosure means that the required information in §226.16(d)(6)(ii)(A)–(C) is disclosed with equal prominence and in close proximity to the promotional rate or payment to which it applies. If the information in §226.16(d)(6)(ii)(A)–(C) is the same type size and is located immediately next to or directly above or below the promotional rate or payment to which it applies, without any intervening text or graphical displays, the disclosures would be deemed to be equally prominent and in close proximity. Notwithstanding the above, for electronic advertisements that disclose promotional rates or payments, compliance with the requirements of §226.16(c) is deemed to satisfy the clear and conspicuous standard.

3. *Clear and conspicuous standard—Internet advertisements for home-equity plans.* For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for home-equity plans subject to the requirements of §226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under §226.16(d). *See also* comment 16(c)(1)–2.

4. *Clear and conspicuous standard—televised advertisements for home-equity plans.* For purposes of this section, including alternative disclosures as provided for by §226.16(e), a clear and conspicuous disclosure in the context of visual text advertisements on television for home-equity plans subject to the requirements of §226.5b means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows for a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under §226.16(d). For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. *Clear and conspicuous standard—oral advertisements for home-equity plans.* For purposes of this section, including alternative disclosures as provided for by §226.16(e), a

clear and conspicuous disclosure in the context of an oral advertisement for home-equity plans subject to the requirements of §226.5b, whether by radio, television, the Internet, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

6. *Expressing the annual percentage rate in abbreviated form.* * * *

7. *Effective date.* For guidance on the applicability of the Board's revisions to §226.16 published on July 30, 2008, see comment 1(d)(5)–1.

* * * * *

*16(d) Additional requirements for home-equity plans.*

* * * * *

3. *Statements of tax deductibility.* An advertisement that refers to deductibility for tax purposes is not misleading if it includes a statement such as ''consult a tax advisor regarding the deductibility of interest.'' An advertisement distributed in paper form or through the Internet (rather than by radio or television) that states that the advertised extension of credit may exceed the fair market value of the consumer's dwelling is not misleading if it clearly and conspicuously states the required information in §§226.16(d)(4)(i) and (ii).

* * * * *

5. *Promotional rates and payments in advertisements for home-equity plans.* Section 226.16(d)(6) requires additional disclosures for promotional rates or payments.

i. *Variable-rate plans.* In advertisements for variable-rate plans, if the advertised annual percentage rate is based on (or the advertised payment is derived from) the index and margin that will be used to make rate (or payment) adjustments over the term of the loan, then there is no promotional rate or promotional payment. If, however, the advertised annual percentage rate is not based on (or the advertised payment is not derived from) the index and margin that will be used to make rate (or payment) adjustments, and a reasonably current application of the index and margin would result in a higher annual percentage rate (or, given an assumed balance, a higher payment) then there is a promotional rate or promotional payment.

ii. *Equal prominence, close proximity.* Information required to be disclosed in §226.16(d)(6)(ii) that is immediately next to or directly above or below the promotional rate or payment (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed in §226.16(d)(6)(ii) that is in the same type size as the promotional rate or payment is deemed to be equally prominent.

iii. *Amounts and time periods of payments.* Section 226.16(d)(6)(ii)(C) requires disclosure of the amount and time periods of any payments that will apply under the plan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an advertisement for a home-equity plan offers a $100,000 five-year line of credit and assumes that the entire line is drawn resulting in a minimum payment of $800 per month for the first six months, increasing to $1,000 per month after month six, followed by a $50,000 balloon payment after five years, the advertisement must disclose the amount and time period of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to the promotional payment. However, if the final payment could not be more than twice the amount of other minimum payments, the final payment need not be disclosed.

iv. *Plans other than variable-rate plans.* For a plan other than a variable-rate plan, if an advertised payment is calculated in the same way as other payments based on an assumed balance, the fact that the minimum payment could increase solely if the consumer made an additional draw does not make the payment a promotional payment. For example, if a payment of $500 results from an assumed $10,000 draw, and the payment would increase to $1,000 if the consumer made an additional $10,000 draw, the payment is not a promotional payment.

v. *Conversion option.* Some home-equity plans permit the consumer to repay all or part of the balance during the draw period at a fixed rate (rather than a variable rate) and over a specified time period. The fixed-rate conversion option does not, by itself, make the rate or payment that would apply if the consumer exercised the fixed-rate conversion option a promotional rate or payment.

vi. *Preferred-rate provisions.* Some home-equity plans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ, the consumer closing an existing deposit account with the creditor, or the consumer revoking an election to make automated payments. A preferred-rate provision does not, by itself, make the rate or payment under the preferred-rate provision a promotional rate or payment.

6. *Reasonably current index and margin.* For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

7. *Relation to other sections.* Advertisements for home-equity plans must comply with all provisions in §226.16 not solely the rules in §226.16(d). If an advertisement contains information (such as the payment terms) that triggers the duty under §226.16(d) to state the annual percentage rate, the additional disclosures in §226.16(b) must be provided in the advertisement. While §226.16(d) does not require a statement of fees to use or maintain the plan (such as membership fees and transaction charges), such fees must be disclosed under §226.16(b)(1) and (3).

* * * * *

9. *Balloon payment.* See comment 5b(d)(5)(ii)–3 for information not required to be stated in advertisements, and on situations in which the balloon payment requirement does not apply.

*16(e) Alternative disclosures—television or radio advertisements.*

1. *Multi-purpose telephone number.* When an advertised telephone number provides a recording, disclosures should be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options—such as providing directions to the advertiser's place of business—the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. *Statement accompanying telephone number.* Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as ''call 1–800–000–0000 for details about credit costs and terms.''

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*Section 226.17—General Disclosure Requirements*

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*17(c) Basis of disclosures and use of estimates.*

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*Paragraph 17(c)(1).*

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8. *Basis of disclosures in variable-rate transactions.* The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer buydown, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to §226.17(c) for a discussion of buydown, discounted, and premium transactions and the commentary to §226.19(a)(2) for a discussion of the redisclosure in certain mortgage transactions with a variable-rate feature.)

* * * * *

*17(f) Early disclosures.*

* * * * *

4. *Special rules.* In mortgage transactions subject to §226.19, the creditor must redisclose if, between the delivery of the required early disclosures and consummation, the annual percentage rate changes by more than a stated tolerance. When subsequent events occur after consummation, new disclosures are required only if there is a refinancing or an assumption within the meaning of §226.20.

* * * * *

*Section 226.19—Certain Mortgage and Variable-Rate Transactions*

*19(a)(1)(i) Time of disclosure.*

1. *Coverage.* This section requires early disclosure of credit terms in mortgage transactions that are secured by a consumer's principal dwelling and also subject to the Real Estate Settlement Procedures Act (RESPA) and its implementing Regulation X, administered by the Department of Housing and Urban Development (HUD). To be covered by §226.19, a transaction must be a federally related mortgage loan under RESPA. ''Federally related mortgage loan''

is defined under RESPA (12 U.S.C. 2602) and Regulation X (24 CFR 3500.2), and is subject to any interpretations by HUD. RESPA coverage includes such transactions as loans to purchase dwellings, refinancings of loans secured by dwellings, and subordinate-lien home-equity loans, among others. Although RESPA coverage relates to any dwelling, §226.19(a) applies to such transactions only if they are secured by a consumer's principal dwelling. Also, home equity lines of credit subject to §226.5b are not covered by §226.19(a). For guidance on the applicability of the Board's revisions to §226.19(a) published on July 30, 2008, see comment 1(d)(5)–1.

* * * * *

5. *Itemization of amount financed*. In many mortgage transactions, the itemization of the amount financed required by §226.18(c) will contain items, such as origination fees or points, that also must be disclosed as part of the good faith estimates of settlement costs required under RESPA. Creditors furnishing the RESPA good faith estimates need not give consumers any itemization of the amount financed, either with the disclosures provided within three days after application or with the disclosures given at consummation or settlement.

*19(a)(1)(ii) Imposition of fees.*

1. *Timing of fees*. The consumer must receive the disclosures required by this section before paying or incurring any fee imposed by a creditor or other person in connection with the consumer's application for a mortgage transaction that is subject to §226.19(a)(1)(i), except as provided in §226.19(a)(1)(iii). If the creditor delivers the disclosures to the consumer in person, a fee may be imposed anytime after delivery. If the creditor places the disclosures in the mail, the creditor may impose a fee after the consumer receives the disclosures or, in all cases, after midnight on the third business day following mailing of the disclosures. For purposes of §226.19(a)(1)(ii), the term ''business day'' means all calendar days except Sundays and legal public holidays referred to in §226.2(a)(6). *See* Comment 2(a)(6)–2. For example, assuming that there are no intervening legal public holidays, a creditor that receives the consumer's written application on Monday and mails the early mortgage loan disclosure on Tuesday may impose a fee on the consumer after midnight on Friday.

2. *Fees restricted*. A creditor or other person may not impose any fee, such as for an appraisal, underwriting, or broker services, until the consumer has received the disclosures required by §226.19(a)(1)(i). The only exception to the fee restriction allows the creditor or other person to impose a *bona fide* and reasonable fee for obtaining a consumer's credit history, such as for a credit report(s).

3. *Collection of fees*. A creditor complies with §226.19(a)(1)(ii) if—

i. The creditor receives a consumer's written application directly from the consumer and does not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure.

ii. A third party submits a consumer's written application to a creditor and both the creditor and third party do not collect any fee, other than a fee for obtaining a consumer's credit history, until the consumer receives the early mortgage loan disclosure from the creditor.

iii. A third party submits a consumer's written application to a second creditor following a prior creditor's denial of an application made by the same consumer (or following the consumer's withdrawal), and, if a fee already has been assessed, the new creditor or third party does not collect or impose any additional fee until the consumer receives an early mortgage loan disclosure from the new creditor.

*19(a)(1)(iii) Exception to fee restriction.*

1. *Requirements*. A creditor or other person may impose a fee before the consumer receives the required disclosures if it is for obtaining the consumer's credit history, such as by purchasing a credit report(s) on the consumer. The fee also must be *bona fide* and reasonable in amount. For example, a creditor may collect a fee for obtaining a credit report(s) if it is in the creditor's ordinary course of business to obtain a credit report(s). If the criteria in §226.19(a)(1)(iii) are met, the creditor may describe or refer to this fee, for example, as an ''application fee.''

* * * * *

*Section 226.24—Advertising*

1. *Effective date*. For guidance on the applicability of the Board's changes to §226.24 published on July 30, 2008, see comment 1(d)(5)–1.

* * * * *

*24(b) Clear and conspicuous standard.*

1. *Clear and conspicuous standard—general*. This section is subject to the general ''clear and conspicuous'' standard for this subpart, *see* §226.17(a)(1), but prescribes no specific rules for the format of the necessary disclosures, other than the format requirements related to the advertisement of rates and payments as described in comment 24(b)–2 below. The credit terms need not be printed in a certain type size nor need they appear in any particular place in the advertisement. For example, a merchandise tag that is an advertisement under the regulation complies with this section if the necessary credit

terms are on both sides of the tag, so long as each side is accessible.

2. *Clear and conspicuous standard—rates and payments in advertisements for credit secured by a dwelling.* For purposes of §226.24(f), a clear and conspicuous disclosure means that the required information in §§226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is disclosed with equal prominence and in close proximity to the advertised rates or payments triggering the required disclosures, and that the required information in §226.24(f)(3)(i)(C) is disclosed prominently and in close proximity to the advertised rates or payments triggering the required disclosures. If the required information in §§226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) is the same type size as the advertised rates or payments triggering the required disclosures, the disclosures are deemed to be equally prominent. The information in §226.24(f)(3)(i)(C) must be disclosed prominently, but need not be disclosed with equal prominence or be the same type size as the payments triggering the required disclosures. If the required information in §§226.24(f)(2)(i) and 226.24(f)(3)(i) is located immediately next to or directly above or below the advertised rates or payments triggering the required disclosures, without any intervening text or graphical displays, the disclosures are deemed to be in close proximity. Notwithstanding the above, for electronic advertisements that disclose rates or payments, compliance with the requirements of §226.24(e) is deemed to satisfy the clear and conspicuous standard.

3. *Clear and conspicuous standard—Internet advertisements for credit secured by a dwelling.* For purposes of this section, a clear and conspicuous disclosure for visual text advertisements on the Internet for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices and comply with all other requirements for clear and conspicuous disclosures under §226.24. *See also* comment 24(e)–4.

4. *Clear and conspicuous standard—televised advertisements for credit secured by a dwelling.* For purposes of this section, including alternative disclosures as provided for by §226.24(g), a clear and conspicuous disclosure in the context of visual text advertisements on television for credit secured by a dwelling means that the required disclosures are not obscured by techniques such as graphical displays, shading, coloration, or other devices, are displayed in a manner that allows a consumer to read the information required to be disclosed, and comply with all other requirements for clear and conspicuous disclosures under §226.24. For example, very fine print in a television advertisement would not meet the clear and conspicuous standard if consumers cannot see and read the information required to be disclosed.

5. *Clear and conspicuous standard—oral advertisements for credit secured by a dwelling.* For purposes of this section, including alternative disclosures as provided for by §226.24(g), a clear and conspicuous disclosure in the context of an oral advertisement for credit secured by a dwelling, whether by radio, television, or other medium, means that the required disclosures are given at a speed and volume sufficient for a consumer to hear and comprehend them. For example, information stated very rapidly at a low volume in a radio or television advertisement would not meet the clear and conspicuous standard if consumers cannot hear and comprehend the information required to be disclosed.

*24(c) Advertisement of rate of finance charge.*

* * * * *

2. *Simple or periodic rates.* The advertisement may not simultaneously state any other rate, except that a simple annual rate or periodic rate applicable to an unpaid balance may appear along with (but not more conspicuously than) the annual percentage rate. An advertisement for credit secured by a dwelling may not state a periodic rate, other than a simple annual rate, that is applied to an unpaid balance. For example, in an advertisement for credit secured by a dwelling, a simple annual interest rate may be shown in the same type size as the annual percentage rate for the advertised credit, subject to the requirements of section 226.24(f). A simple annual rate or periodic rate that is applied to an unpaid balance is the rate at which interest is accruing; those terms do not include a rate lower than the rate at which interest is accruing, such as an effective rate, payment rate, or qualifying rate.

3. *Buydowns.* When a third party (such as a seller) or a creditor wishes to promote the availability of reduced interest rates (consumer or seller buydowns), the advertised annual percentage rate must be determined in accordance with the commentary to §226.17(c) regarding the basis of transactional disclosures for buydowns. The seller or creditor may advertise the reduced simple interest rate, provided the advertisement shows the limited term to which the reduced rate applies and states the simple interest rate applicable to the balance of the term. The advertisement may also show the effect of the buydown agreement on the payment schedule for the buydown period, but this will trigger the additional disclosures under §226.24(d)(2).

4. *Discounted variable-rate transactions.* The advertised annual percentage rate for discounted variable-rate transactions must be determined in accordance with comment 17(c)(1)–10 regarding the basis of transactional disclosures for such financing.

i. A creditor or seller may promote the availability of the initial rate reduction in such transactions by advertising the reduced simple annual rate, provided the advertisement shows with equal prominence and in close proximity the limited term to which the reduced rate applies and the annual percentage rate that will apply after the term of the initial rate reduction expires. *See* § 226.24(f).

ii. Limits or caps on periodic rate or payment adjustments need not be stated. To illustrate using the second example in comment 17(c)(1)–10, the fact that the rate is presumed to be 11 percent in the second year and 12 percent for the remaining 28 years need not be included in the advertisement.

iii. The advertisement may also show the effect of the discount on the payment schedule for the discount period, but this will trigger the additional disclosures under § 226.24(d).

*24(d) Advertisement of terms that require additional disclosures.*

1. *General rule.* Under § 226.24(d)(1), whenever certain triggering terms appear in credit advertisements, the additional credit terms enumerated in § 226.24(d)(2) must also appear. These provisions apply even if the triggering term is not stated explicitly but may be readily determined from the advertisement. For example, an advertisement may state ''80 percent financing available,'' which is in fact indicating that a 20 percent downpayment is required.

*Paragraph 24(d)(1).*

* * * * *

3. *Payment amount.* The dollar amount of any payment includes statements such as:

- ''Payable in installments of $103''.
- ''$25 weekly''.
- ''$500,000 loan for just $1,650 per month''.
- ''$1,200 balance payable in 10 equal installments''.

In the last example, the amount of each payment is readily determinable, even though not explicitly stated. But statements such as ''monthly payments to suit your needs'' or ''regular *monthly* payments'' are not deemed to be statements of the amount of any payment.

* * * * *

*Paragraph 24(d)(2).*

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2. *Disclosure of repayment terms.* The phrase ''terms of repayment'' generally has the same meaning as the ''payment schedule'' required to be disclosed under § 226.18(g). Section 226.24(d)(2)(ii) provides flexibility to creditors in making this disclosure for advertising purposes. Repayment terms may be expressed in a variety of ways in addition to an exact repayment schedule; this is particularly true for advertisements that do not contemplate a single specific transaction. Repayment terms, however, must reflect the consumer's repayment obligations over the full term of the loan, including any balloon payment, *see* comment 24(d)(2)–3, not just the repayment terms that will apply for a limited period of time. For example:

i. A creditor may use a unit-cost approach in making the required disclosure, such as ''48 monthly payments of $27.83 per $1,000 borrowed.''

ii. In an advertisement for credit secured by a dwelling, when any series of payments varies because of the inclusion of mortgage insurance premiums, a creditor may state the number and timing of payments, the fact that payments do not include amounts for mortgage insurance premiums, and that the actual payment obligation will be higher.

iii. In an advertisement for credit secured by a dwelling, when one series of monthly payments will apply for a limited period of time followed by a series of higher monthly payments for the remaining term of the loan, the advertisement must state the number and time period of each series of payments, and the amounts of each of those payments. For this purpose, the creditor must assume that the consumer makes the lower series of payments for the maximum allowable period of time.

3. *Balloon payment; disclosure of repayment terms.* In some transactions, a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement. A balloon payment results if paying the minimum payments does not fully amortize the outstanding balance by a specified date or time, usually the end of the term of the loan, and the consumer must repay the entire outstanding balance at such time. If a balloon payment will occur when the consumer only makes the minimum payments specified in an advertisement, the advertisement must state with equal prominence and in close proximity to the minimum payment statement the amount and timing of the balloon payment that will result if the consumer makes only the minimum payments for the maximum period of time that the consumer is permitted to make such payments.

4. *Annual percentage rate.* * * *

5. *Use of examples.* A creditor may use illustrative credit transactions to make the necessary disclosures under § 226.24(d)(2). That is, where a range of possible combinations of credit terms is offered, the advertisement may use examples of typical transactions, so

long as each example contains all of the applicable terms required by § 226.24(d). The examples must be labeled as such and must reflect representative credit terms made available by the creditor to present and prospective customers.

*24(e) Catalogs or other multiple-page advertisements; electronic advertisements.*

1. *Definition.* The multiple-page advertisements to which this section refers are advertisements consisting of a series of sequentially numbered pages—for example, a supplement to a newspaper. A mailing consisting of several separate flyers or pieces of promotional material in a single envelope does not constitute a single multiple-page advertisement for purposes of § 226.24(e).

2. *General.* Section 226.24(e) permits creditors to put credit information together in one place in a catalog or other multiple-page advertisement or in an electronic advertisement (such as an advertisement appearing on an Internet Web site). The rule applies only if the advertisement contains one or more of the triggering terms from § 226.24(d)(1). A list of different annual percentage rates applicable to different balances, for example, does not trigger further disclosures under § 226.24(d)(2) and so is not covered by § 226.24(e).

* * * * *

4. *Electronic advertisement.* If an electronic advertisement (such as an advertisement appearing on an Internet Web site) contains the table or schedule permitted under § 226.24(e)(1), any statement of terms set forth in § 226.24(d)(1) appearing anywhere else in the advertisement must clearly direct the consumer to the location where the table or schedule begins. For example, a term triggering additional disclosures may be accompanied by a link that directly takes the consumer to the additional information.

*24(f) Disclosure of rates and payments in advertisements for credit secured by a dwelling.*

1. *Applicability.* The requirements of § 226.24(f)(2) apply to advertisements for loans where more than one simple annual rate of interest will apply. The requirements of § 226.24(f)(3)(i)(A) require a clear and conspicuous disclosure of each payment that will apply over the term of the loan. In determining whether a payment will apply when the consumer may choose to make a series of lower monthly payments that will apply for a limited period of time, the creditor must assume that the consumer makes the series of lower payments for the maximum allowable period of time. *See* comment 24(d)(2)–2.iii. However, for purposes of § 226.24(f), the creditor may, but need not, assume that specific events which trigger changes to the simple annual rate of interest or to the applicable payments will occur. For example:

i. *Fixed-rate conversion loans.* If a loan program permits consumers to convert their variable-rate loans to fixed rate loans, the creditor need not assume that the fixed-rate conversion option, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose as a separate payment under § 226.24(f)(3)(i)(A) the payment that would apply if the consumer exercised the fixed-rate conversion option.

ii. *Preferred-rate loans.* Some loans contain a preferred-rate provision, where the rate will increase upon the occurrence of some event, such as the consumer-employee leaving the creditor's employ or the consumer closing an existing deposit account with the creditor or the consumer revoking an election to make automated payments. A creditor need not assume that the preferred-rate provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and the payments that would apply upon occurrence of the event that triggers the rate increase need not be disclosed as a separate payments under § 226.24(f)(3)(i)(A).

iii. *Rate reductions.* Some loans contain a provision where the rate will decrease upon the occurrence of some event, such as if the consumer makes a series of payments on time. A creditor need not assume that the rate reduction provision, by itself, means that more than one simple annual rate of interest will apply to the loan under § 226.24(f)(2) and need not disclose the payments that would apply upon occurrence of the event that triggers the rate reduction as a separate payments under § 226.24(f)(3)(i)(A).

2. *Equal prominence, close proximity.* Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i) that is immediately next to or directly above or below the simple annual rate or payment amount (but not in a footnote) is deemed to be closely proximate to the listing. Information required to be disclosed under §§ 226.24(f)(2)(i) and 226.24(f)(3)(i)(A) and (B) that is in the same type size as the simple annual rate or payment amount is deemed to be equally prominent.

3. *Clear and conspicuous standard.* For more information about the applicable clear and conspicuous standard, see comment 24(b)–2.

4. *Comparisons in advertisements.* When making any comparison in an advertisement between actual or hypothetical credit payments or rates and the payments or rates available under the advertised product, the advertisement must state all applicable payments or rates for the advertised product and the time periods for which those payments or rates will apply, as required by this section.

5. *Application to variable-rate transactions—disclosure of rates.* In advertisements for variable-rate transactions, if a simple annual

rate that applies at consummation is not based on the index and margin that will be used to make subsequent rate adjustments over the term of the loan, the requirements of § 226.24(f)(2)(i) apply.

6. *Reasonably current index and margin.* For the purposes of this section, an index and margin is considered reasonably current if:

i. For direct mail advertisements, it was in effect within 60 days before mailing;

ii. For advertisements in electronic form it was in effect within 30 days before the advertisement is sent to a consumer's e-mail address, or in the case of an advertisement made on an Internet Web site, when viewed by the public; or

iii. For printed advertisements made available to the general public, including ones contained in a catalog, magazine, or other generally available publication, it was in effect within 30 days before printing.

*24(f)(3) Disclosure of payments.*

1. *Amounts and time periods of payments.* Section 226.24(f)(3)(i) requires disclosure of the amounts and time periods of all payments that will apply over the term of the loan. This section may require disclosure of several payment amounts, including any balloon payment. For example, if an advertisement for credit secured by a dwelling offers $300,000 of credit with a 30-year loan term for a payment of $600 per month for the first six months, increasing to $1,500 per month after month six, followed by a balloon payment of $30,000 at the end of the loan term, the advertisement must disclose the amount and time periods of each of the two monthly payment streams, as well as the amount and timing of the balloon payment, with equal prominence and in close proximity to each other. However, if the final scheduled payment of a fully amortizing loan is not greater than two times the amount of any other regularly scheduled payment, the final payment need not be disclosed.

2. *Application to variable-rate transactions—disclosure of payments.* In advertisements for variable-rate transactions, if the payment that applies at consummation is not based on the index and margin that will be used to make subsequent payment adjustments over the term of the loan, the requirements of § 226.24(f)(3)(i) apply.

*24(g) Alternative disclosures—television or radio advertisements.*

1. *Multi-purpose telephone number.* When an advertised telephone number provides a recording, disclosures should be provided early in the sequence to ensure that the consumer receives the required disclosures. For example, in providing several options—such as providing directions to the advertiser's place of business—the option allowing the consumer to request disclosures should be provided early in the telephone message to ensure that the option to request disclosures is not obscured by other information.

2. *Statement accompanying telephone number.* Language must accompany a telephone number indicating that disclosures are available by calling the telephone number, such as ''call 1–800–000–0000 for details about credit costs and terms.''

*24(i) Prohibited acts or practices in advertisements for credit secured by a dwelling.*

1. *Comparisons in advertisements.* The requirements of § 226.24(i)(2) apply to all advertisements for credit secured by a dwelling, including radio and television advertisements. A comparison includes a claim about the amount a consumer may save under the advertised product. For example, a statement such as ''save $300 per month on a $300,000 loan'' constitutes an implied comparison between the advertised product's payment and a consumer's current payment.

2. *Misrepresentations about government endorsement.* A statement that the federal Community Reinvestment Act entitles the consumer to refinance his or her mortgage at the low rate offered in the advertisement is prohibited because it conveys a misleading impression that the advertised product is endorsed or sponsored by the federal government.

3. *Misleading claims of debt elimination.* The prohibition against misleading claims of debt elimination or waiver or forgiveness does not apply to legitimate statements that the advertised product may reduce debt payments, consolidate debts, or shorten the term of the debt. Examples of misleading claims of debt elimination or waiver or forgiveness of loan terms with, or obligations to, another creditor of debt include: ''Wipe-Out Personal Debts!'', ''New DEBT-FREE Payment'', ''Set yourself free; get out of debt today'', ''Refinance today and wipe your debt clean!'', ''Get yourself out of debt * * * Forever!'', and ''Pre-payment Penalty Waiver.''

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*Section 226.32—Requirements for Certain Closed-End Home Mortgages 32(a) Coverage.*

* * * * *

*Paragraph 32(a)(2).*

1. *Exemption limited.* Section 226.32(a)(2) lists certain transactions exempt from the provisions of § 226.32. Nevertheless, those transactions may be subject to the provisions of § 226.35, including any provisions of § 226.32 to which § 226.35 refers. *See* 12 CFR 226.35(a).

* * * * *

*32(d) Limitations.*

1. *Additional prohibitions applicable under other sections.* Section 226.34 sets forth certain prohibitions in connection with mortgage credit subject to § 226.32, in addition to

the limitations in §226.32(d). Further, §226.35(b) prohibits certain practices in connection with transactions that meet the coverage test in §226.35(a). Because the coverage test in §226.35(a) is generally broader than the coverage test in §226.32(a), most §226.32 mortgage loans are also subject to the prohibitions set forth in §226.35(b) (such as escrows), in addition to the limitations in §226.32(d).

2. *Effective date*. For guidance on the application of the Board's revisions published on July 30, 2008 to §226.32, see comment 1(d)(5)–1.

* * * * *

*32(d)(7) Prepayment penalty exception.*

*Paragraph 32(d)(7)(iii).*

1. *Calculating debt-to-income ratio*. ''Debt'' does not include amounts paid by the borrower in cash at closing or amounts from the loan proceeds that directly repay an existing debt. Creditors may consider combined debt-to-income ratios for transactions involving joint applicants. For more information about obligations and inflows that may constitute ''debt'' or ''income'' for purposes of §226.32(d)(7)(iii), see comment 34(a)(4)–6 and comment 34(a)(4)(iii)(C)–1.

2. *Verification*. Creditors shall verify income in the manner described in §226.34(a)(4)(ii) and the related comments. Creditors may verify debt with a credit report. However, a credit report may not reflect certain obligations undertaken just before or at consummation of the transaction and secured by the same dwelling that secures the transaction. Section 226.34(a)(4) may require creditors to consider such obligations; see comment 34(a)(4)–3 and comment 34(a)(4)(ii)(C)–1.

3. *Interaction with Regulation B*. Section 226.32(d)(7)(iii) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

*Paragraph 32(d)(7)(iv).*

1. *Payment change*. Section 226.32(d)(7) sets forth the conditions under which a mortgage transaction subject to this section may have a prepayment penalty. Section 226.32(d)(7)(iv) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation. The following examples show whether prepayment penalties are permitted or prohibited under §226.32(d)(7)(iv) in particular circumstances.

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A prepayment penalty is permitted with this mortgage transaction provided that the other §226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before Dec. 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

iii. Initial payments for a graduated-payment transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is January 1, 2014. A prepayment penalty is permitted with this mortgage transaction provided that the other §226.32(d)(7) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate, and at consummation the consumer's total monthly debts do not exceed 50 percent of the consumer's monthly gross income, as verified.

iv. Initial payments for a step-rate transaction consummated on January 1, 2010 are $1,000 per month. Under the loan agreement, the first possible date that a payment in a different amount may be due is December 31, 2013. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

2. *Payment changes excluded*. Payment changes due to the following circumstances are not considered payment changes for purposes of this section:

i. A change in the amount of a periodic payment that is allocated to principal or interest that does not change the total amount of the periodic payment.

ii. The borrower's actual unanticipated late payment, delinquency, or default; and

iii. The borrower's voluntary payment of additional amounts (for example when a consumer chooses to make a payment of interest and principal on a loan that only requires the consumer to pay interest).

* * * * *

*Section 226.34—Prohibited Acts or Practices in Connection with Credit Subject to § 226.32*

*34(a) Prohibited acts or practices for loans subject to § 226.32.*

* * * * *

*34(a)(4) Repayment ability.*

1. *Application of repayment ability rule.* The § 226.34(a)(4) prohibition against making loans without regard to consumers' repayment ability applies to mortgage loans described in § 226.32(a). In addition, the § 226.34(a)(4) prohibition applies to higher-priced mortgage loans described in § 226.35(a). *See* 12 CFR 226.35(b)(1). For guidance on the application of the Board's revisions to § 226.34(a)(4) published on July 30, 2008, see comment 1(d)(5)–1.

2. *General prohibition.* Section 226.34(a)(4) prohibits a creditor from extending credit subject to § 226.32 to a consumer based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation, including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and property tax and insurance obligations. A creditor may base its determination of repayment ability on current or reasonably expected income from employment or other sources, on assets other than the collateral, or both.

3. *Other dwelling-secured obligations.* For purposes of § 226.34(a)(4), current obligations include another credit obligation of which the creditor has knowledge undertaken prior to or at consummation of the transaction and secured by the same dwelling that secures the transaction subject to § 226.32 or § 226.35. For example, where a transaction subject to § 226.35 is a first-lien transaction for the purchase of a home, a creditor must consider a ''piggyback'' second-lien transaction of which it has knowledge that is used to finance part of the down payment on the house.

4. *Discounted introductory rates and non-amortizing or negatively-amortizing payments.* A credit agreement may determine a consumer's initial payments using a temporarily discounted interest rate or permit the consumer to make initial payments that are non-amortizing or negatively amortizing. (Negative amortization is permissible for loans covered by § 226.35(a), but not § 226.32). In such cases the creditor may determine repayment ability using the assumptions provided in § 226.34(a)(4)(iv).

5. *Repayment ability as of consummation.* Section 226.34(a)(4) prohibits a creditor from disregarding repayment ability based on the facts and circumstances known to the creditor as of consummation. In general, a creditor does not violate this provision if a consumer defaults because of a significant reduction in income (for example, a job loss) or a significant obligation (for example, an obligation arising from a major medical expense) that occurs after consummation. However, if a creditor has knowledge as of consummation of reductions in income, for example, if a consumer's written application states that the consumer plans to retire within twelve months without obtaining new employment, or states that the consumer will transition from full-time to part-time employment, the creditor must consider that information.

6. *Income, assets, and employment.* Any current or reasonably expected assets or income may be considered by the creditor, except the collateral itself. For example, a creditor may use information about current or expected salary, wages, bonus pay, tips, and commissions. Employment may be full-time, part-time, seasonal, irregular, military, or self-employment. Other sources of income could include interest or dividends; retirement benefits; public assistance; and alimony, child support, or separate maintenance payments. A creditor may also take into account assets such as savings accounts or investments that the consumer can or will be able to use.

7. *Interaction with Regulation B.* Section 226.34(a)(4) does not require or permit the creditor to make inquiries or verifications that would be prohibited by Regulation B, 12 CFR part 202.

*34(a)(4)(i) Mortgage-related obligations.*

1. *Mortgage-related obligations.* A creditor must include in its repayment ability analysis the expected property taxes and premiums for mortgage-related insurance required by the creditor as set forth in § 226.35(b)(3)(i), as well as similar mortgage-related expenses. Similar mortgage-related expenses include homeowners' association dues and condominium or cooperative fees.

*34(a)(4)(ii) Verification of repayment ability.*

1. *Income and assets relied on.* A creditor must verify the income and assets the creditor relies on to evaluate the consumer's repayment ability. For example, if a consumer earns a salary and also states that he or she is paid an annual bonus, but the creditor only relies on the applicant's salary to evaluate repayment ability, the creditor need only verify the salary.

2. *Income and assets—co-applicant.* If two persons jointly apply for credit and both list income or assets on the application, the creditor must verify repayment ability with respect to both applicants unless the creditor relies only on the income or assets of one of the applicants in determining repayment ability.

3. *Expected income.* If a creditor relies on expected income, the expectation must be reasonable and it must be verified with

third-party documents that provide reasonably reliable evidence of the consumer's expected income. For example, if the creditor relies on an expectation that a consumer will receive an annual bonus, the creditor may verify the basis for that expectation with documents that show the consumer's past annual bonuses and the expected bonus must bear a reasonable relationship to past bonuses. Similarly, if the creditor relies on a consumer's expected salary following the consumer's receipt of an educational degree, the creditor may verify that expectation with a written statement from an employer indicating that the consumer will be employed upon graduation at a specified salary.

*Paragraph 34(a)(4)(ii)(A).*

1. *Internal Revenue Service (IRS) Form W–2.* A creditor may verify a consumer's income using a consumer's IRS Form W–2 (or any subsequent revisions or similar IRS Forms used for reporting wages and tax withholding). The creditor may also use an electronic retrieval service for obtaining the consumer's W–2 information.

2. *Tax returns.* A creditor may verify a consumer's income or assets using the consumer's tax return. A creditor may also use IRS Form 4506 ''Request for Copy of Tax Return,'' Form 4506–T ''Request for Transcript of Tax Return,'' or Form 8821 ''Tax Information Authorization'' (or any subsequent revisions or similar IRS Forms appropriate for obtaining tax return information directly from the IRS) to verify the consumer's income or assets. The creditor may also use an electronic retrieval service for obtaining tax return information.

3. *Other third-party documents that provide reasonably reliable evidence of consumer's income or assets.* Creditors may verify income and assets using documents produced by third parties. Creditors may not rely on information provided orally by third parties, but may rely on correspondence from the third party, such as by letter or e-mail. The creditor may rely on any third-party document that provides reasonably reliable evidence of the consumer's income or assets. For example, creditors may verify the consumer's income using receipts from a check-cashing or remittance service, or by obtaining a written statement from the consumer's employer that states the consumer's income.

4. *Information specific to the consumer.* Creditors must verify a consumer's income or assets using information that is specific to the individual consumer. Creditors may use third-party databases that contain individual-specific data about a consumer's income or assets, such as a third-party database service used by the consumer's employer for the purpose of centralizing income verification requests, so long as the information is reasonably current and accurate. Information about average incomes for the consumer's occupation in the consumer's geographic location or information about average incomes paid by the consumer's employer, however, would not be specific to the individual consumer.

5. *Duplicative collection of documentation.* A creditor that has made a loan to a consumer and is refinancing or extending new credit to the same consumer need not collect from the consumer a document the creditor previously obtained if the creditor has no information that would reasonably lead the creditor to believe that document has changed since it was initially collected. For example, if the creditor has obtained the consumer's 2006 tax return to make a home purchase loan in May 2007, the creditor may rely on the 2006 tax return if the creditor makes a home equity loan to the same consumer in August 2007. Similarly, if the creditor has obtained the consumer's bank statement for May 2007 in making the first loan, the creditor may rely on that bank statement for that month in making the subsequent loan in August 2007.

*Paragraph 34(a)(4)(ii)(B).*

1. *No violation if income or assets relied on not materially greater than verifiable amounts.* A creditor that does not verify income or assets used to determine repayment ability with reasonably reliable third-party documents does not violate §226.34(a)(4)(ii) if the creditor demonstrates that the income or assets it relied upon were not materially greater than the amounts that the creditor would have been able to verify pursuant to §226.34(a)(4)(ii). For example, if a creditor determines a consumer's repayment ability by relying on the consumer's annual income of $40,000 but fails to obtain documentation of that amount before extending the credit, the creditor will not have violated this section if the creditor later obtains evidence that would satisfy §226.34(a)(4)(ii)(A), such as tax return information, showing that the creditor could have documented, at the time the loan was consummated, that the consumer had an annual income not materially less than $40,000.

2. *Materially greater than.* Amounts of income or assets relied on are not materially greater than amounts that could have been verified at consummation if relying on the verifiable amounts would not have altered a reasonable creditor's decision to extend credit or the terms of the credit.

*Paragraph 34(a)(4)(ii)(C).*

1. *In general.* A credit report may be used to verify current obligations. A credit report, however, might not reflect an obligation that a consumer has listed on an application. The creditor is responsible for considering such an obligation, but the creditor is not required to independently verify the obligation. Similarly, a creditor is responsible for considering certain obligations undertaken just before or at consummation of the

transaction and secured by the same dwelling that secures the transaction (for example, a ''piggy back'' loan), of which the creditor knows, even if not reflected on a credit report. *See* comment 34(a)(4)–3.

*34(a)(4)(iii) Presumption of compliance.*

1. *In general.* A creditor is presumed to have complied with § 226.34(a)(4) if the creditor follows the three underwriting procedures specified in paragraph 34(a)(4)(iii) for verifying repayment ability, determining the payment obligation, and measuring the relationship of obligations to income. The procedures for verifying repayment ability are required under paragraph 34(a)(4)(ii); the other procedures are not required but, if followed along with the required procedures, create a presumption that the creditor has complied with § 226.34(a)(4). The consumer may rebut the presumption with evidence that the creditor nonetheless disregarded repayment ability despite following these procedures. For example, evidence of a very high debt-to-income ratio and a very limited residual income could be sufficient to rebut the presumption, depending on all of the facts and circumstances. If a creditor fails to follow one of the non-required procedures set forth in paragraph 34(a)(4)(iii), then the creditor's compliance is determined based on all of the facts and circumstances without there being a presumption of either compliance or violation.

*Paragraph 34(a)(4)(iii)(B).*

1. *Determination of payment schedule.* To retain a presumption of compliance under § 226.34(a)(4)(iii), a creditor must determine the consumer's ability to pay the principal and interest obligation based on the maximum scheduled payment in the first seven years following consummation. In general, a creditor should determine a payment schedule for purposes of § 226.34(a)(4)(iii)(B) based on the guidance in the staff commentary to § 226.17(c)(1). Examples of how to determine the maximum scheduled payment in the first seven years are provided as follows (all payment amounts are rounded):

i. *Balloon-payment loan; fixed interest rate.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 7-year term but is amortized over 30 years. The monthly payment scheduled for 7 years is $733 with a balloon payment of remaining principal due at the end of 7 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $733.

ii. *Fixed-rate loan with interest-only payment for five years.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 5 years would cover only the interest due. After the fifth year, the scheduled payment would increase to $772, an amount that fully amortizes the principal balance over the remaining 25 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $772.

iii. *Fixed-rate loan with interest-only payment for seven years.* A loan in an amount of $100,000 with a fixed interest rate of 8.0 percent (no points) has a 30-year term. The monthly payment of $667 scheduled for the first 7 years would cover only the interest due. After the seventh year, the scheduled payment would increase to $793, an amount that fully amortizes the principal balance over the remaining 23 years. The creditor will retain the presumption of compliance if it assesses repayment ability based on the interest-only payment of $667.

iv. *Variable-rate loan with discount for five years.* A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.0 percent for an initial period of 5 years. Accordingly, the payment scheduled for the first 5 years is $665. The agreement provides that, after 5 years, the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining 25 years is $727. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $727.

v. *Variable-rate loan with discount for seven years.* A loan in an amount of $100,000 has a 30-year term. The loan agreement provides for a fixed interest rate of 7.125 percent for an initial period of 7 years. Accordingly, the payment scheduled for the first 7 years is $674. After 7 years, the agreement provides that the interest rate will adjust each year based on a specified index and margin. As of consummation, the sum of the index value and margin (the fully-indexed rate) is 8.0 percent. Accordingly, the payment scheduled for the remaining years is $725. The creditor will retain the presumption of compliance if it assesses repayment ability based on the payment of $674.

vi. *Step-rate loan.* A loan in an amount of $100,000 has a 30-year term. The agreement provides that the interest rate will be 5 percent for two years, 6 percent for three years, and 7 percent thereafter. Accordingly, the payment amounts are $537 for two years, $597 for three years, and $654 thereafter. To retain the presumption of compliance, the creditor must assess repayment ability based on the payment of $654.

*Paragraph 34(a)(4)(iii)(C).*

1. *''Income'' and ''debt''.* To determine whether to classify particular inflows or obligations as ''income'' or ''debt,'' creditors may look to widely accepted governmental and non-governmental underwriting standards, including, for example, those set forth in the Federal Housing Administration's handbook on Mortgage Credit Analysis for

Mortgage Insurance on One- to Four-Unit Mortgage Loans.

*34(a)(4)(iv) Exclusions from the presumption of compliance.*

1. *In general.* The exclusions from the presumption of compliance should be interpreted consistent with staff comments 32(d)(1)(i)–1 and 32(d)(2)–1.

2. *Renewable balloon loan.* If a creditor is unconditionally obligated to renew a balloon-payment loan at the consumer's option (or is obligated to renew subject to conditions within the consumer's control), the full term resulting from such renewal is the relevant term for purposes of the exclusion of certain balloon-payment loans. See comment 17(c)(1)–11 for a discussion of conditions within a consumer's control in connection with renewable balloon-payment loans.

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*Section 226.35—Prohibited Acts or Practices in Connection With Higher-priced Mortgage Loans*

35(a) *Higher-priced mortgage loans.*

*Paragraph 35(a)(2).*

1. *Average prime offer rate.* Average prime offer rates are annual percentage rates derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. Other pricing terms include commonly used indices, margins, and initial fixed-rate periods for variable-rate transactions. Relevant pricing characteristics include a consumer's credit history and transaction characteristics such as the loan-to-value ratio, owner-occupant status, and purpose of the transaction. To obtain average prime offer rates, the Board uses a survey of creditors that both meets the criteria of §226.35(a)(2) and provides pricing terms for at least two types of variable-rate transactions and at least two types of non-variable-rate transactions. An example of such a survey is the Freddie Mac Primary Mortgage Market Survey®.

2. *Comparable transaction.* A higher-priced mortgage loan is a consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by the specified margin. The table of average prime offer rates published by the Board indicates how to identify the comparable transaction.

3. *Rate set.* A transaction's annual percentage rate is compared to the average prime offer rate as of the date the transaction's interest rate is set (or ''locked'') before consummation. Sometimes a creditor sets the interest rate initially and then re-sets it at a different level before consummation. The creditor should use the last date the interest rate is set before consummation.

4. *Board table.* The Board publishes on the Internet, in table form, average prime offer rates for a wide variety of transaction types. The Board calculates an annual percentage rate, consistent with Regulation Z (see §226.22 and appendix J), for each transaction type for which pricing terms are available from a survey. The Board estimates annual percentage rates for other types of transactions for which direct survey data are not available based on the loan pricing terms available in the survey and other information. The Board publishes on the Internet the methodology it uses to arrive at these estimates.

*35(b) Rules for higher-priced mortgage loans.*

1. *Effective date.* For guidance on the applicability of the rules in §226.35(b), see comment 1(d)(5)–1.

*Paragraph 35(b)(2)(ii)(C).*

1. *Payment change.* Section 226.35(b)(2) provides that a loan subject to this section may not have a penalty described by §226.32(d)(6) unless certain conditions are met. Section 226.35(b)(2)(ii)(C) lists as a condition that the amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation. For examples showing whether a prepayment penalty is permitted or prohibited in connection with particular payment changes, see comment 32(d)(7)(iv)–1. Those examples, however, include a condition that §226.35(b)(2) does not include: the condition that, at consummation, the consumer's total monthly debt payments may not exceed 50 percent of the consumer's monthly gross income. For guidance about circumstances in which payment changes are not considered payment changes for purposes of this section, see comment 32(d)(7)(iv)–2.

2. *Negative amortization.* Section 226.32(d)(2) provides that a loan described in §226.32(a) may not have a payment schedule with regular periodic payments that cause the principal balance to increase. Therefore, the commentary to §226.32(d)(7)(iv) does not include examples of payment changes in connection with negative amortization. The following examples show whether, under §226.35(b)(2), prepayment penalties are permitted or prohibited in connection with particular payment changes, when a loan agreement permits negative amortization:

i. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014 and the creditor does not have the right to change scheduled payments prior to that date even if negative amortization occurs. A prepayment penalty is permitted with this

mortgage transaction provided that the other §226.35(b)(2) conditions are met, that is: provided that the prepayment penalty is permitted by other applicable law, the penalty expires on or before December 31, 2011, and the penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or its affiliate.

ii. Initial payments for a variable-rate transaction consummated on January 1, 2010 are $1,000 per month and the loan agreement permits negative amortization to occur. Under the loan agreement, the first date that a scheduled payment in a different amount may be due is January 1, 2014, but the creditor has the right to change scheduled payments prior to that date if negative amortization occurs. A prepayment penalty is prohibited with this mortgage transaction because the payment may change within the four-year period following consummation.

*35(b)(3) Escrows.*

*Paragraph 35(b)(3)(i).*

1. Section 226.35(b)(3) applies to principal dwellings, including structures that are classified as personal property under state law. For example, an escrow account must be established on a higher-priced mortgage loan secured by a first-lien on a mobile home, boat or a trailer used as the consumer's principal dwelling. *See* the commentary under §§226.2(a)(19), 226.2(a)(24), 226.15 and 226.23. Section 226.35(b)(3) also applies to higher-priced mortgage loans secured by a first lien on a condominium or a cooperative unit if it is in fact used as principal residence.

2. *Administration of escrow accounts.* Section 226.35(b)(3) requires creditors to establish before the consummation of a loan secured by a first lien on a principal dwelling an escrow account for payment of property taxes and premiums for mortgage-related insurance required by creditor. Section 6 of RESPA, 12 U.S.C. 2605, and Regulation X address how escrow accounts must be administered.

3. *Optional insurance items.* Section 226.35(b)(3) does not require that escrow accounts be established for premiums for mortgage-related insurance that the creditor does not require in connection with the credit transaction, such as an earthquake insurance or debt-protection insurance.

*Paragraph 35(b)(3)(ii)(B).*

1. *Limited exception.* A creditor is required to escrow for payment of property taxes for all first lien loans secured by condominium units regardless of whether the creditors escrows insurance premiums for condominium unit.

*Section 226.36—Prohibited Acts or Practices in Connection With Credit Secured by a Consumer's Principal Dwelling*

1. *Effective date.* For guidance on the applicability of the rules in §226.36, see comment 1(d)(5)–1.

*36(a) Mortgage broker defined.*

1. *Meaning of mortgage broker.* Section 226.36(a) provides that a mortgage broker is any person who for compensation or other monetary gain arranges, negotiates, or otherwise obtains an extension of consumer credit for another person, but is not an employee of a creditor. In addition, this definition expressly includes any person that satisfies this definition but makes use of ''table funding.'' Table funding occurs when a transaction is consummated with the debt obligation initially payable by its terms to one person, but another person provides the funds for the transaction at consummation and receives an immediate assignment of the note, loan contract, or other evidence of the debt obligation. Although §226.2(a)(17)(1)(B) provides that a person to whom a debt obligation is initially payable on its face generally is a creditor, §226.36(a) provides that, solely for the purposes of §226.36, such a person is considered a mortgage broker. In addition, although consumers themselves often arrange, negotiate, or otherwise obtain extensions of consumer credit on their own behalf, they do not do so for compensation or other monetary gain or for another person and, therefore, are not mortgage brokers under this section.

*36(b) Misrepresentation of value of consumer's principal dwelling.*

*36(b)(2) When extension of credit prohibited.*

1. *Reasonable diligence.* A creditor will be deemed to have acted with reasonable diligence under §226.36(b)(2) if the creditor extends credit based on an appraisal other than the one subject to the restriction in §226.36(b)(2).

2. *Material misstatement or misrepresentation.* Section 226.36(b)(2) prohibits a creditor who knows of a violation of §226.36(b)(1) in connection with an appraisal from extending credit based on such appraisal, unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. A misstatement or misrepresentation of such dwelling's value is not material if it does not affect the credit decision or the terms on which credit is extended.

*36(c) Servicing practices.*

*Paragraph 36(c)(1)(i).*

1. *Crediting of payments.* Under §226.36(c)(1)(i), a mortgage servicer must credit a payment to a consumer's loan account as of the date of receipt. This does not require that a mortgage servicer post the payment to the consumer's loan account on a particular date; the servicer is only required to credit the payment *as of* the date of receipt. Accordingly, a servicer that receives a payment on or before its due date (or within any grace period), and does not enter the payment on its books or in its system until after the payment's due date (or expiration of any grace period), does not violate this

rule as long as the entry does not result in the imposition of a late charge, additional interest, or similar penalty to the consumer, or in the reporting of negative information to a consumer reporting agency.

2. *Payments to be credited*. Payments should be credited based on the legal obligation between the creditor and consumer. The legal obligation is determined by applicable state or other law.

3. *Date of receipt*. The ''date of receipt'' is the date that the payment instrument or other means of payment reaches the mortgage servicer. For example, payment by check is received when the mortgage servicer receives it, not when the funds are collected. If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the mortgage servicer receives the third-party payor's check or other transfer medium, such as an electronic fund transfer.

*Paragraph 36(c)(1)(ii)*.

1. *Pyramiding of late fees*. The prohibition on pyramiding of late fees in this subsection should be construed consistently with the ''credit practices rule'' of Regulation AA, 12 CFR 227.15.

*Paragraph 36(c)(1)(iii)*.

1. *Reasonable time*. The payoff statement must be provided to the consumer, or person acting on behalf of the consumer, within a reasonable time after the request. For example, it would be reasonable under most circumstances to provide the statement within five business days of receipt of a consumer's request. This time frame might be longer, for example, when the servicer is experiencing an unusually high volume of refinancing requests.

2. *Person acting on behalf of the consumer*. For purposes of § 226.36(c)(1)(iii), a person acting on behalf of the consumer may include the consumer's representative, such as an attorney representing the individual, a nonprofit consumer counseling or similar organization, or a creditor with which the consumer is refinancing and which requires the payoff statement to complete the refinancing. A servicer may take reasonable measures to verify the identity of any person acting on behalf of the consumer and to obtain the consumer's authorization to release information to any such person before the ''reasonable time'' period begins to run.

3. *Payment requirements*. The servicer may specify reasonable requirements for making payoff requests, such as requiring requests to be in writing and directed to a mailing address, e-mail address or fax number specified by the servicer or orally to a telephone number specified by the servicer, or any other reasonable requirement or method. If the consumer does not follow these requirements, a longer time frame for responding to the request would be reasonable.

4. *Accuracy of payoff statements*. Payoff statements must be accurate when issued.

*Paragraph 36(c)(2)*.

1. *Payment requirements*. The servicer may specify reasonable requirements for making payments in writing, such as requiring that payments be accompanied by the account number or payment coupon; setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person; specifying that only checks or money orders should be sent by mail; specifying that payment is to be made in U.S. dollars; or specifying one particular address for receiving payments, such as a post office box. The servicer may be prohibited, however, from requiring payment solely by preauthorized electronic fund transfer. (*See* section 913 of the Electronic Fund Transfer Act, 15 U.S.C. 1693k.)

2. *Payment requirements—limitations*. Requirements for making payments must be reasonable; it should not be difficult for most consumers to make conforming payments. For example, it would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check.

3. *Implied guidelines for payments*. In the absence of specified requirements for making payments, payments may be made at any location where the servicer conducts business; any time during the servicer's normal business hours; and by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed.

* * * * *

# PART 227—UNFAIR OR DECEPTIVE ACTS OR PRACTICES (REGULATION AA)

## Subpart A—Consumer Complaints

Sec.
227.1 Definitions.
227.2 Consumer complaint procedure.

## Subpart B—Credit Practices Rule

227.11 Authority, purpose, and scope.
227.12 Definitions.
227.13 Unfair credit contract provisions.
227.14 Unfair or deceptive practices involving cosigners.
227.15 Unfair late charges.
227.16 State exemptions.

## Subpart A—Consumer Complaints

AUTHORITY: Sec. 18(f), Federal Trade Commission Act, as amended by Pub. L. 93–637.

### § 227.1 Definitions.

For the purposes of this part,[1] unless the context indicates otherwise, the following definitions apply:

(a) *Board* means the Board of Governors of the Federal Reserve System.

(b) *Consumer complaint* means an allegation by or on behalf of an individual, group of individuals, or other entity that a particular act or practice of a State member bank is unfair or deceptive, or in violation of a regulation issued by the Board pursuant to a Federal statute, or in violation of any other Act or regulation under which the bank must operate.

(c) *State member bank* means a bank that is chartered by a State and is a member of the Federal Reserve System.

(d) Unless the context indicates otherwise, *bank* shall be construed to mean a *State member bank*, and *complaint* to mean a *consumer complaint*.

[Reg. AA, 41 FR 44362, Oct. 8, 1976]

### § 227.2 Consumer complaint procedure.

(a) *Submission of complaints*. (1) Any consumer having a complaint regarding a State member bank is invited to submit it to the Federal Reserve System. The complaint should be submitted in writing, if possible, and should include the following information:

(i) A description of the act or practice that is thought to be unfair or deceptive, or in violation of existing law or regulation, including all relevant facts;

(ii) The name and address of the bank that is the subject of the complaint; and

(iii) The name and address of the complainant.

(2) Consumer complaints should be made to—Federal Reserve Consumer Help Center, P.O. Box 1200, Minneapolis, MN 55480, Toll-free number: (888) 851–1920, Fax number: (877) 888–2520, TDD number: (877) 766–8533.

(b) *Response to complaints*. Within 15 business days of receipt of a written complaint by the Board or a Federal Reserve Bank, a substantive response or an acknowledgment setting a reasonable time for a substantive response will be sent to the individual making the complaint.

(c) *Referrals to other agencies*. Complaints received by the Board or a Federal Reserve Bank regarding an act or practice of an institution other than a State member bank will be forwarded to the Federal agency having jurisdiction over that institution.

[Reg. AA, 41 FR 44362, Oct. 8, 1976, as amended at 42 FR 2950, Jan. 14, 1977; 71 FR 11297, Mar. 7, 2006; 72 FR 55021, Sept. 28, 2007]

## Subpart B—Credit Practices Rule

AUTHORITY: 15 U.S.C. 57a.

SOURCE: Reg. AA, 50 FR 16697, Apr. 29, 1985, unless otherwise noted.

### § 227.11 Authority, purpose, and scope.

(a) *Authority*. This subpart is issued by the Board under section 18(f) of the Federal Trade Commission Act, 15 U.S.C. 57a(f) (section 202(a) of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. 93–637).

(b) *Purpose*. Unfair or deceptive acts or practices in or affecting commerce are unlawful under section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1). This subpart defines unfair or deceptive acts or practices of banks in connection with extensions of credit to consumers.

(c) *Scope*. This subpart applies to all banks and their subsidiaries, except savings banks that are members of the Federal Home Loan Bank System. Compliance is to be enforced by:

(1) The Comptroller of the Currency, in the case of national banks, banks operating under the code of laws for the District of Columbia, and federal branches and federal agencies of foreign banks;

(2) The Board of Governors of the Federal Reserve System, in the case of banks that are members of the Federal

[1] The words *this part*, as used herein, mean title 12, chapter II, part 227 of the Code of Federal Regulations, cited as 12 CFR part 227 and designated as Regulation AA.

Reserve System (other than banks referred to in paragraph (c)(1) of this section), branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

(3) The Federal Deposit Insurance Corporation, in the case of banks insured by the Federal Deposit Insurance Corporation (other than banks referred to in paragraphs (c)(1) and (c)(2) of this section), and insured state branches of foreign banks.

(d) The terms used in paragraph (c) of this section that are not defined in the Federal Trade Commission Act or in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

[Reg. AA, 50 FR 16697, Apr. 29, 1985, as amended at 57 FR 20401, May 13, 1992]

### § 227.12 Definitions.

For the purposes of this subpart, the following definitions apply:

(a) *Consumer* means a natural person who seeks or acquires goods, services, or money for personal, family, or household use other than for the purchase of real property.

(b)(1) *Cosigner* means a natural person who assumes liability for the obligation of a consumer without receiving goods, services, or money in return for the obligation, or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the account.

(2) *Cosigner* includes any person whose signature is requested as a condition to granting credit to a consumer, or as a condition for forbearance on collection of a consumer's obligation that is in default. The term does not include a spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law.

(3) A person who meets the definition in this paragraph is a *cosigner*, whether or not the person is designated as such on the credit obligation.

(c) *Earnings* means compensation paid or payable to an individual or for the individual's account for personal services rendered or to be rendered by the individual, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

(d) *Household goods* means clothing, furniture, appliances, linens, china, crockery, kitchenware, and personal effects of the consumer and the consumer's dependents. The term *household goods* does not include:

(1) Works of art;

(2) Electronic entertainment equipment (other than one television and one radio);

(3) Items acquired as antiques; that is, items over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character; and

(4) Jewelry (other than wedding rings).

(e) *Obligation* means an agreement between a consumer and a creditor.

(f) *Person* means an individual, corporation, or other business organization.

### § 227.13 Unfair credit contract provisions.

It is an unfair act or practice for a bank to enter into a consumer credit obligation that contains, or to enforce in a consumer credit obligation purchased by the bank, any of the following provisions:

(a) *Confession of judgment.* A cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right of notice and the opportunity to be heard in the event of suit or process thereon.

(b) *Waiver of exemption.* An executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(c) *Assignment of wages.* An assignment of wages or other earnings unless:

(1) The assignment by its terms is revocable at the will of the debtor;

(2) The assignment is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment; or

(3) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(d) *Security interest in household goods.* A nonpossessory security interest in household goods other than a purchase money security interest.

### § 227.14 Unfair or deceptive practices involving cosigners.

(a) *Prohibited practices.* In connection with the extension of credit to consumers, it is:

(1) A deceptive act or practice for a bank to misrepresent the nature or extent of cosigner liability to any person; and

(2) An unfair act or practice for a bank to obligate a cosigner unless the cosigner is informed prior to becoming obligated of the nature of the cosigner's liability.

(b) *Disclosure requirement.* (1) A clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to becoming obligated. The disclosure statement shall be substantially similar to the following statement and shall either be a separate document or included in the documents evidencing the consumer credit obligation.

NOTICE TO COSIGNER

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The bank can collect this debt from you without first trying to collect from the borrower. The bank can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of *your* credit record.

This notice is not the contract that makes you liable for the debt.

(2) In the case of open-end credit, the disclosure statement shall be given to the cosigner prior to the time that the cosigner becomes obligated for fees or transactions on the account.

(3) A bank that is in compliance with this paragraph may not be held in violation of paragraph (a)(2) of this section.

### § 227.15 Unfair late charges.

(a) In connection with collecting a debt arising out of an extension of credit to a consumer, it is an unfair act or practice for a bank to levy or collect any delinquency charge on a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on earlier installments, and the payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period.

(b) For the purposes of this section, *collecting a debt* means any activity, other than the use of judicial process, that is intended to bring about or does bring about repayment of all or part of money due (or alleged to be due) from a consumer.

### § 227.16 State exemptions.

(a) *General rule.* (1) An appropriate state agency may apply to the Board for a determination that:

(i) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of this subpart applies; and

(ii) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this subpart.

(2) If the Board makes such a determination, the provision of this subpart will not be in effect in that state to the extent specified by the Board in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

(b) *Applications.* The procedures under which a state agency may apply for an exemption under this section are the same as those set forth in appendix B to Regulation Z (12 CFR part 226).

# PART 228—COMMUNITY REINVESTMENT (REGULATION BB)

Sec.
228.1–228.2 [Reserved]

Subpart A—General

228.11 Authority, purposes, and scope.
228.12 Definitions.

Subpart B—Standards for Assessing Performance

228.21 Performance tests, standards, and ratings, in general.
228.22 Lending test.
228.23 Investment test.
228.24 Service test.
228.25 Community development test for wholesale or limited purpose banks.
228.26 Small bank performance standards.
228.27 Strategic plan.
228.28 Assigned ratings.
228.29 Effect of CRA performance on applications.

Subpart C—Records, Reporting, and Disclosure Requirements

228.41 Assessment area delineation.
228.42 Data collection, reporting, and disclosure.
228.43 Content and availability of public file.
228.44 Public notice by banks.
228.45 Publication of planned examination schedule.

APPENDIX A TO PART 228—RATINGS
APPENDIX B TO PART 228—CRA NOTICE

AUTHORITY: 12 U.S.C. 321, 325, 1828(c), 1842, 1843, 1844, and 2901 *et seq.*

SOURCE: 43 FR 47148, Oct. 12, 1978, unless otherwise noted.

### §§ 228.1–228.2 [Reserved]

## Subpart A—General

SOURCE: Reg. BB, 60 FR 22190, May 4, 1995, unless otherwise noted.

### § 228.11 Authority, purposes, and scope.

(a) *Authority*. The Board of Governors of the Federal Reserve System (the Board) issues this part to implement the Community Reinvestment Act (12 U.S.C. 2901 *et seq.*) (CRA). The regulations comprising this part are issued under the authority of the CRA and under the provisions of the United States Code authorizing the Board:

(1) To conduct examinations of State-chartered banks that are members of the Federal Reserve System (12 U.S.C. 325);

(2) To conduct examinations of bank holding companies and their subsidiaries (12 U.S.C. 1844); and

(3) To consider applications for:

(i) Domestic branches by State member banks (12 U.S.C. 321);

(ii) Mergers in which the resulting bank would be a State member bank (12 U.S.C. 1828(c));

(iii) Formations of, acquisitions of banks by, and mergers of, bank holding companies (12 U.S.C. 1842); and

(iv) The acquisition of savings associations by bank holding companies (12 U.S.C. 1843).

(b) *Purposes*. In enacting the CRA, the Congress required each appropriate Federal financial supervisory agency to assess an institution's record of helping to meet the credit needs of the local communities in which the institution is chartered, consistent with the safe and sound operation of the institution, and to take this record into account in the agency's evaluation of an application for a deposit facility by the institution. This part is intended to carry out the purposes of the CRA by:

(1) Establishing the framework and criteria by which the Board assesses a bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank; and

(2) Providing that the Board takes that record into account in considering certain applications.

(c) *Scope*—(1) *General*. This part applies to all banks except as provided in paragraph (c)(3) of this section.

(2) *Foreign bank acquisitions*. This part also applies to an uninsured State branch (other than a limited branch) of a foreign bank that results from an acquisition described in section 5(a)(8) of the International Banking Act of 1978 (12 U.S.C. 3103(a)(8)). The terms ''State branch'' and ''foreign bank'' have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101 *et seq.*); the term ''uninsured State branch'' means a State branch the deposits of which are not insured

by the Federal Deposit Insurance Corporation; the term ''limited branch'' means a State branch that accepts only deposits that are permissible for a corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611 *et seq.*).

(3) *Certain special purpose banks.* This part does not apply to special purpose banks that do not perform commercial or retail banking services by granting credit to the public in the ordinary course of business, other than as incident to their specialized operations. These banks include banker's banks, as defined in 12 U.S.C. 24 (Seventh), and banks that engage only in one or more of the following activities: providing cash management controlled disbursement services or serving as correspondent banks, trust companies, or clearing agents.

**§ 228.12 Definitions.**

For purposes of this part, the following definitions apply:

(a) *Affiliate* means any company that controls, is controlled by, or is under common control with another company. The term ''control'' has the meaning given to that term in 12 U.S.C. 1841(a)(2), and a company is under common control with another company if both companies are directly or indirectly controlled by the same company.

(b) *Area median income* means:

(1) The median family income for the MSA, if a person or geography is located in an MSA, or for the metropolitan division, if a person or geography is located in an MSA that has been subdivided into metropolitan divisions; or

(2) The statewide nonmetropolitan median family income, if a person or geography is located outside an MSA.

(c) *Assessment area* means a geographic area delineated in accordance with § 228.41.

(d) *Automated teller machine (ATM)* means an automated, unstaffed banking facility owned or operated by, or operated exclusively for, the bank at which deposits are received, cash dispersed, or money lent.

(e) *Bank* means a State member bank as that term is defined in section 3(d)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(d)(2)), except as provided in § 228.11(c)(3), and includes an uninsured State branch (other than a limited branch) of a foreign bank described in § 228.11(c)(2).

(f) *Branch* means a staffed banking facility approved as a branch, whether shared or unshared, including, for example, a mini-branch in a grocery store or a branch operated in conjunction with any other local business or nonprofit organization.

(g) *Community development* means:

(1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;

(2) Community services targeted to low- or moderate-income individuals;

(3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or

(4) Activities that revitalize or stabilize—

(i) Low-or moderate-income geographies;

(ii) Designated disaster areas; or

(iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on—

(A) Rates of poverty, unemployment, and population loss; or

(B) Population size, density, and dispersion. Activities revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

(h) *Community development loan* means a loan that:

(1) Has as its primary purpose community development; and

(2) Except in the case of a wholesale or limited purpose bank:

(i) Has not been reported or collected by the bank or an affiliate for consideration in the bank's assessment as a home mortgage, small business, small farm, or consumer loan, unless it is a multifamily dwelling loan (as described

in appendix A to part 203 of this chapter); and

(ii) Benefits the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

(i) *Community development service* means a service that:

(1) Has as its primary purpose community development;

(2) Is related to the provision of financial services; and

(3) Has not been considered in the evaluation of the bank's retail banking services under § 228.24(d).

(j) *Consumer loan* means a loan to one or more individuals for household, family, or other personal expenditures. A consumer loan does not include a home mortgage, small business, or small farm loan. Consumer loans include the following categories of loans:

(1) *Motor vehicle loan,* which is a consumer loan extended for the purchase of and secured by a motor vehicle;

(2) *Credit card loan,* which is a line of credit for household, family, or other personal expenditures that is accessed by a borrower's use of a ''credit card,'' as this term is defined in § 226.2 of this chapter;

(3) *Home equity loan,* which is a consumer loan secured by a residence of the borrower;

(4) *Other secured consumer loan,* which is a secured consumer loan that is not included in one of the other categories of consumer loans; and

(5) *Other unsecured consumer loan,* which is an unsecured consumer loan that is not included in one of the other categories of consumer loans.

(k) *Geography* means a census tract delineated by the United States Bureau of the Census in the most recent decennial census.

(l) *Home mortgage loan* means a ''home improvement loan,'' ''home purchase loan,'' or a ''refinancing'' as defined in § 203.2 of this title.

(m) *Income level* includes:

(1) *Low-income,* which means an individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography.

(2) *Moderate-income,* which means an individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent, in the case of a geography.

(3) *Middle-income,* which means an individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 and less than 120 percent, in the case of a geography.

(4) *Upper-income,* which means an individual income that is 120 percent or more of the area median income, or a median family income that is 120 percent or more, in the case of a geography.

(n) *Limited purpose bank* means a bank that offers only a narrow product line (such as credit card or motor vehicle loans) to a regional or broader market and for which a designation as a limited purpose bank is in effect, in accordance with § 228.25(b).

(o) *Loan location.* A loan is located as follows:

(1) A consumer loan is located in the geography where the borrower resides;

(2) A home mortgage loan is located in the geography where the property to which the loan relates is located; and

(3) A small business or small farm loan is located in the geography where the main business facility or farm is located or where the loan proceeds otherwise will be applied, as indicated by the borrower.

(p) *Loan production office* means a staffed facility, other than a branch, that is open to the public and that provides lending-related services, such as loan information and applications.

(q) *Metropolitan division* means a metropolitan division as defined by the Director of the Office of Management and Budget.

(r) *MSA* means a metropolitan statistical area as defined by the Director of the Office of Management and Budget.

(s) *Nonmetropolitan area* means any area that is not located in an MSA.

(t) *Qualified investment* means a lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

(u) *Small bank*—(1) *Definition.* Small bank means a bank that, as of December 31 of either of the prior two calendar years, had assets of less than

$1.109 billion. Intermediate small bank means a small bank with assets of at least $277 million as of December 31 of both of the prior two calendar years and less than $1.109 billion as of December 31 of either of the prior two calendar years.

(2) *Adjustment*. The dollar figures in paragraph (u)(1) of this section shall be adjusted annually and published by the Board, based on the year-to-year change in the average of the Consumer Price Index for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each twelve-month period ending in November, with rounding to the nearest million.

(v) *Small business loan* means a loan included in ''loans to small businesses'' as defined in the instructions for preparation of the Consolidated Report of Condition and Income.

(w) *Small farm loan* means a loan included in ''loans to small farms'' as defined in the instructions for preparation of the Consolidated Report of Condition and Income.

(x) *Wholesale bank* means a bank that is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and for which a designation as a wholesale bank is in effect, in accordance with § 228.25(b).

[Reg. BB, 60 FR 22190, May 4, 1995, as amended at 60 FR 66050, Dec. 20, 1995; 61 FR 21363, May 10, 1996; 69 FR 41187, July 8, 2004; 70 FR 44267, Aug. 2, 2005; 71 FR 78336, Dec. 29, 2006; 72 FR 72573, Dec. 21, 2007; 73 FR 78154, Dec. 22, 2008]

## Subpart B—Standards for Assessing Performance

SOURCE: Reg. BB, 60 FR 22191, May 4, 1995, unless otherwise noted.

### § 228.21 Performance tests, standards, and ratings, in general.

(a) *Performance tests and standards*. The Board assesses the CRA performance of a bank in an examination as follows:

(1) *Lending, investment, and service tests*. The Board applies the lending, investment, and service tests, as provided in §§ 228.22 through 228.24, in evaluating the performance of a bank, except as provided in paragraphs (a)(2), (a)(3), and (a)(4) of this section.

(2) *Community development test for wholesale or limited purpose banks*. The Board applies the community development test for a wholesale or limited purpose bank, as provided in § 228.25, except as provided in paragraph (a)(4) of this section.

(3) *Small bank performance standards*. The Board applies the small bank performance standards as provided in § 228.26 in evaluating the performance of a small bank or a bank that was a small bank during the prior calendar year, unless the bank elects to be assessed as provided in paragraphs (a)(1), (a)(2), or (a)(4) of this section. The bank may elect to be assessed as provided in paragraph (a)(1) of this section only if it collects and reports the data required for other banks under § 228.42.

(4) *Strategic plan*. The Board evaluates the performance of a bank under a strategic plan if the bank submits, and the Board approves, a strategic plan as provided in § 228.27.

(b) *Performance context*. The Board applies the tests and standards in paragraph (a) of this section and also considers whether to approve a proposed strategic plan in the context of:

(1) Demographic data on median income levels, distribution of household income, nature of housing stock, housing costs, and other relevant data pertaining to a bank's assessment area(s);

(2) Any information about lending, investment, and service opportunities in the bank's assessment area(s) maintained by the bank or obtained from community organizations, state, local, and tribal governments, economic development agencies, or other sources;

(3) The bank's product offerings and business strategy as determined from data provided by the bank;

(4) Institutional capacity and constraints, including the size and financial condition of the bank, the economic climate (national, regional, and local), safety and soundness limitations, and any other factors that significantly affect the bank's ability to provide lending, investments, or services in its assessment area(s);

(5) The bank's past performance and the performance of similarly situated lenders;

(6) The bank's public file, as described in § 228.43, and any written comments about the bank's CRA performance submitted to the bank or the Board; and

(7) Any other information deemed relevant by the Board.

(c) *Assigned ratings.* The Board assigns to a bank one of the following four ratings pursuant to § 228.28 and appendix A of this part: ''outstanding''; ''satisfactory''; ''needs to improve''; or ''substantial noncompliance'' as provided in 12 U.S.C. 2906(b)(2). The rating assigned by the Board reflects the bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank.

(d) *Safe and sound operations.* This part and the CRA do not require a bank to make loans or investments or to provide services that are inconsistent with safe and sound operations. To the contrary, the Board anticipates banks can meet the standards of this part with safe and sound loans, investments, and services on which the banks expect to make a profit. Banks are permitted and encouraged to develop and apply flexible underwriting standards for loans that benefit low- or moderate-income geographies or individuals, only if consistent with safe and sound operations.

**§ 228.22 Lending test.**

(a) *Scope of test.* (1) The lending test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through its lending activities by considering a bank's home mortgage, small business, small farm, and community development lending. If consumer lending constitutes a substantial majority of a bank's business, the Board will evaluate the bank's consumer lending in one or more of the following categories: motor vehicle, credit card, home equity, other secured, and other unsecured loans. In addition, at a bank's option, the Board will evaluate one or more categories of consumer lending, if the bank has collected and maintained, as required in § 228.42(c)(1), the data for each category that the bank elects to have the Board evaluate.

(2) The Board considers originations and purchases of loans. The Board will also consider any other loan data the bank may choose to provide, including data on loans outstanding, commitments and letters of credit.

(3) A bank may ask the Board to consider loans originated or purchased by consortia in which the bank participates or by third parties in which the bank has invested only if the loans meet the definition of community development loans and only in accordance with paragraph (d) of this section. The Board will not consider these loans under any criterion of the lending test except the community development lending criterion.

(b) *Performance criteria.* The Board evaluates a bank's lending performance pursuant to the following criteria:

(1) *Lending activity.* The number and amount of the bank's home mortgage, small business, small farm, and consumer loans, if applicable, in the bank's assessment area(s);

(2) *Geographic distribution.* The geographic distribution of the bank's home mortgage, small business, small farm, and consumer loans, if applicable, based on the loan location, including:

(i) The proportion of the bank's lending in the bank's assessment area(s);

(ii) The dispersion of lending in the bank's assessment area(s); and

(iii) The number and amount of loans in low-, moderate-, middle-, and upper-income geographies in the bank's assessment area(s);

(3) *Borrower characteristics.* The distribution, particularly in the bank's assessment area(s), of the bank's home mortgage, small business, small farm, and consumer loans, if applicable, based on borrower characteristics, including the number and amount of:

(i) Home mortgage loans to low-, moderate-, middle-, and upper-income individuals;

(ii) Small business and small farm loans to businesses and farms with gross annual revenues of $1 million or less;

(iii) Small business and small farm loans by loan amount at origination; and

(iv) Consumer loans, if applicable, to low-, moderate-, middle-, and upper-income individuals;

(4) *Community development lending.* The bank's community development lending, including the number and amount of community development loans, and their complexity and innovativeness; and

(5) *Innovative or flexible lending practices.* The bank's use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies.

(c) *Affiliate lending.* (1) At a bank's option, the Board will consider loans by an affiliate of the bank, if the bank provides data on the affiliate's loans pursuant to § 228.42.

(2) The Board considers affiliate lending subject to the following constraints:

(i) No affiliate may claim a loan origination or loan purchase if another institution claims the same loan origination or purchase; and

(ii) If a bank elects to have the Board consider loans within a particular lending category made by one or more of the bank's affiliates in a particular assessment area, the bank shall elect to have the Board consider, in accordance with paragraph (c)(1) of this section, all the loans within that lending category in that particular assessment area made by all of the bank's affiliates.

(3) The Board does not consider affiliate lending in assessing a bank's performance under paragraph (b)(2)(i) of this section.

(d) *Lending by a consortium or a third party.* Community development loans originated or purchased by a consortium in which the bank participates or by a third party in which the bank has invested:

(1) Will be considered, at the bank's option, if the bank reports the data pertaining to these loans under § 228.42(b)(2); and

(2) May be allocated among participants or investors, as they choose, for purposes of the lending test, except that no participant or investor:

(i) May claim a loan origination or loan purchase if another participant or investor claims the same loan origination or purchase; or

(ii) May claim loans accounting for more than its percentage share (based on the level of its participation or investment) of the total loans originated by the consortium or third party.

(e) *Lending performance rating.* The Board rates a bank's lending performance as provided in appendix A of this part.

**§ 228.23 Investment test.**

(a) *Scope of test.* The investment test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through qualified investments that benefit its assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

(b) *Exclusion.* Activities considered under the lending or service tests may not be considered under the investment test.

(c) *Affiliate investment.* At a bank's option, the Board will consider, in its assessment of a bank's investment performance, a qualified investment made by an affiliate of the bank, if the qualified investment is not claimed by any other institution.

(d) *Disposition of branch premises.* Donating, selling on favorable terms, or making available on a rent-free basis a branch of the bank that is located in a predominantly minority neighborhood to a minority depository institution or women's depository institution (as these terms are defined in 12 U.S.C. 2907(b)) will be considered as a qualified investment.

(e) *Performance criteria.* The Board evaluates the investment performance of a bank pursuant to the following criteria:

(1) The dollar amount of qualified investments;

(2) The innovativeness or complexity of qualified investments;

(3) The responsiveness of qualified investments to credit and community development needs; and

(4) The degree to which the qualified investments are not routinely provided by private investors.

(f) *Investment performance rating.* The Board rates a bank's investment performance as provided in appendix A of this part.

**§ 228.24 Service test.**

(a) *Scope of test.* The service test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) by analyzing both the availability and effectiveness of a bank's systems for delivering retail banking services and the extent and innovativeness of its community development services.

(b) *Area(s) benefitted.* Community development services must benefit a bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

(c) *Affiliate service.* At a bank's option, the Board will consider, in its assessment of a bank's service performance, a community development service provided by an affiliate of the bank, if the community development service is not claimed by any other institution.

(d) *Performance criteria—retail banking services.* The Board evaluates the availability and effectiveness of a bank's systems for delivering retail banking services, pursuant to the following criteria:

(1) The current distribution of the bank's branches among low-, moderate-, middle-, and upper-income geographies;

(2) In the context of its current distribution of the bank's branches, the bank's record of opening and closing branches, particularly branches located in low- or moderate-income geographies or primarily serving low- or moderate-income individuals;

(3) The availability and effectiveness of alternative systems for delivering retail banking services (*e.g.*, ATMs, ATMs not owned or operated by or exclusively for the bank, banking by telephone or computer, loan production offices, and bank-at-work or bank-by-mail programs) in low- and moderate-income geographies and to low- and moderate-income individuals; and

(4) The range of services provided in low-, moderate-, middle-, and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies.

(e) *Performance criteria—community development services.* The Board evaluates community development services pursuant to the following criteria:

(1) The extent to which the bank provides community development services; and

(2) The innovativeness and responsiveness of community development services.

(f) *Service performance rating.* The Board rates a bank's service performance as provided in appendix A of this part.

**§ 228.25 Community development test for wholesale or limited purpose banks.**

(a) *Scope of test.* The Board assesses a wholesale or limited purpose bank's record of helping to meet the credit needs of its assessment area(s) under the community development test through its community development lending, qualified investments, or community development services.

(b) *Designation as a wholesale or limited purpose bank.* In order to receive a designation as a wholesale or limited purpose bank, a bank shall file a request, in writing, with the Board, at least three months prior to the proposed effective date of the designation. If the Board approves the designation, it remains in effect until the bank requests revocation of the designation or until one year after the Board notifies the bank that the Board has revoked the designation on its own initiative.

(c) *Performance criteria.* The Board evaluates the community development performance of a wholesale or limited purpose bank pursuant to the following criteria:

(1) The number and amount of community development loans (including originations and purchases of loans and other community development loan data provided by the bank, such as data on loans outstanding, commitments, and letters of credit), qualified investments, or community development services;

(2) The use of innovative or complex qualified investments, community development loans, or community development services and the extent to which the investments are not routinely provided by private investors; and

(3) The bank's responsiveness to credit and community development needs.

(d) *Indirect activities.* At a bank's option, the Board will consider in its community development performance assessment:

(1) Qualified investments or community development services provided by an affiliate of the bank, if the investments or services are not claimed by any other institution; and

(2) Community development lending by affiliates, consortia and third parties, subject to the requirements and limitations in § 228.22(c) and (d).

(e) *Benefit to assessment area(s)*—(1) *Benefit inside assessment area(s).* The Board considers all qualified investments, community development loans, and community development services that benefit areas within the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

(2) *Benefit outside assessment area(s).* The Board considers the qualified investments, community development loans, and community development services that benefit areas outside the bank's assessment area(s), if the bank has adequately addressed the needs of its assessment area(s).

(f) *Community development performance rating.* The Board rates a bank's community development performance as provided in appendix A of this part.

### § 228.26 Small bank performance standards.

(a) *Performance criteria*—(1) *Small banks that are not intermediate small banks.* The Board evaluates the record of a small bank that is not, or that was not during the prior calendar year, an intermediate small bank, of helping to meet the credit needs of its assessment area(s) pursuant to the criteria set forth in paragraph (b) of this section.

(2) *Intermediate small banks.* The Board evaluates the record of a small bank that is, or that was during the prior calendar year, an intermediate small bank, of helping to meet the credit needs of its assessment area(s) pursuant to the criteria set forth in paragraphs (b) and (c) of this section.

(b) *Lending test.* A small bank's lending performance is evaluated pursuant to the following criteria:

(1) The bank's loan-to-deposit ratio, adjusted for seasonal variation, and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets, community development loans, or qualified investments;

(2) The percentage of loans and, as appropriate, other lending-related activities located in the bank's assessment area(s);

(3) The bank's record of lending to and, as appropriate, engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes;

(4) The geographic distribution of the bank's loans; and

(5) The bank's record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment area(s).

(c) *Community development test.* An intermediate small bank's community development performance also is evaluated pursuant to the following criteria:

(1) The number and amount of community development loans;

(2) The number and amount of qualified investments;

(3) The extent to which the bank provides community development services; and

(4) The bank's responsiveness through such activities to community development lending, investment, and services needs.

(d) *Small bank performance rating.* The Board rates the performance of a bank evaluated under this section as provided in appendix A of this part.

[70 FR 44268, Aug. 2, 2005, as amended at 71 FR 78337, Dec. 29, 2006; 72 FR 72573, Dec. 21, 2007]

### § 228.27 Strategic plan.

(a) *Alternative election.* The Board will assess a bank's record of helping to meet the credit needs of its assessment area(s) under a strategic plan if:

(1) The bank has submitted the plan to the Board as provided for in this section;

(2) The Board has approved the plan;

(3) The plan is in effect; and

(4) The bank has been operating under an approved plan for at least one year.

(b) *Data reporting.* The Board's approval of a plan does not affect the

bank's obligation, if any, to report data as required by § 228.42.

(c) *Plans in general*—(1) *Term.* A plan may have a term of no more than five years, and any multi-year plan must include annual interim measurable goals under which the Board will evaluate the bank's performance.

(2) *Multiple assessment areas.* A bank with more than one assessment area may prepare a single plan for all of its assessment areas or one or more plans for one or more of its assessment areas.

(3) *Treatment of affiliates.* Affiliated institutions may prepare a joint plan if the plan provides measurable goals for each institution. Activities may be allocated among institutions at the institutions' option, provided that the same activities are not considered for more than one institution.

(d) *Public participation in plan development.* Before submitting a plan to the Board for approval, a bank shall:

(1) Informally seek suggestions from members of the public in its assessment area(s) covered by the plan while developing the plan;

(2) Once the bank has developed a plan, formally solicit public comment on the plan for at least 30 days by publishing notice in at least one newspaper of general circulation in each assessment area covered by the plan; and

(3) During the period of formal public comment, make copies of the plan available for review by the public at no cost at all offices of the bank in any assessment area covered by the plan and provide copies of the plan upon request for a reasonable fee to cover copying and mailing, if applicable.

(e) *Submission of plan.* The bank shall submit its plan to the Board at least three months prior to the proposed effective date of the plan. The bank shall also submit with its plan a description of its informal efforts to seek suggestions from members of the public, any written public comment received, and, if the plan was revised in light of the comment received, the initial plan as released for public comment.

(f) *Plan content*—(1) *Measurable goals.* (i) A bank shall specify in its plan measurable goals for helping to meet the credit needs of each assessment area covered by the plan, particularly the needs of low- and moderate-income geographies and low- and moderate-income individuals, through lending, investment, and services, as appropriate.

(ii) A bank shall address in its plan all three performance categories and, unless the bank has been designated as a wholesale or limited purpose bank, shall emphasize lending and lending-related activities. Nevertheless, a different emphasis, including a focus on one or more performance categories, may be appropriate if responsive to the characteristics and credit needs of its assessment area(s), considering public comment and the bank's capacity and constraints, product offerings, and business strategy.

(2) *Confidential information.* A bank may submit additional information to the Board on a confidential basis, but the goals stated in the plan must be sufficiently specific to enable the public and the Board to judge the merits of the plan.

(3) *Satisfactory and outstanding goals.* A bank shall specify in its plan measurable goals that constitute ''satisfactory'' performance. A plan may specify measurable goals that constitute ''outstanding'' performance. If a bank submits, and the Board approves, both ''satisfactory'' and ''outstanding'' performance goals, the Board will consider the bank eligible for an ''outstanding'' performance rating.

(4) *Election if satisfactory goals not substantially met.* A bank may elect in its plan that, if the bank fails to meet substantially its plan goals for a satisfactory rating, the Board will evaluate the bank's performance under the lending, investment, and service tests, the community development test, or the small bank performance standards, as appropriate.

(g) *Plan approval*—(1) *Timing.* The Board will act upon a plan within 60 calendar days after the Board receives the complete plan and other material required under paragraph (e) of this section. If the Board fails to act within this time period, the plan shall be deemed approved unless the Board extends the review period for good cause.

(2) *Public participation.* In evaluating the plan's goals, the Board considers the public's involvement in formulating the plan, written public comment on the plan, and any response by

the bank to public comment on the plan.

(3) *Criteria for evaluating plan.* The Board evaluates a plan's measurable goals using the following criteria, as appropriate:

(i) The extent and breadth of lending or lending-related activities, including, as appropriate, the distribution of loans among different geographies, businesses and farms of different sizes, and individuals of different income levels, the extent of community development lending, and the use of innovative or flexible lending practices to address credit needs;

(ii) The amount and innovativeness, complexity, and responsiveness of the bank's qualified investments; and

(iii) The availability and effectiveness of the bank's systems for delivering retail banking services and the extent and innovativeness of the bank's community development services.

(h) *Plan amendment.* During the term of a plan, a bank may request the Board to approve an amendment to the plan on grounds that there has been a material change in circumstances. The bank shall develop an amendment to a previously approved plan in accordance with the public participation requirements of paragraph (d) of this section.

(i) *Plan assessment.* The Board approves the goals and assesses performance under a plan as provided for in appendix A of this part.

[Reg. BB, 60 FR 22193, May 4, 1995, as amended at 60 FR 66050, Dec. 20, 1995; 69 FR 41187, July 8, 2004]

### § 228.28 Assigned ratings.

(a) *Ratings in general.* Subject to paragraphs (b) and (c) of this section, the Board assigns to a bank a rating of ''outstanding,'' ''satisfactory,'' ''needs to improve,'' or ''substantial noncompliance'' based on the bank's performance under the lending, investment and service tests, the community development test, the small bank performance standards, or an approved strategic plan, as applicable.

(b) *Lending, investment, and service tests.* The Board assigns a rating for a bank assessed under the lending, investment, and service tests in accordance with the following principles:

(1) A bank that receives an ''outstanding'' rating on the lending test receives an assigned rating of at least ''satisfactory'';

(2) A bank that receives an ''outstanding'' rating on both the service test and the investment test and a rating of at least ''high satisfactory'' on the lending test receives an assigned rating of ''outstanding''; and

(3) No bank may receive an assigned rating of ''satisfactory'' or higher unless it receives a rating of at least ''low satisfactory'' on the lending test.

(c) *Effect of evidence of discriminatory or other illegal credit practices.* (1) The Board's evaluation of a bank's CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank or in any assessment area by any affiliate whose loans have been considered as part of the bank's lending performance. In connection with any type of lending activity described in § 228.22(a), evidence of discriminatory or other credit practices that violate an applicable law, rule, or regulation includes, but is not limited to:

(i) Discrimination against applicants on a prohibited basis in violation, for example, of the Equal Credit Opportunity Act or the Fair Housing Act;

(ii) Violations of the Home Ownership and Equity Protection Act;

(iii) Violations of section 5 of the Federal Trade Commission Act;

(iv) Violations of section 8 of the Real Estate Settlement Procedures Act; and

(v) Violations of the Truth in Lending Act provisions regarding a consumer's right of rescission.

(2) In determining the effect of evidence of practices described in paragraph (c)(1) of this section on the bank's assigned rating, the Board considers the nature, extent, and strength of the evidence of the practices; the policies and procedures that the bank (or affiliate, as applicable) has in place to prevent the practices; any corrective action that the bank (or affiliate, as applicable) has taken or has committed to take, including voluntary corrective action resulting from self-assessment; and any other relevant information.

[43 FR 47148, Oct. 12, 1978, as amended at 70 FR 44268, Aug. 2, 2005]

**§ 228.29 Effect of CRA performance on applications.**

(a) *CRA performance*. Among other factors, the Board takes into account the record of performance under the CRA of:

(1) Each applicant bank for the:

(i) Establishment of a domestic branch by a State member bank; and

(ii) Merger, consolidation, acquisition of assets, or assumption of liabilities requiring approval under the Bank Merger Act (12 U.S.C. 1828(c)) if the acquiring, assuming, or resulting bank is to be a State member bank; and

(2) Each insured depository institution (as defined in 12 U.S.C. 1813) controlled by an applicant and subsidiary bank or savings association proposed to be controlled by an applicant:

(i) To become a bank holding company in a transaction that requires approval under section 3 of the Bank Holding Company Act (12 U.S.C. 1842);

(ii) To acquire ownership or control of shares or all or substantially all of the assets of a bank, to cause a bank to become a subsidiary of a bank holding company, or to merge or consolidate a bank holding company with any other bank holding company in a transaction that requires approval under section 3 of the Bank Holding Company Act (12 U.S.C. 1842); and

(iii) To own, control or operate a savings association in a transaction that requires approval under section 4 of the Bank Holding Company Act (12 U.S.C. 1843).

(b) *Interested parties*. In considering CRA performance in an application described in paragraph (a) of this section, the Board takes into account any views expressed by interested parties that are submitted in accordance with the Board's Rules of Procedure set forth in part 262 of this chapter.

(c) *Denial or conditional approval of application*. A bank's record of performance may be the basis for denying or conditioning approval of an application listed in paragraph (a) of this section.

(d) *Definitions*. For purposes of paragraph (a)(2) of this section, ''bank,'' ''bank holding company,'' ''subsidiary,'' and ''savings association'' have the meanings given to those terms in section 2 of the Bank Holding Company Act (12 U.S.C. 1841).

## Subpart C—Records, Reporting, and Disclosure Requirements

SOURCE: Reg. BB, 60 FR 22195, May 4, 1995, unless otherwise noted.

**§ 228.41 Assessment area delineation.**

(a) *In general*. A bank shall delineate one or more assessment areas within which the Board evaluates the bank's record of helping to meet the credit needs of its community. The Board does not evaluate the bank's delineation of its assessment area(s) as a separate performance criterion, but the Board reviews the delineation for compliance with the requirements of this section.

(b) *Geographic area(s) for wholesale or limited purpose banks*. The assessment area(s) for a wholesale or limited purpose bank must consist generally of one or more MSAs or metropolitan divisions (using the MSA or metropolitan division boundaries that were in effect as of January 1 of the calendar year in which the delineation is made) or one or more contiguous political subdivisions, such as counties, cities, or towns, in which the bank has its main office, branches, and deposit-taking ATMs.

(c) *Geographic area(s) for other banks*. The assessment area(s) for a bank other than a wholesale or limited purpose bank must:

(1) Consist generally of one or more MSAs or metropolitan divisions (using the MSA or metropolitan division boundaries that were in effect as of January 1 of the calendar year in which the delineation is made) or one or more contiguous political subdivisions, such as counties, cities, or towns; and

(2) Include the geographies in which the bank has its main office, its branches, and its deposit-taking ATMs, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans (including home mortgage loans, small business and small farm loans, and any other loans the bank chooses, such as those consumer loans on which

the bank elects to have its performance assessed).

(d) *Adjustments to geographic area(s).* A bank may adjust the boundaries of its assessment area(s) to include only the portion of a political subdivision that it reasonably can be expected to serve. An adjustment is particularly appropriate in the case of an assessment area that otherwise would be extremely large, of unusual configuration, or divided by significant geographic barriers.

(e) *Limitations on the delineation of an assessment area.* Each bank's assessment area(s):

(1) Must consist only of whole geographies;

(2) May not reflect illegal discrimination;

(3) May not arbitrarily exclude low- or moderate-income geographies, taking into account the bank's size and financial condition; and

(4) May not extend substantially beyond an MSA boundary or beyond a state boundary unless the assessment area is located in a multistate MSA. If a bank serves a geographic area that extends substantially beyond a state boundary, the bank shall delineate separate assessment areas for the areas in each state. If a bank serves a geographic area that extends substantially beyond an MSA boundary, the bank shall delineate separate assessment areas for the areas inside and outside the MSA.

(f) *Banks serving military personnel.* Notwithstanding the requirements of this section, a bank whose business predominantly consists of serving the needs of military personnel or their dependents who are not located within a defined geographic area may delineate its entire deposit customer base as its assessment area.

(g) *Use of assessment area(s).* The Board uses the assessment area(s) delineated by a bank in its evaluation of the bank's CRA performance unless the Board determines that the assessment area(s) do not comply with the requirements of this section.

[Reg. BB, 60 FR 22195, May 4, 1995, as amended at 69 FR 41187, July 8, 2004]

## § 228.42 Data collection, reporting, and disclosure.

(a) *Loan information required to be collected and maintained.* A bank, except a small bank, shall collect, and maintain in machine readable form (as prescribed by the Board) until the completion of its next CRA examination, the following data for each small business or small farm loan originated or purchased by the bank:

(1) A unique number or alpha-numeric symbol that can be used to identify the relevant loan file;

(2) The loan amount at origination;

(3) The loan location; and

(4) An indicator whether the loan was to a business or farm with gross annual revenues of $1 million or less.

(b) *Loan information required to be reported.* A bank, except a small bank or a bank that was a small bank during the prior calendar year, shall report annually by March 1 to the Board in machine readable form (as prescribed by the Board) the following data for the prior calendar year:

(1) *Small business and small farm loan data.* For each geography in which the bank originated or purchased a small business or small farm loan, the aggregate number and amount of loans:

(i) With an amount at origination of $100,000 or less;

(ii) With amount at origination of more than $100,000 but less than or equal to $250,000;

(iii) With an amount at origination of more than $250,000; and

(iv) To businesses and farms with gross annual revenues of $1 million or less (using the revenues that the bank considered in making its credit decision);

(2) *Community development loan data.* The aggregate number and aggregate amount of community development loans originated or purchased; and

(3) *Home mortgage loans.* If the bank is subject to reporting under part 203 of this chapter, the location of each home mortgage loan application, origination, or purchase outside the MSAs in which the bank has a home or branch office (or outside any MSA) in accordance with the requirements of part 203 of this chapter.

(c) *Optional data collection and maintenance*—(1) *Consumer loans.* A bank may

collect and maintain in machine readable form (as prescribed by the Board) data for consumer loans originated or purchased by the bank for consideration under the lending test. A bank may maintain data for one or more of the following categories of consumer loans: motor vehicle, credit card, home equity, other secured, and other unsecured. If the bank maintains data for loans in a certain category, it shall maintain data for all loans originated or purchased within that category. The bank shall maintain data separately for each category, including for each loan:

(i) A unique number or alpha-numeric symbol that can be used to identify the relevant loan file;

(ii) The loan amount at origination or purchase;

(iii) The loan location; and

(iv) The gross annual income of the borrower that the bank considered in making its credit decision.

(2) *Other loan data.* At its option, a bank may provide other information concerning its lending performance, including additional loan distribution data.

(d) *Data on affiliate lending.* A bank that elects to have the Board consider loans by an affiliate, for purposes of the lending or community development test or an approved strategic plan, shall collect, maintain, and report for those loans the data that the bank would have collected, maintained, and reported pursuant to paragraphs (a), (b), and (c) of this section had the loans been originated or purchased by the bank. For home mortgage loans, the bank shall also be prepared to identify the home mortgage loans reported under part 203 of this chapter by the affiliate.

(e) *Data on lending by a consortium or a third party.* A bank that elects to have the Board consider community development loans by a consortium or third party, for purposes of the lending or community development tests or an approved strategic plan, shall report for those loans the data that the bank would have reported under paragraph (b)(2) of this section had the loans been originated or purchased by the bank.

(f) *Small banks electing evaluation under the lending, investment, and service tests.* A bank that qualifies for evaluation under the small bank performance standards but elects evaluation under the lending, investment, and service tests shall collect, maintain, and report the data required for other banks pursuant to paragraphs (a) and (b) of this section.

(g) *Assessment area data.* A bank, except a small bank or a bank that was a small bank during the prior calendar year, shall collect and report to the Board by March 1 of each year a list for each assessment area showing the geographies within the area.

(h) *CRA Disclosure Statement.* The Board prepares annually for each bank that reports data pursuant to this section a CRA Disclosure Statement that contains, on a state-by-state basis:

(1) For each county (and for each assessment area smaller than a county) with a population of 500,000 persons or fewer in which the bank reported a small business or small farm loan:

(i) The number and amount of small business and small farm loans reported as originated or purchased located in low-, moderate-, middle-, and upper-income geographies;

(ii) A list grouping each geography according to whether the geography is low-, moderate-, middle-, or upper-income;

(iii) A list showing each geography in which the bank reported a small business or small farm loan; and

(iv) The number and amount of small business and small farm loans to businesses and farms with gross annual revenues of $1 million or less;

(2) For each county (and for each assessment area smaller than a county) with a population in excess of 500,000 persons in which the bank reported a small business or small farm loan:

(i) The number and amount of small business and small farm loans reported as originated or purchased located in geographies with median income relative to the area median income of less than 10 percent, 10 or more but less than 20 percent, 20 or more but less than 30 percent, 30 or more but less than 40 percent, 40 or more but less than 50 percent, 50 or more but less than 60 percent, 60 or more but less than 70 percent, 70 or more but less than 80 percent, 80 or more but less

than 90 percent, 90 or more but less than 100 percent, 100 or more but less than 110 percent, 110 or more but less than 120 percent, and 120 percent or more;

(ii) A list grouping each geography in the county or assessment area according to whether the median income in the geography relative to the area median income is less than 10 percent, 10 or more but less than 20 percent, 20 or more but less than 30 percent, 30 or more but less than 40 percent, 40 or more but less than 50 percent, 50 or more but less than 60 percent, 60 or more but less than 70 percent, 70 or more but less than 80 percent, 80 or more but less than 90 percent, 90 or more but less than 100 percent, 100 or more but less than 110 percent, 110 or more but less than 120 percent, and 120 percent or more;

(iii) A list showing each geography in which the bank reported a small business or small farm loan; and

(iv) The number and amount of small business and small farm loans to businesses and farms with gross annual revenues of $1 million or less;

(3) The number and amount of small business and small farm loans located inside each assessment area reported by the bank and the number and amount of small business and small farm loans located outside the assessment area(s) reported by the bank; and

(4) The number and amount of community development loans reported as originated or purchased.

(i) *Aggregate disclosure statements*. The Board, in conjunction with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, prepares annually, for each MSA or metropolitan division (including an MSA or metropolitan division that crosses a state boundary) and the nonmetropolitan portion of each state, an aggregate disclosure statement of small business and small farm lending by all institutions subject to reporting under this part or parts 25, 345, or 563e of this title. These disclosure statements indicate, for each geography, the number and amount of all small business and small farm loans originated or purchased by reporting institutions, except that the Board may adjust the form of the disclosure if necessary, because of special circumstances, to protect the privacy of a borrower or the competitive position of an institution.

(j) *Central data depositories*. The Board makes the aggregate disclosure statements, described in paragraph (i) of this section, and the individual bank CRA Disclosure Statements, described in paragraph (h) of this section, available to the public at central data depositories. The Board publishes a list of the depositories at which the statements are available.

[Reg. BB, 60 FR 22195, May 4, 1995, as amended at 69 FR 41187, July 8, 2004]

### § 228.43 Content and availability of public file.

(a) *Information available to the public*. A bank shall maintain a public file that includes the following information:

(1) All written comments received from the public for the current year and each of the prior two calendar years that specifically relate to the bank's performance in helping to meet community credit needs, and any response to the comments by the bank, if neither the comments nor the responses contain statements that reflect adversely on the good name or reputation of any persons other than the bank or publication of which would violate specific provisions of law;

(2) A copy of the public section of the bank's most recent CRA Performance Evaluation prepared by the Board. The bank shall place this copy in the public file within 30 business days after its receipt from the Board;

(3) A list of the bank's branches, their street addresses, and geographies;

(4) A list of branches opened or closed by the bank during the current year and each of the prior two calendar years, their street addresses, and geographies;

(5) A list of services (including hours of operation, available loan and deposit products, and transaction fees) generally offered at the bank's branches and descriptions of material differences in the availability or cost of services at particular branches, if any. At its option, a bank may include information regarding the availability of alternative systems for delivering retail

banking services (*e.g.*, ATMs, ATMs not owned or operated by or exclusively for the bank, banking by telephone or computer, loan production offices, and bank-at-work or bank-by-mail programs);

(6) A map of each assessment area showing the boundaries of the area and identifying the geographies contained within the area, either on the map or in a separate list; and

(7) Any other information the bank chooses.

(b) *Additional information available to the public*—(1) *Banks other than small banks.* A bank, except a small bank or a bank that was a small bank during the prior calendar year, shall include in its public file the following information pertaining to the bank and its affiliates, if applicable, for each of the prior two calendar years:

(i) If the bank has elected to have one or more categories of its consumer loans considered under the lending test, for each of these categories, the number and amount of loans:

(A) To low-, moderate-, middle-, and upper-income individuals;

(B) Located in low-, moderate-, middle-, and upper-income census tracts; and

(C) Located inside the bank's assessment area(s) and outside the bank's assessment area(s); and

(ii) The bank's CRA Disclosure Statement. The bank shall place the statement in the public file within three business days of its receipt from the Board.

(2) *Banks required to report Home Mortgage Disclosure Act (HMDA) data.* A bank required to report home mortgage loan data pursuant to part 203 of this chapter shall include in its public file a copy of the HMDA Disclosure Statement provided by the Federal Financial Institutions Examination Council pertaining to the bank for each of the prior two calendar years. In addition, a bank that elected to have the Board consider the mortgage lending of an affiliate for any of these years shall include in its public file the affiliate's HMDA Disclosure Statement for those years. The bank shall place the statement(s) in the public file within three business days after its receipt.

(3) *Small banks.* A small bank or a bank that was a small bank during the prior calendar year shall include in its public file:

(i) The bank's loan-to-deposit ratio for each quarter of the prior calendar year and, at its option, additional data on its loan-to-deposit ratio; and

(ii) The information required for other banks by paragraph (b)(1) of this section, if the bank has elected to be evaluated under the lending, investment, and service tests.

(4) *Banks with strategic plans.* A bank that has been approved to be assessed under a strategic plan shall include in its public file a copy of that plan. A bank need not include information submitted to the Board on a confidential basis in conjunction with the plan.

(5) *Banks with less than satisfactory ratings.* A bank that received a less than satisfactory rating during its most recent examination shall include in its public file a description of its current efforts to improve its performance in helping to meet the credit needs of its entire community. The bank shall update the description quarterly.

(c) *Location of public information.* A bank shall make available to the public for inspection upon request and at no cost the information required in this section as follows:

(1) At the main office and, if an interstate bank, at one branch office in each state, all information in the public file; and

(2) At each branch:

(i) A copy of the public section of the bank's most recent CRA Performance Evaluation and a list of services provided by the branch; and

(ii) Within five calendar days of the request, all the information in the public file relating to the assessment area in which the branch is located.

(d) *Copies.* Upon request, a bank shall provide copies, either on paper or in another form acceptable to the person making the request, of the information in its public file. The bank may charge a reasonable fee not to exceed the cost of copying and mailing (if applicable).

(e) *Updating.* Except as otherwise provided in this section, a bank shall ensure that the information required by

this section is current as of April 1 of each year.

### § 228.44 Public notice by banks.

A bank shall provide in the public lobby of its main office and each of its branches the appropriate public notice set forth in appendix B of this part. Only a branch of a bank having more than one assessment area shall include the bracketed material in the notice for branch offices. Only a bank that is an affiliate of a holding company shall include the next to the last sentence of the notices. A bank shall include the last sentence of the notices only if it is an affiliate of a holding company that is not prevented by statute from acquiring additional banks.

### § 228.45 Publication of planned examination schedule.

The Board publishes at least 30 days in advance of the beginning of each calendar quarter a list of banks scheduled for CRA examinations in that quarter.

## APPENDIX A TO PART 228—RATINGS

(a) *Ratings in general.* (1) In assigning a rating, the Board evaluates a bank's performance under the applicable performance criteria in this part, in accordance with § 228.21, and § 228.28, which provides for adjustments on the basis of evidence of discriminatory or other illegal credit practices.

(2) A bank's performance need not fit each aspect of a particular rating profile in order to receive that rating, and exceptionally strong performance with respect to some aspects may compensate for weak performance in others. The bank's overall performance, however, must be consistent with safe and sound banking practices and generally with the appropriate rating profile as follows.

(b) *Banks evaluated under the lending, investment, and service tests*—(1) *Lending performance rating.* The Board assigns each bank's lending performance one of the five following ratings.

(i) *Outstanding.* The Board rates a bank's lending performance ''outstanding'' if, in general, it demonstrates:

(A) Excellent responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) A substantial majority of its loans are made in its assessment area(s);

(C) An excellent geographic distribution of loans in its assessment area(s);

(D) An excellent distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) An excellent record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of $1 million or less, consistent with safe and sound operations;

(F) Extensive use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It is a leader in making community development loans.

(ii) *High satisfactory.* The Board rates a bank's lending performance ''high satisfactory'' if, in general, it demonstrates:

(A) Good responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) A high percentage of its loans are made in its assessment area(s);

(C) A good geographic distribution of loans in its assessment area(s);

(D) A good distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) A good record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of $1 million or less, consistent with safe and sound operations;

(F) Use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made a relatively high level of community development loans.

(iii) *Low satisfactory.* The Board rates a bank's lending performance ''low satisfactory'' if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) An adequate percentage of its loans are made in its assessment area(s);

(C) An adequate geographic distribution of loans in its assessment area(s);

(D) An adequate distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) An adequate record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of $1 million or less, consistent with safe and sound operations;

(F) Limited use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made an adequate level of community development loans.

(iv) *Needs to improve*. The Board rates a bank's lending performance ''needs to improve'' if, in general, it demonstrates:

(A) Poor responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) A small percentage of its loans are made in its assessment area(s);

(C) A poor geographic distribution of loans, particularly to low- or moderate-income geographies, in its assessment area(s);

(D) A poor distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) A poor record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of $1 million or less, consistent with safe and sound operations;

(F) Little use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made a low level of community development loans.

(v) *Substantial noncompliance*. The Board rates a bank's lending performance as being in ''substantial noncompliance'' if, in general, it demonstrates:

(A) A very poor responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) A very small percentage of its loans are made in its assessment area(s);

(C) A very poor geographic distribution of loans, particularly to low- or moderate-income geographies, in its assessment area(s);

(D) A very poor distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) A very poor record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of $1 million or less, consistent with safe and sound operations;

(F) No use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made few, if any, community development loans.

(2) *Investment performance rating*. The Board assigns each bank's investment performance one of the five following ratings.

(i) *Outstanding*. The Board rates a bank's investment performance ''outstanding'' if, in general, it demonstrates:

(A) An excellent level of qualified investments, particularly those that are not routinely provided by private investors, often in a leadership position;

(B) Extensive use of innovative or complex qualified investments; and

(C) Excellent responsiveness to credit and community development needs.

(ii) *High satisfactory*. The Board rates a bank's investment performance ''high satisfactory'' if, in general, it demonstrates:

(A) A significant level of qualified investments, particularly those that are not routinely provided by private investors, occasionally in a leadership position;

(B) Significant use of innovative or complex qualified investments; and

(C) Good responsiveness to credit and community development needs.

(iii) *Low satisfactory*. The Board rates a bank's investment performance ''low satisfactory'' if, in general, it demonstrates:

(A) An adequate level of qualified investments, particularly those that are not routinely provided by private investors, although rarely in a leadership position;

(B) Occasional use of innovative or complex qualified investments; and

(C) Adequate responsiveness to credit and community development needs.

(iv) *Needs to improve*. The Board rates a bank's investment performance ''needs to improve'' if, in general, it demonstrates:

(A) A poor level of qualified investments, particularly those that are not routinely provided by private investors;

(B) Rare use of innovative or complex qualified investments; and

(C) Poor responsiveness to credit and community development needs.

(v) *Substantial noncompliance*. The Board rates a bank's investment performance as being in ''substantial noncompliance'' if, in general, it demonstrates:

(A) Few, if any, qualified investments, particularly those that are not routinely provided by private investors;

(B) No use of innovative or complex qualified investments; and

(C) Very poor responsiveness to credit and community development needs.

(3) *Service performance rating*. The Board assigns each bank's service performance one of the five following ratings.

(i) *Outstanding*. The Board rates a bank's service performance ''outstanding'' if, in general, the bank demonstrates:

(A) Its service delivery systems are readily accessible to geographies and individuals of different income levels in its assessment area(s);

(B) To the extent changes have been made, its record of opening and closing branches has improved the accessibility of its delivery systems, particularly in low- or moderate-income geographies or to low- or moderate-income individuals;

(C) Its services (including, where appropriate, business hours) are tailored to the convenience and needs of its assessment area(s), particularly low- or moderate-income geographies or low- or moderate-income individuals; and

(D) It is a leader in providing community development services.

(ii) *High satisfactory*. The Board rates a bank's service performance ''high satisfactory'' if, in general, the bank demonstrates:

(A) Its service delivery systems are accessible to geographies and individuals of different income levels in its assessment area(s);

(B) To the extent changes have been made, its record of opening and closing branches has not adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and to low- and moderate-income individuals;

(C) Its services (including, where appropriate, business hours) do not vary in a way that inconveniences its assessment area(s), particularly low- and moderate-income geographies and low- and moderate-income individuals; and

(D) It provides a relatively high level of community development services.

(iii) *Low satisfactory*. The Board rates a bank's service performance ''low satisfactory'' if, in general, the bank demonstrates:

(A) Its service delivery systems are reasonably accessible to geographies and individuals of different income levels in its assessment area(s);

(B) To the extent changes have been made, its record of opening and closing branches has generally not adversely affected the accessibility of its delivery systems, particularly in low- and moderate-income geographies and to low- and moderate-income individuals;

(C) Its services (including, where appropriate, business hours) do not vary in a way that inconveniences its assessment area(s), particularly low- and moderate-income geographies and low- and moderate-income individuals; and

(D) It provides an adequate level of community development services.

(iv) *Needs to improve*. The Board rates a bank's service performance ''needs to improve'' if, in general, the bank demonstrates:

(A) Its service delivery systems are unreasonably inaccessible to portions of its assessment area(s), particularly to low- or moderate-income geographies or to low- or moderate-income individuals;

(B) To the extent changes have been made, its record of opening and closing branches has adversely affected the accessibility its delivery systems, particularly in low- or moderate-income geographies or to low- or moderate-income individuals;

(C) Its services (including, where appropriate, business hours) vary in a way that inconveniences its assessment area(s), particularly low- or moderate-income geographies or low- or moderate-income individuals; and

(D) It provides a limited level of community development services.

(v) *Substantial noncompliance*. The Board rates a bank's service performance as being in ''substantial noncompliance'' if, in general, the bank demonstrates:

(A) Its service delivery systems are unreasonably inaccessible to significant portions of its assessment area(s), particularly to low- or moderate-income geographies or to low- or moderate-income individuals;

(B) To the extent changes have been made, its record of opening and closing branches has significantly adversely affected the accessibility of its delivery systems, particularly in low- or moderate-income geographies or to low- or moderate-income individuals;

(C) Its services (including, where appropriate, business hours) vary in a way that significantly inconveniences its assessment area(s), particularly low- or moderate-income geographies or low- or moderate-income individuals; and

(D) It provides few, if any, community development services.

(c) *Wholesale or limited purpose banks*. The Board assigns each wholesale or limited purpose bank's community development performance one of the four following ratings.

(1) *Outstanding*. The Board rates a wholesale or limited purpose bank's community development performance ''outstanding'' if, in general, it demonstrates:

(i) A high level of community development loans, community development services, or qualified investments, particularly investments that are not routinely provided by private investors;

(ii) Extensive use of innovative or complex qualified investments, community development loans, or community development services; and

(iii) Excellent responsiveness to credit and community development needs in its assessment area(s).

(2) *Satisfactory*. The Board rates a wholesale or limited purpose bank's community

development performance ''satisfactory'' if, in general, it demonstrates:

(i) An adequate level of community development loans, community development services, or qualified investments, particularly investments that are not routinely provided by private investors;

(ii) Occasional use of innovative or complex qualified investments, community development loans, or community development services; and

(iii) Adequate responsiveness to credit and community development needs in its assessment area(s).

(3) *Needs to improve.* The Board rates a wholesale or limited purpose bank's community development performance as ''needs to improve'' if, in general, it demonstrates:

(i) A poor level of community development loans, community development services, or qualified investments, particularly investments that are not routinely provided by private investors;

(ii) Rare use of innovative or complex qualified investments, community development loans, or community development services; and

(iii) Poor responsiveness to credit and community development needs in its assessment area(s).

(4) *Substantial noncompliance.* The Board rates a wholesale or limited purpose bank's community development performance in ''substantial noncompliance'' if, in general, it demonstrates:

(i) Few, if any, community development loans, community development services, or qualified investments, particularly investments that are not routinely provided by private investors;

(ii) No use of innovative or complex qualified investments, community development loans, or community development services; and

(iii) Very poor responsiveness to credit and community development needs in its assessment area(s).

(d) *Banks evaluated under the small bank performance standards*—(1) *Lending test ratings.* (i) *Eligibility for a satisfactory lending test rating.* The Board rates a small bank's lending performance ''satisfactory'' if, in general, the bank demonstrates:

(A) A reasonable loan-to-deposit ratio (considering seasonal variations) given the bank's size, financial condition, the credit needs of its assessment area(s), and taking into account, as appropriate, other lending-related activities such as loan originations for sale to the secondary markets and community development loans and qualified investments;

(B) A majority of its loans and, as appropriate, other lending-related activities, are in its assessment area;

(C) A distribution of loans to and, as appropriate, other lending-related activities for individuals of different income levels (including low- and moderate-income individuals) and businesses and farms of different sizes that is reasonable given the demographics of the bank's assessment area(s);

(D) A record of taking appropriate action, when warranted, in response to written complaints, if any, about the bank's performance in helping to meet the credit needs of its assessment area(s); and

(E) A reasonable geographic distribution of loans given the bank's assessment area(s).

(ii) *Eligibility for an ''outstanding'' lending test rating.* A small bank that meets each of the standards for a ''satisfactory'' rating under this paragraph and exceeds some or all of those standards may warrant consideration for a lending test rating of ''outstanding.''

(iii) *Needs to improve or substantial noncompliance ratings.* A small bank may also receive a lending test rating of ''needs to improve'' or ''substantial noncompliance'' depending on the degree to which its performance has failed to meet the standard for a ''satisfactory'' rating.

(2) *Community development test ratings for intermediate small banks*—(i) *Eligibility for a satisfactory community development test rating.* The Board rates an intermediate small bank's community development performance ''satisfactory'' if the bank demonstrates adequate responsiveness to the community development needs of its assessment area(s) through community development loans, qualified investments, and community development services. The adequacy of the bank's response will depend on its capacity for such community development activities, its assessment area's need for such community development activities, and the availability of such opportunities for community development in the bank's assessment area(s).

(ii) *Eligibility for an outstanding community development test rating.* The Board rates an intermediate small bank's community development performance ''outstanding'' if the bank demonstrates excellent responsiveness to community development needs in its assessment area(s) through community development loans, qualified investments, and community development services, as appropriate, considering the bank's capacity and the need and availability of such opportunities for community development in the bank's assessment area(s).

(iii) *Needs to improve or substantial noncompliance ratings.* An intermediate small bank may also receive a community development test rating of ''needs to improve'' or ''substantial noncompliance'' depending on the degree to which its performance has failed to meet the standards for a ''satisfactory'' rating.

(3) *Overall rating*—(i) *Eligibility for a satisfactory overall rating.* No intermediate small bank may receive an assigned overall rating

of ''satisfactory'' unless it receives a rating of at least ''satisfactory'' on both the lending test and the community development test.

(ii) *Eligibility for an outstanding overall rating.* (A) An intermediate small bank that receives an ''outstanding'' rating on one test and at least ''satisfactory'' on the other test may receive an assigned overall rating of ''outstanding.''

(B) A small bank that is not an intermediate small bank that meets each of the standards for a ''satisfactory'' rating under the lending test and exceeds some or all of those standards may warrant consideration for an overall rating of ''outstanding.'' In assessing whether a bank's performance is ''outstanding,'' the Board considers the extent to which the bank exceeds each of the performance standards for a ''satisfactory'' rating and its performance in making qualified investments and its performance in providing branches and other services and delivery systems that enhance credit availability in its assessment area(s).

(iii) *Needs to improve or substantial noncompliance overall ratings.* A small bank may also receive a rating of ''needs to improve'' or ''substantial noncompliance'' depending on the degree to which its performance has failed to meet the standards for a ''satisfactory'' rating.

(e) *Strategic plan assessment and rating*—(1) *Satisfactory goals.* The Board approves as ''satisfactory'' measurable goals that adequately help to meet the credit needs of the bank's assessment area(s).

(2) *Outstanding goals.* If the plan identifies a separate group of measurable goals that substantially exceed the levels approved as ''satisfactory,'' the Board will approve those goals as ''outstanding.''

(3) *Rating.* The Board assesses the performance of a bank operating under an approved plan to determine if the bank has met its plan goals:

(i) If the bank substantially achieves its plan goals for a satisfactory rating, the Board will rate the bank's performance under the plan as ''satisfactory.''

(ii) If the bank exceeds its plan goals for a satisfactory rating and substantially achieves its plan goals for an outstanding rating, the Board will rate the bank's performance under the plan as ''outstanding.''

(iii) If the bank fails to meet substantially its plan goals for a satisfactory rating, the Board will rate the bank as either ''needs to improve'' or ''substantial noncompliance,'' depending on the extent to which it falls short of its plan goals, unless the bank elected in its plan to be rated otherwise, as provided in § 228.27(f)(4).

[Reg. BB, 60 FR 22198, May 4, 1995, as amended at 70 FR 44268, Aug. 2, 2005]

## APPENDIX B TO PART 228—CRA NOTICE

(a) Notice for main offices and, if an interstate bank, one branch office in each state.

### COMMUNITY REINVESTMENT ACT NOTICE

Under the Federal Community Reinvestment Act (CRA), the Federal Reserve Board (Board) evaluates our record of helping to meet the credit needs of this community consistent with safe and sound operations. The Board also takes this record into account when deciding on certain applications submitted by us.

Your involvement is encouraged.

You are entitled to certain information about our operations and our performance under the CRA, including, for example, information about our branches, such as their location and services provided at them; the public section of our most recent CRA Performance Evaluation, prepared by the Federal Reserve Bank of _____ (Reserve Bank); and comments received from the public relating to our performance in helping to meet community credit needs, as well as our responses to those comments. You may review this information today.

At least 30 days before the beginning of each quarter, the Federal Reserve System publishes a list of the banks that are scheduled for CRA examination by the Reserve Bank in that quarter. This list is available from (title of responsible official), Federal Reserve Bank of _____ (address). You may send written comments about our performance in helping to meet community credit needs to (name and address of official at bank) and (title of responsible official), Federal Reserve Bank of _____ (address). Your letter, together with any response by us, will be considered by the Federal Reserve System in evaluating our CRA performance and may be made public.

You may ask to look at any comments received by the Reserve Bank. You may also request from the Reserve Bank an announcement of our applications covered by the CRA filed with the Reserve Bank. We are an affiliate of (name of holding company), a bank holding company. You may request from (title of responsible official), Federal Reserve Bank of _____ (address) an announcement of applications covered by the CRA filed by bank holding companies.

(b) Notice for branch offices.

### COMMUNITY REINVESTMENT ACT NOTICE

Under the Federal Community Reinvestment Act (CRA), the Federal Reserve Board (Board) evaluates our record of helping to meet the credit needs of this community consistent with safe and sound operations. The Board also takes this record into account when deciding on certain applications submitted by us.

Your involvement is encouraged.

You are entitled to certain information about our operations and our performance under the CRA. You may review today the public section of our most recent CRA evaluation, prepared by the Federal Reserve Bank of _____ (address), and a list of services provided at this branch. You may also have access to the following additional information, which we will make available to you at this branch within five calendar days after you make a request to us: (1) a map showing the assessment area containing this branch, which is the area in which the Board evaluates our CRA performance in this community; (2) information about our branches in this assessment area; (3) a list of services we provide at those locations; (4) data on our lending performance in this assessment area; and (5) copies of all written comments received by us that specifically relate to our CRA performance in this assessment area, and any responses we have made to those comments. If we are operating under an approved strategic plan, you may also have access to a copy of the plan.

[If you would like to review information about our CRA performance in other communities served by us, the public file for our entire bank is available at (name of office located in state), located at (address).]

At least 30 days before the beginning of each quarter, the Federal Reserve System publishes a list of the banks that are scheduled for CRA examination by the Reserve Bank in that quarter. This list is available from (title of responsible official), Federal Reserve Bank of _____ (address). You may send written comments about our performance in helping to meet community credit needs to (name and address of official at bank) and (title of responsible official), Federal Reserve Bank of _____ (address). Your letter, together with any response by us, will be considered by the Federal Reserve System in evaluating our CRA performance and may be made public.

You may ask to look at any comments received by the Reserve Bank. You may also request from the Reserve Bank an announcement of our applications covered by the CRA filed with the Reserve Bank. We are an affiliate of (name of holding company), a bank holding company. You may request from (title of responsible official), Federal Reserve Bank of _____ (address) an announcement of applications covered by the CRA filed by bank holding companies.

[Reg. BB, 60 FR 22200, May 4, 1995]

# PART 229—AVAILABILITY OF FUNDS AND COLLECTION OF CHECKS (REGULATION CC)

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APPENDIX E TO PART 229—COMMENTARY
APPENDIX F TO PART 229—OFFICIAL BOARD INTERPRETATIONS; PREEMPTION DETERMINATIONS

AUTHORITY: 12 U.S.C. 4001–4010, 12 U.S.C. 5001–5018.

SOURCE: 53 FR 19433, May 27, 1988, unless otherwise noted.

## Subpart A—General

### § 229.1 Authority and purpose; organization.

(a) *Authority and purpose.* This part is issued by the Board of Governors of the Federal Reserve System (Board) to implement the Expedited Funds Availability Act (12 U.S.C. 4001–4010) (the EFA Act) and the Check Clearing for the 21st Century Act (12 U.S.C. 5001–5018) (the Check 21 Act).

(b) *Organization.* This part is divided into subparts and appendices as follows—

(1) Subpart A contains general information. It sets forth—

(i) The authority, purpose, and organization;

(ii) Definition of terms; and

(iii) Authority for administrative enforcement of this part's provisions.

(2) Subpart B of this part contains rules regarding the duty of banks to make funds deposited into accounts available for withdrawal, including availability schedules. Subpart B of this part also contains rules regarding exceptions to the schedules, disclosure of funds availability policies, payment of interest, liability of banks for failure to comply with Subpart B of this part, and other matters.

(3) Subpart C of this part contains rules to expedite the collection and return of checks by banks. These rules cover the direct return of checks, the manner in which the paying bank and returning banks must return checks to the depositary bank, notification of nonpayment by the paying bank, indorsement and presentment of checks, same-day settlement for certain checks, the liability of banks for failure to comply with subpart C of this part, and other matters.

(4) Subpart D of this part contains rules relating to substitute checks. These rules address the creation and legal status of substitute checks; the substitute check warranties and indemnity; expedited recredit procedures for resolving improper charges and warranty claims associated with substitute checks provided to consumers; and the disclosure and notices that banks must provide.

[53 FR 19433, May 27, 1988, as amended at 57 FR 36598, Aug. 14, 1992; 57 FR 46972, Oct. 14, 1992; Reg. CC, 60 FR 51670, Oct. 3, 1995; 69 FR 47309, Aug. 4, 2004]

### § 229.2 Definitions.

As used in this part, and unless the context requires otherwise, the following terms have the meanings set forth in this section, and the terms not defined in this section have the meanings set forth in the Uniform Commercial Code:

(a) *Account.* (1) Except as provided in paragraphs (a)(2) and (a)(3) of this section, *account* means a deposit as defined in 12 CFR 204.2(a)(1)(i) that is a transaction account as described in 12 CFR 204.2(e). As defined in these sections, *account* generally includes accounts at a bank from which the account holder is permitted to make transfers or withdrawals by negotiable or transferable instrument, payment order of withdrawal, telephone transfer, electronic payment, or other similar means for the purpose of making payments or transfers to third persons or others. *Account* also includes accounts at a bank from which the account holder may make third party payments at an ATM, remote service unit, or other electronic device, including by debit card, but the term does not include savings deposits or accounts described in 12 CFR 204.2(d)(2) even though such accounts permit third party transfers. An account may be in the form of—

(i) A demand deposit account,

(ii) A negotiable order of withdrawal account,

(iii) A share draft account,

(iv) An automatic transfer account, or

(v) Any other transaction account described in 12 CFR 204.2(e).

(2) For purposes of subpart B of this part and, in connection therewith, this subpart A, *account* does not include an account where the account holder is a bank, where the account holder is an office of an institution described in paragraphs (e)(1) through (e)(6) of this section or an office of a ''foreign bank'' as defined in section 1(b) of the International Banking Act (12 U.S.C. 3101) that is located outside the United States, or where the direct or indirect account holder is the Treasury of the United States.

(3) For purposes of subpart D of this part and, in connection therewith, this subpart A, *account* means any deposit, as defined in 12 CFR 204.2(a)(1)(i), at a bank, including a demand deposit or other transaction account and a savings deposit or other time deposit, as those terms are defined in 12 CFR 204.2.

(b) *Automated clearinghouse* or *ACH* means a facility that processes debit and credit transfers under rules established by a Federal Reserve Bank operating circular on automated clearinghouse items or under rules of an automated clearinghouse association.

(c) *Automated teller machine* or *ATM* means an electronic device at which a natural person may make deposits to an account by cash or check and perform other account transactions.

(d) *Available for withdrawal* with respect to funds deposited means available for all uses generally permitted to the customer for actually and finally collected funds under the bank's account agreement or policies, such as for payment of checks drawn on the account, certification of checks drawn on the account, electronic payments, withdrawals by cash, and transfers between accounts.

(e) *Bank* means—

(1) An *insured bank* as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 18I3) or a bank that is eligible to apply to become an insured bank under section 5 of that Act (12 U.S.C. 1815);

(2) A *mutual savings bank* as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(3) A *savings bank* as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(4) An *insured credit union* as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752) or a credit union that is eligible to make application to become an insured credit union under section 201 of that Act (12 U.S.C. 1781);

(5) A *member* as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422);

(6) A *savings association* as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) that is an insured depository institution as defined in section 3 of that Act (12 U.S.C. 1813(c)(2)) or that is eligible to apply to become an insured depository institution under section 5 of that Act (12 U.S.C. 1815); or

(7) An *agency* or a *branch* of a *foreign bank* as defined in section l(b) of the International Banking Act (12 U.S.C. 3101).

For purposes of subparts C and D of this part and, in connection therewith, this subpart A, the term *bank* also includes any person engaged in the business of banking, as well as a Federal Reserve Bank, a Federal Home Loan Bank, and a state or unit of general local government to the extent that the state or unit of general local government acts as a paying bank. Unless otherwise specified, the term *bank* includes all of a bank's offices in the United States, but not offices located outside the United States.

NOTE: For purposes of subpart D of this part and, in connection therewith, this subpart A, *bank* also includes the Treasury of the United States or the United States Postal Service to the extent that the Treasury or the Postal Service acts as a paying bank.

(f) *Banking day* means that part of any business day on which an office of a bank is open to the public for carrying on substantially all of its banking functions.

(g) *Business day* means a calendar day other than a Saturday or a Sunday, January 1, the third Monday in January, the third Monday in February, the last Monday in May, July 4, the first Monday in September, the second Monday in October, November 11, the

fourth Thursday in November, or December 25. If January 1, July 4, November 11, or December 25 fall on a Sunday, the next Monday is not a business day.

(h) *Cash* means United States coins and currency.

(i) *Cashier's check* means a check that is—

(1) Drawn on a bank;

(2) Signed by an officer or employee of the bank on behalf of the bank as drawer;

(3) A direct obligation of the bank; and

(4) Provided to a customer of the bank or acquired from the bank for remittance purposes.

(j) *Certified check* means a check with respect to which the drawee bank certifies by signature on the check of an officer or other authorized employee of the bank that—

(1) (i) The signature of the drawer on the check is genuine; and

(ii) The bank has set aside funds that—

(A) Are equal to the amount of the check, and

(B) Will be used to pay the check; or

(2) The bank will pay the check upon presentment.

(k) *Check* means—

(1) A negotiable demand draft drawn on or payable through or at an office of a bank;

(2) A negotiable demand draft drawn on a Federal Reserve Bank or a Federal Home Loan Bank;

(3) A negotiable demand draft drawn on the Treasury of the United States;

(4) A demand draft drawn on a state government or unit of general local government that is not payable through or at a bank;

(5) A United States Postal Service money order; or

(6) A traveler's check drawn on or payable through or at a bank.

(7) The term check includes an original check and a substitute check.

NOTE: The term *check* does not include a noncash item or an item payable in a medium other than United States money. A draft may be a *check* even though it is described on its face by another term, such as *money order*. For purposes of subparts C and D, and in connection therewith, subpart A, of this part, the term *check* also includes a demand draft of the type described above that is nonnegotiable.

(l) [Reserved]

(m) *Check processing region* means the geographical area served by an office of a Federal Reserve Bank for purposes of its check processing activities.

(n) *Consumer account* means any account used primarily for personal, family, or household purposes.

(o) *Depositary bank* means the first bank to which a check is transferred even though it is also the paying bank or the payee. A check deposited in an account is deemed to be transferred to the bank holding the account into which the check is deposited, even though the check is physically received and indorsed first by another bank.

(p) *Electronic payment* means a wire transfer or an ACH credit transfer.

(q) *Forward collection* means the process by which a bank sends a check on a cash basis to a collecting bank for settlement or to the paying bank for payment.

(r) *Local check* means a check payable by or at a local paying bank, or a check payable by a nonbank payor and payable through a local paying bank.

(s) *Local paying bank* means a paying bank that is located in the same check-processing region as the physical location of the branch, contractual branch, or proprietary ATM of the depositary bank in which that check was deposited.

(t) *Merger transaction* means—

(1) A merger or consolidation of two or more banks; or

(2) The transfer of substantially all of the assets of one or more banks or branches to another bank in consideration of the assumption by the acquiring bank of substantially all of the liabilities of the transferring banks, including the deposit liabilities.

(u) *Noncash item* means an item that would otherwise be a check, except that—

(1) A passbook, certificate, or other document is attached;

(2) It is accompanied by special instructions, such as a request for special advice of payment or dishonor;

(3) It consists of more than a single thickness of paper, except a check that qualifies for handling by automated check processing equipment; or

(4) It has not been preprinted or postencoded in magnetic ink with the routing number of the paying bank.

(v) *Nonlocal check* means a check payable by, through, or at a nonlocal paying bank.

(w) *Nonlocal paying bank* means a paying bank that is not a local paying bank with respect to the depositary bank.

(x) *Nonproprietary ATM* means an ATM that is not a proprietary ATM.

(y) [Reserved]

(z) *Paying bank* means—

(1) The bank by which a check is payable, unless the check is payable at another bank and is sent to the other bank for payment or collection;

(2) The bank at which a check is payable and to which it is sent for payment or collection;

(3) The Federal Reserve Bank or Federal Home Loan Bank by which a check is payable;

(4) The bank through which a check is payable and to which it is sent for payment or collection, if the check is not payable by a bank; or

(5) The state or unit of general local government on which a check is drawn and to which it is sent for payment or collection.

For purposes of subparts C and D, and in connection therewith, subpart A, *paying bank* includes the bank through which a check is payable and to which the check is sent for payment or collection, regardless of whether the check is payable by another bank, and the bank whose routing number appears on a check in fractional or magnetic form and to which the check is sent for payment or collection.

NOTE: For purposes of subpart D of this part and, in connection therewith, this subpart A, *paying bank* also includes the Treasury of the United States or the United States Postal Service for a check that is payable by that entity and that is sent to that entity for payment or collection.

(aa) *Proprietary ATM* means an ATM that is—

(1) Owned or operated by, or operated exclusively for, the depositary bank;

(2) Located on the premises (including the outside wall) of the depositary bank; or

(3) Located within 50 feet of the premises of the depositary bank, and not identified as being owned or operated by another entity.

If more than one bank meets the owned or operated criterion of paragraph (aa)(1) of this section, the ATM is considered proprietary to the bank that operates it.

(bb) *Qualified returned check* means a returned check that is prepared for automated return to the depositary bank by placing the check in a carrier envelope or placing a strip on the check and encoding the strip or envelope in magnetic ink. A qualified returned check need not contain other elements of a check drawn on the depositary bank, such as the name of the depositary bank.

(cc) *Returning bank* means a bank (other than the paying or depositary bank) handling a returned check or notice in lieu of return. A returning bank is also a collecting bank for purposes of UCC 4–202(b).

(dd) *Routing number* means—

(1) The number printed on the face of a check in fractional form on in nine-digit form; or

(2) The number in a bank's indorsement in fractional or nine-digit form.

(ee) *Similarly situated bank* means a bank of similar size, located in the same community, and with similar check handling activities as the paying bank or returning bank.

(ff) *State* means a state, the District of Columbia, Puerto Rico, or the U.S. Virgin Islands. For purposes of subpart D of this part and, in connection therewith, this subpart A, *state* also means Guam, American Samoa, the Trust Territory of the Pacific Islands, the Northern Mariana Islands, and any other territory of the United States.

(gg) *Teller's check* means a check provided to a customer of a bank or acquired from a bank for remittance purposes, that is drawn by the bank, and drawn on another bank or payable through or at a bank.

(hh) *Traveler's check* means an instrument for the payment of money that—

(1) Is drawn on or payable through or at a bank;

(2) Is designated on its face by the term *traveler's check* or by any substantially similar term or is commonly known and marketed as a traveler's

check by a corporation or bank that is an issuer of traveler's checks;

(3) Provides for a specimen signature of the purchaser to be completed at the time of purchase; and

(4) Provides for a countersignature of the purchaser to be completed at the time of negotiation.

(ii) *Uniform Commercial Code*, *Code*, or *U.C.C.* means the Uniform Commercial Code as adopted in a state.

(jj) *United States* means the states, including the District of Columbia, the U.S. Virgin Islands, and Puerto Rico.

(kk) *Unit of general local government* means any city, county, parish, town, township, village, or other general purpose political subdivision of a state. The term does not include special purpose units of government, such as school districts or water districts.

(ll) *Wire transfer* means an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt or on a day stated in the order, that is transmitted by electronic or other means through Fedwire, the Clearing House Interbank Payments System, other similar network, between banks, or on the books of a bank. *Wire transfer* does not include an electronic fund transfer as defined in section 903(6) of the Electronic Fund Transfer Act (15 U.S.C. 1693a(6)).

(mm) *Fedwire* has the same meaning as that set forth in § 210.26(e) of this chapter.

(nn) *Good faith* means honesty in fact and observance of reasonable commercial standards of fair dealing.

(oo) *Interest compensation* means an amount of money calculated at the average of the Federal Funds rates published by the Federal Reserve Bank of New York for each of the days for which interest compensation is payable, divided by 360. The Federal Funds rate for any day on which a published rate is not available is the same as the published rate for the last preceding day for which there is a published rate.

(pp) *Contractual branch*, with respect to a bank, means a branch of another bank that accepts a deposit on behalf of the first bank.

(qq) *Claimant bank* means a bank that submits a claim for a recredit for a substitute check to an indemnifying bank under § 229.55.

(rr) *Collecting bank* means any bank handling a check for forward collection, except the paying bank.

(ss) *Consumer* means a natural person who—

(1) With respect to a check handled for forward collection, draws the check on a consumer account; or

(2) With respect to a check handled for return, deposits the check into or cashes the check against a consumer account.

(tt) *Customer* means a person having an account with a bank.

(uu) *Indemnifying bank* means a bank that provides an indemnity under § 229.53 with respect to a substitute check.

(vv) *Magnetic ink character recognition line* and *MICR line* mean the numbers, which may include the routing number, account number, check number, check amount, and other information, that are printed near the bottom of a check in magnetic ink in accordance with American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (hereinafter ANS X9.13) for an original check and American National Standard Specifications for an Image Replacement Document—IRD, X9.100–140 (hereinafter ANS X9.100–140) for a substitute check (unless the Board by rule or order determines that different standards apply).

(ww) *Original check* means the first paper check issued with respect to a particular payment transaction.

(xx) *Paper or electronic representation of a substitute check* means any copy of or information related to a substitute check that a bank handles for forward collection or return, charges to a customer's account, or provides to a person as a record of a check payment made by the person.

(yy) *Person* means a natural person, corporation, unincorporated company, partnership, government unit or instrumentality, trust, or any other entity or organization.

(zz) *Reconverting bank* means—

(1) The bank that creates a substitute check; or

(2) With respect to a substitute check that was created by a person that is not a bank, the first bank that transfers, presents, or returns that substitute check or, in lieu thereof, the

first paper or electronic representation of that substitute check.

(aaa) *Substitute check* means a paper reproduction of an original check that—

(1) Contains an image of the front and back of the original check;

(2) Bears a MICR line that, except as provided under ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies), contains all the information appearing on the MICR line of the original check at the time that the original check was issued and any additional information that was encoded on the original check's MICR line before an image of the original check was captured;

(3) Conforms in paper stock, dimension, and otherwise with ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies); and

(4) Is suitable for automated processing in the same manner as the original check.

(bbb) *Sufficient copy and copy*. (1) A *sufficient copy* is a copy of an original check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or is otherwise sufficient to determine whether or not a claim is valid.

(2) A *copy* of an original check means any paper reproduction of an original check, including a paper printout of an electronic image of the original check, a photocopy of the original check, or a substitute check.

(ccc) *Transfer and consideration*. The terms *transfer* and *consideration* have the meanings set forth in the Uniform Commercial Code and in addition, for purposes of subpart D—

(1) The term *transfer* with respect to a substitute check or a paper or electronic representation of a substitute check means delivery of the substitute check or other representation of the substitute check by a bank to a person other than a bank; and

(2) A bank that transfers a substitute check or a paper or electronic representation of a substitute check directly to a person other than a bank has received *consideration* for the substitute check or other paper or electronic representation of the substitute check if it has charged, or has the right to charge, the person's account or otherwise has received value for the original check, a substitute check, or a representation of the original check or substitute check.

(ddd) *Truncate* means to remove an original check from the forward collection or return process and send to a recipient, in lieu of such original check, a substitute check or, by agreement, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without the subsequent delivery of the original check.

(eee) *Truncating bank* means—

(1) The bank that truncates the original check; or

(2) If a person other than a bank truncates the original check, the first bank that transfers, presents, or returns, in lieu of such original check, a substitute check or, by agreement with the recipient, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without the subsequent delivery of the original check.

(fff) *Remotely created check* means a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn. For purposes of this definition, ''account'' means an account as defined in paragraph (a) of this section as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank.

[53 FR 19433, May 27, 1988, as amended at 53 FR 31292, Aug. 18, 1988; 53 FR 44324, Nov. 2, 1988; Reg. CC, 54 FR 13850, Apr. 6, 1989; 57 FR 46972, Oct. 14, 1992; 58 FR 2, Jan. 4, 1993; 60 FR 51670, Oct. 3, 1995; 62 FR 13809, Mar. 24, 1997; 69 FR 47309, 47310, Aug. 4, 2004; 70 FR 71225, Nov. 28, 2005]

### § 229.3 Administrative enforcement.

(a) *Enforcement agencies*. Compliance with this part is enforced under—

(1) Section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818 *et seq.*) in the case of—

(i) National banks, and Federal branches and Federal agencies of foreign banks, by the Office of the Comptroller of the Currency;

(ii) Member banks of the Federal Reserve System (other than national banks), and offices, branches, and agencies of foreign banks located in the United States (other than Federal branches, Federal agencies, and insured State branches of foreign banks), by the Board; and

(iii) Banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System) and insured State branches of foreign banks, by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) Section 8 of the Federal Deposit Insurance Act, by the Director of the Office of Thrift Supervision in the case of savings associations the deposits of which are insured by the Federal Deposit Insurance Corporation; and

(3) The Federal Credit Union Act (12 U.S.C. 1751 *et seq.*) by the National Credit Union Administration Board with respect to any federal credit union or credit union insured by the National Credit Union Share Insurance Fund.

The terms used in paragraph (a)(1) of this section that are not defined in this part or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(b) *Additional powers.* (1) For the purposes of the exercise by any agency referred to in paragraph (a) of this section of its powers under any statute referred to in that paragraph, a violation of any requirement imposed under the EFA Act is deemed to be a violation of a requirement imposed under that statute.

(2) In addition to its powers under any provision of law specifically referred to in paragraph (a) of this section, each of the agencies referred to in that paragraph may exercise, for purposes of enforcing compliance with any requirement imposed under this part, any other authority conferred on it by law.

(c) *Enforcement by the Board.* (1) Except to the extent that enforcement of the requirements imposed under this part is specifically committed to some other government agency, the Board shall enforce such requirements.

(2) If the Board determines that—

(i) Any bank that is not a bank described in paragraph (a) of this section; or

(ii) Any other person subject to the authority of the Board under the EFA Act and this part,

has failed to comply with any requirement imposed by this part, the Board may issue an order prohibiting any bank, any Federal Reserve Bank, or any other person subject to the authority of the Board from engaging in any activity or transaction that directly or indirectly involves such noncomplying bank or person (including any activity or transaction involving the receipt, payment, collection, and clearing of checks, and any related function of the payment system with respect to checks).

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 55 FR 21855, May 30, 1990; 57 FR 36600, Aug. 14, 1992; 69 FR 47310, Aug. 4, 2004]

## Subpart B—Availability of Funds and Disclosure of Funds Availability Policies

### § 229.10 Next-day availability.

(a) *Cash deposits.* (1) A bank shall make funds deposited in an account by cash available for withdrawal not later than the business day after the banking day on which the cash is deposited, if the deposit is made in person to an employee of the depositary bank.

(2) A bank shall make funds deposited in an account by cash available for withdrawal not later than the second business day after the banking day on which the cash is deposited, if the deposit is not made in person to an employee of the depositary bank.

(b) *Electronic payments*—(1) *In general.* A bank shall make funds received for deposit in an account by an electronic payment available for withdrawal not later than the business day after the banking day on which the bank received the electronic payment.

(2) *When an electronic payment is received.* An electronic payment is received when the bank receiving the payment has received both—

(i) Payment in actually and finally collected funds; and

(ii) Information on the account and amount to be credited.

A bank receives an electronic payment only to the extent that the bank has received payment in actually and finally collected funds.

(c) *Certain check deposits*—(1) *General rule.* A depositary bank shall make funds deposited in an account by check available for withdrawal not later than the business day after the banking day on which the funds are deposited, in the case of—

(i) A check drawn on the Treasury of the United States and deposited in an account held by a payee of the check;

(ii) A U.S. Postal Service money order deposited—

(A) In an account held by a payee of the money order; and

(B) In person to an employee of the depositary bank.

(iii) A check drawn on a Federal Reserve Bank or Federal Home Loan Bank and deposited—

(A) In an account held by a payee of the check; and

(B) In person to an employee of the depositary bank;

(iv) A check drawn by a state or a unit of general local government and deposited—

(A) In an account held by a payee of the check;

(B) In a depositary bank located in the state that issued the check, or the same state as the unit of general local government that issued the check;

(C) In person to an employee of the depositary bank; and

(D) With a special deposit slip or deposit envelope, if such slip or envelope is required by the depositary bank under paragraph (c)(3) of this section.

(v) A cashier's, certified, or teller's check deposited—

(A) In an account held by a payee of the check;

(B) In person to an employee of the depositary bank; and

(C) With a special deposit slip or deposit envelope, if such slip or envelope is required by the depositary bank under paragraph (c)(3) of this section.

(vi) A check deposited in a branch of the depositary bank and drawn on the same or another branch of the same bank if both branches are located in the same state or the same check processing region; and,

(vii) The lesser of—

(A) $100, or

(B) The aggregate amount deposited on any one banking day to all accounts of the customer by check or checks not subject to next-day availability under paragraphs (c)(1) (i) through (vi) of this section.

(2) *Checks not deposited in person.* A depositary bank shall make funds deposited in an account by check or checks available for withdrawal not later than the second business day after the banking day on which funds are deposited, in the case of a check deposit described in and that meets the requirements of paragraphs (c)(1) (ii), (iii), (iv), and (v), of this section, except that it is not deposited in person to an employee of the depositary bank.

(3) *Special deposit slip.* (i) As a condition to making the funds available for withdrawal in accordance with this section, a depositary bank may require that a state or local government check or a cashier's, certified, or teller's check be deposited with a special deposit slip or deposit envelope that identifies the type of check.

(ii) If a depositary bank requires the use of a special deposit slip or deposit envelope, the bank must either provide the special deposit slip or deposit envelope to its customers or inform its customers how the slip or envelope may be prepared or obtained and make the slip or envelope reasonably available.

### § 229.11 [Reserved]

### § 229.12 Availability schedule.

(a) *Effective date.* The availability schedule contained in this section is effective September 1, 1990.

(b) *Local checks and certain other checks.* Except as provided in paragraphs (d), (e), and (f) of this section, a depository bank shall make funds deposited in an account by a check available for withdrawal not later than the second business day following the

banking day on which funds are deposited, in the case of—

(1) A local check;

(2) A check drawn on the Treasury of the United States that is not governed by the availability requirements of § 229.10(c);

(3) A U.S. Postal Service money order that is not governed by the availability requirements of § 229.10(c); and

(4) A check drawn on a Federal Reserve Bank or Federal Home Loan Bank; a check drawn by a state or unit of general local government; or a cashier's, certified, or teller's check; if any check referred to in this paragraph (b)(4) is a local check that is not governed by the availability requirements of § 229.10(c).

(c) *Nonlocal checks*—(1) *In general.* Except as provided in paragraphs (d), (e), and (f) of this section, a depositary bank shall make funds deposited in an account by a check available for withdrawal not later than the fifth business day following the banking day on which funds are deposited, in the case of—

(i) A nonlocal check; and

(ii) A check drawn on a Federal Reserve Bank or Federal Home Loan Bank; a check drawn by a state or unit of general local government; a cashier's, certified, or teller's check; or a check deposited in a branch of the depositary bank and drawn on the same or another branch of the same bank, if any check referred to in this paragraph (c)(1)(ii) is a nonlocal check that is not governed by the availability requirements of § 229.10(c).

(2) Nonlocal checks specified in appendix B–2 to this part must be made available for withdrawal not later than the times prescribed in that appendix.

(d) *Time period adjustment for withdrawal by cash or similar means.* A depositary bank may extend by one business day the time that funds deposited in an account by one or more checks subject to paragraphs (b), (c), or (f) of this section are available for withdrawal by cash or similar means. Similar means include electronic payment, issuance of a cashier's or teller's check, or certification of a check, or other irrevocable commitment to pay, but do not include the granting of credit to a bank, a Federal Reserve Bank, or a Federal Home Loan Bank that presents a check to the depositary bank for payment. A depositary bank shall, however, make $400 of these funds available for withdrawal by cash or similar means not later than 5:00 p.m. on the business day on which the funds are available under paragraphs (b), (c), or (f) of this section. This $400 is in addition to the $100 available under § 229.10(c)(1)(vii).

(e) *Extension of schedule for certain deposits in Alaska, Hawaii, Puerto Rico, and the U.S. Virgin Islands.* The depositary bank may extend the time periods set forth in this section by one business day in the case of any deposit, other than a deposit described in § 229.10, that is—

(1) Deposited in an account at a branch of a depositary bank if the branch is located in Alaska, Hawaii, Puerto Rico, or the U.S. Virgin Islands; and

(2) Deposited by a check drawn on or payable at or through a paying bank not located in the same state as the depositary bank.

(f) *Deposits at nonproprietary ATMs.* A depositary bank shall make funds deposited in an account at a nonproprietary ATM by cash or check available for withdrawal not later than the fifth business day following the banking day on which the funds are deposited.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 55 FR 50818, Dec. 11, 1990; 56 FR 7801, Feb. 26, 1991; 56 FR 66343, Dec. 23, 1991; 57 FR 36601, Aug. 14, 1992; 60 FR 51670, Oct. 3, 1995]

### § 229.13 Exceptions.

(a) *New accounts.* For purposes of this paragraph, checks subject to § 229.10(c)(1)(v) include traveler's checks.

(1) A deposit in a new account—

(i) Is subject to the requirements of § 229.10 (a) and (b) to make funds from deposits by cash and electronic payments available for withdrawal on the business day following the banking day of deposit or receipt;

(ii) Is subject to the requirements of § 229.10(c)(1) (i) through (v) and § 229.10(c)(2) only with respect to the first $5,000 of funds deposited on any one banking day; but the amount of the deposit in excess of $5,000 shall be available for withdrawal not later than

the ninth business day following the banking day on which funds are deposited; and

(iii) Is not subject to the availability requirements of §§ 229.10(c)(1)(vi) and (vii) and 229.12.

(2) An account is considered a new account during the first 30 calendar days after the account is established. An account is not considered a new account if each customer on the account has had, within 30 calendar days before the account is established, another account at the depositary bank for at least 30 calendar days.

(b) *Large deposits*. Sections 229.10(c) and 229.12 do not apply to the aggregate amount of deposits by one or more checks to the extent that the aggregate amount is in excess of $5,000 on any one banking. day. For customers that have multiple accounts at a depositary bank, the bank may apply this exception to the aggregate deposits to all accounts held by the customer, even if the customer is not the sole holder of the accounts and not all of the holders of the accounts are the same.

(c) *Redeposited checks*. Sections 229.10(c) and 229.12 do not apply to a check that has been returned unpaid and redeposited by the customer or the depositary bank. This exception does not apply—

(1) To a check that has been returned due to a missing indorsement and redeposited after the missing indorsement has been obtained, if the reason for return indication on the check states that it was returned due to a missing indorsement; or

(2) To a check that has been returned because it was post dated, if the reason for return indicated on the check states that it was returned because it was post dated, and if the check is no longer postdated when redeposited.

(d) *Repeated overdrafts*. If any account or combination of accounts of a depositary bank's customer has been repeatedly overdrawn, then for a period of six months after the last such overdraft, §§ 229.10(c) and 229.12 do not apply to any of the accounts. A depositary bank may consider a customer's account to be repeatedly overdrawn if—

(1) On six or more banking days within the preceding six months, the account balance is negative, or the account balance would have become negative if checks or other charges to the account had been paid; or

(2) On two or more banking days within the preceding six months, the account balance is negative, or the account balance would have become negative, in the amount of $5,000 or more, if checks or other charges to the account had been paid.

(e) *Reasonable cause to doubt collectibility*—(1) *In general*. Sections 229.10(c) and 229.12 do not apply to a check deposited in an account at a depositary bank if the depositary bank has reasonable cause to believe that the check is uncollectible from the paying bank. Reasonable cause to believe a check is uncollectible requires the existence of facts that would cause a well-grounded belief in the mind of a reasonable person. Such belief shall not be based on the fact that the check is of a particular class or is deposited by a particular class of persons. The reason for the bank's belief that the check is uncollectible shall be included in the notice required under paragraph (g) of this section.

(2) *Overdraft and returned check fees*. A depositary bank that extends the time when funds will be available for withdrawal as described in paragraph (e)(1) of this section, and does not furnish the depositor with written notice at the time of deposit shall not assess any fees for any subsequent overdrafts (including use of a line of credit) or return of checks of other debits to the account, if—

(i) The overdraft or return of the check would not have occurred except for the fact that the deposited funds were delayed under paragraph (e)(1) of this section; and

(ii) The deposited check was paid by the paying bank.

Notwithstanding the foregoing, the depositary bank may assess an overdraft or returned check fee if it includes a notice concerning overdraft and returned check fees with the notice of exception required in paragraph (g) of this section and, when required, refunds any such fees upon the request of the customer. The notice must state that the customer may be entitled to a refund of overdraft or returned check

fees that are assessed if the check subject to the exception is paid and how to obtain a refund.

(f) *Emergency conditions.* Sections 229.10(c) and 229.12 do not apply to funds deposited by check in a depositary bank in the case of—

(1) An interruption of communications or computer or other equipment facilities;

(2) A suspension of payments by another bank;

(3) A war; or

(4) An emergency condition beyond the control of the depositary bank,

if the depositary bank exercises such diligence as the circumstances require.

(g) *Notice of exception*—(1) *In general.* Subject to paragraphs (g)(2) and (g)(3) of this section, when a depositary bank extends the time when funds will be available for withdrawal based on the application of an exception contained in paragraphs (b) through (e) of this section, it must provide the depositor with a written notice.

(i) The notice shall include the following information—

(A) A number or code, which need not exceed four digits, that identifies the customer's account;

(B) The date of the deposit;

(C) The amount of the deposit that is being delayed;

(D) The reason the exception was invoked; and

(E) The time period within which the funds will be available for withdrawal.

(ii) *Timing of notice.* The notice shall be provided to the depositor at the time of the deposit, unless the deposit is not made in person to an employee of the depositary bank, or, if the facts upon which a determination to invoke one of the exceptions in paragraphs (b) through (e) of this section to delay a deposit only become known to the depositary bank after the time of the deposit. If the notice is not given at the time of the deposit, the depositary bank shall mail or deliver the notice to the customer as soon as practicable, but no later than the first business day following the day the facts become known to the depositary bank, or the deposit is made, whichever is later.

(2) *One-time exception notice.* In lieu of providing notice pursuant to paragraph (g)(1) of this section, a depositary bank that extends the time when the funds deposited in a nonconsumer account will be available for withdrawal based on an exception contained in paragraph (b) or (c) of this section may provide a single notice to the customer that includes the following information—

(i) The reason(s) the exception may be invoked; and

(ii) The time period within which deposits subject to the exception generally will be available for withdrawal.

This one-time notice shall be provided only if each type of exception cited in the notice will be invoked for most check deposits in the account to which the exception could apply. This notice shall be provided at or prior to the time notice must be provided under paragraph (g)(1)(ii) of this section.

(3) *Notice of repeated overdrafts exception.* In lieu of providing notice pursuant to paragraph (g)(1) of this section, a depositary bank that extends the time when funds deposited in an account will be available for withdrawal based on the exception contained in paragraph (d) of this section may provide a notice to the customer for each time period during which the exception will be in effect. The notice shall include the following information—

(i) The account number of the customer;

(ii) The fact that the availability of funds deposited in the customer's account will be delayed because the repeated overdrafts exception will be invoked;

(iii) The time period within which deposits subject to the exception generally will be available for withdrawal; and

(iv) The time period during which the exception will apply.

This notice shall be provided at or prior to the time notice must be provided under paragraph (g)(1)(ii) of this section and only if the exception cited in the notice will be invoked for most check deposits in the account.

(4) *Emergency conditions exception notice.* When a depositary bank extends the time when funds will be available for withdrawal based on the application of the emergency conditions exception contained in paragraph (f) of this section, it must provide the depositor with notice in a reasonable

form and within a reasonable time given the circumstances. The notice shall include the reason the exception was invoked and the time period within which funds shall be made available for withdrawal, unless the depositary bank, in good faith, does not know at the time the notice is given the duration of the emergency and, consequently, when the funds must be made available. The depositary bank is not required to provide a notice if the funds subject to the exception become available before the notice must be sent.

(5) *Record retention.* A depositary bank shall retain a record, in accordance with § 229.21(g), of each notice provided pursuant to its application of the reasonable cause exception under paragraph (e) of this section, together with a brief statement of the facts giving rise to the bank's reason to doubt the collectibility of the check.

(h) *Availability of deposits subject to exceptions.* (1) If an exception contained in paragraphs (b) through (f) of this section applies, the depositary bank may extend the time periods established under §§ 229.10(c) and 229.12 by a reasonable period of time.

(2) If a depositary bank invokes an exception contained in paragraphs (b) through (e) of this section with respect to a check described in § 229.10(c)(1) (i) through (v) or § 229.10(c)(2), it shall make the funds available for withdrawal not later than a reasonable period after the day the funds would have been required to be made available had the check been subject to 229.12.

(3) If a depositary bank invokes an exception under paragraph (f) of this section based on an emergency condition, the depositary bank shall make the funds available for withdrawal not later than a reasonable period after the emergency has ceased or the period established in §§ 229.10(c) and 229.12, whichever is later.

(4) For the purposes of this section, a ''reasonable period'' is an extension of up to one business day for checks described in § 229.10(c)(1)(vi), five business days for checks described in § 229.12(b)(1) through (4), and six business days for checks described in § 229.12(c) (1) and (2) or § 229.12(f). A longer extension may be reasonable, but the bank has the burden of so establishing.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 54 FR 13850, Apr. 6, 1989; Reg. CC, 55 FR 21855, May 30, 1990; 57 FR 3279, Jan. 29, 1992; 57 FR 36598, Aug. 14, 1992; 60 FR 51671, Oct. 3, 1995; Reg. CC, 62 FR 13809, Mar. 24, 1997; 69 FR 47310, Aug. 4, 2004]

### § 229.14 Payment of interest.

(a) *In general.* A depositary bank shall begin to accrue interest or dividends on funds deposited in an interest-bearing account not later than the business day on which the depositary bank receives credit for the funds. For the purposes of this section, the depositary bank may—

(1) Rely on the availability schedule of its Federal Reserve Bank, Federal Home Loan Bank, or correspondent bank to determine the time credit is actually received; and

(2) Accrue interest or dividends on funds deposited in interest-bearing accounts by checks that the depositary bank sends to paying banks or subsequent collecting banks for payment or collection based on the availability of funds the depositary bank receives from the paying or collecting banks.

(b) *Special rule for credit unions.* Paragraph (a) of this section does not apply to any account at a bank described in § 229.2(e)(4), if the bank—

(1) Begins the accrual of interest or dividends at a later date than the date described in paragraph (a) of this section with respect to all funds, including cash, deposited in the account; and

(2) Provides notice of its interest or dividend payment policy in the manner required under § 229.16(d).

(c) *Exception for checks returned unpaid.* This subpart does not require a bank to pay interest or dividends on funds deposited by a check that is returned unpaid.

### § 229.15 General disclosure requirements.

(a) *Form of disclosures.* A bank shall make the disclosures required by this subpart clearly and conspicuously in writing. Disclosures, other than those posted at locations where employees accept consumer deposits and ATMs and the notice on preprinted deposit

slips, must be in a form that the customer may keep. The disclosures shall be grouped together and shall not contain any information not related to the disclosures required by this subpart. If contained in a document that sets forth other account terms, the disclosures shall be highlighted within the document by, for example, use of a separate heading.

(b) *Uniform reference to day of availability*. In its disclosure, a bank shall describe funds as being available for withdrawal on ''the _____ business day after'' the day of deposit. In this calculation, the first business day is the business day following the banking day the deposit was received, and the last business day is the day on which the funds are made available.

(c) *Multiple accounts and multiple account holders*. A bank need not give multiple disclosures to a customer that holds multiple accounts if the accounts are subject to the same availability policies. Similarly, a bank need not give separate disclosures to each customer on a jointly held account.

(d) *Dormant or inactive accounts*. A bank need not give availability disclosures to a customer that holds a dormant or inactive account.

### § 229.16 Specific availability policy disclosure.

(a) *General*. To meet the requirements of a specific availability policy disclosure under §§ 229.17 and 229.18(d), a bank shall provide a disclosure describing the bank's policy as to when funds deposited in an account are available for withdrawal. The disclosure must reflect the policy followed by the bank in most cases. A bank may impose longer delays on a case-by-case basis or by invoking one of the exceptions in § 229.13, provided this is reflected in the disclosure.

(b) *Content of specific availability policy disclosure*. The specific availability policy disclosure shall contain the following, as applicable—

(1) A summary of the bank's availability policy;

(2) A description of any categories of deposits or checks used by the bank when it delays availability (such as local or nonlocal checks); how to determine the category to which a particular deposit or check belongs; and when each category will be available for withdrawal (including a description of the bank's business days and when a deposit is considered received);[1]

(3) A description of any of the exceptions in § 229.13 that may be invoked by the bank, including the time following a deposit that funds generally will be available for withdrawal and a statement that the bank will notify the customer if the bank invokes one of the exceptions;

(4) A description, as specified in paragraph (c)(1) of this section, of any case-by-case policy of delaying availability that may result in deposited funds being available for withdrawal later than the time periods stated in the bank's availability policy; and

(5) A description of how the customer can differentiate between a proprietary and a nonproprietary ATM, if the bank makes funds from deposits at nonproprietary ATMs available for withdrawal later than funds from deposits at proprietary ATMs.

(c) *Longer delays on a case-by-case basis*—(1) *Notice in specific policy disclosure*. A bank that has a policy of making deposited funds available for withdrawal sooner than required by this subpart may extend the time when funds are available up to the time periods allowed under this subpart on a case-by-case basis, provided the bank includes the following in its specific policy disclosure—

[1] A bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check must disclose that certain checks, such as some credit union share drafts that are payable by one bank but payable through another bank, will be treated as local or nonlocal checks based upon the location of the bank by which they are payable and not on the basis of the location of the bank whose routing number appears on the check. A bank that makes funds from nonlocal checks available for withdrawal within the time periods required for local checks under §§ 229.12 and 229.13 is not required to provide this disclosure on payable-through checks to its customers. The statement concerning payable-through checks must describe how the customer can determine whether these checks will be treated as local or nonlocal, or state that special rules apply to such checks and that the customer may ask about the availability of these checks.

(i) A statement that the time when deposited funds are available for withdrawal may be extended in some cases, and the latest time following a deposit that funds will be available for withdrawal;

(ii) A statement that the bank will notify the customer if funds deposited in the customer's account will not be available for withdrawal until later than the time periods stated in the bank's availability policy; and

(iii) A statement that customers should ask if they need to be sure about when a particular deposit will be available for withdrawal.

(2) *Notice at time of case-by-case delay*—(i) *In general*. When a depositary bank extends the time when funds will be available for withdrawal on a case-by-case basis, it must provide the depositor with a written notice. The notice shall include the following information—

(A) A number or code, which need not exceed four digits, that identifies the customer's account.

(B) The date of the deposit;

(C) The amount of the deposit that is being delayed; and

(D) The day the funds will be available for withdrawal.

(ii) *Timing of notice*. The notice shall be provided to the depositor at the time of the deposit, unless the deposit is not made in person to an employee of the depositary bank or the decision to extend the time when the deposited funds will be available is made after the time of the deposit. If notice is not given at the time of the deposit, the depositary bank shall mail or deliver the notice to the customer not later than the first business day following the banking day the deposit is made.

(3) Overdraft and returned check fees. A depositary bank that extends the time when funds will be available for withdrawal on a case-by-case basis and does not furnish the depositor with written notice at the time of deposit shall not assess any fees for any subsequent overdrafts (including use of a line of credit) or return of checks or other debits to the account, if—

(i) The overdraft or return of the check or other debit would not have occurred except for the fact that the deposited funds were delayed under paragraph (c)(1) of this section; and

(ii) The deposited check was paid by the paying bank.

Notwithstanding the foregoing, the depositary bank may assess an overdraft or returned check fee if it includes a notice concerning overdraft and returned check fees with the notice required in paragraph (c)(2) of this section and, when required, refunds any such fees upon the request of the customer. The notice must state that the customer may be entitled to a refund of overdraft or returned check fees that are assessed if the check subject to the delay is paid and how to obtain a refund.

(d) *Credit union notice of interest payment policy*. If a bank described in § 229.2(e)(4) begins to accrue interest or dividends on all deposits made in an interest-bearing account, including cash deposits, at a later time than the day specified in § 229.14(a), the bank's specific policy disclosures shall contain an explanation of when interest or dividends on deposited funds begin to accrue.

[53 FR 19433, May 27, 1988, as amended at 53 FR 31292, Aug. 18, 1988; 53 FR 44324, Nov. 2, 1988; Reg. CC, 54 FR 13850, Apr. 6, 1989; 60 FR 51671, Oct. 3, 1995; Reg. CC, 62 FR 13810, Mar. 24, 1997; 69 FR 47311, Aug. 4, 2004]

### § 229.17 Initial disclosures.

Before opening a new account, a bank shall provide a potential customer with the applicable specific availability policy disclosure described in § 229.16.

[Reg. CC, 60 FR 51671, Oct. 3, 1995]

### § 229.18 Additional disclosure requirements.

(a) *Deposit slips*. A bank shall include on all preprinted deposit slips furnished to its customers a notice that deposits may not be available for immediate withdrawal.

(b) *Locations where employees accept consumer deposits*. A bank shall post in a conspicuous place in each location where its employees receive deposits to consumer accounts a notice that sets forth the time periods applicable to the availability of funds deposited in a consumer account.

(c) *Automated teller machines*. (1) A depositary bank shall post or provide a

notice at each ATM location that funds deposited in the ATM may not be available for immediate withdrawal.

(2) A depositary bank that operates an off-premises ATM from which deposits are removed not more than two times each week, as described in § 229.19(a)(4), shall disclose at or on the ATM the days on which deposits made at the ATM will be considered received.

(d) *Upon request*. A bank shall provide to any person, upon oral or written request, a notice containing the applicable specific availability policy disclosure described in § 229.16.

(e) *Changes in policy*. A bank shall send a notice to holders of consumer accounts at least 30 days before implementing a change to the bank's availability policy regarding such accounts, except that a change that expedites the availability of funds may be disclosed not later than 30 days after implementation.

**§ 229.19 Miscellaneous.**

(a) *When funds are considered deposited*. For the purposes of this subpart—

(1) Funds deposited at a staffed facility, ATM, or contractual branch are considered deposited when they are received at the staffed facility, ATM, or contractual branch;

(2) Funds mailed to the depositary bank are considered deposited on the day they are received by the depositary bank;

(3) Funds deposited to a night depository, lock box, or similar facility are considered deposited on the day on which the deposit is removed from such facility and is available for processing by the depositary bank;

(4) Funds deposited at an ATM that is not on, or within 50 feet of, the premises of the depositary bank are considered deposited on the day the funds are removed from the ATM, if funds normally are removed from the ATM not more than two times each week; and

(5) Funds may be considered deposited on the next banking day, in the case of funds that are deposited—

(i) On a day that is not a banking day for the depositary bank; or

(ii) After a cut-off hour set by the depositary bank for the receipt of deposits of 2:00 p.m. or later, or, for the receipt of deposits at ATMs, contractual branches, or off-premise facilities, of 12:00 noon or later. Different cut-off hours later than these times may be established for the receipt of different types of deposits, or receipt of deposits at different locations.

(b) *Availability at start of business day*. Except as otherwise provided in § 229.12(d), if any provision of this subpart requires that funds be made available for withdrawal on any business day, the funds shall be available for withdrawal by the later of:

(1) 9:00 a.m. (local time of the depositary bank); or

(2) The time the depositary bank's teller facilities (including ATMs) are available for customer account withdrawals.

(c) *Effect on policies of depositary bank*. This part does not—

(1) Prohibit a depositary bank from making funds available to a customer for withdrawal in a shorter period of time than the time required by this subpart;

(2) Affect a depositary bank's right—

(i) To accept or reject a check for deposit;

(ii) To revoke any settlement made by the depositary bank with respect to a check accepted by the bank for deposit, to charge back the customer's account for the amount of a check based on the return of the check or receipt of a notice of nonpayment of the check, or to claim a refund of such credit; and

(iii) To charge back funds made available to its customer for an electronic payment for which the bank has not received payment in actually and finally collected funds;

(3) Require a depositary bank to open or otherwise to make its facilities available for customer transactions on a given business day; or

(4) Supersede any policy of a depositary bank that limits the amount of cash a customer may withdraw from its account on any one day, if that policy—

(i) Is not dependent on the time the funds have been deposited in the account, as long as the funds have been on deposit for the time period specified in §§ 229.10, 229.12, or 229.13; and

(ii) In the case of withdrawals made in person to an employee of the depositary bank—

(A) Is applied without discrimination to all customers of the bank; and

(B) Is related to security, operating, or bonding requirements of the depositary bank.

(d) *Use of calculated availability*. A depositary bank may provide availability to its nonconsumer accounts based on a sample of checks that represents the average composition of the customer's deposits, if the terms for availability based on the sample are equivalent to or more prompt than the availability requirements of this subpart.

(e) *Holds on other funds*. (1) A depositary bank that receives a check for deposit in an account may not place a hold on any funds of the customer at the bank, where—

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in §§ 229.10, 229.12, and 229.13.

(2) A depositary bank that cashes a check for a customer over the counter, other than a check drawn on the depositary bank, may not place a hold on funds in an account of the customer at the bank, if—

(i) The amount of funds that are held exceeds the amount of the check; or

(ii) The funds are not made available for withdrawal within the times specified in §§ 229.10, 229.12, and 229.13.

(f) *Employee training and compliance*. Each bank shall establish procedures to ensure that the bank complies with the requirements of this subpart, and shall provide each employee who performs duties subject to the requirements of this subpart with a statement of the procedures applicable to that employee.

(g) *Effect of merger transaction*—(1) *In general*. For purposes of this subpart, except for the purposes of the new accounts exception of § 229.13(a), and when funds are considered deposited under § 229.19(a), two or more banks that have engaged in a merger transaction may be considered to be separate banks for a period of one year following the consummation of the merger transaction.

(2) *Merger transactions on or after July 1, 1998, and before March 1, 2000*. If banks have consummated a merger transaction on or after July 1, 1998, and before March 1, 2000, the merged banks may be considered separate banks until March 1, 2001.

[Reg. CC, 53 FR 19433, May 27, 1988, as amended by 54 FR 13850, Apr. 6, 1989; 60 FR 51671, Oct. 3, 1995; 62 FR 13810, Mar. 24, 1997; 64 FR 14577, Mar. 26, 1999]

### § 229.20 Relation to state law.

(a) *In general*. Any provision of a law or regulation of any state in effect on or before September 1, 1989, that requires funds deposited in an account at a bank chartered by the state to be made available for withdrawal in a shorter time than the time provided in subpart B, and, in connection therewith, subpart A, shall—

(1) Supersede the provisions of the EFA Act and subpart B, and, in connection therewith, subpart A, to the extent the provisions relate to the time by which funds deposited or received for deposit in an account are available for withdrawal; and

(2) Apply to all federally insured banks located within the state.

No amendment to a state law or regulation governing the availability of funds that becomes effective after September 1, 1989, shall supersede the EFA Act and subpart B, and, in connection therewith, subpart A, but unamended provisions of state law shall remain in effect.

(b) *Preemption of inconsistent law*. Except as provided in paragraph (a), the EFA Act and subpart B, and, in connection therewith, subpart A, supersede any provision of inconsistent state law.

(c) *Standards for preemption*. A provision of a state law in effect on or before September 2, 1989, is not inconsistent with the EFA Act, or subpart B, or in connection therewith, subpart A, if it requires that funds shall be available in a shorter period of time than the time provided in this subpart. Inconsistency with the EFA Act and subpart B, and in connection therewith, subpart A, may exist when state law—

(1) Permits a depositary bank to make funds deposited in an account by cash, electronic payment, or check

available for withdrawal in a longer period of time than the maximum period of time permitted under subpart B, and, in connection therewith, subpart A; or

(2) Provides for disclosures or notices concerning funds availability relating to accounts.

(d) *Preemption determinations.* The Board may determine, upon the request of any state, bank, or other interested party, whether the EFA Act and subpart B, and, in connection therewith, subpart A, preempt provisions of state laws relating to the availability of funds.

(e) *Procedures for preemption determinations.* A request for a preemption determination shall include the following—

(1) A copy of the full text of the state law in question, including any implementing regulations or judicial interpretations of that law; and

(2) A comparison of the provisions of state law with the corresponding provisions in the EFA Act and subparts A and B of this part, together with a discussion of the reasons why specific provisions of state law are either consistent or inconsistent with corresponding sections of the EFA Act and subparts A and B of this part.

A request for a preemption determination shall be addressed to the Secretary, Board of Governors of the Federal Reserve System.

[53 FR 19433, May 27, 1988, as amended at 69 FR 47311, Aug. 4, 2004]

### § 229.21 Civil liability.

(a) *Civil liability.* A bank that fails to comply with any requirement imposed under subpart B, and in connection therewith, subpart A, of this part or any provision of state law that supersedes any provision of subpart B, and in connection therewith, subpart A, with respect to any person is liable to that person in an amount equal to the sum of—

(1) Any actual damage sustained by that person as a result of the failure;

(2) Such additional amount as the court may allow, except that—

(i) In the case of an individual action, liability under this paragraph shall not be less than $100 nor greater than $1,000; and

(ii) In the case of a class action—

(A) No minimum recovery shall be applicable to each member of the class; and

(B) The total recovery under this paragraph in any class action or series of class actions arising out of the same failure to comply by the same depositary bank shall not be more than the lesser of $500,000 or 1 percent of the net worth of the bank involved; and

(3) In the case of a successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

(b) *Class action awards.* In determining the amount of any award in any class action, the court shall consider, among other relevant factors—

(1) The amount of any damages awarded;

(2) The frequency and persistence of failures of compliance;

(3) The resources of the bank;

(4) The number of persons adversely affected; and

(5) The extent to which the failure of compliance was intentional.

(c) *Bona fide errors*—(1) *General rule.* A bank is not liable in any action brought under this section for a violation of this subpart if the bank demonstrates by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error, notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.

(2) *Examples.* Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to the bank's obligation under this subpart is not a bona fide error.

(d) *Jurisdiction.* Any action under this section may be brought in any United States district court or in any other court of competent jurisdiction, and shall be brought within one year after the date of the occurrence of the violation involved.

(e) *Reliance on Board rulings.* No provision of this subpart imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, regardless

of whether such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason after the act or omission has occurred.

(f) *Exclusions.* This section does not apply to claims that arise under subpart C of this part or to actions for wrongful dishonor.

(g) *Record retention.* (1) A bank shall retain evidence of compliance with the requirements imposed by this subpart for not less than two years. Records may be stored by use of microfiche, microfilm, magnetic tape, or other methods capable of accurately retaining and reproducing information.

(2) If a bank has actual notice that it is being investigated, or is subject to an enforcement proceeding by an agency charged with monitoring that bank's compliance with the EFA Act and this subpart, or has been served with notice of an action filed under this section, it shall retain the records pertaining to the action or proceeding pending final disposition of the matter, unless an earlier time is allowed by order of the agency or court.

[53 FR 19433, May 27, 1988, as amended at 69 FR 47311, Aug. 4, 2004]

## Subpart C—Collection of Checks

### § 229.30 Paying bank's responsibility for return of checks.

(a) *Return of checks.* If a paying bank determines not to pay a check, it shall return the check in an expeditious manner as provided in either paragraph (a)(1) or (a)(2) of this section.

(1) *Two-day/four-day test.* A paying bank returns a check in an expeditious manner if it sends the returned check in a manner such that the check would normally be received by the depositary bank not later than 4:00 p.m. (local time of the depositary bank) of—

(i) The second business day following the banking day on which the check was presented to the paying bank, if the paying bank is located in the same check processing region as the depositary bank; or

(ii) The fourth business day following the banking day on which the check was presented to the paying bank, if the paying bank is not located in the same check processing region as the depositary bank.

If the last business day on which the paying bank may deliver a returned check to the depositary bank is not a banking day for the depositary bank, the paying bank meets the two-day/four-day test if the returned check is received by the depositary bank on or before the depositary bank's next banking day.

(2) *Forward collection test.* A paying bank also returns a check in an expeditious manner if it sends the returned check in a manner that a similarly situated bank would normally handle a check—

(i) Of similar amount as the returned check;

(ii) Drawn on the depositary bank; and

(iii) Deposited for forward collection in the similarly situated bank by noon on the banking day following the banking day on which the check was presented to the paying bank.

Subject to the requirement for expeditious return, a paying bank may send a returned check to the depositary bank, or to any other bank agreeing to handle the returned check expeditiously under § 229.31(a). A paying bank may convert a check to a qualified returned check. A qualified returned check shall be encoded in magnetic ink with the routing number of the depositary bank, the amount of the returned check, and a ''2'' in the case of an original check (or a ''5'' in the case of a substitute check) in position 44 of the qualified return MICR line as a return identifier. A qualified returned original check shall be encoded in accordance with ANS X9.13, and a qualified returned substitute check shall be encoded in accordance with ANS X9.100–140. This paragraph does not affect a paying bank's responsibility to return a check within the deadlines required by the U.C.C., Regulation J (12 CFR part 210), or § 229.30(c).

(b) *Unidentifiable depositary bank.* A paying bank that is unable to identify the depositary bank with respect to a check may send the returned check to any bank that handled the check for forward collection even if that bank does not agree to handle the check expeditiously under § 229.31(a). A paying

bank sending a returned check under this paragraph to a bank that handled the check for forward collection must advise the bank to which the check is sent that the paying bank is unable to identify the depositary bank. The expeditious return requirements in § 229.30(a) do not apply to the paying bank's return of a check under this paragraph.

(c) *Extension of deadline.* The deadline for return or notice of nonpayment under the U.C.C. or Regulation J (12 CFR part 210), or § 229.36(f)(2) is extended to the time of dispatch of such return or notice of nonpayment where a paying bank uses a means of delivery that would ordinarily result in receipt by the bank to which it is sent—

(1) On or before the receiving bank's next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. or later set by the receiving bank under U.C.C. 4–108, for all deadlines other than those described in paragraph (c)(2) of this section; this deadline is extended further if a paying bank uses a highly expeditious means of transportation, even if this means of transportation would ordinarily result in delivery after the receiving bank's next cutoff hour or banking day referred to above; or

(2) Prior to the cut-off hour for the next processing cycle (if sent to a returning bank), or on the next banking day (if sent to the depositary bank), for a deadline falling on a Saturday that is a banking day (as defined in the applicable U.C.C.) for the paying bank.

(d) *Identification of returned check.* A paying bank returning a check shall clearly indicate on the front of the check that it is a returned check and the reason for return. If the check is a substitute check, the paying bank shall place this information within the image of the original check that appears on the front of the substitute check.

(e) *Depositary bank without accounts.* The expeditious return requirements of paragraph (a) of this section do not apply to checks deposited in a depositary bank that does not maintain accounts.

(f) *Notice in lieu of return.* If a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment containing the information specified in § 229.33(b). The copy or notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the expeditious return requirements of this section and to the other requirements of this subpart.

(g) *Reliance on routing number.* A paying bank may return a returned check based on any routing number designating the depositary bank appearing on the returned check in the depositary bank's indorsement.

[53 FR 19433, May 27, 1988, as amended at 53 FR 31292, Aug. 18, 1988; Reg. CC, 55 FR 21855, May 30, 1990; 57 FR 46972, Oct. 14, 1993; Reg. CC, 62 FR 13810, Mar. 24, 1997; 69 FR 47311, Aug. 4, 2004]

### § 229.31 Returning bank's responsibility for return of checks.

(a) *Return of checks.* A returning bank shall return a returned check in an expeditious manner as provided in either paragraph (a)(1) or (a)(2) of this section.

(1) *Two-day/four-day test.* A returning bank returns a check in an expeditious manner if it sends the returned check in a manner such that the check would normally be received by the depositary bank not later than 4:00 p.m. (local time) of—

(i) The second business day following the banking day on which the check was presented to the paying bank if the paying bank is located in the same check processing region as the depositary bank; or

(ii) The fourth business day following the banking day on which the check was presented to the paying bank if the paying bank is not located in the same check processing region as the depositary bank.

If the last business day on which the returning bank may deliver a returned check to the depositary bank is not a banking day for the depositary bank, the returning bank meets this requirement if the returned check is received by the depositary bank on or before the depositary bank's next banking day.

(2) *Forward collection test.* A returning bank also returns a check in an expeditious manner if it sends the returned check in a manner that a similarly situated bank would normally handle a check—

(i) Of similar amount as the returned check;

(ii) Drawn on the depositary bank; and

(iii) Received for forward collection by the similarly situated bank at the time the returning bank received the returned check, except that a returning bank may set a cut-off hour for the receipt of returned checks that is earlier than the similarly situated bank's cut-off hour for checks received for forward collection, if the cut-off hour is not earlier than 2:00 p.m.

Subject to the requirement for expeditious return, the returning bank may send the returned check to the depositary bank, or to any bank agreeing to handle the returned check expeditiously under § 229.31(a). The returning bank may convert the returned check to a qualified returned check. A qualified returned check shall be encoded in magnetic ink with the routing number of the depositary bank, the amount of the returned check, and a ''2'' in the case of an original check (or a ''5'' in the case of a substitute check) in position 44 of the qualified return MICR line as a return identifier. A qualified returned original check shall be encoded in accordance with ANS X9.13, and a qualified returned substitute check shall be encoded in accordance with ANS X9.100–140. The time for expeditious return under the forward collection test, and the deadline for return under the U.C.C. and Regulation J (12 CFR part 210), are extended by one business day if the returning bank converts a returned check to a qualified returned check. This extension does not apply to the two-day/four-day test specified in paragraph (a)(1) of this section or when a returning bank is returning a check directly to the depositary bank.

(b) *Unidentifiable depositary bank.* A returning bank that is unable to identify the depositary bank with respect to a returned check may send the returned check to—

(1) Any collecting bank that handled the check for forward collection if the returning bank was not a collecting bank with respect to the returned check; or

(2) A prior collecting bank, if the returning bank was a collecting bank with respect to the returned check;

even if that collecting bank does not agree to handle the returned check expeditiously under § 229.31(a). A returning bank sending a returned check under this paragraph must advise the bank to which the check is sent that the returning bank is unable to identify the depositary bank. The expeditious return requirements in paragraph (a) of this section do not apply to return of a check under this paragraph. A returning bank that receives a returned check from a paying bank under § 229.30(b), or from a returning bank under this paragraph, but that is able to identify the depositary bank, must thereafter return the check expeditiously to the depositary bank.

(c) *Settlement.* A returning bank shall settle with a bank sending a returned check to it for return by the same means that it settles or would settle with the sending bank for a check received for forward collection drawn on the depositary bank. This settlement is final when made.

(d) *Charges.* A returning bank may impose a charge on a bank sending a returned check for handling the returned check.

(e) *Depositary bank without accounts.* The expeditious return requirements of paragraph (a) of this section do not apply to checks deposited with a depositary bank that does not maintain accounts.

(f) *Notice in lieu of return.* If a check is unavailable for return, the returning bank may send in its place a copy of the front and back of the returned check, or, if no copy is available, a written notice of nonpayment containing the information specified in § 229.33(b). The copy or notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check subject to the expeditious return requirements of this section and to the other requirements of this subpart.

(g) *Reliance on routing number.* A returning bank may return a returned check based on any routing number designating the depositary bank appearing on the returned check in the depositary bank's indorsement or in magnetic ink on a qualified returned check.

[53 FR 19433, May 27, 1988, as amended at 53 FR 31292, Aug. 18, 1988; Reg. CC, 54 FR 13850, Apr. 6, 1989; 69 FR 47311, Aug. 4, 2004]

### § 229.32 Depositary bank's responsibility for returned checks.

(a) *Acceptance of returned checks.* A depositary bank shall accept returned checks and written notices of nonpayment

(1) At a location at which presentment of checks for forward collection is requested by the depositary bank; and

(2) (i) At a branch, head office, or other location consistent with the name and address of the bank in its indorsement on the check;

(ii) If no address appears in the indorsement, at a branch or head office associated with the routing number of the bank in its indorsement on the check;

(iii) If the address in the indorsement is not in the same check processing region as the address associated with the routing number of the bank in its indorsement on the check, at a location consistent with the address in the indorsement and at a branch or head office associated with the routing number in the bank's indorsement; or

(iv) If no routing number or address appears in its indorsement on the check, at any branch or head office of the bank.

A depositary bank may require that returned checks be separated from forward collection checks.

(b) *Payment.* A depositary bank shall pay the returning or paying bank returning the check to it for the amount of the check prior to the close of business on the banking day on which it received the check (''payment date'') by—

(1) Debit to an account of the depositary bank on the books of the returning or paying bank;

(2) Cash;

(3) Wire transfer; or

(4) Any other form of payment acceptable to the returning or paying bank;

provided that the proceeds of the payment are available to the returning or paying bank in cash or by credit to an account of the returning or paying bank on or as of the payment date. If the payment date is not a banking day for the returning or paying bank or the depositary bank is unable to make the payment on the payment date, payment shall be made by the next day that is a banking day for the returning or paying bank. These payments are final when made.

(c) *Misrouted returned checks and written notices of nonpayment.* If a bank receives a returned check or written notice of nonpayment on the basis that it is the depositary bank, and the bank determines that it is not the depositary bank with respect to the check or notice, it shall either promptly send the returned check or notice to the depositary bank directly or by means of a returning bank agreeing to handle the returned check expeditiously under § 229.31(a), or send the check or notice back to the bank from which it was received.

(d) *Charges.* A depositary bank may not impose a charge for accepting and paying checks being returned to it.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 54 FR 13850, Apr. 6, 1989]

### § 229.33 Notice of nonpayment.

(a) *Requirement.* If a paying bank determines not to pay a check in the amount of $2,500 or more, it shall provide notice of nonpayment such that the notice is received by the depositary bank by 4:00 p.m. (local time) on the second business day following the banking day on which the check was presented to the paying bank. If the day the paying bank is required to provide notice is not a banking day for the depositary bank, receipt of notice on the depositary bank's next banking day constitutes timely notice. Notice may be provided by any reasonable means, including the returned check, a writing (including a copy of the check), telephone, Fedwire, telex, or other form of telegraph.

(b) *Content of notice.* Notice must include the—

(1) Name and routing number of the paying bank;

(2) Name of the payee(s);

(3) Amount;

(4) Date of the indorsement of the depositary bank;

(5) Account number of the customer(s) of the depositary bank;

(6) Branch name or number of the depositary bank from its indorsement;

(7) Trace number associated with the indorsement of the depositary bank; and

(8) Reason for nonpayment.

The notice may include other information from the check that may be useful in identifying the check being returned and the customer, and, in the case of a written notice, must include the name and routing number of the depositary bank from its indorsement. If the paying bank is not sure of an item of information, it shall include the information required by this paragraph to the extent possible, and identify any item of information for which the bank is not sure of the accuracy.

(c) *Acceptance of notice.* The depositary bank shall accept notices during its banking day—

(1) Either at the telephone or telegraph number of its return check unit indicated in the indorsement, or, if no such number appears in the indorsement or if the number is illegible, at the general purpose telephone or telegraph number of its head office or the branch indicated in the indorsement; and

(2) At any other number held out by the bank for receipt of notice of nonpayment, and, in the case of written notice, as specified in § 229.32(a).

(d) *Notification to customer.* If the depositary bank receives a returned check or notice of nonpayment, it shall send or give notice to its customer of the facts by midnight of the banking day following the banking day on which it received the returned check or notice, or within a longer reasonable time.

(e) *Depositary bank without accounts.* The requirements of this section do not apply to checks deposited in a depositary bank that does not maintain accounts.

[53 FR 19433, May 27, 1988, as amended at 69 FR 47311, Aug. 4, 2004]

## § 229.34 Warranties.

(a) *Warranties.* Each paying bank or returning bank that transfers a returned check and receives a settlement or other consideration for it warrants to the transferee returning bank, to any subsequent returning bank, to the depositary bank, and to the owner of the check, that—

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned the check within its deadline under the U.C.C., Regulation J (12 CFR part 210), or § 229.30(c) of this part;

(2) It is authorized to return the check;

(3) The check has not been materially altered; and

(4) In the case of a notice in lieu of return, the original check has not and will not be returned.

These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or checks drawn on a state or a unit of general local government that are not payable through or at a bank.

(b) *Warranty of notice of nonpayment.* Each paying bank that gives a notice of nonpayment warrants to the transferee bank, to any subsequent transferee bank, to the depositary bank, and to the owner of the check that—

(1) The paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, returned or will return the check within its deadline under the U.C.C., Regulation J (12 CFR part 210), or § 229.30(c) of this part;

(2) It is authorized to send the notice; and

(3) The check has not been materially altered.

These warranties are not made with respect to checks drawn on a state or a unit of general local government that are not payable through or at a bank.

(c) *Warranty of settlement amount, encoding, and offset.* (1) Each bank that presents one or more checks to a paying bank and in return receives a settlement or other consideration warrants to the paying bank that the total amount of the checks presented is

equal to the total amount of the settlement demanded by the presenting bank from the paying bank.

(2) Each bank that transfers one or more checks or returned checks to a collecting, returning, or depositary bank and in return receives a settlement or other consideration warrants to the transferee bank that the accompanying information, if any, accurately indicates the total amount of the checks or returned checks transferred.

(3) Each bank that presents or transfers a check or returned check warrants to any bank that subsequently handles it that, at the time of presentment or transfer, the information encoded after issue in magnetic ink on the check or returned check is correct. For purposes of this paragraph, the information encoded after issue on the check or returned check includes any information placed in the MICR line of a substitute check that represents that check or returned check.

(4) If a bank settles with another bank for checks presented, or for returned checks for which it is the depositary bank, in amount exceeding the total amount of the checks, the settling bank may set off the excess settlement amount against subsequent settlements for checks presented, or for returned checks for which it is the depositary bank, that it receives from the other bank.

(d) *Transfer and presentment warranties with respect to a remotely created check.* (1) A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the remotely created check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. For purposes of this paragraph (d)(1), ''account'' includes an account as defined in § 229.2(a) as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank.

(2) If a paying bank asserts a claim for breach of warranty under paragraph (d)(1) of this section, the warranting bank may defend by proving that the customer of the paying bank is precluded under U.C.C. 4–406, as applicable, from asserting against the paying bank the unauthorized issuance of the check.

(e) *Damages.* Damages for breach of these warranties shall not exceed the consideration received by the bank that presents or transfers a check or returned check, plus interest compensation and expenses related to the check or returned check, if any.

(f) *Tender of defense.* If a bank is sued for breach of a warranty under this section, it may give a prior bank in the collection or return chain written notice of the litigation, and the bank notified may then give similar notice to any other prior bank. If the notice states that the bank notified may come in and defend and that failure to do so will bind the bank notified in an action later brought by the bank giving the notice as to any determination of fact common to the two litigations, the bank notified is so bound unless after seasonable receipt of the notice the bank notified does come in and defend.

(g) *Notice of claim.* Unless a claimant gives notice of a claim for breach of warranty under this section to the bank that made the warranty within 30 days after the claimant has reason to know of the breach and the identity of the warranting bank, the warranting bank is discharged to the extent of any loss caused by the delay in giving notice of the claim.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 54 FR 13850, Apr. 6, 1989; 57 FR 46972, Oct. 14, 1992; 62 FR 13810, Mar. 24, 1997; 69 FR 47311, Aug. 4, 2004; 70 FR 71225, Nov. 28, 2005]

### § 229.35 Indorsements.

(a) *Indorsement standards.* A bank (other than a paying bank) that handles a check during forward collection or a returned check shall indorse the check in a manner that permits a person to interpret the indorsement, in accordance with the indorsement standard set forth in appendix D of this part.

(b) *Liability of bank handling check.* A bank that handles a check for forward collection or return is liable to any bank that subsequently handles the check to the extent that the subsequent bank does not receive payment for the check because of suspension of

payments by another bank or otherwise. This paragraph applies whether or not a bank has placed its indorsement on the check. This liability is not affected by the failure of any bank to exercise ordinary care, but any bank failing to do so remains liable. A bank seeking recovery against a prior bank shall send notice to that prior bank reasonably promptly after it learns the facts entitling it to recover. A bank may recover from the bank with which it settled for the check by revoking the settlement, charging back any credit given to an account, or obtaining a refund. A bank may have the rights of a holder with respect to each check it handles.

(c) *Indorsement by a bank.* After a check has been indorsed by a bank, only a bank may acquire the rights of a holder—

(1) Until the check has been returned to the person initiating collection; or

(2) Until the check has been specially indorsed by a bank to a person who is not a bank.

(d) *Indorsement for depositary bank.* A depositary bank may arrange with another bank to apply the other bank's indorsement as the depositary bank indorsement, provided that any indorsement of the depositary bank on the check avoids the area reserved for the depositary bank indorsement as specified in appendix D. The other bank indorsing as depositary bank is considered the depositary bank for purposes of subpart C of this part.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 55 FR 21855, May 30, 1990; 69 FR 47311, Aug. 4, 2004]

### § 229.36 Presentment and issuance of checks.

(a) *Payable through and payable at checks.* A check payable at or through a paying bank is considered to be drawn on that bank for purposes of the expeditious return and notice of nonpayment requirements of this subpart.

(b) *Receipt at bank office or processing center.* A check is considered received by the paying bank when it is received:

(1) At a location to which delivery is requested by the paying bank;

(2) At an address of the bank associated with the routing number on the check, whether in magnetic ink or in fractional form;

(3) At any branch or head office, if the bank is identified on the check by name without address; or

(4) At a branch, head office, or other location consistent with the name and address of the bank on the check if the bank is identified on the check by name and address.

(c) [Reserved]

(d) *Liability of bank during forward collection.* Settlements between banks for the forward collection of a check are final when made; however, a collecting bank handling a check for forward collection may be liable to a prior collecting bank, including the depositary bank, and the depositary bank's customer.

(e) *Issuance of payable-through checks.* (1) A bank that arranges for checks payable by it to be payable through another bank shall require that the following information be printed conspicuously on the face of each check:

(i) The name, location, and first four digits of the nine-digit routing number of the bank by which the check is payable; and

(ii) The words ''payable through'' followed by the name of the payable-through bank.

(2) A bank is responsible for damages under § 229.38 to the extent that a check payable by it and not payable through another bank is labelled as provided in this section.

(f) *Same-day settlement.* (1) A check is considered presented, and a paying bank must settle for or return the check pursuant to paragraph (f)(2) of this section, if a presenting bank delivers the check in accordance with reasonable delivery requirements established by the paying bank and demands payment under this paragraph (f)—

(i) At a location designated by the paying bank for receipt of checks under this paragraph (f) that is in the check processing region consistent with the routing number encoded in magnetic ink on the check and at which the paying bank would be considered to have received the check under paragraph (b) of this section or, if no location is designated, at any location described in paragraph (b) of this section; and

(ii) By 8 a.m. on a business day (local time of the location described in paragraph (f)(1)(i) of this section).

A paying bank may require that checks presented for settlement pursuant to this paragraph (f)(1) be separated from other forward-collection checks or returned checks.

(2) If presentment of a check meets the requirements of paragraph (f)(1) of this section, the paying bank is accountable to the presenting bank for the amount of the check unless, by the close of Fedwire on the business day it receives the check, it either:

(i) Settles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the presenting bank; or

(ii) Returns the check.

(3) Notwithstanding paragraph (f)(2) of this section, if a paying bank closes on a business day and receives presentment of a check on that day in accordance with paragraph (f)(1) of this section, the paying bank is accountable to the presenting bank for the amount of the check unless, by the close of Fedwire on its next banking day, it either:

(i) Settles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the presenting bank; or

(ii) Returns the check.

If the closing is voluntary, unless the paying bank settles for or returns the check in accordance with paragraph (f)(2) of this section, it shall pay interest compensation to the presenting bank for each day after the business day on which the check was presented until the paying bank settles for the check, including the day of settlement.

[Reg. CC, 53 FR 19433, May 27, 1988, as amended by 54 FR 32047, Aug. 4, 1989; 55 FR 21855, May 30, 1990; 57 FR 46972, Oct. 14, 1992; 60 FR 51671, Oct. 3, 1995; 62 FR 13810, Mar. 24, 1997; 64 FR 59613, Nov. 3, 1999]

### § 229.37 Variation by agreement.

The effect of the provisions of subpart C may be varied by agreement, except that no agreement can disclaim the responsibility of a bank for its own lack of good faith or failure to exercise ordinary care, or can limit the measure of damages for such lack or failure; but the parties may determine by agreement the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

### § 229.38 Liability.

(a) *Standard of care; liability; measure of damages.* A bank shall exercise ordinary care and act in good faith in complying with the requirements of this subpart. A bank that fails to exercise ordinary care or act in good faith under this subpart may be liable to the depositary bank, the depositary bank's customer, the owner of a check, or another party to the check. The measure of damages for failure to exercise ordinary care is the amount of the loss incurred, up to the amount of the check, reduced by the amount of the loss that party would have incurred even if the bank had exercised ordinary care. A bank that fails to act in good faith under this subpart may be liable for other damages, if any, suffered by the party as a proximate consequence. Subject to a bank's duty to exercise ordinary care or act in good faith in choosing the means of return or notice of nonpayment, the bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person, or for loss or destruction of a check or notice of nonpayment in transit or in the possession of others. This section does not affect a paying bank's liability to its customer under the U.C.C. or other law.

(b) *Paying bank's failure to make timely return.* If a paying bank fails both to comply with § 229.30(a) and to comply with the deadline for return under the U.C.C., Regulation J (12 CFR part 210), or § 229.30(c) in connection with a single nonpayment of a check, the paying bank shall be liable under either § 229.30(a) or such other provision, but not both.

(c) *Comparative negligence.* If a person, including a bank, fails to exercise ordinary care or act in good faith under this subpart in indorsing a check (§ 229.35), accepting a returned check or notice of nonpayment (§§ 229.32(a) and 229.33(c)), or otherwise, the damages incurred by that person under § 229.38(a) shall be diminished in proportion to

the amount of negligence or bad faith attributable to that person.

(d) *Responsibility for certain aspects of checks*—(1) A paying bank, or in the case of a check payable through the paying bank and payable by another bank, the bank by which the check is payable, is responsible for damages under paragraph (a) of this section to the extent that the condition of the check when issued by it or its customer adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. A depositary bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the back of a check arising after the issuance of the check and prior to acceptance of the check by it adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. A reconverting bank is responsible for damages under paragraph (a) of this section to the extent that the condition of the back of a substitute check transferred, presented, or returned by it—

(i) Adversely affects the ability of a subsequent bank to indorse the check legibly in accordance with § 229.35; or

(ii) Causes an indorsement that previously was applied in accordance with § 229.35 to become illegible.

NOTE: Responsibility under this paragraph (d) shall be treated as negligence of the paying bank, depositary bank, or reconverting bank for purposes of paragraph (c) of this section.

(2) *Responsibility for payable through checks*. In the case of a check that is payable by a bank and payable through a paying bank located in a different check processing region than the bank by which the check is payable, the bank by which the check is payable is responsible for damages under paragraph (a) of this section, to the extent that the check is not returned to the depositary bank through the payable through bank as quickly as the check would have been required to be returned under § 229.30(a) had the bank by which the check is payable—

(i) Received the check as paying bank on the day the payable through bank received the check; and

(ii) Returned the check as paying bank in accordance with § 229.30(a)(1).

Responsibility under this paragraph shall be treated as negligence of the bank by which the check is payable for purposes of paragraph (c) of this section.

(e) *Timeliness of action*. If a bank is delayed in acting beyond the time limits set forth in this subpart because of interruption of communication or computer facilities, suspension of payments by a bank, war, emergency conditions, failure of equipment, or other circumstances beyond its control, its time for acting is extended for the time necessary to complete the action, if it exercises such diligence as the circumstances require.

(f) *Exclusion*. Section 229.21 of this part and section 611 (a), (b), and (c) of the EFA Act (12 U.S.C. 4010 (a), (b), and (c)) do not apply to this subpart.

(g) *Jurisdiction*. Any action under this subpart may be brought in any United States district court, or in any other court of competent jurisdiction, and shall be brought within one year after the date of the occurrence of the violation involved.

(h) *Reliance on Board rulings*. No provision of this subpart imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board, regardless of whether the rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason after the act or omission has occurred.

[53 FR 19433, May 27, 1988, as amended by Reg. CC, 54 FR 13850, Apr. 6, 1989; 54 FR 32047, Aug. 4, 1989; 69 FR 47311, Aug. 4, 2004]

### § 229.39 Insolvency of bank.

(a) *Duty of receiver*. A check or returned check in, or coming into, the possession of a paying, collecting, depositary, or returning bank that suspends payment, and which is not paid, shall be returned by the receiver, trustee, or agent in charge of the closed bank to the bank or customer that transferred the check to the closed bank.

(b) *Preference against paying or depositary bank*. If a paying bank finally pays a check, or if a depositary bank becomes obligated to pay a returned check, and suspends payment without

making a settlement for the check or returned check with the prior bank that is or becomes final, the prior bank has a preferred claim against the paying bank or the depositary bank.

(c) *Preference against collecting, paying, or returning bank.* If a collecting, paying, or returning bank receives settlement from a subsequent bank for a check or returned check, which settlement is or becomes final, and suspends payments without making a settlement for the check with the prior bank, which is or becomes final, the prior bank has a preferred claim against the collecting or returning bank.

(d) *Preference against presenting bank.* If a paying bank settles with a presenting bank for one or more checks, and if the presenting bank breaches a warranty specified in § 229.34(c) (1) or (3) with respect to those checks and suspends payments before satisfying the paying bank's warranty claim, the paying bank has a preferred claim against the presenting bank for the amount of the warranty claim.

(e) *Finality of settlement.* If a paying or depositary bank gives, or a collecting, paying, or returning bank gives or receives, a settlement for a check or returned check and thereafter suspends payment, the suspension does not prevent or interfere with the settlement becoming final if such finality occurs automatically upon the lapse of a certain time or the happening of certain events.

[Reg. CC, 53 FR 19433, May 27, 1988, as amended at 57 FR 46973, Oct. 14, 1992; Reg. CC, 62 FR 13810, Mar. 24, 1997]

### § 229.40 Effect of merger transaction.

(a) *In general.* For purposes of this subpart, two or more banks that have engaged in a merger transaction may be considered to be separate banks for a period of one year following the consummation of the merger transaction.

(b) *Merger transactions on or after July 1, 1998, and before March 1, 2000.* If banks have consummated a merger transaction on or after July 1, 1998, and before March 1, 2000, the merged banks may be considered separate banks until March 1, 2001.

[Reg. CC, 53 FR 19433, May 27, 1988, as amended at 64 FR 14577, Mar. 26, 1999]

### § 229.41 Relation to State law.

The provisions of this subpart supersede any inconsistent provisions of the U.C.C. as adopted in any state, or of any other state law, but only to the extent of the inconsistency.

### § 229.42 Exclusions.

The expeditious-return (§§ 229.30(a) and 229.31(a)), notice-of-nonpayment (§ 229.33), and same-day settlement (§ 229.36(f)) requirements of this subpart do not apply to a check drawn upon the United States Treasury, to a U.S. Postal Service money order, or to a check drawn on a state or a unit of general local government that is not payable through or at a bank.

[Reg. CC, 62 FR 13810, Mar. 24, 1997]

### § 229.43 Checks payable in Guam, American Samoa, and the Northern Mariana Islands.

(a) *Definitions.* The definitions in § 229.2 apply to this section, unless otherwise noted. In addition, for the purposes of this section—

(1) *Pacific island bank* means an office of an institution that would be a bank as defined in § 229.2(e) but for the fact that the office is located in Guam, American Samoa, or the Northern Mariana Islands;

(2) *Pacific island check* means a demand draft drawn on or payable through or at a Pacific island bank, which is not a check as defined in § 229.2(k).

(b) *Rules applicable to Pacific island checks.* To the extent a bank handles a Pacific island check as if it were a check defined in § 229.2(k), the bank is subject to the following sections of this part (and the word ''check'' in each such section is construed to include a Pacific island check)—

(1) § 229.31, except that the returning bank is not subject to the requirement to return a Pacific island check in an expeditious manner;

(2) § 229.32;

(3) § 229.34(c)(2), (c)(3), (d), (e), and (f);

(4) § 229.35; for purposes of § 229.35(c), the Pacific island bank is deemed to be a bank;

(5) § 229.36(d);

(6) § 229.37;

(7) § 229.38(a) and (c) through (h);

(8) § 229.39(a), (b), (c) and (e); and
(9) §§ 229.40 through 229.42.

[Reg. CC, 62 FR 13810, Mar. 24, 1997, as amended at 70 FR 71225, Nov. 28, 2005]

## Subpart D—Substitute Checks

AUTHORITY: 12 U.S.C. 5001–5018.

SOURCE: 69 FR 47311, Aug. 4, 2004, unless otherwise noted.

### § 229.51 General provisions governing substitute checks.

(a) *Legal equivalence.* A substitute check for which a bank has provided the warranties described in § 229.52 is the legal equivalent of an original check for all persons and all purposes, including any provision of federal or state law, if the substitute check—

(1) Accurately represents all of the information on the front and back of the original check as of the time the original check was truncated; and

(2) Bears the legend, ''This is a legal copy of your check. You can use it the same way you would use the original check.''

(b) *Reconverting bank duties.* A bank shall ensure that a substitute check for which it is the reconverting bank—

(1) Bears all indorsements applied by parties that previously handled the check in any form (including the original check, a substitute check, or another paper or electronic representation of such original check or substitute check) for forward collection or return;

(2) Identifies the reconverting bank in a manner that preserves any previous reconverting bank identifications, in accordance with ANS X9.100–140 and appendix D of this part; and

(3) Identifies the bank that truncated the original check, in accordance with ANS X9.100–140 and appendix D of this part.

(c) *Applicable law.* A substitute check that is the legal equivalent of an original check under paragraph (a) of this section shall be subject to any provision, including any provision relating to the protection of customers, of this part, the U.C.C., and any other applicable federal or state law as if such substitute check were the original check, to the extent such provision of law is not inconsistent with the Check 21 Act or this subpart.

### § 229.52 Substitute check warranties.

(a) *Content and provision of substitute check warranties.* A bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) for which it receives consideration warrants to the parties listed in paragraph (b) of this section that—

(1) The substitute check meets the requirements for legal equivalence described in § 229.51(a)(1)–(2); and

(2) No depositary bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, the substitute check, the original check, or a paper or electronic representation of the substitute check or original check such that that person will be asked to make a payment based on a check that it already has paid.

(b) *Warranty recipients.* A bank makes the warranties described in paragraph (a) of this section to the person to which the bank transfers, presents, or returns the substitute check or a paper or electronic representation of such substitute check and to any subsequent recipient, which could include a collecting or returning bank, the depositary bank, the drawer, the drawee, the payee, the depositor, and any indorser. These parties receive the warranties regardless of whether they received the substitute check or a paper or electronic representation of a substitute check.

### § 229.53 Substitute check indemnity.

(a) *Scope of indemnity.* A bank that transfers, presents, or returns a substitute check or a paper or electronic representation of a substitute check for which it receives consideration shall indemnify the recipient and any subsequent recipient (including a collecting or returning bank, the depositary bank, the drawer, the drawee, the payee, the depositor, and any indorser) for any loss incurred by any recipient of a substitute check if that loss occurred due to the receipt of a substitute check instead of the original check.

(b) *Indemnity amount*—(1) *In general.* Unless otherwise indicated by paragraph (b)(2) or (b)(3) of this section, the amount of the indemnity under paragraph (a) of this section is as follows:

(i) If the loss resulted from a breach of a substitute check warranty provided under § 229.52, the amount of the indemnity shall be the amount of any loss (including interest, costs, reasonable attorney's fees, and other expenses of representation) proximately caused by the warranty breach.

(ii) If the loss did not result from a breach of a substitute check warranty provided under § 229.52, the amount of the indemnity shall be the sum of—

(A) The amount of the loss, up to the amount of the substitute check; and

(B) Interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to the substitute check.

(2) *Comparative negligence.* (i) If a loss described in paragraph (a) of this section results in whole or in part from the indemnified person's negligence or failure to act in good faith, then the indemnity amount described in paragraph (b)(1) of this section shall be reduced in proportion to the amount of negligence or bad faith attributable to the indemnified person.

(ii) Nothing in this paragraph (b)(2) reduces the rights of a consumer or any other person under the U.C.C. or other applicable provision of state or federal law.

(3) *Effect of producing the original check or a sufficient copy*—

(i) If an indemnifying bank produces the original check or a sufficient copy, the indemnifying bank shall—

(A) Be liable under this section only for losses that are incurred up to the time that the bank provides that original check or sufficient copy to the indemnified person; and

(B) Have a right to the return of any funds it has paid under this section in excess of those losses.

(ii) The production by the indemnifying bank of the original check or a sufficient copy under paragraph (b)(3)(i) of this section shall not absolve the indemnifying bank from any liability under any warranty that the bank has provided under § 229.52 or other applicable law.

(c) *Subrogation of rights*—(1) *In general.* An indemnifying bank shall be subrogated to the rights of the person that it indemnifies to the extent of the indemnity it has provided and may attempt to recover from another person based on a warranty or other claim.

(2) *Duty of indemnified person for subrogated claims.* Each indemnified person shall have a duty to comply with all reasonable requests for assistance from an indemnifying bank in connection with any claim the indemnifying bank brings against a warrantor or other person related to a check that forms the basis for the indemnification.

### § 229.54 Expedited recredit for consumers.

(a) *Circumstances giving rise to a claim.* A consumer may make a claim under this section for a recredit with respect to a substitute check if the consumer asserts in good faith that—

(1) The bank holding the consumer's account charged that account for a substitute check that was provided to the consumer (although the consumer need not be in possession of that substitute check at the time he or she submits a claim);

(2) The substitute check was not properly charged to the consumer account or the consumer has a warranty claim with respect to the substitute check;

(3) The consumer suffered a resulting loss; and

(4) Production of the original check or a sufficient copy is necessary to determine whether or not the substitute check in fact was improperly charged or whether the consumer's warranty claim is valid.

(b) *Procedures for making claims.* A consumer shall make his or her claim for a recredit under this section with the bank that holds the consumer's account in accordance with the timing, content, and form requirements of this section.

(1) *Timing of claim.* (i) The consumer shall submit his or her claim such that the bank receives the claim by the end of the 40th calendar day after the later of the calendar day on which the bank mailed or delivered, by a means agreed to by the consumer—

(A) The periodic account statement that contains information concerning the transaction giving rise to the claim; or

(B) The substitute check giving rise to the claim.

(ii) If the consumer cannot submit his or her claim by the time specified in paragraph (b)(1)(i) of this section because of extenuating circumstances, the bank shall extend the 40-calendar-day period by an additional reasonable amount of time.

(iii) If a consumer makes a claim orally and the bank requires the claim to be in writing, the consumer's claim is timely if the oral claim was received within the time described in paragraphs (b)(1)(i)–(ii) of this section and the written claim was received within the time described in paragraph (b)(3)(ii) of this section.

(2) *Content of claim.* (i) The consumer's claim shall include the following information:

(A) A description of the consumer's claim, including the reason why the consumer believes his or her account was improperly charged for the substitute check or the nature of his or her warranty claim with respect to such check;

(B) A statement that the consumer suffered a loss and an estimate of the amount of that loss;

(C) The reason why production of the original check or a sufficient copy is necessary to determine whether or not the charge to the consumer's account was proper or the consumer's warranty claim is valid; and

(D) Sufficient information to allow the bank to identify the substitute check and investigate the claim.

(ii) If a consumer attempts to make a claim but fails to provide all the information in paragraph (b)(2)(i) of this section that is required to constitute a claim, the bank shall inform the consumer that the claim is not complete and identify the information that is missing.

(3) *Form and submission of claim; computation of time for bank action.* The bank holding the account that is the subject of the consumer's claim may, in its discretion, require the consumer to submit the information required by this section in writing. A bank that requires a written submission—

(i) May permit the consumer to submit the written claim electronically;

(ii) Shall inform a consumer who submits a claim orally of the written claim requirement at the time of the oral claim and may require such consumer to submit the written claim such that the bank receives the written claim by the 10th business day after the banking day on which the bank received the oral claim; and

(iii) Shall compute the time periods for acting on the consumer's claim described in paragraph (c) of this section from the date on which the bank received the written claim.

(c) *Action on claims.* A bank that receives a claim that meets the requirements of paragraph (b) of this section shall act as follows:

(1) *Valid consumer claim.* If the bank determines that the consumer's claim is valid, the bank shall—

(i) Recredit the consumer's account for the amount of the consumer's loss, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the business day after the banking day on which the bank makes that determination; and

(ii) Send to the consumer the notice required by paragraph (e)(1) of this section.

(2) *Invalid consumer claim.* If a bank determines that the consumer's claim is not valid, the bank shall send to the consumer the notice described in paragraph (e)(2) of this section.

(3) *Recredit pending investigation.* If the bank has not taken an action described in paragraph (c)(1) or (c)(2) of this section before the end of the 10th business day after the banking day on which the bank received the claim, the bank shall—

(i) By the end of that business day—

(A) Recredit the consumer's account for the amount of the consumer's loss, up to the lesser of the amount of the substitute check or $2,500, plus interest on that amount if the account is an interest-bearing account; and

(B) Send to the consumer the notice required by paragraph (e)(1) of this section; and

(ii) Recredit the consumer's account for the remaining amount of the consumer's loss, if any, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the 45th calendar day after the banking day on which the bank received the claim and send to the consumer the notice required by paragraph (e)(1) of this section, unless the bank prior to that time has determined that the consumer's claim is or is not valid in accordance with paragraph (c)(1) or (c)(2) of this section.

(4) *Reversal of recredit.* A bank may reverse a recredit that it has made to a consumer account under paragraph (c)(1) or (c)(3) of this section, plus interest that the bank has paid, if any, on that amount, if the bank—

(i) Determines that the consumer's claim was not valid; and

(ii) Notifies the consumer in accordance with paragraph (e)(3) of this section.

(d) *Availability of recredit*—(1) *Next-day availability.* Except as provided in paragraph (d)(2) of this section, a bank shall make any amount that it recredits to a consumer account under this section available for withdrawal no later than the start of the business day after the banking day on which the bank provides the recredit.

(2) *Safeguard exceptions.* A bank may delay availability to a consumer of a recredit provided under paragraph (c)(3)(i) of this section until the start of the earlier of the business day after the banking day on which the bank determines the consumer's claim is valid or the 45th calendar day after the banking day on which the bank received the oral or written claim, as required by paragraph (b) of this section, if—

(i) The consumer submits the claim during the 30-calendar-day period beginning on the banking day on which the consumer account was established;

(ii) Without regard to the charge that gave rise to the recredit claim—

(A) On six or more business days during the six-month period ending on the calendar day on which the consumer submitted the claim, the balance in the consumer account was negative or would have become negative if checks or other charges to the account had been paid; or

(B) On two or more business days during such six-month period, the balance in the consumer account was negative or would have become negative in the amount of $5,000 or more if checks or other charges to the account had been paid; or

(iii) The bank has reasonable cause to believe that the claim is fraudulent, based on facts that would cause a well-grounded belief in the mind of a reasonable person that the claim is fraudulent. The fact that the check in question or the consumer is of a particular class may not be the basis for invoking this exception.

(3) *Overdraft fees.* A bank that delays availability as permitted in paragraph (d)(2) of this section may not impose an overdraft fee with respect to drafts drawn by the consumer on such recredited funds until the fifth calendar day after the calendar day on which the bank sent the notice required by paragraph (e)(1) of this section.

(e) *Notices relating to consumer expedited recredit claims*—(1) *Notice of recredit.* A bank that recredits a consumer account under paragraph (c) of this section shall send notice to the consumer of the recredit no later than the business day after the banking day on which the bank recredits the consumer account. This notice shall describe—

(i) The amount of the recredit; and

(ii) The date on which the recredited funds will be available for withdrawal.

(2) *Notice that the consumer's claim is not valid.* If a bank determines that a substitute check for which a consumer made a claim under this section was in fact properly charged to the consumer account or that the consumer's warranty claim for that substitute check was not valid, the bank shall send notice to the consumer no later than the business day after the banking day on which the bank makes that determination. This notice shall—

(i) Include the original check or a sufficient copy, except as provided in § 229.58;

(ii) Demonstrate to the consumer that the substitute check was properly charged or the consumer's warranty claim is not valid; and

(iii) Include the information or documents (in addition to the original check or sufficient copy), if any, on which the bank relied in making its determination or a statement that the consumer may request copies of such information or documents.

(3) *Notice of a reversal of recredit.* A bank that reverses an amount it previously recredited to a consumer account shall send notice to the consumer no later than the business day after the banking day on which the bank made the reversal. This notice shall include the information listed in paragraph (e)(2) of this section and also describe—

(i) The amount of the reversal, including both the amount of the recredit (including the interest component, if any) and the amount of interest paid on the recredited amount, if any, being reversed; and

(ii) The date on which the bank made the reversal.

(f) *Other claims not affected.* Providing a recredit in accordance with this section shall not absolve the bank from liability for a claim made under any other provision of law, such as a claim for wrongful dishonor of a check under the U.C.C., or from liability for additional damages, such as damages under § 229.53 or § 229.56 of this subpart or U.C.C. 4–402.

**§ 229.55 Expedited recredit for banks.**

(a) *Circumstances giving rise to a claim.* A bank that has an indemnity claim under § 229.53 with respect to a substitute check may make an expedited recredit claim against an indemnifying bank if—

(1) The claimant bank or a bank that the claimant bank has indemnified—

(i) Has received a claim for expedited recredit from a consumer under § 229.54; or

(ii) Would have been subject to such a claim if the consumer account had been charged for the substitute check;

(2) The claimant bank is obligated to provide an expedited recredit with respect to such substitute check under § 229.54 or otherwise has suffered a resulting loss; and

(3) The production of the original check or a sufficient copy is necessary to determine the validity of the charge to the consumer account or the validity of any warranty claim connected with such substitute check.

(b) *Procedures for making claims.* A claimant bank shall send its claim to the indemnifying bank, subject to the timing, content, and form requirements of this section.

(1) *Timing of claim.* The claimant bank shall submit its claim such that the indemnifying bank receives the claim by the end of the 120th calendar day after the date of the transaction that gave rise to the claim.

(2) *Content of claim.* The claimant bank's claim shall include the following information—

(i) A description of the consumer's claim or the warranty claim related to the substitute check, including why the bank believes that the substitute check may not be properly charged to the consumer account;

(ii) A statement that the claimant bank is obligated to recredit a consumer account under § 229.54 or otherwise has suffered a loss and an estimate of the amount of that recredit or loss, including interest if applicable;

(iii) The reason why production of the original check or a sufficient copy is necessary to determine the validity of the charge to the consumer account or the warranty claim; and

(iv) Sufficient information to allow the indemnifying bank to identify the substitute check and investigate the claim.

(3) *Requirements relating to copies of substitute checks.* If the information submitted by a claimant bank under paragraph (b)(2) of this section includes a copy of any substitute check, the claimant bank shall take reasonable steps to ensure that the copy cannot be mistaken for the legal equivalent of the check under § 229.51(a) or sent or handled by any bank, including the indemnifying bank, for forward collection or return.

(4) *Form and submission of claim; computation of time.* The indemnifying bank may, in its discretion, require the claimant bank to submit the information required by this section in writing, including a copy of the paper or electronic claim submitted by the consumer, if any. An indemnifying bank that requires a written submission—

(i) May permit the claimant bank to submit the written claim electronically;

(ii) Shall inform a claimant bank that submits a claim orally of the written claim requirement at the time of the oral claim; and

(iii) Shall compute the 10-day time period for acting on the claim described in paragraph (c) of this section from the date on which the bank received the written claim.

(c) *Action on claims*. No later than the 10th business day after the banking day on which the indemnifying bank receives a claim that meets the requirements of paragraph (b) of this section, the indemnifying bank shall—

(1) Recredit the claimant bank for the amount of the claim, up to the amount of the substitute check, plus interest if applicable;

(2) Provide to the claimant bank the original check or a sufficient copy; or

(3) Provide information to the claimant bank regarding why the indemnifying bank is not obligated to comply with paragraph (c)(1) or (c)(2) of this section.

(d) *Recredit does not abrogate other liabilities*. Providing a recredit to a claimant bank under this section does not absolve the indemnifying bank from liability for claims brought under any other law or from additional damages under § 229.53 or § 229.56.

(e) *Indemnifying bank's right to a refund*. (1) If a claimant bank reverses a recredit it previously made to a consumer account under § 229.54 or otherwise receives reimbursement for a substitute check that formed the basis of its claim under this section, the claimant bank shall provide a refund promptly to any indemnifying bank that previously advanced funds to the claimant bank. The amount of the refund to the indemnifying bank shall be the amount of the reversal or reimbursement obtained by the claimant bank, up to the amount previously advanced by the indemnifying bank.

(2) If the indemnifying bank provides the claimant bank with the original check or a sufficient copy under paragraph (c)(2) of this section, § 229.53(b)(3) governs the indemnifying bank's entitlement to repayment of any amount provided to the claimant bank that exceeds the amount of losses the claimant bank incurred up to that time.

**§ 229.56 Liability.**

(a) *Measure of damages*—(1) *In general*. Except as provided in paragraph (a)(2) or (a)(3) of this section or § 229.53, any person that breaches a warranty described in § 229.52 or fails to comply with any requirement of this subpart with respect to any other person shall be liable to that person for an amount equal to the sum of—

(i) The amount of the loss suffered by the person as a result of the breach or failure, up to the amount of the substitute check; and

(ii) Interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to the substitute check.

(2) *Offset of recredits*. The amount of damages a person receives under paragraph (a)(1) of this section shall be reduced by any amount that the person receives and retains as a recredit under § 229.54 or § 229.55.

(3) *Comparative negligence*. (i) If a person incurs damages that resulted in whole or in part from that person's negligence or failure to act in good faith, then the amount of any damages due to that person under paragraph (a)(1) of this section shall be reduced in proportion to the amount of negligence or bad faith attributable to that person.

(ii) Nothing in this paragraph (a)(3) reduces the rights of a consumer or any other person under the U.C.C. or other applicable provision of federal or state law.

(b) *Timeliness of action*. Delay by a bank beyond any time limits prescribed or permitted by this subpart is excused if the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank and if the bank uses such diligence as the circumstances require.

(c) *Jurisdiction*. A person may bring an action to enforce a claim under this subpart in any United States district court or in any other court of competent jurisdiction. Such claim shall be brought within one year of the date on

which the person's cause of action accrues. For purposes of this paragraph, a cause of action accrues as of the date on which the injured person first learns, or by which such person reasonably should have learned, of the facts and circumstances giving rise to the cause of action, including the identity of the warranting or indemnifying bank against which the action is brought.

(d) *Notice of claims.* Except as otherwise provided in this paragraph (d), unless a person gives notice of a claim under this section to the warranting or indemnifying bank within 30 calendar days after the person has reason to know of both the claim and the identity of the warranting or indemnifying bank, the warranting or indemnifying bank is discharged from liability in an action to enforce a claim under this subpart to the extent of any loss caused by the delay in giving notice of the claim. A timely recredit claim by a consumer under § 229.54 constitutes timely notice under this paragraph.

### § 229.57 Consumer awareness.

(a) *General disclosure requirement and content.* Each bank shall provide, in accordance with paragraph (b) of this section, a brief disclosure to each of its consumer customers that describes—

(1) That a substitute check is the legal equivalent of an original check; and

(2) The consumer recredit rights that apply when a consumer in good faith believes that a substitute check was not properly charged to his or her account.

(b) *Distribution*—(1) *Disclosure to consumers who receive paid checks with periodic account statements.* A bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer who receives paid original checks or paid substitute checks with his or her periodic account statement—

(i) No later than the first regularly scheduled communication with the consumer after October 28, 2004, for each consumer who is a customer of the bank on that date; and

(ii) At the time the customer relationship is initiated, for each customer relationship established after October 28, 2004.

(2) *Disclosure to consumers who receive substitute checks on an occasional basis*—(i) The bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer of the bank who requests an original check or a copy of a check and receives a substitute check. If feasible, the bank shall provide this disclosure at the time of the consumer's request; otherwise, the bank shall provide this disclosure no later than the time at which the bank provides a substitute check in response to the consumer's request.

(ii) The bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer of the bank who receives a returned substitute check, at the time the bank provides such substitute check.

(3) *Multiple account holders.* A bank need not give separate disclosures to each customer on a jointly held account.

### § 229.58 Mode of delivery of information.

A bank may deliver any notice or other information that it is required to provide under this subpart by United States mail or by any other means through which the recipient has agreed to receive account information. If a bank is required to provide an original check or a sufficient copy, the bank instead may provide an electronic image of the original check or sufficient copy if the recipient has agreed to receive that information electronically.

### § 229.59 Relation to other law.

The Check 21 Act and this subpart supersede any provision of federal or state law, including the Uniform Commercial Code, that is inconsistent with the Check 21 Act or this subpart, but only to the extent of the inconsistency.

### § 229.60 Variation by agreement.

Any provision of § 229.55 may be varied by agreement of the banks involved. No other provision of this subpart may be varied by agreement by any person or persons.

## APPENDIX A TO PART 229—ROUTING NUMBER GUIDE TO NEXT-DAY AVAILABILITY CHECKS AND LOCAL CHECKS

A. Each bank is assigned a routing number by an agent of the American Bankers Association. The routing number takes two forms: a fractional form and a nine-digit form. A paying bank generally is identified on the face of a check by its routing number in both the fractional form (which generally appears in the upper right-hand corner of the check) and the nine-digit form (which is printed in magnetic ink along the bottom of the check). Where a check is payable by one bank but payable through another bank, the routing number appearing on the check is that of the payable-through bank, not the payor bank.

B. The first four digits of the nine-digit routing number (and the denominator of the fractional routing number) form the ''Federal Reserve routing symbol,'' and the first two digits of the routing number identify the Federal Reserve District in which the bank is located. Thus, 01 will be the first two digits of the routing number of a bank in the First Federal Reserve District (Boston), and 12 will be the first two digits of the routing number of a bank in the Twelfth District (San Francisco). Adding 2 to the first digit denotes a thrift institution. Thus, 21 identifies a thrift in the First District, and 32 denotes a thrift in the Twelfth District.

C. Each Federal Reserve check-processing office is listed below, followed by the Federal Reserve routing symbols of the banks that are located within the check-processing region served by that office. Because some check-processing regions cross Federal Reserve District lines, there are some cases in which banks in different Federal Reserve Districts are located in the same check-processing region and therefore considered local to each other. For example, banks in Fairfield County, Connecticut are located in the Second District and have Second District routing symbols (0211 or 2211), but the head office of the Federal Reserve Bank of Philadelphia processes the checks of these banks. Thus, as indicated below, checks drawn on banks with 0211 or 2211 routing numbers would be local for banks served by the head office of the Federal Reserve Bank of Philadelphia.

### THIRD FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Philadelphia]

*Head Office*

| | |
|---|---|
| 0110[1] | 0115 |
| 0111 | 0116 |
| 0112 | 0117 |
| 0113 | 0118 |
| 0114 | 0119 |
| 0210 | 2115 |
| 0211 | 2116 |
| 0212 | 2117 |
| 0213 | 2118 |
| 0214 | 2119 |
| 0215 | 2210 |
| 0216 | 2211 |
| 0219 | 2212 |
| 0260 | 2213 |
| 0280 | 2214 |
| 0310 | 2215 |
| 0311 | 2216 |
| 0312 | 2219 |
| 0313 | 2260 |
| 0319 | 2280 |
| 0360 | 2310 |
| 2110 | 2311 |
| 2111 | 2312 |
| 2112 | 2313 |
| 2113 | 2319 |
| 2114 | 2360 |

### FOURTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Cleveland]

*Head Office*

| | |
|---|---|
| 0220 | 2220 |
| 0223 | 2223 |
| 0410 | 2410 |
| 0412 | 2412 |
| 0420 | 2420 |
| 0421 | 2421 |
| 0422 | 2422 |
| 0423 | 2423 |
| 0430 | 2430 |
| 0432 | 2432 |
| 0433 | 2433 |
| 0434 | 2434 |
| 0440 | 2440 |
| 0441 | 2441 |
| 0442 | 2442 |
| 0515 | 2515 |
| 0519 | 2519 |
| 0720 | 2720 |
| 0724 | 2724 |
| 0740 | 2740 |
| 0749 | 2749 |
| 0813 | 2813 |
| 0830 | 2830 |
| 0839 | 2839 |
| 0863 | 2863 |

[1] The first two digits identify the bank's Federal Reserve District. For example, 01 identifies the First Federal Reserve District (Boston), and 12 identifies the Twelfth District (San Francisco). Adding 2 to the first digit denotes a thrift institution. For example, 21 identifies a thrift in the First District, and 32 denotes a thrift in the Twelfth District.

FIFTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Richmond]

*Baltimore Branch*

| | |
|---|---|
| 0510 | 2510 |
| 0514 | 2514 |
| 0520 | 2520 |
| 0521 | 2521 |
| 0522 | 2522 |
| 0540 | 2540 |
| 0550 | 2550 |
| 0560 | 2560 |
| 0570 | 2570 |

*Charlotte Branch*

| | |
|---|---|
| 0530 | 2530 |
| 0531 | 2531 |
| 0532 | 2532 |
| 0539 | 2539 |

SIXTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Atlanta]

*Head Office*

| | |
|---|---|
| 0610 | 2610 |
| 0611 | 2611 |
| 0612 | 2612 |
| 0613 | 2613 |
| 0620 | 2620 |
| 0621 | 2621 |
| 0622 | 2622 |
| 0630 | 2630 |
| 0631 | 2631 |
| 0632 | 2632 |
| 0640 | 2640 |
| 0641 | 2641 |
| 0642 | 2642 |
| 0650 | 2650 |
| 0651 | 2651 |
| 0652 | 2652 |
| 0653 | 2653 |
| 0654 | 2654 |
| 0655 | 2655 |
| 0660 | 2660 |
| 0670 | 2670 |
| 0820 | 2820 |
| 0829 | 2829 |
| 0840 | 2840 |
| 0841 | 2841 |
| 0842 | 2842 |
| 0843 | 2843 |

SEVENTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Chicago]

*Head Office*

| | |
|---|---|
| 0710 | 2710 |
| 0711 | 2711 |
| 0712 | 2712 |
| 0719 | 2719 |
| 0750 | 2750 |
| 0759 | 2759 |

*Des Moines Office*

| | |
|---|---|
| 0730 | 2730 |
| 0739 | 2739 |
| 1040 | 3040 |
| 1041 | 3041 |
| 1049 | 3049 |

EIGHTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of St. Louis]

*Head Office*

| | |
|---|---|
| 0810 | 2810 |
| 0812 | 2812 |
| 0815 | 2815 |
| 0819 | 2819 |
| 0865 | 2865 |

NINTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Minneapolis]

*Head Office*

| | |
|---|---|
| 0910 | 2910 |
| 0911 | 2911 |
| 0912 | 2912 |
| 0913 | 2913 |
| 0914 | 2914 |
| 0915 | 2915 |
| 0918 | 2918 |
| 0919 | 2919 |
| 0960 | 2960 |

TENTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Kansas City]

*Denver Branch*

| | |
|---|---|
| 0920 | 2920 |
| 0921 | 2921 |
| 0929 | 2929 |
| 1020 | 3020 |
| 1021 | 3021 |
| 1022 | 3022 |
| 1023 | 3023 |
| 1070 | 3070 |
| 1240 | 3240 |
| 1241 | 3241 |
| 1242 | 3242 |
| 1243 | 3243 |

ELEVENTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Dallas]

*Head Office*

| | |
|---|---|
| 1010 | 1119 |
| 1011 | 1120 |
| 1012 | 1122 |
| 1019 | 1123 |
| 1030 | 1130 |
| 1031 | 1131 |
| 1039 | 1140 |
| 1110 | 1149 |
| 1111 | 1163 |
| 1113 | 3010 |

| | |
|---|---|
| 3011 | 3119 |
| 3012 | 3120 |
| 3019 | 3122 |
| 3030 | 3123 |
| 3031 | 3130 |
| 3039 | 3131 |
| 3110 | 3140 |
| 3111 | 3149 |
| 3113 | 3163 |

TWELFTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of San Francisco]

*Los Angeles Branch*

| | |
|---|---|
| 1210 | 3210 |
| 1211 | 3211 |
| 1212 | 3212 |
| 1213 | 3213 |
| 1220 | 3220 |
| 1221 | 3221 |
| 1222 | 3222 |
| 1223 | 3223 |
| 1224 | 3224 |

*Seattle Branch*

| | |
|---|---|
| 1230 | 3230 |
| 1231 | 3231 |
| 1232 | 3232 |
| 1233 | 3233 |
| 1250 | 3250 |
| 1251 | 3251 |
| 1252 | 3252 |

*U.S. Treasury Checks*

| | |
|---|---|
| 0000 0050 5 | 0000 0051 8 |

*Postal Money Orders*

| | |
|---|---|
| 0000 0119 3 | 0000 0800 2 |

FEDERAL RESERVE BANKS

| | |
|---|---|
| 0110 0001 5 | 0720 0029 0 |
| 0111 0048 1 | 0730 0033 8 |
| 0210 0120 8 | 0740 0020 1 |
| 0212 0400 5 | 0750 0012 9 |
| 0213 0500 1 | 0810 0004 5 |
| 0220 0026 6 | 0820 0013 8 |
| 0310 0004 0 | 0830 0059 3 |
| 0410 0001 4 | 0840 0003 9 |
| 0420 0043 7 | 0910 0008 0 |
| 0430 0030 0 | 0920 0026 7 |
| 0440 0050 3 | 1010 0004 8 |
| 0510 0003 3 | 1020 0019 9 |
| 0519 0002 3 | 1030 0024 0 |
| 0520 0027 8 | 1040 0012 6 |
| 0530 0020 6 | 1110 0003 8 |
| 0539 0008 9 | 1120 0001 1 |
| 0610 0014 6 | 1130 0004 9 |
| 0620 0019 0 | 1140 0072 1 |
| 0630 0019 9 | 1210 0037 4 |
| 0640 0010 1 | 1220 0016 6 |
| 0650 0021 0 | 1230 0001 3 |
| 0660 0010 9 | 1240 0031 3 |
| 0710 0030 1 | 1250 0001 1 |
| 0711 0711 0 | |

FEDERAL HOME LOAN BANKS

| | |
|---|---|
| 0110 0053 6 | 0740 0101 9 |
| 0212 0639 1 | 0810 0091 9 |
| 0260 0973 9 | 0910 0091 2 |
| 0410 0291 5 | 1010 0091 2 |
| 0420 0091 6 | 1011 0194 7 |
| 0430 0143 5 | 1110 1083 7 |
| 0430 1862 2 | 1119 1083 0 |
| 0610 0876 6 | 1210 0070 1 |
| 0710 0450 1 | 1240 0287 4 |
| 0730 0091 4 | 1250 0050 3 |

[53 FR 19433, May 27, 1988]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting appendix A to part 229, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

EFFECTIVE DATE NOTE: 1. At 73 FR 70591, Nov. 21, 2008, appendix A to part 229 was amended by revising the Seventh District routing symbol list, effective Jan. 31, 2009. For the convenience of the user, the revised text is set forth as follows:

## APPENDIX A TO PART 229—ROUTING NUMBER GUIDE TO NEXT-DAY AVAILABILITY CHECKS AND LOCAL CHECKS

* * * * *

SEVENTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Chicago]

*Head Office*

| | |
|---|---|
| 0710 | 2710 |
| 0711 | 2711 |
| 0712 | 2712 |
| 0719 | 2719 |
| 0730 | 2730 |
| 0739 | 2739 |
| 0750 | 2750 |
| 0759 | 2759 |
| 1040 | 3040 |
| 1041 | 3041 |
| 1049 | 3049 |

2. At 73 FR 77492, Dec. 19, 2008, appendix A to part 229 was amended by removing the headings and listings for the Eighth Federal Reserve District and revising the listings for the Sixth Federal Reserve District, effective Feb 21, 2009. For the convenience of the user, the revised text is set forth as follows:

## APPENDIX A TO PART 229—ROUTING NUMBER GUIDE TO NEXT-DAY AVAILABILITY CHECKS AND LOCAL CHECKS

* * * * *

SIXTH FEDERAL RESERVE DISTRICT

[Federal Reserve Bank of Atlanta]

*Head office*

| | |
|---|---|
| 0610 | 2610 |
| 0611 | 2611 |
| 0612 | 2612 |
| 0613 | 2613 |
| 0620 | 2620 |
| 0621 | 2621 |
| 0622 | 2622 |
| 0630 | 2630 |
| 0631 | 2631 |
| 0632 | 2632 |
| 0640 | 2640 |
| 0641 | 2641 |
| 0642 | 2642 |
| 0650 | 2650 |
| 0651 | 2651 |
| 0652 | 2652 |
| 0653 | 2653 |
| 0654 | 2654 |
| 0655 | 2655 |
| 0660 | 2660 |
| 0670 | 2670 |
| 0810 | 2810 |
| 0812 | 2812 |
| 0815 | 2815 |
| 0819 | 2819 |
| 0820 | 2820 |
| 0829 | 2829 |
| 0840 | 2840 |
| 0841 | 2841 |
| 0842 | 2842 |
| 0843 | 2843 |
| 0865 | 2865 |

* * * * *

## APPENDIX B TO PART 229 [RESERVED]

## APPENDIX C TO PART 229—MODEL AVAILABILITY POLICY DISCLOSURES, CLAUSES, AND NOTICES; MODEL SUBSTITUTE CHECK POLICY DISCLOSURE AND NOTICES

This appendix contains model availability policy and substitute check policy disclosures, clauses, and notices to facilitate compliance with the disclosure and notice requirements of Regulation CC (12 CFR part 229). Although use of these models is not required, banks using them properly (with the exception of models C–22 through C–25) to make disclosures required by Regulation CC are deemed to be in compliance.

*Model Availability Policy Disclosures*

C–1 Next-day availability
C–2 Next-day availability and §229.13 exceptions
C–3 Next-day availability, case-by-case holds to statutory limits, and §229.13 exceptions
C–4 Holds to statutory limits on all deposits (includes chart)
C–5 Holds to statutory limits on all deposits
C–5A Substitute check policy disclosure

*Model Clauses*

C–6 Holds on other funds (check cashing)
C–7 Holds on other funds (other account)
C–8 Appendix B availability (nonlocal checks)
C–9 Automated teller machine deposits (extended hold)
C–10 Cash withdrawal limitation
C–11 Credit union interest payment policy
C–11A Availability of Funds Deposited at Other Locations

*Model Notices*

C–12 Exception hold notice
C–13 Reasonable cause hold notice
C–14 One-time notice for large deposit and redeposited check exception holds
C–15 One-time notice for repeated overdraft exception holds
C–16 Case-by-case hold notice
C–17 Notice at locations where employees accept consumer deposits
C–18 Notice at locations where employees accept consumer deposits (case-by-case holds)
C–19 Notice at automated teller machines
C–20 Notice at automated teller machines (delayed receipt)
C–21 Deposit slip notice
C–22 Expedited Recredit Claim, Valid Claim Refund Notice
C–23 Expedited Recredit Claim, Provisional Refund Notice
C–24 Expedited Recredit Claim, Denial Notice
C–25 Expedited Recredit Claim, Reversal Notice

*Model Availability Policy Disclosures*

C–1—Next-Day Availability

Your Ability To Withdraw Funds

Our policy is to make funds from your cash and check deposits available to you on the first business day after the day we receive your deposit. Electronic direct deposits will be available on the day we receive the deposit. Once the funds are available, you can withdraw them in cash and we will use them to pay checks that you have written.

For determining the availability of your deposits, every day is a business day, except Saturdays, Sundays, and federal holidays. If you make a deposit before (*time of day*) on a business day that we are open, we will consider that day to be the day of your deposit. However, if you make a deposit after (*time of*

*day*) or on a day we are not open, we will consider that the deposit was made on the next business day we are open.

C–2—Next-day availability and § 229.13 exceptions

Your Ability To Withdraw Funds

Our policy is to make funds from your cash and check deposits available to you on the first business day after the day we receive your deposit. Electronic direct deposits will be available on the day we receive the deposit. Once they are available, you can withdraw the funds in cash and we will use the funds to pay checks that you have written.

For determining the availability of your deposits, every day is a business day, except Saturdays, Sundays, and federal holidays. If you make a deposit before (*time of day*) on a business day that we are open, we will consider that day to be the day of your deposit. However, if you make a deposit after (*time of day*) or on a day we are not open, we will consider that the deposit was made on the next business day we are open.

Longer Delays May Apply

Funds you deposit by check may be delayed for a longer period under the following circumstances:

• We believe a check you deposit will not be paid.

• You deposit checks totaling more than $5,000 on any one day.

• You redeposit a check that has been returned unpaid.

• You have overdrawn your account repeatedly in the last six months.

• There is an emergency, such as failure of computer or communications equipment.

We will notify you if we delay your ability to withdraw funds for any of these reasons, and we will tell you when the funds will be available. They will generally be available no later than the (*number*) business day after the day of your deposit.

Special Rules for New Accounts

If you are a new customer, the following special rules will apply during the first 30 days your account is open.

Funds from electronic direct deposits to your account will be available on the day we receive the deposit. Funds from deposits of cash, wire transfers, and the first $5,000 of a day's total deposits of cashier's, certified, teller's, traveler's, and federal, state and local government checks will be available on the first business day after the day of your deposit if the deposit meets certain conditions. For example, the checks must be payable to you (and you may have to use a special deposit slip). The excess over $5,000 will be available on the ninth business day after the day of your deposit. If your deposit of these checks (other than a U.S. Treasury check) is not made in person to one of our employees, the first $5,000 will not be available until the second business day after the day of your deposit.

Funds from all other check deposits will be available on the (*number*) business day after the day of your deposit.

C–3—Next-Day Availability, Case-by-Case Holds to Statutory Limits, and § 229.13 Exceptions

Your Ability To Withdraw Funds

Our policy is to make funds from your cash and check deposits available to you on the first business day after the day we receive your deposit. Electronic direct deposits will be available on the day we receive the deposit. Once they are available, you can withdraw the funds in cash and we will use the funds to pay checks that you have written.

For determining the availability of your deposits, every day is a business day, except Saturdays, Sundays, and federal holidays. If you make a deposit before (*time of day*) on a business day that we are open, we will consider that day to be the day of your deposit. However, if you make a deposit after (*time of day*) or on a day we are not open, we will consider that the deposit was made on the next business day we are open.

Longer Delays May Apply

In some cases, we will not make all of the funds that you deposit by check available to you on the first business day after the day of your deposit. Depending on the type of check that you deposit, funds may not be available until the fifth business day after the day of your deposit. The first $100 of your deposits, however, may be available on the first business day.

If we are not going to make all of the funds from your deposit available on the first business day, we will notify you at the time you make your deposit. We will also tell you when the funds will be available. If your deposit is not made directly to one of our employees, or if we decide to take this action after you have left the premises, we will mail you the notice by the day after we receive your deposit.

If you will need the funds from a deposit right away, you should ask us when the funds will be available.

In addition, funds you deposit by check may be delayed for a longer period under the following circumstances:

• We believe a check you deposit will not be paid.

• You deposit checks totaling more than $5,000 on any one day.

• You redeposit a check that has been returned unpaid.

• You have overdrawn your account repeatedly in the last six months.

• There is an emergency, such as failure of computer or communications equipment.

We will notify you if we delay your ability to withdraw funds for any of these reasons, and we will tell you when the funds will be available. They will generally be available no later than the (*number*) business day after the day of your deposit.

Special Rules for New Accounts

If you are a new customer, the following special rules will apply during the first 30 days your account is open.

Funds from electronic direct deposits to your account will be available on the day we receive the deposit. Funds from deposits of cash, wire transfers, and the first $5,000 of a day's total deposits of cashier's, certified, teller's, traveler's, and federal, state and local government checks will be available on the first business day after the day of your deposit if the deposit meets certain conditions. For example, the checks must be payable to you (and you may have to use a special deposit slip). The excess over $5,000 will be available on the ninth business day after the day of your deposit. If your deposit of these checks (other than a U.S. Treasury check) is not made in person to one of our employees, the first $5,000 will not be available until the second business day after the day of your deposit.

Funds from all other check deposits will be available on the (*number*) business day after the day of your deposit.

C–4—Holds to Statutory Limits On All Deposits (Includes Chart)

Your Ability To Withdraw Funds

Our policy is to delay the availability of funds from your cash and check deposits. During the delay, you may not withdraw the funds in cash and we will not use the funds to pay checks that you have written.

Determining the Availability of a Deposit

The length of the delay is counted in business days from the day of your deposit. Every day is a business day except Saturdays, Sundays, and federal holidays. If you make a deposit before (*time of day*) on a business day that we are open, we will consider that day to be the day of your deposit. However, if you make a deposit after (*time of day*) or on a day we are not open, we will consider that the deposit was made on the next business day we are open.

The length of the delay varies depending on the type of deposit and is explained below.

Same-Day Availability

Funds from electronic direct deposits to your account will be available on the day we receive the deposit.

Next-Day Availability

Funds from the following deposits are available on the first business day after the day of your deposit:

• U.S. Treasury checks that are payable to you.

• Wire transfers.

• Checks drawn on (*bank name*) [unless (*any limitations related to branches in different states or check processing regions*)].

If you make the deposit in person to one of our employees, funds from the following deposits are also available on the first business day after the day of your deposit:

• Cash.

• State and local government checks that are payable to you [if you use a special deposit slip available from (*where deposit slip may be obtained*)].

• Cashier's, certified, and teller's checks that are payable to you [if you use a special deposit slip available from (*where deposit slip may be obtained*)].

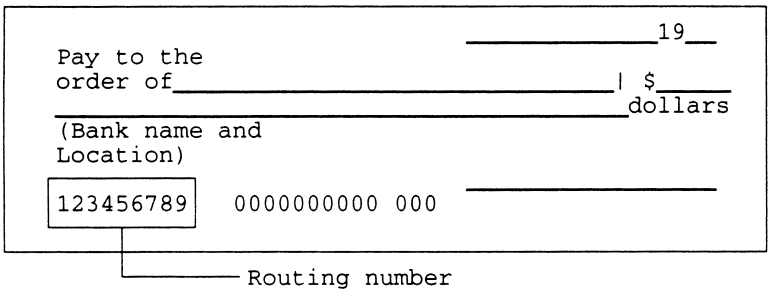
• Federal Reserve Bank checks, Federal Home Loan Bank checks, and postal money orders, if these items are payable to you.

If you do not make your deposit in person to one of our employees (for example, if you mail the deposit), funds from these deposits will be available on the second business day after the day we receive your deposit.

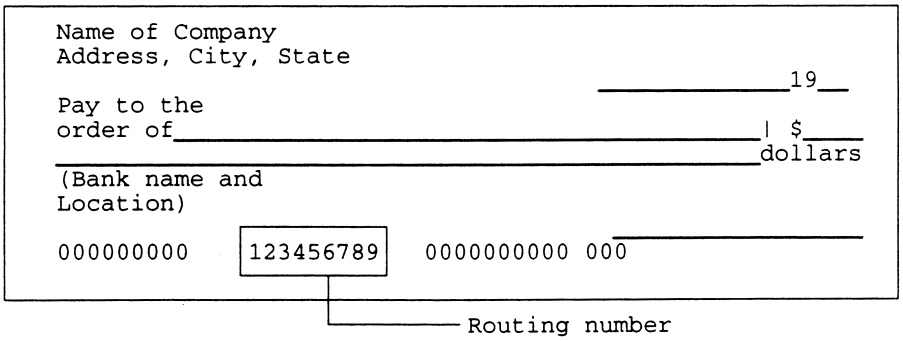
Other Check Deposits

To find out when funds from other check deposits will be available, look at the first four digits of the routing number on the check:

Personal Check




Business Check




Some checks are marked ''payable through'' and have a four-or nine-digit number nearby. For these checks, use this four-digit number (or the first four digits of the nine-digit number), not the routing number on the bottom of the check, to determine if these checks are local or nonlocal. Once you have determined the first four digits of the routing number (1234 in the examples above), the following chart will show you when funds from the check will be available:

| First four digits from routing number | When funds are available | When funds are available if a deposit is made on a Monday |
|---|---|---|
| [local numbers] | $100 on the first business day after the day of your deposit. | Tuesday. |
| | Remaining funds on the second business day after the day of your deposit. | Wednesday. |
| All other numbers | $100 on the first business day after the day of your deposit. | Tuesday. |
| | Remaining funds on the fifth business day after the day of your deposit. | Monday of the following week. |

If you deposit both categories of checks, $100 from the checks will be available on the first business day after the day of your deposit, not $100 from each category of check.

Longer Delays May Apply

Funds you deposit by check may be delayed for a longer period under the following circumstances:

- We believe a check you deposit will not be paid.
- You deposit checks totaling more than $5,000 on any one day.
- You redeposit a check that has been returned unpaid.
- You have overdrawn your account repeatedly in the last six months.

• There is an emergency, such as failure of computer or communications equipment.

We will notify you if we delay your ability to withdraw funds for any of these reasons, and we will tell you when the funds will be available. They will generally be available no later than the (*number*) business day after the day of your deposit.

Special Rules for New Accounts

If you are a new customer, the following special rules will apply during the first 30 days your account is open.

Funds from electronic direct deposits to your account will be available on the day we receive the deposit. Funds from deposits of cash, wire transfers, and the first $5,000 of a day's total deposits of cashier's, certified, teller's, traveler's, and federal, state and local government checks will be available on the first business day after the day of your deposit if the deposit meets certain conditions. For example, the checks must be payable to you (and you may have to use a special deposit slip). The excess over $5,000 will be available on the ninth business day after the day of your deposit. If your deposit of these checks (other than a U.S. Treasury check) is not made in person to one of our employees, the first $5,000 will not be available until the second business day after the day of your deposit.

Funds from all other check deposits will be available on the (*number*) business day after the day of your deposit.

C–5—Holds to Statutory Limits on All Deposits

Your Ability To Withdraw Funds

Our policy is to delay the availability of funds from your cash and check deposits. During the delay, you may not withdraw the funds in cash and we will not use the funds to pay checks that you have written.

Determining the Availability Of A Deposit

The length of the delay is counted in business days from the day of your deposit. Every day is a business day except Saturdays, Sundays, and federal holidays. If you make a deposit before (*time of day*) on a business day that we are open, we will consider that day to be the day of your deposit. However, if you make a deposit after (*time of day*) or on a day we are not open, we will consider that the deposit was made on the next business day we are open.

The length of the delay varies depending on the type of deposit and is explained below.

Same-Day Availability

Funds from electronic direct deposits to your account will be available on the day we receive the deposit.

Next-Day Availability

Funds from the following deposits are available on the first business day after the day of your deposit:

• U.S. Treasury checks that are payable to you.

• Wire transfers.

• Checks drawn on (*bank name*) [unless (*any limitations related to branches in different states or check processing regions*)].

If you make the deposit in person to one of our employees, funds from the following deposits are also available on the first business day after the day of your deposit:

• Cash.

• State and local government checks that are payable to you [if you use a special deposit slip available from (*where deposit slip may be obtained*)].

• Cashier's, certified, and teller's checks that are payable to you [if you use a special deposit slip available from (*where deposit slip may be obtained*)].

• Federal Reserve Bank checks, Federal Home Loan Bank checks, and postal money orders, if these items are payable to you.

If you do not make your deposit in person to one of our employees (for example, if you mail the deposit), funds from these deposits will be available on the second business day after the day we receive your deposit.

Other Check Deposits

The delay for other check deposits depends on whether the check is a local or a nonlocal check. To see whether a check is a local or a nonlocal check, look at the routing number on the check:

Personal Check

```
                                        _____19__
   Pay to the
   order of_____________________________| $____
   ____________________________________dollars
   (Bank name and
   Location)
                                        _________________
   [123456789] 0000000000 000
```

Routing number

Business Check

```
Name of Company
Address, City, State

                                        _____19__

   Pay to the
   order of_____________________________| $____
   ____________________________________dollars
   (Bank name and
   Location)

                                        _________________

 000000000 [123456789] 0000000000 000
```

Routing number

If the first four digits of the routing number (1234 in the examples above) are (*list of local numbers*), then the check is a local check. Otherwise, the check is a nonlocal check. Some checks are marked ''payable through'' and have a four- or nine-digit number nearby. For these checks, use the four-digit number (or the first four digits of the nine-digit number), not the routing number on the bottom of the check, to determine if these checks are local or nonlocal. Our policy is to make funds from local and nonlocal checks available as follows.

1. Local checks. The first $100 from a deposit of local checks will be available on the first business day after the day of your deposit. The remaining funds will be available on the second business day after the day of your deposit.

For example, if you deposit a local check of $700 on a Monday, $100 of the deposit is available on Tuesday. The remaining $600 is available on Wednesday.

2. Nonlocal checks. The first $100 from a deposit of nonlocal checks will be available on the first business day after the day of your deposit. The remaining funds will be available on the fifth business day after the day of your deposit.

For example, if you deposit a $700 nonlocal check on a Monday, $100 of the deposit is available on Tuesday. The remaining $600 is available on Monday of the following week.

3. Local and nonlocal checks. If you deposit both categories of checks, $100 from the

checks will be available on the first business day after the day of your deposit, not $100 from each category of check.

Longer Delays May Apply

Funds you deposit by check may be delayed for a longer period under the following circumstances:

• We believe a check you deposit will not be paid.

• You deposit checks totaling more than $5,000 on any one day.

• You redeposit a check that has been returned unpaid.

• You have overdrawn your account repeatedly in the last six months.

• There is an emergency, such as failure of computer or communications equipment.

We will notify you if we delay your ability to withdraw funds for any of these reasons, and we will tell you when the funds will be available. They will generally be available no later than the (*number*) business day after the day of your deposit.

Special Rules For New Accounts

If you are a new customer, the following special rules will apply during the first 30 days your account is open.

Funds from electronic direct deposits to your account will be available on the day we receive the deposit. Funds from deposits of cash, wire transfers, and the first $5,000 of a day's total deposits of cashier's, certified, teller's, traveler's, and federal, state and local government checks will be available on the first business day after the day of your deposit if the deposit meets certain conditions. For example, the checks must be payable to you (and you may have to use a special deposit slip). The excess over $5,000 will be available on the ninth business day after the day of your deposit. If your deposit of these checks (other than a U.S. Treasury check) is not made in person to one of our employees, the first $5,000 will not be available until the second business day after the day of your deposit.

Funds from all other check deposits will be available on the (*number*) business day after the day of your deposit.

C–5A—Substitute Check Policy Disclosure

Substitute Checks and Your Rights—[Important Information About Your Checking Account]

Substitute Checks and Your Rights

What Is a Substitute Check?

To make check processing faster, federal law permits banks to replace original checks with ''substitute checks.'' These checks are similar in size to original checks with a slightly reduced image of the front and back of the original check. The front of a substitute check states: ''This is a legal copy of your check. You can use it the same way you would use the original check.'' You may use a substitute check as proof of payment just like the original check.

Some or all of the checks that you receive back from us may be substitute checks. This notice describes rights you have when you receive substitute checks from us. The rights in this notice do not apply to original checks or to electronic debits to your account. However, you have rights under other law with respect to those transactions.

What Are My Rights Regarding Substitute Checks?

In certain cases, federal law provides a special procedure that allows you to request a refund for losses you suffer if a substitute check is posted to your account (for example, if you think that we withdrew the wrong amount from your account or that we withdrew money from your account more than once for the same check). The losses you may attempt to recover under this procedure may include the amount that was withdrawn from your account and fees that were charged as a result of the withdrawal (for example, bounced check fees).

The amount of your refund under this procedure is limited to the amount of your loss or the amount of the substitute check, whichever is less. You also are entitled to interest on the amount of your refund if your account is an interest-bearing account. If your loss exceeds the amount of the substitute check, you may be able to recover additional amounts under other law.

If you use this procedure, you may receive up to (*amount, not lower than $2,500*) of your refund (plus interest if your account earns interest) within (*number of days, not more than 10*) business days after we received your claim and the remainder of your refund (plus interest if your account earns interest) not later than (*number of days, not more than 45*) calendar days after we received your claim.

We may reverse the refund (including any interest on the refund) if we later are able to demonstrate that the substitute check was correctly posted to your account.

How Do I Make a Claim for a Refund?

If you believe that you have suffered a loss relating to a substitute check that you received and that was posted to your account, please contact us at (*contact information, for example phone number, mailing address, e-mail address*). You must contact us within (*number of days, not less than 40*) calendar days of the date that we mailed (or otherwise delivered by a means to which you agreed) the substitute check in question or the account statement showing that the substitute check was posted to your account, whichever is later. We will extend this time period if you

were not able to make a timely claim because of extraordinary circumstances.

Your claim must include—

• A description of why you have suffered a loss (for example, you think the amount withdrawn was incorrect);

• An estimate of the amount of your loss;

• An explanation of why the substitute check you received is insufficient to confirm that you suffered a loss; and

• A copy of the substitute check [and/or] the following information to help us identify the substitute check: (*identifying information, for example the check number, the name of the person to whom you wrote the check, the amount of the check*).

*Model Clauses*

C–6—Holds on Other Funds (Check Cashing)

If we cash a check for you that is drawn on another bank, we may withhold the availability of a corresponding amount of funds that are already in your account. Those funds will be available at the time funds from the check we cashed would have been available if you had deposited it.

C–7—Holds on Other Funds (Other Account)

If we accept for deposit a check that is drawn on another bank, we may make funds from the deposit available for withdrawal immediately but delay your availability to withdraw a corresponding amount of funds that you have on deposit in another account with us. The funds in the other account would then not be available for withdrawal until the time periods that are described elsewhere in this disclosure for the type of check that you deposited.

C–8—Appendix B Availability (Nonlocal Checks)

*3. Certain other checks.* We can process nonlocal checks drawn on financial institutions in certain areas faster than usual. Therefore, funds from deposits of checks drawn on institutions in those areas will be available to you more quickly. Call us if you would like a list of the routing numbers for these institutions.

C–9—Automated Teller Machine Deposits (Extended Hold)

Deposits at Automated Teller Machines

Funds from any deposits (cash or checks) made at automated teller machines (ATMs) we do not own or operate will not be available until the fifth business day after the day of your deposit. This rule does not apply at ATMs that we own or operate.

(*A list of our ATMs is enclosed.* or *A list of ATMs where you can make deposits but that are not owned or operated by us is enclosed.* or *All ATMs that we own or operate are identified as our machines.*)

C–10—Cash Withdrawal Limitation

Cash Withdrawal Limitation

We place certain limitations on withdrawals in cash. In general, $100 of a deposit is available for withdrawal in cash on the first business day after the day of deposit. In addition, a total of $400 of other funds becoming available on a given day is available for withdrawal in cash at or after (*time no later than 5:00 p.m.*) on that day. Any remaining funds will be available for withdrawal in cash on the following business day.

C–11—Credit Union Interest Payment Policy

*Interest Payment Policy*

If we receive a deposit to your account on or before the tenth of the month, you begin earning interest on the deposit (whether it was a deposit of cash or checks) as of the first day of that month. If we receive the deposit after the tenth of the month, you begin earning interest on the deposit as of the first of the following month. For example, a deposit made on June 7 earns interest from June 1, while a deposit made on June 17 earns interest from July 1.

C–11A—Availability of Funds Deposited at Other Locations

Deposits at Other Locations

This availability policy only applies to funds deposited at (*location*). Please inquire for information about the availability of funds deposited at other locations.

*Model Notices*

C–12—Exception Hold Notice

Notice of Hold

Account number: (*number*)
Date of deposit: (*date*)

We are delaying the availability of (*amount being held*) from this deposit. These funds will be available on the (*number*) business day after the day of your deposit.

We are taking this action because:

—A check you deposited was previously returned unpaid.
—You have overdrawn your account repeatedly in the last six months.
—The checks you deposited on this day exceed $5,000.
—An emergency, such as failure of computer or communications equipment, has occurred.
—We believe a check you deposited will not be paid for the following reasons [*]:

_____

_____

[*If you did not receive this notice at the time you made the deposit and the check you deposited is paid, we will refund to you any fees for overdrafts or returned checks that result solely from the additional delay that we are imposing. To obtain a refund of such fees, (*description of procedure for obtaining refund)*.]

C–13—Reasonable Cause Hold Notice

Notice of Hold

Account number: (*number*)
Date of deposit: (*date*)

We are delaying the availability of the funds you deposited by the following check: (*description of check, such as amount and drawer*.)

These funds will be available on the (*number*) business day after the day of your deposit. The reason for the delay is explained below:

—We received notice that the check is being returned unpaid.
—We have confidential information that indicates that the check may not be paid.
—The check is drawn on an account with repeated overdrafts.
—We are unable to verify the endorsement of a joint payee.
—Some information on the check is not consistent with other information on the check.
—There are erasures or other apparent alterations on the check.
—The routing number of the paying bank is not a current routing number.
—The check is postdated or has a stale date.
—Information from the paying bank indicates that the check may not be paid.
—We have been notified that the check has been lost or damaged in collection.
—Other:

[If you did not receive this notice at the time you made the deposit and the check you deposited is paid, we will refund to you any fees for overdrafts or returned checks that result solely from the additional delay that we are imposing. To obtain a refund of such fees, (*description of procedure for obtaining refund*).]

C–14—One-Time Notice for Large Deposit and Redeposited Check Exception Holds

Notice of Hold

If you deposit into your account:

• Checks totaling more than $5,000 on any one day, the first $5,000 deposited on any one banking day will be available to you according to our general policy. The amount in excess of $5,000 will generally be available on the (*number*) business day after the day of deposit for checks drawn on (*bank name*), the (*number*) business day after the day of deposit for local checks and (*number*) business day after the day of deposit for nonlocal checks. If checks (not drawn on us) that otherwise would receive next-day availability exceed $5,000, the excess will be treated as either local or nonlocal checks depending on the location of the paying bank. If your check deposit, exceeding $5,000 on any one day, is a mix of local checks, nonlocal checks, checks drawn on (*bank name*), or checks that generally receive next-day availability, the excess will be calculated by first adding together the (*type of check*), then the (*type of check*), then the (*type of check*), then the (*type of check*).

• A check that has been returned unpaid, the funds will generally be available on the (*number*) business day after the day of deposit for checks drawn on (*bank name*), the (*number*) business day after the day of deposit for local checks and the (*number*) business day after the day of deposit for nonlocal checks. Checks (not drawn on us) that otherwise would receive next-day availability will be treated as either local or nonlocal checks depending on the location of the paying bank.

C–15—One-Time Notice for Repeated Overdraft Exception Hold

Notice of Hold

Account Number: (*number*) Date of Notice: (*date*)

We are delaying the availability of checks deposited into your account due to repeated overdrafts of your account. For the next six months, deposits will generally be available on the (*number*) business day after the day of your deposit for checks drawn on (*bank name*), the (*number*) business day after the day of your deposit for local checks, and the (*number*) business day after the day of deposit for nonlocal checks. Checks (not drawn on us) that otherwise would have received next-day availability will be treated as either local or nonlocal checks depending on the location of the paying bank.

C–16—Case-by-Case Hold Notice

Notice of Hold

Account number: (*number*)
Date of deposit: (*date*)

We are delaying the availability of (*amount being held*) from this deposit. These funds will be available on the (*number*) business day after the day of your deposit [(*subject to our cash withdrawal limitation policy*)].

[If you did not receive this notice at the time you made the deposit and the check you deposited is paid, we will refund to you any fees for overdrafts or returned checks that result solely from the additional delay

that we are imposing. To obtain a refund of such fees, (*description of procedure for obtaining refund*).]

C–17—Notice at locations where employees accept consumer deposits

*FUNDS AVAILABILITY POLICY*

| Description of deposit | When funds can be withdrawn by cash or check |
|---|---|
| Direct deposits | The day we receive the deposit |
| Cash, wire transfers, cashier's, certified, teller's, or government checks, checks on (*bank name*) [unless (*any limitation related to branches in different check processing regions*)], and the first $100 of a day's deposits of other checks. | The first business day after the day of deposit. |
| Local checks | The second business day after the day of deposit. |
| Nonlocal checks | The fifth business day after the day of deposit. |

C–18—Notice at locations where employees accept consumer deposits (case-by-case holds)

*FUNDS AVAILABILITY POLICY*

Our general policy is to allow you to withdraw funds deposited in your account on the (*number*) business day after the day we receive your deposit. Funds from electronic direct deposits will be available on the day we receive the deposit. In some cases, we may delay your ability to withdraw funds beyond the (*number*) business day. Then, the funds will generally be available by the fifth business day after the day of deposit.

C–19—Notice at Automated Teller Machines

*AVAILABILITY OF DEPOSITS*

Funds from deposits may not be available for immediate withdrawal. Please refer to your institution's rules governing funds availability for details.

C–20—Notice at Automated Teller Machines (Delayed Receipt)

*NOTICE*

Deposits at this ATM between (*day*) and (*day*) will not be considered received until (*day*). The availability of funds from the deposit may be delayed as a result.

C–21—Deposit Slip Notice

Deposits may not be available for immediate withdrawal.

C–22—Expedited Recredit Claim, Valid Claim Refund Notice

*Notice of Valid Claim and Refund*

We have determined that your substitute check claim is valid. We are refunding (*amount*) [of which [(*amount*) represents fees] [and] [(*amount*) represents accrued interest]] to your account. You may withdraw these funds as of (*date*). [This refund is the amount in excess of the $2,500 [plus interest] that we credited to your account on (*date*).]

C–23—Expedited Recredit Claim, Provisional Refund Notice

*Notice of Provisional Refund*

In response to your substitute check claim, we are refunding (*amount*) [of which [(*amount*) represents fees] [and] [(*amount*) represents accrued interest]] to your account, while we complete our investigation of your claim. You may withdraw these funds as of (*date*). [Unless we determine that your claim is not valid, we will credit the remaining amount of your refund to your account no later than the 45th calendar day after we received your claim.]

If, based on our investigation, we determine that your claim is not valid, we will reverse the refund by withdrawing the amount of the refund [plus interest that we have paid you on that amount] from your account. We will notify you within one day of any such reversal.

C–24—Expedited Recredit Claim, Denial Notice

*Denial of Claim*

Based on our review, we are denying your substitute check claim. As the enclosed (*type of document, for example original check or sufficient) shows, (describe reason for denial, for example the check was properly posted, the signature is authentic, there was no warranty breach*).

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the other information that we used to make our decision.]

C–25—Expedited Recredit Claim, Reversal Notice

*Reversal of Refund*

In response to your substitute check claim, we provided a refund of (*amount*) by crediting your account on (*date(s)*). We now have determined that your substitute check claim was not valid. As the enclosed (*type of document, for example original check or sufficient copy*) shows, (*describe reason for reversal, for example the check was properly posted, the signature is authentic, there was no warranty breach*). As a result, we have reversed the refund to your

account [plus interest that we have paid you on that amount] by withdrawing (*amount*) from your account on (*date*).

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the information we used to make our decision.]

[53 FR 19433, May 27, 1988, as amended at 53 FR 31293, Aug. 18, 1988; Reg. CC, 55 FR 21855, May 30, 1990; 55 FR 50818, Dec. 11, 1990; 56 FR 7802, Feb. 26, 1991; 57 FR 3280, Jan. 29, 1992; 60 FR 51671, Oct. 3, 1995; 62 FR 13811, Mar. 24, 1997; 62 FR 48752, Sept. 17, 1997; 69 FR 47315, 47316, Aug. 4, 2004]

## APPENDIX D TO PART 229—INDORSEMENT, RECONVERTING BANK IDENTIFICATION, AND TRUNCATING BANK IDENTIFICATION STANDARDS

(1) The depositary bank shall indorse an original check or substitute check according to the following specifications:

(i) The indorsement shall contain—

(A) The bank's nine-digit routing number, set off by an arrow at each end of the number and pointing toward the number, and, if the depositary bank is a reconverting bank with respect to the check, an asterisk outside the arrow at each end of the routing number to identify the bank as a reconverting bank;

(B) The indorsement date; and

(C) The bank's name or location, if the depositary bank applies the indorsement physically.

(ii) The indorsement also may contain—

(A) A branch identification;

(B) A trace or sequence number;

(C) A telephone number for receipt of notification of large-dollar returned checks; and

(D) Other information, provided that the inclusion of such information does not interfere with the readability of the indorsement.

(iii) The indorsement, if applied to an existing paper check, shall be placed on the back of the check so that the routing number is wholly contained in the area 3.0 inches from the leading edge of the check to 1.5 inches from the trailing edge of the check.[31]

(iv) When printing its depositary bank indorsement (or a depositary bank indorsement that previously was applied electronically) onto a substitute check at the time that the substitute check is created, a reconverting bank shall place the indorsement on the back of the check between 1.88 and 2.74 inches from the leading edge of the check. The reconverting bank may omit the depositary bank's name and location from the indorsement.

(2) Each subsequent collecting bank or returning bank indorser shall protect the identifiability and legibility of the depositary bank indorsement by indorsing an original check or substitute check according to the following specifications:

(i) The indorsement shall contain only—

(A) The bank's nine-digit routing number (without arrows) and, if the collecting bank or returning bank is a reconverting bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconverting bank;

(B) The indorsement date, and

(C) An optional trace or sequence number.

(ii) The indorsement, if applied to an existing paper check, shall be placed on the back of the check from 0.0 inches to 3.0 inches from the leading edge of the check.

(iii) When printing its collecting bank or returning bank indorsement (or a collecting bank or returning bank indorsement that previously was applied electronically) onto a substitute check at the time that the substitute check is created, a reconverting bank shall place the indorsement on the back of the check between 0.25 and 2.50 inches from the trailing edge of the check.

(3) A reconverting bank shall comply with the following specifications when creating a substitute check:

(i) If it is a depositary bank, collecting bank, or returning bank with respect to the substitute check, the reconverting bank shall place its own indorsement onto the back of the check as specified in this appendix.

(ii) A reconverting bank that also is the paying bank with respect to the substitute check shall so identify itself by placing on the back of the check, between 0.25 and 2.50 inches from the trailing edge of the check, its nine-digit routing number (without arrows) and an asterisk at each end of the number.

(iii) The reconverting bank shall place on the front of the check, outside the image of the original check, its nine-digit routing number (without arrows) and an asterisk at each end of the number, in accordance with ANS X9.100–140.

(iv) The reconverting bank shall place on the front of the check, outside the image of the original check, the truncating bank's nine-digit routing number (without arrows) and a bracket at each end of the number, in accordance with ANS X9.100–140.

(4) Any indorsement, reconverting bank identification, or truncating bank identification placed on an original check or substitute check shall be printed in black ink.

[69 FR 47316, Aug. 4, 2004]

[31] The leading edge is definded as the right side of the check looking at it from the front. The trailing edge is defined as the left side of the check looking at it from the front. *See* American National Standards Specifications for the Placement and Location of MICR Printing, X9.13.

## APPENDIX E TO PART 229—COMMENTARY

### *I. Introduction*

#### A. Background

1. The Board interpretations, which are labeled ''Commentary'' and follow each section of Regulation CC (12 CFR Part 229), provide background material to explain the Board's intent in adopting a particular part of the regulation; the Commentary also provides examples to aid in understanding how a particular requirement is to work. Under section 611(e) of the Expedited Funds Availability Act (12 U.S.C. 4010(e)), no provision of section 611 imposing any liability shall apply to any act done or omitted in good faith conformity with any rule, regulation, or interpretation thereof by the Board of Governors of the Federal Reserve System, notwithstanding the fact that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason. The Commentary is an ''interpretation'' of a regulation by the Board within the meaning of section 611.

### *II. Section 229.2 Definitions*

#### A. Background

1. Section 229.2 defines the terms used in the regulation. For the most part, terms are defined as they are in section 602 of the Expedited Funds Availability Act (12 U.S.C. 4001). The Board has made a number of changes for the sake of clarity, to conform the terminology to that which is familiar to the banking industry, to define terms that are not defined in the EFA Act, and to carry out the purposes of the EFA Act. The Board also has incorporated by reference the definitions of the Uniform Commercial Code where appropriate. Some of Regulation CC's definitions are self-explanatory and therefore are not discussed in this Commentary.

#### B. 229.2(a) Account

1. The EFA Act defines account to mean ''a demand deposit account or similar transaction account at a depository institution.'' The regulation defines account, for purposes other than subpart D, in terms of the definition of ''transaction account'' in the Board's Regulation D (12 CFR part 204). This definition of account, however, excludes certain deposits, such as nondocumentary obligations (see 12 CFR 204.2(a)(1)(vii)), that are covered under the definition of ''transaction account'' in Regulation D. The definition applies to accounts with general third party payment powers but does not cover time deposits or savings deposits, including money market deposit accounts, even though they may have limited third party payment powers. The Board believes that it is appropriate to exclude these accounts because of the reference to demand deposits in the EFA Act, which suggests that the EFA Act is intended to apply only to accounts that permit unlimited third party transfers.

2. The term account also differs from the definition of transaction account in Regulation D because the term account refers to accounts held at banks. Under Subparts A and C, the term bank includes not only any depository institution, as defined in the EFA Act, but also any person engaged in the business of banking, such as a Federal Reserve Bank, a Federal Home Loan Bank, or a private banker that is not subject to Regulation D. Thus, accounts at these institutions benefit from the expeditious return requirements of Subpart C.

3. Interbank deposits, including accounts of offices of domestic banks or foreign banks located outside the United States, and direct and indirect accounts of the United States Treasury (including Treasury General Accounts and Treasury Tax and Loan deposits) are exempt from subpart B and, in connection therewith, subpart A. However, interbank deposits are included as accounts for purposes of subparts C and D and, in connection therewith, subpart A.

4. The Check 21 Act defines account to mean any deposit account at a bank. Therefore, for purposes of subpart D and, in connection therewith, subpart A, account means any deposit, as that term is defined by § 204.2(a)(1)(i) of Regulation D, at a bank. Many deposits that are not accounts for purposes of the other subparts of Regulation CC, such as savings deposits, are accounts for purposes of subpart D.

#### C. 229.2(b) Automated Clearinghouse (ACH)

1. The Board has defined automated clearinghouse as a facility that processes debit and credit transfers under rules established by a Federal Reserve Bank operating circular governing automated clearinghouse items or the rules of an ACH association. ACH credit transfers are included in the definition of electronic payment.

2. The reference to ''debit and credit transfers'' does not refer to the corresponding debit and credit entries that are part of the same transaction, but to different kinds of ACH payments. In an ACH credit transfer, the originator orders that its account be debited and another account credited. In an ACH debit transfer, the originator, with prior authorization, orders another account to be debited and the originator's account to be credited.

3. A facility that handles only wire transfers (defined elsewhere) is not an ACH.

#### D. 229.2(c) Automated Teller Machine (ATM)

1. ATM is not defined in the EFA Act. The regulation defines an ATM as an electronic

device at which a natural person may make deposits to an account by cash or check and perform other account transactions. Point-of-sale terminals, machines that only dispense cash, night depositories, and lobby deposit boxes are not ATMs within the meaning of the definition, either because they do not accept deposits of cash or checks (e.g., point-of-sale terminals and cash dispensers) or because they only accept deposits (e.g., night depositories and lobby boxes) and cannot perform other transactions. A lobby deposit box or similar receptacle in which written payment orders or deposits may be placed is not an ATM.

2. A facility may be an ATM within this definition even if it is a branch under state or federal law, although an ATM is not a branch as that term is used in this regulation.

E. 229.2(d) Available for Withdrawal

1. Under this definition, when funds become available for withdrawal, the funds may be put to all uses for which the customer may use actually and finally collected funds in the customer's account under the customer's account agreement with the bank. Examples of such uses include payment of checks drawn on the account, certification of checks, electronic payments, and cash withdrawals. Funds are available for these uses notwithstanding provisions of other law that may restrict the use of uncollected funds (e.g., 18 U.S.C. 1004; 12 U.S.C. 331).

2. If a bank makes funds available to a customer for a specific purpose (such as paying checks that would otherwise overdraw the customer's account and be returned for insufficient funds) before the funds must be made available under the bank's policy or this regulation, it may nevertheless apply a hold consistent with this regulation to those funds for other purposes (such as cash withdrawals). For purposes of this regulation, funds are considered available for withdrawal even though they are being held by the bank to satisfy an obligation of the customer other than the customer's potential liability for the return of the check. For example, a bank does not violate its obligations under this subpart by holding funds to satisfy a garnishment, tax levy, or court order restricting disbursements from the account; or to satisfy the customer's liability arising from the certification of a check, sale of a cashier's or teller's check, guaranty or acceptance of a check, or similar transaction to be debited from the customer's account.

F. 229.2(e) Bank

1. The EFA Act uses the term depository institution, which it defines by reference to section 19(b)(1)(A)(i) through (vi) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)(i) through (vi)). This regulation uses the term bank, a term that conforms to the usage the Board has previously adopted in Regulation J. Bank is also used in Articles 4 and 4A of the Uniform Commercial Code.

2. Bank is defined to include depository institutions, such as commercial banks, savings banks, savings and loan associations, and credit unions as defined in the EFA Act, and U.S. branches and agencies of foreign banks. For purposes of Subpart B, the term does not include corporations organized under section 25A of the Federal Reserve Act, 12 U.S.C. 611–631 (Edge corporations) or corporations having an agreement or undertaking with the Board under section 25 of the Federal Reserve Act, 12 U.S.C. 601–604a (agreement corporations). For purposes of Subparts C and D, and in connection therewith, Subpart A, any Federal Reserve Bank, Federal Home Loan Bank, or any other person engaged in the business of banking is regarded as a bank. The phrase ''any other person engaged in the business of banking'' is derived from U.C.C. 1–201(4), and is intended to cover entities that handle checks for collection and payment, such as Edge and agreement corporations, commercial lending companies under 12 U.S.C. 3101, certain industrial banks, and private bankers, so that virtually all checks will be covered by the same rules for forward collection and return, even though they may not be covered by the requirements of Subpart B. For the purposes of Subparts C and D, and in connection therewith, Subpart A, the term also may include a state or a unit of general local government to the extent that it pays warrants or other drafts drawn directly on the state or local government itself, and the warrants or other drafts are sent to the state or local government for payment or collection.

3. Unless otherwise specified, the term bank includes all of a bank's offices in the United States. The regulation does not cover foreign offices of U.S. banks.

4. For purposes of subpart D and, in connection therewith, subpart A, the term bank also includes the Treasury of the United States and the United States Postal Service to the extent that they act as paying banks because the Check 21 Act includes these two entities in the definition of the term bank to the extent that they act as payors.

G. 229.2(f) Banking Day and (g) Business Day

1. The EFA Act defines business day as any day excluding Saturdays, Sundays, and legal holidays. Legal holiday, however, is not defined, and the variety of local holidays, together with the practice of some banks to close midweek, makes the EFA Act's definition difficult to apply. The Board believes that two kinds of business days are relevant. First, when determining the day when funds are deposited or when a bank must perform

certain actions (such as returning a check), the focus should be on a day that the bank is actually open for business. Second, when counting days for purposes of determining when funds must be available under the regulation or when notice of nonpayment must be received by the depositary bank, there would be confusion and uncertainty in trying to follow the schedule of a particular bank, and there is less need to identify a day when a particular bank is open. Most banks that act as intermediaries (large correspondents and Federal Reserve Banks) follow the same holiday schedule. Accordingly, the regulation has two definitions: Business day generally follows the standard Federal Reserve Bank holiday schedule (which is followed by most large banks), and banking day is defined to mean that part of a business day on which a bank is open for substantially all of its banking activities.

2. The definition of banking day corresponds to the definition of banking day in U.C.C. 4–104(a)(3), except that a banking day is defined in terms of a business day. Thus, if a bank is open on Saturday, Saturday might be a banking day for purposes of the U.C.C., but it would not be a banking day for purposes of Regulation CC because Saturday is never a business day under the regulation.

3. The definition of banking day is phrased in terms of when ''an office of a bank is open'' to indicate that a bank may observe a banking day on a per-branch basis. A deposit made at an ATM or off-premise facility (such as a remote depository or a lock box) is considered made at the branch holding the account into which the deposit is made for the purpose of determining the day of deposit. All other deposits are considered made at the branch at which the deposit is received. For example, under §229.19(a)(1), funds deposited at an ATM are considered deposited at the time they are received at the ATM. On a calendar day that is a banking day for the branch or other location of the depositary bank at which the account is maintained, a deposit received at an ATM before the ATM's cut-off hour is considered deposited on that banking day, and a deposit received at an ATM after the ATM's cut-off hour is considered deposited on the next banking day of the branch or other location where the account is maintained. On a calendar day that is not a banking day for the account-holding location, all ATM deposits are considered deposited on that location's next banking day. This rule for determining the day of deposit also would apply to a deposit to an off-premise facility, such as a night depository or lock box, which is considered deposited when removed from the facility and available for processing under §229.19(a)(3). If an unstaffed facility, such as a night depository or lock box, is on branch premises, the day of deposit is determined by the banking day at the branch at which the deposit is received, whether or not it is the branch at which the account is maintained.

H. 229.2(h) Cash

1. Cash means U.S. coins and currency. The phrase in the EFA Act ''including Federal Reserve notes'' has been deleted as unnecessary. (See 31 U.S.C. 5103.)

I. 229.2(i) Cashier's Check

1. The regulation adds to the second item in the EFA Act's definition of cashier's check the phrase, ''on behalf of the bank as drawer,'' to clarify that the term cashier's check is intended to cover only checks that a bank draws on itself. The definition of cashier's check includes checks provided to a customer of the bank in connection with customer deposit account activity, such as account disbursements and interest payments. The definition also includes checks acquired from a bank by noncustomers for remittance purposes, such as certain loan disbursement checks. Cashier's checks provided to customers or others are often labeled as ''cashier's check,'' ''officer's check,'' or ''official check.'' The definition excludes checks that a bank draws on itself for other purposes, such as to pay employees and vendors, and checks issued by the bank in connection with a payment service, such as a payroll or a bill-paying service. Cashier's checks generally are sold by banks to substitute the bank's credit for the customer's credit and thereby enhance the collectibility of the checks. A check issued in connection with a payment service generally is provided as a convenience to the customer rather than as a guarantee of the check's collectibility. In addition, such checks are often more difficult to distinguish from other types of checks than are cashier's checks as defined by this regulation.

J. 229.2(j) Certified Check

1. The EFA Act defines a certified check as one to which a bank has certified that the drawer's signature is genuine and that the bank has set aside funds to pay the check. Under the Uniform Commercial Code, certification of a check means the bank's signed agreement that it will honor the check as presented (U.C.C. 3–409). The regulation defines certified check to include both the EFA Act's and U.C.C.'s definitions.

K. 229.2(k) Check

1. Check is defined in section 602(7) of the EFA Act as a negotiable demand draft drawn on or payable through an office of a depository institution located in the United States, excluding noncash items. The regulation includes six categories of instruments within the definition of check.

2. The first category is negotiable demand drafts drawn on, or payable through or at, an

office of a bank. As the definition of bank includes only offices located in the United States, this category is limited to checks drawn on, or payable through or at, a banking office located in the United States.

3. The EFA Act treats drafts payable through a bank as checks, even though under the U.C.C. the payable-through bank is a collecting bank to make presentment and generally is not authorized to make payment (U.C.C. 4–106(a)). The EFA Act does not expressly address items that are payable at a bank. This regulation treats both payable-through and payable-at demand drafts as checks. The Board believes that treating demand drafts payable at a bank as checks will not have a substantial effect on the operations of payable-at banks—by far the largest proportion of payable-at items are not negotiable demand drafts, but time items, such as commercial paper, bonds, notes, bankers' acceptances, and securities. These time items are not covered by the requirements of the EFA Act or this regulation. (The treatment of payable-through drafts is discussed in greater detail in connection with the definitions of local check and paying bank.)

4. The second category is checks drawn on Federal Reserve Banks and Federal Home Loan Banks. Principal and interest payments on federal debt instruments often are paid with checks drawn on a Federal Reserve Bank as fiscal agent of the United States, and these fiscal agency checks are indistinguishable from other checks drawn on Federal Reserve Banks. (See 31 CFR Part 355.) Federal Reserve Bank checks also are used by some banks as substitutes for cashier's or teller's checks. Similarly, savings and loan associations often use checks drawn on Federal Home Loan Banks as teller's checks. The definition of check includes checks drawn on Federal Home Loan Banks and Federal Reserve Banks because in many cases they are the functional equivalent of Treasury checks or teller's checks.

5. The third and fourth categories of instrument included in the definition of check refer to government checks. The EFA Act refers to checks drawn on the U.S. Treasury, even though these instruments are not drawn on or payable through an office of a depository institution, and checks drawn by state and local governments. The EFA Act also gives the Board authority to define functionally equivalent instruments as depository checks.[1] Thus, the EFA Act is intended to apply to instruments other than those that meet the strict definition of check in section 602(7) of the EFA Act. Checks and warrants drawn by states and local governments often are used for the purposes of making unemployment compensation payments and other payments that are important to the recipients. Consequently, the Board has expressly defined check to include drafts drawn on the U.S. Treasury and drafts or warrants drawn by a state or a unit of general local government on itself.

6. The fifth category of instrument included in the definition of check is U.S. Postal Service money orders. These instruments are defined as checks because they often are used as a substitute for checks by consumers, even though money orders are not negotiable under Postal Service regulations. The Board has not provided specific rules for other types of money orders; these instruments generally are drawn on or payable through or payable at banks and are treated as checks on that basis.

7. The sixth and final category of instrument included in the definition of check is traveler's checks drawn on or payable through or at a bank. Traveler's check is defined in paragraph (hh) of this section.

8. Finally, for the purposes of Subparts C and D, and in connection therewith, Subpart A, the definition of check includes nonnegotiable demand drafts because these instruments are often handled as cash items in the forward collection process.

9. A substitute check as defined in §229.2(aaa) is a check for purposes of Regulation CC and the U.C.C., even if that substitute check does not meet the requirements for legal equivalence set forth in §229.51(a).

10. The definition of check does not include an instrument payable in a foreign currency (i.e., other than in United States money as defined in 31 U.S.C. 5101) or a credit card draft (i.e., a sales draft used by a merchant or a draft generated by a bank as a result of a cash advance), or an ACH debit transfer. The definition of check includes a check that a bank may supply to a customer as a means of accessing a credit line without the use of a credit card.

L. 229.2(l) [Reserved]

M. 229.2(m) Check Processing Region

1. The EFA Act defines this term as ''the geographic area served by a Federal Reserve bank check processing center or such larger area as the Board may prescribe by regulations.'' The Board has defined check processing region as the territory served by one of the Federal Reserve head offices, branches, or regional check processing centers. Appendix A includes a list of routing numbers arranged by Federal Reserve Bank office. The definition of check processing region is key to determining whether a check is considered local or nonlocal.

[1] Section 602(11) of the EFA Act (12 U.S.C. 4001(11)) defines ''depository check'' as ''any cashier's check, certified check, teller's check, and any other functionally equivalent instrument as determined by the Board.''

N. 229.2(n) Consumer Account

1. Consumer account is defined as an account used primarily for personal, family, or household purposes. An account that does not meet the definition of consumer account is a nonconsumer account. A clearing account maintained at a bank directly by a brokerage firm is not a consumer account, even if the account is used to pay checks drawn by consumers using the funds in that account. The bank's relationship is with the brokerage firm, and the account is used by the brokerage firm to facilitate the clearing of its customers' checks. Because for purposes of Regulation CC the term account includes only deposit accounts, a consumer's revolving credit relationship or other line of credit with a bank is not a consumer account, even if the consumer draws on such credit lines by using a check. Both consumer and nonconsumer accounts are subject to the requirements of this regulation, including the requirement that funds be made available according to specific schedules and that the bank make specified disclosures of its availability policies. Section 229.18(b) (notices at branch locations) and §229.18(e) (notice of changes in policy) apply only to consumer accounts. Section 229.13(g)(2) (one-time exception notice) and §229.19(d) (use of calculated availability) apply only to nonconsumer accounts.

O. 229.2(o) Depositary Bank

1. The regulation uses the term depositary bank rather than the term receiving depository institution. Receiving depository institution is a term unique to the EFA Act, while depositary bank is the term used in Article 4 of the U.C.C. and Regulation J.

2. A depositary bank includes the bank in which the check is first deposited. If a foreign office of a U.S. or foreign bank sends checks to its U.S. correspondent bank for forward collection, the U.S. correspondent is the depositary bank because foreign offices of banks are not included in the definition of bank.

3. If a customer deposits a check in its account at a bank, the customer's bank is the depositary bank with respect to the check. For example, if a person deposits a check into an account at a nonproprietary ATM, the bank holding the account into which the check is deposited is the depositary bank even though another bank may service the nonproprietary ATM and send the check for collection. (Under §229.35 the depositary bank may agree with the bank servicing the nonproprietary ATM to have the servicing bank place its own indorsement on the check as the depositary bank. For the purposes of Subpart C, the bank applying its indorsement as the depositary bank indorsement on the check is the depositary bank.)

4. For purposes of Subpart B, a bank may act as both the depositary bank and the paying bank with respect to a check, if the check is payable by the bank in which it was deposited, or if the check is payable by a nonbank payor and payable through or at the bank in which it was deposited. A bank also is considered a depositary bank with respect to checks it receives as payee. For example, a bank is a depositary bank with respect to checks it receives for loan repayment, even though these checks are not deposited in an account at the bank. Because these checks would not be ''deposited to accounts,'' they would not be subject to the availability or disclosure requirements of Subpart B.

P. 229.2(p) Electronic Payment

1. Electronic payment is defined to mean a wire transfer as defined in §229.2(11) or an ACH credit transfer. The EFA Act requires that funds deposited by wire transfer be made available for withdrawal on the business day following deposit but expressly leaves the definition of the term wire transfer to the Board. Because ACH credit transfers frequently involve important consumer payments, such as wages, the regulation requires that funds deposited by ACH credit transfers be available for withdrawal on the business day following deposit.

2. ACH debit transfers, even though they may be transmitted electronically, are not defined as electronic payments because the receiver of an ACH debit transfer has the right to return the transfer, which would reverse the credit given to the originator. Thus, ACH debit transfers are more like checks than wire transfers. Further, bank customers that receive funds by originating ACH debit transfers are primarily large corporations, which generally would be able to negotiate with their banks for prompt availability.

3. A point-of-sale transaction would not be considered an electronic payment unless the transaction was effected by means of an ACH credit transfer or wire transfer.

Q. 229.2(q) Forward Collection

1. Forward collection is defined to mean the process by which a bank sends a check to the paying bank for collection, including sending the check to an intermediary collecting bank for settlement, as distinguished from the process by which the check is returned unpaid. Noncash collections are not included in the term forward collection.

R. 229.2(r) Local Check

1. Local check is defined as a check payable by or at a local paying bank, or, in the case of nonbank payors, payable through a local paying bank. A check payable by a local bank but payable through a nonlocal

bank is a local check. Conversely, a check payable through a local bank but payable by a nonlocal bank is a nonlocal check. Where two banks are named on a check and neither is designated as a payable-through bank, the check is considered payable by either bank and may be considered local or nonlocal depending on the bank to which it is sent for payment. Generally, the depositary bank may rely on the routing number to determine whether a check is local or nonlocal. Appendix A includes a list of routing numbers arranged by Federal Reserve Bank Office to assist persons in determining whether or not such a check is local. If, however, a check is payable by one bank but payable through another bank, the routing number appearing on the check will be that of the payable-through bank, not the paying bank. Many credit union share drafts and certain other checks payable by banks are payable through other banks. In such cases, the routing number cannot be relied on to determine whether the check is local or nonlocal. For payable-through checks that meet the labeling requirements of §229.36(e), the depositary bank may rely on the four-digit routing symbol of the paying bank that is printed on the face of the check as required by that section, e.g., in the title plate, but not on the first four digits of the payable-through bank's routing number printed in magnetic ink in the MICR line or in fractional form, to determine whether the check is local or nonlocal.

S. 229.2(s) Local Paying Bank

1. ''Local paying bank'' is defined as a paying bank located in the same check-processing region as the branch, contractual branch, or proprietary ATM of the depositary bank. For example, a check deposited at a contractual branch would be deemed local or nonlocal based on the location of the contractual branch with respect to the location of the paying bank.

Examples.

a. If a check that is payable by a bank that is located in the same check processing region as the depositary bank is payable through a bank located in another check processing region, the check is considered local or nonlocal depending on the location of the bank by which it is payable even if the check is sent to the nonlocal bank for collection.

b. The location of the depositary bank is determined by the physical location of the branch or proprietary ATM at which a check is deposited, regardless of whether the deposit is made in person, by mail, or otherwise. For example, if a branch of the depositary bank located in one check-processing region sends a check that was deposited at that branch to the depositary bank's central facility in another check-processing region, and the central facility is in the same check-processing region as the paying bank, the check is still considered nonlocal. (*See* the commentary to the definition of ''paying bank.'')

c. If a person deposits a check to an account by mailing or otherwise sending the check to a facility or office that is not a bank, the check is considered local or nonlocal depending on the location of the bank whose indorsement appears on the check as the depositary bank.

T. 229.2(t) Merger Transaction

1. Merger transaction is a term used in Subparts B and C in connection with transition rules for merged banks. It encompasses mergers, consolidations, and purchase/assumption transactions of the type that usually must be approved under the Bank Merger Act (12 U.S.C. 1828(c)) or similar statutes; it does not encompass acquisitions of a bank under the Bank Holding Company Act (12 U.S.C. 1842) where an acquired bank maintains its separate corporate existence.

2. Regulation CC adopts a one-year transition period for banks that are party to a merger transaction during which the merged banks will continue to be treated as separate entities. (See §§229.19(g) and 229.40.)

U. 229.2(u) Noncash Item

1. The EFA Act defines the term check to exclude noncash items, and defines noncash items to include checks to which another document is attached, checks accompanied by special instructions, or any similar item classified as a noncash item in the Board's regulation. To qualify as a noncash item, an item must be handled as such and may not be handled as a cash item by the depositary bank.

2. The regulation's definition of noncash item also includes checks that consist of more than a single thickness of paper (except checks that qualify for handling by automated check processing equipment, e.g. those placed in carrier envelopes) and checks that have not been preprinted or post-encoded in magnetic ink with the paying bank's routing number, as well as checks with documents attached or accompanied by special instructions. (In the context of this definition, paying bank refers to the paying bank as defined for purposes of Subpart C.)

3. A check that has been preprinted or post-encoded with a routing number that has been retired (e.g., because of a merger) for at least three years is a noncash item unless the current number is added for processing purposes by placing the check in an encoded carrier envelope or adding a strip to the check.

4. Checks that are accompanied by special instructions are also noncash items. For example, a person concerned about whether a check will be paid may request the depositary bank to send a check for collection as a

noncash item with an instruction to the paying bank to notify the depositary bank promptly when the check is paid or dishonored.

5. For purposes of forward collection, a copy of a check is neither a check nor a noncash item, but may be treated as either. For purposes of return, a copy is generally a notice in lieu of return. (See §§229.30(f) and 229.31(f).)

V. 229.2(v) [Reserved]

W. 229.2(w) [Reserved]

X. 229.2(x) [Reserved]

Y. 229.2(y) [Reserved]

Z. 229.2(z) Paying Bank

1. The regulation uses this term in lieu of the EFA Act's ''originating depository institution.'' For purposes of all subparts of Regulation CC, the term paying bank includes the bank by which a check is payable, the payable-at bank to which a check is sent, or, if the check is payable by a nonbank payor, the bank through which the check is payable and to which it is sent for payment or collection. For purposes of subparts C and D, the term paying bank also includes the payable-through bank and the bank whose routing number appears on the check, regardless of whether the check is payable by a different bank, provided that the check is sent for payment or collection to the payable through bank or the bank whose routing number appears on the check.

2. Under §§229.30 and 229.36(a), a bank designated as a payable-through bank or payable-at bank and to which the check is sent for payment or collection is responsible for the expedited return of checks and notice of nonpayment requirements of Subpart C. The payable-through or payable-at bank may contract with the payor with respect to its liability in discharging these responsibilities. The Board believes that the EFA Act makes a clear connection between availability and the time it takes for checks to be cleared and returned. Allowing the payable-through bank additional time to forward checks to the payor and await return or pay instructions from the payor would delay the return of these checks, increasing the risks to depositary banks. Subpart C places on payable-through and payable-at banks the requirements of expeditious return based on the time the payable-through or payable-at bank received the check for forward collection.

3. If a check is sent for forward collection based on the routing number, the bank associated with the routing number is a paying bank for the purposes of Subparts C and D requirements, including notice of nonpayment, even if the check is not drawn by a customer of that bank or the check is fraudulent.

4. The phrase ''and to which [the check] is sent for payment or collection'' includes sending not only the physical check, but information regarding the check under a truncation arrangement.

5. Federal Reserve Banks and Federal Home Loan Banks are also paying banks under all subparts of the regulation with respect to checks payable by them, even though such banks are not defined as banks for purposes of Subpart B.

6. In accordance with the Check 21 Act, for purposes of subpart D and, in connection therewith, subpart A, paying bank includes the Treasury of the United States or the United States Postal Service with respect to a check payable by that entity and sent to that entity for payment or collection, even though the Treasury and Postal Service are not defined as banks for purposes of subparts B and C. Because the Federal Reserve Banks act as fiscal agents for the Treasury and the U.S. Postal Service and in that capacity are designated as presentment locations for Treasury checks and U.S. Postal Service money orders, a Treasury check or U.S. Postal Service money order presented to a Federal Reserve Bank is considered to be presented to the Treasury or U.S. Postal Service, respectively.

AA. 229.2(aa) Proprietary ATM

1. All deposits at nonproprietary ATMs are treated as deposits of nonlocal checks, and deposits at proprietary ATMs generally are treated as deposits at banking offices. The Conference Report on the EFA Act indicates that the special availability rules for deposits received through nonproprietary ATMs are provided because ''nonproprietary ATMs today do not distinguish among check deposits or between check and cash deposits'' (H.R. Rep. No. 261, 100th Cong., 1st Sess. at 179 (1987)). Thus, a deposit of any combination of cash and checks at a nonproprietary ATM may be treated as if it were a deposit of nonlocal checks, because the depositary bank does not know the makeup of the deposit and consequently is unable to place different holds on cash, local check, and nonlocal check deposits made at the ATM.

2. A colloquy between Senators Proxmire and Dodd during the floor debate on the Competitive Equality Banking Act (133 Cong. Rec. S11289 (Aug. 4, 1987)) indicates that whether a bank operates the ATM is the primary criterion in determining whether the ATM is proprietary to that bank. Because a bank should be capable of ascertaining the composition of deposits made to an ATM operated by that bank, an exception to the availability schedules is not warranted for these deposits. If more than one bank meets the ''owns or operates'' criterion, the ATM is

considered proprietary to the bank that operates it. For the purpose of this definition, the bank that operates an ATM is the bank that puts checks deposited into the ATM into the forward collection stream. An ATM owned by one or more banks, but operated by a nonbank servicer, is considered proprietary to the bank or banks that own it.

3. The EFA Act also includes location as a factor in determining whether an ATM that is either owned or operated by a bank is proprietary to that bank. The definition of proprietary ATM includes an ATM located on the premises of the bank, either inside the branch or on its outside wall, regardless of whether the ATM is owned or operated by that bank. Because the EFA Act also defines a proprietary ATM as one that is ''in close proximity'' to the bank, the regulation defines an ATM located within 50 feet of a bank to be proprietary to that bank unless it is identified as being owned or operated by another entity. The Board believes that the statutory proximity test was designed to apply to situations where it would appear to the depositor that the ATM is run by his or her bank, because of the proximity of the ATM to the bank. The Board believes that an ATM located within 50 feet of a banking office would be presumed proprietary to that bank unless it is clearly identified as being owned or operated by another entity.

BB. 229.2(bb) Qualified Returned Check

1. Subpart C requires the paying bank and returning bank(s) to return checks in an expeditious manner. The banks may meet this responsibility by returning a check to the depositary bank by the same general means used for forward collection of a check from the depositary bank to the paying bank. One way to speed the return process is to prepare the returned check for automated processing. Qualified returned checks are identified by placing a ''2'' in the case of an original check (or a ''5'' in the case of a substitute check) in position 44 of the qualified return MICR line as a return identifier in accordance with American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (hereinafter ''ANS X9.13'') for original checks or American National Standard Specifications for an Image Replacement Document—IRD, X9.100–140 (hereinafter ''ANS X9.100–140'') for substitute checks.

2. Generally, under the standard of care imposed by §229.38, a paying or returning bank would be liable for any damages incurred due to misencoding of the routing number, the amount of the check, or return identifier on a qualified returned check unless the error was due to problems with the depositary bank's indorsement. (See also discussion of §229.38(c).) A qualified returned check that contains an encoding error would still be a qualified returned check for purposes of the regulation.

3. A qualified returned check need not contain the elements of a check drawn on the depositary bank, such as the name of the depositary bank. Because indorsements and other information on carrier envelopes or strips will not appear on a returned check itself, banks will wish to retain carrier envelopes and/or microfilm or other records of carrier envelopes or strips with their check records.

CC. 229.2(cc) Returning Bank

1. Returning bank is defined to mean any bank (excluding the paying bank and the depositary bank) handling a returned check. A returning bank may or may not be a bank that handled the returned check in the forward collection process. A returning bank includes a bank that agrees to handle a returned check for expeditious return to the depositary bank under §229.31(a). A returning bank is also a collecting bank for the purpose of a collecting bank's duty to exercise ordinary care under U.C.C. 4–202(b) and is analogous to a collecting bank for purposes of final settlement. (See Commentary to §229.35(b).)

DD. 229.2(dd) Routing Number

1. Each bank is assigned a routing number by an agent of the American Bankers Association. The routing number takes two forms—a fractional form and a nine-digit form. A paying bank is identified by both the fractional form routing number (which normally appears in the upper right hand corner of the check) and the nine-digit form. The nine-digit routing number of the paying bank generally is printed in magnetic ink near the bottom of the check (the MICR strip; see ANSI X9.13–1983). Subpart C requires depositary banks and subsequent collecting banks to place their routing numbers in nine-digit form in their indorsements.

EE. 229.2(ee) [Reserved]

FF. 229.2(ff) [Reserved]

GG. 229.2(gg) Teller's Check

1. Teller's check is defined in the EFA Act to mean a check issued by a depository institution and drawn on another depository institution. The definition in the regulation includes not only checks drawn by a bank on another bank, but also checks payable through or at a bank. This would include checks drawn on a nonbank, as long as the check is payable through or at a bank. The definition does not include checks that are drawn by a nonbank on a nonbank even if payable through or at a bank. The definition includes checks provided to a customer of

the bank in connection with customer deposit account activity, such as account disbursements and interest payments. The definition also includes checks acquired from a bank by a noncustomer for remittance purposes, such as certain loan disbursement checks. The definition excludes checks used by the bank to pay employees or vendors and checks issued by the bank in connection with a payment service, such as a payroll or a bill-paying service. Teller's checks generally are sold by banks to substitute the bank's credit for the customer's credit and thereby enhance the collectibility of the checks. A check issued in connection with a payment service generally is provided as a convenience to the customer rather than as a guarantee of the check's collectibility. In addition, such checks are often more difficult to distinguish from other types of checks than are teller's checks as defined by this regulation.

HH. 229.2(hh) Traveler's Check

1. The EFA Act and regulation require that traveler's checks be treated as cashier's, teller's, or certified checks when a new depositor opens an account. (See §229.13(a); 12 U.S.C. 4003(a)(1)(C).) The EFA Act does not define traveler's check.

2. One element of the definition states that a traveler's check is ''drawn on or payable through or at a bank.'' Sometimes traveler's checks that are not issued by banks do not have any words on them identifying a bank as drawee or paying agent, but instead bear unique routing numbers with an 8000 prefix that identifies a bank as paying agent.

3. Because a traveler's check is payable by, at, or through a bank, it is also a check for purposes of this regulation. When not subject to the next-day availability requirement for new accounts, a traveler's check should be treated as a local or nonlocal check depending on the location of the paying bank. The depositary bank may rely on the designation of the paying bank by the routing number to determine whether local or nonlocal treatment is required.

II. 229.2(ii) Uniform Commercial Code

1. Uniform Commercial Code is defined as the version of the Code adopted by the individual states. For purposes of uniform citation, all citations to the U.C.C. in this part refer to the Official Text as approved by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

JJ. 229.2(jj) [Reserved]

KK. 229.2(kk) Unit of General Local Government

1. Unit of general local government is defined to include a city, county, parish, town, township, village, or other general purpose political subdivision of a state. The term does not include special purpose units, such as school districts, water districts, or Indian nations.

LL. 229.2(ll) Wire Transfer

1. The EFA Act delegates to the Board the authority to define the term wire transfer. The regulation defines wire transfer as an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary, upon receipt or on a day stated in the order, that is transmitted by electronic or other means over certain networks or on the books of banks and that is used primarily to transfer funds between commercial accounts. ''Unconditional'' means that no condition, such as presentation of documents, must be met before the bank receiving the order is to make payment. A wire transfer may be transmitted by electronic or other means. ''Electronic means'' include computer-to-computer links, on-line terminals, telegrams (including TWX, TELEX, or similar methods of communication), telephone calls, or other similar methods. Fedwire (the Federal Reserve's wire transfer network), CHIPS (Clearing House Interbank Payments System, operated by the New York Clearing House), and book transfers among banks or within one bank are covered by this definition. Credits for credit and debit card transactions are not wire transfers. The term wire transfer excludes electronic fund transfers as that term is defined by the Electronic Fund Transfer Act.

MM. 229.2(mm) [Reserved]

NN. 229.2(nn) Good Faith

1. This definition of good faith derives from U.C.C. 3–103(a)(4).

OO. 229.2(oo) Interest Compensation

1. This calculation of *interest compensation* derives from U.C.C. 4A–506(b). (See §§229.34(e) and 229.36(f).)

PP. 229.2(pp) Contractual Branch

1. When one bank arranges for another bank to accept deposits on its behalf, the second bank is a contractual branch of the first bank. For further discussion of contractual branch deposits and related disclosures, see §§229.2(s) and 229.19(a) of the regulation and the commentary to §§229.2(s), 229.10(c), 229.14(a), 229.16(a), 229.18(b), and 229.19(a).

QQ. 229.2(qq) [Reserved]

RR. 229.2(rr) [Reserved]

SS. 229.2(ss) [Reserved]

TT. 229.2(tt) [Reserved]

UU. 229.2(uu) [Reserved]

VV. 229.2(vv) MICR Line

1. Information in the MICR line of a check must be printed in accordance with ANS X9.13 for original checks and ANS X9.100–140 for substitute checks. These standards could vary the requirements for printing the MICR line, such as by indicating circumstances under which the use of magnetic ink is not required.

WW. 229.2(ww) Original Check

1. The definition of original check distinguishes the first paper check signed or otherwise authorized by the drawer to effect a particular payment transaction from a substitute check or other paper or electronic representation that is derived from an original check or substitute check. There is only one original check for any particular payment transaction. However, multiple substitute checks could be created to represent that original check at various points in the check collection and return process.

XX. 229.2(xx) Paper or Electronic Representation of a Substitute Check

1. Receipt of a paper or electronic representation of a substitute check does not trigger indemnity or expedited recredit rights, although the recipient nonetheless could have a warranty claim or a claim under other check law with respect to that document or the underlying payment transaction. A paper or electronic representation of a substitute check would include a representation of a substitute check that was drawn on an account, as well as a representation of a substitute traveler's check, credit card check, or other item that meets the substitute check definition. The following examples illustrate the scope of the definition.

*Examples.*

a. A bank receives electronic presentment of a substitute check that has been converted to electronic form and charges the customer's account for that electronic item. The periodic account statement that the bank provides to the customer includes information about the electronically-presented substitute check in a line-item list describing all the checks the bank charged to the customer's account during the previous month. The electronic file that the bank received for presentment and charged to the customer's account would be an electronic representation of a substitute check, and the line-item appearing on the customer's account statement would be a paper representation of a substitute check.

b. A paying bank receives and settles for a substitute check and then realizes that its settlement was for the wrong amount. The paying bank sends an adjustment request to the presenting bank to correct the error. The adjustment request is not a paper or electronic representation of a substitute check under the definition because it is not being handled for collection or return as a check. Rather, it is a separate request that is related to a check. As a result, no substitute check warranty, indemnity, or expedited recredit rights attach to the adjustment.

YY. 229.2(yy) [Reserved]

ZZ. 229.2(zz) Reconverting Bank

1. A substitute check is ''created'' when and where a paper reproduction of an original check that meets the requirements of §229.2(aaa) is physically printed. A bank is a reconverting bank if it creates a substitute check directly or if another person by agreement creates a substitute check on the bank's behalf. A bank also is a reconverting bank if it is the first bank that receives a substitute check created by a nonbank and transfers, presents, or returns that substitute check or, in lieu thereof, the first paper or electronic representation of such substitute check.

*Examples.*

a. Bank A, by agreement, sends an electronic check file for collection to Bank B. Bank B chooses to use that file to print a substitute check that meets the requirements of §229.2(aaa). Bank B is the reconverting bank as of the time it prints the substitute check.

b. Company A, which is not a bank, by agreement receives check information electronically from Bank A. Bank A becomes the reconverting bank when Company A prints a substitute check on behalf of Bank A in accordance with that agreement.

c. A depositary bank's customer, which is a nonbank business, receives a check for payment, truncates that original check, and creates a substitute check to deposit with its bank. The depositary bank receives that substitute check from its customer and is the first bank to handle the substitute check. The depositary bank becomes the reconverting bank as of the time that it transfers or presents the substitute check (or in lieu thereof the first paper or electronic representation of the substitute check) for forward collection.

d. A bank is the payable-through bank for checks that are drawn on a nonbank payor, which is the bank's customer. When the customer decides not to pay a check that is payable through the bank, the customer creates

a substitute check for purposes of return. The payable-through bank becomes the reconverting bank when it returns the substitute check (or in lieu thereof the first paper or electronic representation of the substitute check) to a returning bank or the depositary bank.

e. A paying bank returns a substitute check to the depositary bank, which in turn gives that substitute check back to its nonbank customer. That customer then redeposits the substitute check for collection at a different bank. Because the substitute check was already transferred by a bank, the second depositary bank does not become a reconverting bank when it transfers or presents that substitute check for collection.

2. In some cases there will be one or more banks between the truncating bank and the reconverting bank.

*Example.*

A depositary bank truncates the original check and sends an electronic representation of the original check for collection to an intermediary bank. The intermediary bank sends the electronic representation of the original check to the presenting bank, which creates a substitute check to present to the paying bank. The presenting bank is the reconverting bank.

3. A check could move from electronic form to substitute check form several times during the collection and return process. It therefore is possible that there could be multiple substitute checks, and thus multiple reconverting banks, with respect to the same underlying payment.

AAA. 229.2(aaa) Substitute Check

1. ''A paper reproduction of an original check'' could include a reproduction created directly from the original check or a reproduction of the original check that is created from some other source that contains an image of the original check, such as an electronic representation of an original check or substitute check, or a previous substitute check.

2. Because a substitute check must be a piece of paper, an electronic file or electronic check image that has not yet been printed in accordance with the substitute check definition is not a substitute check.

3. Because a substitute check must be a representation of a check, a paper reproduction of something that is not a check cannot be a substitute check. For example, a savings bond or a check drawn on a non-U.S. branch of a foreign bank cannot be reconverted to a substitute check.

4. As described in §229.51(b) and the commentary thereto, a reconverting bank is required to ensure that a substitute check contains all indorsements applied by previous parties that handled the check in any form. Therefore, the image of the original check that appears on the back of a substitute check would include indorsements that were physically applied to the original check before an image of the original check was captured. An indorsement that was applied physically to the original check after an image of the original check was captured would be conveyed as an electronic indorsement (see paragraph 3 of the commentary to §229.35(a)). The back of the substitute check would contain a physical representation of any indorsements that were applied electronically to the check after an image of the check was captured but before creation of the substitute check.

*Example.*

Bank A, which is the depositary bank, captures an image of an original check, indorses it electronically and, by agreement, transmits to Bank B an electronic image of the check accompanied by the electronic indorsement. Bank B then creates a substitute check to send to Bank C. The back of the substitute check created by Bank B must contain a representation of the indorsement previously applied electronically by Bank A and Bank B's own indorsement. (For more information on indorsement requirements, see §229.35, appendix D, and the commentary thereto.)

5. Some substitute checks will not be created directly from the original check, but rather will be created from a previous substitute check. The back of a subsequent substitute check will contain an image of the full length of the back of the previous substitute check. ANS X9.100–140 requires preservation of the full length of the back of the previous substitute check in order to preserve previous indorsements and reconverting bank identifications. By contrast, the front of a subsequent substitute check will not contain an image of the entire previous substitute check. Rather, the image field of the subsequent substitute check will contain the image of the front of the original check that appeared on the previous substitute check at the time the previous substitute check was converted to electronic form. The portions of the front of the subsequent substitute check other than the image field will contain information applied by the subsequent reconverting bank, such as its reconverting bank identification, the MICR line, the legal equivalence legend, and optional security information.

*Examples.*

a. The back of a subsequent substitute check would contain the following indorsements, all of which would be preserved through the image of the back of the previous substitute check: (1) The indorsements that were applied physically to

the original check before an image of the original check was captured; (2) a physical representation of indorsements that were applied electronically to the original check after an image of the original check was captured but before creation of the first substitute check; and (3) indorsements that were applied physically to the previous substitute check. In addition, the reconverting bank for the subsequent substitute check must overlay onto the back of that substitute check a physical representation of any indorsements that were applied electronically after the previous substitute check was converted to electronic form but before creation of the subsequent substitute check.

b. Because information could have been physically added to the image of the front of the original check that appeared on the previous substitute check, the original check image that appears on the front of a subsequent substitute check could contain information in addition to that which appeared on the original check at the time it was truncated.

6. The MICR line applied to a substitute check must contain information in all fields of the MICR line that were encoded on the original check at any time before an image of the original check was captured. This includes all the MICR-line information that was preprinted on the original check, plus any additional information that was added to the MICR line before the image of the original check was captured (for example, the amount of the check). The information in each field of the substitute check's MICR line must be the same information as in the corresponding field of the MICR line of the original check, except as provided by ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies). Industry standards may not, however, vary the requirement that a substitute check at the time of its creation must bear a full-field MICR line.

7. ANS X9.100–140, provides that a substitute check must have a ''4'' in position 44 and that a qualified returned substitute check must have a ''4'' in position 44 of the forward-collection MICR line as well as a ''5'' in position 44 of the qualified return MICR line. The ''4'' and ''5'' indicate that the document is a substitute check so that the size of the check image remains constant throughout the collection and return process, regardless of the number of substitute checks created that represent the same original check (*see also* §§229.30(a)(2) and 229.31(a)(2) and the commentary thereto regarding requirements for qualified returned substitute checks). An original check generally has a blank position 44 for forward collection. Because a reconverting bank must encode position 44 of a substitute check's forward collection MICR line with a ''4,'' the reconverting bank must vary any character that appeared in position 44 of the forward-collection MICR line of the original check. A bank that misencodes or fails to encode position 44 at the time it attempts to create a substitute check has failed to create a substitute check. A bank that receives a properly-encoded substitute check may further encode that item but does so subject to the encoding warranties in Regulation CC and the U.C.C.

8. A substitute check's MICR line could contain information in addition to the information required at the time the substitute check is created. For example, if the amount field of the original check was not encoded and the substitute check therefore did not, when created, have an encoded amount field, the MICR line of the substitute check later could be amount-encoded.

9. A bank may receive a substitute check that contains a MICR-line variation but nonetheless meets the MICR-line replication requirements of §229.2(aaa)(2) because that variation is permitted by ANS X9.100–140. If such a substitute check contains a MICR-line error, a bank that receives it may, but is not required to, repair that error. Such a repair must be made in accordance with ANS X9.100–140 for repairing a MICR line, which generally allows a bank to correct an error by applying a strip that may or may not contain information in all fields encoded on the check's MICR line. A bank's repair of a MICR-line error on a substitute check is subject to the encoding warranties in Regulation CC and the U.C.C.

10. A substitute check must conform to all the generally applicable industry standards for substitute checks set forth in ANS X9.100–140, which incorporates other industry standards by reference. Thus, multiple substitute check images contained on the same page of an account statement are not substitute checks.

BBB. 229.2(bbb) Sufficient Copy and Copy

1. A copy must be a paper reproduction of a check. An electronic image therefore is not a copy or a sufficient copy. However, if a customer has agreed to receive such information electronically, a bank that is required to provide an original check or sufficient copy may satisfy that requirement by providing an electronic image in accordance with §229.58 and the commentary thereto.

2. A bank under §229.53(b)(3) may limit its liability for an indemnity claim and under §§229.54(e)(2) and 229.55(c)(2) may respond to an expedited recredit claim by providing the claimant with a copy of a check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or that otherwise is sufficient to determine the validity of the claim against the bank.

*Examples.*

a. A copy of an original check that accurately represents all the information on the front and back of the original check as of the time of truncation would constitute a sufficient copy if that copy resolved the claim. For example, if resolution of the claim required accurate payment and indorsement information, an accurate copy of the front and back of a legible original check (including but not limited to a substitute check) would be a sufficient copy.

b. A copy of the original check that does not accurately represent all the information on both the front and back of the original check also could be a sufficient copy if such copy contained all the information necessary to determine the validity of the relevant claim. For instance, if a consumer received a substitute check that contained a blurry image of a legible original check, the consumer might seek an expedited recredit because his or her account was charged for $1,000, but he or she believed that the check was written for only $100. If the amount that appeared on the front of the original check was legible, an accurate copy of only the front of the original check that showed the amount of the check would be sufficient to determine whether or not the consumer's claim regarding the amount of the check was valid.

CCC. 229.2(ccc) Transfer and Consideration

1. Under §§229.52 and 229.53, a bank is responsible for the warranties and indemnity when it transfers, presents, or returns a substitute check (or a paper or electronic representation thereof) for consideration. Drawers and other nonbank persons that receive checks from a bank are not transferees that receive consideration as those terms are defined in the U.C.C. However, the Check 21 Act clearly contemplates that such nonbank persons that receive substitute checks (or representations thereof) from a bank will receive the warranties and indemnity from all previous banks that handled the check. To ensure that these parties are covered by the substitute check warranties and indemnity in the manner contemplated by the Check 21 Act, §229.2(ccc) incorporates the U.C.C. definitions of the term transfer and consideration by reference and expands those definitions to cover a broader range of situations. Delivering a check to a nonbank that is acting on behalf of a bank (such as a third-party check processor or presentment point) is a transfer of the check to that bank.

*Examples.*

a. A paying bank pays a substitute check and then provides that paid substitute check (or a representation thereof) to a drawer with a periodic statement. Under the expanded definitions, the paying bank thereby transfers the substitute check (or representation thereof) to the drawer for consideration and makes the substitute check warranties described in §229.52. A drawer that suffers a loss due to receipt of a substitute check may have warranty, indemnity, and, if the drawer is a consumer, expedited recredit rights under the Check 21 Act and subpart D. A drawer that suffers a loss due to receipt of a paper or electronic representation of a substitute check would receive the substitute check warranties but would not have indemnity or expedited recredit rights.

b. The expanded definitions also operate such that a paying bank that pays an original check (or a representation thereof) and then creates a substitute check to provide to the drawer with a periodic statement transfers the substitute check for consideration and thereby provides the warranties and indemnity.

c. The expanded definitions ensure that a bank that receives a returned check in any form and then provides a substitute check to the depositor gives the substitute check warranties and indemnity to the depositor.

d. The expanded definitions apply to substitute checks representing original checks that are not drawn on deposit accounts, such as checks used to access a credit card or a home equity line of credit.

DDD. 229.2(ddd) Truncate

1. Truncate means to remove the original check from the forward collection or return process and to send in lieu of the original check either a substitute check or, by agreement, information relating to the original check. Truncation does not include removal of a substitute check from the check collection or return process.

EEE. 229.2(eee) Truncating Bank

1. A bank is a truncating bank if it truncates an original check or if it is the first bank to transfer, present, or return another form of an original check that was truncated by a person that is not a bank.

*Example.*

a. A bank's customer that is a nonbank business receives a check for payment and deposits either a substitute check or an electronic representation of the original check with its depositary bank instead of the original check. That depositary bank is the truncating bank when it transfers, presents, or returns the substitute check or electronic representation in lieu of the original check. That bank also would be the reconverting bank if it were the first bank to transfer, present, or return a substitute check that it received from (or created from the information given by) its nonbank customer (see §229.2(yy) and the commentary thereto).

2. A truncating bank does not make the subpart D warranties and indemnity unless it also is the reconverting bank. Therefore, a bank that truncates the original check and sends an electronic file to a collecting bank does not provide subpart D protections to the recipient of that electronic item. However, a recipient of an electronic item may protect itself against losses associated with that item by agreement with the truncating bank.

FFF. 229.2(fff) Remotely Created Check

1. A check authorized by a consumer over the telephone that is not created by the paying bank and bears a legend on the signature line, such as ''Authorized by Drawer,'' is an example of a remotely created check. A check that bears the signature applied, or purported to be applied, by the person on whose account the check is drawn is not a remotely created check. A typical forged check, such as a stolen personal check fraudulently signed by a person other than the drawer, is not covered by the definition of a remotely created check.

2. The term signature as used in this definition has the meaning set forth at U.C.C. 3–401. The term ''applied by'' refers to the physical act of placing the signature on the check.

3. The definition of a ''remotely created check'' differs from the definition of a ''remotely created consumer item'' under the U.C.C. A ''remotely created check'' may be drawn on an account held by a consumer, corporation, unincorporated company, partnership, government unit or instrumentality, trust, or any other entity or organization. A ''remotely created consumer item'' under the U.C.C., however, must be drawn on a consumer account.

4. Under Regulation CC (12 CFR part 229), the term ''check'' includes a negotiable demand draft drawn on or payable through or at an office of a bank. In the case of a ''payable through'' or ''payable at'' check, the signature of the person on whose account the check is drawn would include the signature of the payor institution or the signatures of the customers who are authorized to draw checks on that account, depending on the arrangements between the ''payable through'' or ''payable at'' bank, the payor institution, and the customers.

5. The definition of a remotely created check includes a remotely created check that has been reconverted to a substitute check.

*III. Section 229.3 Administrative Enforcement [Reserved]*

*IV. Section 229.10 Next-Day Availability*

A. Business Days and Banking Days

1. This section, as well as other provisions of this subpart governing the availability of funds, provides that funds must be made available for withdrawal not later than a specified number of business days following the banking day on which the funds are deposited. Thus, a deposit is considered made only on a banking day, i.e., a day that the bank is open to the public for carrying on substantially all of its banking functions. For example, if a deposit is made at an ATM on a Saturday, Sunday, or other day on which the bank is closed to the public, the deposit is considered received on that bank's next banking day.

2. Nevertheless, business days are used to determine the number of days following the banking day of deposit that funds must be available for withdrawal. For example, if a deposit of a local check were made on a Monday, the availability schedule requires that funds be available for withdrawal on the second business day after deposit. Therefore, funds must be made available on Wednesday regardless of whether the bank was closed on Tuesday for other than a standard legal holiday as specified in the definition of business day.

B. 229.10(a) Cash Deposits

1. This paragraph implements the EFA Act's requirement for next-day availability for cash deposits to accounts at a depositary bank ''staffed by individuals employed by such institution.''[2] Under this paragraph, cash deposited in an account at a staffed teller station on a Monday must become available for withdrawal by the start of business on Tuesday. It must become available for withdrawal by the start of business on Wednesday if it is deposited by mail, at a proprietary ATM, or by other means other than at a staffed teller station.

C. 229.10(b) Electronic Payments

1. The EFA Act provides next-day availability for funds received for deposit by wire transfer. The regulation uses the term electronic payment, rather than wire transfer, to include both wire transfers and ACH credit transfers under the next-day availability requirement. (See discussion of definitions of automated clearinghouse, electronic payment, and wire transfer in § 229.2.)

[2] Nothing in the EFA Act or this regulation affects terms of account arrangements, such as negotiable order of withdrawal accounts, which may require prior notice of withdrawal. (See 12 CFR 204.2(e)(2).)

2. The EFA Act requires that funds received by wire transfer be available for withdrawal not later than the business day following the day a wire transfer is received. This paragraph clarifies what constitutes receipt of an electronic payment. For the purposes of this paragraph, a bank receives an electronic payment when the bank receives both payment in finally collected funds and the payment instructions indicating the customer accounts to be credited and the amount to be credited to each account. For example, in the case of Fedwire, the bank receives finally collected funds at the time the payment is made. (See 12 CFR 210.31.) Finally collected funds generally are received for an ACH credit transfer when they are posted to the receiving bank's account on the settlement day. In certain cases, the bank receiving ACH credit payments will not receive the specific payment instructions indicating which accounts to credit until after settlement day. In these cases, the payments are not considered received until the information on the account and amount to be credited is received.

3. This paragraph also establishes the extent to which an electronic payment is considered made. Thus, if a participant on a private network fails to settle and the receiving bank receives finally settled funds representing only a partial amount of the payment, it must make only the amount that it actually received available for withdrawal.

4. The availability requirements of this regulation do not preempt or invalidate other rules, regulations, or agreements which require funds to be made available on a more prompt basis. For example, the next-day availability requirement for ACH credits in this section does not preempt ACH association rules and Treasury regulations (31 CFR part 210), which provide that the proceeds of these credit payments be available to the recipient for withdrawal on the day the bank receives the funds.

D. 229.10(c) Certain Check Deposits

1. The EFA Act generally requires that funds be made available on the business day following the banking day of deposit for Treasury checks, state and local government checks, cashier's checks, certified checks, teller's checks, and ''on us'' checks, under specified conditions. (Treasury checks are checks drawn on the Treasury of the United States and have a routing number beginning with the digits ''0000.'') This section also requires next-day availability for additional types of checks not addressed in the EFA Act. Checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank and U.S. Postal Service money orders also must be made available on the first business day following the day of deposit under specified conditions. For the purposes of this section, all checks drawn on a Federal Reserve Bank or a Federal Home Loan Bank that contain in the MICR line a routing number that is listed in appendix A are subject to the next-day availability requirement if they are deposited in an account held by a payee of the check and in person to an employee of the depositary bank, regardless of the purposes for which the checks were issued. For all new accounts, even if the new account exception is not invoked, traveler's checks must be included in the $5,000 aggregation of checks deposited on any one banking day that are subject to the next-day availability requirement. (*See* § 229.13(a).)

2. Deposit in Account of Payee. One statutory condition to receipt of next-day availability of Treasury checks, state and local government checks, cashier's checks, certified checks, and teller's checks is that the check must be ''endorsed only by the person to whom it was issued.'' The EFA Act could be interpreted to include a check that has been indorsed in blank and deposited into an account of a third party that is not named as payee. The Board believes that such a check presents greater risks than a check deposited by the payee and that Congress did not intend to require next-day availability for such checks. The regulation, therefore, provides that funds must be available on the business day following deposit only if the check is deposited in an account held by a payee of the check. For the purposes of this section, payee does not include transferees other than named payees. The regulation also applies this condition to Postal Service money orders and checks drawn on Federal Reserve Banks and Federal Home Loan Banks.

3. Deposits Made to an Employee of the Depositary Bank.

a. In most cases, next-day availability of the proceeds of checks subject to this section is conditioned on the deposit of these checks in person to an employee of the depositary bank. If the deposit is not made to an employee of the depositary bank on the premises of such bank, the proceeds of the deposit must be made available for withdrawal by the start of business on the second business day after deposit, under paragraph (c)(2) of this section. For example, second-day availability rather than next-day availability would be allowed for deposits of checks subject to this section made at a proprietary ATM, night depository, through the mail or a lock box, or at a teller station staffed by a person who is not an employee of the depositary bank. Second-day availability also may be allowed for deposits picked up by an employee of the depositary bank at the customer's premises; such deposits would be considered made upon receipt at the branch or other location of the depositary bank. Employees of a contractual branch would not be considered employees of the depositary bank for the purposes of this regulation,

and deposits at contractual branches would be treated the same as deposits to a proprietary ATM for the purposes of this regulation. (See also, Commentary to §229.19(a).)

b. In the case of Treasury checks, the EFA Act and regulation do not condition the receipt of next-day availability to deposits at staffed teller stations. Therefore, Treasury checks deposited at a proprietary ATM must be accorded next-day availability, if the check is deposited to an account of a payee of the check.

4. ''On Us'' Checks. The EFA Act and regulation require next-day availability for ''on us'' checks, i.e., checks deposited in a branch of the depositary bank and drawn on the same or another branch of the same bank, if both branches are located in the same state or check processing region. Thus, checks deposited in one branch of a bank and drawn on another branch of the same bank must receive next-day availability even if the branch on which the checks are drawn is located in another check processing region but in the same state as the branch in which the check is deposited. For the purposes of this requirement, deposits at facilities that are not located on the premises of a brick-and-mortar branch of the bank, such as off-premise ATMs and remote depositories, are not considered deposits made at branches of the depositary bank.

5. First $100.

a. The EFA Act and regulation also require that up to $100 of the aggregate deposit by check or checks not subject to next-day availability on any one banking day be made available on the next business day. For example, if $70 were deposited in an account by check(s) on a Monday, the entire $70 must be available for withdrawal at the start of business on Tuesday. If $200 were deposited by check(s) on a Monday, this section requires that $100 of the funds be available for withdrawal at the start of business on Tuesday. The portion of the customer's deposit to which the $100 must be applied is at the discretion of the depositary bank, as long as it is not applied to any checks subject to next-day availability. The $100 next-day availability rule does not apply to deposits at nonproprietary ATMs.

b. The $100 that must be made available under this rule is in addition to the amount that must be made available for withdrawal on the business day after deposit under other provisions of this section. For example, if a customer deposits a $1,000 Treasury check, and a $1,000 local check in its account on Monday, $1,100 must be made available for withdrawal on Tuesday—the proceeds of the $1,000 Treasury check, as well as the first $100 of the local check.

c. A depositary bank may aggregate all local and nonlocal check deposits made by the customer on a given banking day for the purposes of the $100 next-day availability rule. Thus, if a customer has two accounts at the depositary bank, and on a particular banking day makes deposits to each account, $100 of the total deposited to the two accounts must be made available on the business day after deposit. Banks may aggregate deposits to individual and joint accounts for the purposes of this provision.

d. If the customer deposits a $500 local check, and gets $100 cash back at the time of deposit, the bank need not make an additional $100 available for withdrawal on the following day. Similarly, if the customer depositing the local check has a negative book balance, or negative available balance in its account at the time of deposit, the $100 that must be available on the next business day may be made available by applying the $100 to the negative balance, rather than making the $100 available for withdrawal by cash or check on the following day.

6. Special Deposit Slips.

a. Under the EFA Act, a depositary bank may require the use of a special deposit slip as a condition to providing next-day availability for certain types of checks. This condition was included in the EFA Act because many banks determine the availability of their customers' check deposits in an automated manner by reading the MICR-encoded routing number on the deposited checks. Using these procedures, a bank can determine whether a check is a local or nonlocal check, a check drawn on the Treasury, a Federal Reserve Bank, a Federal Home Loan Bank, or a branch of the depositary bank, or a U.S. Postal Service money order. Appendix A includes the routing numbers of certain categories of checks that are subject to next-day availability. The bank cannot require a special deposit slip for these checks.

b. A bank cannot distinguish whether the check is a state or local government check, cashier's check, certified check, or teller's check by reading the MICR-encoded routing number, because these checks bear the same routing number as other checks drawn on the same bank that are not accorded next-day availability. Therefore, a bank may require a special deposit slip for these checks.

c. The regulation specifies that if a bank decides to require the use of a special deposit slip (or a special deposit envelope in the case of a deposit at an ATM or other unstaffed facility) as a condition to granting next-day availability under paragraphs (c)(1)(iv) or (c)(1)(v) of this section or second-day availability under paragraph (c)(2) of this section, and if the deposit slip that must be used is different from the bank's regular deposit slips, the bank must either provide the special slips to its customers or inform its customers how such slips may be obtained and make the slips reasonably available to the customers.

d. A bank may meet this requirement by providing customers with an order form for

the special deposit slips and allowing sufficient time for the customer to order and receive the slips before this condition is imposed. If a bank provides deposit slips in its branches for use by its customers, it also must provide the special deposit slips in the branches. If special deposit envelopes are required for deposits at an ATM, the bank must provide such envelopes at the ATM.

e. Generally, a teller is not required to advise depositors of the availability of special deposit slips merely because checks requiring special deposit slips for next-day availability are deposited without such slips. If a bank provides the special deposit slips only upon the request of a depositor, however, the teller must advise the depositor of the availability of the special deposit slips, or the bank must post a notice advising customers that the slips are available upon request. Such notice need not be posted at each teller window, but the notice must be posted in a place where consumers seeking to make deposits are likely to see it before making their deposits. For example, the notice might be posted at the point where the line forms for teller service in the lobby. The notice is not required at any drive-through teller windows nor is it required at night depository locations, or at locations where consumer deposits are not accepted. If a bank prepares a deposit for a depositor, it must use a special deposit slip where appropriate. A bank may require the customer to segregate the checks subject to next-day availability for which special deposit slips could be required, and to indicate on a regular deposit slip that such checks are being deposited, if the bank so instructs its customers in its initial disclosure.

*V. Section 229.11 [Reserved]*

*VI. Section 229.12 Availability Schedule*

A. 229.12(a) Effective Date

1. The availability schedule set forth in this section supersedes the temporary schedule that was effective September 1, 1988, through August 31, 1990.

B. 229.12(b) Local Checks and Certain Other Checks

1. Local checks must be made available for withdrawal not later than the second business day following the banking day on which the checks were deposited.

2. In addition, the proceeds of Treasury checks and U.S. Postal Service money orders not subject to next-day (or second-day) availability under §229.10(c), checks drawn on Federal Reserve Banks and Federal Home Loan Banks, checks drawn by a state or unit of general local government, cashier's checks, certified checks, and teller's checks not subject to next-day (or second-day) availability under §229.10(c) and payable in the same check processing region as the depositary bank, must be made available for withdrawal by the second business day following deposit.

3. Exceptions are made for withdrawals by cash or similar means and for deposits in banks located outside the 48 contiguous states. Thus, the proceeds of a local check deposited on a Monday generally must be made available for withdrawal on Wednesday.

C. 229.12(c) Nonlocal Checks

1. Nonlocal checks must be made available for withdrawal not later than the fifth business day following deposit, i.e., proceeds of a nonlocal check deposited on a Monday must be made available for withdrawal on the following Monday. In addition, a check described in §229.10(c) that does not meet the conditions for next-day availability (or second-day availability) is treated as a nonlocal check, if the check is drawn on or payable through or at a nonlocal paying bank. Adjustments are made to the schedule for withdrawals by cash or similar means and deposits in banks located outside the 48 contiguous states.

2. Reduction in Schedules.

a. Section 603(d)(1) of the EFA Act (12 U.S.C. 4002(d)(1)) requires the Board to reduce the statutory schedules for any category of checks where most of those checks would be returned in a shorter period of time than provided in the schedules. The conferees indicated that ''if the new system makes it possible for two-thirds of the items of a category of checks to meet this test in a shorter period of time, then the Federal Reserve must shorten the schedules accordingly.'' H.R. Rep. No. 261, 100th Cong., 1st Sess. at 179 (1987).

b. Reduced schedules are provided for certain nonlocal checks where significant improvements can be made to the EFA Act's schedules due to transportation arrangements or proximity between the check processing regions of the depositary bank and the paying bank, allowing for faster collection and return. Appendix B sets forth the specific reduction of schedules applicable to banks located in certain check processing regions.

c. A reduction in schedules may apply even in those cases where the determination that the check is nonlocal cannot be made based on the routing number on the check. For example, a nonlocal credit union payable-through share draft may be subject to a reduction in schedules if the routing number of the payable-through bank that appears on the draft is included in appendix B, even though the determination that the payable-through share draft is nonlocal is based on the location of the credit union and not the routing number on the draft.

D. 229.12(d) Time Period Adjustment for Withdrawal by Cash or Similar Means

1. The EFA Act provides an adjustment to the availability rules for cash withdrawals. Funds from local and nonlocal checks need not be available for cash withdrawal until 5:00 p.m. on the day specified in the schedule. At 5:00 p.m., $400 of the deposit must be made available for cash withdrawal. This $400 is in addition to the first $100 of a day's deposit, which must be made available for withdrawal at the start of business on the first business day following the banking day of deposit. If the proceeds of local and nonlocal checks become available for withdrawal on the same business day, the $400 withdrawal limitation applies to the aggregate amount of the funds that became available for withdrawal on that day. The remainder of the funds must be available for cash withdrawal at the start of business on the business day following the business day specified in the schedule.

2. The EFA Act recognizes that the $400 that must be provided on the day specified in the schedule may exceed a bank's daily ATM cash withdrawal limit, and explicitly provides that the EFA Act does not supersede the bank's policy in this regard. The Board believes that the rationale for accommodating a bank's ATM withdrawal limit also applies to other cash withdrawal limits established by that bank. Section 229.19(c)(4) of the regulation addresses the relation between a bank's cash withdrawal limit (for over-the-counter cash withdrawals as well as ATM cash withdrawals) and the requirements of this subpart.

3. The Board believes that the Congress included this special cash withdrawal rule to provide a depositary bank with additional time to learn of the nonpayment of a check before it must make funds available to its customer. If a customer deposits a local check on a Monday, and that check is returned by the paying bank, the depositary bank may not receive the returned check until Thursday, the day after funds for a local check ordinarily must be made available for withdrawal. The intent of the special cash withdrawal rule is to minimize this risk to the depositary bank. For this rule to minimize the depositary bank's risk, it must apply not only to cash withdrawals, but also to withdrawals by other means that result in an irrevocable debit to the customer's account or commitment to pay by the bank on the customer's behalf during the day. Thus, the cash withdrawal rule also includes withdrawals by electronic payment, issuance of a cashier's or teller's check, certification of a check, or other irrevocable commitment to pay, such as authorization of an on-line point-of-sale debit. The rule also would apply to checks presented over the counter for payment on the day of presentment by the depositor or another person. Such checks could not be dishonored for insufficient funds if an amount sufficient to cover the check had became available for cash withdrawal under this rule; however, payment of such checks would be subject to the bank's cut-off hour established under U.C.C. 4–108. The cash withdrawal rule does not apply to checks and other provisional debits presented to the bank for payment that the bank has the right to return.

E. 229.12(e) Extension of Schedule for Certain Deposits in Alaska, Hawaii, Puerto Rico, and the U.S. Virgin Islands

1. The EFA Act and regulation provide an extension of the availability schedules for check deposits at a branch of a bank if the branch is located in Alaska, Hawaii, Puerto Rico, or the U.S. Virgin Islands. The schedules for local checks, nonlocal checks (including nonlocal checks subject to the reduced schedules of appendix B), and deposits at nonproprietary ATMs are extended by one business day for checks deposited to accounts in banks located in these jurisdictions that are drawn on or payable at or through a paying bank not located in the same jurisdiction as the depositary bank. For example, a check deposited in a bank in Hawaii and drawn on a San Francisco paying bank must be made available for withdrawal not later than the third business day following deposit. This extension does not apply to deposits that must be made available for withdrawal on the next business day.

2. The Congress did not provide this extension of the schedules to checks drawn on a paying bank located in Alaska, Hawaii, Puerto Rico, or the U.S. Virgin Islands and deposited in an account at a depositary bank in the 48 contiguous states. Therefore, a check deposited in a San Francisco bank drawn on a Hawaii paying bank must be made available for withdrawal not later than the second rather than the third business day following deposit.

F. 229.12(f) Deposits at Nonproprietary ATMs

1. The EFA Act and regulation provide a special rule for deposits made at nonproprietary ATMs. This paragraph does not apply to deposits made at proprietary ATMs. All deposits at a nonproprietary ATM must be made available for withdrawal by the fifth business day following the banking day of deposit. For example, a deposit made at a nonproprietary ATM on a Monday, including any deposit by cash or checks that would otherwise be subject to next-day (or second-day) availability, must be made available for withdrawal not later than Monday of the following week. The provisions of §229.10(c)(1)(vii) requiring a depositary bank

to make up to $100 of an aggregate daily deposit available for withdrawal on the first business day after the banking day of deposit do not apply to deposits at a nonproprietary ATM.

*VII. Section 229.13 Exceptions*

A. Introduction

1. While certain safeguard exceptions (such as those for new accounts and checks the bank has reasonable cause to believe are uncollectible) are established in the EFA Act, the Congress gave the Board the discretion to determine whether certain other exceptions should be included in its regulations. Specifically, the EFA Act gives the Board the authority to establish exceptions to the schedules for large or redeposited checks and for accounts that have been repeatedly overdrawn. These exceptions apply to local and nonlocal checks as well as to checks that must otherwise be accorded next-day (or second-day) availability under §229.10(c).

2. Many checks will not be returned to the depositary bank by the time funds must be made available for withdrawal under the next-day (or second-day), local, and nonlocal schedules. In order to reduce risk to depositary banks, the Board has exercised its statutory authority to adopt these exceptions to the schedules in the regulation to allow the depositary bank to extend the time within which it is required to make funds available.

3. The EFA Act also gives the Board the authority to suspend the schedules for any classification of checks, if the schedules result in an unacceptable level of fraud losses. The Board will adopt regulations or issue orders to implement this statutory authority if and when circumstances requiring its implementation arise.

B. 229.13(a) New Accounts

1. Definition of New Account.

a. The EFA Act provides an exception to the availability schedule for new accounts. An account is defined as a new account during the first 30 calendar days after the account is opened. An account is opened when the first deposit is made to the account. An account is not considered a new account, however, if each customer on the account has a transaction account relationship with the depositary bank, including a dormant account, that is at least 30 calendar days old or if each customer has had an established transaction account with the depositary bank within the 30 calendar days prior to opening the second account.

b. The following are examples of what constitutes, and does not constitute, a new account:

i. If the customer has an established account with a bank and opens a second account with the bank, the second account is not subject to the new account exception.

ii. If a customer's account were closed and another account opened as a successor to the original account (due, for example, to the theft of checks or a debit card used to access the original account), the successor account is not subject to the new account exception, assuming the previous account relationship is at least 30 days old. Similarly, if a customer closes an established account and opens a separate account within 30 days, the new account is not subject to the new account exception.

iii. If a customer has a savings deposit or other deposit that is not an account (as that term is defined in §229.2(a)) at the bank, and opens an account, the account is subject to the new account exception.

iv. If a person that is authorized to sign on a corporate account (but has no other relationship with the bank) opens a personal account, the personal account is subject to the new account exception.

v. If a customer has an established joint account at a bank, and subsequently opens an individual account with that bank, the individual account is not subject to the new account exception.

vi. If two customers that each have an established individual account with the bank open a joint account, the joint account is not subject to the new account exception. If one of the customers on the account has no current or recent established account relationship with the bank, however, the joint account is subject to the new account exception, even if the other individual on the account has an established account relationship with the bank.

2. Rules Applicable to New Accounts.

a. During the new account exception period, the schedules for local and nonlocal checks do not apply, and, unlike the other exceptions provided in this section, the regulation provides no maximum time frames within which the proceeds of these deposits must be made available for withdrawal. Maximum times within which funds must be available for withdrawal during the new account period are provided, however, for certain other deposits. Deposits received by cash and electronic payments must be made available for withdrawal in accordance with §229.10.

b. Special rules also apply to deposits of Treasury checks, U.S. Postal Service money orders, checks drawn on Federal Reserve Banks and Federal Home Loan Banks, state and local government checks, cashier's checks, certified checks, teller's checks, and, for the purposes of the new account exception only, traveler's checks. The first $5,000 of funds deposited to a new account on any one banking day by these check deposits must be made available for withdrawal in accordance with §229.10(c). Thus, the first $5,000

of the proceeds of these check deposits must be made available on the first business day following deposit, if the deposit is made in person to an employee of the depositary bank and the other conditions of next-day availability are met. Funds must be made available on the second business day after deposit for deposits that are not made over the counter, in accordance with §229.10(c)(2). (Proceeds of Treasury check deposits must be made available on the first business day after deposit, even if the check is not deposited in person to an employee of the depositary bank.) Funds in excess of the first $5,000 deposited by these types of checks on a banking day must be available for withdrawal not later than the ninth business day following the banking day of deposit. The requirements of §229.10(c)(1)(vi) and (vii) that ''on us'' checks and the first $100 of a day's deposit be made available for withdrawal on the next business day do not apply during the new account period.

3. Representation by Customer. The depositary bank may rely on the representation of the customer that the customer has no established account relationship with the bank, and has not had any such account relationship within the past 30 days, to determine whether an account is subject to the new account exception.

C. 229.13(b) Large Deposits

1. Under the large deposit exception, a depositary bank may extend the hold placed on check deposits to the extent that the amount of the aggregate deposit on any banking day exceeds $5,000. This exception applies to local and nonlocal checks, as well as to checks that otherwise would be made available on the next (or second) business day after the day of deposit under §229.10(c). Although the first $5,000 of a day's deposit is subject to the availability otherwise provided for checks, the amount in excess of $5,000 may be held for an additional period of time as provided in §229.13(h). When the large deposit exception is applied to deposits composed of a mix of checks that would otherwise be subject to differing availability schedules, the depositary bank has the discretion to choose the portion of the deposit to which it applies the exception. Deposits by cash or electronic payment are not subject to this exception for large deposits.

2. The following example illustrates the operation of the large deposit exception. If a customer deposits $2,000 in cash and a $9,000 local check on a Monday, $2,100 (the proceeds of the cash deposit and $100 from the local check deposit) must be made available for withdrawal on Tuesday. An additional $4,900 of the proceeds of the local check must be available for withdrawal on Wednesday in accordance with the local schedule, and the remaining $4,000 may be held for an additional period of time under the large deposit exception.

3. Where a customer has multiple accounts with a depositary bank, the bank may apply the large deposit exception to the aggregate deposits to all of the customer's accounts, even if the customer is not the sole holder of the accounts and not all of the holders of the customer's accounts are the same. Thus, a depositary bank may aggregate the deposits made to two individual accounts in the same name, to an individual and a joint account with one common name, or to two joint accounts with at least one common name for the purpose of applying the large deposit exception. Aggregation of deposits to multiple accounts is permitted because the Board believes that the risk to the depositary bank associated with large deposits is similar regardless of how the deposits are allocated among the customer's accounts.

D. 229.13(c) Redeposited Checks

1. The EFA Act gives the Board the authority to promulgate an exception to the schedule for checks that have been returned unpaid and redeposited. Section 229.13(c) provides such an exception for checks that have been returned unpaid and redeposited by the customer or the depositary bank. This exception applies to local and nonlocal checks, as well as to checks that would otherwise be made available on the next (or second) business day after the day of deposit under §229.10(c).

2. This exception addresses the increased risk to the depositary bank that checks that have been returned once will be uncollectible when they are presented to the paying bank a second time. The Board, however, does not believe that this increased risk is present for checks that have been returned due to a missing indorsement. Thus, the exception does not apply to checks returned unpaid due to missing indorsements and redeposited after the missing indorsement has been obtained, if the reason for return indicated on the check (see §229.30(d)) states that it was returned due to a missing indorsement. For the same reason, this exception does not apply to a check returned because it was postdated (future dated), if the reason for return indicated on the check states that it was returned because it was postdated, and if it is no longer postdated when redeposited.

3. To determine when funds must be made available for withdrawal, the banking day on which the check is redeposited is considered to be the day of deposit. A depositary bank that made $100 of a check available for withdrawal under §229.10(c)(1)(vii) can charge back the full amount of the check, including the $100, if the check is returned unpaid, and the $100 need not be made available again if the check is redeposited.

E. 229.13(d) Repeated Overdrafts

1. The EFA Act gives the Board the authority to establish an exception for ''deposit accounts which have been overdrawn repeatedly.'' This paragraph provides two tests to determine what constitutes repeated overdrafts. Under the first test, a customer's accounts are considered repeatedly overdrawn if, on six banking days within the preceding six months, the available balance in any account held by the customer is negative, or the balance would have become negative if checks or other charges to the account had been paid, rather than returned. This test can be met based on separate occurrences (e.g., checks that are returned for insufficient funds on six different days), or based on one occurrence (e.g., a negative balance that remains on the customer's account for six banking days). If the bank dishonors a check that otherwise would have created a negative balance, however, the incident is considered an overdraft only on that day.

2. The second test addresses substantial overdrafts. Such overdrafts increase the risk to the depositary bank of dealing with the repeated overdrafter. Under this test, a customer incurs repeated overdrafts if, on two banking days within the preceding six months, the available balance in any account held by the customer is negative in an amount of $5,000 or more, or would have become negative in an amount of $5,000 or more if checks or other charges to the account had been paid.

3. The exception relates not only to overdrafts caused by checks drawn on the account, but also overdrafts caused by other debit charges (e.g. ACH debits, point-of-sale transactions, returned checks, account fees, etc.). If the potential debit is in excess of available funds, the exception applies regardless of whether the items were paid or returned unpaid. An overdraft resulting from an error on the part of the depositary bank, or from the imposition of overdraft charges for which the customer is entitled to a refund under §§229.13(e) or 229.16(c), cannot be considered in determining whether the customer is a repeated overdrafter. The exception excludes accounts with overdraft lines of credit, unless the credit line has been exceeded or would have been exceeded if the checks or other charges to the account had been paid.

4. This exception applies to local and nonlocal checks, as well as to checks that otherwise would be made available on the next (or second) business day after the day of deposit under §229.10(c). When a bank places or extends a hold under this exception, it need not make the first $100 of a deposit available for withdrawal on the next business day, as otherwise would be required by §229.10(c)(1)(vii).

F. 229.13(e) Reasonable Cause To Doubt Collectibility

1. In the case of certain check deposits, if the bank has reasonable cause to believe the check is uncollectible, it may extend the time funds must be made available for withdrawal. This exception applies to local and nonlocal checks, as well as to checks that would otherwise be made available on the next (or second) business day after the day of deposit under §229.10(c). When a bank places or extends a hold under this exception, it need not make the first $100 of a deposit available for withdrawal on the next business day, as otherwise would be required by §229.10(c)(1)(vii). If the reasonable cause exception is invoked, the bank must include in the notice to its customer, required by §229.13(g), the reason that the bank believes that the check is uncollectible.

2. The following are several examples of circumstances under which the reasonable cause exception may be invoked:

a. If a bank received a notice from the paying bank that a check was not paid and is being returned to the depositary bank, the depositary bank could place a hold on the check or extend a hold previously placed on that check, and notify the customer that the bank had received notice that the check is being returned. The exception could be invoked even if the notice were incomplete, if the bank had reasonable cause to believe that the notice applied to that particular check.

b. The depositary bank may have received information from the paying bank, prior to the presentment of the check, that gives the bank reasonable cause to believe that the check is uncollectible. For example, the paying bank may have indicated that payment has been stopped on the check, or that the drawer's account does not currently have sufficient funds to honor the check. Such information may provide sufficient basis to invoke this exception. In these cases, the depositary bank could invoke the exception and disclose as the reason the exception is being invoked the fact that information from the paying bank indicates that the check may not be paid.

c. The fact that a check is deposited more than six months after the date on the check (*i.e.* a stale check) is a reasonable indication that the check may be uncollectible, because under U.C.C. 4–404 a bank has no duty to its customer to pay a check that is more than six months old. Similarly, if a check being deposited is postdated (future dated), the bank may have a reasonable cause to believe the check is uncollectible, because the check may not be properly payable under U.C.C. 4–401. The bank, in its notice, should specify that the check is stale-dated or postdated.

d. There are reasons that may cause a bank to believe that a check is uncollectible that

are based on confidential information. For example, a bank could conclude that a check being deposited is uncollectible based on its reasonable belief that the depositor is engaging in kiting activity. Reasonable belief as to the insolvency or pending insolvency of the drawer of the check or the drawee bank and that the checks will not be paid also may justify invoking this exception. In these cases, the bank may indicate, as the reason it is invoking the exception, that the bank has confidential information that indicates that the check might not be paid.

3. The Board has included a reasonable cause exception notice as a model notice in appendix C (C–13). The model notice includes several reasons for which this exception may be invoked. The Board does not intend to provide a comprehensive list of reasons for which this exception may be invoked; another reason that does not appear on the model notice may be used as the basis for extending a hold, if the reason satisfies the conditions for invoking this exception. A depositary bank may invoke the reasonable cause exception based on a combination of factors that give rise to a reasonable cause to doubt the collectibility of a check. In these cases, the bank should disclose the primary reasons for which the exception was invoked in accordance with paragraph (g) of this section.

4. The regulation provides that the determination that a check is uncollectible shall not be based on a class of checks or persons. For example, a depositary bank cannot invoke this exception simply because the check is drawn on a paying bank in a rural area and the depositary bank knows it will not have the opportunity to learn of nonpayment of that check before funds must be made available under the availability schedules. Similarly, a depositary bank cannot invoke the reasonable cause exception based on the race or national origin of the depositor.

5. If a depositary bank invokes this exception with respect to a particular check and does not provide a written notice to the depositor at the time of deposit, the depositary bank may not assess any overdraft fee (such as an ''NSF'' charge) or charge interest for use of overdraft credit, if the check is paid by the paying bank and these charges would not have occurred had the exception not been invoked. A bank may assess an overdraft fee under these circumstances, however, if it provides notice to the customer, in the notice of exception required by paragraph (g) of this section, that the fee may be subject to refund, and refunds the charges upon the request of the customer. The notice must state that the customer may be entitled to a refund of any overdraft fees that are assessed if the check being held is paid, and indicate where such requests for a refund of overdraft fees should be directed.

G. 229.13(f) Emergency Conditions

1. Certain emergency conditions may arise that delay the collection or return of checks, or delay the processing and updating of customer accounts. In the circumstances specified in this paragraph, the depositary bank may extend the holds that are placed on deposits of checks that are affected by such delays, if the bank exercises such diligence as the circumstances require. For example, if a bank learns that a check has been delayed in the process of collection due to severe weather conditions or other causes beyond its control, an emergency condition covered by this section may exist and the bank may place a hold on the check to reflect the delay. This exception applies to local and nonlocal checks, as well as checks that would otherwise be made available on the next (or second) business day after the day of deposit under § 229.10(c). When a bank places or extends a hold under this exception, it need not make the first $100 of a deposit available for withdrawal on the next business day, as otherwise would be required by § 229.10(c)(1)(vii). In cases where the emergency conditions exception does not apply, as in the case of deposits of cash or electronic payments under § 229.10 (a) and (b), the depositary bank may not be liable for a delay in making funds available for withdrawal if the delay is due to a bona fide error such as an unavoidable computer malfunction.

H. 229.13(g) Notice of Exception

1. In general.

a. If a depositary bank invokes any of the safeguard exceptions to the schedules listed above, other than the new account or emergency conditions exception, and extends the hold on a deposit beyond the time periods permitted in §§ 229.10(c) and 229.12, it must provide a notice to its customer. Except in the cases described in paragraphs (g)(2) and (g)(3) of this section, notices must be given each time an exception hold is invoked and must state the customer's account number, the date of deposit, the reason the exception was invoked, and the time period within which funds will be available for withdrawal. For a customer that is not a consumer, a depositary bank satisfies the written-notice requirement by sending an electronic notice that displays the text and is in a form that the customer may keep, if the customer agrees to such means of notice. Information is in a form that the customer may keep if, for example, it can be downloaded or printed. For a customer who is a consumer, a depositary bank satisfies the written-notice requirement by sending an electronic notice in compliance with the requirements of the Electronic Signatures in Global and National Commerce Act (12 U.S.C. 7001 *et seq.*), which

include obtaining the consumer's affirmative consent to such means of notice.

b. With respect to paragraph (g)(1), the requirement that the notice state the time period within which the funds shall be made available may be satisfied if the notice identifies the date the deposit is received and information sufficient to indicate when funds will be available and the amounts that will be available at those times. For example, for a deposit involving more than one check, the bank need not provide a notice that discloses when funds from each individual check in the deposit will be available for withdrawal; instead, the bank may provide a total dollar amount for each of the time periods when funds will be available, or provide the customer with an explanation of how to determine the amount of the deposit that will be held and when the funds will be available for deposit. Appendix C (C–12) contains a model notice.

c. For deposits made in person to an employee of the depositary bank, the notice generally must be given to the person making the deposit, i.e., the ''depositor'', at the time of deposit. The depositor need not be the customer holding the account. For other deposits, such as deposits received at an ATM, lobby deposit box, night depository, or through the mail, notice must be mailed to the customer not later than the close of the business day following the banking day on which the deposit was made.

d. Notice to the customer also may be provided at a later time, if the facts upon which the determination to invoke the exception do not become known to the depositary bank until after notice would otherwise have to be given. In these cases, the bank must mail the notice to the customer as soon as practicable, but not later than the business day following the day the facts become known. A bank is deemed to have knowledge when the facts are brought to the attention of the person or persons in the bank responsible for making the determination, or when the facts would have been brought to their attention if the bank had exercised due diligence.

e. In those cases described in paragraphs (g)(2) and (g)(3), the depositary bank need not provide a notice every time an exception hold is applied to a deposit. When paragraph (g)(2) or (g)(3) requires disclosure of the time period within which deposits subject to the exception generally will be available for withdrawal, the requirement may be satisfied if the one-time notice states when ''on us,'' local, and nonlocal checks will be available for withdrawal if an exception is invoked.

2. One-time exception notice.

a. Under paragraph (g)(2), if a nonconsumer account (see Commentary to §229.2(n)) is subject to the large deposit or redeposited check exception, the depositary bank may give its customer a single notice at or prior to the time notice must be provided under paragraph (g)(1). Notices provided under paragraph (g)(2) must contain the reason the exception may be invoked and the time period within which deposits subject to the exception will be available for withdrawal (see Model Notice C–14). A depositary bank may provide a one-time notice to a nonconsumer customer under paragraph (g)(2) only if each exception cited in the notice (the large deposit and/or the redeposited check exception) will be invoked for most check deposits to the customer's account to which the exception could apply. A one-time notice may state that the depositary bank will apply exception holds to certain subsets of deposits to which the large deposit or redeposited check exception may apply, and the notice should identify such subsets. For example, the depositary bank may apply the redeposited check exception only to checks that were redeposited automatically by the depositary bank in accordance with an agreement with the customer, rather than to all redeposited checks. In lieu of sending the one-time notice, a depositary bank may send individual hold notices for each deposit subject to the large deposit or redeposited check exception in accordance with §229.13(g)(1) (see Model Notice C–12).

b. In the case of a deposit of multiple checks, the depositary bank has the discretion to place an exception hold on any combination of checks in excess of $5,000. The notice should enable a customer to determine the availability of the deposit in the case of a deposit of multiple checks. For example, if a customer deposits a $5,000 local check and a $5,000 nonlocal check, under the large deposit exception, the depositary bank may make funds available in the amount of (1) $100 on the first business day after deposit, $4,900 on the second business day after deposit (local check), and $5,000 on the eleventh business day after deposit (nonlocal check with 6-day exception hold), or (2) $100 on the first business day after deposit, $4,900 on the fifth business day after deposit (nonlocal check), and $5,000 on the seventh business day after deposit (local check with 5-day exception hold). The notice should reflect the bank's priorities in placing exception holds on next-day (or second-day), local, and nonlocal checks.

3. Notice of repeated overdraft exception. Under paragraph (g)(3), if an account is subject to the repeated overdraft exception, the depositary bank may provide one notice to its customer for each time period during which the exception will apply. Notices sent pursuant to paragraph (g)(3) must state the customer's account number, the fact the exception was invoked under the repeated overdraft exception, the time period within which deposits subject to the exception will be made available for withdrawal, and the time period during which the exception will

apply (see Model Notice C–15). A depositary bank may provide a one-time notice to a customer under paragraph (g)(3) only if the repeated overdraft exception will be invoked for most check deposits to the customer's account.

4. Emergency conditions exception notice.

a. If an account is subject to the emergency conditions exception under §229.13(f), the depositary bank must provide notice in a reasonable form within a reasonable time, depending on the circumstances. For example, a depositary bank may learn of a weather emergency or a power outage that affects the paying bank's operations. Under these circumstances, it likely would be reasonable for the depositary bank to provide an emergency conditions exception notice in the same manner and within the same time as required for other exception notices. On the other hand, if a depositary bank experiences a weather or power outage emergency that affects its own operations, it may be reasonable for the depositary bank to provide a general notice to all depositors via postings at branches and ATMs, or through newspaper, television, or radio notices.

b. If the depositary bank extends the hold placed on a deposit due to an emergency condition, the bank need not provide a notice if the funds would be available for withdrawal before the notice must be sent. For example, if on the last day of a hold period the depositary bank experiences a computer failure and customer accounts cannot be updated in a timely fashion to reflect the funds as available balances, notices are not required if the funds are made available before the notices must be sent.

5. Record retention. A depositary bank must retain a record of each notice of a reasonable cause exception for a period of two years, or such longer time as provided in the record retention requirements of §229.21. This record must contain a brief description of the facts on which the depositary bank based its judgment that there was reasonable cause to doubt the collectibility of a check. In many cases, such as where the exception was invoked on the basis of a notice of nonpayment received, the record requirement may be met by retaining a copy of the notice sent to the customer. In other cases, such as where the exception was invoked on the basis of confidential information, a further description to the facts, such as insolvency of drawer, should be included in the record.

### I. 229.13(h) Availability of Deposits Subject to Exceptions

1. If a depositary bank invokes any exception other than the new account exception, the bank may extend the time within which funds must be made available under the schedule by a reasonable period of time. This provision establishes that an extension of up to one business day for ''on us'' checks, five business days for local checks, and six business days for nonlocal checks and checks deposited in a nonproprietary ATM is reasonable. Under certain circumstances, however, a longer extension of the schedules may be reasonable. In these cases, the burden is placed on the depositary bank to establish that a longer period is reasonable.

2. For example, assume a bank extended the hold on a local check deposit by five business days based on its reasonable cause to believe that the check is uncollectible. If, on the day before the extended hold is scheduled to expire, the bank receives a notification from the paying bank that the check is being returned unpaid, the bank may determine that a longer hold is warranted, if it decides not to charge back the customer's account based on the notification. If the bank decides to extend the hold, the bank must send a second notice, in accordance with paragraph (g) of this section, indicating the new date that the funds will be available for withdrawal.

3. With respect to Treasury checks, U.S. Postal Service money orders, checks drawn on Federal Reserve Banks or Federal Home Loan Banks, state and local government checks, cashier's checks, certified checks, and teller's checks subject to the next-day (or second-day) availability requirement, the depositary bank may extend the time funds must be made available for withdrawal under the large deposit, redeposited check, repeated overdraft, or reasonable cause exception by a reasonable period beyond the delay that would have been permitted under the regulation had the checks not been subject to the next-day (or second-day) availability requirement. The additional hold is added to the local or nonlocal schedule that would apply based on the location of the paying bank.

4. One business day for ''on us'' checks, five business days for local checks, and six business days for nonlocal checks or checks deposited in a nonproprietary ATM, in addition to the time period provided in the schedule, should provide adequate time for the depositary bank to learn of the nonpayment of virtually all checks that are returned. For example, if a customer deposits a $7,000 cashier's check drawn on a nonlocal bank, and the depositary bank applies the large deposit exception to that check, $5,000 must be available for withdrawal on the first business day after the day of deposit and the remaining $2,000 must be available for withdrawal on the eleventh business day following the day of deposit (six business days added to the five-day schedule for nonlocal checks), unless the depositary bank establishes that a longer hold is reasonable.

5. In the case of the application of the emergency conditions exception, the depositary bank may extend the hold placed on a check by not more than a reasonable period

following the end of the emergency or the time funds must be available for withdrawal under §§ 229.10(c) or 229.12, whichever is later.

6. This provision does not apply to holds imposed under the new account exception. Under that exception, the maximum time period within which funds must be made available for withdrawal is specified for deposits that generally must be accorded next-day availability under § 229.10. This subpart does not specify the maximum time period within which the proceeds of local and nonlocal checks must be made available for withdrawal during the new account period.

*VIII. Section 229.14 Payment of Interest*

A. 229.14(a) In General

1. This section requires that a depositary bank begin accruing interest on interest-bearing accounts not later than the day on which the depositary bank receives credit for the funds deposited.[3] A depositary bank generally receives credit on checks within one or two days following deposit. A bank receives credit on a cash deposit, an electronic payment, and the deposit of a check that is drawn on the depositary bank itself on the day the cash, electronic payment, or check is received. In the case of a deposit at a nonproprietary ATM, credit generally is received on the day the bank that operates the ATM credits the depositary bank for the amount of the deposit. In the case of a deposit at a contractual branch, credit is received on the day the depositary bank receives credit for the amount of the deposit, which may be different from the day the contractual branch receives credit for the deposit.

2. Because account includes only transaction accounts, other interest-bearing accounts of the depositary bank, such as money market deposit accounts, savings deposits, and time deposits, are not subject to this requirement; however, a bank may accrue interest on such deposits in the same way that it accrues interest under this paragraph for simplicity of operation. The Board intends the term interest to refer to payments to or for the account of any customer as compensation for the use of funds, but to exclude the absorption of expenses incident to providing a normal banking function or a bank's forbearance from charging a fee in connection with such a service. (See 12 CFR 217.2(d).) Thus, earnings credits often applied to corporate accounts are not interest payments for the purposes of this section.

3. It may be difficult for a depositary bank to track which day the depositary bank receives credit for specific checks in order to accrue interest properly on the account to which the check is deposited. This difficulty may be pronounced if the bank uses different means of collecting checks based on the time of day the check is received, the dollar amount of the check, and/or the paying bank to which it must be sent. Thus, for the purpose of the interest accrual requirement, a bank may rely on an availability schedule from its Federal Reserve Bank, Federal Home Loan Bank, or correspondent to determine when the depositary bank receives credit. If availability is delayed beyond that specified in the availability schedule, a bank may charge back interest erroneously accrued or paid on the basis of that schedule.

4. This paragraph also permits a depositary bank to accrue interest on checks deposited to all of its interest-bearing accounts based on when the bank receives credit on all checks sent for payment or collection. For example, if a bank receives credit on 20 percent of the funds deposited in the bank by check as of the business day of deposit (e.g., "on us" checks), 70 percent as of the business day following deposit, and 10 percent on the second business day following deposit, the bank can apply these percentages to determine the day interest must begin to accrue on check deposits to all interest-bearing accounts, regardless of when the bank received credit on the funds deposited in any particular account. Thus, a bank may begin accruing interest on a uniform basis for all interest-bearing accounts, without the need to track the type of check deposited to each account.

5. This section is not intended to limit a policy of a depositary bank that provides that interest accrues only on balances that exceed a specified amount, or on the minimum balance maintained in the account

[3] This section implements section 606 of the EFA Act (12 U.S.C. 4005). The EFA Act keys the requirement to pay interest to the time the depositary bank receives provisional credit for a check. Provisional credit is a term used in the U.C.C. that is derived from the Code's concept of provisional settlement. (See U.C.C. 4–214 and 4–215.) Provisional credit is credit that is subject to charge-back if the check is returned unpaid; once the check is finally paid, the right to charge back expires and the provisional credit becomes final. Under Subpart C, a paying bank no longer has an automatic right to charge back credits given in settlement of a check, and the concept of provisional settlement is no longer useful and has been eliminated by the regulation. Accordingly, this section uses the term credit rather than provisional credit, and this section applies regardless of whether a credit would be provisional or final under the U.C.C. Credit does not include a bookkeeping entry (sometimes referred to as deferred credit) that does not represent funds actually available for the bank's use.

during a given period, provided that the balance is determined based on the date that the depositary bank receives credit for the funds. This section also is not intended to limit any policy providing that interest accrues sooner than required by this paragraph.

B. 229.14(b) Special Rule for Credit Unions

1. This provision implements a requirement in section 606(b) of the EFA Act, and provides an exemption from the payment-of-interest requirements for credit unions that do not begin to accrue interest or dividends on their customer accounts until a later date than the day the credit union receives credit for those deposits, including cash deposits. These credit unions are exempt from the payment-of-interest requirements, as long as they provide notice of their interest accrual policies in accordance with §229.16(d). For example, if a credit union has a policy of computing interest on all deposits received by the 10th of the month from the first of that month, and on all deposits received after the 10th of the month from the first of the next month, that policy is not superseded by this regulation, if the credit union provides proper disclosure of this policy to its customers.

2. The EFA Act limits this exemption to credit unions; other types of banks must comply with the payment-of-interest requirements. In addition, credit unions that compute interest from the day of deposit or day of credit should not change their existing practices in order to avoid compliance with the requirement that interest accrue from the day the credit union receives credit.

C. 229.14(c) Exception for Checks Returned Unpaid

1. This provision is based on section 606(c) of the EFA Act (12 U.S.C. 4005(c)) and provides that interest need not be paid on funds deposited in an interest-bearing account by check that has been returned unpaid, regardless of the reason for return.

*IX. Section 229.15 General Disclosure Requirements*

A. 229.15(a) Form of Disclosures

1. This paragraph sets forth the general requirements for the disclosures required under Subpart B. All of the disclosures must be given in a clear and conspicuous manner, must be in writing, and, in most cases, must be in a form the customer may keep. A disclosure is in a form that the customer may keep if, for example, it can be downloaded or printed. For a customer that is not a consumer, a depositary bank satisfies the written-disclosure requirement by sending an electronic disclosure that displays the text and is in a form that the customer may keep, if the customer agrees to such means of disclosure. For a customer who is a consumer, a depositary bank satisfies the written-notice requirement by sending an electronic notice in compliance with the requirements of the Electronic Signatures in Global and National Commerce Act (12 U.S.C. 7001 *et seq.*), which include obtaining the consumer's affirmative consent to such means of notice. Disclosures posted at locations where employees accept consumer deposits, at ATMs, and on preprinted deposit slips need not be in a form that the customer may keep. Appendix C of the regulation contains model forms, clauses, and notices to assist banks in preparing disclosures.

2. Disclosures concerning availability must be grouped together and may not contain any information that is not related to the disclosures required by this subpart. Therefore, banks may not intersperse the required disclosures with other account disclosures, and may not include other account information that is not related to their availability policy within the text of the required disclosures. Banks may, however, include information that is related to their availability policies. For example, a bank may inform its customers that, even when the bank has already made funds available for withdrawal, the customer is responsible for any problem with the deposit, such as the return of a deposited check.

3. The regulation does not require that the disclosures be segregated from other account terms and conditions. For example, banks may include the disclosure of their specific availability policy in a booklet or pamphlet that sets out all of the terms and conditions of the bank's accounts. The required disclosures must, however, be grouped together and highlighted or identified in some manner, for example, by use of a separate heading for the disclosures, such as ''When Deposits are Available for Withdrawal.''

4. A bank may, by agreement or at the consumer's request, provide any disclosure or notice required by subpart B in a language other than English, provided that the bank makes a complete disclosure available in English at the customer's request.

B. 229.15(b) Uniform Reference to Day of Availability

1. This paragraph requires banks to disclose in a uniform manner when deposited funds will be available for withdrawal. Banks must disclose when deposited funds are available for withdrawal by stating the business day on which the customer may begin to withdraw funds. The business day funds will be available must be disclosed as ''the _____ business day after'' the day of deposit, or substantially similar language. The business day of availability is determined by counting the number of business

days starting with the business day following the banking day on which the deposit is received, as determined under § 229.19(a), and ending with the business day on which the customer may begin to withdraw funds. For example, a bank that imposes delays of four intervening business days for nonlocal checks must describe those checks as being available on ''the fifth business day after'' the day of the deposit.

C. 229.15(c) Multiple Accounts and Multiple Account Holders

1. This paragraph clarifies that banks need not provide multiple disclosures under the regulation. A single disclosure to a customer that holds multiple accounts, or a single disclosure to one of the account holders of a jointly held account, satisfies the disclosure requirements of the regulation.

D. 229.15(d) Dormant or Inactive Accounts

1. This paragraph makes clear that banks need not provide disclosure of their specific availability policies to customers that hold accounts that are either dormant or inactive. The determination that certain accounts are dormant or inactive must be made by the bank. If a bank considers an account dormant or inactive for purposes other than this regulation and no longer provides statements and other mailings to an account for this reason, such an account is considered dormant or inactive for purposes of this regulation.

*X. Section 229.16 Specific Availability Policy Disclosure*

A. 229.16(a) General

1. This section describes the information that must be disclosed by banks to comply with §§ 229.17 and 229.18(d), which require that banks furnish notices of their specific policy regarding availability of deposited funds. The disclosure provided by a bank must reflect the availability policy followed by the bank in most cases, even though a bank may in some cases make funds available sooner or impose a longer delay.

2. The disclosure must reflect the policy and practice of the bank regarding availability as to most accounts and most deposits into those accounts. In disclosing the availability policy that it follows in most cases, a bank may provide a single disclosure that reflects one policy to all its transaction account customers, even though some of its customers may receive faster availability than that reflected in the policy disclosure. Thus, a bank need not disclose to some customers that they receive faster availability than indicated in the disclosure. If, however, a bank has a policy of imposing delays in availability on any customers longer than those specified in its disclosure, those customers must receive disclosures that reflect the longer applicable availability periods. A bank may establish different availability policies for different groups of customers, such as customers in a particular geographic area or customers of a particular branch. For purposes of providing a specific availability policy, the bank may allocate customers among groups through good faith use of a reasonable method. A bank may also establish different availability policies for deposits at different locations, such as deposits at a contractual branch.

3. A bank may disclose that funds are available for withdrawal on a given day notwithstanding the fact that the bank uses the funds to pay checks received before that day. For example, a bank may disclose that its policy is to make funds available from deposits of local checks on the second business day following the day of deposit, even though it may use the deposited funds to pay checks prior to the second business day; the funds used to pay checks in this example are not available for withdrawal until the second business day after deposit because the funds are not available for all uses until the second business day. (See the definition of available for withdrawal in § 229.2(d).)

B. 229.16(b) Content of Specific Policy Disclosure

1. This paragraph sets forth the items that must be included, as applicable, in a bank's specific availability policy disclosure. The information that must be disclosed by a particular bank will vary considerably depending upon the bank's availability policy. For example, a bank that makes deposited funds available for withdrawal on the business day following the day of deposit need simply disclose that deposited funds will be available for withdrawal on the first business day after the day of deposit, the bank's business days, and when deposits are considered received.

2. On the other hand, a bank that has a policy of routinely delaying on a blanket basis the time when deposited funds are available for withdrawal would have a more detailed disclosure. Such blanket hold policies might be for the maximum time allowed under the federal law or might be for shorter periods. These banks must disclose the types of deposits that will be subject to delays, how the customer can determine the type of deposit being made, and the day that funds from each type of deposit will be available for withdrawal.

3. Some banks may have a combination of next-day availability and blanket delays. For example, a bank may provide next-day availability for all deposits except for one or two categories, such as deposits at nonproprietary ATMs and nonlocal personal checks over a specified dollar amount. The bank would describe the categories that are subject to delays in availability and tell the

customer when each category would be available for withdrawal, and state that other deposits will be available for withdrawal on the first business day after the day of deposit. Similarly, a bank that provides availability on the second business day for most of its deposits would need to identify the categories of deposits which, under the regulation, are subject to next-day availability and state that all other deposits will be available on the second business day.

4. Because many banks' availability policies may be complex, a bank must give a brief summary of its policy at the beginning of the disclosure. In addition, the bank must describe any circumstances when actual availability may be longer than the schedules disclosed. Such circumstances would arise, for example, when the bank invokes one of the exceptions set forth in §229.13 of the regulation, or when the bank delays or extends the time when deposited funds are available for withdrawal up to the time periods allowed by the regulation on a case-by-case basis. Also, a bank that must make certain checks available faster under appendix B (reduction of schedules for certain nonlocal checks) must state that some check deposits will be available for withdrawal sooner because of special rules and that a list of the pertinent routing numbers is available upon request.

5. Generally, a bank that distinguishes in its disclosure between local and nonlocal checks based on the routing number on the check must disclose to its customers that certain checks, such as some credit union payable-through drafts, will be treated as local or nonlocal based on the location of the bank by which they are payable (e.g., the credit union), and not on the basis of the location of the bank whose routing number appears on the check. A bank is not required to provide this disclosure, however, if it makes the proceeds of both local and nonlocal checks available for withdrawal within the time periods required for local checks in §§229.12 and 229.13.

6. The business day cut-off time used by the bank must be disclosed and if some locations have different cut-off times the bank must note this in the disclosure and state the earliest time that might apply. A bank need not list all of the different cut-off times that might apply. If a bank does not have a cut-off time prior to its closing time, the bank need not disclose a cut-off time.

7. A bank taking advantage of the extended time period for making deposits at nonproprietary ATMs available for withdrawal under §229.12(f) must explain this in the initial disclosure. In addition, the bank must provide a list (on or with the initial disclosure) of either the bank's proprietary ATMs or those ATMs that are nonproprietary at which customers may make deposits. As an alternative to providing such a list, the bank may label all of its proprietary ATMs with the bank's name and state in the initial disclosure that this has been done. Similarly, a bank taking advantage of the cash withdrawal limitations of §229.12(d), or the provision in §229.19(e) allowing holds to be placed on other deposits when a deposit is made or a check is cashed, must explain this in the initial disclosure.

8. A bank that provides availability based on when the bank generally receives credit for deposited checks need not disclose the time when a check drawn on a specific bank will be available for withdrawal. Instead, the bank may disclose the categories of deposits that must be available on the first business day after the day of deposit (deposits subject to §229.10) and state the other categories of deposits and the time periods that will be applicable to those deposits. For example, a bank might disclose the four-digit Federal Reserve routing symbol for local checks and indicate that such checks as well as certain nonlocal checks will be available for withdrawal on the first or second business day following the day of deposit, depending on the location of the particular bank on which the check is drawn, and disclose that funds from all other checks will be available on the second or third business day. The bank must also disclose that the customer may request a copy of the bank's detailed schedule that would enable the customer to determine the availability of any check and must provide such schedule upon request. A change in the bank's detailed schedule would not trigger the change in policy disclosure requirement of §229.18(e).

C. 229.16(c) Longer Delays on a Case-by-Case Basis

1. Notice in specific policy disclosure.

a. Banks that make deposited funds available for withdrawal sooner than required by the regulation—for example, providing their customers with immediate or next-day availability for deposited funds—and delay the time when funds are available for withdrawal only from time to time determined on a case-by-case basis, must provide notice of this in their specific availability policy disclosure. This paragraph outlines the requirements for that notice.

b. In addition to stating what their specific availability policy is in most cases, banks that may delay or extend the time when deposits are available on a case-by-case basis must: state that from time to time funds may be available for withdrawal later than the time periods in their specific policy disclosure, disclose the latest time that a customer may have to wait for deposited funds to be available for withdrawal when a case-by-case hold is placed, state that customers will be notified when availability of a deposit is delayed on a case-by-case basis, and advise customers to ask if they need to be

sure of the availability of a particular deposit.

c. A bank that imposes delays on a case-by-case basis is still subject to the availability requirements of this regulation. If the bank imposes a delay on a particular deposit that is not longer than the availability required by §229.12 for local and nonlocal checks, the reason for the delay need not be based on the exceptions provided in §229.13. If the delay exceeds the time periods permitted under §229.12, however, then it must be based on an exception provided in §229.13, and the bank must comply with the §229.13 notice requirements. A bank that imposes delays on a case-by-case basis may avail itself of the one-time notice provisions in §229.13(g)(2) and (3) for deposits to which those provisions apply.

2. Notice at time of case-by-case delay.

a. In addition to including the disclosures required by paragraph (c)(1) of this section in their specific availability policy disclosure, banks that delay or extend the time period when funds are available for withdrawal on a case-by-case basis must give customers a notice when availability of funds from a particular deposit will be delayed or extended beyond the time when deposited funds are generally available for withdrawal. The notice must state that a delay is being imposed and indicate when the funds will be available. In addition, the notice must include the account number, the date of the deposit, and the amount of the deposit being delayed.

b. If notice of the delay was not given at the time the deposit was made and the bank assesses overdraft or returned check fees on accounts when a case-by-case hold has been placed, the case-by-case hold notice provided to the customer must include a notice concerning overdraft or returned check fees. The notice must state that the customer may be entitled to a refund of any overdraft or returned check fees that result from the deposited funds not being available if the check that was deposited was in fact paid by the payor bank, and explain how to request a refund of any fees. (See §229.16(c)(3).)

c. The requirement that the case-by-case hold notice state the day that funds will be made available for withdrawal may be met by stating the date or the number of business days after deposit that the funds will be made available. This requirement is satisfied if the notice provides information sufficient to indicate when funds will be available and the amounts that will be available at those times. For example, for a deposit involving more than one check, the bank need not provide a notice that discloses when funds from each individual item in the deposit will be available for withdrawal. Instead, the bank may provide a total dollar amount for each of the time periods when funds will be available, or provide the customer with an explanation of how to determine the amount of the deposit that will be held and when the held funds will be available for withdrawal.

d. For deposits made in person to an employee of the depositary bank, the notice generally must be given at the time of the deposit. The notice at the time of the deposit must be given to the person making the deposit, that is, the ''depositor.'' The depositor need not be the customer holding the account. For other deposits, such as deposits received at an ATM, lobby deposit box, night depository, through the mail, or by armored car, notice must be mailed to the customer not later than the close of the business day following the banking day on which the deposit was made. Notice to the customer also may be provided not later than the close of the business day following the banking day on which the deposit was made if the decision to delay availability is made after the time of the deposit.

3. Overdraft and returned check fees. If a depositary bank delays or extends the time when funds from a deposited check are available for withdrawal on a case-by-case basis and does not provide a written notice to its depositor at the time of deposit, the depositary bank may not assess any overdraft or returned check fees (such as an insufficient funds charge) or charge interest for use of an overdraft line of credit, if the deposited check is paid by the paying bank and these fees would not have occurred had the additional case-by-case delay not been imposed. A bank may assess an overdraft or returned check fee under these circumstances, however, if it provides notice to the customer in the notice required by paragraph (c)(2) of this section that the fee may be subject to refund, and refunds the fee upon the request of the customer when required to do so. The notice must state that the customer may be entitled to a refund of any overdraft or returned check fees that are assessed if the deposited check is paid, and indicate where such requests for a refund of overdraft fees should be directed. Paragraph (c)(3) applies when a bank provides a case-by-case notice in accordance with paragraph (c)(2) and does not apply if the bank has provided an exception hold notice in accordance with §229.13.

### D. 229.16(d) Credit Union Notice of Interest Payment Policy

1. This paragraph sets forth the special disclosure requirement for credit unions that delay accrual of interest or dividends for all cash and check deposits beyond the date of receiving provisional credit for checks being deposited. (The interest payment requirement is set forth in §229.14(a).) Such credit unions are required to describe their policy with respect to accrual of interest or dividends on deposits in their specific availability policy disclosure.

*XI. Section 229.17 Initial Disclosures*

A. This paragraph requires banks to provide a notice of their availability policy to all potential customers prior to opening an account. The requirement of a notice prior to opening an account requires banks to provide disclosures prior to accepting a deposit to open an account. Disclosures must be given at the time the bank accepts an initial deposit regardless of whether the bank has opened the account yet for the customer. If a bank, however, receives a written request by mail from a person asking that an account be opened and the request includes an initial deposit, the bank may open the account with the deposit, provided the bank mails the required disclosures to the customer not later than the business day following the banking day on which the bank receives the deposit. Similarly, if a bank receives a telephone request from a customer asking that an account be opened with a transfer from a separate account of the customer's at the bank, the disclosure may be mailed not later than the business day following the banking day of the request.

*XII. Section 229.18 Additional Disclosure Requirements*

A. 229.18(a) Deposit Slips

1. This paragraph requires banks to include a notice on all preprinted deposit slips. The deposit slip notice need only state, somewhere on the front of the deposit slip, that deposits may not be available for immediate withdrawal. The notice is required only on preprinted deposit slips—those printed with the customer's account number and name and furnished by the bank in response to a customer's order to the bank. A bank need not include the notice on deposit slips that are not preprinted and supplied to the customer—such as counter deposit slips—or on those special deposit slips provided to the customer under §229.10(c). A bank is not responsible for ensuring that the notice appear on deposit slips that the customer does not obtain from or through the bank. This paragraph applies to preprinted deposit slips furnished to customers on or after September 1, 1988.

B. 229.18(b) Locations Where Employees Accept Consumer Deposits

1. This paragraph describes the statutory requirement that a bank post in each location where its employees accept consumer deposits a notice of its availability policy pertaining to consumer accounts. The notice that is required must specifically state the availability periods for the various deposits that may be made to consumer accounts. The notice need not be posted at each teller window, but the notice must be posted in a place where consumers seeking to make deposits are likely to see it before making their deposits. For example, the notice might be posted at the point where the line forms for teller service in the lobby. The notice is not required at any drive-through teller windows nor is it required at night depository locations, or at locations where consumer deposits are not accepted. A bank that acts as a contractual branch at a particular location must include the availability policy that applies to its own customers but need not include the policy that applies to the customers of the bank for which it is acting as a contractual branch.

C. 229.18(c) Automated Teller Machines

1. This paragraph sets forth the required notices for ATMs. Paragraph (c)(1) provides that the depositary bank is responsible for posting a notice on all ATMs at which deposits can be made to accounts at the depositary bank. The depositary bank may arrange for a third party, such as the owner or operator of the ATM, to post the notice and indemnify the depositary bank from liability if the depositary bank is liable under §229.21 for the owner or operator failing to provide the required notice.

2. The notice may be posted on a sign, shown on the screen, or included on deposit envelopes provided at the ATM. This disclosure must be given before the customer has made the deposit. Therefore, a notice provided on the customer's deposit receipt or appearing on the ATM's screen after the customer has made the deposit would not satisfy this requirement.

3. Paragraph (c)(2) requires a depositary bank that operates an off-premise ATM from which deposits are removed not more than two times a week to make a disclosure of this fact on the off-premise ATM. The notice must disclose to the customer the days on which deposits made at the ATM will be considered received.

D. 229.18(d) Upon Request

1. This paragraph requires banks to provide written notice of their specific availability policy to any person upon that person's oral or written request. The notice must be sent within a reasonable period of time following receipt of the request.

E. 229.18(e) Changes in Policy

1. This paragraph requires banks to send notices to their customers when the banks change their availability policies with regard to consumer accounts. A notice may be given in any form as long as it is clear and conspicuous. If the bank gives notice of a change by sending the customer a complete new availability disclosure, the bank must direct the customer to the changed terms in the disclosure by use of a letter or insert, or

by highlighting the changed terms in the disclosure.

2. Generally, a bank must send a notice at least 30 calendar days before implementing any change in its availability policy. If the change results in faster availability of deposits—for example, if the bank changes its availability for nonlocal checks from the fifth business day after deposit to the fourth business day after deposit—the bank need not send advance notice. The bank must, however, send notice of the change no later than 30 calendar days after the change is implemented. A bank is not required to give a notice when there is a change in appendix B (reduction of schedules for certain nonlocal checks).

3. A bank that has provided its customers with a list of ATMs under §229.16(b)(5) shall provide its customers with an updated list of ATMs once a year if there are changes in the list of ATMs previously disclosed to the customers.

*XIII. Section 229.19 Miscellaneous*

A. 229.19(a) When Funds Are Considered Deposited

1. The time funds must be made available for withdrawal under this subpart is determined by the day the deposit is made. This paragraph provides rules to determine the day funds are considered deposited in various circumstances.

2. Staffed facilities and ATMs. Funds received at a staffed teller station or ATM are considered deposited when received by the teller or placed in the ATM. Funds received at a contractual branch are considered deposited when received by a teller at the contractual branch or deposited into a proprietary ATM of the contractual branch. (See also, Commentary to §229.10(c) on deposits made to an employee of the depositary bank.) Funds deposited to a deposit box in a bank lobby that is accessible to customers only during regular business hours generally are considered deposited when placed in the lobby box; a bank may, however, treat deposits to lobby boxes the same as deposits to night depositories (as provided in §229.19(a)(3)), provided a notice appears on the lobby box informing the customer when such funds will be considered deposited.

3. Mail. Funds mailed to the depositary bank are considered deposited on the banking day they are received by the depositary bank. The funds are received by the depositary bank at the time the mail is delivered to the bank, even if it is initially delivered to a mail room, rather than the check processing area.

4. Other facilities.

a. In addition to deposits at staffed facilities, at ATMs, and by mail, funds may be deposited at a facility such as a night depository or a lock box. A night depository is a receptacle for receipt of deposits, typically used by corporate depositors when the branch is closed. Funds deposited at a night depository are considered deposited on the banking day the deposit is removed, and the contents of the deposit are accessible to the depositary bank for processing. For example, some businesses deposit their funds in a locked bag at the night depository late in the evening, and return to the bank the following day to open the bag. Other depositors may have an agreement with their bank that the deposit bag must be opened under the dual control of the bank and the depositor. In these cases, the funds are considered deposited when the customer returns to the bank and opens the deposit bag.

b. A lock box is a post office box used by a corporation for the collection of bill payments or other check receipts. The depositary bank generally assumes the responsibility for collecting the mail from the lock box, processing the checks, and crediting the corporation for the amount of the deposit. Funds deposited through a lock box arrangement are considered deposited on the day the deposit is removed from the lock box and are accessible to the depositary bank for processing.

5. Certain off-premise ATMs. A special provision is made for certain off-premise ATMs that are not serviced daily. Funds deposited at such an ATM are considered deposited on the day they are removed from the ATM, if the ATM is not serviced more than two times each week. This provision is intended to address the practices of some banks of servicing certain remote ATMs infrequently. If a depositary bank applies this provision with respect to an ATM, a notice must be posted at the ATM informing depositors that funds deposited at the ATM may not be considered deposited until a future day, in accordance with §229.18.

6. Banking day of deposit.

a. This paragraph also provides that a deposit received on a day that the depositary bank is closed, or after the bank's cut-off hour, may be considered made on the next banking day. Generally, for purposes of the availability schedules of this subpart, a bank may establish a cut-off hour of 2 p.m. or later for receipt of deposits at its head office or branch offices. For receipt of deposits at ATMs, contractual branches, or other off-premise facilities, such as night depositories or lock boxes, the depositary bank may establish a cut-off hour of 12:00 noon or later (either local time of the branch or other location of the depositary bank at which the account is maintained or local time of the ATM, contractual branch, or other off-premise facility). The depositary bank must use the same timing method for establishing the cut-off hour for all ATMs, contractual branches, and other off-premise facilities used by its customers. The choice of cut-off

hour must be reflected in the bank's internal procedures, and the bank must inform its customers of the cut-off hour upon request. This earlier cut-off for ATM, contractual branch, or other off-premise deposits is intended to provide greater flexibility in the servicing of these facilities.

b. Different cut-off hours may be established for different types of deposits. For example, a bank may establish a 2 p.m. cut-off for the receipt of check deposits, but a later cut-off for the receipt of wire transfers. Different cut-off hours also may be established for deposits received at different locations. For example, a different cut-off may be established for ATM deposits than for over-the-counter deposits, or for different teller stations at the same branch. With the exception of the 12 noon cut-off for deposits at ATMs and off-premise facilities, no cut-off hour for receipt of deposits for purposes of this subpart can be established earlier than 2 p.m.

c. A bank is not required to remain open until 2 p.m. If a bank closes before 2 p.m., deposits received after the closing may be considered deposited on the next banking day. Further, as §229.2(f) defines the term banking day as the portion of a business day on which a bank is open to the public for substantially all of its banking functions, a day, or a portion of a day, is not necessarily a banking day merely because the bank is open for only limited functions, such as keeping drive-in or walk-up teller windows open, when the rest of the bank is closed to the public. For example, a banking office that usually provides a full range of banking services may close at 12 noon but leave a drive-in teller window open for the limited purpose of receiving deposits and making cash withdrawals. Under those circumstances, the bank is considered closed and may consider deposits received after 12 noon as having been received on the next banking day. The fact that a bank may reopen for substantially all of its banking functions after 2 p.m., or that it continues its back office operations throughout the day, would not affect this result. A bank may not, however, close individual teller stations and reopen them for next-day's business before 2 p.m. during a banking day.

B. 229.19(b) Availability at Start of Business Day

1. If funds must be made available for withdrawal on a business day, the funds must be available for withdrawal by the later of 9 a.m. or the time the depositary bank's teller facilities, including ATMs, are available for customer account withdrawals, except under the special rule for cash withdrawals set forth in §229.12(d). Thus, if a bank has no ATMs and its branch facilities are available for customer transactions beginning at 10 a.m., funds must be available for customer withdrawal beginning at 10 a.m. If the bank has ATMs that are available 24 hours a day, rather than establishing 12:01 a.m. as the start of the business day, this paragraph sets 9 a.m. as the start of the day with respect to ATM withdrawals. The Board believes that this rule provides banks with sufficient time to update their accounting systems to reflect the available funds in customer accounts for that day.

2. The start of business is determined by the local time of the branch or other location of the depositary bank at which the account is maintained. For example, if funds in a customer's account at a west coast bank are first made available for withdrawal at the start of business on a given day, and the customer attempts to withdraw the funds at an east coast ATM, the depositary bank is not required to make the funds available until 9 a.m. west coast time (12 noon east coast time).

C. 229.19(c) Effect on Policies of Depositary Bank

1. This subpart establishes the maximum hold that may be placed on customer deposits. A depositary bank may provide availability to its customers in a shorter time than prescribed in this subpart. A depositary bank also may adopt different funds availability policies for different segments of its customer base, as long as each policy meets the schedules in the regulation. For example, a bank may differentiate between its corporate and consumer customers, or may adopt different policies for its consumer customers based on whether a customer has an overdraft line of credit associated with the account.

2. This regulation does not affect a depositary bank's right to accept or reject a check for deposit, to charge back the customer's account based on a returned check or notice of nonpayment, or to claim a refund for any credit provided to the customer. For example, even if a check is returned or a notice of nonpayment is received after the time by which funds must be made available for withdrawal in accordance with this regulation, the depositary bank may charge back the customer's account for the full amount of the check. (See §229.33(d) and Commentary.)

3. Nothing in the regulation requires a depositary bank to have facilities open for customers to make withdrawals at specified times or on specified days. For example, even though the special cash withdrawal rule set forth in §229.12(d) states that a bank must make up to $400 available for cash withdrawals no later than 5 p.m. on specific business days, if a bank does not participate in an ATM system and does not have any teller windows open at or after 5 p.m., the bank need not join an ATM system or keep

offices open. In this case, the bank complies with this rule if the funds that are required to be available for cash withdrawal at 5 p.m. on a particular day are available for withdrawal at the start of business on the following day. Similarly, if a depositary bank is closed for customer transactions, including ATMs, on a day funds must be made available for withdrawal, the regulation does not require the bank to open.

4. The special cash withdrawal rule in the EFA Act recognizes that the $400 that must be made available for cash withdrawal by 5 p.m. on the day specified in the schedule may exceed a bank's daily ATM cash withdrawal limit and explicitly provides that the EFA Act does not supersede a bank's policy in this regard. As a result, if a bank has a policy of limiting cash withdrawals from automated teller machines to $250 per day, the regulation would not require that the bank dispense $400 of the proceeds of the customer's deposit that must be made available for cash withdrawal on that day.

5. Even though the EFA Act clearly provides that the bank's ATM withdrawal limit is not superseded by the federal availability rules on the day funds must first be made available, the EFA Act does not specifically permit banks to limit cash withdrawals at ATMs on subsequent days when the entire amount of the deposit must be made available for withdrawal. The Board believes that the rationale behind the EFA Act's provision that a bank's ATM withdrawal limit is not superseded by the requirement that funds be made available for cash withdrawal applies on subsequent days. Nothing in the regulation prohibits a depositary bank from establishing ATM cash withdrawal limits that vary among customers of the bank, as long as the limit is not dependent on the length of time funds have been in the customer's account (provided that the permissible hold has expired).

6. Some small banks, particularly credit unions, due to lack of secure facilities, keep no cash on their premises and hence offer no cash withdrawal capability to their customers. Other banks limit the amount of cash on their premises due to bonding requirements or cost factors, and consequently reserve the right to limit the amount of cash each customer can withdraw over-the-counter on a given day. For example, some banks require advance notice for large cash withdrawals in order to limit the amount of cash needed to be maintained on hand at any time.

7. Nothing in the regulation is intended to prohibit a bank from limiting the amount of cash that may be withdrawn at a staffed teller station if the bank has a policy limiting the amount of cash that may be withdrawn, and if that policy is applied equally to all customers of the bank, is based on security, operating, or bonding requirements, and is not dependent on the length of time the funds have been in the customer's account (as long as the permissible hold has expired). The regulation, however, does not authorize such policies if they are otherwise prohibited by statutory, regulatory, or common law.

D. 229.19(d) Use of Calculated Availability

1. A depositary bank may provide availability to its nonconsumer accounts on a calculated availability basis. Under calculated availability, a specified percentage of funds from check deposits may be made available to the customer on the next business day, with the remaining percentage deferred until subsequent days. The determination of the percentage of deposited funds that will be made available each day is based on the customer's typical deposit mix as determined by a sample of the customer's deposits. Use of calculated availability is permitted only if, on average, the availability terms that result from the sample are equivalent to or more prompt than the requirements of this subpart.

E. 229.19(e) Holds on Other Funds

1. Section 607(d) of the EFA Act (12 U.S.C. 4006(d)) provides that once funds are available for withdrawal under the EFA Act, such funds shall not be frozen solely due to the subsequent deposit of additional checks that are not yet available for withdrawal. This provision of the EFA Act is designed to prevent evasion of the EFA Act's availability requirements.

2. This paragraph clarifies that if a customer deposits a check in an account (as defined in §229.2(a)), the bank may not place a hold on any of the customer's funds so that the funds that are held exceed the amount of the check deposited or the total amount of funds held are not made available for withdrawal within the times required in this subpart. For example, if a bank places a hold on funds in a customer's non transaction account, rather than a transaction account, for deposits made to the customer's transaction account, the bank may place such a hold only to the extent that the funds held do not exceed the amount of the deposit and the length of the hold does not exceed the time periods permitted by this regulation.

3. These restrictions also apply to holds placed on funds in a customer's account (as defined in §229.2(a)) if a customer cashes a check at a bank (other than a check drawn on that bank) over the counter. The regulation does not prohibit holds that may be placed on other funds of the customer for checks cashed over the counter, to the extent that the transaction does not involve a deposit to an account. A bank may not, however, place a hold on any account when an ''on us'' check is cashed over the counter. ''On us'' checks are considered finally paid

when cashed (see U.C.C. 4–215(a)(1)). When a customer cashes a check over the counter and the bank places a hold on an account of the customer, the bank must give whatever notice would have been required under §§229.13 or 229.16 had the check been deposited in the account.

F. 229.19(f) Employee Training and Compliance

1. The EFA Act requires banks to take such actions as may be necessary to inform fully each employee that performs duties subject to the EFA Act of the requirements of the EFA Act, and to establish and maintain procedures reasonably designed to assure and monitor employee compliance with such requirements.

2. This paragraph requires a bank to establish procedures to ensure compliance with these requirements and provide these procedures to the employees responsible for carrying them out.

G. 229.19(g) Effect of Merger Transaction

1. After banks merge, there is often a period of adjustment before their operations are consolidated. This paragraph accommodates this adjustment period by allowing merged banks to be treated as separate banks for purposes of this subpart for a period of up to one year after consummation of the merger transaction, except that a customer of any bank that is a party to the transaction that has an established account with that bank may not be treated as a new account holder for any other party to the transaction for purposes of the new account exception of §229.13(a), and a deposit in any branch of the merged bank is considered deposited in the bank for purposes of the availability schedules in accordance with §229.19(a).

2. This rule affects the status of the combined entity in several areas. For example, this rule would affect when an ATM is a proprietary ATM (§229.2(aa) and §229.12(b)) and when a check is considered drawn on a branch of the depositary bank (§229.10(c)(1)(vi)).

3. Merger transaction is defined in §229.2(t).

*XIV. Section 229.20 Relation to State Law*

A. 229.20(a) In General

1. Several states have enacted laws that govern when banks in those states must make funds available to their customers. The EFA Act provides that any state law in effect on September 1, 1989, that provides that funds be made available in a shorter period of time than provided in this regulation, will supersede the time periods in the EFA Act and the regulation. The Conference Report on the EFA Act clarifies this provision by stating that any state law enacted on or before September 1, 1989, may supersede federal law to the extent that the law relates to the time funds must be made available for withdrawal. H.R. Rep. No. 261, 100th Cong. 1st Sess. at 182 (1987).

2. Thus, if a state had wished to adopt a law governing funds availability, it had to have made that law effective on or before September 1, 1989. Laws adopted after that date do not supersede federal law, even if they provide for shorter availability periods than are provided under federal law. If a state that had a law governing funds availability in effect before September 1, 1989, amended its law after that date, the amendment would not supersede federal law, but an amendment deleting a state requirement would be effective.

3. If a state provides for a shorter hold for a certain category of checks than is provided for under federal law, that state requirement will supersede the federal provision. For example, most state laws base some hold periods on whether the check being deposited is drawn on an in-state or out-of-state bank. If a state contains more than one check processing region, the state's hold period for in-state checks may be shorter than the federal maximum hold period for nonlocal checks. Thus, the state schedule would supersede the federal schedule to the extent that it applies to in-state, nonlocal checks.

4. The EFA Act also provides that any state law that provides for availability in a shorter period of time than required by federal law is applicable to all federally insured institutions in that state, including federally chartered institutions. If a state law provides shorter availability only for deposits in accounts in certain categories of banks, such as commercial banks, the superseding state law continues to apply only to those categories of banks, rather than to all federally insured banks in the state.

B. 229.20(b) Preemption of Inconsistent Law

1. This paragraph reflects the statutory provision that other provisions of state law that are inconsistent with federal law are preempted. Preemption does not require a determination by the Board to be effective.

C. 229.20(c) Standards for Preemption

1. This section describes the standards the Board uses in making determinations on whether federal law will preempt state laws governing funds availability. A provision of state law is considered inconsistent with federal law if it permits a depositary bank to make funds available to a customer in a longer period of time than the maximum period permitted by the EFA Act and this regulation. For example, a state law that permits a hold of four business days or longer for local checks permits a hold that is longer

than that permitted under the EFA Act and this regulation, and therefore is inconsistent and preempted. State availability schedules that provide for availability in a shorter period of time than required under Regulation CC supersede the federal schedule.

2. Under a state law, some categories of deposits could be available for withdrawal sooner or later than the time required by this subpart, depending on the composition of the deposit. For example, the EFA Act and this regulation (§229.10(c)(1)(vii)) require next-day availability for the first $100 of the aggregate deposit of local or nonlocal checks on any day, and a state law could require next-day availability for any check of $100 or less that is deposited. Under the EFA Act and this regulation, if either one $150 check or three $50 checks are deposited on a given day, $100 must be made available for withdrawal on the next business day, and $50 must be made available in accordance with the local or nonlocal schedule. Under the state law, however, the two deposits would be subject to different availability rules. In the first case, none of the proceeds of the deposit would be subject to next-day availability; in the second case, the entire proceeds of the deposit would be subject to next-day availability. In this example, because the state law would, in some situations, permit a hold longer than the maximum permitted by the EFA Act, this provision of state law is inconsistent and preempted in its entirety.

3. In addition to the differences between state and federal availability schedules, a number of state laws contain exceptions to the state availability schedules that are different from those provided under the EFA Act and this regulation. The state exceptions continue to apply only in those cases where the state schedule is shorter than or equal to the federal schedule, and then only up to the limit permitted by the Regulation CC schedule. Where a deposit is subject to a state exception under a state schedule that is not preempted by Regulation CC and is also subject to a federal exception, the hold on the deposit cannot exceed the hold permissible under the federal exception in accordance with Regulation CC. In such cases, only one exception notice is required, in accordance with §229.13(g). This notice need only include the applicable federal exception as the reason the exception was invoked. For those categories of checks for which the state schedule is preempted by the federal schedule, only the federal exceptions may be used.

4. State laws that provide maximum availability periods for categories of deposits that are not covered by the EFA Act would not be preempted. Thus, state funds availability laws that apply to funds in time and savings deposits are not affected by the EFA Act or this regulation. In addition, the availability schedules of several states apply to ''items'' deposited to an account. The term items may encompass deposits, such as nonnegotiable instruments, that are not subject to the Regulation CC availability schedules. Deposits that are not covered by Regulation CC continue to be subject to the state availability schedules. State laws that provide maximum availability periods for categories of institutions that are not covered by the EFA Act also would not be preempted. For example, a state law that governs money market mutual funds would not be affected by the EFA Act or this regulation.

5. Generally, state rules governing the disclosure or notice of availability policies applicable to accounts also are preempted, if they are different from the federal rules. Nevertheless, a state law requiring disclosure of funds availability policies that apply to deposits other than ''accounts,'' such as savings or time deposits, are not inconsistent with the EFA Act and this subpart. Banks in these states would have to follow the state disclosure rules for these deposits.

D. 229.20(d) Preemption Determinations

1. The Board may issue preemption determinations upon the request of an interested party in a state. The determinations will relate only to the provisions of Subparts A and B; generally the Board will not issue individual preemption determinations regarding the relation of state U.C.C. provisions to the requirements of Subpart C.

E. 229.20(e) Procedures for Preemption Determinations

1. This provision sets forth the information that must be included in a request by an interested party for a preemption determination by the Board.

*XV. Section 229.21 Civil Liability*

A. 229.21(a) Civil Liability

1. This paragraph sets forth the statutory penalties for failure to comply with the requirements of this subpart. These penalties apply to provisions of state law that supersede provisions of this regulation, such as requirements that funds deposited in accounts at banks be made available more promptly than required by this regulation, but they do not apply to other provisions of state law. (See Commentary to §229.20.)

B. 229.21(b) Class Action Awards

1. This paragraph sets forth the provision in the EFA Act concerning the factors that should be considered by the court in establishing the amount of a class action award.

C. 229.21(c) Bona Fide Errors

1. A bank is shielded from liability under this section for a violation of a requirement of this subpart if it can demonstrate, by a

preponderance of the evidence, that the violation resulted from a bona fide error and that it maintains procedures designed to avoid such errors. For example, a bank may make a bona fide error if it fails to give next-day availability on a check drawn on the Treasury because the bank's computer system malfunctions in a way that prevents the bank from updating its customer's account; or if it fails to identify whether a payable-through check is a local or nonlocal check despite procedures designed to make this determination accurately.

D. 229.21(d) Jurisdiction

1. The EFA Act confers subject matter jurisdiction on courts of competent jurisdiction and provides a time limit for civil actions for violations of this subpart.

E. 229.21(e) Reliance on Board Rulings

1. This provision shields banks from civil liability if they act in good faith in reliance on any rule, regulation, model form, notice, or clause (if the disclosure actually corresponds to the bank's availability policy), or interpretation of the Board, even if it were subsequently determined to be invalid. Banks may rely on this Commentary, which is issued as an official Board interpretation, as well as on the regulation itself.

F. 229.21(f) Exclusions

1. This provision clarifies that liability under this section does not apply to violations of the requirements of Subpart C of this regulation, or to actions for wrongful dishonor of a check by a paying bank's customer.

G. 229.21(g) Record Retention

1. Banks must keep records to show compliance with the requirements of this subpart for at least two years. This record retention period is extended in the case of civil actions and enforcement proceedings. Generally, a bank is not required to retain records showing that it actually has given disclosures or notices required by this subpart to each customer, but it must retain evidence demonstrating that its procedures reasonably ensure the customers' receipt of the required disclosures and notices. A bank must, however, retain a copy of each notice provided pursuant to its use of the reasonable cause exception under §229.13(g) as well as a brief description of the facts giving rise to the availability of that exception.

*XVI. Section 229.30 Paying Bank's Responsibility for Return of Checks*

A. 229.30(a) Return of Checks

1. This section requires a paying bank (which, for purposes of Subpart C, may include a payable-through and payable-at bank; see §229.2(z)) that determines not to pay a check to return the check expeditiously. Generally, a check is returned expeditiously if the return process is as fast as the forward collection process. This paragraph provides two standards for expeditious return, the ''two-day/four-day'' test, and the ''forward collection'' test.

2. Under the ''two-day/four-day'' test, if a check is returned such that it would normally be received by the depositary bank two business days after presentment where both the paying and depositary banks are located in the same check processing region or four business days after presentment where the paying and depositary banks are not located in the same check processing region, the check is considered returned expeditiously. In certain limited cases, however, these times are shorter than the time it would normally take a forward collection check deposited in the paying bank and payable by the depositary bank to be collected. Therefore, the Board has included a ''forward collection'' test, whereby a check is nonetheless considered to be returned expeditiously if the paying bank uses transportation methods and banks for return comparable to those used for forward collection checks, even if the check is not received by the depositary banks within the two-day or four-day period.

3. Two-day/four-day test.

a. Under the first test, a paying bank must return the check so that the check would normally be received by the depositary bank within specified times, depending on whether or not the paying and depositary banks are located in the same check processing region.

b. Where both banks are located in the same check processing region, a check is returned expeditiously if it is returned to the depositary bank by 4:00 p.m. (local time of the depositary bank) of the second business day after the banking day on which the check was presented to the paying bank. For example, a check presented on Monday to a paying bank must be returned to a depositary bank located in the same check processing region by 4 p.m. on Wednesday. For a paying bank that is located in a different check processing region than the depositary bank, the deadline to complete return is 4 p.m. (local time of the depositary bank) of the fourth business day after the banking day on which the check was presented to the paying bank. For example, a check presented to such a paying bank on Monday must be returned to the depositary bank by 4:00 p.m. on Friday.

c. This two-day/four-day test does not necessarily require actual receipt of the check by the depositary bank within these times. Rather, the paying bank must send the check so that the check would normally be received by the depositary bank within the specified time. Thus, the paying bank is not

responsible for unforeseeable delays in the return of the check, such as transportation delays.

d. Often, returned checks will be delivered to the depositary bank together with forward collection checks. Where the last day on which a check could be delivered to a depositary bank under this two-day/four-day test is not a banking day for the depositary bank, a returning bank might not schedule delivery of forward collection checks to the depositary bank on that day. Further, the depositary bank may not process checks on that day. Consequently, if the last day of the time limit is not a banking day for the depositary bank, the check may be delivered to the depositary bank before the close of the depositary bank's next banking day and the return will still be considered expeditious. Ordinarily, this extension of time will allow the returned checks to be delivered with the next shipment of forward collection checks destined for the depositary bank.

e. The times specified in this two-day/four-day test are based on estimated forward collection times, but take into account the particular difficulties that may be encountered in handling returned checks. It is anticipated that the normal process for forward collection of a check coupled with these return requirements will frequently result in the return of checks before the proceeds of nonlocal checks, other than those covered by §229.10(c), must be made available for withdrawal.

f. Under this two-day/four-day test, no particular means of returning checks is required, thus providing flexibility to paying banks in selecting means of return. The Board anticipates that paying banks will often use returning banks (see §229.31) as their agents to return checks to depositary banks. A paying bank may rely on the availability schedule of the returning bank it uses in determining whether the returned check would ''normally'' be returned within the required time under this two-day/four-day test, unless the paying bank has reason to believe that these schedules do not reflect the actual time for return of a check.

4. Forward collection test.

a. Under the second, ''forward collection,'' test, a paying bank returns a check expeditiously if it returns a check by means as swift as the means similarly situated banks would use for the forward collection of a check drawn on the depositary bank.

b. Generally, the paying bank would satisfy the ''forward collection'' test if it uses a transportation method and collection path for return comparable to that used for forward collection, provided that the returning bank selected to process the return agrees to handle the returned check under the standards for expeditious return for returning banks under §229.31(a). This test allows many paying banks a simple means of expeditious return of checks and takes into account the longer time for return that will be required by banks that do not have ready access to direct courier transportation.

c. The paying bank's normal method of sending a check for forward collection would not be expeditious, however, if it is materially slower than that of other banks of similar size and with similar check handling activity in its community.

d. Under the ''forward collection'' test, a paying bank must handle, route, and transport a returned check in a manner designed to be at least as fast as a similarly situated bank would collect a forward collection check (1) of similar amount, (2) drawn on the depositary bank, and (3) received for deposit by a branch of the paying bank or a similarly situated bank by noon on the banking day following the banking day of presentment of the returned check.

e. This test refers to similarly situated banks to indicate a general community standard. In the case of a paying bank (other than a Federal Reserve Bank), a similarly situated bank is a bank of similar asset size, in the same community, and with similar check handling activity as the paying bank. (See §229.2(ee).) A paying bank has similar check handling activity to other banks that handle similar volumes of checks for collection.

f. Under the forward collection test, banks that use means of handling returned checks that are less efficient than the means used by similarly situated banks must improve their procedures. On the other hand, a bank with highly efficient means of collecting checks drawn on a particular bank, such as a direct presentment of checks to a bank in a remote community, is not required to use that means for returned checks, i.e. direct return, if similarly situated banks do not present checks directly to that depositary bank.

5. Examples.

a. If a check is presented to a paying bank on Monday and the depositary bank and the paying bank are participants in the same clearinghouse, the paying bank should arrange to have the returned check received by the depositary bank by Wednesday. This would be the same day the paying bank would deliver a forward collection check to the depositary bank if the paying bank received the deposit by noon on Tuesday.

b. i. If a check is presented to a paying bank on Monday and the paying bank would normally collect checks drawn on the depositary bank by sending them to a correspondent or a Federal Reserve Bank by courier, the paying bank could send the returned check to its correspondent or Federal Reserve Bank, provided that the correspondent has agreed to handle returned checks expeditiously under §229.31(a). (All

Federal Reserve Banks agree to handle returned checks expeditiously.)

ii. The paying bank must deliver the returned check to the correspondent or Federal Reserve Bank by the correspondent's or Federal Reserve Bank's appropriate cut-off hour. The appropriate cut-off hour is the cut-off hour for returned checks that corresponds to the cut-off hour for forward collection checks drawn on the depositary bank that would normally be used by the paying bank or a similarly situated bank. A returned check cut-off hour corresponds to a forward collection cut-off hour if it provides for the same or faster availability for checks destined for the same depositary banks.

iii. In this example, delivery to the correspondent or a Federal Reserve Bank by the appropriate cut-off hour satisfies the paying bank's duty, even if use of the correspondent or Federal Reserve Bank is not the most expeditious means of returning the check. Thus, a paying bank may send a local returned check to a correspondent instead of a Federal Reserve Bank, even if the correspondent then sends the returned check to a Federal Reserve Bank the following day as a qualified returned check. Where the paying bank delivers forward collection checks by courier to the correspondent or the Federal Reserve Bank, mailing returned checks to the correspondent or Federal Reserve Bank would not satisfy the forward collection test.

iv. If a paying bank ordinarily mails its forward collection checks to its correspondent or Federal Reserve Bank in order to avoid the costs of a courier delivery, but similarly situated banks use a courier to deliver forward collection checks to their correspondent or Federal Reserve Bank, the paying bank must send its returned checks by courier to meet the forward collection test.

c. If a paying bank normally sends its forward collection checks directly to the depositary bank, which is located in another community, but similarly situated banks send forward collection checks drawn on the depositary bank to a correspondent or a Federal Reserve Bank, the paying bank would not have to send returned checks directly to the depositary bank, but could send them to a correspondent or a Federal Reserve Bank.

d. The dollar amount of the returned check has a bearing on how it must be returned. If the paying bank and similarly situated banks present large-dollar checks drawn on the depositary bank directly to the depositary bank, but use a Federal Reserve Bank or a correspondent to collect small-dollar checks, generally the paying bank would be required to send its large-dollar returns directly to the depositary bank (or through a returning bank, if the checks are returned as quickly), but could use a Federal Reserve Bank or a correspondent for its small-dollar returns.

6. Choice of returning bank. In meeting the requirements of the forward collection test, the paying bank is responsible for its own actions, but not for those of the depositary bank or returning banks. (This is analogous to the responsibility of collecting banks under U.C.C. 4–202(c).) For example, if the paying bank starts the return of the check in a timely manner but return is delayed by a returning bank (including delay to create a qualified returned check), generally the paying bank has met its requirements. (See §229.38.) If, however, the paying bank selects a returning bank that the paying bank should know is not capable of meeting its return requirements, the paying bank will not have met its obligation of exercising ordinary care in selecting intermediaries to return the check. The paying bank is free to use a method of return, other than its method of forward collection, as long as the alternate method results in delivery of the returned check to the depositary bank as quickly as the forward collection of a check drawn on the depositary bank or, where the returning bank takes a day to create a qualified returned check under §229.31(a), one day later than the forward collection time. If a paying bank returns a check on its banking day of receipt without settling for the check, as permitted under U.C.C. 4–302(a), and receives settlement for the returned check from a returning bank, it must promptly pay the amount of the check to the collecting bank from which it received the check.

7. Qualified returned checks. Although paying banks may wish to prepare qualified returned checks because they will be handled at a lower cost by returning banks, the one business day extension provided to returning banks is not available to paying banks because of the longer time that a paying bank has to dispatch the check. Normally, paying banks will be able to convert a check to a qualified returned check at any time after the determination is made to return the check until late in the day following presentment, while a returning bank may receive returned checks late on one day and be expected to dispatch them early the next morning. A check that is converted to a qualified returned check must be encoded in accordance with ANS X9.13 for original checks or ANS X9.100–140 for substitute checks.

8. Routing of returned checks.

a. In effect, under either test, the paying bank acts as an agent or subagent of the depositary bank in selecting a means of return. Under §229.30(a), a paying bank is authorized to route the returned check in a variety of ways:

i. It may send the returned check directly to the depositary bank by courier or other means of delivery, bypassing returning banks; or

ii. It may send the returned check to any returning bank agreeing to handle the returned check for expeditious return to the depositary bank under §229.31(a), regardless of whether or not the returning bank handled the check for forward collection.

b. If the paying bank elects to return the check directly to the depositary bank, it is not necessarily required to return the check to the branch of first deposit. The check may be returned to the depositary bank at any location permitted under §229.32(a).

9. Midnight deadline.

a. Except for the extension permitted by §229.30(c), discussed below, this section does not relieve a paying bank from the requirement for timely return (i.e., midnight deadline) under U.C.C. 4–301 and 4–302, which continue to apply. Under U.C.C. 4–302, a paying bank is ''accountable'' for the amount of a demand item, other than a documentary draft, if it does not pay or return the item or send notice of dishonor by its midnight deadline. Under U.C.C. 3–418(c) and 4–215(a), late return constitutes payment and would be final in favor of a holder in due course or a person who has in good faith changed his position in reliance on the payment. Thus, retaining this requirement gives the paying bank an additional incentive to make a prompt return.

b. The expeditious return requirement applies to a paying bank that determines not to pay a check. This requirement applies to a payable-through or a payable-at bank that is defined as a paying bank (see §229.2(z)) and that returns a check. This requirement begins when the payable-through or payable-at bank receives the check during forward collection, not when the payor returns the check to the payable-through or payable-at bank. Nevertheless, a check sent for payment or collection to a payable-through or payable-at bank is not considered to be drawn on that bank for purposes of the midnight deadline provision of U.C.C. 4–301. (See discussion of §229.36(a).)

c. The liability section of this subpart (§229.38) provides that a paying bank is not subject to both ''accountability'' for missing the midnight deadline under the U.C.C. and liability for missing the timeliness requirements of this regulation. Also, a paying bank is not responsible for failure to make expeditious return to a party that has breached a presentment warranty under U.C.C. 4–208, notwithstanding that the paying bank has returned the check. (See Commentary to §229.33(a).)

10. U.C.C. provisions affected. This paragraph directly affects the following provisions of the U.C.C., and may affect other sections or provisions:

a. Section 4–301(d), in that instead of returning a check through a clearinghouse or to the presenting bank, a paying bank may send a returned check to the depositary bank or to a returning bank.

b. Section 4–301(a), in that time limits specified in that section may be affected by the additional requirement to make an expeditious return and in that settlement for returned checks is made under §229.31(c), not by revocation of settlement.

B. 229.30(b) Unidentifiable Depositary Bank

1. In some cases, a paying bank will be unable to identify the depositary bank through the use of ordinary care and good faith. The Board expects that these cases will be unusual as skilled return clerks will readily identify the depositary bank from the depositary bank indorsement required under §229.35 and appendix D. In cases where the paying bank is unable to identify the depositary bank, the paying bank may, in accordance with §229.30(a), send the returned check to a returning bank that agrees to handle the returned check for expeditious return to the depositary bank under §229.31(a). The returning bank may be better able to identify the depositary bank.

2. In the alternative, the paying bank may send the check back up the path used for forward collection of the check. The presenting bank and prior collecting banks normally will be able to trace the collection path of the check through the use of their internal records in conjunction with the indorsements on the returned check. In these limited cases, the paying bank may send such a returned check to any bank that handled the check for forward collection, even if that bank does not agree to handle the returned check for expeditious return to the depositary bank under §229.31(a). A paying bank returning a check under this paragraph to a bank that has not agreed to handle the check expeditiously must advise that bank that it is unable to identify the depositary bank. This advice must be conspicuous, such as a stamp on each check for which the depositary bank is unknown if such checks are commingled with other returned checks, or, if such checks are sent in a separate cash letter, by one notice on the cash letter. This information will warn the bank that this check will require special research and handling in accordance with §229.31(b). The returned check may not be prepared for automated return. The return of a check to a bank that handled the check for forward collection is consistent with §229.35(b), which requires a bank handling a check to take up the check it is has not been paid.

3. The sending of a check to a bank that handled the check for forward collection under this paragraph is not subject to the requirements for expeditious return by the paying bank. Often, the paying bank will not have courier or other expeditious means of

transportation to the collecting or presenting bank. Although the lack of a requirement of expeditious return will create risks for the depositary bank, in many cases the inability to identify the depositary bank will be due to the depositary bank's, or a collecting bank's, failure to use the indorsement required by §229.35(a) and appendix D. If the depositary bank failed to use the proper indorsement, it should bear the risks of less than expeditious return. Similarly, where the inability to identify the depositary bank is due to indorsements or other information placed on the back of the check by the depositary bank's customer or other prior indorser, the depositary bank should bear the risk that it cannot charge a returned check back to that customer. Where the inability to identify the depositary bank is due to subsequent indorsements of collecting banks, these collecting banks may be liable for a loss incurred by the depositary bank due to less than expeditious return of a check; those banks therefore have an incentive to return checks sent to them under this paragraph quickly.

4. This paragraph does not relieve a paying bank from the liability for the lack of expeditious return in cases where the paying bank is itself responsible for the inability to identify the depositary bank, such as when the paying bank's customer has used a check with printing or other material on the back in the area reserved for the depositary bank's indorsement, making the indorsement unreadable. (See §229.38(d).)

5. A paying bank's return under this paragraph is also subject to its midnight deadline under U.C.C. 4–301, Regulation J (if the check is returned through a Federal Reserve Bank), and the exception provided in §229.30(c). A paying bank also may send a check to a prior collecting bank to make a claim against that bank under §229.35(b) where the depositary bank is insolvent or in other cases as provided in §229.35(b). Finally, a paying bank may make a claim against a prior collecting bank based on a breach of warranty under U.C.C. 4–208.

C. 229.30(c) Extension of Deadline

1. This paragraph permits extension of the deadlines for returning a check for which the paying bank previously has settled (generally midnight of the banking day following the banking day on which the check is received by the paying bank) and for returning a check without settling for it (generally midnight of the banking day on which the check is received by the paying bank, or such other time provided by §210.9 of Regulation J (12 CFR part 210) or §229.36(f)(2) of this part), but not of the duty of expeditious return, in two circumstances:

a. A paying bank may have a courier that leaves after midnight (or after any other applicable deadline) to deliver its forward-collection checks. This paragraph removes the constraint of the midnight deadline for returned checks if the returned check reaches the receiving bank on or before the receiving bank's next banking day following the otherwise applicable deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. or later set by the receiving bank under U.C.C. 4–108. The extension also applies if the check reaches the bank to which it is sent later than the time described in the previous sentence if highly expeditious means of transportation are used. For example, a West Coast paying bank may use this further extension to ship a returned check by air courier directly to an East Coast returning bank even if the check arrives after the returning bank's cutoff hour. This paragraph applies to the extension of all midnight deadlines except Saturday midnight deadlines (see paragraph XVI.C.1.b of this appendix).

b. A paying bank may observe a banking day, as defined in the applicable U.C.C., on a Saturday, which is not a business day and therefore not a banking day under Regulation CC. In such a case, the U.C.C. deadline for returning checks received and settled for on Friday, or for returning checks received on Saturday without settling for them, might require the bank to return the checks by midnight Saturday. However, the bank may not have couriers leaving on Saturday to carry returned checks, and even if it did, the returning or depositary bank to which the returned checks were sent might not be open until Sunday night or Monday morning to receive and process the checks. This paragraph extends the midnight deadline if the returned checks reach the returning bank by a cut-off hour (usually on Sunday night or Monday morning) that permits processing during its next processing cycle or reach the depositary bank by the cut-off hour on its next banking day following the Saturday midnight deadline. This paragraph applies exclusively to the extension of Saturday midnight deadlines.

2. The time limits that are extended in each case are the paying bank's midnight deadline for returning a check for which it has already settled and the paying bank's deadline for returning a check without settling for it in U.C.C. 4–301 and 4–302, §§210.9 and 210.12 of Regulation J (12 CFR 210.9 and 210.12), and §229.36(f)(2) of this part. As these extensions are designed to speed (§229.30(c)(1)), or at least not slow (§229.30(c)(2)), the overall return of checks, no modification or extension of the expeditious return requirements in §229.30(a) is required.

3. The paying bank satisfies its midnight or other return deadline by dispatching returned checks to another bank by courier, including a courier under contract with the

paying bank, prior to expiration of the deadline.

4. This paragraph directly affects U.C.C. 4–301 and 4–302 and §§ 210.9 and 210.12 of Regulation J (12 CFR 210.9 and 210.12) to the extent that this paragraph applies by its terms, and may affect other provisions.

D. 229.30(d) Identification of Returned Check

1. The reason for the return must be clearly indicated. A check is identified as a returned check if the front of that check indicates the reason for return, even though it does not specifically state that the check is a returned check. A reason such as ''Refer to Maker'' is permissible in appropriate cases. If the returned check is a substitute check, the reason for return must be placed within the image of the original check that appears on the front of the substitute check so that the information is retained on any subsequent substitute check. If the paying bank places the returned check in a carrier envelope, the carrier envelope should indicate that it is a returned check but need not repeat the reason for return stated on the check if it in fact appears on the check.

E. 229.30(e) Depositary Bank Without Accounts

1. Subpart B of this regulation applies only to ''checks'' deposited in transaction-type ''accounts.'' Thus, a depositary bank with only time or savings accounts need not comply with the availability requirements of Subpart B. Collecting banks will not have couriers delivering checks to these banks as paying banks, because no checks are drawn on them. Consequently, the costs of using a courier or other expedited means to deliver returned checks directly to such a depositary bank may not be justified. Thus, the expedited return requirement of § 229.30(a) and the notice of nonpayment requirement of § 229.33 do not apply to checks being returned to banks that do not hold accounts. The paying bank's midnight deadline in U.C.C. 4–301 and 4–302 and § 210.12 of Regulation J (12 CFR 210.12) would continue to apply to these checks. Returning banks also would be required to act on such checks within their midnight deadline. Further, in order to avoid complicating the process of returning checks generally, banks without accounts are required to use the standard indorsement, and their checks are returned by returning banks and paid for by the depositary bank under the same rules as checks deposited in other banks, with the exception of the expeditious return and notice of nonpayment requirements of §§ 229.30(a), 229.31(a), and 229.33.

2. The expeditious return requirements also apply to a check deposited in a bank that is not a depository institution. Federal Reserve Banks, Federal Home Loan Banks, private bankers, and possibly certain industrial banks are not depository institutions within the meaning of the EFA Act, and therefore are not subject to the expedited availability and disclosure requirements of Subpart B. These banks do, however, maintain accounts as defined in § 229.2(a), and a paying bank returning a check to one of these banks would be required to return the check to the depositary bank, in accordance with the requirements of this section.

F. 229.30(f) Notice in Lieu of Return

1. A check that is lost or otherwise unavailable for return may be returned by sending a legible copy of both sides of the check or, if such a copy is not available to the paying bank, a written notice of nonpayment containing the information specified in § 229.33(b). The copy or written notice must clearly indicate it is a notice in lieu of return and must be handled in the same manner as other returned checks. Notice by telephone, telegraph, or other electronic transmission, other than a legible facsimile or similar image transmission of both sides of the check, does not satisfy the requirements for a notice in lieu of return. The requirement for a writing and the indication that the notice is a substitute for the returned check is necessary so that the returning and depositary banks are informed that the notice carries value. Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. A check is not unavailable for return if it is merely difficult to retrieve from a filing system or from storage by a keeper of checks in a truncation system. A notice in lieu of return may be used by a bank handling a returned check that has been lost or destroyed, including when the original returned check has been charged back as lost or destroyed as provided in § 229.35(b). A bank using a notice in lieu of return gives a warranty under § 229.34(a)(4) that the original check has not been and will not be returned.

2. The requirement of this paragraph supersedes the requirement of U.C.C. 4–301(a) as to the form and information required of a notice of dishonor or nonpayment. Reference in the regulation and this commentary to a returned check includes a notice in lieu of return unless the context indicates otherwise.

3. The notice in lieu of return is subject to the provisions of § 229.30 and is treated like a returned check for settlement purposes. If the original check is over $2,500, the notice of nonpayment under § 229.33 is still required, but may be satisfied by the notice in lieu of return if the notice in lieu meets the time and information requirements of § 229.33.

4. If not all of the information required by § 229.33(b) is available, the paying bank may make a claim against any prior bank handling the check as provided in § 229.35(b).

G. 229.30(g) Reliance on Routing Number

1. Although §229.35 and appendix D require that the depositary bank indorsement contain its nine-digit routing number, it is possible that a returned check will bear the routing number of the depositary bank in fractional, nine-digit, or other form. This paragraph permits a paying bank to rely on the routing number of the depositary bank as it appears on the check (in the depositary bank's indorsement) when it is received by the paying bank.

2. If there are inconsistent routing numbers, the paying bank may rely on any routing number designating the depositary bank. The paying bank is not required to resolve the inconsistency prior to processing the check. The paying bank remains subject to the requirement to act in good faith and use ordinary care under §229.38(a).

*XVII. Section 229.31 Returning Bank's Responsibility for Return of Checks*

A. 229.31(a) Return of Checks

1. The standards for return of checks established by this section are similar to those for paying banks in §229.30(a). This section requires a returning bank to return a returned check expeditiously if it agrees to handle the returned check for expeditious return under this paragraph. In effect, the returning bank is an agent or subagent of the paying bank and a subagent of the depositary bank for the purposes of returning the check.

2. A returning bank agrees to handle a returned check for expeditious return to the depositary bank if it:

a. Publishes or distributes availability schedules for the return of returned checks and accepts the returned check for return;

b. Handles a returned check for return that it did not handle for forward collection; or

c. Otherwise agrees to handle a returned check for expeditious return.

3. Two-day/four-day test. As in the case of a paying bank, a returning bank's return of a returned check is expeditious if it meets either of two tests. Under the ''two-day/four-day'' test, the check must be returned so that it would normally be received by the depositary bank by 4:00 p.m. either two or four business days after the check was presented to the paying bank, depending on whether or not the paying bank is located in the same check processing region as the depositary bank. This is the same test as the two-day/four-day test applicable to paying banks. (See Commentary to §229.30(a).) While a returning bank will not have first hand knowledge of the day on which a check was presented to the paying bank, returning banks may, by agreement, allocate with paying banks liability for late return based on the delays caused by each. In effect, the two-day/four day test protects all paying and returning banks that return checks from claims that they failed to return a check expeditiously, where the check is returned within the specified time following presentment to the paying bank, or a later time as would result from unforeseen delays.

4. Forward collection test.

a. The ''forward collection'' test is similar to the forward collection test for paying banks. Under this test, a returning bank must handle a returned check in the same manner that a similarly situated collecting bank would handle a check of similar size drawn on the depositary bank for forward collection. A similarly situated bank is a bank (other than a Federal Reserve Bank) that is of similar asset size and check handling activity in the same community. A bank has similar check handling activity if it handles a similar volume of checks for forward collection as the forward collection volume of the returning bank.

b. Under the forward collection test, a returning bank must accept returned checks, including both qualified and other returned checks (''raw returns''), at approximately the same times and process them according to the same general schedules as checks handled for forward collection. Thus, a returning bank generally must process even raw returns on an overnight basis, unless its time limit is extended by one day to convert a raw return to a qualified returned check.

5. Cut-off hours. A returning bank may establish earlier cut-off hours for receipt of returned checks than for receipt of forward collection checks, but the cut-off hour for returned checks may not be earlier than 2:00 p.m. The returning bank also may set different sorting requirements for returned checks than those applicable to other checks. Thus, a returning bank may allow itself more processing time for returns than for forward collection checks. All returned checks received by a cut-off hour for returned checks must be processed and dispatched by the returning bank by the time that it would dispatch forward collection checks received at a corresponding forward collection cut-off hour that provides for the same or faster availability for checks destined for the same depositary banks.

6. Examples.

a. If a returning bank receives a returned check by its cut-off hour for returned checks on Monday and the depositary bank and the returning bank are participants in the same clearinghouse, the returning bank should arrange to have the returned check received by the depositary bank by Tuesday. This would be the same day that it would deliver a forward collection check drawn on the depositary bank and received by the returning bank at a corresponding forward collection cut-off hour on Monday.

b. i. If a returning bank receives a returned check, and the returning bank normally

would collect a forward collection check drawn on the depositary bank by sending the forward collection check to a correspondent or a Federal Reserve Bank by courier, the returning bank could send the returned check in the same manner if the correspondent has agreed to handle returned checks expeditiously under §229.31(a). The returning bank would have to deliver the check by the correspondent's or Federal Reserve Bank's cut-off hour for returned checks that corresponds to its cut-off hour for forward collection checks drawn on the depositary bank. A returning bank may take a day to convert a check to a qualified returned check. Where the forward collection checks are delivered by courier, mailing the returned checks would not meet the duty established by this section for returning banks.

ii. A returning bank must return a check to the depositary bank by courier or other means as fast as a courier, if similarly situated returning banks use couriers to deliver their forward collection checks to the depositary bank.

iii. For some depositary banks, no community practice exists as to delivery of checks. For example, a credit union whose customers use payable-through drafts normally does not have checks presented to it because the drafts are normally sent to the payable-through bank for collection. In these circumstances, the community standard is established by taking into account the dollar volume of the checks being sent to the depositary bank and the location of the depositary bank, and determining whether similarly situated banks normally would deliver forward collection checks to the depositary bank, taking into account the particular risks associated with returned checks. Where the community standard does not require courier delivery, other means of delivery, including mail, are acceptable.

7. Qualified returned checks.

a. The expeditious return requirement for a returning bank in this regulation is more stringent in many cases than the duty of a collecting bank to exercise ordinary care under U.C.C. 4–202 in returning a check. A returning bank is under a duty to act as expeditiously in returning a check as it would in the forward collection of a check. Notwithstanding its duty of expeditious return, its midnight deadline under U.C.C. 4–202 and §210.12(a) of Regulation J (12 CFR 210.12(a)), under the forward collection test, a returning bank may take an extra day to qualify a returned check. A qualified returned check will be handled by subsequent returning banks more efficiently than a raw return. This paragraph gives a returning bank an extra business day beyond the time that would otherwise be required to return the returned check to convert a returned check to a qualified returned check. The qualified returned check must include the routing number of the depositary bank, the amount of the check, and a return identifier encoded on the check in magnetic ink. A check that is converted to a qualified returned check must be encoded in accordance with ANS X9.13 for original checks or ANS X9.100–140 for substitute checks.

b. If the returning bank is sending the returned check directly to the depositary bank, this extra day is not available because preparing a qualified returned check will not expedite handling by other banks. If the returning bank makes an encoding error in creating a qualified returned check, it may be liable under §229.38 for losses caused by any negligence or under §229.34(c)(3) for breach of an encoding warranty. The returning bank would not lose the one-day extension available to it for creating a qualified returned check because of an encoding error.

8. Routing of returned check.

a. Under §229.31(a), the returning bank is authorized to route the returned check in a variety of ways:

i. It may send the returned check directly to the depositary bank by courier or other expeditious means of delivery; or

ii. It may send the returned check to any returning bank agreeing to handle the returned check for expeditious return to the depositary bank under this section regardless of whether or not the returning bank handled the check for forward collection.

b. If the returning bank elects to send the returned check directly to the depositary bank, it is not required to send the check to the branch of the depositary bank that first handled the check. The returned check may be sent to the depositary bank at any location permitted under §229.32(a).

9. Responsibilities of returning bank. In meeting the requirements of this section, the returning bank is responsible for its own actions, but not those of the paying bank, other returning banks, or the depositary bank. (See U.C.C. 4–202(c) regarding the responsibility of collecting banks.) For example, if the paying bank has delayed the start of the return process, but the returning bank acts in a timely manner, the returning bank may satisfy the requirements of this section even if the delayed return results in a loss to the depositary bank. (See §229.38.) A returning bank must handle a notice in lieu of return as expeditiously as a returned check.

10. U.C.C. sections affected. This paragraph directly affects the following provisions of the U.C.C., and may affect other sections or provisions:

a. Section 4–202(b), in that time limits required by that section may be affected by the additional requirement to make an expeditious return.

b. Section 4–214(a), in that settlement for returned checks is made under §229.31(c) and not by charge-back of provisional credit, and

in that the time limits may be affected by the additional requirement to make an expeditious return.

B. 229.31(b) Unidentifiable Depositary Bank

1. This section is similar to §229.30(b), but applies to returning banks instead of paying banks. In some cases a returning bank will be unable to identify the depositary bank with respect to a check. Returning banks agreeing to handle checks for return to depositary banks under §229.31(a) are expected to be expert in identifying depositary bank indorsements. In the limited cases where the returning bank cannot identify the depositary bank, the returning bank may send the returned check to a returning bank that agrees to handle the returned check for expeditious return under §229.31(a), or it may send the returned check to a bank that handled the check for forward collection, even if that bank does not agree to handle the returned check expeditiously under §229.31(a).

2. If the returning bank itself handled the check for forward collection, it may send the returned check to a collecting bank that was prior to it in the forward collection process, which will be better able to identify the depositary bank. If there are no prior collecting banks, the returning bank must research the collection of the check and identify the depositary bank. As in the case of paying banks under §229.30(b), a returning bank's sending of a check to a bank that handled the check for forward collection under §229.31(b) is not subject to the expeditious return requirements of §229.31(a).

3. The returning bank's return of a check under this paragraph is subject to the midnight deadline under U.C.C. 4–202(b). (See definition of returning bank in §229.2(cc).)

4. Where a returning bank receives a check that it does not agree to handle expeditiously under §229.31(a), such as a check sent to it under §229.30(b), but the returning bank is able to identify the depositary bank, the returning bank must thereafter return the check expeditiously to the depositary bank. The returning bank returns a check expeditiously under this paragraph if it returns the check by the same means it would use to return a check drawn on it to the depositary bank or by other reasonably prompt means.

5. As in the case of a paying bank returning a check under §229.30(b), a returning bank returning a check under this paragraph to a bank that has not agreed to handle the check expeditiously must advise that bank that it is unable to identify the depositary bank. This advice must be conspicuous, such as a stamp on each check for which the depositary bank is unknown if such checks are commingled with other returned checks, or, if such checks are sent in a separate cash letter, by one notice on the cash letter. The returned check may not be prepared for automated return.

C. 229.31(c) Settlement

1. Under the U.C.C., a collecting bank receives settlement for a check when it is presented to the paying bank. The paying bank may recover the settlement when the paying bank returns the check to the presenting bank. Under this regulation, however, the paying bank may return the check directly to the depositary bank or through returning banks that did not handle the check for forward collection. On these more efficient return paths, the paying bank does not recover the settlement made to the presenting bank. Thus, this paragraph requires the returning bank to settle for a returned check (either with the paying bank or another returning bank) in the same way that it would settle for a similar check for forward collection. To achieve uniformity, this paragraph applies even if the returning bank handled the check for forward collection.

2. Any returning bank, including one that handled the check for forward collection, may provide availability for returned checks pursuant to an availability schedule as it does for forward collection checks. These settlements by returning banks, as well as settlements between banks made during the forward collection of a check, are considered final when made subject to any deferment of availability. (See §229.36(d) and Commentary to §229.35(b).)

3. A returning bank may vary the settlement method it uses by agreement with paying banks or other returning banks. Special rules apply in the case of insolvency of banks. (See §229.39.) If payment cannot be obtained from a depositary or returning bank because of its insolvency or otherwise, recovery can be had by returning, paying, and collecting banks from prior banks on this basis of the liability of prior banks under §229.35(b).

4. This paragraph affects U.C.C. 4–214(a) in that a paying or collecting bank does not ordinarily have a right to charge back against the bank from which it received the returned check, although it is entitled to settlement if it returns the returned check to that bank, and may affect other sections or provisions. Under §229.36(d), a bank collecting a check remains liable to prior collecting banks and the depositary bank's customer under the U.C.C.

D. 229.31(d) Charges

1. This paragraph permits any returning bank, even one that handled the check for forward collection, to impose a fee on the paying bank or other returning bank for its service in handling a returned check. Where a claim is made under §229.35(b), the bank on which the claim is made is not authorized by this paragraph to impose a charge for taking up a check. This paragraph preempts state laws to the extent that these laws prevent

returning banks from charging fees for handling returned checks.

E. 229.31(e) Depositary Bank Without Accounts

1. This paragraph is similar to §229.30(e) and relieves a returning bank of its obligation to make expeditious return to a depositary bank that does not maintain any accounts. (See the Commentary to §229.30(e).)

F. 229.31(f) Notice in Lieu of Return

1. This paragraph is similar to §229.30(f) and authorizes a returning bank to originate a notice in lieu of return if the returned check is unavailable for return. Notice in lieu of return is permitted only when a bank does not have and cannot obtain possession of the check or must retain possession of the check for protest. A check is not unavailable for return if it is merely difficult to retrieve from a filing system or from storage by a keeper of checks in a truncation system. (See the Commentary to §229.30(f).)

G. 229.31(g) Reliance on Routing Number

1. This paragraph is similar to §229.30(g) and permits a returning bank to rely on routing numbers appearing on a returned check such as routing numbers in the depositary bank's indorsement or on qualified returned checks. (See the Commentary to §229.30(g).)

*XVIII. Section 229.32 Depositary Bank's Responsibility for Returned Checks*

A. 229.32(a) Acceptance of Returned Checks

1. This regulation seeks to encourage direct returns by paying and returning banks and may result in a number of banks sending checks to depositary banks with no preexisting arrangements as to where the returned checks should be delivered. This paragraph states where the depositary bank is required to accept returned checks and written notices of nonpayment under §229.33. (These locations differ from locations at which a depositary bank must accept electronic notices.) It is derived from U.C.C. 3–111, which specifies that presentment for payment may be made at the place specified in the instrument or, if there is none, at the place of business of the party to pay. In the case of returned checks, the depositary bank does not print the check and can only specify the place of ''payment'' of the returned check in its indorsement.

2. The paragraph specifies four locations at which the depositary bank must accept returned checks:

a. The depositary bank must accept returned checks at any location at which it requests presentment of forward collection checks such as a processing center. A depositary bank does not request presentment of forward collection checks at a branch of the bank merely by paying checks presented over the counter.

b. i. If the depositary bank indorsement states the name and address of the depositary bank, it must accept returned checks at the branch, head office, or other location, such as a processing center, indicated by the address. If the address is too general to identify a particular location, then the depositary bank must accept returned checks at any branch or head office consistent with the address. If, for example, the address is ''New York, New York,'' each branch in New York City must accept returned checks.

ii. If no address appears in the depositary bank's indorsement, the depositary bank must accept returned checks at any branch or head office associated with the depositary bank's routing number. The offices associated with the routing number of a bank are found in *American Bankers Association Key to Routing Numbers*, published by an agent of the American Bankers Association, which lists a city and state address for each routing number.

iii. The depositary bank must accept returned checks at the address in its indorsement and at an address associated with its routing number in the indorsement if the written address in the indorsement and the address associated with the routing number in the indorsement are not in the same check processing region. Under §§229.30(g) and 229.31(g), a paying or returning bank may rely on the depositary bank's routing number in its indorsement in handling returned checks and is not required to send returned checks to an address in the depositary bank's indorsement that is not in the same check processing region as the address associated with the routing number in the indorsement.

iv. If no routing number or address appears in its indorsement, the depositary bank must accept a returned check at any branch or head office of the bank. The indorsement requirement of §229.35 and appendix D requires that the indorsement contain a routing number, a name, and a location. Consequently, this provision, as well as paragraph (a)(2)(ii) of this section, only applies where the depositary bank has failed to comply with the indorsement requirement.

3. For ease of processing, a depositary bank may require that returning or paying banks returning checks to it separate returned checks from forward collection checks being presented.

4. Under §229.33(d), a depositary bank receiving a returned check or notice of nonpayment must send notice to its customer by its midnight deadline or within a longer reasonable time.

B. 229.32(b) Payment

1. As discussed in the commentary to §229.31(c), under this regulation a paying or returning bank does not obtain credit for a returned check by charge-back but by, in effect, presenting the returned check to the depositary bank. This paragraph imposes an obligation to ''pay'' a returned check that is similar to the obligation to pay a forward collection check by a paying bank, except that the depositary bank may not return a returned check for which it is the depositary bank. Also, certain means of payment, such as remittance drafts, may be used only with the agreement of the returning bank.

2. The depositary bank must pay for a returned check by the close of the banking day on which it received the returned check. The day on which a returned check is received is determined pursuant to U.C.C. 4–108, which permits the bank to establish a cut-off hour, generally not earlier than 2:00 p.m., and treat checks received after that hour as being received on the next banking day. If the depositary bank is unable to make payment to a returning or paying bank on the banking day that it receives the returned check, because the returning or paying bank is closed for a holiday or because the time when the depositary bank received the check is after the close of Fedwire, e.g., west coast banks with late cut-off hours, payment may be made on the next banking day of the bank receiving payment.

3. Payment must be made so that the funds are available for use by the bank returning the check to the depositary bank on the day the check is received by the depositary bank. For example, a depositary bank meets this requirement if it sends a wire transfer of funds to the returning or paying bank on the day it receives the returned check, even if the returning or paying bank has closed for the day. A wire transfer should indicate the purpose of the payment.

4. The depositary bank may use a net settlement arrangement to settle for a returned check. Banks with net settlement agreements could net the appropriate credits and debits for returned checks with the accounting entries for forward collection checks if they so desired. If, for purposes of establishing additional controls or for other reasons, the banks involved desired a separate settlement for returned checks, a separate net settlement agreement could be established.

5. The bank sending the returned check to the depositary bank may agree to accept payment at a later date if, for example, it does not believe that the amount of the returned check or checks warrants the costs of same-day payment. Thus, a returning or paying bank may agree to accept payment through an ACH credit or debit transfer that settles the day after the returned check is received instead of a wire transfer that settles on the same day.

6. This paragraph and this subpart do not affect the depositary bank's right to recover a provisional settlement with its nonbank customer for a check that is returned. (See also §§229.19(c)(2)(ii), 229.33(d) and 229.35(b).)

C. 229.32(c) Misrouted Returned Checks

1. This paragraph permits a bank receiving a check on the basis that it is the depositary bank to send the misrouted returned check to the correct depositary bank, if it can identify the correct depositary bank, either directly or through a returning bank agreeing to handle the check expeditiously under §229.30(a). In these cases, the bank receiving the check is acting as a returning bank. Alternatively, the bank receiving the misrouted returned check must send the check back to the bank from which it was received. In either case the bank to which the returned check was misrouted could receive settlement for the check. The depositary bank would be required to pay for the returned check under §229.32(b), and any other bank to which the check is sent under this paragraph would be required to settle for the check as a returning bank under §229.31(c). If the check was originally received ''free,'' that is, without a charge for the check, the bank incorrectly receiving the check would have to return the check, without a charge, to the bank from which it came. The bank to which the returned check was misrouted is required to act promptly but is not required to meet the expeditious return requirements of §229.31(a); however, it must act within its midnight deadline. This paragraph does not affect a bank's duties under §229.35(b).

D. 229.32(d) Charges

1. This paragraph prohibits a depositary bank from charging the equivalent of a presentment fee for returned checks. A returning bank, however, may charge a fee for handling returned checks. If the returning bank receives a mixed cash letter of returned checks, which includes some checks for which the returning bank also is the depositary bank, the fee may be applied to all the returned checks in the cash letter. In the case of a sorted cash letter containing only returned checks for which the returning bank is the depositary bank, however, no fee may be charged.

*XIX. Section 229.33 Notice of Nonpayment*

A. 229.33(a) Requirement

1. Notice of nonpayment as required by this section and written notice in lieu of return as provided in §§229.30(f) and 229.31(f) serve different functions. The two kinds of notice, however, must meet the content requirements of this section. The paying bank

must send a notice of nonpayment if it decides not to pay a check of $2,500 or more. A paying bank may rely on an amount encoded on the check in magnetic ink to determine whether the check is in the amount of $2,500 or more. The notice of nonpayment carries no value, and the check itself (or the notice in lieu of return) must be returned. The paying bank must ensure that the notice of nonpayment is received by the depositary bank by 4:00 p.m. local time on the second business day following presentment. A bank identified by routing number as the paying bank is considered the paying bank under this regulation and would be required to create a notice of nonpayment even though that bank determined that the check was not drawn by a customer of that bank. (See Commentary to the definition of paying bank in §229.2(z).)

2. The paying bank should not send a notice of nonpayment until it has finally determined not to pay the check. Under §229.34(b), by sending the notice the paying bank warrants that it has returned or will return the check. If a paying bank sends a notice and subsequently decides to pay the check, the paying bank may mitigate its liability on this warranty by notifying the depositary bank that the check has been paid.

3. Because the return of the check itself may serve as the required notice of nonpayment, in many cases no notice other than the return of the check will be necessary. For example, in many cases the return of a check through a clearinghouse to another participant of the clearinghouse will be made in time to meet the time requirements of this section. If the check normally will not be received by the depositary bank within the time limits for notice, the return of the check will not satisfy the notice requirement. In determining whether the returned check will satisfy the notice requirement, the paying bank may rely on the availability schedules of returning banks as the time that the returned check is expected to be delivered to the depositary bank, unless the paying bank has reason to know the availability schedules are inaccurate.

4. Unless the returned check is used to satisfy the notice requirement, the requirement for notice is independent of and does not affect the requirements for timely and expeditious return of the check under §229.30 and the U.C.C. (See §229.30(a).) If a paying bank fails both to comply with this section and to comply with the requirements for timely and expeditious return under §229.30 and the U.C.C. and Regulation J (12 CFR part 210), the paying bank shall be liable under either this section or such other requirements, but not both. (See §229.38(b).) A paying bank is not responsible for failure to give notice of nonpayment to a party that has breached a presentment warranty under U.C.C. 4–208, notwithstanding that the paying bank may have returned the check. (See U.C.C. 4–208 and 4–302.)

B. 229.33(b) Content of Notices

1. This paragraph provides that the notice must at a minimum contain eight elements which are specifically enumerated. In the case of written notices, the name and routing number of the depositary bank also are required.

2. If the paying bank cannot identify the depositary bank from the check itself, it may wish to send the notice to the earliest collecting bank it can identify and indicate that the notice is not being sent to the depositary bank. The collecting bank may be able to identify the depositary bank and forward the notice, but is under no duty to do so. In addition, the collecting bank may actually be the depositary bank.

3. A bank must identify an item of information if the bank is uncertain as to that item's accuracy. A bank may make this identification by setting the item off with question marks, asterisks, or other symbols designated for this purpose by generally applicable industry standards.

C. 229.33(c) Acceptance of Notice

1. In the case of a written notice, the depositary bank is required to accept notices at the locations specified in §229.32(a). In the case of telephone notices, the bank may not refuse to accept notices at the telephone numbers identified in this section, but may transfer calls or use a recording device. Banks may vary by agreement the location and manner in which notices are received.

D. 229.33(d) Notification to Customer

1. This paragraph requires a depositary bank to notify its customer of nonpayment upon receipt of a returned check or notice of nonpayment, regardless of the amount of the check or notice. This requirement is similar to the requirement under the U.C.C. as interpreted in *Appliance Buyers Credit Corp.* v. *Prospect National Bank,* 708 F.2d 290 (7th Cir. 1983), that a depositary bank may be liable for damages incurred by its customer for its failure to give its customer timely advice that it has received a notice of nonpayment. Notice also must be given if a depositary bank receives a notice of recovery under §229.35(b). A bank that chooses to provide the notice required by §229.33(d) in writing may send the notice by e-mail or facsimile if the bank sends the notice to the e-mail address or facsimile number specified by the customer for that purpose. The notice to the customer required under this paragraph also may satisfy the notice requirement of §229.13(g) if the depositary bank invokes the reasonable-cause exception of §229.13(e) due to the receipt of a notice of nonpayment,

provided the notice meets all the requirements of § 229.13(g).

*XX. Section 229.34 Warranties*

A. 229.34(a) Warranty of Returned Check

1. This paragraph includes warranties that a returned check, including a notice in lieu of return, was returned by the paying bank, or in the case of a check payable by a bank and payable through another bank, the bank by which the check is payable, within the deadline under the U.C.C. (subject to any claims or defenses under the U.C.C., such as breach of a presentment warranty), Regulation J (12 CFR part 210), or § 229.30(c); that the paying or returning bank is authorized to return the check; that the returned check has not been materially altered; and that, in the case of a notice in lieu of return, the original check has not been and will not be returned for payment. (See the Commentary to § 229.30(f).) The warranty does not include a warranty that the bank complied with the expeditious return requirements of §§ 229.30(a) and 229.31(a). These warranties do not apply to checks drawn on the United States Treasury, to U.S. Postal Service money orders, or to checks drawn on a state or a unit of general local government that are not payable through or at a bank. (See § 229.42.)

B. 229.34(b) Warranty of Notice of Nonpayment

1. This paragraph provides for warranties for notices of nonpayment. This warranty does not include a warranty that the notice is accurate and timely under § 229.33. The requirements of § 229.33 that are not covered by the warranty are subject to the liability provisions of § 229.38. These warranties are designed to give the depositary bank more confidence in relying on notices of nonpayment. This paragraph imposes liability on a paying bank that gives notice of nonpayment and then subsequently returns the check. (See Commentary on § 229.33(a).)

C. 229.34(c) Warranty of Settlement Amount, Encoding, and Offset

1. Paragraph (c)(1) provides that a bank that presents and receives settlement for checks warrants to the paying bank that the settlement it demands (e.g., as noted on the cash letter) equals the total amount of the checks it presents. This paragraph gives the paying bank a warranty claim against the presenting bank for the amount of any excess settlement made on the basis of the amount demanded, plus expenses. If the amount demanded is understated, a paying bank discharges its settlement obligation under U.C.C. 4–301 by paying the amount demanded, but remains liable for the amount by which the demand is understated; the presenting bank is nevertheless liable for expenses in resolving the adjustment.

2. When checks or returned checks are transferred to a collecting, returning, or depositary bank, the transferor bank is not required to demand settlement, as is required upon presentment to the paying bank. However, often the checks or returned checks will be accompanied by information (such as a cash letter listing) that will indicate the total of the checks or returned checks. Paragraph (c)(2) provides that if the transferor bank includes information indicating the total amount of checks or returned checks transferred, it warrants that the information is correct (i.e., equals the actual total of the items).

3. Paragraph (c)(3) provides that a bank that presents or transfers a check or returned check warrants the accuracy of the magnetic ink encoding that was placed on the item after issue, and that exists at the time of presentment or transfer, to any bank that subsequently handles the check or returned check. Under U.C.C. 4–209(a), only the encoder (or the encoder and the depositary bank, if the encoder is a customer of the depositary bank) warrants the encoding accuracy, thus any claims on the warranty must be directed to the encoder. Paragraph (c)(3) expands on the U.C.C. by providing that all banks that transfer or present a check or returned check make the encoding warranty. In addition, under the U.C.C., the encoder makes the warranty to subsequent collecting banks and the paying bank, while paragraph (c)(3) provides that the warranty is made to banks in the return chain as well. Paragraph (c)(3) applies to all MICR-line encoding on a substitute check.

4. A paying bank that settles for an overstated cash letter because of a misencoded check may make a warranty claim against the presenting bank under paragraph (c)(1) (which would require the paying bank to show that the check was part of the overstated cash letter) or an encoding warranty claim under paragraph (c)(3) against the presenting bank or any preceding bank that handled the misencoded check.

5. Paragraph (c)(4) provides that a paying bank or a depositary bank may set off excess settlement paid to another bank against settlement owed to that bank for checks presented or returned checks received (for which it is the depositary bank) subsequent to the excess settlement.

D. 229.34(d) Transfer and Presentment Warranties

1. A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants that the person on whose account the check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check. The warranties

are given only by banks and only to subsequent banks in the collection chain. The warranties ultimately shift liability for the loss created by an unauthorized remotely created check to the depositary bank. The depositary bank cannot assert the transfer and presentment warranties against a depositor. However, a depositary bank may, by agreement, allocate liability for such an item to the depositor and also may have a claim under other laws against that person.

2. The transfer and presentment warranties for remotely created checks supplement the Federal Trade Commission's Telemarketing Sales Rule, which requires telemarketers that submit checks for payment to obtain the customer's ''express verifiable authorization'' (the authorization may be either in writing or tape recorded and must be made available upon request to the customer's bank). 16 CFR 310.3(a)(3). The transfer and presentment warranties shift liability to the depositary bank only when the remotely created check is unauthorized, and would not apply when the customer initially authorizes a check but then experiences ''buyer's remorse'' and subsequently tries to revoke the authorization by asserting a claim against the paying bank under U.C.C. 4–401. If the depositary bank suspects ''buyer's remorse,'' it may obtain from its customer the express verifiable authorization of the check by the paying bank's customer, required under the Federal Trade Commission's Telemarketing Sales Rule, and use that authorization as a defense to the warranty claim.

3. The scope of the transfer and presentment warranties for remotely created checks differs from that of the corresponding U.C.C. warranty provisions in two respects. The U.C.C. warranties differ from the §229.34(d) warranties in that they are given by any person, including a nonbank depositor, that transfers a remotely created check and not just to a bank, as is the case under §229.34(d). In addition, the U.C.C. warranties state that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn. The §229.34(d) warranties specifically cover the amount as well as the payee stated on the check. Neither the U.C.C. warranties, nor the §229.34(d) warranties apply to the date stated on the remotely created check.

4. A bank making the §229.34(d) warranties may defend a claim asserting violation of the warranties by proving that the customer of the paying bank is precluded by U.C.C. 4–406 from making a claim against the paying bank. This may be the case, for example, if the customer failed to discover the unauthorized remotely created check in a timely manner.

5. The transfer and presentment warranties for a remotely created check apply to a remotely created check that has been reconverted to a substitute check.

E. 229.34(d) Damages

1. This paragraph adopts for the warranties in §229.34 (a), (b), and (c) the damages provided in U.C.C. 4–207(c) and 4A–506(b). (See definition of interest compensation in §229.2(oo).)

F. 229.34(e) Tender of Defense

1. This paragraph adopts for this regulation the vouching-in provisions of U.C.C. 3–119.

G. 229.34(f) Notice of Claim

1. This paragraph adopts the notice provisions of U.C.C. sections 4–207(d) and 4–208(e). The time limit set forth in this paragraph applies to notices of claims for warranty breaches only. As provided in §229.38(g), all actions under this section must be brought within one year after the date of the occurrence of the violation involved.

*XXI. Section 229.35 Indorsements*

A. 229.35(a) Indorsement Standards

1. This section and appendix D require banks to use a standard form of indorsement when indorsing checks during the forward collection and return process. The standard provides for indorsements by all collecting and returning banks, plus a unique standard for depositary bank indorsements. It is designed to facilitate the identification of the depositary bank and the prompt return of checks. The regulation places a duty on banks to ensure that their indorsements can be interpreted by any person. The indorsement standard specifies the information each indorsement must contain and its location and ink color.

2. Banks generally apply indorsements to a paper check in one of two ways: (1) banks print or ''spray'' indorsements onto a check when the check is processed through the banks'' automated check sorters (regardless of whether the checks are original checks or substitute checks), and (2) reconverting banks print or ''overlay'' previously applied electronic indorsements and their own indorsements and identifications onto a substitute check at the time that the substitute check is created. If a subsequent substitute check is created in the course of collection or return, that substitute check will contain, in its image of the back of the previous substitute check, reproductions of indorsements that were sprayed or overlaid onto the previous item. For purposes of the indorsement standard set forth in appendix D, a reproduction of a previously applied sprayed or overlaid indorsement contained within an image of a check does not constitute ''an indorsement that previously was applied electronically.'' To accommodate these two indorsement scenarios, the appendix includes two indorsement location specifications: one

standard applies to banks spraying indorsements onto existing paper original checks and substitute checks, and another applies to reconverting banks overlaying indorsements that previously were applied electronically and their own indorsements onto substitute checks at the time the substitute checks are created.

3. A bank might use check processing equipment that captures an image of a check prior to spraying an indorsement onto that item. If the bank truncates that item, it should ensure that it also applies an indorsement to the item electronically. A reconverting bank satisfies its obligation to preserve all previously applied indorsements by overlaying a bank's indorsement that previously was applied electronically onto a substitute check that the reconverting bank creates.

4. The location of an indorsement applied to an original paper check in accordance with appendix D may shift if that check is truncated and later reconverted to a substitute check. If an indorsement applied to the original check in accordance with appendix D is overwritten by a subsequent indorsement applied to the substitute check in accordance with appendix D, then one or both of those indorsements could be rendered illegible. As explained in §229.38(d) and the commentary thereto, a reconverting bank is liable for losses associated with indorsements that are rendered illegible as a result of check substitution.

5. To ensure that indorsements can be easily read and would remain legible after an image of a check is captured, the standard requires all indorsements applied to original checks and substitute checks to be printed in black ink as of January 1, 2006.

6. The standard requires the depositary bank's indorsement to include (1) its nine-digit routing number set off by an arrow at each end of the routing number and, if the depositary bank is a reconverting bank with respect to the check, an asterisk outside the arrow at each end of the routing number to identify the bank as a reconverting bank; (2) the indorsement date; and (3) if the indorsement is applied physically, name or location information. The standard also permits but does not require the indorsement to include other identifying information. The standard requires a collecting bank's or returning bank's indorsement to include only (1) the bank's nine digit routing number (without arrows) and, if the collecting bank or returning bank is a reconverting bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconverting bank, (2) the indorsement date, and (3) an optional trace or sequence number.

7. Depositary banks should not include information that can be confused with required information. For example, a nine-digit zip code could be confused with the nine-digit routing number.

8. A depositary bank may want to include an address in its indorsement in order to limit the number of locations at which it must receive returned checks. In instances where this address is not consistent with the routing number in the indorsement, the depositary bank is required to receive returned checks at a branch or head office consistent with the routing number. Banks should note, however, that §229.32 requires a depositary bank to receive returned checks at the location(s) at which it receives forward-collection checks.

9. In addition to indorsing a substitute check in accordance with appendix D, a reconverting bank must identify itself and the truncating bank by applying its routing number and the routing number of the truncating bank to the front of the check in accordance with appendix D and ANS X9.100–140. Further, if the reconverting bank is the paying bank, it also must identify itself by applying its routing number to the back of the check in accordance with appendix D. In these instances, the reconverting bank and truncating bank routing numbers are for identification purposes only and are not indorsements or acceptances.

10. Under the U.C.C., a specific guarantee of prior indorsement is not necessary. (See U.C.C. 4–207(a) and 4–208(a).) Use of guarantee language in indorsements, such as ''P.E.G.'' (''prior endorsements guaranteed''), may result in reducing the type size used in bank indorsements, thereby making them more difficult to read. Use of this language may make it more difficult for other banks to identify the depositary bank. Subsequent collecting bank indorsements may not include this language.

11. If the bank maintaining the account into which a check is deposited agrees with another bank (a correspondent, ATM operator, or lock box operator) to have the other bank accept returns and notices of nonpayment for the bank of account, the indorsement placed on the check as the depositary bank indorsement may be the indorsement of the bank that acts as correspondent, ATM operator, or lock box operator as provided in paragraph (d) of this section.

12. The backs of many checks bear preprinted information or blacked out areas for various reasons. For example, some checks are printed with a carbon band across the back that allows the transfer of information from the check to a ledger with one writing. Also, contracts or loan agreements are printed on certain checks. Other checks that are mailed to recipients may contain areas on the back that are blacked out so that they may not be read through the mailer. On the deposit side, the payee of the check may

place its indorsement or information identifying the drawer of the check in the area specified for the depositary bank indorsement, thus making the depositary bank indorsement unreadable.

13. The indorsement standard does not prohibit the use of a carbon band or other printed or written matter on the backs of checks and does not require banks to avoid placing their indorsements in these areas. Nevertheless, checks will be handled more efficiently if depositary banks design indorsement stamps so that the nine-digit routing number avoids the carbon band area. Indorsing parties other than banks, e.g., corporations, will benefit from the faster return of checks if they protect the identifiability and legibility of the depositary bank indorsement by staying clear of the area reserved for the depositary bank indorsement.

14. Section 229.38(d) allocates responsibility for loss resulting from a delay in return of a check due to indorsements that are unreadable because of material on the back of the check. The depositary bank is responsible for a loss resulting from a delay in return caused by the condition of the check arising after its issuance until its acceptance by the depositary bank that made the depositary bank's indorsement illegible. The paying bank is responsible for loss resulting from a delay in return caused by indorsements that are not readable because of other material on the back of the check at the time that it was issued. Depositary and paying banks may shift these risks to their customers by agreement.

15. The standard does not require the paying bank to indorse the check; however, if a paying bank does indorse a check that is returned, it should follow the indorsement standard for collecting banks and returning banks. The standard requires collecting and returning banks to indorse the check for tracing purposes. With respect to the identification of a paying bank that is also a reconverting bank, see the commentary to § 229.51(b)(2).

### B. 229.35(b) Liability of Bank Handling Check

1. When a check is sent for forward collection, the collection process results in a chain of indorsements extending from the depositary bank through any subsequent collecting banks to the paying bank. This section extends the indorsement chain through the paying bank to the returning banks, and would permit each bank to recover from any prior indorser if the claimant bank does not receive payment for the check from a subsequent bank in the collection or return chain. For example, if a returning bank returned a check to an insolvent depositary bank, and did not receive the full amount of the check from the failed bank, the returning bank could obtain the unrecovered amount of the check from any bank prior to it in the collection and return chain including the paying bank. Because each bank in the collection and return chain could recover from a prior bank, any loss would fall on the first collecting bank that received the check from the depositary bank. To avoid circuity of actions, the returning bank could recover directly from the first collecting bank. Under the U.C.C., the first collecting bank might ultimately recover from the depositary bank's customer or from the other parties on the check.

2. Where a check is returned through the same banks used for the forward collection of the check, priority during the forward collection process controls over priority in the return process for the purpose of determining prior and subsequent banks under this regulation.

3. Where a returning bank is insolvent and fails to pay the paying bank or a prior returning bank for a returned check, § 229.39(a) requires the receiver of the failed bank to return the check to the bank that transferred the check to the failed bank. That bank then either could continue the return to the depositary bank or recover based on this paragraph. Where the paying bank is insolvent, and fails to pay the collecting bank, the collecting bank also could recover from a prior collecting bank under this paragraph, and the bank from which it recovered could in turn recover from its prior collecting bank until the loss settled on the depositary bank (which could recover from its customer).

4. A bank is not required to make a claim against an insolvent bank before exercising its right to recovery under this paragraph. Recovery may be made by charge-back or by other means. This right of recovery also is permitted even where nonpayment of the check is the result of the claiming bank's negligence such as failure to make expeditious return, but the claiming bank remains liable for its negligence under § 229.38.

5. This liability is imposed on a bank handling a check for collection or return regardless of whether the bank's indorsement appears on the check. Notice must be sent under this paragraph to a prior bank from which recovery is sought reasonably promptly after a bank learns that it did not receive payment from another bank, and learns the identity of the prior bank. Written notice reasonably identifying the check and the basis for recovery is sufficient if the check is not available. Receipt of notice by the bank against which the claim is made is not a precondition to recovery by charge-back or other means; however, a bank may be liable for negligence for failure to provide timely notice. A paying or returning bank also may recover from a prior collecting bank as provided in §§ 229.30(b) and 229.31(b). This provision is not a substitute for a paying or returning bank making expeditious return

under §§ 229.30(a) or 229.31(b). This paragraph does not affect a paying bank's accountability for a check under U.C.C. 4–215(a) and 4–302. Nor does this paragraph affect a collecting bank's accountability under U.C.C. 4–213 and 4–215(d). A collecting bank becomes accountable upon receipt of final settlement as provided in the foregoing U.C.C. sections. The term final settlement in §§ 229.31 (c), 229.32 (b), and 229.36(d) is intended to be consistent with the use of the term final settlement in the U.C.C. (e.g., U.C.C. 4–213, 4–214, and 4–215). (See also § 229.2(cc) and Commentary.)

6. This paragraph also provides that a bank may have the rights of a holder based on the handling of the check for collection or return. A bank may become a holder or a holder in due course regardless of whether prior banks have complied with the indorsement standard in § 229.35(a) and appendix D.

7. This paragraph affects the following provisions of the U.C.C., and may affect other provisions:

a. Section 4–214(a), in that the right to recovery is not based on provisional settlement, and recovery may be had from any prior bank. Section 4–214(a) would continue to permit a depositary bank to recover a provisional settlement from its customer. (See § 229.33(d).)

b. Section 3–415 and related provisions (such as section 3–503), in that such provisions would not apply as between banks, or as between the depositary bank and its customer.

C. 229.35(c) Indorsement by Bank

1. This section protects the rights of a customer depositing a check in a bank without requiring the words ''pay any bank,'' as required by the U.C.C. (See U.C.C. 4–201(b).) Use of this language in a depositary bank's indorsement will make it more difficult for other banks to identify the depositary bank. The indorsement standard in appendix D prohibits such material in subsequent collecting bank indorsements. The existence of a bank indorsement provides notice of the restrictive indorsement without any additional words.

D. 229.35(d) Indorsement for Depositary Bank

1. This section permits a depositary bank to arrange with another bank to indorse checks. This practice may occur when a correspondent indorses for a respondent, or when the bank servicing an ATM or lock box indorses for the bank maintaining the account in which the check is deposited—i.e., the depositary bank. If the indorsing bank applies the depositary bank's indorsement, checks will be returned to the depositary bank. If the indorsing bank does not apply the depositary bank's indorsement, by agreement with the depositary bank it may apply its own indorsement as the depositary bank indorsement. In that case, the depositary bank's own indorsement on the check (if any) should avoid the location reserved for the depositary bank. The actual depositary bank remains responsible for the availability and other requirements of Subpart B, but the bank indorsing as depositary bank is considered the depositary bank for purposes of Subpart C. The check will be returned, and notice of nonpayment will be given, to the bank indorsing as depositary bank.

2. Because the depositary bank for Subpart B purposes will desire prompt notice of nonpayment, its arrangement with the indorsing bank should provide for prompt notice of nonpayment. The bank indorsing as depositary bank may require the depositary bank to agree to take up the check if the check is not paid even if the depositary bank's indorsement does not appear on the check and it did not handle the check. The arrangement between the banks may constitute an agreement varying the effect of provisions of Subpart C under § 229.37.

*XXII. Section 229.36 Presentment and Issuance of Checks*

A. 229.36(a) Payable Through and Payable at Checks

1. For purposes of Subpart C, the regulation defines a payable-through or payable-at bank (which could be designated the collectible-through or collectible-at bank) as a paying bank. The requirements of § 229.30(a) and the notice of nonpayment requirements of § 229.33 are imposed on a payable-through or payable-at bank and are based on the time of receipt of the forward collection check by the payable-through or payable-at bank. This provision is intended to speed the return of checks that are payable through or at a bank to the depositary bank.

B. 229.36(b) Receipt at Bank Office or Processing Center

1. This paragraph seeks to facilitate efficient presentment of checks to promote early return or notice of nonpayment to the depositary bank and clarifies the law as to the effect of presentment by routing number. This paragraph differs from § 229.32(a) because presentment of checks differs from delivery of returned checks.

2. The paragraph specifies four locations at which the paying bank must accept presentment of checks. Where the check is payable through a bank and the check is sent to that bank, the payable-through bank is the paying bank for purposes of this subpart, regardless of whether the paying bank must present the check to another bank or to a nonbank payor for payment.

a. Delivery of checks may be made, and presentment is considered to occur, at a location (including a processing center) requested by the paying bank. This is the way most checks are presented by banks today. This provision adopts the common law rule of a number of legal decisions that the processing center acts as the agent of the paying bank to accept presentment and to begin the time for processing of the check. (See also U.C.C. 4–204(c).) If a bank designates different locations for the presentment of forward collection checks bearing different routing numbers, for purposes of this paragraph it requests presentment of checks bearing a particular routing number only at the location designated for receipt of forward collection checks bearing that routing number.

b. i. Delivery may be made at an office of the bank associated with the routing number on the check. The office associated with the routing number of a bank is found in *American Bankers Association Key to Routing Numbers*, published by an agent of the American Bankers Association, which lists a city and state address for each routing number. Checks generally are handled by collecting banks on the basis of the nine-digit routing number encoded in magnetic ink (or on the basis of the fractional form routing number if the magnetic ink characters are obliterated) on the check, rather than the printed name or address. The definition of a paying bank in §229.2(z) includes a bank designated by routing number, whether or not there is a name on the check, and whether or not any name is consistent with the routing number. Where a check is payable by one bank, but payable through another, the routing number is that of the payable-through bank, not that of the payor bank. As the payor bank has selected the payable-through bank as the point through which presentment is to be made, it is proper to treat the payable-through bank as the paying bank for purposes of this section.

ii. There is no requirement in the regulation that the name and address on the check agree with the address associated with the routing number on the check. A bank generally may control the use of its routing number, just as it does the use of its name. The address associated with the routing number may be a processing center.

iii. In some cases, a paying bank may have several offices in the city associated with the routing number. In such case, it would not be reasonable or efficient to require the presenting bank to sort the checks by more specific branch addresses that might be printed on the checks, and to deliver the checks to each branch. A collecting bank normally would deliver all checks to one location. In cases where checks are delivered to a branch other than the branch on which they may be drawn, computer and courier communication among branches should permit the paying bank to determine quickly whether to pay the check.

c. If the check specifies the name of the paying bank but no address, the bank must accept delivery at any office. Where delivery is made by a person other than a bank, or where the routing number is not readable, delivery will be made based on the name and address of the paying bank on the check. If there is no address, delivery may be made at any office of the paying bank. This provision is consistent with U.C.C. 3–111, which states that presentment for payment may be made at the place specified in the instrument, or, if there is none, at the place of business of the party to pay. Thus, there is a trade-off for a paying bank between specifying a particular address on a check to limit locations of delivery, and simply stating the name of the bank to encourage wider currency for the check.

d. If the check specifies the name and address of a branch or head office, or other location (such as a processing center), the check may be delivered by delivery to that office or other location. If the address is too general to identify a particular office, delivery may be made at any office consistent with the address. For example, if the address is ''San Francisco, California,'' each office in San Francisco must accept presentment. The designation of an address on the check generally is in the control of the paying bank.

3. This paragraph may affect U.C.C. 3–111 to the extent that the U.C.C. requires presentment to occur at a place specified in the instrument.

C. [Reserved]

D. 229.36(d) Liability of Bank During Forward Collection

1. This paragraph makes settlement between banks during forward collection final when made, subject to any deferment of credit, just as settlements between banks during the return of checks are final. In addition, this paragraph clarifies that this change does not affect the liability scheme under U.C.C. 4–201 during forward collection of a check. That U.C.C. section provides that, unless a contrary intent clearly appears, a bank is an agent or subagent of the owner of a check, but that Article 4 of the U.C.C. applies even though a bank may have purchased an item and is the owner of it. This paragraph preserves the liability of a collecting bank to prior collecting banks and the depositary bank's customer for negligence during the forward collection of a check under the U.C.C., even though this paragraph provides that settlement between banks during forward collection is final rather than provisional. Settlement by a paying bank is not considered to be final payment for the purposes of U.C.C. 4–215(a)(2) or (3),

because a paying bank has the right to recover settlement from a returning or depositary bank to which it returns a check under this subpart. Other provisions of the U.C.C. not superseded by this subpart, such as section 4–202, also continue to apply to the forward collection of a check and may apply to the return of a check. (See definition of returning bank in § 229.2(cc).)

E. 229.36(e) Issuance of Payable Through Checks

1. If a bank arranges for checks payable by it to be payable through another bank, it must require its customers to use checks that contain conspicuously on their face the name, location, and first four digits of the nine-digit routing number of the bank by which the check is payable and the legend ''payable through'' followed by the name of the payable-through bank. The first four digits of the nine-digit routing number and the location of the bank by which the check is payable must be associated with the same check processing region. (This section does not affect § 229.36(b).) The required information is deemed conspicuous if it is printed in a type size not smaller than six-point type and if it is contained in the title plate, which is located in the lower left quadrant of the check. The required information may be conspicuous if it is located elsewhere on the check.

2. If a payable-through check does not meet the requirements of this paragraph, the bank by which the check is payable may be liable to the depositary bank or others as provided in § 229.38. For example, a bank by which a payable-through check is payable could be liable to a depositary bank that suffers a loss, such as lost interest or liability under Subpart B, that would not have occurred had the check met the requirements of this paragraph. Similarly, a bank may be liable under § 229.38 if a check payable by it that is not payable through another bank is labeled as provided in this section. For example, a bank that holds checking accounts and processes checks at a central location but has widely-dispersed branches may be liable under this section if it labels all of its checks as ''payable through'' a single branch and includes the name, address, and four-digit routing symbol of another branch. These checks would not be payable through another bank and should not be labeled as payable-through checks. (All of a bank's offices within the United States are considered part of the same bank; see § 229.2(e).) In this example, the bank by which the checks are payable could be liable to a depositary bank that suffers a loss, such as lost interest or liability under Subpart B, due to the mislabeled check. The bank by which the check is payable may be liable for additional damages if it fails to act in good faith.

F. 229.36(f) Same-Day Settlement

1. This paragraph provides that, under certain conditions, a paying bank must settle with a presenting bank for a check on the same day the check is presented in order to avail itself of the ability to return the check on its next banking day under U.C.C. 4–301 and 4–302. This paragraph does not apply to checks presented for immediate payment over the counter. Settling for a check under this paragraph does not constitute final payment of the check under the U.C.C. This paragraph does not supersede or limit the rules governing collection and return of checks through Federal Reserve Banks that are contained in Subpart A of Regulation J (12 CFR part 210).

2. Presentment requirements.

a. Location and time.

i. For presented checks to qualify for mandatory same-day settlement, information accompanying the checks must indicate that presentment is being made under this paragraph—e.g. ''these checks are being presented for same-day settlement''—and must include a demand for payment of the total amount of the checks together with appropriate payment instructions in order to enable the paying bank to discharge its settlement responsibilities under this paragraph. In addition, the check or checks must be presented at a location designated by the paying bank for receipt of checks for same-day settlement by 8:00 a.m. local time of that location. The designated presentment location must be a location at which the paying bank would be considered to have received a check under § 229.36(b). The paying bank may not designate a location solely for presentment of checks subject to settlement under this paragraph; by designating a location for the purposes of § 229.36(f), the paying bank agrees to accept checks at that location for the purposes of § 229.36(b).

ii. The designated presentment location also must be within the check processing region consistent with the nine-digit routing number encoded in magnetic ink on the check. A paying bank that uses more than one routing number associated with a single check processing region may designate, for purposes of this paragraph, one or more locations in that check processing region at which checks will be accepted, but the paying bank must accept any checks with a routing number associated with that check processing region at each designated location. A paying bank may designate a presentment location for traveler's checks with an 8000-series routing number anywhere in the country because these traveler's checks are not associated with any check processing region. The paying bank, however, must accept at that presentment location any other checks for which it is paying bank that have

a routing number consistent with the check processing region of that location.

iii. If the paying bank does not designate a presentment location, it must accept presentment for same-day settlement at any location identified in §229.36(b), i.e., at an address of the bank associated with the routing number on the check, at any branch or head office if the bank is identified on the check by name without address, or at a branch, head office, or other location consistent with the name and address of the bank on the check if the bank is identified on the check by name and address. A paying bank and a presenting bank may agree that checks will be accepted for same-day settlement at an alternative location (e.g., at an intercept processor located in a different check processing region) or that the cut-off time for same-day settlement be earlier or later than 8:00 a.m. local time.

iv. In the case of a check payable through a bank but payable by another bank, this paragraph does not authorize direct presentment to the bank by which the check is payable. The requirements of same-day settlement under this paragraph would apply to a payable-through or payable-at bank to which the check is sent for payment or collection.

b. Reasonable delivery requirements. A check is considered presented when it is delivered to and payment is demanded at a location specified in paragraph (f)(1). Ordinarily, a presenting bank will find it necessary to contact the paying bank to determine the appropriate presentment location and any delivery instructions. Further, because presentment might not take place during the paying bank's banking day, a paying bank may establish reasonable delivery requirements to safeguard the checks presented, such as use of a night depository. If a presenting bank fails to follow reasonable delivery requirements established by the paying bank, it runs the risk that it will not have presented the checks. However, if no reasonable delivery requirements are established or if the paying bank does not make provisions for accepting delivery of checks during its non-business hours, leaving the checks at the presentment location constitutes effective presentment.

c. Sorting of checks. A paying bank may require that checks presented to it for same-day settlement be sorted separately from other forward collection checks it receives as a collecting bank or returned checks it receives as a returning or depositary bank. For example, if a bank provides correspondent check collection services and receives unsorted checks from a respondent bank that include checks for which it is the paying bank and that would otherwise meet the requirements for same-day settlement under this section, the collecting bank need not make settlement in accordance with paragraph (f)(2). If the collecting bank receives sorted checks from its respondent bank, consisting only of checks for which the collecting bank is the paying bank and that meet the requirements for same-day settlement under this paragraph, the collecting bank may not charge a fee for handling those checks and must make settlement in accordance with this paragraph.

3. Settlement

a. If a bank presents a check in accordance with the time and location requirements for presentment under paragraph (f)(1), the paying bank either must settle for the check on the business day it receives the check without charging a presentment fee or return the check prior to the time for settlement. (This return deadline is subject to extension under §229.30(c).) The settlement must be in the form of a credit to an account designated by the presenting bank at a Federal Reserve Bank (e.g., a Fedwire transfer). The presenting bank may agree with the paying bank to accept settlement in another form (e.g., credit to an account of the presenting bank at the paying bank or debit to an account of the paying bank at the presenting bank). The settlement must occur by the close of Fedwire on the business day the check is received by the paying bank. Under the provisions of §229.34(c), a settlement owed to a presenting bank may be set off by adjustments for previous settlements with the presenting bank. (See also §229.39(d).)

b. Checks that are presented after the 8 a.m. (local time) presentment deadline for same-day settlement and before the paying bank's cut-off hour are treated as if they were presented under other applicable law and settled for or returned accordingly. However, for purposes of settlement only, the presenting bank may require the paying bank to treat such checks as presented for same-day settlement on the next business day in lieu of accepting settlement by cash or other means on the business day the checks are presented to the paying bank. Checks presented after the paying bank's cut-off hour or on non-business days, but otherwise in accordance with this paragraph, are considered presented for same-day settlement on the next business day.

4. Closed Paying Bank

a. There may be certain business days that are not banking days for the paying bank. Some paying banks may continue to settle for checks presented on these days (e.g., by opening their back office operations or by using an intercept processor). In other cases, a paying bank may be unable to settle for checks presented on a day it is closed.

If the paying bank closes on a business day and checks are presented to the paying bank in accordance with paragraph (f)(1), the paying bank is accountable for the checks unless it settles for or returns the checks by the close of Fedwire on its next banking day. In addition, checks presented on a business day

on which the paying bank is closed are considered received on the paying bank's next banking day for purposes of the U.C.C. midnight deadline (U.C.C. 4–301 and 4–302) and this regulation's expeditious return and notice of nonpayment provisions.

b. If the paying bank is closed on a business day voluntarily, the paying bank must pay interest compensation, as defined in §229.2(oo), to the presenting bank for the value of the float associated with the check from the day of the voluntary closing until the day of settlement. Interest compensation is not required in the case of an involuntary closing on a business day, such as a closing required by state law. In addition, if the paying bank is closed on a business day due to emergency conditions, settlement delays and interest compensation may be excused under §229.38(e) or U.C.C. 4–109(b).

5. Good faith. Under §229.38(a), both presenting banks and paying banks are held to a standard of good faith, defined in §229.2(nn) to mean honesty in fact and the observance of reasonable commercial standards of fair dealing. For example, designating a presentment location or changing presentment locations for the primary purpose of discouraging banks from presenting checks for same-day settlement might not be considered good faith on the part of the paying bank. Similarly, presenting a large volume of checks without prior notice could be viewed as not meeting reasonable commercial standards of fair dealing and therefore may not constitute presentment in good faith. In addition, if banks, in the general course of business, regularly agree to certain practices related to same-day settlement, it might not be considered consistent with reasonable commercial standards of fair dealing, and therefore might not be considered good faith, for a bank to refuse to agree to those practices if agreeing would not cause it harm.

6. U.C.C. sections affected. This paragraph directly affects the following provisions of the U.C.C. and may affect other sections or provisions:

a. Section 4–204(b)(1), in that a presenting bank may not send a check for same-day settlement directly to the paying bank, if the paying bank designates a different location in accordance with paragraph (f)(1).

b. Section 4–213(a), in that the medium of settlement for checks presented under this paragraph is limited to a credit to an account at a Federal Reserve Bank and that, for checks presented after the deadline for same-day settlement and before the paying bank's cut-off hour, the presenting bank may require settlement on the next business day in accordance with this paragraph rather than accept settlement on the business day of presentment by cash.

c. Section 4–301(a), in that, to preserve the ability to exercise deferred posting, the time limit specified in that section for settlement or return by a paying bank on the banking day a check is received is superseded by the requirement to settle for checks presented under this paragraph by the close of Fedwire.

d. Section 4–302(a), in that, to avoid accountability, the time limit specified in that section for settlement or return by a paying bank on the banking day a check is received is superseded by the requirement to settle for checks presented under this paragraph by the close of Fedwire.

*XXIII. Section 229.37 Variations by Agreement*

A. This section is similar to U.C.C. 4–103, and permits consistent treatment of agreements varying Article 4 or Subpart C, given the substantial interrelationship of the two documents. To achieve consistency, the official comment to U.C.C. 4–103(a) (which in turn follows U.C.C. 1–201(3)) should be followed in construing this section. For example, as stated in Official Comment 2 to section 4–103, owners of items and other interested parties are not affected by agreements under this section unless they are parties to the agreement or are bound by adoption, ratification, estoppel, or the like. In particular, agreements varying this subpart that delay the return of a check beyond the times required by this subpart may result in liability under §229.38 to entities not party to the agreement.

B. The Board has not followed U.C.C. 4–103(b), which permits Federal Reserve regulations and operating letters, clearinghouse rules, and the like to apply to parties that have not specifically assented. Nevertheless, this section does not affect the status of such agreements under the U.C.C.

C. The following are examples of situations where variation by agreement is permissible, subject to the limitations of this section:

1. A depositary bank may authorize another bank to apply the other bank's indorsement to a check as the depositary bank. (See §229.35(d).)

2. A depositary bank may authorize returning banks to commingle qualified returned checks with forward collection checks. (See §229.32(a).)

3. A depositary bank may limit its liability to its customer in connection with the late return of a deposited check where the lateness is caused by markings on the check by the depositary bank's customer or prior indorser in the area of the depositary bank indorsement. (See §229.38(d).)

4. A paying bank may require its customer to assume the paying bank's liability for delayed or missent checks where the delay or missending is caused by markings placed on the check by the paying bank's customer that obscured a properly placed indorsement of the depositary bank. (See §229.38(d).)

5. A collecting or paying bank may agree to accept forward collection checks without

the indorsement of a prior collecting bank. (See § 229.35(a).)

6. A bank may agree to accept returned checks without the indorsement of a prior bank. (See § 229.35(a).)

7. A presenting bank may agree with a paying bank to present checks for same-day settlement at a location that is not in the check processing region consistent with the routing number on the checks. (See § 229.36(f)(1)(i).)

8. A presenting bank may agree with a paying bank to present checks for same-day settlement by a deadline earlier or later than 8:00 a.m. (See § 229.36(f)(1)(ii).)

9. A presenting bank and a paying bank may agree that presentment takes place when the paying bank receives an electronic transmission of information describing the check rather than upon delivery of the physical check. (See § 229.36(b).)

10. A depositary bank may agree with a paying or returning bank to accept an image or other notice in lieu of a returned check even when the check is available for return under this part. Except to the extent that other parties interested in the check assent to or are bound by the variation of the notice-in-lieu provisions of this part, banks entering into such an agreement may be responsible under this part or other applicable law to other interested parties for any losses caused by the handling of a returned check under the agreement. (See §§ 229.30(f), 229.31(f), 229.38(a).)

D. The Board expects to review the types of variation by agreement that develop under this section and will consider whether it is necessary to limit certain variations.

### *XXIV. Section 229.38 Liability*

#### A. 229.38(a) Standard of care; liability; measure of damages

1. The standard of care established by this section applies to any bank covered by the requirements of Subpart C of the regulation. Thus, the standard of care applies to a paying bank under §§ 229.30 and 229.33, to a returning bank under § 229.31, to a depositary bank under §§ 229.32 and 229.33, to a bank erroneously receiving a returned check or written notice of nonpayment as depositary bank under § 229.32(d), and to a bank indorsing a check under § 229.35. The standard of care is similar to the standard imposed by U.C.C. 1–203 and 4–103(a) and includes a duty to act in good faith, as defined in § 229.2(nn) of this regulation.

2. A bank not meeting this standard of care is liable to the depositary bank, the depositary bank's customer, the owner of the check, or another party to the check. The depositary bank's customer is usually a depositor of a check in the depositary bank (but see § 229.35(d)). The measure of damages provided in this section (loss incurred up to amount of check, less amount of loss party would have incurred even if bank had exercised ordinary care) is based on U.C.C. 4–103(e) (amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care), as limited by 4–202(c) (bank is liable only for its own negligence and not for actions of subsequent banks in chain of collection). This subpart does not absolve a collecting bank of liability to prior collecting banks under U.C.C. 4–201.

3. Under this measure of damages, a depositary bank or other person must show that the damage incurred results from the negligence proved. For example, the depositary bank may not simply claim that its customer will not accept a charge-back of a returned check, but must prove that it could not charge back when it received the returned check and could have charged back if no negligence had occurred, and must first attempt to collect from its customer. (See *Marcoux* v. *Van Wyk,* 572 F.2d 651 (8th Cir. 1978); *Appliance Buyers Credit Corp.* v. *Prospect Nat'l Bank,* 708 F.2d 290 (7th Cir. 1983).) Generally, a paying or returning bank's liability would not be reduced because the depositary bank did not place a hold on its customer's deposit before it learned of nonpayment of the check.

4. This paragraph also states that it does not affect a paying bank's liability to its customer. Under U.C.C. 4–402, for example, a paying bank is liable to its customer for wrongful dishonor, which is different from failure to exercise ordinary care and has a different measure of damages.

#### B. 229.38(b) Paying Bank's Failure To Make Timely Rreturn

1. Section 229.30(a) imposes requirements on the paying bank for expeditious return of a check and leaves in place the U.C.C. deadlines (as they may be modified by § 229.30(c)), which may allow return at a different time. This paragraph clarifies that the paying bank could be liable for failure to meet either standard, but not for failure to meet both. The regulation intends to preserve the paying bank's accountability for missing its midnight or other deadline under the U.C.C., (e.g., sections 4–215 and 4–302), provisions that are not incorporated in this regulation, but may be useful in establishing the time of final payment by the paying bank.

#### C. 229.38(c) Comparative negligence

1. This paragraph establishes a ''pure'' comparative negligence standard for liability under Subpart C of this regulation. This comparative negligence rule may have particular application where a paying or returning bank delays in returning a check because of difficulty in identifying the depositary bank. Some examples will illustrate liability

in such cases. In each example, it is assumed that the returned check is received by the depositary bank after it has made funds available to its customer, that it may no longer recover the funds from its customer, and that the inability to recover the funds from the customer is due to a delay in returning the check contrary to the standards established by §§ 229.30(a) or 229.31(a).

2. Examples.

a. If a depositary bank fails to use the indorsement required by this regulation, and this failure is caused by a failure to exercise ordinary care, and if a paying or returning bank is delayed in returning the check because additional time is required to identify the depositary bank or find its routing number, the paying or returning bank's liability to the depositary bank would be reduced or eliminated.

b. If the depositary bank uses the standard indorsement, but that indorsement is obscured by a subsequent collecting bank's indorsement, and a paying or returning bank is delayed in returning the check because additional time was required to identify the depositary bank or find its routing number, the paying or returning bank may not be liable to the depositary bank because the delay was not due to its negligence. Nonetheless, the collecting bank may be liable to the depositary bank to the extent that its negligence in indorsing the check caused the paying or returning bank's delay.

c. If a depositary bank accepts a check that has printing, a carbon band, or other material on the back of the check that existed at the time the check was issued, and the depositary bank's indorsement is obscured by the printing, carbon band, or other material, and a paying or returning bank is delayed in returning the check because additional time was required to identify the depositary bank, the returning bank may not be liable to the depositary bank because the delay was not due to its negligence. Nonetheless, the paying bank may be liable to the depositary bank to the extent that the printing, carbon band, or other material caused the delay.

### D. 229.38(d) Responsibility for Certain Aspects of Checks

1. Responsibility for back of check. The indorsement standard in § 229.35 is most effective if the back of the check remains clear of other matter that may obscure bank indorsements. Because bank indorsements are usually applied by automated equipment, it is not possible to avoid pre-existing matter on the back of the check. For example, bank indorsements are not required to avoid a carbon band or printed, stamped, or written terms or notations on the back of the check. Accordingly, this provision places responsibility on the paying bank, depositary bank, or reconverting bank, as appropriate, for keeping the back of the check clear for bank indorsements during forward collection and return.

2. ANS X9.100–140 provides that an image of an original check must be reduced in size when placed on the first substitute check associated with that original check. (The image thereafter would be constant in size on any subsequent substitute check that might be created.) Because of this size reduction, the location of an indorsement, particularly a depositary bank indorsement, applied to an original paper check likely will change when the first reconverting bank creates a substitute check that contains that indorsement within the image of the original paper check. If the indorsement was applied to the original paper check in accordance with appendix D's location requirements for indorsements applied to existing paper checks, and if the size reduction of the image causes the placement of the indorsement to no longer be consistent with the appendix's requirements, then the reconverting bank bears the liability for any loss that results from the shift in the placement of the indorsement. Such a loss could result either because the original indorsement applied in accordance with appendix D is rendered illegible by a subsequent indorsement that later is applied to the substitute check in accordance with appendix D, or because the subsequent bank cannot apply its indorsement to the substitute check legibly in accordance with appendix D as a result of the shift in the previous indorsement.

Example.

In accordance with appendix D's specifications, a depositary bank sprays its indorsement onto a business-sized original check between 3.0 inches from the leading edge of the check and 1.5 inches from the trailing edge of the check. The check's conversion to electronic form and subsequent reconversion to paper form causes the location of the depositary bank indorsement, now contained within the image of the original check, to change such that it is less than 3.0 inches from the leading edge of the substitute check. In accordance with appendix D's specifications, a subsequent collecting bank sprays its indorsement onto the substitute check between the leading edge of the check and 3.0 inches from the leading edge of the check and the indorsement happens to be on top of the shifted depositary bank indorsement. If the check is returned unpaid and the return is not expeditious because of the illegibility of the depositary bank indorsement, and the depositary bank incurs a loss that it would not have incurred had the return been expeditious, the reconverting bank bears the liability for that loss.

3. Responsibility for payable-through checks.

a. This paragraph provides that the bank by which a payable-through check is payable is liable for damages under paragraph (a) of this section to the extent that the check is not returned through the payable-through bank as quickly as would have been necessary to meet the requirements of §229.30(a)(1) (the 2-day/4-day test) had the bank by which it is payable received the check as paying bank on the day the payable-through bank received it. The location of the bank by which a check is payable for purposes of the 2-day/4-day test may be determined from the location or the first four digits of the routing number of the bank by which the check is payable. This information should be stated on the check. (See §229.36(e) and accompanying Commentary.) Responsibility under paragraph (d)(2) does not include responsibility for the time required for the forward collection of a check to the payable-through bank.

b. Generally, liability under paragraph (d)(2) will be limited in amount. Under §229.33(a), a paying bank that returns a check in the amount of $2,500 or more must provide notice of nonpayment to the depositary bank by 4:00 p.m. on the second business day following the banking day on which the check is presented to the paying bank. Even if a payable-through check in the amount of $2,500 or more is not returned through the payable-through bank as quickly as would have been required had the check been received by the bank by which it is payable, the depositary bank should not suffer damages unless it has not received timely notice of nonpayment. Thus, ordinarily the bank by which a payable-through check is payable would be liable under paragraph (a) only for checks in amounts up to $2,500, and the paying bank would be responsible for notice of nonpayment for checks in the amount of $2,500 or more.

4. Responsibility under paragraphs (d)(1) and (d)(2) is treated as negligence for comparative negligence purposes, and the contribution to damages under paragraphs (d)(1) and (d)(2) is treated in the same way as the degree of negligence under paragraph (c) of this section.

E. 229.38(e) Timeliness of Action

1. This paragraph excuses certain delays. It adopts the standard of U.C.C. 4–109(b).

F. 229.38(f) Exclusion

1. This paragraph provides that the civil liability and class action provisions, particularly the punitive damage provisions of sections 611(a) and (b), and the bona fide error provision of 611(c) of the EFA Act (12 U.S.C. 4010(a), (b), and (c)) do not apply to regulatory provisions adopted to improve the efficiency of the payments mechanism. Allowing punitive damages for delays in the return of checks where no actual damages are incurred would only encourage litigation and provide little or no benefit to the check collection system. In view of the provisions of paragraph (a), which incorporate traditional bank collection standards based on negligence, the provision on bona fide error is not included in Subpart C.

G. 229.38(g) Jurisdiction

1. The EFA Act confers subject matter jurisdiction on courts of competent jurisdiction and provides a time limit for civil actions for violations of this subpart.

H. 229.38(h) Reliance on Board Rulings

1. This provision shields banks from civil liability if they act in good faith in reliance on any rule, regulation, or interpretation of the Board, even if it were subsequently determined to be invalid. Banks may rely on the Commentary to this regulation, which is issued as an official Board interpretation, as well as on the regulation itself.

*XXV. Section 229.39 Insolvency of Bank*

A. Introduction

1. These provisions cover situations where a bank becomes insolvent during collection or return and are derived from U.C.C. 4–216. They are intended to apply to all banks.

B. 229.39(a) Duty of Receiver

1. This paragraph requires a receiver of a closed bank to return a check to the prior bank if it does not pay for the check. This permits the prior bank, as holder, to pursue its claims against the closed bank or prior indorsers on the check.

C. 229.39(b) Preference Against Paying or Depositary Bank

1. This paragraph gives a bank a preferred claim against a closed paying bank that finally pays a check without settling for it or a closed depositary bank that becomes obligated to pay a returned check without settling for it. If the bank with a preferred claim under this paragraph recovers from a prior bank or other party to the check, the prior bank or other party to the check is subrogated to the preferred claim.

D. 229.39(c) Preference Against Paying, Collecting, or Depositary Bank

1. This paragraph gives a bank a preferred claim against a closed collecting, paying, or returning bank that receives settlement but does not settle for a check. (See Commentary to §229.35(b) for discussion of prior and subsequent banks.) As in the case of §229.39(b), if the bank with a preferred claim under this paragraph recovers from a prior bank or other party to the check, the prior

bank or other party to the check is subrogated to the preferred claim.

E. 229.39(d) Preference Against Presenting Bank

1. This paragraph gives a paying bank a preferred claim against a closed presenting bank in the event that the presenting bank breaches an amount or encoding warranty as provided in §229.34(c)(1) or (3) and does not reimburse the paying bank for adjustments for a settlement made by the paying bank in excess of the value of the checks presented. This preference is intended to have the effect of a perfected security interest and is intended to put the paying bank in the position of a secured creditor for purposes of the receivership provisions of the Federal Deposit Insurance Act and similar provisions of state law.

F. 229.39(e) Finality of Settlement

1. This paragraph provides that insolvency does not interfere with the finality of a settlement, such as a settlement by a paying bank that becomes final by expiration of the midnight deadline.

*XXVI. Section 229.40 Effect on Merger Transaction*

A. When banks merge, there is normally a period of adjustment required before their operations are consolidated. To allow for this adjustment period, the regulation provides that the merged banks may be treated as separate banks for a period of up to one year after the consummation of the transaction. The term merger transaction is defined in §229.2(t). This rule affects the status of the combined entity in a number of areas in this subpart. For example:

1. The paying bank's responsibility for expeditious return (§229.30).
2. The returning bank's responsibility for expeditious return (§229.31).
3. Whether a returning bank is entitled to an extra day to qualify a return that will be delivered directly to a depositary bank that has merged with the returning bank (§229.31(a)).
4. Where the depositary bank must accept returned checks (§229.32(a)).
5. Where the depositary bank must accept notice of nonpayment (§229.33(c)).
6. Where a paying bank must accept presentment of checks (§229.36(b)).

*XXVII. Section 229.41 Relation to State Law*

A. This section specifies that state law relating to the collection of checks is preempted only to the extent that it is inconsistent with this regulation. Thus, this regulation is not a complete replacement for state laws relating to the collection or return of checks.

*XXVIII. Section 229.42 Exclusions*

A. Checks drawn on the United States Treasury, U.S. Postal Service money orders, and checks drawn on states and units of general local government that are presented directly to the state or unit of general local government and that are not payable through or at a bank are excluded from the coverage of the expeditious-return, notice-of-nonpayment, and same-day settlement requirements of subpart C of this part. Other provisions of this subpart continue to apply to the checks. This exclusion does not apply to checks drawn by the U.S. government on banks.

*XXIX. Section 229.43 Checks Payable in Guam, American Samoa, and the Northern Mariana Islands*

A. 229.43(a) Definitions

1. Bank offices in Guam, American Samoa, and the Northern Mariana Islands (which Regulation CC defines as Pacific island banks) do not meet the definition of bank in §229.2(e) because they are not located in the United States. Some checks drawn on Pacific island banks (defined as Pacific island checks) bear U.S. routing numbers and are collected and returned by banks in the same manner as checks payable in the U.S.

B. 229.43(b) Rules Applicable to Pacific Island Checks

1. When a bank handles a Pacific island check as if it were a check as defined in §229.2(k), the bank is subject to certain provisions of Regulation CC, as provided in this section. Because the Pacific island bank is not a bank as defined in §229.2(e), it is not a paying bank as defined in §229.2(z) (unless otherwise noted in this section). Pacific island banks are not subject to the provisions of Regulation CC.

2. A bank may agree to handle a Pacific island check as a returned check under §229.31 and may convert the returned Pacific island check to a qualified returned check. The returning bank is not, however, subject to the expeditious-return requirements of §229.31. The returning bank may receive the Pacific island check directly from a Pacific island bank or from another returning bank. As a Pacific island bank is not a paying bank under Regulation CC, §229.31(c) does not apply to a returning bank settling with the Pacific island bank.

3. A depositary bank that handles a Pacific island check is not subject to the provisions of subpart B of Regulation CC, including the availability, notice, and interest accrual requirements, with respect to that check. If, however, a bank accepts a Pacific island check for deposit (or otherwise accepts the check as transferee) and collects the Pacific island check in the same manner as other

checks, the bank is subject to the provisions of § 229.32, including the provisions regarding time and manner of settlement for returned checks in § 229.32(b), in the event the Pacific island check is returned by a returning bank. If the depositary bank receives the returned Pacific island check directly from the Pacific island bank, however, the provisions of § 229.32(b) do not apply, because the Pacific island bank is not a paying bank under Regulation CC. The depositary bank is not subject to the notice of nonpayment provisions in § 229.33 for Pacific island checks.

4. Banks that handle Pacific island checks in the same manner as other checks are subject to the indorsement provisions of § 229.35. Section 229.35(c) eliminates the need for the restrictive indorsement ''pay any bank.'' For purposes of § 229.35(c), the Pacific island bank is deemed to be a bank.

5. Pacific island checks will often be intermingled with other checks in a single cash letter. Therefore, a bank that handles Pacific island checks in the same manner as other checks is subject to the transfer warranty provision in § 229.34(c)(2) regarding accurate cash letter totals and the encoding warranty in § 229.34(c)(3). A bank that acts as a returning bank for a Pacific island check is not subject to the warranties in § 229.34(a). Similarly, because the Pacific island bank is not a ''bank'' or a ''paying bank'' under Regulation CC, § 229.34(b), (c)(1), and (c)(4) do not apply. For the same reason, the provisions of § 229.36 governing paying bank responsibilities such as place of receipt and same-day settlement do not apply to checks presented to a Pacific island bank, and the liability provisions applicable to paying banks in § 229.38 do not apply to Pacific island banks. Section 229.36(d), regarding finality of settlement between banks during forward collection, applies to banks that handle Pacific island checks in the same manner as other checks, as do the liability provisions of § 229.38, to the extent the banks are subject to the requirements of Regulation CC as provided in this section, and §§ 229.37 and 229.39 through 229.42.

*XXX. § 229.51 General provisions governing substitute checks*

A. § 229.51(a) Legal Equivalence

1. Section 229.51(a) states that a substitute check for which a bank has provided the substitute check warranties is the legal equivalent of the original check for all purposes and all persons if it meets the accuracy and legend requirements. Where the law (or a contract) requires production of the original check, production of a legally equivalent substitute check would satisfy that requirement. A person that receives a substitute check cannot be assessed costs associated with the creation of the substitute check, absent agreement to the contrary.

Examples.

a. A presenting bank presents a substitute check that meets the legal equivalence requirements to a paying bank. The paying bank cannot refuse presentment of the substitute check on the basis that it is a substitute check, because the substitute check is the legal equivalent of the original check.

b. A depositor's account agreement with a bank provides that the depositor is entitled to receive original cancelled checks back with his or her periodic account statement. The bank may honor that agreement by providing original checks, substitute checks, or a combination thereof. However, a bank may not honor such an agreement by providing something other than an original check or a substitute check.

c. A mortgage company argues that a consumer missed a monthly mortgage payment that the consumer believes she made. A legally equivalent substitute check concerning that mortgage payment could be used in the same manner as the original check to prove the payment.

2. A person other than a bank that creates a substitute check could transfer, present, or return that check only by agreement unless and until a bank provided the substitute check warranties.

3. To be the legal equivalent of the original check, a substitute check must accurately represent all the information on the front and back of the check as of the time the original check was truncated. An accurate representation of information that was illegible on the original check would satisfy this requirement. The payment instructions placed on the check by, or as authorized by, the drawer, such as the amount of the check, the payee, and the drawer's signature, must be accurately represented, because that information is an essential element of a negotiable instrument. Other information that must be accurately represented includes (1) the information identifying the drawer and the paying bank that is preprinted on the check, including the MICR line; and (2) other information placed on the check prior to the time an image of the check is captured, such as any required identification written on the front of the check and any indorsements applied to the back of the check. A substitute check need not capture other characteristics of the check, such as watermarks, microprinting, or other physical security features that cannot survive the imaging process or decorative images, in order to meet the accuracy requirement. Conversely, some security features that are latent on the original check might become visible as a result of the check imaging process. For example, the original check might have a faint representation of the word ''void'' that will appear more clearly on a photocopied or electronic image of the check. Provided the inclusion of

the clearer version of the word on the image used to create a substitute check did not obscure the required information listed above, a substitute check that contained such information could be the legal equivalent of an original check under §229.51(a). However, if a person suffered a loss due to receipt of such a substitute check instead of the original check, that person could have an indemnity claim under §229.53 and, in the case of a consumer, an expedited recredit claim under §229.54.

4. To be the legal equivalent of the original check, a substitute check must bear the legal equivalence legend described in §229.51(a)(2). A bank may not vary the language of the legal equivalence legend and must place the legend on the substitute check as specified by generally applicable industry standards for substitute checks contained in ANS X9.100–140.

5. In some cases, the original check used to create a substitute check could be forged or otherwise fraudulent. A substitute check created from a fraudulent original check would have the same status under Regulation CC and the U.C.C. as the original fraudulent check. For example, a substitute check of a fraudulent original check would not be properly payable under U.C.C. 4–401 and would be subject to the transfer and presentment warranties in U.C.C. 4–207 and 4–208.

B. 229.51(b) Reconverting Bank Duties

1. As discussed in more detail in appendix D and the commentary to §229.35, a reconverting bank must indorse (or, if it is a paying bank with respect to the check, identify itself on) the back of a substitute check in a manner that preserves all indorsements applied, whether physically or electronically, by persons that previously handled the check in any form for forward collection or return. Indorsements applied physically to the original check before an image of the check was captured would be preserved through the image of the back of the original check that a substitute check must contain. Indorsements applied physically to the original check after an image of the original check was captured would be conveyed as electronic indorsements (see paragraph 3 of the commentary to §229.35(a)). If indorsements were applied electronically after an image of the original check was captured or were applied electronically after a previous substitute check was converted to electronic form, the reconverting bank must apply those indorsements physically to the substitute check. A reconverting bank is not responsible for obtaining indorsements that persons that previously handled the check should have applied but did not apply.

2. A reconverting bank also must identify itself as such on the front and back of the substitute check and must preserve on the back of the substitute check the identifications of any previous reconverting banks in accordance with appendix D. The presence on the back of a substitute check of indorsements that were applied by previous reconverting banks and identified with asterisks in accordance with appendix D would satisfy the requirement that the reconverting bank preserve the identification of previous reconverting banks. As discussed in more detail in the commentary to §229.35, the reconverting bank and truncating bank routing numbers on the front of a substitute check and, if the reconverting bank is the paying bank, the reconverting bank's routing number on the back of a substitute check are for identification only and are not indorsements or acceptances.

3. The reconverting bank must place the routing number of the truncating bank surrounded by brackets on the front of the substitute check in accordance with appendix D and ANS X9.100–140.

Example.

A bank's customer, which is a nonbank business, receives checks for payment and by agreement deposits substitute checks instead of the original checks with its depositary bank. The depositary bank is the reconverting bank with respect to the substitute checks and the truncating bank with respect to the original checks. In accordance with appendix D and with ANS X9.100–140, the bank must therefore be identified on the front of the substitute checks as a reconverting bank and as the truncating bank, and on the back of the substitute checks as the depositary bank and a reconverting bank.

C. 229.51(c) Applicable Law

1. A substitute check that meets the requirements for legal equivalence set forth in this section is subject to any provision of federal or state law that applies to original checks, except to the extent such provision is inconsistent with the Check 21 Act or subpart D. A legally equivalent substitute check is subject to all laws that are not preempted by the Check 21 Act in the same manner and to the same extent as is an original check. Thus, any person could satisfy a law that requires production of an original check by producing a substitute check that is derived from the relevant original check and that meets the legal equivalence requirements of §229.51(a).

2. A law is not inconsistent with the Check 21 Act or subpart D merely because it allows for the recovery of a greater amount of damages.

Example.

A drawer that suffers a loss with respect to a substitute check that was improperly charged to its account and for which the

drawer has an indemnity claim but not a warranty claim would be limited under the Check 21 Act to recovery of the amount of the substitute check plus interest and expenses. However, if the drawer also suffered damages that were proximately caused because the bank wrongfully dishonored subsequently presented checks as a result of the improper substitute check charge, the drawer could recover those losses under U.C.C. 4–402.

*XXXI. § 229.52 Substitute Check Warranties*

A. 229.52(a) Warranty Content and Provision

1. The responsibility for providing the substitute check warranties begins with the reconverting bank. In the case of a substitute check created by a bank, the reconverting bank starts the flow of warranties when it transfers, presents, or returns a substitute check for which it receives consideration. A bank that receives a substitute check created by a nonbank starts the flow of warranties when it transfers, presents, or returns for consideration either the substitute check it received or an electronic or paper representation of that substitute check. To ensure that warranty protections flow all the way through to the ultimate recipient of a substitute check or paper or electronic representation thereof, any subsequent bank that transfers, presents, or returns for consideration either the substitute check or a paper or electronic representation of the substitute check is responsible to subsequent transferees for the warranties. Any warranty recipient could bring a claim for a breach of a substitute check warranty if it received either the actual substitute check or a paper or electronic representation of a substitute check.

2. The substitute check warranties and indemnity are not given under §§ 229.52 and 229.53 by a bank that truncates the original check and by agreement transfers the original check electronically to a subsequent bank for consideration. However, parties may, by agreement, allocate liabilities associated with the exchange of electronic check information.

Example.

A bank that receives check information electronically and uses it to create substitute checks is the reconverting bank and, when it transfers, presents, or returns that substitute check, becomes the first warrantor. However, that bank may protect itself by including in its agreement with the sending bank provisions that specify the sending bank's warranties and responsibilities to the receiving bank, particularly with respect to the accuracy of the check image and check data transmitted under the agreement.

3. A bank need not affirmatively make the warranties because they attach automatically when a bank transfers, presents, or returns the substitute check (or a representation thereof) for which it receives consideration. Because a substitute check transferred, presented, or returned for consideration is warranted to be the legal equivalent of the original check and thereby subject to existing laws as if it were the original check, all U.C.C. and other Regulation CC warranties that apply to the original check also apply to the substitute check.

4. The legal equivalence warranty by definition must be linked to a particular substitute check. When an original check is truncated, the check may move from electronic form to substitute check form and then back again, such that there would be multiple substitute checks associated with one original check. When a check changes form multiple times in the collection or return process, the first reconverting bank and subsequent banks that transfer, present, or return the first substitute check (or a paper or electronic representation of the first substitute check) warrant the legal equivalence of only the first substitute check. If a bank receives an electronic representation of a substitute check and uses that representation to create a second substitute check, the second reconverting bank and subsequent transferees of the second substitute check (or a representation thereof) warrant the legal equivalence of both the first and second substitute checks. A reconverting bank would not be liable for a warranty breach under § 229.52 if the legal equivalence defect is the fault of a subsequent bank that handled the substitute check, either as a substitute check or in other paper or electronic form.

5. The warranty in § 229.52(a)(2), which addresses multiple payment requests for the same check, is not linked to a particular substitute check but rather is given by each bank handling the substitute check, an electronic representation of a substitute check, or a subsequent substitute check created from an electronic representation of a substitute check. All banks that transfer, present, or return a substitute check (or a paper or electronic representation thereof) therefore provide the warranty regardless of whether the ultimate demand for double payment is based on the original check, the substitute check, or some other electronic or paper representation of the substitute or original check, and regardless of the order in which the duplicative payment requests occur. This warranty is given by the banks that transfer, present, or return a substitute check even if the demand for duplicative payment results from a fraudulent substitute check about which the warranting bank had no knowledge.

Example.

A nonbank depositor truncates a check and in lieu thereof sends an electronic version of that check to both Bank A and Bank B. Bank A and Bank B each uses the check information that it received electronically to create a substitute check, which it presents to Bank C for payment. Bank A and Bank B each is a reconverting bank that made the substitute check warranties when it presented a substitute check to and received payment from Bank C. Bank C could pursue a warranty claim for the loss it suffered as a result of the duplicative payment against either Bank A or Bank B.

B. 229.52(b) Warranty Recipients

1. A reconverting bank makes the warranties to the person to which it transfers, presents, or returns the substitute check for consideration and to any subsequent recipient that receives either the substitute check or a paper or electronic representation derived from the substitute check. These subsequent recipients could include a subsequent collecting or returning bank, the depositary bank, the drawer, the drawee, the payee, the depositor, and any indorser. The paying bank would be included as a warranty recipient, for example because it would be the drawee of a check or a transferee of a check that is payable through it.

2. The warranties flow with the substitute check to persons that receive a substitute check or a paper or electronic representation of a substitute check. The warranties do not flow to a person that receives only the original check or a representation of an original check that was not derived from a substitute check. However, a person that initially handled only the original check could become a warranty recipient if that person later receives a returned substitute check or a paper or electronic representation of a substitute check that was derived from that original check.

*XXXII. § 229.53 Substitute Check Indemnity*

A. 229.53(a) Scope of Indemnity

1. Each bank that for consideration transfers, presents, or returns a substitute check or a paper or electronic representation of a substitute check is responsible for providing the substitute check indemnity. The indemnity covers losses due to any subsequent recipient's receipt of the substitute check instead of the original check. The indemnity therefore covers the loss caused by receipt of the substitute check as well as the loss that a bank incurs because it pays an indemnity to another person. A bank that pays an indemnity would in turn have an indemnity claim regardless of whether it received the substitute check or a paper or electronic representation of the substitute check The indemnity would not apply to a person that handled only the original check or a paper or electronic version of the original check that was not derived from a substitute check.

Examples.

a. A paying bank makes payment based on a substitute check that was derived from a fraudulent original cashier's check. The amount and other characteristics of the original cashier's check are such that, had the original check been presented instead, the paying bank would have inspected the original check for security features. The paying bank's fraud detection procedures were designed to detect the fraud in question and allow the bank to return the fraudulent check in a timely manner. However, the security features that the bank would have inspected were security features that did not survive the imaging process (see the commentary to § 229.51(a)). Under these circumstances, the paying bank could assert an indemnity claim against the bank that presented the substitute check.

b. By contrast with the previous examples, the indemnity would not apply if the characteristics of the presented substitute check were such that the bank's security policies and procedures would not have detected the fraud even if the original had been presented. For example, if the check was under the threshold amount at which the bank subjects an item to its fraud detection procedures, the bank would not have inspected the item for security features regardless of the form of the item and accordingly would have suffered a loss even if it had received the original check.

c. A paying bank makes an erroneous payment based on an electronic representation of a substitute check because the electronic cash letter accompanying the electronic item included the wrong amount to be charged. The paying bank would not have an indemnity claim associated with that payment because its loss did not result from receipt of an actual substitute check instead of the original check. However, the paying bank could protect itself from such losses through its agreement with the bank that sent the check to it electronically and may have rights under other law.

d. A drawer has agreed with its bank that the drawer will not receive paid checks with periodic account statements. The drawer requested a copy of a paid check in order to prove payment and received a photocopy of a substitute check. The photocopy that the bank provided in response to this request was illegible, such that the drawer could not prove payment. Any loss that the drawer suffered as a result of receiving the blurry check image would not trigger an indemnity claim because the loss was not caused by the receipt of a substitute check. The drawer may, however, still have a warranty claim if

he received a copy of a substitute check, and may also have rights under the U.C.C.

B. 229.53(b) Indemnity Amount

1. If a recipient of a substitute check is making an indemnity claim because a bank has breached one of the substitute check warranties, the recipient can recover any losses proximately caused by that warranty breach.

Examples.

a. A drawer discovers that its account has been charged for two different substitute checks that were provided to the drawer and that were associated with the same original check. As a result of this duplicative charge, the paying bank dishonored several subsequently-presented checks that it otherwise would have paid and charged the drawer returned check fees. The payees of the returned checks also charged the drawer returned check fees. The drawer would have a warranty claim against any of the warranting banks, including its bank, for breach of the warranty described in §229.52(a)(2). The drawer also could assert an indemnity claim. Because there is only one original check for any payment transaction, if the collecting and presenting bank had collected the original check instead of using a substitute check the bank would have been asked to make only one payment. The drawer could assert its warranty and indemnity claims against the paying bank, because that is the bank with which the drawer has a customer relationship and the drawer has received an indemnity from that bank. The drawer could recover from the indemnifying bank the amount of the erroneous charge, as well as the amount of the returned check fees charged by both the paying bank and the payees of the returned checks. If the drawer's account were an interest-bearing account, the drawer also could recover any interest lost on the erroneously debited amount and the erroneous returned check fees. The drawer also could recover its expenditures for representation in connection with the claim. Finally, the drawer could recover any other losses that were proximately caused by the warranty breach.

b. In the example above, the paying bank that received the duplicate substitute checks also would have a warranty claim against the previous transferor(s) of those substitute checks and could seek an indemnity from that bank (or either of those banks). The indemnifying bank would be responsible for compensating the paying bank for all the losses proximately caused by the warranty breach, including representation expenses and other costs incurred by the paying bank in settling the drawer's claim.

2. If the recipient of the substitute check does not have a substitute check warranty claim with respect to the substitute check, the amount of the loss the recipient may recover under §229.53 is limited to the amount of the substitute check, plus interest and expenses. However, the indemnified person might be entitled to additional damages under some other provision of law.

Examples.

a. A drawer received a substitute check that met all the legal equivalence requirements and for which the drawer was only charged once, but the drawer believed that the underlying original check was a forgery. If the drawer suffered a loss because it could not prove the forgery based on the substitute check, for example because proving the forgery required analysis of pen pressure that could be determined only from the original check, the drawer would have an indemnity claim. However, the drawer would not have a substitute check warranty claim because the substitute check was the legal equivalent of the original check and no person was asked to pay the substitute check more than once. In that case, the amount of the drawer's indemnity under §229.53 would be limited to the amount of the substitute check, plus interest and expenses. However, the drawer could attempt to recover additional losses, if any, under other law.

b. As described more fully in the commentary to §229.53(a) regarding the scope of the indemnity, a paying bank could have an indemnity claim if it paid a legally equivalent substitute check that was created from a fraudulent cashier's check that the paying bank's fraud detection procedures would have caught and that the bank would have returned by its midnight deadline had it received the original check. However, if the substitute check was not subject to a warranty claim (because it met the legal equivalence requirements and there was only one payment request) the paying bank's indemnity would be limited to the amount of the substitute check plus interest and expenses.

3. The amount of an indemnity would be reduced in proportion to the amount of any amount loss attributable to the indemnified person's negligence or bad faith. This comparative negligence standard is intended to allocate liability in the same manner as the comparative negligence provision of §229.38(c).

4. An indemnifying bank may limit the losses for which it is responsible under §229.53 by producing the original check or a sufficient copy. However, production of the original check or a sufficient copy does not absolve the indemnifying bank from liability claims relating to a warranty the bank has provided under §229.52 or any other law, including but not limited to subpart C of this part or the U.C.C.

C. 229.53(c) Subrogation of Rights

1. A bank that pays an indemnity claim is subrogated to the rights of the person it indemnified, to the extent of the indemnity it provided, so that it may attempt to recover that amount from another person based on an indemnity, warranty, or other claim. The person that the bank indemnified must comply with reasonable requests from the indemnifying bank for assistance with respect to the subrogated claim.

Example.

A paying bank indemnifies a drawer for a substitute check that the drawer alleged was a forgery that would have been detected had the original check instead been presented. The bank that provided the indemnity could pursue its own indemnity claim against the bank that presented the substitute check, could attempt to recover from the forger, or could pursue any claim that it might have under other law. The bank also could request from the drawer any information that the drawer might possess regarding the possible identity of the forger.

*XXXIII. § 229.54 Expedited Recredit for Consumers*

A. 229.54(a) Circumstances Giving Rise to a Claim

1. A consumer may make a claim for expedited recredit under this section only for a substitute check that he or she has received and for which the bank charged his or her deposit account. As a result, checks used to access loans, such as credit card checks or home equity line of credit checks, that are reconverted to substitute checks would not give rise to an expedited recredit claim, unless such a check was returned unpaid and the bank charged the consumer's deposit account for the amount of the returned check. In addition, a consumer who received only a statement that contained images of multiple substitute checks per page would not be entitled to make an expedited recredit claim, although he or she could seek redress under other provisions of law, such as § 229.52 or U.C.C. 4–401. However, a consumer who originally received only a statement containing images of multiple substitute checks per page but later received a substitute check, such as in response to a request for a copy of a check shown in the statement, could bring a claim if the other expedited recredit criteria were met. Although a consumer must at some point have received a substitute check to make an expedited recredit claim, the consumer need not be in possession of the substitute check at the time he or she submits the claim.

2. A consumer must in good faith assert that the bank improperly charged the consumer's account for the substitute check or that the consumer has a warranty claim for the substitute check (or both). The warranty in question could be a substitute check warranty described in § 229.52 or any other warranty that a bank provides with respect to a check under other law. A consumer could, for example, have a warranty claim under § 229.34(b), which contains returned check warranties that are made to the owner of the check.

3. A consumer's recovery under the expedited recredit section is limited to the amount of his or her loss, up to the amount of the substitute check subject to the claim, plus interest if the consumer's account is an interest-bearing account. The consumer's loss could include fees that resulted from the allegedly incorrect charge, such as bounced check fees that were imposed because the improper charge caused the bank to dishonor subsequently presented checks that it otherwise would have honored. A consumer who suffers a total loss greater than the amount of the substitute check plus interest could attempt to recover the remainder of that loss by bringing warranty, indemnity, or other claim under this subpart or other applicable law.

Examples.

a. A consumer who received a substitute check believed that he or she wrote the check for $150, but the bank charged his or her account for $1,500. The amount on the substitute check the consumer received is illegible. If the substitute check contained a blurry image of what was a legible original check, the consumer could have a claim for a breach of the legal equivalence warranty in addition to an improper charge claim. Because the amount of the check cannot be determined from the substitute check provided to the consumer, the consumer, if acting in good faith, could assert that the production of the original check or a better copy of the original check is necessary to determine the validity of the claim. The consumer in this case could attempt to recover his or her losses by using the expedited recredit procedure. The consumer's losses recoverable under § 229.54 could include the $1,350 he or she believed was incorrectly charged plus any improperly charged fees associated with that charge, up to $150 (plus foregone interest on the amount of the consumer's loss if the account was an interest-bearing account). The consumer could recover any additional losses, if any, under other law, such as U.C.C. 4–401 and 4–402.

b. A consumer received a substitute check for which his or her account was charged and believed that the original check from which the substitute was derived was a forgery. The forgery was good enough that analysis of the original check was necessary to verify

whether the signature is that of the consumer. Under those circumstances, the consumer, if acting in good faith, could assert that the charge was improper, that he or she therefore had incurred a loss in the amount of the check (plus foregone interest if the account was an interest-bearing account), and that he or she needed the original check to determine the validity of the forgery claim. By contrast, if the signature on the substitute check obviously was forged (for example, if the forger signed a name other than that of the account holder) and there was no other defect with the substitute check, the consumer would not need the original check or a sufficient copy to determine the fact of the forgery and thus would not be able to make an expedited recredit claim under this section. However, the consumer would have a claim under U.C.C. 4–401 if the item was not properly payable.

B. 229.54(b) Procedures for Making Claims

1. The consumer must submit his or her expedited recredit claim to the bank within 40 calendar days of the later of the day on which the bank mailed or delivered, by a means agreed to by the consumer, (1) the periodic account statement containing information concerning the transaction giving rise to the claim, or (2) the substitute check giving rise to the claim. The mailing or delivery of a substitute check could be in connection with a regular account statement, in response to a consumer's specific request for a copy of a check, or in connection with the return of a substitute check to the payee.

2. Section 229.54(b) contemplates more than one possible means of delivering an account statement or a substitute check to the consumer. The time period for making a claim thus could be triggered by the mailed, in-person, or electronic delivery of an account statement or by the mailed or in-person delivery of a substitute check. In-person delivery would include, for example, making an account statement or substitute check available at the bank for the consumer's retrieval under an arrangement agreed to by the consumer. In the case of a mailed statement or substitute check, the 40-day period should be calculated from the postmark on the envelope. In the case of in-person delivery, the 40-day period should be calculated from the earlier of the calendar day on which delivery occurred or the bank first made the statement or substitute check available for the consumer's retrieval.

3. A bank must extend the consumer's time for submitting a claim for a reasonable period if the consumer is prevented from submitting his or her claim within 40 days because of extenuating circumstances. Extenuating circumstances could include, for example, the extended travel or illness of the consumer.

4. For purposes of determining the timeliness of a consumer's actions, a consumer's claim is considered received on the banking day on which the consumer's bank receives a complete claim in person or by telephone or on the banking day on which the consumer's bank receives a letter or e-mail containing a complete claim. (But see paragraphs 9–11 of this section for a discussion of time periods related to oral claims that the bank requires to be put in writing.)

5. A consumer who makes an untimely claim would not be entitled to recover his or her losses using the expedited recredit procedure. However, he or she still could have rights under other law, such as a warranty or indemnity claim under subpart D, a claim for an improper charge to his or her account under U.C.C. 4–401, or a claim for wrongful dishonor under U.C.C. 4–402.

6. A consumer's claim must include the reason why the consumer believes that his or her account was charged improperly or why he or she has a warranty claim. A charge could be improper, for example, if the bank charged the consumer's account for an amount different than the consumer believes he or she authorized or charged the consumer more than once for the same check, or if the check in question was a forgery or otherwise fraudulent.

7. A consumer also must provide a reason why production of the original check or a sufficient copy is necessary to determine the validity of the claim identified by the consumer. For example, if the consumer believed that the bank charged his or her account for the wrong amount, the original check might be necessary to prove this claim if the amount of the substitute check were illegible. Similarly, if the consumer believed that his or her signature had been forged, the original check might be necessary to confirm the forgery if, for example, pen pressure or similar analysis were necessary to determine the genuineness of the signature.

8. The information that the consumer is required to provide under §229.54(b)(2)(iv) to facilitate the bank's investigation of the claim could include, for example, a copy of the allegedly defective substitute check or information related to that check, such as the number, amount, and payee.

9. A bank may accept an expedited recredit claim in any form but could in its discretion require the consumer to submit the claim in writing. A bank that requires a recredit claim to be in writing must inform the consumer of that requirement and provide a location to which such a written claim should be sent. If the consumer attempts to make a claim orally, the bank must inform the consumer at that time of the written notice requirement. A bank that receives a timely oral claim and then requires the consumer to submit the claim in writing may require the consumer to submit the written claim within

10 business days of the bank's receipt of the timely oral claim. If the consumer's oral claim was timely and the consumer's written claim was received within the 10-day period for submitting the claim in writing, the consumer would satisfy the requirement of §229.54(b)(1) to submit his or her claim within 40 days, even if the bank received the written claim after that 40-day period.

10. A bank may permit but may not require a consumer to submit a written claim electronically.

11. If a bank requires a consumer to submit a claim in writing, the bank may compute time periods for the bank's action on the claim from the date that the bank received the written claim. Thus, if a consumer called the bank to make an expedited recredit claim and the bank required the consumer to submit the claim in writing, the time at which the bank must take action on the claim would be determined based on the date on which the bank received the written claim, not the date on which the consumer made the oral claim.

12. Regardless of whether the consumer's communication with the bank is oral or written, a consumer complaint that does not contain all the elements described in §229.54(b) is not a claim for purposes of §229.54. If the consumer attempts to submit a claim but does not provide all the required information, then the bank has a duty to inform the consumer that the complaint does not constitute a claim under §229.54 and identify what information is missing.

C. 229.54(c) Action on Claims

1. If the bank has not determined whether or not the consumer's claim is valid by the end of the 10th business day after the banking day on which the consumer submitted the claim, the bank must by that time recredit the consumer's account for the amount of the consumer's loss, up to the lesser of the amount of the substitute check or $2,500, plus interest if the account is an interest-bearing account. A bank must provide the recredit pending investigation for each substitute check for which the consumer submitted a claim, even if the consumer submitted multiple substitute check claims in the same communication.

2. A bank that provides a recredit to the consumer, either provisionally or after determining that the consumer's claim is valid, may reverse the amount of the recredit if the bank later determines that the claim in fact was not valid. A bank that reverses a recredit also may reverse the amount of any interest that it has paid on the previously recredited amount. A bank's time for reversing a recredit may be limited by a statute of limitations.

D. 229.54(d) Availability of Recredit

1. The availability of a recredit provided by a bank under §229.54(c) is governed solely by §229.54(d) and therefore is not subject to the availability provisions of subpart B. A bank generally must make a recredit available for withdrawal no later than the start of the business day after the banking day on which the bank provided the recredit. However, a bank may delay the availability of up to the first $2,500 that it provisionally recredits to a consumer account under §229.54(c)(3)(i) if (1) the account is a new account, (2) without regard to the substitute check giving rise to the recredit claim, the account has been repeatedly overdrawn during the six month period ending on the date the bank received the claim, or (3) the bank has reasonable cause to believe that the claim is fraudulent. These first two exceptions are meant to operate in the same manner as the corresponding new account and repeated overdraft exceptions in subpart B, as described in §229.13(a) and (d) and the commentary thereto regarding application of the exceptions. When a recredit amount for which a bank delays availability contains an interest component, that component also is subject to the delay because it is part of the amount recredited under §229.54(c)(3)(i). However, interest continues to accrue during the hold period.

2. Section 229.54(d)(2) describes the maximum period of time that a bank may delay availability of a recredit provided under §229.54(c). The bank may delay availability under one of the three listed exceptions until the business day after the banking day on which the bank determines that the consumer's claim is valid or the 45th calendar day after the banking day on which the bank received the consumer's claim, whichever is earlier. The only portion of the recredit that is subject to delay under §229.54(d)(2) is the amount that the bank recredits under §229.54(c)(3)(i) (including the interest component, if any) pending its investigation of a claim.

E. 229.54(e) Notices Relating to Consumer Expedited Recredit Claims

1. A bank must notify a consumer of its action regarding a recredit claim no later than the business day after the banking day that the bank makes a recredit, determines a claim is not valid, or reverses a recredit, as appropriate. As provided in §229.58, a bank may provide any notice required by this section by U.S. mail or by any other means through which the consumer has agreed to receive account information.

2. A bank that denies the consumer's recredit claim must demonstrate to the consumer that the substitute check was properly charged or that the warranty claim was not valid, such as by explaining the reason

that the substitute check charge was proper or the consumer's warranty claim was not valid. For example, if a consumer has claimed that the bank charged its account for an improper amount, the bank denying that claim must explain why it determined that the charged amount was proper.

3. A bank denying a recredit claim also must provide the original check or a sufficient copy, unless the bank is providing the claim denial notice electronically and the consumer has agreed to receive that type of information electronically. In that case, § 229.58 allows the bank instead to provide an image of the original check or an image of the sufficient copy that the bank would have sent to the consumer had the bank provided the notice by mail.

4. A bank that relies on information or documents in addition to the original check or sufficient copy when denying a consumer expedited recredit claim also must either provide such information or documents to the consumer or inform the consumer that he or she may request copies of such information or documents. This requirement does not apply to a bank that relies only on the original check or a sufficient copy to make its determination.

5. Models C–22 through C–25 in appendix C contain model language for each of three notices described in § 229.54(e). A bank may, but is not required to, use the language listed in the appendix. The Check 21 Act does not provide banks that use these models with a safe harbor. However, the Board has published these models to aid banks' efforts to comply with § 229.54(e).

F. 229.54(f) Recredit Does Not Abrogate Other Liabilities

1. The amount that a consumer may recover under § 229.54 is limited to the lesser of the amount of his or her loss or the amount of the substitute check, plus interest on that amount if his or her account earns interest. However, a consumer's total loss associated with the substitute check could exceed that amount, and the consumer could be entitled to additional damages under other law. For example, if a consumer's loss exceeded the amount of the substitute check plus interest and he or she had both a warranty and an indemnity claim with respect to the substitute check, he or she would be entitled to additional damages under § 229.53 of this subpart. Similarly, if a consumer was charged bounced check fees as a result of an improperly charged substitute check and could not recover all of those fees because of the § 229.54's limitation on recovery, he or she could attempt to recover additional amounts under U.C.C. 4–402.

*XXXIV. § 229.55 Expedited Recredit Procedures for Banks*

A. 229.55(a) Circumstances Giving Rise to a Claim

1. This section allows a bank to make an expedited recredit claim under two sets of circumstances: first, because it is obligated to provide a recredit, either to the consumer or to another bank that is obligated to provide a recredit in connection with the consumer's claim; and second, because the bank detected a problem with the substitute check that, if uncaught, could have given rise to a consumer claim.

2. The loss giving rise to an interbank recredit claim could be the recredit that the claimant bank provided directly to its consumer customer under § 229.54 or a loss incurred because the claimant bank was required to indemnify another bank that provided an expedited recredit to either a consumer or a bank.

Examples.

a. A paying bank charged a consumer's account based on a substitute check that contained a blurry image of a legible original check, and the consumer whose account was charged made an expedited recredit claim against the paying bank because the consumer suffered a loss and needed the original check or a sufficient copy to determine the validity of his or her claim. The paying bank would have a warranty claim against the presenting bank that transferred the defective substitute check to it and against any previous transferring bank(s) that handled that substitute check or another paper or electronic representation of the check. The paying bank therefore would meet each of the requirements necessary to bring an interbank expedited recredit claim.

b. Continuing with the example in paragraph a, if the presenting bank determined that the paying bank's claim was valid and provided a recredit, the presenting bank would have suffered a loss in the amount of the recredit it provided and could, in turn, make an expedited recredit claim against the bank that transferred the defective substitute check to it.

B. 229.55(b) Procedures for Making Claims

1. An interbank recredit claim under this section must be brought within 120 calendar days of the transaction giving rise to the claim. For purposes of computing this period, the transaction giving rise to the claim is the claimant bank's settlement for the substitute check in question.

2. When estimating the amount of its loss, § 229.55(b)(2)(ii) states that the claimant bank should include ''interest if applicable.'' The quoted phrase refers to any interest that the claimant bank or a bank that the claimant

bank indemnified paid to a consumer who has an interest-bearing account in connection with an expedited recredit under § 229.54.

3. The information that the claimant bank is required to provide under § 229.55(b)(2)(iv) to facilitate investigation of the claim could include, for example, a copy of any written claim that a consumer submitted under § 229.54 or any written record the bank may have of a claim the consumer submitted orally. The information also could include a copy of the defective substitute check or information relating to that check, such as the number, amount, and payee of the check. However, a claimant bank that provides a copy of the substitute check must take reasonable steps to ensure that the copy is not mistaken for a legal equivalent of the original check or handled for forward collection or return.

4. The indemnifying bank's right to require a claimant bank to submit a claim in writing and the computation of time from the date of the written submission parallel the corresponding provision in the consumer recredit section (§ 229.54(b)(3)). However, the indemnifying bank also may require the claimant bank to submit a copy of the written or electronic claim submitted by the consumer under that section, if any.

C. 229.55(c) Action on Claims

1. An indemnifying bank that responds to an interbank expedited recredit claim by providing the original check or a sufficient copy of the original check need not demonstrate why that claim or the underlying consumer expedited recredit claim is or is not valid.

*XXXV. § 229.56 Liability*

A. 229.56(a) Measure of Damages

1. In general, a person's recovery under this section is limited to the amount of the loss up to the amount of the substitute check that is the subject of the claim, plus interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to that substitute check. However, a person that is entitled to an indemnity under § 229.53 because of a breach of a substitute check warranty also may recover under § 229.53 any losses proximately caused by the warranty breach, including interest, costs, wrongfully-charged fees imposed as a result of the warranty breach, reasonable attorney's fees, and other expenses of representation.

2. A reconverting bank also may be liable under § 229.38 for damages associated with the illegibility of indorsements applied to substitute checks if that illegibility results because the reduction of the original check image and its placement on the substitute check shifted a previously-applied indorsement that, when applied, complied with appendix D. For more detailed discussion of this topic, see § 229.38 and the accompanying commentary.

B. 229.56(b) Timeliness of Action

1. A bank's delay beyond the time limits prescribed or permitted by any provision of subpart D is excused if the delay is caused by certain circumstances beyond the bank's control. This parallels the standard of U.C.C. 4–109(b).

C. 229.56(c) Jurisdiction

1. The Check 21 Act confers subject matter jurisdiction on courts of competent jurisdiction and provides a time limit for civil actions for violations of subpart D.

D. 229.56(d) Notice of Claims

1. This paragraph is designed to adopt the notice of claim provisions of U.C.C. 4–207(d) and 4–208(e), with an added provision that a timely § 229.54 expedited recredit claim satisfies the generally-applicable notice requirement. The time limit described in this paragraph applies only to notices of warranty and indemnity claims. As provided in § 229.56(c), all actions under § 229.56 must be brought within one year of the date that the cause of action accrues.

*XXXVI. Consumer Awareness*

A. 229.57(a) General Disclosure Requirement and Content

1. A bank must provide the disclosure required by § 229.57 under two circumstances. First, each bank must provide the disclosure to each of its consumer customers who receives paid checks with his or her account statement. This requirement does not apply if the bank provides with the account statement something other than paid original checks, paid substitute checks, or a combination thereof. For example, this requirement would not apply if a bank provided with the account statement only a document that contained multiple check images per page. Second, a bank also must provide the disclosure when it (a) provides a substitute check to a consumer in response to that consumer's request for a check or check copy or (b) returns a substitute check to a consumer depositor. A bank must provide the disclosure each time it provides a substitute check to a consumer on an occasional basis, regardless of whether the bank previously provided the disclosure to that consumer.

2. A bank may, but is not required to, use the model disclosure in appendix C–5A to satisfy the disclosure content requirements of this section. A bank that uses the model language is deemed to comply with the disclosure content requirement(s) for which it uses the model language, provided the information in the disclosure accurately describes

the bank's policies and practices. A bank also may include in its disclosure additional information relating to substitute checks that is not required by this section.

3. A bank may, by agreement or at the consumer's request, provide the disclosure required by this section in a language other than English, provided that the bank makes a complete English notice available at the consumer's request.

B. 229.57(b) Distribution

1. A consumer may request a check or a copy of a check on an occasional basis, such as to prove that he or she made a particular payment. A bank that responds to the consumer's request by providing a substitute check must provide the required disclosure at the time of the consumer's request if feasible. Otherwise, the bank must provide the disclosure no later than the time at which the bank provides a substitute check in response to the consumer's request. It would not be feasible for a bank to provide notice to the consumer at the time of the request if, for example, the bank did not know at the time of the request whether it would provide a substitute check in response to that request, regardless of the form of the consumer's request. It also would not be feasible for a bank to provide notice at the time of the request if the consumer's request was mailed to the bank or made by telephone, even if the bank knew when it received the request that it would provide a substitute check in response. A bank's provision to the consumer of something other a substitute check, such as a photocopy of a check or a statement containing images of multiple substitute checks per page, does not trigger the notice requirement.

2. A consumer who does not routinely receive paid checks might receive a returned substitute check. For example, a consumer deposits an original check that is payable to him or her into his or her deposit account. The paying bank returns the check unpaid and the depositary bank returns the check to the depositor in the form of a substitute check. A depositary bank that provides a returned substitute check to a consumer depositor must provide the substitute check disclosure at that time.

*XXXVII. Variation by Agreement*

Section 229.60 provides that banks involved in an interbank expedited recredit claim under § 229.55 may vary the terms of that section by agreement, but otherwise no person may vary the terms of subpart D by agreement. A bank's decision to provide more generous protections for consumers than this subpart requires, such as by providing consumers additional time to submit expedited claims under § 229.54 under non-exigent circumstances, would not be a variation prohibited by § 229.60.

*XXXVIII. Appendix C—Model Availability Policy Disclosures, Clauses, and Notices; and Model Substitute Check Policy Disclosure and Notices*

A. Introduction

1. Appendix C contains model disclosure, clauses, and notices that may be used by banks to meet their disclosure and notice responsibilities under the regulation. Banks using the models (except models C–22 through C–25) properly will be deemed in compliance with the regulation's disclosure requirements.

2. Information that must be inserted by a bank using the models is italicized within parentheses in the text of the models. Optional information is enclosed in brackets.

3. Banks may make certain changes to the format or content of the models, including deleting material that is inapplicable, without losing the EFA Act's protection from liability for banks that use the models properly. For example, if a bank does not have a cut-off hour prior to it's closing time, or if a bank does not take advantage of the § 229.13 exceptions, it may delete the references to those provisions. Changes to the models may not be so extensive as to affect the substance, clarity, or meaningful sequence of the models. Acceptable changes include, for example:

a. Using ''customer'' and ''bank'' instead of pronouns.

b. Changing the typeface or size.

c. Incorporating certain state law ''plain English'' requirements.

4. Shorter time periods for availability may always be substituted for time periods used in the models.

5. Banks may also add related information. For example, a bank may indicate that although funds have been made available to a customer and the customer has withdrawn them, the customer is still responsible for problems with the deposit, such as checks that were deposited being returned unpaid. Or a bank could include a telephone number to be used if a customer has an inquiry regarding a deposit.

6. Banks are cautioned against using the models without reviewing their own policies and practices, as well as state and federal laws regarding the time periods for availability of specific types of checks. A bank using the models will be in compliance with the EFA Act and the regulation only if the bank's disclosures correspond to its availability policy.

7. Banks that have used earlier versions of the models (such as those models that gave Social Security benefits and payroll payments as examples of preauthorized credits available the day after deposit, or that did

not address the cash withdrawal limitation) are protected from civil liability under §229.21(e). Banks are encouraged, however, to use current versions of the models when reordering or reprinting supplies.

B. Model Availability Policy and Substitute Check Policy Disclosures, Models C–1 through C–5A

1. *Models C–1 through C–5 generally.*

a. Models C–1 through C–5A are models for the availability policy disclosures described in §229.16 and substitute check policy disclosure described in §229.57. The models accommodate a variety of availability policies, ranging from next-day availability to holds to statutory limits on all deposits. Model C–3 reflects the additional disclosures discussed in §§229.16 (b) and (c) for banks that have a policy of extending availability times on a case-by-case basis.

b. As already noted, there are several places in the models where information must be inserted. This information includes the bank's cut-off times, limitations relating to next-day availability, and the first four digits of routing numbers for local banks. In disclosing when funds will be available for withdrawal, the bank must insert the ordinal number (such as first, second, etc.) of the business day after deposit that the funds will become available.

c. Models C–1 through C–5A generally do not reflect any optional provisions of the regulation, or those that apply only to certain banks. Instead, disclosures for these provisions are included in Models C–6 through C–11A. A bank using one of the model availability policy disclosures should also consider whether it must incorporate one or more of Models C–6 through C–11A.

d. While §229.10(b) requires next-day availability for electronic payments, Treasury regulations (31 CFR part 210) and ACH association rules require that preauthorized credits (''direct deposits'') be made available on the day the bank receives the funds. Models C–1 through C–5 reflect these rules. Wire transfers, however, are not governed by Treasury or ACH rules, but banks generally make funds from wire transfers available on the day received or on the business day following receipt. Banks should ensure that their disclosures reflect the availability given in most cases for wire transfers.

2. *Model C–1 Next-day availability.* A bank may use this model when its policy is to make funds from all deposits available on the first business day after a deposit is made. This model may also be used by banks that provide immediate availability by substituting the word ''immediately'' in place of ''on the first business day after the day we receive your deposit.''

3. *Model C–2 Next-day availability and §229.13 exceptions.* A bank may use this model when its policy is to make funds from all deposits available to its customers on the first business day after the deposit is made, and to reserve the right to invoke the new account and other exceptions in §229.13. In disclosing that a longer delay may apply, a bank may disclose when funds will generally be available based on when the funds would be available if the deposit were of a nonlocal check.

4. *Model C–3 Next-day availability, case-by-case holds to statutory limits, and §229.13 exceptions.* A bank may use this model when its policy, in most cases, is to make funds from all types of deposits available the day after the deposit is made, but to delay availability on some deposits on a case-by-case basis up to the maximum time periods allowed under the regulation. A bank using this model also reserves the right to invoke the exceptions listed in §229.13. In disclosing that a longer delay may apply, a bank may disclose when funds will generally be available based on when the funds would be available if the deposit were of a nonlocal check.

5. *Model C–4 Holds to statutory limits on all deposits.* A bank may use this model when its policy is to impose delays to the full extent allowed under §229.12 and to reserve the right to invoke the §229.13 exceptions. In disclosing that a longer delay may apply, a bank may disclose when funds will generally be available based on when the funds would be available if the deposit were of a nonlocal check. Model C–4 uses a chart to show the bank's availability policy for local and nonlocal checks and Model C–5 uses a narrative description.

6. *Model C–5 Holds to statutory limits on all deposits.* A bank may use this model when its policy is to impose delays to the full extent allowed under §229.12 and to reserve the right to invoke the §229.13 exceptions. In disclosing that a longer delay may apply, a bank may disclose when funds will generally be available based on when the funds would be available if the deposit were of a nonlocal check.

7. *Model C–5A* A bank may use this form when it is providing the disclosure to its consumers required by §229.57 explaining that a substitute check is the legal equivalent of an original check and the circumstances under which the consumer may make a claim for expedited recredit.

C. Model Clauses, Models C–6 Through C–11A

1. *Models C–6 through C–11A generally.* Certain clauses like those in the models must be incorporated into a bank's availability policy disclosure under certain circumstances. The commentary to each clause indicates when a clause similar to the model clause is required.

2. *Model C–6 Holds on other funds (check cashing).* A bank that reserves the right to place a hold on funds already on deposit

when it cashes a check for a customer, as addressed in §229.19(e), must incorporate this type of clause in its availability policy disclosure.

3. *Model C–7 Holds on other funds (other account).* A bank that reserves the right to place a hold on funds in an account of the customer other than the account into which the deposit is made, as addressed in §229.19(e), must incorporate this type of clause in its availability policy disclosure.

4. *Model C–8 Appendix B availability (nonlocal checks).* A bank in a check processing region where the availability schedules for certain nonlocal checks have been reduced, as described in appendix B of Regulation CC, must incorporate this type of clause in its availability policy disclosure. Banks using Model C–5 may insert this clause at the conclusion of the discussion titled ''Nonlocal checks.''

5. *Model C–9 Automated teller machine deposits (extended holds).* A bank that reserves the right to delay availability of deposits at nonproprietary ATMs until the fifth business day following the date of deposit, as permitted by §229.12(f), must incorporate this type of clause in its availability policy disclosure. A bank must choose among the alternative language based on how it chooses to differentiate between proprietary and nonproprietary ATMs, as required under §229.16(b)(5).

6. *Model C–10 Cash withdrawal limitation.* A bank that imposes cash withdrawal limitations under §229.12 must incorporate this type of clause in its availability policy disclosure. Banks reserving the right to impose the cash withdrawal limitation and using Model C–3 should disclose that funds may not be available until the sixth (rather than fifth) business day in the first paragraph under the heading ''Longer Delays May Apply.''

7. *Model C–11 Credit union interest payment policy.* A credit union subject to the notice requirement of §229.14(b)(2) must incorporate this type of clause in its availability policy disclosure. This model clause is only an example of a hypothetical policy. Credit unions may follow any policy for accrual provided the method of accruing interest is the same for cash and check deposits.

8. *Model C–11A Availability of funds deposited at other locations.* A clause similar to Model C–11A should be used if a bank bases the availability of funds on the location where the funds are deposited (for example, at a contractual or other branch located in a different check processing region). Similarly, a clause similar to Model C–11A should be used if a bank distinguishes between local and non-local checks (for example, a bank using model availability policy disclosure C–4 or C–5), and accepts deposits in more than one check processing region.

D. Model Notices, Models C–12 through C–25

*1. Models C–12 through C–25 generally.* Models C–12 through C–25 provide models of the various notices required by the regulation. A bank that cashes a check and places a hold on funds in an account of the customer (see §229.19(e)) should modify the model hold notice accordingly. For example, the bank could replace the word ''deposit'' with the word ''transaction'' and could add the phrase ''or cashed'' after the word ''deposited.''

2. *Model C–12 Exception hold notice.* This model satisfies the written notice required under §229.13(g) when a bank places a hold based on a §229.13 exception. If a hold is being placed on more than one check in a deposit, each check need not be described, but if different reasons apply, each reason must be indicated. A bank may use the actual date when funds will be available for withdrawal rather than the number of the business day following the day of deposit. A bank must incorporate in the notice the material set out in brackets if it imposes overdraft or returned check fees after invoking the reasonable cause exception under §229.13(e).

3. *Model C–13 Reasonable cause hold notice.* This notice satisfies the written notice required under §229.13(g) when a bank invokes the reasonable cause exception under §229.13(e). The notice provides the bank with a list of specific reasons that may be given for invoking the exception. If a hold is being placed on more than one check in a deposit, each check must be described separately, and if different reasons apply, each reason must be indicated. A bank may disclose its reason for doubting collectibility by checking the appropriate reason on the model. If the ''Other'' category is checked, the reason must be given. A bank may use the actual date when funds will be available for withdrawal rather than the number of the business day following the day of deposit. A bank must incorporate in the notice the material set out in brackets if it imposes overdraft or returned check fees after invoking the reasonable cause exception under §229.13(e).

4. *Model C–14 One-time notice for large deposit and redeposited check exception holds.* This model satisfies the notice requirements of §229.13(g)(2) concerning nonconsumer accounts.

5. *Model C–15 One-time notice for repeated overdraft exception hold.* This model satisfies the notice requirements of §229.13(g)(3).

6. *Model C–16 Case-by-case hold notice.* This model satisfies the notice required under §229.16(c)(2) when a bank with a case-by-case hold policy imposes a hold on a deposit. This notice does not require a statement of the specific reason for the hold, as is the case when a §229.13 exception hold is placed. A bank may specify the actual date when funds will be available for withdrawal rather than the number of the business day following the

day of deposit when funds will be available. A bank must incorporate in the notice the material set out in brackets if it imposes overdraft fees after invoking a case-by-case hold.

7. *Model C–17 Notice at locations where employees accept consumer deposits and Model C–18 Notice at locations where employees accept consumer deposits (case-by-case holds).* These models satisfy the notice requirement of § 229.18(b). Model C–17 reflects an availability policy of holds to statutory limits on all deposits, and Model C–18 reflects a case-by-case availability policy.

8. *Model C–19 Notice at automated teller machines.* This model satisfies the ATM notice requirement of § 229.18(c)(1).

9. *Model C–20 Notice at automated teller machines (delayed receipt).* This model satisfies the ATM notice requirement of § 229.18(c)(2) when receipt of deposits at off-premises ATMs is delayed under § 229.19(a)(4). It is based on collection of deposits once a week. If collections occur more or less frequently, the description of when deposits are received must be adjusted accordingly.

10. *Model C–21 Deposit slip notice.* This model satisfies the notice requirements of § 229.18(a) for deposit slips.

11. *Models C–22 through C–25 generally.* Models C–22 through C–25 provide models for the various notices required when a consumer who receives substitute checks makes an expedited recredit claim under § 229.54 for a loss related to a substitute check. The Check 21 Act does not provide banks that use these models with a safe harbor. However, the Board has published these models to aid banks' efforts to comply with § 229.54(e).

12. *Model C–22 Valid Claim Refund Notice.* A bank may use this model when crediting the entire amount or the remaining amount of a consumer's expedited recredit claim after determining that the consumer's claim is valid. This notice could be used when the bank provides the consumer a full recredit based on a valid claim determination within ten days of the receipt of the consumer's claim or when the bank recredits the remaining amount of a consumer's expedited recredit claim by the 45th calendar day after receiving the consumer's claim, as required under § 229.54(e)(1).

13. *Model C–23 Provisional Refund Notice.* A bank may use this model when providing a full or partial expedited recredit to a consumer pending further investigation of the consumer's claim, as required under § 229.54(e)(1).

14. *Model C–24 Denial Notice.* A bank may use this model when denying a claim for an expedited recredit under § 229.54(e)(2).

15. *Model C–25 Reversal Notice.* A bank may use this model when reversing an expedited recredit that was credited to a consumer's account under § 229.54(e)(3).

[Reg. CC, 60 FR 51672, Oct. 3, 1995, as amended by Reg. CC, 62 FR 13816, Mar. 24, 1997; 64 FR 59613, Nov. 3, 1999; 68 FR 52078, Sept. 2, 2003; 68 FR 53672, Sept. 12, 2003; 69 FR 47317–47328, Aug. 4, 2004; 70 FR 71225, Nov. 28, 2005]

## APPENDIX F TO PART 229—OFFICIAL BOARD INTERPRETATIONS; PREEMPTION DETERMINATIONS

### *Uniform Commercial Code, Section 4–213(5)*

Section 4–213(5) of the Uniform Commercial Code (''U.C.C.'') provides that money deposited in a bank is available for withdrawal as of right at the opening of business of the banking day after deposit. Although the language ''deposited in a bank'' is unclear, arguably it is broader than the language ''made in person to an employee of the depositary bank'', which conditions the next-day availability of cash under Regulation CC (§ 229.10(a)(1)). Under Regulation CC, deposits of cash that are not made in person to an employee of the depositary bank must be made available by the second business day after the banking day of deposit (§ 229.10(a)(2)). Therefore, this provision of the U.C.C. may call for the availability of certain cash deposits in a shorter time than provided in Regulation CC.

This provision of the U.C.C., however, is subject to Section 4–103(1), which provides, in part, that ''the effect of the provisions of this Article may be varied by agreement * * *.'' (The Regulation CC funds availability requirements may not be varied by agreement.) U.C.C. Section 4–213(5) supersedes the Regulation CC provision in § 229.10(a)(2), but a depositary bank may not agree with its customer under section 4–103(1) of the Code to extend availability beyond the time periods provided in § 229.10(a) of Regulation CC.

### *California*

#### Background

The Board has been requested, in accordance with § 229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC preempt the provisions of California law concerning availability of funds. This preemption determination specifies those provisions of the California funds availability law that supersede the Act and Regulation CC. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

California has four separate sets of regulations establishing maximum availability

schedules. The regulations applicable to commercial banks and branches of foreign banks located in California (Cal. Admin. Code tit. 10, §§10.190401–10.190402) were promulgated by the Superintendent of Banks. The regulations applicable to savings banks and savings and loan associations (Cal. Admin. Code tit. 10, §§106.200–106.202) were adopted by the Savings and Loan Commissioner. The regulations applicable to credit unions (Cal. Admin. Code tit. 10, section 901) and to industrial loan companies (Cal. Admin. Code tit. 10, section 1101) were adopted by the Commissioner of Corporations.

All the regulations were adopted pursuant to California Financial Code section 866.5 and California Commercial Code section 4213(4)(a), under which the appropriate state regulatory agency for each depository institution must issue administrative regulations to define a reasonable time for permitting customers to draw on items received for deposit in the customer's account. California Financial Code section 867 also establishes availability periods for funds deposited by cashier's check, certified check, teller's check, or depository check under certain circumstances. Finally, California Financial Code section 866.2 establishes disclosure requirements.

The Board's determination with respect to these California laws and regulations governing the funds availability requirements applicable to depository institutions in California are as follows.

### Commercial Banks and Branches of Foreign Banks

#### Coverage

The California State Banking Department regulations, which apply to California state commercial banks, California national banks, and California branch offices of foreign banks, provide that a depositary bank shall make funds deposited into a deposit account available for withdrawal as provided in Regulation CC with certain exceptions. The funds availability schedules in Regulation CC apply only to *accounts* as defined in Regulation CC, which generally consist of transaction accounts. The California funds availability law and regulations apply to accounts as defined by Regulation CC as well as savings accounts (other than time accounts), as defined in the Board's Regulation D (12 CFR 204.2(d)). (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds,* the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC in certain circumstances.)

#### Availability Schedules

*Temporary schedule.* Regulation CC provides that, until September 1, 1990, nonlocal checks must be made available for withdrawal by the seventh business day after the banking day of deposit, except for certain nonlocal checks listed in appendix B–1, which must be made available within a shorter time (by the fifth business day following deposit for those California checks listed). Under the temporary schedule in the California regulations, a depositary bank with a four-digit routing symbol of 1210 (''1210 bank'') or of 1220 (''1220 bank'') that receives for deposit a check drawn on a nonlocal, in-state commercial bank or foreign bank branch[1] must make the funds available for withdrawal by the fourth business day after the day of deposit. The California regulations provide that 1210 and 1220 banks must make deposited checks drawn on nonlocal in-state thrifts (defined as savings and loan associations, savings banks, and credit unions) available by the fifth business day after deposit. In addition, California law provides that all other depositary banks must make deposited checks drawn on a nonlocal in-state commercial bank or foreign bank branch available by the fifth business day after deposit and checks drawn on nonlocal in-state thrifts available by the sixth business day after deposit. To the extent that these schedules provide for shorter holds than Regulation CC and its appendix B–1, the state schedules supersede the federal schedules.[2] For example, the California four-day schedule that applies to checks drawn on in-state nonlocal commercial banks or foreign bank branches and deposited in a 1210 or 1220 bank would be shorter than and would supersede the federal schedules.

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[1] The California regulation uses the term *paying bank* when describing the institution on which these checks are drawn, but does not define *paying bank* or *bank*. Regulation CC's definitions of *paying bank* and *bank* include savings institutions and credit unions as well as commercial banks and branches of foreign banks. However, because the California regulation makes separate provisions for checks drawn on savings institutions and credit unions, the Board concludes that the term *paying bank,* as used in the California regulation, includes only commercial banks and foreign bank branches.

[2] Appendix B–1 of Regulation CC provides that the federal schedules will be the same as the California schedules (5 days) in the following cases: A depositary bank bearing a 1210 routing number receiving for deposit checks bearing a 3220 or a 3223 routing number, and a depositary bank bearing a 1220 routing number receiving for deposit checks bearing a 3210 routing number. In the cases where federal and state law are the same, the state law is not preempted by, nor does it supersede, the federal law.

The California regulations do not specify whether the state schedules apply to deposits of checks at nonproprietary ATMs. Under the temporary schedules in Regulation CC, deposits at nonproprietary ATMs must be made available for withdrawal by the seventh business day following deposit. To the extent that the California schedules provide for shorter availability for deposits at nonproprietary ATMs, they would supersede the temporary schedule in Regulation CC for deposits at nonproprietary ATMs specified in §229.11(d).

*Permanent schedule.* Regulation CC provides that, as of September 1, 1990, nonlocal checks must be made available for withdrawal by the fifth business day after the banking day of deposit. Under the permanent schedule in the California regulations, a depositary bank with a four-digit routing symbol of 1210 or of 1220 that receives for deposit a check drawn on a nonlocal, in-state commercial bank or foreign bank branch must make the funds available for withdrawal by the fourth business day after the day of deposit. These state schedules provide for shorter hold periods than and thus supersede the federal schedules.

*Second-day availability.* Section 867 of the California Financial Code requires depository institutions to make funds deposited by cashier's check, teller's check, certified check, or depository check available for withdrawal on the second business day following deposit, if certain conditions are met. The Regulation CC next-day availability requirement for cashier's checks and teller's checks applies only to those checks issued to a customer of the bank or acquired from the bank for remittance purposes. To the extent that the state second-day availability requirement applies to cashier's and teller's checks issued to a non-customer of the bank for other than remittance purposes, the state two-day requirement supersedes the federal local and nonlocal schedules.

*Availability at start of day.* The California regulations do not specify when during the day funds must be made available for withdrawal. Section 229.19(b) of Regulation CC provides that funds must be made available at the start of the business day. In those cases where federal and state law provide for holds for the same number of days, to the extent that the California regulations allow funds to be made available later in the day than does Regulation CC, the federal law would preempt state law.

*Exceptions to the availability schedules.* Under the state preemption standards of Regulation CC (see §229.20(c) and accompanying Commentary), for deposits subject to the state availability schedules, a state exception may be used to extend the state availability schedule up to the federal availability schedule. Once the deposit is held up to the federal availability schedule limit under a state exception, the depositary bank may further extend the hold under any federal exception that can be applied to the deposit. If no state exceptions exist, then no exceptions holds may be placed on deposits covered by state schedules. Thus, to the extent that California law provides for exceptions to the California schedules that supersede Regulation CC, those exceptions may be applied in order to extend the state availability schedules up to the federal availability schedules or such later time as is permitted by a federal exception.

Disclosures

California law (Cal. Fin. Code §866.2) requires depository institutions to provide written disclosures of their general availability policies to potential customers prior to opening any deposit account. The law also requires that preprinted deposit slips and ATM deposit envelopes contain a conspicuous summary of the general policy. Finally, the law requires depository institutions to provide specific notice of the time the customer may withdraw funds deposited by check or similar instrument into a deposit account if the funds are not available for immediate withdrawal.

Section 229.20(c)(2) of Regulation CC provides that inconsistency may exist when a state law provides for disclosures or notices concerning funds availability relating to accounts. California Financial Code §866.2 requires disclosures that differ from those required by Regulation CC and, therefore, is preempted to the extent that it applies to *accounts* as defined in Regulation CC. The state law continues to apply to savings accounts and other accounts not governed by Regulation CC disclosure requirements.

Savings Institutions

Coverage

The California Department of Savings and Loan regulations, which apply to California savings and loan associations and California savings banks, provide that a depositary bank shall make funds deposited into a transaction or non-transaction account available for withdrawal as provided in Regulation CC. The funds availability schedules in Regulation CC apply only to *accounts* as defined in Regulation CC, which generally consist of transaction accounts. The California funds availability law and regulations apply to accounts as defined by Regulation CC as well as savings accounts as defined in the Board's Regulation D (12 CFR 204.2(d)). (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC in certain circumstances.)

Availability Schedules

*Second-day availability.* Section 867 of the California Financial Code requires depository institutions to make funds deposited by cashier's check, teller's check, certified check, or depository check available for withdrawal on the second business day following deposit, if certain conditions are met. The Regulation CC next-day availability requirement for cashier's checks and teller's checks applies only to those checks issued to a customer of the bank or acquired from the bank for remittance purposes. To the extent that the state second-day availability requirement applies to cashier's and teller's checks issued to a non-customer of the bank for other than remittance purposes, the state two-day requirement supersedes the federal local and nonlocal schedules.

*Temporary and permanent schedules.* Other than the provisions of Section 867 discussed above, California law incorporates the Regulation CC availability requirements with respect to deposits to accounts covered by Regulation CC. Because the state requirements are consistent with the federal requirements, the California regulation is not preempted by, nor does it supersede, the federal law.

Disclosures

California law (Cal. Fin. Code §866.2) requires depository institutions to provide written disclosures of their general availability policies to potential customers prior to opening any deposit account. The law also requires that preprinted deposit slips and ATM deposit envelopes contain a conspicuous summary of the general policy. Finally, the law requires depository institutions to provide specific notice of the time the customer may withdraw funds deposited by check or similar instrument into a deposit account if the funds are not available for immediate withdrawal. Section 229.20(c)(2) of Regulation CC provides that inconsistency may exist when a state law provides for disclosures or notices concerning funds availability relating to accounts. To the extent that California Financial Code §866.2 requires disclosures that differ from those required by Regulation CC and apply to *accounts* as defined in Regulation CC (generally, transaction accounts), the California law is preempted by Regulation CC.

The Department of Savings and Loan regulations provide that for those non-transaction accounts covered by state law but not by federal law, disclosures in accordance with Regulation CC will be deemed to comply with the state law disclosure requirements. To the extent that the Department of Savings and Loan regulations permit reliance on Regulation CC disclosures for transaction accounts and to the extent the state regulations survive the preemption of California Financial Code §866.2, they are not preempted by, nor do they supersede, the federal law. The state law continues to apply to savings accounts and other non-transaction accounts not governed by Regulation CC disclosure requirements.

Credit Unions and Industrial Loan Companies

Each credit union and federally-insured industrial loan company that maintains an office in California for the acceptance of deposits must make funds deposited by check available for withdrawal in accordance with the following table:

| | Availability | |
|---|---|---|
| | Credit Union | Industrial Loan Company |
| $100 or less checks; U.S. Treasury checks; state/local gov't checks. | 1st day ..... | 1st day |
| On us checks; cashier's/certifies/teller's/depository checks. | 2nd day ..... | 2nd day |
| In-state checks ..... | 6th day ..... | 6th day |
| out-of-state checks ..... | 10th day ..... | 12th day |

NOTE: These time periods are stated in terms of availability for withdrawal not later than the Xth business day following the banking day of deposit to facilitate comparison with Regulation CC. State regulations are stated in terms of availability at the start of the business day subsequent to the number of days specified in the regulation.

Coverage

The California law and regulations govern the availability of funds to ''demand deposits, negotiable order of withdrawal draft accounts, savings deposits subject to automatic transfers, share draft accounts, and all savings deposits and share accounts, other than time deposits.'' (California Financial Code section 886(b)) The federal preemption of state funds availability laws only applies to *accounts* subject to Regulation CC, which generally includes transaction accounts. Thus, the California funds availability regulations continue to apply to deposits in savings and other accounts (such as accounts in which the account-holder is another bank) that are no *accounts* under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds,* the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC in certain circumstances.)

The California law applies to any *Item* (California Financial Code section 866.5 and California Commercial Code section 4213(4)(a)). The California Commercial Code defines *item* to mean *any instrument for the payment of money even though it is not negotiable* * * * (Cal. Com. Code section 4104(g)). This term is broader in scope than the definition of *check* in the Act and Regulation CC. The Commissioner's regulations, however,

define the term *item* to include checks, negotiable orders of withdrawal, share drafts, warrants, and money orders. As limited by the state regulations, the state law applies only to instruments that are also *checks* as defined in § 229.2(k) of Regulation CC.

Availability Schedules

*Temporary schedule*. The California regulations provide that in-state nonlocal checks must be made available for withdrawal not later than the sixth business day following deposit. This time period is shorter than the seventh business day availability required for nonlocal checks under § 229.11(c) of Regulation CC, although it is not shorter than the schedules for nonlocal checks set forth in § 229.11(c)(2) and appendix B–1 of Regulation CC. Thus, the state scheduled for in-state nonlocal checks supersede the federal schedule to the extent that they apply to an item payable by a California institution that is defined as a nonlocal check under Regulation CC, and is not subject to reduced schedules under § 229.11(c)(2) and appendix B–1.

Under the California regulations, credit unions and industrial loan companies must provide next-day availability to first-indorsed items issued by any federally-insured institution. This regulatory requirement, however, has been superseded by section 867 of the California Financial Code, which requires depository institutions to make funds deposited by cashier's check, teller's check, certified checks, or depository check available for withdrawal on the second business day following deposit, if certain conditions are met. This requirement became effective January 1, 1988.

The Regulation CC next-day availability requirement for cashier's checks and teller's checks applies only to those checks issued for remittance purposes. To the extent that the state second business day availability requirement applies to cashier's and teller's checks issued for other than remittance purposes, the state two-day requirement supersedes the federal local and nonlocal schedules.

The California regulations do not specify whether they apply to deposits of checks at nonproprietary ATMs. Under the temporary schedule in Regulation CC, deposits at nonproprietary ATMs must be made available for withdrawal at the start of the seventh business day after deposit. To the extent that the California schedules provide for shorter availability for deposits at nonproprietary ATMs, they would supersede the temporary schedule in Regulation CC for deposits at nonproprietary ATMs specified in § 229.11(d).

*Permanent schedule*. Under the California regulations, credit unions and industrial loan companies must provide next-day availability to first-indorsed items issued by any federally-insured institution. This regulatory requirement, however, has been superseded by section 867 of the California Financial Code, which requires depository institutions to make funds deposited by cashier's check, teller's check, certified check, or depository check available for withdrawal on the second business day following deposit, if certain conditions are met. This requirement became effective January 1, 1988.

The Regulation CC next-day availability requirement for cashier's and teller's checks applies only to those checks issued for remittance purposes. To the extent that the state second business day availability requirement applies to cashier's and teller's checks issued for other than remittance purposes, the state two-day requirement supersedes the federal local and nonlocal schedules.

*Next-day availability*. Credit unions and industrial loan companies in California are required to give next-day availability to items drawn by the State of California or any of its departments, agencies, or political subdivisions. California law supersedes the fedeal law in that the state law does not condition next-day availability on receipt at a staffed teller station or use of a special deposit slip.

California credit unions and industrial loan companies must provide second business day availability to checks drawn on the depositary bank. Regulation CC requires next-day availability for checks deposited in a branch of the depositary bank and drawn on the same or another branch of the same bank if both branches are located in the same state or the same check processing region. Thus, generally, the Regulation CC rule for availability of on us checks preempts the California regulations. To the extent, however, that an on us check is (1) drawn on an out-of-state branch of the depositary bank that is not in the same check processing region as the branch in which it was deposited, or (2) deposited at an off-premises ATM or another facility of the depositary bank that is not considered a branch under federal law, the state regulation supersedes the Regulation CC availability requirements.

*Exceptions to the availability schedules*. California law provides exceptions to the state availability schedules for large deposits, new accounts, repeated overdrafters, doubtful collectibility, foreign items, and emergency conditions. In all cases where the federal availability schedule preempts the state schedule, only the federal exceptions will apply. For deposits that are covered by the state availability schedule (e.g., in-state nonlocal checks under the temporary schedule; cashier's or teller's checks that are not deposited with a special deposit slip or at a staff teller station), the state exceptions may be used to extend the state availability schedule up to the federal availability schedule. Once the deposit is held up to the federal availability limit under a state exception, the depositary bank may further extend the

hold under any federal exception that can be applied to the deposit. Any time a depositary bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer in accordance with §229.13(g) of Regulation CC.

*Business day/banking day*. The definitions of *business day* and *banking day* in the California regulations are preempted by the Regulation CC definition of those terms. Thus, for determining the permissible hold under the California schedules that supersede the Regulation CC schedule, deposits are considered made on the specified number of *business days* following the *banking day* of deposit.

Disclosures

California law (Cal. Fin. Code section 866.2) requires depository institutions to provide written disclosures of their general availability policies to potential customers prior to opening any deposit account. The law also requires that preprinted deposit slips and ATM deposit envelopes contain a conspicuous summary of the general policy. Finally, the law requires a depository institution to provide specific notice of the time the customer may withdraw funds deposited by check or similar instrument into a deposit account if the funds are not available for immediate withdrawal.

Section 229.20(c)(2) of Regulation CC provides that inconsistency may exist when a state law provides for disclosures or notices concerning funds availability relating to accounts. California Financial Code section 866.2 requires disclosures that differ from those required by Regulation CC, and therefore is preempted to the extent that it applies to *accounts* as defined in Regulation CC. The state law continues to apply to savings accounts and other accounts not governed by Regulation CC disclosure requirements.

*Connecticut*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC, preempt provisions of Connecticut law relating to the availability of funds. This preemption determination specifies those provisions of the Connecticut funds availability law that supersede the Act and Regulation CC. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

In 1987, Connecticut amended its statute governing funds availability (Conn. Gen. Stat. section 36–9v), which requires Connecticut depository institutions to make funds deposited in a checking, time, interest, or savings account available for withdrawal with specified periods.

Generally, the Connecticut statute, as amended, provides that items deposited in a checking, time, interest, or savings account at a depository institution must be available for withdrawal in accordance with the following table:

| | *Availability* |
|---|---|
| On us checks | 2nd day |
| In-state checks | 4th day |
| Out-of-state checks | 6th day |

Exceptions to the schedules are provided for items received for deposit for the purpose of opening an account and for items that the depositary bank has reason to believe will not clear. The Connecticut statute also requires availability policy disclosures to depositors in the form of written notices and notices posted conspicuously at each branch.

Coverage

The Connecticut statute governs the availability of funds deposited in savings and time accounts, as well as *accounts* as defined in §229.2(a) of Regulation CC. The federal preemption of state funds availability requirements only applies to *accounts* subject to Regulation CC, which generally consist of trasaction accounts. Regulation CC does not affect the Connecticut statute to the extent that the state law applies to deposits in savings and other accounts (including transaction accounts where the account holder is a bank, foreign bank or the U.S. Treasury) that are not *accounts* under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC, in certain circumstances.)

The Connecticut statute applies to *items* deposited in accounts. This term encompasses instruments that are not defined as *checks* in Regulation CC (§229.2(k)), such as nonnegotiable instruments, and are therefore not subject to Regulation CC's provisions governing funds availability. Those items that are subject to Connecticut law but are not subject to Regulation CC will continue to be covered by the state availability schedules and exceptions.

Availability Schedules

*Temporary schedule*. Connecticut law provides that certain checks that are nonlocal under Regulation CC must be available in a shorter time (sixth business day after deposit for checks payable by depository institutions not located in Connecticut) than

under the federal regulation (seventh business day after deposit under the temporary schedule for nonlocal checks). Accordingly, the Connecticut law supersedes Regulation CC with respect to nonlocal checks (other than checks covered by appendix B–1) deposited in *accounts* until the federal permanent availability schedules take effect on September 1, 1990.

The Connecticut statute does not specify whether it applies to deposits of checks at nonproprietary ATMs. Under the temporary schedule in Regulation CC, deposits at nonproprietary ATMs must be made available for withdrawal at the start of the seventh business day after deposit. To the extent that the Connecticut schedules provide for shorter availability for deposits at nonproprietary ATMs, they would supersede the temporary schedule in Regulation CC for deposits at nonproprietary ATMs specified in § 229.11(d).

*Exceptions to the availability schedule.* The Connecticut law provides exceptions for items received for deposit for the purpose of opening new accounts and for items that the depositary bank has reason to believe will not clear. In all cases where the federal availability schedule preempts the state schedule, only the federal exceptions will apply. For deposits that are covered by the state availability schedule (e.g., nonlocal out-of-state checks under the temporary schedule), the state exceptions may be used to extend the state availability schedule (of six business days) to meet the federal availability schedule (of seven business days). Once the deposit is held up to the federal availability schedule limit under a state exception, the depositary bank may further extend the hold under any federal exception that can be applied to the deposit. Any time a depositary bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer, in accordance with § 229.13(g) of Regulation CC.

Disclosures

The Connecticut statute (Conn. Gen. Stat. Section 36–9v(b)) requires written notice to depositors of an institution's check hold policy and requires a notice of the policy to be posted in each branch.

Regulation CC preempts state disclosure requirements concerning funds availability that relate to *accounts* that are inconsistent with the federal requirements. The state requriements are different from, and therefore inconsistent with, the federal disclosure rules. (§ 229.20(c)(2)). Thus, the Connecticut statute is preempted by Regulation CC to the extent that these disclosure provisions apply to *accounts* as defined by Regulation CC. The Connecticut disclosure rules would continue to apply to accounts, such as savings and time accounts, not governed by the Regulation CC disclosure requirements.

*Illinois*

The Board has been requested, in accordance with § 229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act and subpart B, and, in connection therewith, subpart A, of Regulation CC, preempt provisions of Illinois law relating to the availability of funds. Section 4–213(5) of the Uniform Commercial Code as adopted in Illinois (Illinois Revised Statutes Chapter 26, paragraph 4–213(5), enacted July 26, 1988) provides that:

Time periods after which deposits must be available for withdrawal shall be determined by the provisions of the federal Expedited Funds Availability Act (Title VI of the Competitive Equality Banking Act of 1987) and the regulations promulgated by the Federal Reserve Board for the implementation of that Act.

Section 4–213(5) of the Illinois law does not supersede Regulation CC; and, because this provision of Illinois law does not permit funds to be made available for withdrawal in a longer period of time than required under the Act and Regulation, it is not preempted by Regulation CC.

*Maine*

Background

The Board has been requested, in accordance with § 229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC, preempt the provisions of Maine law concerning the availability of funds. This preemption determination addresses the relation of the Act and Regulation CC to the Maine funds availability law. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

In 1985, Maine adopted a statute governing funds availability (Title 9–B MRSA section 241(5)), which requires Maine financial institutions to make funds deposited in a transaction account, savings account, or time account available for withdrawal within a reasonable period. The Maine statute gives the Superintendent of Banking for the State of Maine the authority to promulgate rules setting forth time limitations and disclosure requirements governing funds availability.

The Superintendent of Banking issued regulations implementing the Maine funds availability statute, effective July 1, 1987 (Regulation 18(IV)), and adopted amendments to this regulation, effective September 1, 1988. Under the revised regulation, funds deposited to any deposit account in a

Maine financial institution must be made available for withdrawal in accordance with the Act and Regulation CC (Regulation 18–IV(A)(1)). The state regulation provides that an institution's funds availability policies for accounts subject to Regulation CC be disclosed in a manner consistent with the Regulation CC requirements. Funds availability policies for accounts not subject to Regulation CC must be disclosed in accordance with the state regulation (Regulation 18–IV(A)(2)).

Coverage

The Maine law and regulation govern the availability of funds to any deposit account, as defined in the Board's Regulation D (12 CFR 204.2(a)). This coverage is broader than the *accounts* covered in Regulation CC. The Maine law continues to apply to all deposit accounts, including those that are not accounts under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC, in certain circumstances.)

Availability Schedules and Disclosures

The Maine regulation incorporates the Regulation CC availability and disclosure requirements with respect to deposits to accounts covered by Regulation CC. Because the state requirements are consistent with the federal requirements, the Maine regulation is not preempted by, nor does it supersede, the federal law.

*Massachusetts*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC, preempt provisions of Massachusetts law relating to the availability of funds. This preemption determination addresses the relationship of the Act and Regulation CC to the Massachusetts funds availability law. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

In 1988, Massachusetts amended its statute governing funds availability (Mass. Gen. L. ch. 167D, section 35), to require Massachusetts banking institutions to make funds available for withdrawal and disclose their availability policies in accordance with the Act and Regulation CC. The Massachusetts law, however, provides that ''local originating depository institution'' is to be defined as any originating depository institution located in the Commonwealth.

Coverage

The Massachusetts statute governs the availability of funds deposited in ''any demand deposit, negotiable order of withdrawal account, savings deposit, share account or other asset account.'' Regulation CC applies only to *accounts* as defined in §229.2(a). Regulation CC does not affect the Massachusetts statute to the extent that the state law applies to deposits in savings and other accounts (including transaction accounts where the account holder is a bank, foreign bank, or the U.S. Treasury) that are not *accounts* under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Holds on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC, in certain circumstances.)

Availability Schedules

The Massachusetts definition of *local originating depository institution* (local paying bank in Regulation CC terminology) requires that in-state checks that are nonlocal checks under Regulation CC be made available in accordance with the Regulation CC local schedule. The Massachusetts law supersedes Regulation CC under the temporary and permanent schedule with respect to nonlocal checks payable by banks located in Massachusetts and deposited into *accounts*. Regulation CC preempts the Massachusetts law, however, to the extent the state law does not define banks located outside of Massachusetts, but in the same check processing region as the paying bank, as *local originating depository institutions*.

Disclosures

The Massachusetts regulation incorporates the Regulation CC disclosure requirements with respect to both accounts covered by Regulation CC and savings and other accounts not governed by the federal regulation. Because the state requirements are consistent with the federal requirements, the Massachusetts regulation is not preempted by, nor does it supersede, the federal law. The Massachusetts disclosure rules would continue to apply to accounts not governed by the Regulation CC disclosure requirements.

*New Jersey*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC preempt the provisions of New Jersey law concerning disclosure of a bank's funds availability policy.

(See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

New Jersey does not have a law or regulation establishing the maximum time periods within which funds deposited by check or electronic payment must be made available for withdrawal. New Jersey does, however, have regulations concerning the disclosure of a banking institution's availability policy (N.J.A.C. 3:1–15.1 *et seq.*).

Disclosures

New Jersey law requires every banking institution (defined as any state or federally chartered commercial bank, savings bank, or savings and loan association) to provide written disclosure to all holders of and applicants for deposit accounts which describes the institution's funds availability policy. Institutions must also disclose to their customers any significant changes to their availability policy.

Regulation CC preempts state disclosure requirements concerning funds availability that relates to *accounts* that are inconsistent with the federal requirements. The state requirements are different from, and therefore inconsistent with, the federal disclosure rules. (§229.20(c)(2)). Thus, the New Jersey statute (N.J.A.C. sections 3:1–15.1 *et seq.*) is preempted by Regulation CC to the extent that these disclosure provisions apply to *accounts* as defined by Regulation CC. The New Jersey disclosure rules would continue to apply to other *deposit accounts*, as defined by New Jersey law, including money market accounts and savings accounts established by a natural person for personal or family purposes, which are not governed by the Regulation CC disclosure requirements.

*New York*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC, preempt the provisions of New York law concerning the availability of funds. This preemption determination addresses the relation of the Act and Regulation CC to the New York funds availability law. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

In 1983, the New York State Banking Department, pursuant to section 14–d of the New York Banking law, issued regulations requiring that funds deposited in an account be made available for withdrawal within specified time periods, and provided certain exceptions to those availability schedules. Part 34 of the New York State Banking Department's General Regulations established time frames within which commercial banks, trust companies, and branches of foreign banks (*banks*); and savings banks, savings and loan associations, and credit unions (*savings institutions*) must make funds deposited in customer accounts available for withdrawal.

The Banking Department amended part 34, effective September 1, 1988, generally to exclude accounts covered by Regulation CC from the scope of the state regulation. Part 34.4 (a)(2) and (b)(2) of the revised New York rules, however, continue to apply to checks deposited to accounts, as defined in Regulation CC. These provisions require that the proceeds of nonlocal checks payable by a New York institution be made available for withdrawal not later than the start of the fourth business day following deposit, if deposited in a bank, or the fifth business day following deposit, if deposited in a savings institution. The revised regulation also provides that, with respect to savings accounts and time deposits, New York institutions could elect to comply with either the state or federal availability and disclosure requirements.

This preemption determination supersedes the determination issued by the Board on August 18, 1988 (53 FR 32357 (August 24, 1988)).

Coverage

The New York law and regulation govern the availability of funds in savings accounts and time deposits, as well as *accounts* as defined in §229.2(a) of Regulation CC. The New York law continues to apply to deposits to savings accounts and time deposits that are not accounts under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Hold on other funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC, in certain circumstances.)

The New York law and regulation apply to *items* deposited to accounts. Part 34.3(e) defines *item* as *a check, negotiable order of withdrawal or money order deposited into an account*. The Board interprets the definition of *item* in New York law to be consistent with the definition of *check* in Regulation CC (§229.2(k)).

Availability Schedules

The provisions of New York law governing the availability of in-state nonlocal items provide for shorter hold than is provided under Regulation CC, and supersede that federal availability requirements. With the exception of these provisions, the New York regulation does not apply to deposits to accounts covered by Regulation CC.

*Temporary schedule.* The time periods for the availability of in-state nonlocal checks, contained in part 34.4 (a)(2) and (b)(2), are shorter that the seventh business day availability required for nonlocal checks under §229.11(c) of Regulation CC, although they are not necessarily shorter than the schedules for nonlocal checks set forth in §229.11(c)(2) and appendix B–1 of Regulation CC. Thus, these state schedules supersede the federal schedule to the extent that they apply to an item payable by a New York bank or savings institution that is defined as a nonlocal checks under Regulation CC and the applicable state schedule is less than the applicable schedule specified in §229.11(c) and appendix B–1.

*Permanent schedule.* The New York schedule for banks supersedes the Regulation CC requirement in the permanent schedule, effective September 1, 1990, that nonlocal checks be made available for withdrawal by the start of the fifth business day following deposit, to the extent that the in-state checks are defined as nonlocal under Regulation CC, and the Regulation CC schedule for nonlocal checks is not shortened under §229.12(c)(2) and appendix B–2 of Regulation CC. In addition, the New York schedule for savings institutions supersedes the Regulation CC time period adjustment for withdrawal by cash or similar means in the permanent schedule, to the extent that the in-state checks are defined as nonlocal under Regulation CC, and the Regulation CC schedule for nonlocal checks is not shortened under §229.12(c)(2) and appendix B–2.

*Exceptions to the availability schedules.* New York law provides exceptions to the state availability schedules for large deposits, new accounts, repeated overdrafters, doubtful collectibility, foreign items, and emergency conditions (part 34.4). The state exceptions apply only with respect to deposits of in-state nonlocal checks that are subject to the state availability schedule. For these deposits, the depositary bank may invoke a state exception and place a hold on the deposit up to the federal availability schedule limit for that type of deposit. Once the federal availability schedule limit is reached, the depositary bank may further extend the hold under any of the federal exceptions that apply to that deposit. Any time a depositary bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer in accordance with §229.12(g) of Regulation CC.

Disclosures

The revised New York regulation does not contain funds availability disclosure requirements applicable to accounts subject to Regulation CC.

*Rhode Island*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the ''Act'') and subpart B (and in connection therewith, subpart A) of Regulation CC, supersede provisions of Rhode Island law relating to the availability of funds. This preemption determination specifies those provisions in the Rhode Island funds availability law that supersede the Act and Regulation CC. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

In 1986, Rhode Island adopted a statute governing funds availability (R.I. Gen. Laws tit. 6A, sections 4–601 through 4–608), which requires Rhode Island depository institutions to make checks deposited in a personal transaction account available for withdrawal within certain specific periods. Commercial banks and thrift institutions (mutual savings banks, savings banks, savings and loan institutions and credit unions) must make funds available for withdrawal in accordance with the following table:

| | Commercial banks | Thrift institutions |
|---|---|---|
| Treasury checks, Rhode Island Government checks, first-indorsed. | 2nd | 2nd |
| In-state cashier's checks less than $2,500. | 2nd | 2nd |
| On-us checks | 2nd | 3rd |
| In-state clearinghouse checks | 3rd | 4th |
| In-state nonclearinghouse checks | 5th | 6th |
| 1st or 2nd Federal Reserve District checks (out-of-state). | 7th | 7th |
| Other checks | 9th | 10th |

NOTE: These time periods are stated in terms of availability for withdrawal not later than the Xth business day following the banking day of deposit to facilitate comparison with Regulation CC. State regulations are stated in terms of availability at the start of the business day subsequent to the number of days specified in the regulation.

The Rhode Island statute also provides restrictions and exceptions to the schedules and requires institutions to make certain disclosures to their customers.

Coverage

The Rhode Island statute governing the availability of funds deposited in *personal transaction accounts,* a term not defined in the statute. The federal law would continue to apply to *accounts,* as defined in §229.2(a), that are not *personal transaction accounts.*

The Rhode Island statute applies to *items,* defined as checks, negotiable orders of withdrawal, or money orders. The Board interprets the definition of item to be consistent with the definition of *check* in Regulation CC (§299.2(k)).

Availability Schedules

*Temporary schedule.* Rhode Island law requires availability for certain checks in the same time as does Regulation CC. Thus, in these instances, the federal law does not preempt the state law. Rhode Island law requires commercial banks (but not thrift institutions) to make checks payable by a depositary institution that uses the same in-state clearing facility as the depositary bank available for withdrawal on the third business day following the day of the deposit. This is the same time period contained in Regulation CC for local checks payable by a bank that is a member of the same local clearinghouse as the depositary bank. (The Board views the definition of *the same in-state clearing facility* as having the same meaning as the term *the same check clearinghouse association* in the federal law's provision that allows banks to limit the customer's ability to withdraw cash on the third business day if the local check being deposited is payable by a bank that is not a member of the same local clearinghouse as the depositary bank.) Since the Rhode Island law and the federal law both require the funds to be made available no later than the third business day, the state law is not preempted by the federal law.

The Rhode Island law also requires commercial banks and savings institutions to make checks payable by a depository institution located in the First or Second Federal Reserve District (outside of Rhode Island) available on the seventh business day following deposit. To the extent that this provision applies to checks payable by institutions located outside the Boston check processing region, it provides for availability in the same time as required for nonlocal checks under the temporary federal schedule, and thus is not preempted by the federal law.

The Rhode Island statute does not specify whether it applies to deposits of checks at nonproprietary ATMs. Under the temporary schedule in Regulation CC, deposits at nonproprietary ATMs must be made available for withdrawal at the opening of the seventh business day after deposit. To the extent that the Rhode Island schedules provide for shorter availability for deposits at nonproprietary ATMs, they would supersede the temporary schedule.

*Exceptions to the availability schedules.* The Rhode Island law contains exceptions for reason to doubt collectibility or ability of the depositor to reimburse the depositary bank, for new accounts, for large checks, and for foreign checks. In all cases where the federal availability schedule preempts the state schedule, only the federal exceptions will apply. For deposits that are covered by the state availability schedule, the state exceptions may be used to extend the state availability schedule to meet the federal availability schedule. Once the deposit is held up to the federal availability schedule limit under a state exception, the depositary bank may further extend the hold under any federal exception that can be applied to the deposit. Thus, if the state and federal availability schedules are the same for a particular deposit, both a state and a federal exception must be applicable to that deposit in order to extend the hold beyond the schedule. Any time a depositary bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer, in accordance with §229.13(g) of Regulation CC.

*Business day/banking day.* The Rhode Island statute defines *business day* as excluding Saturday, Sunday and legal holidays. This definition is preempted by the Regulation CC definitions of *business day* and *banking day*. Thus, for determining the permissible hold under the Rhode Island schedules that supersede the Regulation CC schedule, deposits are considered made on the specified number of *business days* following the *banking day* of deposit.

Disclosures

The Rhode Island statute requires written notice to depositors of an institution's check hold policy and requires a notice on deposit slips. Regulation CC preempts state disclosure requirements concerning funds availability that relate to accounts that are inconsistent with the federal requirements. The state reuirements are different from, and therefore inconsistent with, the federal rules. (§229.20(c)(2)) Thus, Regulation CC preempts the Rhode Island disclosure requirements concerning funds availability.

*Wisconsin*

Background

The Board has been requested, in accordance with §229.20(d) of Regulation CC (12 CFR part 229), to determine whether the Expedited Funds Availability Act (the Act) and subpart B (and in connection therewith, subpart A) of Regulation CC preempt the provisions of Wisconsin law concerning availability of funds. This preemption determination specifies those provisions of the Wisconsin funds availability law that are not preempted by the Act and Regulation CC. (See also the Board's preemption determination regarding the Uniform Commercial Code, section 4–213(5), pertaining to availability of cash deposits.)

Wisconsin Statutes sections 404.213(4m), 215.136, and 186.117 require Wisconsin banks, savings and loan associations, and credit unions, respectively, to make funds deposited in accounts available for withdrawal within specified time frames. Generally,

checks drawn on the U.S. Treasury, the State of Wisconsin, or on a local government located in Wisconsin must be made available for withdrawal by the second day following deposit. (The law governing commercial banks determines availability based on banking day; the laws governing savings and loan associations and credit unions determine availability based on business days.) In-state and out-of-state checks must be made available for withdrawal within five days and eight days following deposit, respectively. Exceptions are provided for new accounts and reason to doubt collectibility. In addition, Wisconsin Statutes section 404.103 permits commercial banks to vary these availability requirements by agreement.

Coverage

Wisconsin law defines *account,* with respect to the rules governing commercial banks, as *any account with a bank and includes a checking, time, interest or savings account* (Wisconsin Statutes section 404.104(1)(a)). The statutes relating to the funds availability requirements applicable to savings and loan associations and credit unions do not define the term *account*. The Federal preemption of state funds availability requirements applies only to *accounts* subject to Regulation CC, which generally consist of transaction accounts. Regulation CC does not affect the Wisconsin law to the extent that the state law applies to deposits in savings, time, and other accounts (including transaction accounts where the account holder is a bank, foreign bank, or the U.S. Treasury) that are not *accounts* under Regulation CC. (Note, however, that under §229.19(e) of Regulation CC, *Holds on Other Funds*, the federal availability schedules may apply to savings, time, and other accounts not defined as *accounts* under Regulation CC in certain circumstances.)

The Wisconsin statute applies to *items* deposited in accounts. This term encompasses instruments that are not defined as *checks* in Regulation CC (§229.2(k)), such as nonnegotiable instruments, and are therefore not subject to Regulation CC's provisions governing funds availability. Those items that are subject to Wisconsin law but are not subject to Regulation CC will continue to be covered by the state availability schedules and exceptions.

Availability Schedules

*Temporary schedule*. The Wisconsin statute requires that in-state nonlocal checks be made available for withdrawal not later than the fifth day following deposit (Wisconsin Statutes sections 404.213(4m)(b)(2); 215.136(2)(b); 186.117(2)(b)). This time period is shorter than the seventh business day availability required for nonlocal checks under §229.11(c) of Regulation CC, although it is not shorter than the schedules for nonlocal checks set forth in §229.11(c)(2) and appendix B–1 of Regulation CC. Thus, the state schedule for in-state nonlocal checks supersedes the Federal schedule to the extent that it applies to an item payable by a Wisconsin bank that is defined as a nonlocal check under Regulation CC and is not subject to reduced schedules under §229.11(c)(2) and appendix B–1.

*Permanent Schedule*. Under the Federal permanent availability schedule, nonlocal checks must be made available for withdrawal not later than the fifth business day following deposit. The fifth day availability requirement for in-state items in the Wisconsin statute supersedes the Regulation CC time period adjustment for withdrawal by cash or similar means in the permanent schedule, to the extent that the in-state checks are defined as nonlocal under Regulation CC.

*Next-day availability*. Under the Wisconsin statute, the proceeds of state and local government checks must be made available for withdrawal by the second day following deposit, if the check is endorsed only by the person to whom it was issued (Wisconsin Statutes sections 404.213(4m)(b)(1); 215.136(2)(b); and 186.117(2)(a)). Regulation CC requires next-day availability for these checks if they are (1) deposited in an account of a payee of the check, (2) deposited in a depositary bank located in the same state as the state or local government that issued the check, (3) deposited in person to an employee of the depositary bank, and (4) deposited with a special deposit slip, if the depositary bank informed its customers that use of such a slip is a condition to next-day availability. Under the Federal law, if a state or local government check is not deposited in person to an employee of the depositary bank, but meets the other conditions set forth in §229.10(c)(1)(iv), the funds must be made available for withdrawal not later than the second business day following deposit. The Wisconsin statute supersedes Regulation CC to the extent that the state law does not permit the use of a special deposit slip as a condition to receipt of second-day availability.

*Exceptions to the schedules*. Wisconsin law provides exceptions to the state availability schedules for new accounts (those opened less than 90 days) and reason to doubt collectibility (Wisconsin Statutes sections 404.213(4m)(b); 215.136(2); and 186.117(2)). The state availability law also permits commercial banks to vary the funds availability requirements by agreement (Wisconsin Statute section 404.103(1)). In all cases where the Federal schedule preempts the state schedule, only the Federal exceptions apply. For deposits that are covered by the state availability schedule (e.g., in-state nonlocal checks), a state exception must apply in

order to extend the state availability schedule up to the Federal availability schedule. Once the deposit is held up to the Federal availability limit under a state exception, the depositary bank may further extend the hold only if a Federal exception can be applied to the deposit. Any time a depositary bank invokes an exception to extend a hold beyond the time periods otherwise permitted by law, it must give notice of the extended hold to its customer in accordance with § 229.13(g) of Regulation CC.

*Business day/banking day*. The definitions of *business day* and *banking day* in the Wisconsin statutes are preempted by the Regulation CC definition of those terms. For determining the permissible hold under the Wisconsin schedules that supersede the Regulation CC schedule, deposits are considered available for withdrawal on the specified number of *business days* following the *banking day* of deposit.

Wisconsin law considers funds to be deposited, for the purpose of determining when they must be made available for withdrawal, when an item is ''received at the proof and transit facility of the depository.'' For the purposes of this preemption determination, funds are considered deposited under Wisconsin law in accordance with the rules set forth in § 229.19(a) of Regulation CC.

Disclosures

The Wisconsin statute does not require disclosure of a bank's funds availability policy. The state law does require, however, that a bank give notice to its customer if it extends the time within which funds will be available for withdrawal due to the bank's doubt as to the collectibility of the item (Wisconsin Statutes sections 404.213(4m)(b); 215.136(2); and 186.117(2)).

Regulation CC preempts state disclosure requirements concerning funds availability that relate to *accounts* that are inconsistent with the Federal requirements. The state requirement is different from, and therefore inconsistent with, the Federal disclosure rules (§ 229.20(c)(2)). Thus, the Wisconsin statute is preempted by Regulation CC to the extent that the state notice requirement applies to *accounts* as defined by Regulation CC. The Wisconsin requirement would continue to apply to accounts, such as savings and time accounts, not governed by the Regulation CC disclosure requirements.

[53 FR 32356, Aug. 24, 1988, as amended at 53 FR 44328, Nov. 2, 1988; 53 FR 47524, Nov. 22, 1988; 53 FR 51748, Dec. 23, 1988; Reg. CC, 54 FR 13838, Apr. 6, 1989; 55 FR 11358, Mar. 28, 1990; 60 FR 51703, Oct. 3, 1995]

# PART 230—TRUTH IN SAVINGS (REGULATION DD)

Sec.
230.1 Authority, purpose, coverage, and effect on state laws.
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230.3 General disclosure requirements.
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APPENDIX A TO PART 230—ANNUAL PERCENTAGE YIELD CALCULATION
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APPENDIX D TO PART 230—ISSUANCE OF STAFF INTERPRETATIONS
SUPPLEMENT I TO PART 230—OFFICIAL STAFF INTERPRETATIONS

AUTHORITY: 12 U.S.C. 4301 *et seq.*

SOURCE: 57 FR 43376, Sept. 21, 1992, unless otherwise noted.

## § 230.1 Authority, purpose, coverage, and effect on state laws.

(a) *Authority*. This part, known as Regulation DD, is issued by the Board of Governors of the Federal Reserve System to implement the Truth in Savings Act of 1991 (the act), contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4301 et seq., Pub. L. 102–242, 105 Stat. 2236). Information collection requirements contained in this part have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 et seq. and have been assigned OMB No. 7100–0255.

(b) *Purpose*. The purpose of this part is to enable consumers to make informed decisions about accounts at depository institutions. This part requires depository institutions to provide disclosures so that consumers can make meaningful comparisons among depository institutions.

(c) *Coverage*. This part applies to depository institutions except for credit unions. In addition, the advertising rules in § 230.8 of this part apply to any

person who advertises an account offered by a depository institution, including deposit brokers.

(d) *Effect on state laws.* State law requirements that are inconsistent with the requirements of the act and this part are preempted to the extent of the inconsistency. Additional information on inconsistent state laws and the procedures for requesting a preemption determination from the Board are set forth in appendix C of this part.

**§ 230.2 Definitions.**

For purposes of this part, the following definitions apply:

(a) *Account* means a deposit account at a depository institution that is held by or offered to a consumer. It includes time, demand, savings, and negotiable order of withdrawal accounts. For purposes of the advertising requirements in § 230.8 of this part, the term also includes an account at a depository institution that is held by or on behalf of a deposit broker, if any interest in the account is held by or offered to a consumer.

(b) *Advertisement* means a commercial message, appearing in any medium, that promotes directly or indirectly:

(1) The availability or terms of, or a deposit in, a new account; and

(2) For purposes of § 230.8(a) and § 230.11 of this part, the terms of, or a deposit in, a new or existing account.

(c) *Annual percentage yield* means a percentage rate reflecting the total amount of interest paid on an account, based on the interest rate and the frequency of compounding for a 365-day period and calculated according to the rules in appendix A of this part.

(d) *Average daily balance method* means the application of a periodic rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *Bonus* means a premium, gift, award, or other consideration worth more than $10 (whether in the form of cash, credit, merchandise, or any equivalent) given or offered to a consumer during a year in exchange for opening, maintaining, renewing, or increasing an account balance. The term does not include interest, other consideration worth $10 or less given during a year, the waiver or reduction of a fee, or the absorption of expenses.

(g) *Business day* means a calendar day other than a Saturday, a Sunday, or any of the legal public holidays specified in 5 U.S.C. 6103(a).

(h) *Consumer* means a natural person who holds an account primarily for personal, family, or household purposes, or to whom such an account is offered. The term does not include a natural person who holds an account for another in a professional capacity.

(i) *Daily balance method* means the application of a daily periodic rate to the full amount of principal in the account each day.

(j) *Depository institution* and *institution* mean an institution defined in section 19(b)(1)(A)(i)-(vi) of the Federal Reserve Act (12 U.S.C. 461), except credit unions defined in section 19(b)(1)(A)(iv).

(k) *Deposit broker* means any person who is a deposit broker as defined in section 29(g) of the Federal Deposit Insurance Act (12 U.S.C. 1831f(g)).

(l) *Fixed-rate account* means an account for which the institution contracts to give at least 30 calendar days advance written notice of decreases in the interest rate.

(m) *Grace period* means a period following the maturity of an automatically renewing time account during which the consumer may withdraw funds without being assessed a penalty.

(n) *Interest* means any payment to a consumer or to an account for the use of funds in an account, calculated by application of a periodic rate to the balance. The term does not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, or the absorption of expenses.

(o) *Interest rate* means the annual rate of interest paid on an account which does not reflect compounding. For the purposes of the account disclosures in § 230.4(b)(1)(i) of this part, the interest rate may, but need not, be referred to as the ''annual percentage

rate'' in addition to being referred to as the ''interest rate.''

(p) *Passbook savings account* means a savings account in which the consumer retains a book or other document in which the institution records transactions on the account.

(q) *Periodic statement* means a statement setting forth information about an account (other than a time account or passbook savings account) that is provided to a consumer on a regular basis four or more times a year.

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

(s) *Stepped-rate account* means an account that has two or more interest rates that take effect in succeeding periods and are known when the account is opened.

(t) *Tiered-rate account* means an account that has two or more interest rates that are applicable to specified balance levels.

(u) *Time account* means an account with a maturity of at least seven days in which the consumer generally does not have a right to make withdrawals for six days after the account is opened, unless the deposit is subject to an early withdrawal penalty of at least seven days' interest on amounts withdrawn.

(v) *Variable-rate account* means an account in which the interest rate may change after the account is opened, unless the institution contracts to give at least 30 calendar days advance written notice of rate decreases.

[57 FR 43376, Sept. 21, 1992, as amended at 58 FR 15081, Mar. 19, 1993; 59 FR 52658, Oct. 19, 1994; 70 FR 29593, May 24, 2005]

### § 230.3 General disclosure requirements.

(a) *Form.* Depository institutions shall make the disclosures required by §§ 230.4 through 230.6 of this part, as applicable, clearly and conspicuously, in writing, and in a form the consumer may keep. The disclosures required by this part may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act) (15 U.S.C. 7001 *et seq.*). The disclosures required by §§ 230.4(a)(2) and 230.8 may be provided to the consumer in electronic form without regard to the consumer consent or other provisions of the E-Sign Act in the circumstances set forth in those sections. Disclosures for each account offered by an institution may be presented separately or combined with disclosures for the institution's other accounts, as long as it is clear which disclosures are applicable to the consumer's account.

(b) *General.* The disclosures shall reflect the terms of the legal obligation of the account agreement between the consumer and the depository institution. Disclosures may be made in languages other than English, provided the disclosures are available in English upon request.

(c) *Relation to Regulation E (12 CFR part 205).* Disclosures required by and provided in accordance with the Electronic Fund Transfer Act (15 U.S.C. 1601) and its implementing Regulation E (12 CFR part 205) that are also required by this part may be substituted for the disclosures required by this part.

(d) *Multiple consumers.* If an account is held by more than one consumer, disclosures may be made to any one of the consumers.

(e) *Oral response to inquiries.* In an oral response to a consumer's inquiry about interest rates payable on its accounts, the depository institution shall state the annual percentage yield. The interest rate may be stated in addition to the annual percentage yield. No other rate may be stated.

(f) *Rounding and accuracy rules for rates and yields*—(1) *Rounding.* The annual percentage yield, the annual percentage yield earned, and the interest rate shall be rounded to the nearest one-hundredth of one percentage point (.01%) and expressed to two decimal places. For account disclosures, the interest rate may be expressed to more than two decimal places.

(2) *Accuracy.* The annual percentage yield (and the annual percentage yield earned) will be considered accurate if not more that one-twentieth of one percentage point (.05%) above or below the annual percentage yield (and the

annual percentage yield earned) determined in accordance with the rules in appendix A of this part.

[57 FR 43376, Sept. 21, 1992, as amended by Reg. DD, 66 FR 17802, Apr. 4, 2001; 72 FR 63483, Nov. 9, 2007]

### § 230.4 Account disclosures.

(a) *Delivery of account disclosures*—(1) *Account opening*. (i) *General*. A depository institution shall provide account disclosures to a consumer before an account is opened or a service is provided, whichever is earlier. An institution is deemed to have provided a service when a fee required to be disclosed is assessed. Except as provided in paragraph (a)(1)(ii) of this section, if the consumer is not present at the institution when the account is opened or the service is provided and has not already received the disclosures, the institution shall mail or deliver the disclosures no later than 10 business days after the account is opened or the service is provided, whichever is earlier.

(ii) *Timing of electronic disclosures*. If a consumer who is not present at the institution uses electronic means (for example, an Internet Web site) to open an account or request a service, the disclosures required under paragraph (a)(1) of this section must be provided before the account is opened or the service is provided.

(2) *Requests*. (i) A depository institution shall provide account disclosures to a consumer upon request. If a consumer who is not present at the institution makes a request, the institution shall mail or deliver the disclosures within a reasonable time after it receives the request and may provide the disclosures in paper form, or electronically if the consumer agrees.

(ii) In providing disclosures upon request, the institution may:

(A) Specify an interest rate and annual percentage yield that were offered within the most recent seven calendar days; state that the rate and yield are accurate as of an identified date; and provide a telephone number consumers may call to obtain current rate information.

(B) State the maturity of a time account as a term rather than a date.

(b) *Content of account disclosures*. Account disclosures shall include the following, as applicable:

(1) *Rate information*—(i) *Annual percentage yield and interest rate*. The ''annual percentage yield'' and the ''interest rate,'' using those terms, and for fixed-rate accounts the period of time the interest rate will be in effect.

(ii) *Variable rates*. For variable-rate accounts:

(A) The fact that the interest rate and annual percentage yield may change;

(B) How the interest rate is determined;

(C) The frequency with which the interest rate may change; and

(D) Any limitation on the amount the interest rate may change.

(2) *Compounding and crediting*—(i) *Frequency*. The frequency with which interest is compounded and credited.

(ii) *Effect of closing an account*. If consumers will forfeit interest if they close the account before accrued interest is credited, a statement that interest will not be paid in such cases.

(3) *Balance information*—(i) *Minimum balance requirements*. Any minimum balance required to:

(A) Open the account;

(B) Avoid the imposition of a fee; or

(C) Obtain the annual percentage yield disclosed.

Except for the balance to open the account, the disclosure shall state how the balance is determined for these purposes.

(ii) *Balance computation method*. An explanation of the balance computation method specified in § 230.7 of this part used to calculate interest on the account.

(iii) *When interest begins to accrue*. A statement of when interest begins to accrue on noncash deposits.

(4) *Fees*. The amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed.

(5) *Transaction limitations*. Any limitations on the number or dollar amount of withdrawals or deposits.

(6) *Features of time accounts*. For time accounts:

(i) *Time requirements.* The maturity date.

(ii) *Early withdrawal penalties.* A statement that a penalty will or may be imposed for early withdrawal, how it is calculated, and the conditions for its assessment.

(iii) *Withdrawal of interest prior to maturity.* If compounding occurs during the term and interest may be withdrawn prior to maturity, a statement that the annual percentage yield assumes interest remains on deposit until maturity and that a withdrawal will reduce earnings. For accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, that require interest payouts at least annually, and that disclose an APY determined in accordance with section E of appendix A of this part, a statement that interest cannot remain on deposit and that payout of interest is mandatory.

(iv) *Renewal policies.* A statement of whether or not the account will renew automatically at maturity. If it will, a statement of whether or not a grace period will be provided and, if so, the length of that period must be stated. If the account will not renew automatically, a statement of whether interest will be paid after maturity if the consumer does not renew the account must be stated.

(7) *Bonuses.* The amount or type of any bonus, when the bonus will be provided, and any minimum balance and time requirements to obtain the bonus.

(c) *Notice to existing account holders*—(1) *Notice of availability of disclosures.* Depository institutions shall provide a notice to consumers who receive periodic statements and who hold existing accounts of the type offered by the institution on June 21, 1993. The notice shall be included on or with the first periodic statement sent on or after June 21, 1993 (or on or with the first periodic statement for a statement cycle beginning on or after that date). The notice shall state that consumers may request account disclosures containing terms, fees, and rate information for their account. In responding to such a request, institutions shall provide disclosures in accordance with paragraph (a)(2) of this section.

(2) *Alternative to notice.* As an alternative to the notice described in paragraph (c)(1) of this section, institutions may provide account disclosures to consumers. The disclosures may be provided either with a periodic statement or separately, but must be sent no later than when the periodic statement described in paragraph (c)(1) is sent.

[57 FR 43376, Sept. 21, 1992, as amended at 58 FR 15081, Mar. 19, 1993; Reg. DD, 60 FR 5130, Jan. 26, 1995; 63 FR 40637, July 30, 1998; 66 FR 17802, Apr. 4, 2001; 72 FR 63483, Nov. 9, 2007]

### § 230.5 Subsequent disclosures.

(a) *Change in terms*—(1) *Advance notice required.* A depository institution shall give advance notice to affected consumers of any change in a term required to be disclosed under § 230.4(b) of this part if the change may reduce the annual percentage yield or adversely affect the consumer. The notice shall include the effective date of the change. The notice shall be mailed or delivered at least 30 calendar days before the effective date of the change.

(2) *No notice required.* No notice under this section is required for:

(i) *Variable-rate changes.* Changes in the interest rate and corresponding changes in the annual percentage yield in variable-rate accounts.

(ii) *Check printing fees.* Changes in fees assessed for check printing.

(iii) *Short-term time accounts.* Changes in any term for time accounts with maturities of one month or less.

(b) *Notice before maturity for time accounts longer than one month that renew automatically.* For time accounts with a maturity longer than one month that renew automatically at maturity, institutions shall provide the disclosures described below before maturity. The disclosures shall be mailed or delivered at least 30 calendar days before maturity of the existing account. Alternatively, the disclosures may be mailed or delivered at least 20 calendar days before the end of the grace period on the existing account, provided a grace period of at least five calendar days is allowed.

(1) *Maturities of longer than one year.* If the maturity is longer than one year, the institution shall provide account disclosures set forth in § 230.4(b) of this part for the new account, along with

the date the existing account matures. If the interest rate and annual percentage yield that will be paid for the new account are unknown when disclosures are provided, the institution shall state that those rates have not yet been determined, the date when they will be determined, and a telephone number consumers may call to obtain the interest rate and the annual percentage yield that will be paid for the new account.

(2) *Maturities of one year or less but longer than one month.* If the maturity is one year or less but longer than one month, the institution shall either:

(i) Provide disclosures as set forth in paragraph (b)(1) of this section; or

(ii) Disclose to the consumer:

(A) The date the existing account matures and the new maturity date if the account is renewed;

(B) The interest rate and the annual percentage yield for the new account if they are known (or that those rates have not yet been determined, the date when they will be determined, and a telephone number the consumer may call to obtain the interest rate and the annual percentage yield that will be paid for the new account); and

(C) Any difference in the terms of the new account as compared to the terms required to be disclosed under § 230.4(b) of this part for the existing account.

(c) *Notice before maturity for time accounts longer than one year that do not renew automatically.* For time accounts with a maturity longer than one year that do not renew automatically at maturity, institutions shall disclose to consumers the maturity date and whether interest will be paid after maturity. The disclosures shall be mailed or delivered at least 10 calendar days before maturity of the existing account.

[57 FR 43376, Sept. 21, 1992, as amended at 58 FR 15081, Mar. 19, 1993; Reg. DD, 63 FR 52107, Sept. 29, 1998]

### § 230.6 Periodic statement disclosures.

(a) *General rule.* If a depository institution mails or delivers a periodic statement, the statement shall include the following disclosures:

(1) *Annual percentage yield earned.* The ''annual percentage yield earned'' during the statement period, using that term, calculated according to the rules in appendix A of this part.

(2) *Amount of interest.* The dollar amount of interest earned during the statement period.

(3) *Fees imposed.* Fees required to be disclosed under § 230.4(b)(4) of this part that were debited to the account during the statement period. The fees shall be itemized by type and dollar amounts. Except as provided in § 230.11(a)(1) of this part, when fees of the same type are imposed more than once in a statement period, a depository institution may itemize each fee separately or group the fees together and disclose a total dollar amount for all fees of that type.

(4) *Length of period.* The total number of days in the statement period, or the beginning and ending dates of the period.

(b) *Special rule for average daily balance method.* In making the disclosures described in paragraph (a) of this section, institutions that use the average daily balance method and that calculate interest for a period other than the statement period shall calculate and disclose the annual percentage yield earned and amount of interest earned based on that period rather than the statement period. The information in paragraph (a)(4) of this section shall be stated for that period as well as for the statement period.

[Reg. DD 57 FR 43376, Sept. 21, 1992, as amended at 57 FR 46480, Oct. 9, 1992; 64 FR 49848, Sept. 14, 1999; 66 FR 17802, Apr. 4, 2001; 70 FR 29593, May 24, 2005]

### § 230.7 Payment of interest.

(a) *Permissible methods*—(1) *Balance on which interest is calculated.* Institutions shall calculate interest on the full amount of principal in an account for each day by use of either the daily balance method or the average daily balance method.[1]

(2) *Determination of minimum balance to earn interest.* An institution shall use the same method to determine any

[1] Institutions shall calculate interest by use of a daily rate of at least 1/365 of the interest rate. In a leap year a daily rate of 1/366 of the interest rate may be used.

minimum balance required to earn interest as it uses to determine the balance on which interest is calculated. An institution may use an additional method that is unequivocally beneficial to the consumer.

(b) *Compounding and crediting policies.* This section does not require institutions to compound or credit interest at any particular frequency.

(c) *Date interest begins to accrue.* Interest shall begin to accrue not later than the business day specified for interest-bearing accounts in section 606 of the Expedited Funds Availability Act (12 U.S.C. 4005 *et seq.*) and implementing Regulation CC (12 CFR part 229). Interest shall accrue until the day funds are withdrawn.

**§ 230.8 Advertising.**

(a) *Misleading or inaccurate advertisements.* An advertisement shall not:

(1) Be misleading or inaccurate or misrepresent a depository institution's deposit contract; or

(2) Refer to or describe an account as ''free'' or ''no cost'' (or contain a similar term) if any maintenance or activity fee may be imposed on the account. The word ''profit'' shall not be used in referring to interest paid on an account.

(b) *Permissible rates.* If an advertisement states a rate of return, it shall state the rate as an ''annual percentage yield'' using that term. (The abbreviation ''APY'' may be used provided the term ''annual percentage yield'' is stated at least once in the advertisement.) The advertisement shall not state any other rate, except that the ''interest rate,'' using that term, may be stated in conjunction with, but not more conspicuously than, the annual percentage yield to which it relates.

(c) *When additional disclosures are required.* Except as provided in paragraph (e) of this section, if the annual percentage yield is stated in an advertisement, the advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) *Variable rates.* For variable-rate accounts, a statement that the rate may change after the account is opened.

(2) *Time annual percentage yield is offered.* The period of time the annual percentage yield will be offered, or a statement that the annual percentage yield is accurate as of a specified date.

(3) *Minimum balance.* The minimum balance required to obtain the advertised annual percentage yield. For tiered-rate accounts, the minimum balance required for each tier shall be stated in close proximity and with equal prominence to the applicable annual percentage yield.

(4) *Minimum opening deposit.* The minimum deposit required to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield.

(5) *Effect of fees.* A statement that fees could reduce the earnings on the account.

(6) *Features of time accounts.* For time accounts:

(i) *Time requirements.* The term of the account.

(ii) *Early withdrawal penalties:* A statement that a penalty will or may be imposed for early withdrawal.

(iii) *Required interest payouts.* For noncompounding time accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, that require interest payouts at least annually, and that disclose an APY determined in accordance with section E of appendix A of this part, a statement that interest cannot remain on deposit and that payout of interest is mandatory.

(d) *Bonuses.* Except as provided in paragraph (e) of this section, if a bonus is stated in an advertisement, the advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) The ''annual percentage yield,'' using that term;

(2) The time requirement to obtain the bonus;

(3) The minimum balance required to obtain the bonus;

(4) The minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and

(5) When the bonus will be provided.

(e) *Exemption for certain advertisements*—(1) *Certain media.* If an advertisement is made through one of the following media, it need not contain the information in paragraphs (c)(1), (c)(2), (c)(4), (c)(5), (c)(6)(ii), (d)(4), and (d)(5) of this section:

(i) Broadcast or electronic media, such as television or radio;

(ii) Outdoor media, such as billboards; or

(iii) Telephone response machines.

(2) *Indoor signs.* (i) Signs inside the premises of a depository institution (or the premises of a deposit broker) are not subject to paragraphs (b), (c), (d) or (e)(1) of this section.

(ii) If a sign exempt by paragraph (e)(2) of this section states a rate of return, it shall:

(A) State the rate as an ''annual percentage yield,'' using that term or the term ''APY.'' The sign shall not state any other rate, except that the interest rate may be stated in conjunction with the annual percentage yield to which it relates.

(B) Contain a statement advising consumers to contact an employee for further information about applicable fees and terms.

(f) *Additional disclosures in connection with the payment of overdrafts.* Institutions that promote the payment of overdrafts in an advertisement shall include in the advertisement the disclosures required by § 230.11(b) of this part.

[57 FR 43376, Sept. 21, 1992, as amended at 58 FR 15081, Mar. 19, 1993; Reg. DD, 60 FR 5130, Jan. 26, 1995; Reg. DD, 63 FR 40638, July 30, 1998; Reg. DD, 63 FR 52107, Sept. 29, 1998; 70 FR 29593, May 24, 2005]

## § 230.9 Enforcement and record retention.

(a) *Administrative enforcement.* Section 270 of the act contains the provisions relating to administrative sanctions for failure to comply with the requirements of the act and this part. Compliance is enforced by the agencies listed in that section.

(b) *Civil liability.* Section 271 of the Act contains the provisions relating to civil liability for failure to comply with the requirements of the act and this part; Section 271 is repealed effective September 30, 2001.

(c) *Record retention.* A depository institution shall retain evidence of compliance with this part for a minimum of two years after the date disclosures are required to be made or action is required to be taken. The administrative agencies responsible for enforcing this part may require depository institutions under their jurisdiction to retain records for a longer period if necessary to carry out their enforcement responsibilities under section 270 of the act.

[57 FR 43376, Sept. 21, 1992, as amended by Reg. DD, 63 FR 52107, Sept. 29, 1998]

## § 230.10 [Reserved]

## § 230.11 Additional disclosure requirements for institutions advertising the payment of overdrafts.

(a) *Periodic statement disclosures*—(1) *Disclosure of Total Fees.* (i) Except as provided in paragraph (a)(2) of this section, if a depository institution promotes the payment of overdrafts in an advertisement, the institution must separately disclose on each periodic statement:

(A) The total dollar amount for all fees or charges imposed on the account for paying checks or other items when there are insufficient funds and the account becomes overdrawn; and

(B) The total dollar amount for all fees imposed on the account for returning items unpaid.

(ii) The disclosures required by this paragraph must be provided for the statement period and for the calendar year to date, for any account to which the advertisement applies.

(2) *Communications not triggering disclosure of total fees.* The following communications by a depository institution do not trigger the disclosures required by paragraph (a)(1) of this section:

(i) Promoting in an advertisement a service for paying overdrafts where the institution's payment of overdrafts will be agreed upon in writing and subject to the Board's Regulation Z (12 CFR part 226);

(ii) Communicating (whether by telephone, electronically, or otherwise) about the payment of overdrafts in response to a consumer-initiated inquiry about deposit accounts or overdrafts.

Providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as a telephone response machine, an automated teller machine (ATM), or an institution's Internet site, is not a response to a consumer-initiated inquiry for purposes of this paragraph;

(iii) Engaging in an in-person discussion with a consumer;

(iv) Making disclosures that are required by Federal or other applicable law;

(v) Providing a notice or including information on a periodic statement informing a consumer about a specific overdrawn item or the amount the account is overdrawn;

(vi) Including in a deposit account agreement a discussion of the institution's right to pay overdrafts;

(vii) Providing a notice to a consumer, such as at an ATM, that completing a requested transaction may trigger a fee for overdrawing an account, or providing a general notice that items overdrawing an account may trigger a fee; or

(viii) Providing informational or educational materials concerning the payment of overdrafts if the materials do not specifically describe the institution's overdraft service.

(3) *Time period covered by disclosures.* An institution must make the disclosures required by paragraph (a)(1) of this section for the first statement period that begins after an institution advertises the payment of overdrafts. An institution may disclose total fees imposed for the calendar year by aggregating fees imposed since the beginning of the calendar year, or since the beginning of the first statement period that year for which such disclosures are required.

(4) *Termination of promotions.* Paragraph (a)(1) of this section shall cease to apply with respect to a deposit account two years after the date of an institution's last advertisement promoting the payment of overdrafts applicable to that account.

(5) *Acquired accounts.* An institution that acquires an account must thereafter provide the disclosures required by paragraph (a)(1) of this section for the first statement period that begins after the institution promotes the payment of overdrafts in an advertisement that applies to the acquired account. If disclosures under paragraph (a)(1) of this section are required for the acquired account, the institution may, but is not required to, include fees imposed prior to acquisition of the account.

(b) *Advertising disclosures for overdraft services*—(1) *Disclosures.* Except as provided in paragraphs (b)(2),(b)(3), and (b)(4) of this section, any advertisement promoting the payment of overdrafts shall disclose in a clear and conspicuous manner:

(i) The fee or fees for the payment of each overdraft;

(ii) The categories of transactions for which a fee for paying an overdraft may be imposed;

(iii) The time period by which the consumer must repay or cover any overdraft; and

(iv) The circumstances under which the institution will not pay an overdraft.

(2) *Communications about the payment of overdrafts not subject to additional advertising disclosures.* Paragraph (b)(1) of this section does not apply to:

(i) An advertisement promoting a service where the institution's payment of overdrafts will be agreed upon in writing and subject to the Board's Regulation Z (12 CFR part 226);

(ii) A communication by an institution about the payment of overdrafts in response to a consumer-initiated inquiry about deposit accounts or overdrafts. Providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as a telephone response machine, ATM, or an institution's Internet site, is not a response to a consumer-initiated inquiry for purposes of this paragraph;

(iii) An advertisement made through broadcast or electronic media, such as television or radio;

(iv) An advertisement made on outdoor media, such as billboards;

(v) An ATM receipt;

(vi) An in-person discussion with a consumer;

(vii) Disclosures required by federal or other applicable law;

(viii) Information included on a periodic statement or a notice informing a consumer about a specific overdrawn item or the amount the account is overdrawn;

(ix) A term in a deposit account agreement discussing the institution's right to pay overdrafts;

(x) A notice provided to a consumer, such as at an ATM, that completing a requested transaction may trigger a fee for overdrawing an account, or a general notice that items overdrawing an account may trigger a fee; or

(xi) Informational or educational materials concerning the payment of overdrafts if the materials do not specifically describe the institution's overdraft service.

(3) *Exception for ATM screens and telephone response machines.* The disclosures described in paragraphs (b)(1)(ii) and (b)(1)(iv) of this section are not required in connection with any advertisement made on an ATM screen or using a telephone response machine.

(4) *Exception for indoor signs.* Paragraph (b)(1) of this section does not apply to advertisements for the payment of overdrafts on indoor signs as described by §230.8(e)(2) of this part, provided that the sign contains a clear and conspicuous statement that fees may apply and that consumers should contact an employee for further information about applicable fees and terms. For purposes of this paragraph (b)(4), an indoor sign does not include an ATM screen.

[70 FR 29593, May 24, 2005]

## APPENDIX A TO PART 230—ANNUAL PERCENTAGE YIELD CALCULATION

The annual percentage yield measures the total amount of interest paid on an account based on the interest rate and the frequency of compounding.[1] The annual percentage yield is expressed as an annualized rate, based on a 365-day year.[2] Part I of this appendix discusses the annual percentage yield calculations for account disclosures and advertisements, while Part II discusses annual percentage yield earned calculations for periodic statements.

### *Part I. Annual Percentage Yield for Account Disclosures and Advertising Purposes*

In general, the annual percentage yield for account disclosures under §§230.4 and 230.5 and for advertising under §230.8 is an annualized rate that reflects the relationship between the amount of interest that would be earned by the consumer for the term of the account and the amount of principal used to calculate that interest. Special rules apply to accounts with tiered and stepped interest rates, and to certain time accounts with a stated maturity greater than one year.

#### A. GENERAL RULES

Except as provided in Part I.E. of this appendix, the annual percentage yield shall be calculated by the formula shown below. Institutions shall calculate the annual percentage yield based on the actual number of days in the term of the account. For accounts without a stated maturity date (such as a typical savings or transaction account), the calculation shall be based on an assumed term of 365 days. In determining the total interest figure to be used in the formula, institutions shall assume that all principal and interest remain on deposit for the entire term and that no other transactions (deposits or withdrawals) occur during the term.[3] For time accounts that are offered in multiples of months, institutions may base the number of days on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. If institutions choose to use the latter rule, they must use the same number of days to calculate the dollar amount of interest earned on the account that is used in the annual percentage yield formula (where ''Interest'' is divided by ''Principal'').

The annual percentage yield is calculated by use of the following general formula (''APY'' is used for convenience in the formulas):

$$APY = 100 \quad [(1 + Interest/Principal)^{(365/Days\ in\ term)} - 1]$$

[1] The annual percentage yield reflects only interest and does not include the value of any bonus (or other consideration worth $10 or less) that may be provided to the consumer to open, maintain, increase or renew an account. Interest or other earnings are not to be included in the annual percentage yield if such amounts are determined by circumstances that may or may not occur in the future.

[2] Institutions may calculate the annual percentage yield based on a 365–day or a 366–day year in a leap year.

[3] This assumption shall not be used if an institution requires, as a condition of the account, that consumers withdraw interest during the term. In such a case, the interest (and annual percentage yield calculation) shall reflect that requirement.

''Principal'' is the amount of funds assumed to have been deposited at the beginning of the account.

''Interest'' is the total dollar amount of interest earned on the Principal for the term of the account.

''Days in term'' is the actual number of days in the term of the account. When the ''days in term'' is 365 (that is, where the stated maturity is 365 days or where the account does not have a stated maturity), the annual percentage yield can be calculated by use of the following simple formula:

APY=100 (Interest/Principal)

*Examples*

(1) If an institution pays $61.68 in interest for a 365-day year on $1,000 deposited into a NOW account, using the general formula above, the annual percentage yield is 6.17%:

$APY=100[(1+61.68/1,000)^{(365/365)}-1]$
APY=6.17%

Or, using the simple formula above (since, as an account without a stated term, the term is deemed to be 365 days):

APY=100(61.68/1,000)
APY=6.17%

(2) If an institution pays $30.37 in interest on a $1,000 six-month certificate of deposit (where the six-month period used by the institution contains 182 days), using the general formula above, the annual percentage yield is 6.18%:

$APY=100[(1+30.37/1,000)^{(365/182)}-1]$
APY=6.18%

B. STEPPED-RATE ACCOUNTS (DIFFERENT RATES APPLY IN SUCCEEDING PERIODS)

For accounts with two or more interest rates applied in succeeding periods (where the rates are known at the time the account is opened), an institution shall assume each interest rate is in effect for the length of time provided for in the deposit contract.

*Examples*

(1) If an institution offers a $1,000 6-month certificate of deposit on which it pays a 5% interest rate, compounded daily, for the first three months (which contain 91 days), and a 5.5% interest rate, compounded daily, for the next three months (which contain 92 days), the total interest for six months is $26.68 and, using the general formula above, the annual percentage yield is 5.39%:

$APY=100[(1+26.68/1,000)^{(365/183)}-1]$
APY=5.39%

(2) If an institution offers a $1,000 two-year certificate of deposit on which it pays a 6% interest rate, compounded daily, for the first year, and a 6.5% interest rate, compounded daily, for the next year, the total interest for two years is $133.13, and, using the general formula above, the annual percentage yield is 6.45%:

$APY=100[(1+133.13/1,000)^{(365/730)}-1]$
APY=6.45%

C. VARIABLE-RATE ACCOUNTS

For variable-rate accounts without an introductory premium or discounted rate, an institution must base the calculation only on the initial interest rate in effect when the account is opened (or advertised), and assume that this rate will not change during the year.

Variable-rate accounts with an introductory premium (or discount) rate must be calculated like a stepped-rate account. Thus, an institution shall assume that: (1) The introductory interest rate is in effect for the length of time provided for in the deposit contract; and (2) the variable interest rate that would have been in effect when the account is opened or advertised (but for the introductory rate) is in effect for the remainder of the year. If the variable rate is tied to an index, the index-based rate in effect at the time of disclosure must be used for the remainder of the year. If the rate is not tied to an index, the rate in effect for existing consumers holding the same account (who are not receiving the introductory interest rate) must be used for the remainder of the year.

For example, if an institution offers an account on which it pays a 7% interest rate, compounded daily, for the first three months (which, for example, contain 91 days), while the variable interest rate that would have been in effect when the account was opened was 5%, the total interest for a 365-day year for a $1,000 deposit is $56.52 (based on 91 days at 7% followed by 274 days at 5%). Using the simple formula, the annual percentage yield is 5.65%:

APY=100(56.52/1,000)
APY=5.65%

D. TIERED-RATE ACCOUNTS (DIFFERENT RATES APPLY TO SPECIFIED BALANCE LEVELS)

For accounts in which two or more interest rates paid on the account are applicable to specified balance levels, the institution must calculate the annual percentage yield in accordance with the method described below that it uses to calculate interest. In all cases, an annual percentage yield (or a range of annual percentage yields, if appropriate) must be disclosed for each balance tier.

For purposes of the examples discussed below, assume the following:

| Interest rate (percent) | Deposit balance required to earn rate |
|---|---|
| 5.25 | Up to but not exceeding $2,500. |
| 5.50 | Above $2,500 but not exceeding $15,000. |
| 5.75 | Above $15,000. |

*Tiering Method A*. Under this method, an institution pays on the full balance in the account the stated interest rate that corresponds to the applicable deposit tier. For example, if a consumer deposits $8,000, the institution pays the 5.50% interest rate on the entire $8,000.

When this method is used to determine interest, only one annual percentage yield will apply to each tier. Within each tier, the annual percentage yield will not vary with the amount of principal assumed to have been deposited.

For the interest rates and deposit balances assumed above, the institution will state three annual percentage yields—one corresponding to each balance tier. Calculation of each annual percentage yield is similar for this type of account as for accounts with a single interest rate. Thus, the calculation is based on the total amount of interest that would be received by the consumer for each tier of the account for a year and the principal assumed to have been deposited to earn that amount of interest.

*First tier*. Assuming daily compounding, the institution will pay $53.90 in interest on a $1,000 deposit. Using the general formula, for the first tier, the annual percentage yield is 5.39%:

$$APY=100[(1+53.90/1,000)^{(365/365)}-1]$$
APY=5.39%

Using the simple formula:

APY=100(53.90/1,000)
APY=5.39%

*Second tier*. The institution will pay $452.29 in interest on an $8,000 deposit. Thus, using the simple formula, the annual percentage yield for the second tier is 5.65%:

APY=100(452.29/8,000)
APY=5.65%

*Third tier*. The institution will pay $1,183.61 in interest on a $20,000 deposit. Thus, using the simple formula, the annual percentage yield for the third tier is 5.92%:

APY=100(1,183.61/20,000)
APY=5.92%

*Tiering Method B*. Under this method, an institution pays the stated interest rate only on that portion of the balance within the specified tier. For example, if a consumer deposits $8,000, the institution pays 5.25% on $2,500 and 5.50% on $5,500 (the difference between $8,000 and the first tier cut-off of $2,500).

The institution that computes interest in this manner must provide a range that shows the lowest and the highest annual percentage yields for each tier (other than for the first tier, which, like the tiers in Method A, has the same annual percentage yield throughout). The low figure for an annual percentage yield range is calculated based on the total amount of interest earned for a year assuming the minimum principal required to earn the interest rate for that tier. The high figure for an annual percentage yield range is based on the amount of interest the institution would pay on the highest principal that could be deposited to earn that same interest rate. If the account does not have a limit on the maximum amount that can be deposited, the institution may assume any amount.

For the tiering structure assumed above, the institution would state a total of five annual percentage yields—one figure for the first tier and two figures stated as a range for the other two tiers.

*First tier*. Assuming daily compounding, the institution would pay $53.90 in interest on a $1,000 deposit. For this first tier, using the simple formula, the annual percentage yield is 5.39%:

APY=100(53.90/1,000)
APY=5.39%

*Second tier*. For the second tier, the institution would pay between $134.75 and $841.45 in interest, based on assumed balances of $2,500.01 and $15,000, respectively. For $2,500.01, interest would be figured on $2,500 at 5.25% interest rate plus interest on $.01 at 5.50%. For the low end of the second tier, therefore, the annual percentage yield is 5.39%, using the simple formula:

APY=100(134.75/2,500)
APY=5.39%

For $15,000, interest is figured on $2,500 at 5.25% interest rate plus interest on $12,500 at 5.50% interest rate. For the high end of the second tier, the annual percentage yield, using the simple formula, is 5.61%:

APY=100(841.45/15,000)
APY=5.61%

Thus, the annual percentage yield range for the second tier is 5.39% to 5.61%.

*Third tier*. For the third tier, the institution would pay $841.45 in interest on the low end of the third tier (a balance of $15,000.01). For $15,000.01, interest would be figured on $2,500 at 5.25% interest rate, plus interest on $12,500 at 5.50% interest rate, plus interest on $.01 at 5.75% interest rate. For the low end of the third tier, therefore, the annual percentage yield (using the simple formula) is 5.61%:

APY=100 (841.45/15,000)
APY=5.61%

Since the institution does not limit the account balance, it may assume any maximum amount for the purposes of computing the annual percentage yield for the high end of the third tier. For an assumed maximum balance amount of $100,000, interest would be figured on $2,500 at 5.25% interest rate, plus interest on $12,500 at 5.50% interest rate, plus interest on $85,000 at 5.75% interest rate. For the high end of the third tier, therefore, the annual percentage yield, using the simple formula, is 5.87%.

APY=100 (5,871.79/100,000)
APY=5.87%

Thus, the annual percentage yield range that would be stated for the third tier is 5.61% to 5.87%.

If the assumed maximum balance amount is $1,000,000 instead of $100,000, the institution would use $985,000 rather than $85,000 in the last calculation. In that case, for the high end of the third tier the annual percentage yield, using the simple formula, is 5.91%:

APY=100 (59134.22/1,000,000)
APY=5.91%

Thus, the annual percentage yield range that would be stated for the third tier is 5.61% to 5.91%.

E. Time Accounts with a Stated Maturity Greater than One Year that Pay Interest At Least Annually

1. For time accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, and that require the consumer to withdraw interest at least annually, the annual percentage yield may be disclosed as equal to the interest rate.

*Example*

(1) If an institution offers a $1,000 two-year certificate of deposit that does not compound and that pays out interest semi-annually by check or transfer at a 6.00% interest rate, the annual percentage yield may be disclosed as 6.00%.

(2) For time accounts covered by this paragraph that are also stepped-rate accounts, the annual percentage yield may be disclosed as equal to the composite interest rate.

*Example*

(1) If an institution offers a $1,000 three-year certificate of deposit that does not compound and that pays out interest annually by check or transfer at a 5.00% interest rate for the first year, 6.00% interest rate for the second year, and 7.00% interest rate for the third year, the institution may compute the composite interest rate and APY as follows:

(a) Multiply each interest rate by the number of days it will be in effect;

(b) Add these figures together; and

(c) Divide by the total number of days in the term.

(2) Applied to the example, the products of the interest rates and days the rates are in effect are (5.00%×365 days) 1825, (6.00%×365 days) 2190, and (7.00%×365 days) 2555, respectively. The sum of these products, 6570, is divided by 1095, the total number of days in the term. The composite interest rate and APY are both 6.00%.

*Part II. Annual Percentage Yield Earned for Periodic Statements*

The annual percentage yield earned for periodic statements under §230.6(a) is an annualized rate that reflects the relationship between the amount of interest actually earned on the consumer's account during the statement period and the average daily balance in the account for the statement period. Pursuant to §230.6(b), however, if an institution uses the average daily balance method and calculates interest for a period other than the statement period, the annual percentage yield earned shall reflect the relationship between the amount of interest earned and the average daily balance in the account for that other period.

The annual percentage yield earned shall be calculated by using the following formulas (''APY Earned'' is used for convenience in the formulas):

A. *General formula*.

$$\text{APY Earned}=100\ [(1+\text{Interest earned}/\text{Balance})^{(365/\text{Days in period})}-1]$$

''Balance'' is the average daily balance in the account for the period.

''Interest earned'' is the actual amount of interest earned on the account for the period.

''Days in period'' is the actual number of days for the period.

*Examples*

(1) Assume an institution calculates interest for the statement period (and uses either the daily balance or the average daily balance method), and the account has a balance of $1,500 for 15 days and a balance of $500 for the remaining 15 days of a 30-day statement period. The average daily balance for the period is $1,000. The interest earned (under either balance computation method) is $5.25 during the period. The annual percentage yield earned (using the formula above) is 6.58%:

$$\text{APY Earned}=100\ [(1+5.25/1{,}000)^{(365/30)}-1]$$
APY Earned=6.58%

(2) Assume an institution calculates interest on the average daily balance for the calendar month and provides periodic statements that cover the period from the 16th of one month to the 15th of the next month. The account has a balance of $2,000 September 1 through September 15 and a balance of $1,000 for the remaining 15 days of September. The average daily balance for the month of September is $1,500, which results in $6.50 in interest earned for the month. The annual percentage yield earned for the month of September would be shown on the periodic statement covering September 16 through October 15. The annual percentage yield earned (using the formula above) is 5.40%:

$$\text{APY Earned}=100\ [(6.50/1{,}500)^{(365/30)}-1]$$
APY Earned=5.40%

(3) Assume an institution calculates interest on the average daily balance for a quarter (for example, the calendar months of September through November), and provides monthly periodic statements covering calendar months. The account has a balance of

$1,000 throughout the 30 days of September, a balance of $2,000 throughout the 31 days of October, and a balance of $3,000 throughout the 30 days of November. The average daily balance for the quarter is $2,000, which results in $21 in interest earned for the quarter. The annual percentage yield earned would be shown on the periodic statement for November. The annual percentage yield earned (using the formula above) is 4.28%:

APY Earned=100 $[(1+21/2{,}000)^{(365/91)}-1]$

APY Earned=4.28%

B. *Special formula for use where periodic statement is sent more often than the period for which interest is compounded.*

Institutions that use the daily balance method to accrue interest and that issue periodic statements more often than the period for which interest is compounded shall use the following special formula:

$$\text{APY Earned} = 100\left\{\left[1+\frac{(\text{Interest earned/Balance})}{\text{Days in period}}(\text{Compounding})\right]^{(365/\text{Compounding})}-1\right\}$$

The following definition applies for use in this formula (all other terms are defined under Part II):

''Compounding'' is the number of days in each compounding period.

Assume an institution calculates interest for the statement period using the daily balance method, pays a 5.00% interest rate, compounded annually, and provides periodic statements for each monthly cycle. The account has a daily balance of $1,000 for a 30-day statement period. The interest earned is $4.11 for the period, and the annual percentage yield earned (using the special formula above) is 5.00%:

$$\text{APY Earned} = 100\left\{\left[1+\frac{(4.11/1{,}000)}{30}(365)\right]^{(365/365)}-1\right\}$$

APY Earned=5.00%

[57 FR 43376, Sept. 21, 1992, as amended at 57 FR 46480, Oct. 9, 1992; 58 FR 15082, Mar. 19, 1993; 60 FR 5130, Jan. 26, 1995; Reg. DD, 63 FR 40638, July 30, 1998]

## APPENDIX B TO PART 230—MODEL CLAUSES AND SAMPLE FORMS

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### B–1—MODEL CLAUSES FOR ACCOUNT DISCLOSURES

(a) Rate information

(i) Fixed-rate accounts

The interest rate on your account is ____% with an annual percentage yield of ____%. You will be paid this rate [for (time period)/ until (date)/ for at least 30 calendar days].

(ii) Variable-rate accounts

The interest rate on your account is ____% with an annual percentage yield of ____%.

Your interest rate and annual percentage yield may change.

*Determination of Rate*

The interest rate on your account is based on (name of index) [plus/minus a margin of _____].

or

At our discretion, we may change the interest rate on your account.

*Frequency of Rate Changes*

We may change the interest rate on your account [every (time period)/at any time].

*Limitations on Rate Changes*

The interest rate for your account will never change by more than ____% each (time period).

The interest rate will never be [less/more] than ____%.

or

The interest rate will never [exceed____% above/drop more than ____% below] the interest rate initially disclosed to you.

(iii) Stepped-rate accounts

The initial interest rate for your account is ____%. You will be paid this rate [for (time period)/until (date)]. After that time, the interest rate for your account will be ____%, and you will be paid this rate [for (time period)/until (date)]. The annual percentage yield for your account is ____%.

(iv) *Tiered-rate accounts*

*Tiering Method A*

• If your [daily balance/average daily balance] is $____ or more, the interest rate paid on the entire balance in your account will be ____% with an annual percentage yield of ____%.

• If your [daily balance/average daily balance] is more than $____, but less than $____, the interest rate paid on the entire balance in your account will be ____% with an annual percentage yield of ____%.

• If your [daily balance/average daily balance] is $____ or less, the interest rate paid on the entire balance will be ____% with an annual percentage yield of ____%.

*Tiering Method B*

• An interest rate of ____% will be paid only for that portion of your [daily balance/average daily balance] that is greater than $____. The annual percentage yield for this tier will range from ____% to ____%, depending on the balance in the account.

• An interest rate of ____% will be paid only for that portion of your [daily balance/average daily balance] that is greater than $____, but less than $____. The annual percentage yield for this tier will range from ____% to ____%, depending on the balance in the account.

• If your [daily balance/average daily balance] is $____ or less, the interest rate paid on the entire balance will be ____% with an annual percentage yield of ____%.

(b) Compounding and crediting

*(i) Frequency*

Interest will be compounded [on a ____ basis/every (time period)]. Interest will be credited to your account [on a ____ basis/every (time period)].

(ii) Effect of closing an account

If you close your account before interest is credited, you will not receive the accrued interest.

(c) Minimum balance requirements

(i) To open the account

You must deposit $_____ to open this account.

(ii) To avoid imposition of fees

A minimum balance fee of $_____ will be imposed every (time period) if the balance in the account falls below $_____ any day of the (time period).

A minimum balance fee of $_____ will be imposed every (time period) if the average daily balance for the (time period) falls below $_____. The average daily balance is calculated by adding the principal in the account for each day of the period and dividing that figure by the number of days in the period.

(iii) To obtain the annual percentage yield disclosed

You must maintain a minimum balance of $_____ in the account each day to obtain the disclosed annual percentage yield.

You must maintain a minimum average daily balance of $_____ to obtain the disclosed annual percentage yield. The average daily balance is calculated by adding the principal in the account for each day of the period and dividing that figure by the number of days in the period.

(d) Balance computation method

(i) Daily balance method

We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

(ii) Average daily balance method

We use the average daily balance method to calculate interest on your account. This method applies a periodic rate to the average daily balance in the account for the period. The average daily balance is calculated by adding the principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) Accrual of interest on noncash deposits

Interest begins to accrue no later than the business day we receive credit for the deposit of noncash items (for example, checks).

or

Interest begins to accrue on the business day you deposit noncash items (for example, checks).

(f) Fees

The following fees may be assessed against your account:

_____$_____

_____$_____

_____$_____

_____(*conditions for imposing fee*) $_____

_____% of _____.

(g) Transaction limitations

The minimum amount you may [withdraw/write a check for] is $_____.

You may make _____ [deposits into/withdrawals from] your account each (time period).

You may not make [deposits into/withdrawals from] your account until the maturity date.

(h) Disclosures relating to time accounts

(i) Time requirements

Your account will mature on (date).

Your account will mature in (time period).

(ii) Early withdrawal penalties

We [will/may] impose a penalty if you withdraw [any/all] of the [deposited funds/principal] before the maturity date. The fee imposed will equal _____ days/week[s]/month[s] of interest.

or

We [will/may] impose a penalty of $_____ if you withdraw [any/all] of the [deposited funds/principal] before the maturity date.

If you withdraw some of your funds before maturity, the interest rate for the remaining funds in your account will be _____% with an annual percentage yield of _____%.

(iii) Withdrawal of interest prior to maturity

The annual percentage yield assumes interest will remain on deposit until maturity. A withdrawal will reduce earnings.

(iv) Renewal policies

(1) Automatically renewable time accounts

This account will automatically renew at maturity.

You will have [_____ calendar/business] days after the maturity date to withdraw funds without penalty.

or

There is no grace period following the maturity of this account to withdraw funds without penalty.

(2) Non-automatically renewable time accounts

This account will not renew automatically at maturity. If you do not renew the account, your deposit will be placed in [an interest-bearing/a noninterest-bearing] account.

(v) Required interest distribution.

This account requires the distribution of interest and does not allow interest to remain in the account.

(i) Bonuses

You will [be paid/receive] [$_____ /(description of item)] as a bonus [when you open the account/on (date) _____].

You must maintain a minimum [daily balance/average daily balance] of $_____ to obtain the bonus.

To earn the bonus, [$_____ /your entire principal] must remain on deposit [for (time period)/until (date)_____].

B–2—MODEL CLAUSES FOR CHANGE IN TERMS

On (date), the cost of (type of fee) will increase to $_____.

On (date), the interest rate on your account will decrease to _____% with an annual percentage yield of _____%.

On (date), the minimum [daily balance/average daily balance] required to avoid imposition of a fee will increase to $_____.

B–3—MODEL CLAUSES FOR PRE-MATURITY NOTICES FOR TIME ACCOUNTS

(a) Automatically renewable time accounts with maturities of one year or less but longer than one month

Your account will mature on (date).

If the account renews, the new maturity date will be (date).

The interest rate for the renewed account will be _____% with an annual percentage yield of _____%.

or

The interest rate and annual percentage yield have not yet been determined. They will be available on (date). Please call (phone number) to learn the interest rate and annual percentage yield for your new account.

(b) Non-automatically renewable time accounts with maturities longer than one year

Your account will mature on (date).

If you do not renew the account, interest [will/will not] be paid after maturity.

B-4 – SAMPLE FORM (MULTIPLE ACCOUNTS)

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**BANK ABC**

**DISCLOSURE OF ACCOUNT TERMS**

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**This disclosure contains information about your:**

**X NOW Account**

- Your interest rate and annual percentage yield may change. At our discretion, we may change the interest rate on your account daily. The interest rate for your account will never be less than 2.00%.
- Interest begins to accrue on the business day you deposit noncash items (for example, checks).
- Interest is compounded daily and credited on the last day of each month. If you close your account before interest is credited, you will not receive the accrued interest.
- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**___ Passbook Savings Account**

- The interest rate on your account will be paid for at least 30 days.
- Interest begins to accrue on the business day you deposit noncash items (for example, checks).
- Interest is compounded daily and credited on the last day of each month. If you close your account before interest is credited, you will not receive the accrued interest.
- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**Additional disclosures for your account are included on the attached sheets.**

**__ Money Market Account**

- Your interest rate and annual percentage yield may change. At our discretion, we may change the interest rate on your account daily. The interest rate on your account will never be less than 3.00%.
- You may make six (6) transfers from your account, but only three (3) may be payments by check to third parties.
- Interest begins to accrue on the business day you deposit noncash items (for example, checks).
- Interest is compounded daily and credited on the last day of each month. If you close your account before interest is credited, you will not receive the accrued interest.
- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**___ Certificates of Deposit**

- The interest rate for your account will be paid until the maturity date of your certificate (_____).
- Interest is compounded daily and will be credited to your account monthly.
- Interest begins to accrue on the business day you deposit noncash items (for example, checks).
- This account will automatically renew at maturity. You will have ten (10) calendar days from the maturity date to withdraw your funds without being charged a penalty.
- After the account is opened, you may not make deposits into or withdrawals from this account until the maturity date.
- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.
- If any of the deposit is withdrawn before the maturity date, a penalty as shown below will be imposed:

| Term | Early Withdrawal Penalty |
|---|---|
| 3-month CD | 30 days interest |
| 6-month CD | 90 days interest |
| 1-year CD | 120 days interest |
| 2-year CD | 180 days interest |

**Additional disclosures for your account are included on the attached sheets.**

**(Fee Schedule Insert)**

## BANK ABC
## FEE SCHEDULE

### NOW Account

- Monthly minimum balance fee if the daily balance drops below $ 500 any day of the month . . . . . $ 7.50

### Passbook Savings Account

- Monthly minimum balance fee if the daily balance drops below $ 100 any day of the month . . . . . $ 6.00
- You may make three (3) withdrawals per quarter
  Each subsequent withdrawal . . . . . $ 2.00

### Money Market Account

- Monthly minimum balance fee if the daily balance drops below $ 1,000 any day of the month . . . . . $ 5.00

### Other Account Fees

- Deposited checks returned . . . . . $ 5.00
- Balance inquiries (at a branch or at an ATM) . . . . . $ 1.00
- Check printing ♦ . . . . . (Fee depends on style of check ordered)
- Your check returned for insufficient funds (per check) ♦ . . . . . $ 16.00
- Stop payment request (per request) ♦ . . . . . $ 12.50
- Certified check (per check) ♦ . . . . . $ 10.00

♦ Fee does not apply to Passbook Savings Accounts or Certificates of Deposit.

**Additional disclosures for your account are included on the attached sheet.**

(Rate Sheet Insert)

# BANK ABC
# RATE SHEET

| ACCOUNT TYPE | MINIMUM DEPOSIT TO OPEN ACCOUNT | MINIMUM BALANCE* TO OBTAIN ANNUAL PERCENTAGE YIELD | INTEREST RATE | ANNUAL PERCENTAGE YIELD |
|---|---|---|---|---|
| NOW | $ 500 | $ 2,500 | 4.00% | 4.08% |
| PASSBOOK SAVINGS | $ 100 | $ 500 | 3.50% | 3.56% |
| MONEY MARKET | $ 1,000 | $ 1,000 | 4.15% | 4.24% |
| 3-MONTH CD | $ 1,000 | $ 1,000 | 4.20% | 4.29% |
| 6-MONTH CD | $ 1,000 | $ 1,000 | 4.25% | 4.34% |
| 1-YEAR CD | $ 1,000 | $ 1,000 | 5.20% | 5.34% |
| 2-YEAR CD | $ 1,000 | $ 1,000 | 5.80% | 5.97% |

* Daily balance (the amount of principal in the account each day)

**B-5 – SAMPLE FORM (NOW ACCOUNT)**

**BANK XYZ**

**DISCLOSURE OF INTEREST, FEES AND ACCOUNT TERMS**

**NOW ACCOUNT**

**Fee schedule**

- **Monthly minimum balance fee if the daily balance drops below $1,000 any day of the month . . . . . $ 7.00**
- **Fee to stop payment of a check . . . . . $ 12.50**
- **Fee for check returns (insufficient funds – per check) . . . . . $ 16.00**
- **Certified check (per check) . . . . . $ 10.00**
- **Fee for initial check printing (per 200) . . . . . $ 12.00**
  **(Cost for check printing varies depending on the style of checks ordered.)**

**Rate information**

- The interest rate for your account is 4.00 % with an annual percentage yield of 4.08 %. Your interest rate and annual percentage yield may change. At our discretion, we may change the interest rate for your account at any time. The interest rate for your account will never be less than 2% each year.

**Minimum balance requirements**

- You must deposit $500 to open this account.

- You must maintain a minimum balance of $2,500 in the account each day to obtain the annual percentage yield listed above.

**Balance computation method**

- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**Compounding and crediting**

- Interest for your account will be compounded daily and credited to your account on the last day of each month.

**Accrual of interest on deposits other than cash**

- Interest begins to accrue on the business day you deposit noncash items (for example, checks).

**B-6 -- SAMPLE FORM (TIERED-RATE MONEY MARKET ACCOUNT)**

**BANK ABC**

**DISCLOSURE OF INTEREST, FEES AND ACCOUNT TERMS**

**MONEY MARKET ACCOUNT**

**Fee schedule**

- Check returned for insufficient funds (per check) . . . . . $16.00
- Stop payment request (per request) . . . . . $12.50
- Certified check (per check) . . . . . $10.00
- Check printing . . . . . (Fee depends on style of checks ordered)

**Rate information**

- If your daily balance is $15,000 or more, the interest rate paid on the entire balance in your account will be _5.75_ % with an annual percentage yield of _5.92_ %.
- If your daily balance is more than $2,500, but less than $15,000, the interest rate paid on the entire balance in your account will be _5.50_ % with an annual percentage yield of _5.65_ %.
- If your daily balance is $2,500 or less, the interest rate paid on the entire balance will be _5.25_ % with an annual percentage yield of _5.39_ %.
- Your interest rate and annual percentage yield may change. At our discretion, we may change the interest rate for your account at any time. The interest rate for your account will never be less than 2.00%.
- Interest begins to accrue on the business day you deposit noncash items (for example, checks).
- Interest is compounded daily and credited on the last day of each month.

**Minimum balance requirements**

- You must deposit $1,000 to open this account.
- A minimum balance fee of $5.00 will be imposed every month if the balance in your account falls below $1,000 any day of the month.

**Balance computation method**

- We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**Transaction limitations**

- You may make six (6) transfers from your account, but only three (3) may be payments by check to third parties.

B-7 -- SAMPLE FORM (CERTIFICATE OF DEPOSIT)

**XYZ SAVINGS BANK**
**1 YEAR CERTIFICATE OF DEPOSIT**

**Rate information**

The interest rate for your account is _5.20_ % with an annual percentage yield of _5.34_ %. You will be paid this rate until the maturity date of the certificate. Your certificate will mature on _September 30, 1993_. The annual percentage yield assumes interest remains on deposit until maturity. A withdrawal will reduce earnings.

Interest for your account will be compounded daily and credited to your account on the last day of each month.

Interest begins to accrue on the business day you deposit any noncash item (for example, checks).

**Minimum balance requirements**

You must deposit $1,000 to open this account.

You must maintain a minimum balance of $1,000 in your account every day to obtain the annual percentage yield listed above.

**Balance computation method**

We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

**Transaction limitations**

After the account is opened, you may not make deposits into or withdrawals from the account until the maturity date.

**Early withdrawal penalty**

If you withdraw any principal before the maturity date, a penalty equal to three months interest will be charged to your account.

**Renewal policy**

This account will be automatically renewed at maturity. You have a grace period of ten (10) calendar days after the maturity date to withdraw the funds without being charged a penalty.

B-8 -- SAMPLE FORM (CERTIFICATE OF DEPOSIT ADVERTISEMENT)

# BANK XYZ

## ALWAYS OFFERS YOU COMPETITIVE CD RATES!!

| CERTIFICATES OF DEPOSIT | ANNUAL PERCENTAGE YIELD (APY) |
|---|---|
| 5 YEAR | 6.31% |
| 4 YEAR | 6.07% |
| 3 YEAR | 5.72% |
| 2 YEAR | 5.52% |
| 1 YEAR | 4.54% |
| 6 MONTH | 4.34% |
| 90 DAY | 4.21% |
| | APYs are offered on accounts opened from 5/9/93 through 5/18/93. |

The minimum balance to open an account and obtain the APY is $1,000.
A penalty may be imposed for early withdrawal.

For more information call:

202-123-1234

B-9 -- SAMPLE FORM (MONEY MARKET ACCOUNT ADVERTISEMENT)

# BANK XYZ

## ALWAYS OFFERS YOU COMPETITIVE RATES!!

| MONEY MARKET ACCOUNTS | ANNUAL PERCENTAGE YIELD (APY) |
|---|---|
| Accounts with a balance of $5,000 or less | 5.07%* |
| Accounts with a balance over $5,000 | 5.57%* |
| APYs are accurate as of April 30, 1993 | *The rates may change after the account is opened. |

Fees could reduce the earnings on the account.

**For more information call:**

**202-123-1234**

[57 FR 43376, Sept. 21, 1992, as amended at 57 FR 46480, Oct. 9, 1992; Reg. DD, 60 FR 5131, Jan. 26, 1995]

## APPENDIX C TO PART 230—EFFECT ON STATE LAWS

*(a) Inconsistent Requirements*

State law requirements that are inconsistent with the requirements of the act and this part are preempted to the extent of the inconsistency. A state law is inconsistent if it requires a depository institution to make disclosures or take actions that contradict the requirements of the federal law. A state law is also contradictory if it requires the use of the same term to represent a different amount or a different meaning than the federal law, requires the use of a term different from that required in the federal law to describe the same item, or permits a method of calculating interest on an account different from that required in the federal law.

*(b) Preemption Determinations*

A depository institution, state, or other interested party may request the Board to determine whether a state law requirement is inconsistent with the federal requirements. A request for a determination shall be in writing and addressed to the Secretary, Board of Governors of the Federal Reserve

System, Washington, DC 20551. Notice that the Board intends to make a determination (either on request or on its own motion) will be published in the FEDERAL REGISTER, with an opportunity for public comment unless the Board finds that notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest and publishes its reasons for such decision. Notice of a final determination will be published in the FEDERAL REGISTER and furnished to the party who made the request and to the appropriate state official.

*(c) Effect of Preemption Determinations*

After the Board determines that a state law is inconsistent, a depository institution may not make disclosures using the inconsistent term or take actions relying on the inconsistent law.

*(d) Reversal of Determination*

The Board reserves the right to reverse a determination for any reason bearing on the coverage or effect of state or federal law. Notice of reversal of a determination will be published in the FEDERAL REGISTER and a copy furnished to the appropriate state official.

## APPENDIX D TO PART 230—ISSUANCE OF STAFF INTERPRETATIONS

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this part. These interpretations provide the protections afforded under section 271(f) of the act. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official commentary to this part, which will be amended periodically. No staff interpretations will be issued approving depository institutions' forms, statements, or calculation tools or methods.

## SUPPLEMENT I TO PART 230—OFFICIAL STAFF INTERPRETATIONS

### INTRODUCTION

1. *Official status.* This commentary is the means by which the Division of Consumer and Community Affairs of the Federal Reserve Board issues official staff interpretations of Regulation DD. Good faith compliance with this commentary affords protection from liability under section 271(f) of the Truth in Savings Act.

### Section 230.1 Authority, purpose, coverage, and effect on state laws

*(c) Coverage*

1. *Foreign applicability.* Regulation DD applies to all depository institutions, except credit unions, that offer deposit accounts to residents (including resident aliens) of any state as defined in §230.2(r). Accounts held in an institution located in a state are covered, even if funds are transferred periodically to a location outside the United States. Accounts held in an institution located outside the United States are not covered, even if held by a U.S. resident.

2. *Persons who advertise accounts.* Persons who advertise accounts are subject to the advertising rules. For example, if a deposit broker places an advertisement offering consumers an interest in an account at a depository institution, the advertising rules apply to the advertisement, whether the account is to be held by the broker or directly by the consumer.

### Section 230.2 Definitions

*(a) Account*

1. *Covered accounts.* Examples of accounts subject to the regulation are:

i. Interest-bearing and noninterest-bearing accounts

ii. Deposit accounts opened as a condition of obtaining a credit card

iii. Accounts denominated in a foreign currency

iv. Individual retirement accounts (IRAs) and simplified employee pension (SEP) accounts

v. Payable on death (POD) or ''Totten trust'' accounts

2. *Other accounts.* Examples of accounts not subject to the regulation are:

i. Mortgage escrow accounts for collecting taxes and property insurance premiums

ii. Accounts established to make periodic disbursements on construction loans

iii. Trust accounts opened by a trustee pursuant to a formal written trust agreement (not merely declarations of trust on a signature card such as a ''Totten trust,'' or an IRA and SEP account)

iv. Accounts opened by an executor in the name of a decedent's estate

3. *Other investments.* The term ''account'' does not apply to all products of a depository institution. Examples of products not covered are:

i. Government securities

ii. Mutual funds

iii. Annuities

iv. Securities or obligations of a depository institution

v. Contractual arrangements such as repurchase agreements, interest rate swaps, and bankers acceptances

*(b) Advertisement*

1. *Covered messages.* Advertisements include commercial messages in visual, oral, or print media that invite, offer, or otherwise announce generally to prospective customers the availability of consumer accounts—such as:

i. Telephone solicitations

ii. Messages on automated teller machine (ATM) screens

iii. Messages on a computer screen in an institution's lobby (including any printout) other than a screen viewed solely by the institution's employee

iv. Messages in a newspaper, magazine, or promotional flyer or on radio

v. Messages that are provided along with information about the consumer's existing account and that promote another account at the institution

2. *Other messages*. Examples of messages that are not advertisements are:

i. Rate sheets in a newspaper, periodical, or trade journal (unless the depository institution, or a deposit broker offering accounts at the institution, pays a fee for or otherwise controls publication)

ii. In-person discussions with consumers about the terms for a specific account

iii. For purposes of §230.8(b) of this part through §230.8(e) of this part, information given to consumers about existing accounts, such as current rates recorded on a voice-response machine or notices for automatically renewable time account sent before renewal

iv. Information about a particular transaction in an existing account

v. Disclosures required by federal or other applicable law

vi. A deposit account agreement

*(f) Bonus*

1. *Examples*. Bonuses include items of value, other than interest, offered as incentives to consumers, such as an offer to pay the final installment deposit for a holiday club account. Items that are not a bonus include discount coupons for goods or services at restaurants or stores.

2. *De minimis rule*. Items with a *de minimis* value of $10 or less are not bonuses. Institutions may rely on the valuation standard used by the Internal Revenue Service to determine if the value of the item is *de minimis*. Examples of items of *de minimis* value are:

i. Disability insurance premiums valued at an amount of $10 or less per year

ii. Coffee mugs, T-shirts or other merchandise with a market value of $10 or less

3. *Aggregation*. In determining if an item valued at $10 or less is a bonus, institutions must aggregate per account per calendar year items that may be given to consumers. In making this determination, institutions aggregate per account only the market value of items that may be given for a specific promotion. To illustrate, assume an institution offers in January to give consumers an item valued at $7 for each calendar quarter during the year that the average account balance in a negotiable order of withdrawal (NOW) account exceeds $10,000. The bonus rules are triggered, since consumers are eligible under the promotion to receive up to $28 during the year. However, the bonus rules are not triggered if an item valued at $7 is offered to consumers opening a NOW account during the month of January, even though in November the institution introduces a new promotion that includes, for example, an offer to existing NOW account holders for an item valued at $8 for maintaining an average balance of $5,000 for the month.

4. *Waiver or reduction of a fee or absorption of expenses*. Bonuses do not include value that consumers receive through the waiver or reduction of fees (even if the fees waived exceed $10) for banking-related services such as the following:

i. A safe deposit box rental fee for consumers who open a new account

ii. Fees for travelers checks for account holders

iii. Discounts on interest rates charged for loans at the institution

*(h) Consumer*

1. *Professional capacity*. Examples of accounts held by a natural person in a professional capacity for another are attorney-client trust accounts and landlord-tenant security accounts.

2. *Other accounts*. Accounts not held in a professional capacity include accounts held by an individual for a child under the Uniform Gifts to Minors Act.

3. *Sole proprietors*. Accounts held by individuals as sole proprietors are not covered.

4. *Retirement plans*. IRAs and SEP accounts are consumer accounts to the extent that funds are invested in covered accounts. But Keogh accounts are not subject to the regulation.

*(j) Depository institution and institution*

1. *Foreign institutions*. Branches of foreign institutions located in the United States are subject to the regulation if they offer deposit accounts to consumers. Edge Act and Agreement corporations, and agencies of foreign institutions, are not depository institutions for purposes of this regulation.

*(k) Deposit broker*

1. *General*. A deposit broker is a person who is in the business of placing or facilitating the placement of deposits in an institution, as defined by the Federal Deposit Insurance Act (12 U.S.C. 29(g)).

*(n) Interest*

1. *Relation to Regulation Q*. While bonuses are not interest for purposes of this regulation, other regulations may treat them as the equivalent of interest. For example, Regulation Q identifies payments of cash or merchandise that violate the prohibition against paying interest on demand accounts. (See 12 CFR §217.2(d).)

*(p) Passbook savings account*

1. *Relation to Regulation E*. Passbook savings accounts include accounts accessed by preauthorized electronic fund transfers to the account (as defined in 12 CFR §205.2(j)), such as an account that receives direct deposit of social security payments. Accounts permitting access by other electronic means are not ''passbook saving accounts'' and must comply with the requirements of §230.6

if statements are sent four or more times a year.

*(q) Periodic statement*

1. *Examples.* Periodic statements do not include:

i. Additional statements provided solely upon request

ii. General service information such as a quarterly newsletter or other correspondence describing available services and products

*(t) Tiered-rate account*

1. *Time accounts.* Time accounts paying different rates based solely on the amount of the initial deposit are not tiered-rate accounts.

2. *Minimum balance requirements.* A requirement to maintain a minimum balance to earn interest does not make an account a tiered-rate account.

*(u) Time account*

1. *Club accounts.* Although club accounts typically have a maturity date, they are not time accounts unless they also require a penalty of at least seven days' interest for withdrawals during the first six days after the account is opened.

2. *Relation to Regulation D.* Regulation D permits in limited circumstances the withdrawal of funds without penalty during the first six days after a ''time deposit'' is opened. (See 12 CFR §204.2(c)(1)(i).) But the fact that a consumer makes a withdrawal as permitted by Regulation D does not disqualify the account from being a time account for purposes of this regulation.

*(v) Variable-rate account*

1. *General.* A certificate of deposit permitting one or more rate adjustments prior to maturity at the consumer's option is a variable-rate account.

Section 230.3 General disclosure requirements

*(a) Form*

1. *Design requirements.* Disclosures must be presented in a format that allows consumers to readily understand the terms of their account. Institutions are not required to use a particular type size or typeface, nor are institutions required to state any term more conspicuously than any other term. Disclosures may be made:

i. In any order

ii. In combination with other disclosures or account terms

iii. In combination with disclosures for other types of accounts, as long as it is clear to consumers which disclosures apply to their account

iv. On more than one page and on the front and reverse sides

v. By using inserts to a document or filling in blanks

vi. On more than one document, as long as the documents are provided at the same time

2. *Consistent terminology.* Institutions must use consistent terminology to describe terms or features required to be disclosed. For example, if an institution describes a monthly fee (regardless of account activity) as a ''monthly service fee'' in account-opening disclosures, the periodic statement and change-in-term notices must use the same terminology so that consumers can readily identify the fee.

*(b) General*

1. *Specificity of legal obligation.* Institutions may refer to the calendar month or to roughly equivalent intervals during a calendar year as a ''month.''

*(c) Relation to Regulation E*

1. *General rule.* Compliance with Regulation E (12 CFR part 205) is deemed to satisfy the disclosure requirements of this regulation, such as when:

i. An institution changes a term that triggers a notice under Regulation E, and uses the timing and disclosure rules of Regulation E for sending change-in-term notices

ii. Consumers add an ATM access feature to an account, and the institution provides disclosures pursuant to Regulation E, including disclosure of fees (See 12 CFR §205.7.)

iii. An institution complying with the timing rules of Regulation E discloses at the same time fees for electronic services (such as for balance inquiry fees at ATMs) required to be disclosed by this regulation but not by Regulation E

iv. An institution relies on Regulation E's rules regarding disclosure of limitations on the frequency and amount of electronic fund transfers, including security-related exceptions. But any limitations on ''intra-institutional transfers'' to or from the consumer's other accounts during a given time period must be disclosed, even though intra-institutional transfers are exempt from Regulation E.

*(e) Oral response to inquiries*

1. *Application of rule.* Institutions are not required to provide rate information orally.

2. *Relation to advertising.* The advertising rules do not cover an oral response to a question about rates.

3. *Existing accounts.* This paragraph does not apply to oral responses about rate information for existing accounts. For example, if a consumer holding a one-year certificate of deposit (CD) requests interest rate information about the CD during the term, the institution need not disclose the annual percentage yield.

*(f) Rounding and accuracy rules for rates and yields*

*(f)(1) Rounding*

1. *Permissible rounding.* Examples of permissible rounding are an annual percentage yield calculated to be 5.644%, rounded down and disclosed as 5.64%; 5.645% rounded up and disclosed as 5.65%.

*(f)(2) Accuracy*

1. *Annual percentage yield and annual percentage yield earned.* The tolerance for annual

percentage yield and annual percentage yield earned calculations is designed to accommodate inadvertent errors. Institutions may not purposely incorporate the tolerance into their calculation of yields.

Section 230.4 Account disclosures

*(a) Delivery of account disclosures*

*(a)(1) Account opening*

1. *New accounts.* New account disclosures must be provided when:

i. A time account that does not automatically rollover is renewed by a consumer

ii. A consumer changes a term for a renewable time account (see §230.5(b)–5 regarding disclosure alternatives)

iii. An institution transfers funds from an account to open a new account not at the consumer's request, unless the institution previously gave account disclosures and any change-in-term notices for the new account

iv. An institution accepts a deposit from a consumer to an account that the institution had deemed closed for the purpose of treating accrued but uncredited interest as forfeited interest (see §230.7(b)–3)

2. *Acquired accounts.* New account disclosures need not be given when an institution acquires an account through an acquisition of or merger with another institution (but see §230.5(a) regarding advance notice requirements if terms are changed).

*(a)(2) Requests*

*(a)(2)(i)*

1. *Inquiries versus requests.* A response to an oral inquiry (by telephone or in person) about rates and yields or fees does not trigger the duty to provide account disclosures. But when consumers ask for written information about an account (whether by telephone, in person, or by other means), the institution must provide disclosures unless the account is no longer offered to the public.

2. *General requests.* When responding to a consumer's general request for disclosures about a type of account (a NOW account, for example), an institution that offers several variations may provide disclosures for any one of them.

3. *Timing for response.* Ten business days is a reasonable time for responding to requests for account information that consumers do not make in person, including requests made by electronic means (such as by electronic mail).

4. *Use of electronic means.* If a consumer who is not present at the institution makes a request for account disclosures, including a request made by telephone, e-mail, or via the institution's Web site, the institution may send the disclosures in paper form or, if the consumer agrees, may provide the disclosures electronically, such as to an e-mail address that the consumer provides for that purpose, or on the institution's Web site, without regard to the consumer consent or other provisions of the E-Sign Act. The regulation does not require an institution to provide, nor a consumer to agree to receive, the disclosures required by §230.4(a)(2) in electronic form.

*(a)(2)(ii)(A)*

1. *Recent rates.* Institutions comply with this paragraph if they disclose an interest rate and annual percentage yield accurate within the seven calendar days preceding the date they send the disclosures.

*(a)(2)(ii)(B)*

1. *Term.* Describing the maturity of a time account as ''1 year'' or ''6 months,'' for example, illustrates a statement of the maturity of a time account as a term rather than a date (''January 10, 1995'').

*(b) Content of account disclosures*

*(b)(1) Rate information*

*(b)(1)(i) Annual percentage yield and interest rate*

1. *Rate disclosures.* In addition to the interest rate and annual percentage yield, institutions may disclose a periodic rate corresponding to the interest rate. No other rate or yield (such as ''tax effective yield'') is permitted. If the annual percentage yield is the same as the interest rate, institutions may disclose a single figure but must use both terms.

2. *Fixed-rate accounts.* For fixed-rate time accounts paying the opening rate until maturity, institutions may disclose the period of time the interest rate will be in effect by stating the maturity date. (See appendix B, B–7—Sample Form.) For other fixed-rate accounts, institutions may use a date (''This rate will be in effect through May 4, 1995'') or a period (''This rate will be in effect for at least 30 days'').

3. *Tiered-rate accounts.* Each interest rate, along with the corresponding annual percentage yield for each specified balance level (or range of annual percentage yields, if appropriate), must be disclosed for tiered-rate accounts. (See appendix A, Part I, Paragraph D.)

4. *Stepped-rate accounts.* A single composite annual percentage yield must be disclosed for stepped-rate accounts. (See appendix A, Part I, Paragraph B.) The interest rates and the period of time each will be in effect also must be provided. When the initial rate offered for a specified time on a variable-rate account is higher or lower than the rate that would otherwise be paid on the account, the calculation of the annual percentage yield must be made as if for a stepped-rate account. (See appendix A, Part I, Paragraph C.)

*(b)(1)(ii) Variable rates*

*(b)(1)(ii)(B)*

1. *Determining interest rates.* To disclose how the interest rate is determined, institutions must:

i. Identify the index and specific margin, if the interest rate is tied to an index

ii. State that rate changes are within the institution's discretion, if the institution does not tie changes to an index

*(b)(1)(ii)(C)*

1. *Frequency of rate changes.* An institution reserving the right to change rates at its discretion must state the fact that rates may change at any time.

*(b)(1)(ii)(D)*

1. *Limitations.* A floor or ceiling on rates or on the amount the rate may decrease or increase during any time period must be disclosed. Institutions need not disclose the absence of limitations on rate changes.

*(b)(2) Compounding and crediting*

*(b)(2)(ii) Effect of closing an account*

1. *Deeming an account closed.* An institution may, subject to state or other law, provide in its deposit contracts the actions by consumers that will be treated as closing the account and that will result in the forfeiture of accrued but uncredited interest. An example is the withdrawal of all funds from the account prior to the date that interest is credited.

*(b)(3) Balance information*

*(b)(3)(ii) Balance computation method*

1. *Methods and periods.* Institutions may use different methods or periods to calculate minimum balances for purposes of imposing a fee (the daily balance for a calendar month, for example) and accruing interest (the average daily balance for a statement period, for example). Each method and corresponding period must be disclosed.

*(b)(3)(iii) When interest begins to accrue*

1. *Additional information.* Institutions may disclose additional information such as the time of day after which deposits are treated as having been received the following business day, and may use additional descriptive terms such as ''ledger'' or ''collected'' balances to disclose when interest begins to accrue.

*(b)(4) Fees*

1. *Covered fees.* The following are types of fees that must be disclosed:

i. Maintenance fees, such as monthly service fees

ii. Fees to open or to close an account

iii. Fees related to deposits or withdrawals, such as fees for use of the institution's ATMs

iv. Fees for special services, such as stop-payment fees, fees for balance inquiries or verification of deposits, fees associated with checks returned unpaid, and fees for regularly sending to consumers checks that otherwise would be held by the institution

2. *Other fees.* Institutions need not disclose fees such as the following:

i. Fees for services offered to account and nonaccount holders alike, such as travelers checks and wire transfers (even if different amounts are charged to account and nonaccount holders)

ii. Incidental fees, such as fees associated with state escheat laws, garnishment or attorneys fees, and fees for photocopying

3. *Amount of fees.* Institutions must state the amount and conditions under which a fee may be imposed. Naming and describing the fee (such as ''$4.00 monthly service fee'') will typically satisfy these requirements.

4. *Tied-accounts.* Institutions must state if fees that may be assessed against an account are tied to other accounts at the institution. For example, if an institution ties the fees payable on a NOW account to balances held in the NOW account and a savings account, the NOW account disclosures must state that fact and explain how the fee is determined.

5. *Fees for overdrawing an account.* Under §230.4(b)(4) of this part, institutions must disclose the conditions under which a fee may be imposed. In satisfying this requirement institutions must specify the categories of transactions for which an overdraft fee may be imposed. An exhaustive list of transactions is not required. It is sufficient for an institution to state that the fee applies to overdrafts ''created by check, in-person withdrawal, ATM withdrawal, or other electronic means,'' as applicable. Disclosing a fee ''for overdraft items'' would not be sufficient.

*(b)(5) Transaction limitations*

1. *General rule.* Examples of limitations on the number or dollar amount of deposits or withdrawals that institutions must disclose are:

i. Limits on the number of checks that may be written on an account within a given time period

ii. Limits on withdrawals or deposits during the term of a time account

iii. Limitations required by Regulation D on the number of withdrawals permitted from money market deposit accounts by check to third parties each month. Institutions need not disclose reservations of right to require notices for withdrawals from accounts required by federal or state law.

*(b)(6) Features of time accounts*

*(b)(6)(i) Time requirements*

1. *''Callable'' time accounts.* In addition to the maturity date, an institution must state the date or the circumstances under which it may redeem a time account at the institution's option (a ''callable'' time account).

*(b)(6)(ii) Early withdrawal penalties*

1. *General.* The term ''penalty'' may but need not be used to describe the loss of interest that consumers may incur for early withdrawal of funds from time accounts.

2. *Examples.* Examples of early withdrawal penalties are:

i. Monetary penalties, such as ''$10.00'' or ''seven days' interest plus accrued but uncredited interest''

ii. Adverse changes to terms such as a lowering of the interest rate, annual percentage

yield, or compounding frequency for funds remaining on deposit

iii. Reclamation of bonuses

3. *Relation to rules for IRAs or similar plans.* Penalties imposed by the Internal Revenue Code for certain withdrawals from IRAs or similar pension or savings plans are not early withdrawal penalties for purposes of this regulation.

4. *Disclosing penalties.* Penalties may be stated in months, whether institutions assess the penalty using the actual number of days during the period or using another method such as a number of days that occurs in any actual sequence of the total calendar months involved. For example, stating ''one month's interest'' is permissible, whether the institution assesses 30 days' interest during the month of April, or selects a time period between 28 and 31 days for calculating the interest for all early withdrawals regardless of when the penalty is assessed.

*(b)(6)(iv) Renewal policies*

1. *Rollover time accounts.* Institutions offering a grace period on time accounts that automatically renew need not state whether interest will be paid if the funds are withdrawn during the grace period.

2. *Nonrollover time accounts.* Institutions paying interest on funds following the maturity of time accounts that do not renew automatically need not state the rate (or annual percentage yield) that may be paid. (See appendix B, Model Clause B–1(h)(iv)(2).)

Section 230.5 Subsequent disclosures

*(a) Change in terms*

*(a)(1) Advance notice required*

1. *Form of notice.* Institutions may provide a change-in-term notice on or with a periodic statement or in another mailing. If an institution provides notice through revised account disclosures, the changed term must be highlighted in some manner. For example, institutions may note that a particular fee has been changed (also specifying the new amount) or use an accompanying letter that refers to the changed term.

2. *Effective date.* An example of language for disclosing the effective date of a change is ''As of November 21, 1994.''

3. *Terms that change upon the occurrence of an event.* An institution offering terms that will automatically change upon the occurrence of a stated event need not send an advance notice of the change provided the institution fully describes the conditions of the change in the account opening disclosures (and sends any change-in-term notices regardless of whether the changed term affects that consumer's account at that time).

4. *Examples.* Examples of changes not requiring an advance change-in-terms notice are:

i. The termination of employment for consumers for whom account maintenance or activity fees were waived during their employment by the depository institution

ii. The expiration of one year in a promotion described in the account opening disclosures to ''waive $4.00 monthly service charges for one year''

*(a)(2) No notice required*

*(a)(2)(ii) Check printing fees*

1. *Increase in fees.* A notice is not required for an increase in fees for printing checks (or deposit and withdrawal slips) even if the institution adds some amount to the price charged by the vendor.

*(b) Notice before maturity for time accounts longer than one month that renew automatically*

1. *Maturity dates on nonbusiness days.* In determining the term of a time account, institutions may disregard the fact that the term will be extended beyond the disclosed number of days because the disclosed maturity falls on a nonbusiness day. For example, a holiday or weekend may cause a ''one-year'' time account to extend beyond 365 days (or 366, in a leap year) or a ''one-month'' time account to extend beyond 31 days.

2. *Disclosing when rates will be determined.* Ways to disclose when the annual percentage yield will be available include the use of:

i. A specific date, such as ''October 28''

ii. A date that is easily determinable, such as ''the Tuesday before the maturity date stated on this notice'' or ''as of the maturity date stated on this notice''

3. *Alternative timing rule.* Under the alternative timing rule, an institution offering a 10-day grace period would have to provide the disclosures at least 10 days prior to the scheduled maturity date.

4. *Club accounts.* If consumers have agreed to the transfer of payments from another account to a club time account for the next club period, the institution must comply with the requirements for automatically renewable time accounts—even though consumers may withdraw funds from the club account at the end of the current club period.

5. *Renewal of a time account.* In the case of a change in terms that becomes effective if a rollover time account is subsequently renewed:

i. If the change is initiated by the institution, the disclosure requirements of this paragraph apply. (Paragraph 230.5(a) applies if the change becomes effective prior to the maturity of the existing time account.)

ii. If the change is initiated by the consumer, the account opening disclosure requirements of §230.4(b) apply. (If the notice required by this paragraph has been provided, institutions may give new account disclosures or disclosures highlighting only the new term.)

6. *Example.* If a consumer receives a prematurity notice on a one-year time account

and requests a rollover to a six-month account, the institution must provide either account opening disclosures including the new maturity date or, if all other terms previously disclosed in the prematurity notice remain the same, only the new maturity date.

*(b)(1) Maturities of longer than one year*

1. *Highlighting changed terms.* Institutions need not highlight terms that changed since the last account disclosures were provided.

*(c) Notice for time accounts one month or less that renew automatically*

*(d) Notice before maturity for time accounts longer than one year that do not renew automatically*

1. *Subsequent account.* When funds are transferred following maturity of a nonrollover time account, institutions need not provide account disclosures unless a new account is established.

Section 230.6 Periodic statement disclosures

*(a) General rule*

1. *General.* Institutions are not required to provide periodic statements. If they do provide statements, disclosures need only be furnished to the extent applicable. For example, if no interest is earned for a statement period, institutions need not state that fact. Or, institutions may disclose ''$0'' interest earned and ''0%'' annual percentage yield earned.

2. *Regulation E interim statements.* When an institution provides regular quarterly statements, and in addition provides a monthly interim statement to comply with Regulation E, the interim statement need not comply with this section unless it states interest or rate information. (See 12 CFR §205.9(b).)

3. *Combined statements.* Institutions may provide information about an account (such as an MMDA) on the periodic statement for another account (such as a NOW account) without triggering the disclosures required by this section, as long as:

i. The information is limited to the account number, the type of account, or balance information, and

ii. The institution also provides a periodic statement complying with this section for each account.

4. *Other information.* Additional information that may be given on or with a periodic statement includes:

i. Interest rates and corresponding periodic rates applied to balances during the statement period

ii. The dollar amount of interest earned year-to-date

iii. Bonuses paid (or any de minimis consideration of $10 or less)

iv. Fees for products such as safe deposit boxes

*(a)(1) Annual percentage yield earned*

1. *Ledger and collected balances.* Institutions that accrue interest using the collected balance method may use either the ledger or the collected balance in determining the annual percentage yield earned.

*(a)(2) Amount of interest*

1. *Accrued interest.* Institutions must state the amount of interest that accrued during the statement period, even if it was not credited.

2. *Terminology.* In disclosing interest earned for the period, institutions must use the term ''interest'' or terminology such as:

i. ''Interest paid,'' to describe interest that has been credited

ii. ''Interest accrued'' or ''interest earned,'' to indicate that interest is not yet credited

3. *Closed accounts.* If consumers close an account between crediting periods and forfeits accrued interest, the institution may not show any figures for interest earned or annual percentage yield earned for the period (other than zero, at the institution's option).

*(a)(3) Fees imposed*

1. *General.* Periodic statements must state fees disclosed under §230.4(b) that were debited to the account during the statement period, even if assessed for an earlier period.

2. *Itemizing fees by type.* In itemizing fees imposed more than once in the period, institutions may group fees if they are the same type. (See §230.11(a)(1) of this part regarding certain fees that are required to be grouped when an institution promotes the payment of overdrafts.) When fees of the same type are grouped together, the description must make clear that the dollar figure represents more than a single fee, for example, ''total fees for checks written this period.'' Examples of fees that may not be grouped together are—

i. Monthly maintenance and excess-activity fees

ii. ''transfer'' fees, if different dollar amounts are imposed'' such as $.50 for deposits and $1.00 for withdrawals

iii. fees for electronic fund transfers and fees for other services, such as balance-inquiry or maintenance fees

iv. fees for paying overdrafts and fees for returning checks or other items unpaid

3. *Identifying fees.* Statement details must enable consumers to identify the specific fee. For example:

i. Institutions may use a code to identify a particular fee if the code is explained on the periodic statement or in documents accompanying the statement.

ii. Institutions using debit slips may disclose the date the fee was debited on the periodic statement and show the amount and type of fee on the dated debit slip.

4. *Relation to Regulation E.* Disclosure of fees in compliance with Regulation E complies with this section for fees related to

electronic fund transfers (for example, totaling all electronic funds transfer fees in a single figure).

*(a)(4) Length of period*

1. *General*. Institutions providing the beginning and ending dates of the period must make clear whether both dates are included in the period.

2. *Opening or closing an account mid-cycle*. If an account is opened or closed during the period for which a statement is sent, institutions must calculate the annual percentage yield earned based on account balances for each day the account was open.

*(b) Special rule for average daily balance method*

1. *Monthly statements and quarterly compounding*. This rule applies, for example, when an institution calculates interest on a quarterly average daily balance and sends monthly statements. In this case, the first two monthly statements would omit annual percentage yield earned and interest earned figures; the third monthly statement would reflect the interest earned and the annual percentage yield earned for the entire quarter.

2. *Length of the period*. Institutions must disclose the length of both the interest calculation period and the statement period. For example, a statement could disclose a statement period of April 16 through May 15 and further state that ''the interest earned and the annual percentage yield earned are based on your average daily balance for the period April 1 through April 30.''

3. *Quarterly statements and monthly compounding*. Institutions that use the average daily balance method to calculate interest on a monthly basis and that send statements on a quarterly basis may disclose a single interest (and annual percentage yield earned) figure. Alternatively, an institution may disclose three interest and three annual percentage yield earned figures, one for each month in the quarter, as long as the institution states the number of days (or beginning and ending dates) in the interest period if different from the statement period.

Section 230.7 Payment of interest

*(a)(1) Permissible methods*

1. *Prohibited calculation methods*. Calculation methods that do not comply with the requirement to pay interest on the full amount of principal in the account each day include:

i. Paying interest on the balance in the account at the end of the period (the ''ending balance'' method)

ii. Paying interest for the period based on the lowest balance in the account for any day in that period (the ''low balance'' method)

iii. Paying interest on a percentage of the balance, excluding the amount set aside for reserve requirements (the ''investable balance'' method)

2. *Use of 365-day basis*. Institutions may apply a daily periodic rate greater than 1/365 of the interest rate—such as 1/360 of the interest rate—as long as it is applied 365 days a year.

3. *Periodic interest payments*. An institution can pay interest each day on the account and still make uniform interest payments. For example, for a one-year certificate of deposit an institution could make monthly interest payments equal to 1/12 of the amount of interest that will be earned for a 365-day period (or 11 uniform monthly payments—each equal to roughly 1/12 of the total amount of interest—and one payment that accounts for the remainder of the total amount of interest earned for the period).

4. *Leap year*. Institutions may apply a daily rate of 1/366 or 1/365 of the interest rate for 366 days in a leap year, if the account will earn interest for February 29.

5. *Maturity of time accounts*. Institutions are not required to pay interest after time accounts mature. (See 12 CFR part 217, the Board's Regulation Q, for limitations on duration of interest payments.) Examples include:

i. During a grace period offered for an automatically renewable time account, if consumers decide during that period not to renew the account

ii. Following the maturity of nonrollover time accounts

iii. When the maturity date falls on a holiday, and consumers must wait until the next business day to obtain the funds

6. *Dormant accounts*. Institutions must pay interest on funds in an account, even if inactivity or the infrequency of transactions would permit the institution to consider the account to be ''inactive'' or ''dormant'' (or similar status) as defined by state or other law or the account contract.

*(a)(2) Determination of minimum balance to earn interest*

1. *Daily balance accounts*. Institutions that require a minimum balance may choose not to pay interest for days when the balance drops below the required minimum, if they use the daily balance method to calculate interest.

2. *Average daily balance accounts*. Institutions that require a minimum balance may choose not to pay interest for the period in which the balance drops below the required minimum, if they use the average daily balance method to calculate interest.

3. *Beneficial method*. Institutions may not require that consumers maintain both a minimum daily balance and a minimum average daily balance to earn interest, such as by requiring consumers to maintain a $500 daily balance and a prescribed average daily balance (whether higher or lower). But an institution could offer a minimum balance to

earn interest that includes an additional method that is ''unequivocally beneficial'' to consumers such as the following: An institution using the daily balance method to calculate interest and requiring a $500 minimum daily balance could offer to pay interest on the account for those days the minimum balance is not met as long as consumers maintain an average daily balance throughout the month of $400.

4. *Paying on full balance.* Institutions must pay interest on the full balance in the account that meets the required minimum balance. For example, if $300 is the minimum daily balance required to earn interest, and a consumer deposits $500, the institution must pay the stated interest rate on the full $500 and not just on $200.

5. *Negative balances prohibited.* Institutions must treat a negative account balance as zero to determine:

i. The daily or average daily balance on which interest will be paid

ii. Whether any minimum balance to earn interest is met

6. *Club accounts.* Institutions offering club accounts (such as a ''holiday'' or ''vacation'' club) cannot impose a minimum balance requirement for interest based on the total number or dollar amount of payments required under the club plan. For example, if a plan calls for $10 weekly payments for 50 weeks, the institution cannot set a $500 ''minimum balance'' and then pay interest only if the consumer has made all 50 payments.

7. *Minimum balances not affecting interest.* Institutions may use the daily balance, average daily balance, or any other computation method to calculate minimum balance requirements not involving the payment of interest—such as to compute minimum balances for assessing fees.

*(b) Compounding and crediting policies*

1. *General.* Institutions choosing to compound interest may compound or credit interest annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis.

2. *Withdrawals prior to crediting date.* If consumers withdraw funds (without closing the account) prior to a scheduled crediting date, institutions may delay paying the accrued interest on the withdrawn amount until the scheduled crediting date, but may not avoid paying interest.

3. *Closed accounts.* Subject to state or other law, an institution may choose not to pay accrued interest if consumers close an account prior to the date accrued interest is credited, as long as the institution has disclosed that fact.

*(c) Date interest begins to accrue*

1. *Relation to Regulation CC.* Institutions may rely on the Expedited Funds Availability Act (EFAA) and Regulation CC (12 CFR part 229) to determine, for example, when a deposit is considered made for purposes of interest accrual, or when interest need not be paid on funds because a deposited check is later returned unpaid.

2. *Ledger and collected balances.* Institutions may calculate interest by using a ''ledger'' or ''collected'' balance method, as long as the crediting requirements of the EFAA are met (12 CFR 229.14).

3. *Withdrawal of principal.* Institutions must accrue interest on funds until the funds are withdrawn from the account. For example, if a check is debited to an account on a Tuesday, the institution must accrue interest on those funds through Monday.

Section 230.8 Advertising

*(a) Misleading or inaccurate advertisements*

1. *General.* All advertisements are subject to the rule against misleading or inaccurate advertisements, even though the disclosures applicable to various media differ.

2. *Indoor signs.* An indoor sign advertising an annual percentage yield is not misleading or inaccurate when:

i. For a tiered-rate account, it also provides the lower dollar amount of the tier corresponding to the advertised annual percentage yield

ii. For a time account, it also provides the term required to obtain the advertised annual percentage yield

3. *Fees affecting ''free'' accounts.* For purposes of determining whether an account can be advertised as ''free'' or ''no cost,'' maintenance and activity fees include:

i. Any fee imposed when a minimum balance requirement is not met, or when consumers exceed a specified number of transactions

ii. Transaction and service fees that consumers reasonably expect to be imposed on a regular basis

iii. A flat fee, such as a monthly service fee

iv. Fees imposed to deposit, withdraw, or transfer funds, including per-check or per-transaction charges (for example, $.25 for each withdrawal, whether by check or in person)

4. *Other fees.* Examples of fees that are not maintenance or activity fees include:

i. Fees not required to be disclosed under § 230.4(b)(4)

ii. Check printing fees

iii. Balance inquiry fees

iv. Stop-payment fees and fees associated with checks returned unpaid

v. Fees assessed against a dormant account

vi. Fees for ATM or electronic transfer services (such as preauthorized transfers or home banking services) not required to obtain an account

5. *Similar terms.* An advertisement may not use the term ''fees waived'' if a maintenance or activity fee may be imposed because it is similar to the terms ''free'' or ''no cost.''

6. *Specific account services*. Institutions may advertise a specific account service or feature as free if no fee is imposed for that service or feature. For example, institutions offering an account that is free of deposit or withdrawal fees could advertise that fact, as long as the advertisement does not mislead consumers by implying that the account is free and that no other fee (a monthly service fee, for example) may be charged.

7. *Free for limited time*. If an account (or a specific account service) is free only for a limited period of time—for example, for one year following the account opening—the account (or service) may be advertised as free if the time period is also stated.

8. *Conditions not related to deposit accounts*. Institutions may advertise accounts as ''free'' for consumers meeting conditions not related to deposit accounts, such as the consumer's age. For example, institutions may advertise a NOW account as ''free for persons over 65 years old,'' even though a maintenance or activity fee is assessed on accounts held by consumers 65 or younger.

9. *Electronic advertising*. If an electronic advertisement (such as an advertisement appearing on an Internet Web site) displays a triggering term (such as a bonus or annual percentage yield) the advertisement must clearly refer the consumer to the location where the additional required information begins. For example, an advertisement that includes a bonus or annual percentage yield may be accompanied by a link that directly takes the consumer to the additional information.

10. *Examples*. Examples of advertisements that would ordinarily be misleading, inaccurate, or misrepresent the deposit contract are:

i. Representing an overdraft service as a ''line of credit,'' unless the service is subject to the Board's Regulation Z, 12 CFR part 226.

ii. Representing that the institution will honor all checks or authorize payment of all transactions that overdraw an account, with or without a specified dollar limit, when the institution retains discretion at any time not to honor checks or authorize transactions.

iii. Representing that consumers with an overdrawn account are allowed to maintain a negative balance when the terms of the account's overdraft service require consumers promptly to return the deposit account to a positive balance.

iv. Describing an institution's overdraft service solely as protection against bounced checks when the institution also permits overdrafts for a fee for overdrawing their accounts by other means, such as ATM withdrawals, debit card transactions, or other electronic fund transfers.

v. Advertising an account-related service for which the institution charges a fee in an advertisement that also uses the word ''free'' or ''no cost'' (or a similar term) to describe the account, unless the advertisement clearly and conspicuously indicates that there is a cost associated with the service. If the fee is a maintenance or activity fee under §230.8(a)(2) of this part, however, an advertisement may not describe the account as ''free'' or ''no cost'' (or contain a similar term) even if the fee is disclosed in the advertisement.

11. *Additional disclosures in connection with the payment of overdrafts*. The rule in §230.3(a), providing that disclosures required by §230.8 may be provided to the consumer in electronic form without regard to E-Sign Act requirements, applies to the disclosures described in §230.11(b), which are incorporated by reference in §230.8(f).

*(b) Permissible rates*

1. *Tiered-rate accounts*. An advertisement for a tiered-rate account that states an annual percentage yield must also state the annual percentage yield for each tier, along with corresponding minimum balance requirements. Any interest rates stated must appear in conjunction with the applicable annual percentage yields for each tier.

2. *Stepped-rate accounts*. An advertisement that states an interest rate for a stepped-rate account must state all the interest rates and the time period that each rate is in effect.

3. *Representative examples*. An advertisement that states an annual percentage yield for a given type of account (such as a time account for a specified term) need not state the annual percentage yield applicable to other time accounts offered by the institution or indicate that other maturity terms are available. In an advertisement stating that rates for an account may vary depending on the amount of the initial deposit or the term of a time account, institutions need not list each balance level and term offered. Instead, the advertisement may:

i. Provide a representative example of the annual percentage yields offered, clearly described as such. For example, if an institution offers a $25 bonus on all time accounts and the annual percentage yield will vary depending on the term selected, the institution may provide a disclosure of the annual percentage yield as follows: ''For example, our 6-month certificate of deposit currently pays a 3.15% annual percentage yield.''

ii. Indicate that various rates are available, such as by stating short-term and longer-term maturities along with the applicable annual percentage yields: ''We offer certificates of deposit with annual percentage yields that depend on the maturity you choose. For example, our one-month CD earns a 2.75% APY. Or, earn a 5.25% APY for a three-year CD.''

*(c) When additional disclosures are required*

1. *Trigger terms.* The following are examples of information stated in advertisements that are not ''trigger'' terms:

i. ''One, three, and five year CDs available''

ii. ''Bonus rates available''

iii. ''1% over our current rates,'' so long as the rates are not determinable from the advertisement

*(2) Time annual percentage yield is offered*

1. *Specified date.* If an advertisement discloses an annual percentage yield as of a specified date, that date must be recent in relation to the publication or broadcast frequency of the media used, taking into account the particular circumstances or production deadlines involved. For example, the printing date of a brochure printed once for a deposit account promotion that will be in effect for six months would be considered ''recent,'' even though rates change during the six-month period. Rates published in a daily newspaper or on television must reflect rates offered shortly before (or on) the date the rates are published or broadcast.

2. *Reference to date of publication.* An advertisement may refer to the annual percentage yield as being accurate as of the date of publication, if the date is on the publication itself. For instance, an advertisement in a periodical may state that a rate is ''current through the date of this issue,'' if the periodical shows the date.

*(c)(5) Effect of fees*

1. *Scope.* This requirement applies only to maintenance or activity fees described in paragraph 8(a).

*(c)(6) Features of time accounts*

*(c)(6)(i) Time requirements*

1. *Club accounts.* If a club account has a maturity date but the term may vary depending on when the account is opened, institutions may use a phrase such as: ''The maturity date of this club account is November 15; its term varies depending on when the account is opened.''

*(c)(6)(ii) Early withdrawal penalties*

1. *Discretionary penalties.* Institutions imposing early withdrawal penalties on a case-by-case basis may disclose that they ''may'' (rather than ''will'') impose a penalty if such a disclosure accurately describes the account terms.

*(d) Bonuses*

1. *General reference to ''bonus.''* General statements such as ''bonus checking'' or ''get a bonus when you open a checking account'' do not trigger the bonus disclosures.

*(e) Exemption for certain advertisements*

*(e)(1) Certain media*

*(e)(1)(i)*

1. *Internet advertisements.* The exemption for advertisements made through broadcast or electronic media does not extend to advertisements posted on the Internet or sent by e-mail.

*(e)(1)(iii)*

1. *Tiered-rate accounts.* Solicitations for a tiered-rate account made through telephone response machines must provide the annual percentage yields and the balance requirements applicable to each tier.

*(e)(2) Indoor signs*

*(e)(2)(i)*

1. *General.* Indoor signs include advertisements displayed on computer screens, banners, preprinted posters, and chalk or peg boards. Any advertisement inside the premises that can be retained by a consumer (such as a brochure or a printout from a computer) is not an indoor sign.

Section 230.9 Enforcement and record retention

*(c) Record retention*

1. *Evidence of required actions.* Institutions comply with the regulation by demonstrating that they have done the following:

i. Established and maintained procedures for paying interest and providing timely disclosures as required by the regulation, and

ii. Retained sample disclosures for each type of account offered to consumers, such as account-opening disclosures, copies of advertisements, and change-in-term notices; and information regarding the interest rates and annual percentage yields offered.

2. *Methods of retaining evidence.* Institutions must be able to reconstruct the required disclosures or other actions. They need not keep disclosures or other business records in hard copy. Records evidencing compliance may be retained on microfilm, microfiche, or by other methods that reproduce records accurately (including computer files).

3. *Payment of interest.* Institutions must retain sufficient rate and balance information to permit the verification of interest paid on an account, including the payment of interest on the full principal balance.

Section 230.10 Electronic Communication [Reserved]

Section 230.11 Additional disclosure requirements for institutions advertising the payment of overdrafts

*(a) Periodic statement disclosures.*

*(a)(1) Disclosure of total fees.*

1. *Examples of institutions advertising the payment of overdrafts.* An institution would trigger the periodic statement disclosures if it:

i. Promotes the institution's policy or practice of paying some overdrafts (unless the service would be subject to the Board's Regulation Z (12 CFR part 226)), in advertisements using broadcast media, brochures, telephone solicitations or electronic mail, or on Internet sites, ATM screens or receipts, billboards, or indoor signs. (But see §230.11(a)(2) of this part regarding communications about the payment of overdrafts

that would not trigger periodic statement disclosures);

ii. Includes a message on a periodic statement informing the consumer of an overdraft limit or the amount of funds available for overdrafts. For example, an institution that includes a message on a periodic statement informing the consumer of a $500 overdraft limit or that the consumer has $300 remaining on the overdraft limit, is promoting an overdraft service;

iii. Discloses an overdraft limit or includes the dollar amount of an overdraft limit in a balance disclosed by any means, including on an ATM receipt or on an automated system, such as a telephone response machine, ATM screen, or the institution's Internet site.

2. *Applicability of periodic statement disclosures.* The periodic statement disclosures apply to all accounts for which the institution has advertised the payment of overdrafts. For example, if an advertisement promoting the payment of overdrafts specifies the types of accounts to which the advertisement applies, the institution would not be required to provide the periodic statement disclosures for other types of accounts offered by the institution for which the advertisement does not apply. If an advertisement does not specify the types of accounts to which it applies, the advertisement would be considered to apply to all of an institution's deposit accounts.

3. *Transfer services.* The overdraft services covered by §230.11(a)(1) of this part do not include a service providing for the transfer of funds from another deposit account of the consumer to permit the payment of items without creating an overdraft, even if a fee is charged for the transfer.

4. *Fees for paying overdrafts.* An institution that advertises the payment of overdrafts must disclose on periodic statements a total dollar amount for all fees charged to the account for paying overdrafts. The institution must disclose separate totals for the statement period and for the calendar year to date. The total dollar amount includes per-item fees as well as interest charges, daily or other periodic fees, or fees charged for maintaining an account in overdraft status, whether the overdraft is by check or by other means. It also includes fees charged when there are insufficient funds because previously deposited funds are subject to a hold or are uncollected. It does not include fees for transferring funds from another account to avoid an overdraft, or fees charged when the institution has previously agreed in writing to pay items that overdraw the account and the service is subject to the Board's Regulation Z, 12 CFR part 226.

5. *Fees for returning items unpaid.* An institution that advertises the payment of overdrafts must disclose a total dollar amount for all fees charged to the account for dishonoring or returning checks or other items drawn on the account. The institution must disclose separate totals for the statement period and for the calendar year to date. Fees imposed when deposited items are returned are not included.

6. *Waived fees.* In some cases, an institution may provide a statement for the current period reflecting that fees imposed during a previous period were waived and credited to the account. Institutions may, but are not required to, reflect the adjustment in the total for the calendar year to date. Such adjustments should not affect the total disclosed for fees imposed during the current statement period.

7. *Totals for the calendar year to date.* Some institutions' statement periods do not coincide with the calendar month. In such cases, the institution may disclose a calendar year-to-date total by aggregating fees for 12 monthly cycles, starting with the period that begins during January and finishing with the period that begins during December. For example, if statement periods begin on the 10th day of each month, the statement covering December 10, 2006 through January 9, 2007 may disclose the year-to-date total for fees imposed from January 10, 2006 through January 9, 2007. Alternatively, the institution could provide a statement for the cycle ending January 9, 2007 showing the year-to-date total for fees imposed January 1, 2006 through December 31, 2006.

8. *Itemization of fees.* An institution may itemize each fee in addition to providing the disclosures required by §230.11(a)(1) of this part.

*(a)(3) Time period covered by disclosures*

1. *Periodic statement disclosures.* The disclosures under §230.11(a)(1) of this part must be included on periodic statements provided by an institution reflecting the first statement period that begins after the institution advertises the payment of overdrafts. For example, if a consumer's statement period typically closes on the 15th of each month, an institution that promotes the payment of overdrafts on July 1, 2006 must provide the disclosures required by §230.11(a)(1) of this part on subsequent periodic statements for that consumer beginning with the statement reflecting the period from July 16, 2006 through August 15, 2006. Only depository institutions that promote the payment of overdrafts in an advertisement on or after July 1, 2006 must provide disclosures on periodic statements under §230.11(a)(1) of this part.

*(a)(5) Acquired accounts*

1. *Examples.* As provided in §230.11(a)(5) of this part, an institution that acquires deposit accounts through merger or acquisition must provide the disclosures required by paragraph (a)(1) of this section for the first statement period that begins after the institution promotes the payment of overdrafts in an advertisement that applies to the acquired account. If the acquiring institution

does not advertise the payment of overdrafts, or the advertisement does not apply to the acquired accounts, the institution need not provide the disclosures required by §230.11(a)(1) of this part for the acquired accounts even if the depository institution that previously held the accounts advertised the payment of overdrafts with respect to those accounts.

*(b) Advertising Disclosures in Connection With Overdraft Services*

1. *Examples of institutions promoting the payment of overdrafts.* A depository institution would be required to include the advertising disclosures in §230.11(b)(1) of this part if the institution:

i. Promotes the institution's policy or practice of paying overdrafts (unless the service would be subject to the Board's Regulation Z (12 CFR part 226)). This includes advertisements using print media such as newspapers or brochures, telephone solicitations, electronic mail, or messages posted on an Internet site. (But see §230.11(b)(2) of this part for communications that are not subject to the additional advertising disclosures);

ii. Includes a message on a periodic statement informing the consumer of an overdraft limit or the amount of funds available for overdrafts. For example, an institution that includes a message on a periodic statement informing the consumer of a $500 overdraft limit or that the consumer has $300 remaining on the overdraft limit, is promoting an overdraft service.

iii. Discloses an overdraft limit or includes the dollar amount of an overdraft limit in a balance disclosed on an automated system, such as a telephone response machine, ATM screen or the institution's Internet site. (See, however, §230.11(b)(3) of this part.).

2. *Transfer services.* The overdraft services covered by §230.11(b)(1) of this part do not include a service providing for the transfer of funds from another deposit account of the consumer to permit the payment of items without creating an overdraft, even if a fee is charged for the transfer.

3. *Electronic media.* The exception for advertisements made through broadcast or electronic media, such as television or radio, does not apply to advertisements posted on an institution's Internet site, on an ATM screen, provided on telephone response machines, or sent by electronic mail.

4. *Fees.* The fees that must be disclosed under §230.11(b)(1) of this part include per-item fees as well as interest charges, daily or other periodic fees, and fees charged for maintaining an account in overdraft status, whether the overdraft is by check or by other means. The fees also include fees charged when there are insufficient funds because previously deposited funds are subject to a hold or are uncollected. The fees do not include fees for transferring funds from another account to avoid an overdraft, or fees charged when the institution has previously agreed in writing to pay items that overdraw the account and the service is subject to the Board's Regulation Z, 12 CFR part 226.

5. *Categories of transactions.* An exhaustive list of transactions is not required. Disclosing that a fee may be imposed for covering overdrafts ''created by check, in-person withdrawal, ATM withdrawal, or other electronic means' would satisfy the requirements of §230.11(b)(1)(ii) of this part where the fee may be imposed in these circumstances. See comment 4(b)(4)–5 of this part.

6. *Time period to repay.* If a depository institution reserves the right to require a consumer to pay an overdraft immediately or on demand instead of affording consumers a specific time period to establish a positive balance in the account, an institution may comply with §230.11(b)(1)(iii) of this part by disclosing this fact.

7. *Circumstances for nonpayment.* An institution must describe the circumstances under which it will not pay an overdraft. It is sufficient to state, as applicable: ''Whether your overdrafts will be paid is discretionary and we reserve the right not to pay. For example, we typically do not pay overdrafts if your account is not in good standing, or you are not making regular deposits, or you have too many overdrafts.''

8. *Advertising an account as ''free.''* If the advertised account-related service is an overdraft service subject to the requirements of §230.11(b)(1) of this part, institutions must disclose the fee or fees for the payment of each overdraft, not merely that a cost is associated with the overdraft service, as well as other required information. Compliance with comment 8(a)–10.v. is not sufficient.

## APPENDIX A TO PART 230—ANNUAL PERCENTAGE YIELD CALCULATION

*Part I. Annual Percentage Yield for Account Disclosures and Advertising Purposes*

1. *Rounding for calculations.* The following are examples of permissible rounding for calculating interest and the annual percentage yield:

i. The daily rate applied to a balance carried to five or more decimal places

ii. The daily interest earned carried to five or more decimal places

*Part II. Annual Percentage Yield Earned for Periodic Statements*

1. *Balance method.* The interest figure used in the calculation of the annual percentage yield earned may be derived from the daily balance method or the average daily balance method. The balance used in the formula for the annual percentage yield earned is the

sum of the balances for each day in the period divided by the number of days in the period.

2. *Negative balances prohibited*. Institutions must treat a negative account balance as zero to determine the balance on which the annual percentage yield earned is calculated. (See commentary to §230.7(a)(2).)

*A. General Formula*

1. *Accrued but uncredited interest*. To calculate the annual percentage yield earned, accrued but uncredited interest:

i. May not be included in the balance for statements issued at the same time or less frequently than the account's compounding and crediting frequency. For example, if monthly statements are sent for an account that compounds interest daily and credits interest monthly, the balance may not be increased each day to reflect the effect of daily compounding.

ii. Must be included in the balance for succeeding statements if a statement is issued more frequently than compounded interest is credited on an account. For example, if monthly statements are sent for an account that compounds interest daily and credits interest quarterly, the balance for the second monthly statement would include interest that had accrued for the prior month.

2. *Rounding*. The interest earned figure used to calculate the annual percentage yield earned must be rounded to two decimals and reflect the amount actually paid. For example, if the interest earned for a statement period is $20.074 and the institution pays the consumer $20.07, the institution must use $20.07 (not $20.074) to calculate the annual percentage yield earned. For accounts paying interest based on the daily balance method that compound and credit interest quarterly, and send monthly statements, the institution may, but need not, round accrued interest to two decimals for calculating the annual percentage yield earned on the first two monthly statements issued during the quarter. However, on the quarterly statement the interest earned figure must reflect the amount actually paid.

*B. Special Formula for Use Where Periodic Statement is Sent More Often Than the Period for Which Interest is Compounded*

1. *Statements triggered by Regulation E*. Institutions may, but need not, use this formula to calculate the annual percentage yield earned for accounts that receive quarterly statements and are subject to Regulation E's rule calling for monthly statements when an electronic fund transfer has occurred. They may do so even though no monthly statement was issued during a specific quarter. But institutions must use this formula for accounts that compound and credit interest quarterly and receive monthly statements that, while triggered by Regulation E, comply with the provisions of §230.6.

2. *Days in compounding period*. Institutions using the special annual percentage yield earned formula must use the actual number of days in the compounding period.

## APPENDIX B TO PART 230—MODEL CLAUSES AND SAMPLE FORMS

1. *Modifications*. Institutions that modify the model clauses will be deemed in compliance as long as they do not delete required information or rearrange the format in a way that affects the substance or clarity of the disclosures.

2. *Format*. Institutions may use inserts to a document (see Sample Form B–4) or fill-in blanks (see Sample Forms B–5, B–6 and B–7, which use underlining to indicate terms that have been filled in) to show current rates, fees, or other terms.

3. *Disclosures for opening accounts*. The sample forms illustrate the information that must be provided to consumers when an account is opened, as required by §230.4(a)(1). (See §230.4(a)(2), which states the requirements for disclosing the annual percentage yield, the interest rate, and the maturity of a time account in responding to a consumer's request.)

4. *Compliance with Regulation E*. Institutions may satisfy certain requirements under Regulation DD with disclosures that meet the requirements of Regulation E. (See §230.3(c).) For disclosures covered by both this regulation and Regulation E (such as the amount of fees for ATM usage, institutions should consult appendix A to Regulation E for appropriate model clauses.

5. *Duplicate disclosures*. If a requirement such as a minimum balance applies to more than one account term (to obtain a bonus and determine the annual percentage yield, for example), institutions need not repeat the requirement for each term, as long as it is clear which terms the requirement applies to.

6. *Sample forms*. The sample forms (B–4 through B–8) serve a purpose different from the model clauses. They illustrate ways of adapting the model clauses to specific accounts. The clauses shown relate only to the specific transactions described.

*B–1 Model Clauses for Account Disclosures*

*B–1(h) Disclosures Relating to Time Accounts*

1. *Maturity*. The disclosure in Clause (h)(i) stating a specific date may be used in all cases. The statement describing a time period is appropriate only when providing disclosures in response to a consumer's request.

*B–2 Model Clauses for Change in Terms*

1. *General*. The second clause, describing a future decrease in the interest rate and annual percentage yield, applies to fixed-rate accounts only.

*B–4 Sample Form (Multiple Accounts)*

1. *Rate sheet insert*. In the rate sheet insert, the calculations of the annual percentage yield for the three-month and six-month certificates are based on 92 days and 181 days respectively. All calculations in the insert assume daily compounding.

*B–6 Sample Form (Tiered-Rate Money Market Account)*

1. *General*. Sample Form B–6 uses Tiering Method A (discussed in appendix A and Clause (a)(iv)) to calculate interest. It gives a narrative description of a tiered-rate account; institutions may use different formats (for example, a chart similar to the one in Sample Form B–4), as long as all required information for each tier is clearly presented. The form does not contain a separate disclosure of the minimum balance required to obtain the annual percentage yield; the tiered-rate disclosure provides that information.

[Reg. DD, 59 FR 40221, Aug. 8, 1994, as amended at 59 FR 52658, Oct. 19, 1994; 63 FR 52107, Sept. 29, 1998; 66 FR 17803, Apr. 4, 2001; 70 FR 29594, May 24, 2005; 72 FR 63484, Nov. 9, 2007]

# PART 231—NETTING ELIGIBILITY FOR FINANCIAL INSTITUTION (REGULATION EE)

Sec.
231.1 Authority, purpose, and scope.
231.2 Definitions.
231.3 Qualification as a financial institution.

AUTHORITY: 12 U.S.C. 4402(1)(B) and 4402(9).

SOURCE: Reg. EE, 59 FR 4784, Feb. 2, 1994, unless otherwise noted.

## § 231.1 Authority, purpose, and scope.

(a) *Authority*. This part (Regulation EE; 12 CFR part 231) is issued by the Board of Governors of the Federal Reserve System under the authority of sections 402(1)(B) and 402(9) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4402(1)(B) and 4402(9)).

(b) *Purpose and scope*. The purpose of the Act and this part is to enhance efficiency and reduce systemic risk in the financial markets. This part expands the Act's definition of ''financial institution'' to allow more financial market participants to avail themselves of the netting provisions set forth in sections 401–407 of the Act (12 U.S.C. 4401–4407). This part does not affect the status of those financial institutions specifically defined in the Act.

## § 231.2 Definitions.

As used in this part, unless the context requires otherwise:

(a) *Act* means the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. 102–242, 105 Stat. 2236), as amended.

(b) *Affiliate*, with respect to a person, means any other person that controls, is controlled by, or is under common control with the person.

(c) *Financial contract* means a qualified financial contract as defined in section 11(e)(8)(D) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)(D)), as amended, except that a forward contract includes a contract with a maturity date two days or less after the date the contract is entered into (i.e., a ''spot'' contract).

(d) *Financial market* means a market for a financial contract.

(e) *Gross mark-to-market positions* in one or more financial contracts means the sum of the absolute values of positions in those contracts, adjusted to reflect the market values of those positions in accordance with the methods used by the parties to each contract to value the contract.

(f) *Person* means any legal entity, foreign or domestic, including a corporation, unincorporated company, partnership, government unit or instrumentality, trust, natural person, or any other entity or organization.

## § 231.3 Qualification as a financial institution.

(a) A person qualifies as a financial institution for purposes of sections 401–407 of the Act if it represents, orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and either—

(1) Had one or more financial contracts of a total gross dollar value of at least $1 billion in notional principal amount outstanding on any day during the previous 15-month period with

counterparties that are not its affiliates; or

(2) Had total gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.

(b) If a person qualifies as a financial institution under paragraph (a) of this section, that person will be considered a financial institution for the purposes of any contract entered into during the period it qualifies, even if the person subsequently fails to qualify.

(c) If a person qualifies as a financial institution under paragraph (a) of this section on March 7, 1994, that person will be considered a financial institution for the purposes of any outstanding contract entered into prior to March 7, 1994.

[Reg. EE, 59 FR 4784, Feb. 2, 1994, as amended at 61 FR 1274, Jan. 19, 1996]

# PART 232—OBTAINING AND USING MEDICAL INFORMATION IN CONNECTION WITH CREDIT (REGULATION FF)

Sec.

232.1 Scope, General Prohibition and Definitions
232.2 Rule of Construction for Obtaining and Using Unsolicited Medical Information
232.3 Financial Information Exception for Obtaining and Using Medical Information
232.4 Specific Exceptions for Obtaining and Using Medical Information

AUTHORITY: 15 U.S.C. 1681b.

SOURCE: 70 FR 70682, Nov. 22, 2005, unless otherwise noted.

## § 232.1 Scope, General Prohibition and Definitions

(a) *Scope*. This part applies to creditors, as defined in paragraph (c)(3) of this section, except for creditors that are subject to §§ 41.30, 222.30, 334.30, 571.30, or 717.30.

(b) *In general*. A creditor may not obtain or use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit, except as provided in this section.

(c) *Definitions*. (1) *Consumer* means an individual.

(2) *Credit* has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(3) *Creditor* has the same meaning as in section 702 of the Equal Credit Opportunity Act, 15 U.S.C. 1691a.

(4) *Eligibility, or continued eligibility, for credit* means the consumer's qualification or fitness to receive, or continue to receive, credit, including the terms on which credit is offered. The term does not include:

(i) Any determination of the consumer's qualification or fitness for employment, insurance (other than a credit insurance product), or other non-credit products or services;

(ii) Authorizing, processing, or documenting a payment or transaction on behalf of the consumer in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit; or

(iii) Maintaining or servicing the consumer's account in a manner that does not involve a determination of the consumer's eligibility, or continued eligibility, for credit.

(5) *Medical information* means:

(i) Information or data, whether oral or recorded, in any form or medium, created by or derived from a health care provider or the consumer, that relates to—

(A) The past, present, or future physical, mental, or behavioral health or condition of an individual;

(B) The provision of health care to an individual; or

(C) The payment for the provision of health care to an individual.

(ii) The term does not include:

(A) The age or gender of a consumer;

(B) Demographic information about the consumer, including a consumer's residence address or e-mail address;

(C) Any other information about a consumer that does not relate to the physical, mental, or behavioral health or condition of a consumer, including the existence or value of any insurance policy; or

(D) Information that does not identify a specific consumer.

(6) *Person* means any individual, partnership, corporation, trust, estate cooperative, association, government or governmental subdivision or agency, or other entity.

### § 232.2 Rule of construction for obtaining and using unsolicited medical information.

(a) *In general.* A creditor does not obtain medical information in violation of the prohibition if it receives medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit without specifically requesting medical information.

(b) *Use of unsolicited medical information.* A creditor that receives unsolicited medical information in the manner described in paragraph (a) of this section may use that information in connection with any determination of the consumer's eligibility, or continued eligibility, for credit to the extent the creditor can rely on at least one of the exceptions in § 232.3 or § 232.4.

(c) *Examples.* A creditor does not obtain medical information in violation of the prohibition if, for example:

(1) In response to a general question regarding a consumer's debts or expenses, the creditor receives information that the consumer owes a debt to a hospital.

(2) In a conversation with the creditor's loan officer, the consumer informs the creditor that the consumer has a particular medical condition.

(3) In connection with a consumer's application for an extension of credit, the creditor requests a consumer report from a consumer reporting agency and receives medical information in the consumer report furnished by the agency even though the creditor did not specifically request medical information from the consumer reporting agency.

### § 232.3 Financial information exception for obtaining and using medical information.

(a) *In general.* A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit so long as:

(1) The information is the type of information routinely used in making credit eligibility determinations, such as information relating to debts, expenses, income, benefits, assets, collateral, or the purpose of the loan, including the use of proceeds;

(2) The creditor uses the medical information in a manner and to an extent that is no less favorable than it would use comparable information that is not medical information in a credit transaction; and

(3) The creditor does not take the consumer's physical, mental, or behavioral health, condition or history, type of treatment, or prognosis into account as part of any such determination.

(b) *Examples*—(1) *Examples of the types of information routinely used in making credit eligibility determinations.* Paragraph (a)(1) of this section permits a creditor, for example, to obtain and use information about:

(i) The dollar amount, repayment terms, repayment history, and similar information regarding medical debts to calculate, measure, or verify the repayment ability of the consumer, the use of proceeds, or the terms for granting credit;

(ii) The value, condition, and lien status of a medical device that may serve as collateral to secure a loan;

(iii) The dollar amount and continued eligibility for disability income, workers' compensation income, or other benefits related to health or a medical condition that is relied on as a source of repayment; or

(iv) The identity of creditors to whom outstanding medical debts are owed in connection with an application for credit, including but not limited to, a transaction involving the consolidation of medical debts.

(2) *Examples of uses of medical information consistent with the exception.* (i) A consumer includes on an application for credit information about two $20,000 debts. One debt is to a hospital; the other debt is to a retailer. The creditor contacts the hospital and the retailer to verify the amount and payment status of the debts. The creditor learns that both debts are more than 90 days past due. Any two debts of this size

that are more than 90 days past due would disqualify the consumer under the creditor's established underwriting criteria. The creditor denies the application on the basis that the consumer has a poor repayment history on outstanding debts. The creditor has used medical information in a manner and to an extent no less favorable than it would use comparable non-medical information.

(ii) A consumer indicates on an application for a $200,000 mortgage loan that she receives $15,000 in long-term disability income each year from her former employer and has no other income. Annual income of $15,000, regardless of source, would not be sufficient to support the requested amount of credit. The creditor denies the application on the basis that the projected debt-to-income ratio of the consumer does not meet the creditor's underwriting criteria. The creditor has used medical information in a manner and to an extent that is no less favorable than it would use comparable non-medical information.

(iii) A consumer includes on an application for a $10,000 home equity loan that he has a $50,000 debt to a medical facility that specializes in treating a potentially terminal disease. The creditor contacts the medical facility to verify the debt and obtain the repayment history and current status of the loan. The creditor learns that the debt is current. The applicant meets the income and other requirements of the creditor's underwriting guidelines. The creditor grants the application. The creditor has used medical information in accordance with the exception.

(3) *Examples of uses of medical information inconsistent with the exception.* (i) A consumer applies for $25,000 of credit and includes on the application information about a $50,000 debt to a hospital. The creditor contacts the hospital to verify the amount and payment status of the debt, and learns that the debt is current and that the consumer has no delinquencies in her repayment history. If the existing debt were instead owed to a retail department store, the creditor would approve the application and extend credit based on the amount and repayment history of the outstanding debt. The creditor, however, denies the application because the consumer is indebted to a hospital. The creditor has used medical information, here the identity of the medical creditor, in a manner and to an extent that is less favorable than it would use comparable non-medical information.

(ii) A consumer meets with a loan officer of a creditor to apply for a mortgage loan. While filling out the loan application, the consumer informs the loan officer orally that she has a potentially terminal disease. The consumer meets the creditor's established requirements for the requested mortgage loan. The loan officer recommends to the credit committee that the consumer be denied credit because the consumer has that disease. The credit committee follows the loan officer's recommendation and denies the application because the consumer has a potentially terminal disease. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis as part of a determination of eligibility or continued eligibility for credit.

(iii) A consumer who has an apparent medical condition, such as a consumer who uses a wheelchair or an oxygen tank, meets with a loan officer to apply for a home equity loan. The consumer meets the creditor's established requirements for the requested home equity loan and the creditor typically does not require consumers to obtain a debt cancellation contract, debt suspension agreement, or credit insurance product in connection with such loans. However, based on the consumer's apparent medical condition, the loan officer recommends to the credit committee that credit be extended to the consumer only if the consumer obtains a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third party. The credit committee agrees with the loan officer's recommendation. The loan officer informs the consumer that the consumer must obtain a debt cancellation contract, debt suspension agreement, or credit insurance product from a nonaffiliated third

party to qualify for the loan. The consumer obtains one of these products and the creditor approves the loan. The creditor has used medical information in a manner inconsistent with the exception by taking into account the consumer's physical, mental, or behavioral health, condition, or history, type of treatment, or prognosis in setting conditions on the consumer's eligibility for credit.

### § 232.4 Specific exceptions for obtaining and using medical information.

(a) *In general.* A creditor may obtain and use medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit:

(1) To determine whether the use of a power of attorney or legal representative that is triggered by a medical condition or event is necessary and appropriate or whether the consumer has the legal capacity to contract when a person seeks to exercise a power of attorney or act as legal representative for a consumer based on an asserted medical condition or event;

(2) To comply with applicable requirements of local, state, or Federal laws;

(3) To determine, at the consumer's request, whether the consumer qualifies for a legally permissible special credit program or credit-related assistance program that is—

(i) Designed to meet the special needs of consumers with medical conditions; and

(ii) Established and administered pursuant to a written plan that—

(A) Identifies the class of persons that the program is designed to benefit; and

(B) Sets forth the procedures and standards for extending credit or providing other credit-related assistance under the program;

(4) To the extent necessary for purposes of fraud prevention or detection;

(5) In the case of credit for the purpose of financing medical products or services, to determine and verify the medical purpose of a loan and the use of proceeds;

(6) Consistent with safe and sound practices, if the consumer or the consumer's legal representative specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit, to accommodate the consumer's particular circumstances, and such request is documented by the creditor;

(7) Consistent with safe and sound practices, to determine whether the provisions of a forbearance practice or program that is triggered by a medical condition or event apply to a consumer;

(8) To determine the consumer's eligibility for, the triggering of, or the reactivation of a debt cancellation contract or debt suspension agreement if a medical condition or event is a triggering event for the provision of benefits under the contract or agreement; or

(9) To determine the consumer's eligibility for, the triggering of, or the reactivation of a credit insurance product if a medical condition or event is a triggering event for the provision of benefits under the product.

(b) *Example of determining eligibility for a special credit program or credit assistance program.* A not-for-profit organization establishes a credit assistance program pursuant to a written plan that is designed to assist disabled veterans in purchasing homes by subsidizing the down payment for the home purchase mortgage loans of qualifying veterans. The organization works through mortgage lenders and requires mortgage lenders to obtain medical information about the disability of any consumer that seeks to qualify for the program, use that information to verify the consumer's eligibility for the program, and forward that information to the organization. A consumer who is a veteran applies to a creditor for a home purchase mortgage loan. The creditor informs the consumer about the credit assistance program for disabled veterans and the consumer seeks to qualify for the program. Assuming that the program complies with all applicable law, including applicable fair lending laws, the creditor may obtain and use medical information about the medical condition and disability, if any, of the consumer to determine whether the consumer

qualifies for the credit assistance program.

(c) *Examples of verifying the medical purpose of the loan or the use of proceeds.* (1) If a consumer applies for $10,000 of credit for the purpose of financing vision correction surgery, the creditor may verify with the surgeon that the procedure will be performed. If the surgeon reports that surgery will not be performed on the consumer, the creditor may use that medical information to deny the consumer's application for credit, because the loan would not be used for the stated purpose.

(2) If a consumer applies for $10,000 of credit for the purpose of financing cosmetic surgery, the creditor may confirm the cost of the procedure with the surgeon. If the surgeon reports that the cost of the procedure is $5,000, the creditor may use that medical information to offer the consumer only $5,000 of credit.

(3) A creditor has an established medical loan program for financing particular elective surgical procedures. The creditor receives a loan application from a consumer requesting $10,000 of credit under the established loan program for an elective surgical procedure. The consumer indicates on the application that the purpose of the loan is to finance an elective surgical procedure not eligible for funding under the guidelines of the established loan program. The creditor may deny the consumer's application because the purpose of the loan is not for a particular procedure funded by the established loan program.

(d) *Examples of obtaining and using medical information at the request of the consumer.* (1) If a consumer applies for a loan and specifically requests that the creditor consider the consumer's medical disability at the relevant time as an explanation for adverse payment history information in his credit report, the creditor may consider such medical information in evaluating the consumer's willingness and ability to repay the requested loan to accommodate the consumer's particular circumstances, consistent with safe and sound practices. The creditor may also decline to consider such medical information to accommodate the consumer, but may evaluate the consumer's application in accordance with its otherwise applicable underwriting criteria. The creditor may not deny the consumer's application or otherwise treat the consumer less favorably because the consumer specifically requested a medical accommodation, if the creditor would have extended the credit or treated the consumer more favorably under the creditor's otherwise applicable underwriting criteria.

(2) If a consumer applies for a loan by telephone and explains that his income has been and will continue to be interrupted on account of a medical condition and that he expects to repay the loan liquidating assets, the creditor may, but is not required to, evaluate the application using the sale of assets as the primary source of repayment, consistent with safe and sound practices, provided that the creditor documents the consumer's request by recording the oral conversation or making a notation of the request in the consumer's file.

(3) If a consumer applies for a loan and the application form provides a space where the consumer may provide any other information or special circumstances, whether medical or nonmedical, that the consumer would like the creditor to consider in evaluating the consumer's application, the creditor may use medical information provided by the consumer in that space on that application to accommodate the consumer's application for credit, consistent with safe and sound practices, or may disregard that information.

(4) If a consumer specifically requests that the creditor use medical information in determining the consumer's eligibility, or continued eligibility, for credit and provides the creditor with medical information for that purpose, and the creditor determines that it needs additional information regarding the consumer's circumstances, the creditor may request, obtain, and use additional medical information about the consumer as necessary to verify the information provided by the consumer or to determine whether to make an accommodation for the consumer. The consumer may decline to

provide additional information, withdraw the request for an accommodation, and have the application considered under the creditor's otherwise applicable underwriting criteria.

(5) If a consumer completes and signs a credit application that is not for medical purpose credit and the application contains boilerplate language that routinely requests medical information from the consumer or that indicates that by applying for credit the consumer authorizes or consents to the creditor obtaining and using medical information in connection with a determination of the consumer's eligibility, or continued eligibility, for credit, the consumer has not specifically requested that the creditor obtain and use medical information to accommodate the consumer's particular circumstances.

(e) *Example of a forbearance practice or program.* After an appropriate safety and soundness review, a creditor institutes a program that allows consumers who are or will be hospitalized to defer payments as needed for up to three months, without penalty, if the credit account has been open for more than one year and has not previously been in default, and the consumer provides confirming documentation at an appropriate time. A consumer is hospitalized and does not pay her bill for a particular month. This consumer has had a credit account with the creditor for more than one year and has not previously been in default. The creditor attempts to contact the consumer and speaks with the consumer's adult child, who is not the consumer's legal representative. The adult child informs the creditor that the consumer is hospitalized and is unable to pay the bill at that time. The creditor defers payments for up to three months, without penalty, for the hospitalized consumer and sends the consumer a letter confirming this practice and the date on which the next payment will be due. The creditor has obtained and used medical information to determine whether the provisions of a medically-triggered forbearance practice or program apply to a consumer.

# PART 233—PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING (REGULATION GG)

Sec.
233.1 Authority, purpose, collection of information, and incorporation by reference.
233.2 Definitions.
233.3 Designated payment systems.
233.4 Exemptions.
233.5 Policies and procedures required.
233.6 Non-exclusive examples of policies and procedures.
233.7 Regulatory enforcement.
APPENDIX A TO PART 233—MODEL NOTICE

AUTHORITY: 31 U.S.C. 5364.

SOURCE: Reg. GG, 73 FR 69405, Nov. 18, 2008 unless otherwise noted.

EFFECTIVE DATE NOTE: At 73 FR 69405, Nov. 18, 2008, part 233 was added, effective Jan. 19, 2009.

## § 233.1 Authority, purpose, collection of information, and incorporation by reference.

(a) *Authority.* This part is issued jointly by the Board of Governors of the Federal Reserve System (Board) and the Secretary of the Department of the Treasury (Treasury) under section 802 of the Unlawful Internet Gambling Enforcement Act of 2006 (Act) (enacted as Title VIII of the Security and Accountability For Every Port Act of 2006, Pub. L. No. 109–347, 120 Stat. 1884, and codified at 31 U.S.C. 5361–5367). The Act states that none of its provisions shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States. *See* 31 U.S.C. 5361(b). In addition, the Act states that its provisions are not intended to change which activities related to horseracing may or may not be allowed under Federal law, are not intended to change the existing relationship between the Interstate Horseracing Act of 1978 (IHA) (15 U.S.C. 3001 *et seq.*) and other Federal statutes in effect on October 13, 2006, the date of the Act's enactment, and are not intended to resolve any existing disagreements over how to interpret the relationship between the IHA and other Federal statutes. *See* 31 U.S.C. 5362(10)(D)(iii). This part is intended to be consistent with these provisions.

(b) *Purpose*. The purpose of this part is to issue implementing regulations as required by the Act. The part sets out necessary definitions, designates payment systems subject to the requirements of this part, exempts certain participants in designated payment systems from certain requirements of this part, provides nonexclusive examples of policies and procedures reasonably designed to identify and block, or otherwise prevent and prohibit, restricted transactions, and sets out the Federal entities that have exclusive regulatory enforcement authority with respect to the designated payments systems and non-exempt participants therein.

(c) *Collection of information*. The Office of Management and Budget (OMB) has approved the collection of information requirements in this part for the Department of the Treasury and assigned OMB control number 1505–0204. The Board has approved the collection of information requirements in this part under the authority delegated to the Board by OMB, and assigned OMB control number 7100–0317.

(d) *Incorporation by reference—relevant definitions from ACH rules*. (1) This part incorporates by reference the relevant definitions of ACH terms as published in the ''2008 ACH Rules: A Complete Guide to Rules & Regulations Governing the ACH Network'' (the ''ACH Rules''). The Director of the Federal Register approves this incorporation by reference in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies of the ''2008 ACH Rules'' are available from the National Automated Clearing House Association, Suite 100, 13450 Sunrise Valley Drive, Herndon, Virginia 20171, *http://nacha.org*, (703) 561–1100. Copies also are available for public inspection at the Department of Treasury Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220, and the National Archives and Records Administration (NARA). Before visiting the Treasury library, you must call (202) 622–0990 for an appointment. For information on the availability of this material at NARA, call (202) 741–6030, or go to: *http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html 20002*.

(2) Any amendment to definitions of the relevant ACH terms in the ACH Rules shall not apply to this part unless the Treasury and the Board jointly accept such amendment by publishing notice of acceptance of the amendment to this part in the FEDERAL REGISTER. An amendment to the definition of a relevant ACH term in the ACH Rules that is accepted by the Treasury and the Board shall apply to this part on the effective date of the rulemaking specified by the Treasury and the Board in the joint FEDERAL REGISTER notice expressly accepting such amendment.

## § 233.2 Definitions.

The following definitions apply solely for purposes of this part:

(a) *Actual knowledge* with respect to a transaction or commercial customer means when a particular fact with respect to that transaction or commercial customer is known by or brought to the attention of:

(1) An individual in the organization responsible for the organization's compliance function with respect to that transaction or commercial customer; or

(2) An officer of the organization.

(b) *Automated clearing house system* or *ACH system* means a funds transfer system, primarily governed by the ACH Rules, which provides for the clearing and settlement of batched electronic entries for participating financial institutions. When referring to ACH systems, the terms in this regulation (such as ''originating depository financial institution,'' ''operator,'' ''originating gateway operator,'' ''receiving depository financial institution,'' ''receiving gateway operator,'' and ''third-party sender'') are defined as those terms are defined in the ACH Rules.

(c) *Bet or wager:*

(1) Means the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome;

(2) Includes the purchase of a chance or opportunity to win a lottery or other prize (which opportunity to win is predominantly subject to chance);

(3) Includes any scheme of a type described in 28 U.S.C. 3702;

(4) Includes any instructions or information pertaining to the establishment or movement of funds by the bettor or customer in, to, or from an account with the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service); and

(5) Does not include—

(i) Any activity governed by the securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) for the purchase or sale of securities (as that term is defined in section 3(a)(10) of that act (15 U.S.C. 78c(a)(10));

(ii) Any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*);

(iii) Any over-the-counter derivative instrument;

(iv) Any other transaction that—

(A) Is excluded or exempt from regulation under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*); or

(B) Is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act (7 U.S.C. 16(e)) or section 28(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(a));

(v) Any contract of indemnity or guarantee;

(vi) Any contract for insurance;

(vii) Any deposit or other transaction with an insured depository institution;

(viii) Participation in any game or contest in which participants do not stake or risk anything of value other than—

(A) Personal efforts of the participants in playing the game or contest or obtaining access to the Internet; or

(B) Points or credits that the sponsor of the game or contest provides to participants free of charge and that can be used or redeemed only for participation in games or contests offered by the sponsor; or

(ix) Participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in 28 U.S.C. 3701) and that meets the following conditions:

(A) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(B) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(C) No winning outcome is based—

(*1*) On the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams, or

(*2*) Solely on any single performance of an individual athlete in any single real-world sporting or other event.

(d) *Block* means to reject a particular transaction before or during processing, but it does not require freezing or otherwise prohibiting subsequent transfers or transactions regarding the proceeds or account.

(e) *Card issuer* means any person who issues a credit card, debit card, prepaid card, or stored value card, or the agent of such person with respect to such card.

(f) *Card system* means a system for authorizing, clearing and settling transactions in which credit cards, debit cards, pre-paid cards, or stored value cards (such cards being issued or authorized by the operator of the system), are used to purchase goods or services or to obtain a cash advance. The term includes systems both in which the merchant acquirer, card issuer, and system operator are separate entities and in which more than one of these roles are performed by the same entity.

(g) *Check clearing house* means an association of banks or other payors that regularly exchange checks for collection or return.

(h) *Check collection system* means an interbank system for collecting, presenting, returning, and settling for checks or intrabank system for settling for checks deposited in and drawn on the same bank. When referring to check collection systems, the terms in this regulation (such as ''paying bank,'' ''collecting bank,'' ''depositary bank,'' ''returning bank,'' and ''check'') are defined as those terms are defined in 12 CFR 229.2. For purposes of this part, ''check'' also includes an electronic representation of a check that a bank agrees to handle as a check.

(i) *Commercial customer* means a person that is not a consumer and that contracts with a non-exempt participant in a designated payment system to receive, or otherwise accesses, payment transaction services through that non-exempt participant.

(j) *Consumer* means a natural person.

(k) *Designated payment system* means a system listed in § 233.3.

(l) *Electronic fund transfer* has the same meaning given the term in section 903 of the Electronic Fund Transfer Act (15 U.S.C. 1693a), except that such term includes transfers that would otherwise be excluded under section 903(6)(E) of that act (15 U.S.C. 1693a(6)(E)), and includes any funds transfer covered by Article 4A of the Uniform Commercial Code, as in effect in any State.

(m) *Financial institution*n means a State or national bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal credit union, or any other person that, directly or indirectly, holds an account belonging to a consumer. The term does not include a casino, sports book, or other business at or through which bets or wagers may be placed or received.

(n) *Financial transaction provider* means a creditor, credit card issuer, financial institution, operator of a terminal at which an electronic fund transfer may be initiated, money transmitting business, or international, national, regional, or local payment network utilized to effect a credit transaction, electronic fund transfer, stored value product transaction, or money transmitting service, or a participant in such network, or other participant in a designated payment system.

(o) *Foreign banking office* means:

(1) Any non-U.S. office of a financial institution; and

(2) Any non-U.S. office of a foreign bank as described in 12 U.S.C. 3101(7).

(p) *Interactive computer service* means any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet and such systems operated or services offered by libraries or educational institutions.

(q) *Internet* means the international computer network of interoperable packet switched data networks.

(r) *Internet gambling business* means the business of placing, receiving or otherwise knowingly transmitting a bet or wager by any means which involves the use, at least in part, of the Internet, but does not include the performance of the customary activities of a financial transaction provider, or any interactive computer service or telecommunications service.

(s) *Intrastate transaction* means placing, receiving, or otherwise transmitting a bet or wager where—

(1) The bet or wager is initiated and received or otherwise made exclusively within a single State;

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and placed in accordance with the laws of such State, and the State law or regulations include—

(i) Age and location verification requirements reasonably designed to block access to minors and persons located out of such State; and

(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with such State's law or regulations; and

(3) The bet or wager does not violate any provision of—

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 *et seq.*); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*).

(t) *Intratribal transaction* means placing, receiving or otherwise transmitting a bet or wager where—

(1) The bet or wager is initiated and received or otherwise made exclusively—

(i) Within the Indian lands of a single Indian tribe (as such terms are defined under the Indian Gaming Regulatory Act (25 U.S.C. 2703)); or

(ii) Between the Indian lands of two or more Indian tribes to the extent that intertribal gaming is authorized by the Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*);

(2) The bet or wager and the method by which the bet or wager is initiated and received or otherwise made is expressly authorized by and complies with the requirements of—

(i) The applicable tribal ordinance or resolution approved by the Chairman of the National Indian Gaming Commission; and

(ii) With respect to class III gaming, the applicable Tribal-State compact;

(3) The applicable tribal ordinance or resolution or Tribal-State compact includes—

(i) Age and location verification requirements reasonably designed to block access to minors and persons located out of the applicable Tribal lands; and

(ii) Appropriate data security standards to prevent unauthorized access by any person whose age and current location has not been verified in accordance with the applicable tribal ordinance or resolution or Tribal-State Compact; and

(4) The bet or wager does not violate any provision of—

(i) The Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*);

(ii) 28 U.S.C. chapter 178 (professional and amateur sports protection);

(iii) The Gambling Devices Transportation Act (15 U.S.C. 1171 *et seq.*); or

(iv) The Indian Gaming Regulatory Act (25 U.S.C. 2701 *et seq.*).

(u) *Money transmitting business* has the meaning given the term in 31 U.S.C. 5330(d)(1) (determined without regard to any regulations prescribed by the Secretary of the Treasury thereunder).

(v) *Operator* of a designated payment system means an entity that provides centralized clearing and delivery services between participants in the designated payment system and maintains the operational framework for the system. In the case of an automated clearinghouse system, the term ''operator'' has the same meaning as provided in the ACH Rules.

(w) *Participant in a designated payment system* means an operator of a designated payment system, a financial transaction provider that is a member of, or has contracted for financial transaction services with, or is otherwise participating in, a designated payment system, or a third-party processor. This term does not include a customer of the financial transaction provider, unless the customer is also a financial transaction provider otherwise participating in the designated payment system on its own behalf.

(x) *Reasoned legal opinion* means a written expression of professional judgment by a State-licensed attorney that addresses the facts of a particular client's business and the legality of the client's provision of its services to relevant customers in the relevant jurisdictions under applicable federal and State law, and, in the case of intratribal transactions, applicable tribal ordinances, tribal resolutions, and Tribal-State compacts. A written legal opinion will not be considered ''reasoned'' if it does nothing more than recite the facts and express a conclusion.

(y) *Restricted transaction* means any of the following transactions or transmittals involving any credit, funds, instrument, or proceeds that the Act prohibits any person engaged in the business of betting or wagering (which does not include the activities of a financial transaction provider, or any interactive computer service or telecommunications service) from knowingly accepting, in connection with the

participation of another person in unlawful Internet gambling—

(1) Credit, or the proceeds of credit, extended to or on behalf of such other person (including credit extended through the use of a credit card);

(2) An electronic fund transfer, or funds transmitted by or through a money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of such other person; or

(3) Any check, draft, or similar instrument that is drawn by or on behalf of such other person and is drawn on or payable at or through any financial institution.

(z) *State* means any State of the United States, the District of Columbia, or any commonwealth, territory, or other possession of the United States, including the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, and the Virgin Islands.

(aa) *Third-party processor* means a service provider that—

(1) In the case of a debit transaction payment, such as an ACH debit entry or card system transaction, has a direct relationship with the commercial customer that is initiating the debit transfer transaction and acts as an intermediary between the commercial customer and the first depository institution to handle the transaction;

(2) In the case of a credit transaction payment, such as an ACH credit entry, has a direct relationship with the commercial customer that is to receive the proceeds of the credit transfer and acts as an intermediary between the commercial customer and the last depository institution to handle the transaction; and

(3) In the case of a cross-border ACH debit or check collection transaction, is the first service provider located within the United States to receive the ACH debit instructions or check for collection.

(bb) *Unlawful Internet gambling* means to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made. The term does not include placing, receiving, or otherwise transmitting a bet or wager that is excluded from the definition of this term by the Act as an intrastate transaction or an intra-tribal transaction, and does not include any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*; *see* § 233.1(a)). The intermediate routing of electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made.

(cc) *Wire transfer system* means a system through which an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt, or on a day stated in the order, is transmitted by electronic or other means through the network, between banks, or on the books of a bank. When referring to wire transfer systems, the terms in this regulation (such as ''bank,'' ''originator's bank,'' ''beneficiary's bank,'' and ''intermediary bank'') are defined as those terms are defined in 12 CFR part 210, appendix B.

### § 233.3 Designated payment systems.

The following payment systems could be used by participants in connection with, or to facilitate, a restricted transaction:

(a) Automated clearing house systems;

(b) Card systems;

(c) Check collection systems;

(d) Money transmitting businesses solely to the extent they

(1) Engage in the transmission of funds, which does not include check cashing, currency exchange, or the issuance or redemption of money orders, travelers' checks, and other similar instruments; and

(2) Permit customers to initiate transmission of funds transactions remotely from a location other than a physical office of the money transmitting business; and

(e) Wire transfer systems.

**§ 233.4 Exemptions.**

(a) *Automated clearing house systems.* The participants processing a particular transaction through an automated clearing house system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that transaction, except for—

(1) The receiving depository financial institution and any third-party processor receiving the transaction on behalf of the receiver in an ACH credit transaction;

(2) The originating depository financial institution and any third-party processor initiating the transaction on behalf of the originator in an ACH debit transaction; and

(3) The receiving gateway operator and any third-party processor that receives instructions for an ACH debit transaction directly from a foreign sender (which could include a foreign banking office, a foreign third-party processor, or a foreign originating gateway operator).

(b) *Check collection systems.* The participants in a particular check collection through a check collection system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that check collection, except for the depositary bank.

(c) *Money transmitting businesses.* The participants in a money transmitting business are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions, except for the operator.

(d) *Wire transfer systems.* The participants in a particular wire transfer through a wire transfer system are exempt from this regulation's requirements for establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to that transaction, except for the beneficiary's bank.

**§ 233.5 Policies and procedures required.**

(a) All non-exempt participants in designated payment systems shall establish and implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions.

(b) A non-exempt financial transaction provider participant in a designated payment system shall be considered to be in compliance with the requirements of paragraph (a) of this section if—

(1) It relies on and complies with the written policies and procedures of the designated payment system that are reasonably designed to—

(i) Identify and block restricted transactions; or

(ii) Otherwise prevent or prohibit the acceptance of the products or services of the designated payment system or participant in connection with restricted transactions; and

(2) Such policies and procedures of the designated payment system comply with the requirements of this part.

(c) For purposes of paragraph (b)(2) in this section, a participant in a designated payment system may rely on a written statement or notice by the operator of that designated payment system to its participants that states that the operator has designed or structured the system's policies and procedures for identifying and blocking or otherwise preventing or prohibiting restricted transactions to comply with the requirements of this part as conclusive evidence that the system's policies and procedures comply with the requirements of this part, unless the participant is notified otherwise by its Federal functional regulator or, in the case of participants that are not directly supervised by a Federal functional regulator, the Federal Trade Commission.

(d) As provided in the Act, a person that identifies and blocks a transaction, prevents or prohibits the acceptance of its products or services in connection with a transaction, or otherwise refuses to honor a transaction, shall not be liable to any party for such action if—

(1) The transaction is a restricted transaction;

(2) Such person reasonably believes the transaction to be a restricted transaction; or

(3) The person is a participant in a designated payment system and blocks or otherwise prevents the transaction in reliance on the policies and procedures of the designated payment system in an effort to comply with this regulation.

(e) Nothing in this part requires or is intended to suggest that designated payment systems or participants therein must or should block or otherwise prevent or prohibit any transaction in connection with any activity that is excluded from the definition of ''unlawful Internet gambling'' in the Act as an intrastate transaction, an intratribal transaction, or a transaction in connection with any activity that is allowed under the Interstate Horseracing Act of 1978 (15 U.S.C. 3001 *et seq.*; see § 233.1(a)).

(f) Nothing in this part modifies any requirement imposed on a participant by other applicable law or regulation to file a suspicious activity report to the appropriate authorities.

(g) The requirement of this part to establish and implement written policies and procedures applies only to the U.S. offices of participants in designated payment systems.

### § 233.6 Non-exclusive examples of policies and procedures.

(a) *In general.* The examples of policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions set out in this section are non-exclusive. In establishing and implementing written policies and procedures to identify and block or otherwise prevent or prohibit restricted transactions, a non-exempt participant in a designated payment system is permitted to design and implement policies and procedures tailored to its business that may be different than the examples provided in this section. In addition, non-exempt participants may use different policies and procedures with respect to different business lines or different parts of the organization.

(b) *Due diligence.* If a non-exempt participant in a designated payment system establishes and implements procedures for due diligence of its commercial customer accounts or commercial customer relationships in order to comply, in whole or in part, with the requirements of this regulation, those due diligence procedures will be deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if the procedures include the steps set out in paragraphs (b)(1), (b)(2), and (b)(3) of this section and subject to paragraph (b)(4) of this section.

(1) At the establishment of the account or relationship, the participant conducts due diligence of a commercial customer and its activities commensurate with the participant's judgment of the risk of restricted transactions presented by the customer's business.

(2) Based on its due diligence, the participant makes a determination regarding the risk the commercial customer presents of engaging in an Internet gambling business and follows either paragraph (b)(2)(i) or (b)(2)(ii) of this section.

(i) The participant determines that the commercial customer presents a minimal risk of engaging in an Internet gambling business.

(ii) The participant cannot determine that the commercial customer presents a minimal risk of engaging in an Internet gambling business, in which case it obtains the documentation in either paragraph (b)(2)(ii)(A) or (b)(2)(ii)(B) of this section—

(A) Certification from the commercial customer that it does not engage in an Internet gambling business; or

(B) If the commercial customer does engage in an Internet gambling business, each of the following—

(*I*) Evidence of legal authority to engage in the Internet gambling business, such as—

(*i*) A copy of the commercial customer's license that expressly authorizes the customer to engage in the Internet gambling business issued by the appropriate State or Tribal authority or, if the commercial customer does not have such a license, a reasoned legal opinion that demonstrates that the commercial customer's Internet gambling business does not involve restricted transactions; and

(*ii*) A written commitment by the commercial customer to notify the participant of any changes in its legal authority to engage in its Internet gambling business.

(*2*) A third-party certification that the commercial customer's systems for engaging in the Internet gambling business are reasonably designed to ensure that the commercial customer's Internet gambling business will remain within the licensed or otherwise lawful limits, including with respect to age and location verification.

(3) The participant notifies all of its commercial customers, through provisions in the account or commercial customer relationship agreement or otherwise, that restricted transactions are prohibited from being processed through the account or relationship.

(4) With respect to the determination in paragraph (b)(2)(i) of this section, participants may deem the following commercial customers to present a minimal risk of engaging in an Internet gambling business—

(i) An entity that is directly supervised by a Federal functional regulator as set out in § 233.7(a); or

(ii) An agency, department, or division of the Federal government or a State government.

(c) *Automated clearing house system examples*. (1) The policies and procedures of the originating depository financial institution and any third party processor in an ACH debit transaction, and the receiving depository financial institution and any third party processor in an ACH credit transaction, are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(i) Address methods to conduct due diligence in establishing a commercial customer account or relationship as set out in § 233.6(b);

(ii) Address methods to conduct due diligence as set out in § 233.6(b)(2)(ii)(B) in the event that the participant has actual knowledge that an existing commercial customer of the participant engages in an Internet gambling business; and

(iii) Include procedures to be followed with respect to a commercial customer if the originating depository financial institution or third-party processor has actual knowledge that its commercial customer has originated restricted transactions as ACH debit transactions or if the receiving depository financial institution or third-party processor has actual knowledge that its commercial customer has received restricted transactions as ACH credit transactions, such as procedures that address—

(A) The circumstances under which the commercial customer should not be allowed to originate ACH debit transactions or receive ACH credit transactions; and

(B) The circumstances under which the account should be closed.

(2) The policies and procedures of a receiving gateway operator and third-party processor that receives instructions to originate an ACH debit transaction directly from a foreign sender are deemed to be reasonably designed to prevent or prohibit restricted transactions if they include procedures to be followed with respect to a foreign sender if the receiving gateway operator or third-party processor has actual knowledge, obtained through notification by a government entity, such as law enforcement or a regulatory agency, that such instructions included instructions for restricted transactions. Such procedures may address sending notification to the foreign sender, such as in the form of the notice contained in appendix A to this part.

(d) *Card system examples*. The policies and procedures of a card system operator, a merchant acquirer, third-party processor, or a card issuer, are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions, if the policies and procedures—

(1) Provide for either—

(i) Methods to conduct due diligence—

(A) In establishing a commercial customer account or relationship as set out in § 233.6(b); and

(B) As set out in § 233.6(b)(2)(ii)(B) in the event that the participant has actual knowledge that an existing commercial customer of the participant engages in an Internet gambling business; or

(ii) Implementation of a code system, such as transaction codes and merchant/business category codes, that are required to accompany the authorization request for a transaction, including—

(A) The operational functionality to enable the card system operator or the card issuer to reasonably identify and deny authorization for a transaction that the coding procedure indicates may be a restricted transaction; and

(B) Procedures for ongoing monitoring or testing by the card system operator to detect potential restricted transactions, including—

(*1*) Conducting testing to ascertain whether transaction authorization requests are coded correctly; and

(*2*) Monitoring and analyzing payment patterns to detect suspicious payment volumes from a merchant customer; and

(2) For the card system operator, merchant acquirer, or third-party processor, include procedures to be followed when the participant has actual knowledge that a merchant has received restricted transactions through the card system, such as—

(i) The circumstances under which the access to the card system for the merchant, merchant acquirer, or third-party processor should be denied; and

(ii) The circumstances under which the merchant account should be closed.

(e) *Check collection system examples.* (1) The policies and procedures of a depositary bank are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions, if they—

(i) Address methods for the depositary bank to conduct due diligence in establishing a commercial customer account or relationship as set out in § 233.6(b);

(ii) Address methods for the depositary bank to conduct due diligence as set out in § 233.6(b)(2)(ii)(B) in the event that the depositary bank has actual knowledge that an existing commercial customer engages in an Internet gambling business; and

(iii) Include procedures to be followed if the depositary bank has actual knowledge that a commercial customer of the depositary bank has deposited checks that are restricted transactions, such as procedures that address—

(A) The circumstances under which check collection services for the customer should be denied; and

(B) The circumstances under which the account should be closed.

(2) The policies and procedures of a depositary bank that receives checks for collection from a foreign banking office are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they include procedures to be followed by the depositary bank when it has actual knowledge, obtained through notification by a government entity, such as law enforcement or a regulatory agency, that a foreign banking office has sent checks to the depositary bank that are restricted transactions. Such procedures may address sending notification to the foreign banking office, such as in the form of the notice contained in the appendix to this part.

(f) *Money transmitting business examples.* The policies and procedures of an operator of a money transmitting business are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(1) Address methods for the operator to conduct due diligence in establishing a commercial customer relationship as set out in § 233.6(b);

(2) Address methods for the operator to conduct due diligence as set out in § 233.6(b)(2)(ii)(B) in the event that the operator has actual knowledge that an existing commercial customer engages in an Internet gambling business;

(3) Include procedures regarding ongoing monitoring or testing by the operator to detect potential restricted transactions, such as monitoring and analyzing payment patterns to detect suspicious payment volumes to any recipient; and

(4) Include procedures when the operator has actual knowledge that a commercial customer of the operator has received restricted transactions through the money transmitting business, that address—

(i) The circumstances under which money transmitting services should be

denied to that commercial customer; and

(ii) The circumstances under which the commercial customer account should be closed.

(g) *Wire transfer system examples*. The policies and procedures of the beneficiary's bank in a wire transfer are deemed to be reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions if they—

(1) Address methods for the beneficiary's bank to conduct due diligence in establishing a commercial customer account as set out in § 233.6(b);

(2) Address methods for the beneficiary's bank to conduct due diligence as set out in § 233.6(b)(2)(ii)(B) in the event that the beneficiary's bank has actual knowledge that an existing commercial customer of the bank engages in an Internet gambling business;

(3) Include procedures to be followed if the beneficiary's bank obtains actual knowledge that a commercial customer of the bank has received restricted transactions through the wire transfer system, such as procedures that address

(i) The circumstances under which the beneficiary bank should deny wire transfer services to the commercial customer; and

(ii) The circumstances under which the commercial customer account should be closed.

### § 233.7 Regulatory enforcement.

The requirements under this part are subject to the exclusive regulatory enforcement of—

(a) The Federal functional regulators, with respect to the designated payment systems and participants therein that are subject to the respective jurisdiction of such regulators under section 505(a) of the Gramm-Leach-Bliley Act (15 U.S.C. 6805(a)) and section 5g of the Commodity Exchange Act (7 U.S.C. 7b–2); and

(b) The Federal Trade Commission, with respect to designated payment systems and participants therein not otherwise subject to the jurisdiction of any Federal functional regulators (including the Commission) as described in paragraph (a) of this section.

### APPENDIX A TO PART 233—MODEL NOTICE

[Date]

[Name of foreign sender or foreign banking office]

[Address]

Re: *U.S. Unlawful Internet Gambling Enforcement Act Notice*

Dear [Name of foreign counterparty]:

On [date], U.S. government officials informed us that your institution processed payments through our facilities for Internet gambling transactions restricted by U.S. law on [dates, recipients, and other relevant information if available].

We provide this notice to comply with U.S. Government regulations implementing the Unlawful Internet Gambling Enforcement Act of 2006 (Act), a U.S. federal law. Our policies and procedures established in accordance with those regulations provide that we will notify a foreign counterparty if we learn that the counterparty has processed payments through our facilities for Internet gambling transactions restricted by the Act. This notice ensures that you are aware that we have received information that your institution has processed payments for Internet gambling restricted by the Act.

The Act is codified in subchapter IV, chapter 53, title 31 of the U.S. Code (31 U.S.C. 5361 *et seq.*). Implementing regulations that duplicate one another can be found at part 233 of title 12 of the U.S. Code of Federal Regulations (12 CFR part 233) and part 132 of title 31 of the U.S. Code of Federal Regulations (31 CFR part 132).

## PART 250—MISCELLANEOUS INTERPRETATIONS

INTERPRETATIONS

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INTERPRETATIONS OF SECTION 32 OF THE GLASS-STEAGALL ACT

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AUTHORITY: 12 U.S.C. 78, 248(i), 371c(f) and 371c–1(e).

SOURCE: 33 FR 9866, July 10, 1968, unless otherwise noted.

INTERPRETATIONS

## § 250.141 Member bank purchase of stock of "operations subsidiaries."

(a) The Board of Governors has reexamined its position that the so-called ''stock-purchase prohibition'' of section 5136 of the Revised Statutes (12 U.S.C. 24), which is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335), forbids the purchase by a member bank ''for its own account of any shares of stock of any corporation'' (the statutory language), except as specifically permitted by provisions of Federal law or as comprised within the concept of ''such incidental powers as shall be necessary to carry on the business of banking'', referred to in the first sentence of paragraph ''Seventh'' of R.S. 5136.

(b) In 1966 the Board expressed the view that said incidental powers do not permit member banks to purchase stock of ''operations subsidiaries''—that is, organizations designed to serve, in effect, as separately-incorporated departments of the bank, performing, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. (See 1966 Federal Reserve Bulletin 1151.)

(c) The Board now considers that the incidental powers clause permits a bank to organize its operations in the manner that it believes best facilitates the performance thereof. One method of organization is through departments; another is through separate incorporation of particular operations. In other words, a wholly owned subsidiary corporation engaged in activities that the bank itself may perform is simply a convenient alternative organizational arrangement.

(d) Reexamination of the apparent purposes and legislative history of the stock-purchase prohibition referred to above has led the Board to conclude that such prohibition should not be interpreted to preclude a member bank from adopting such an organizational arrangement unless its use would be inconsistent with other Federal law, either statutory or judicial.

(e) In view of the relationship between the operation of certain subsidiaries and the branch banking laws, the Board has also reexamined its rulings on what constitutes ''money lent'' for the purposes of section 5155 of the Revised Statutes (12 U.S.C. 36), which provides that ''The term*branch* * * * shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of

business * * * at which deposits are received, or checks paid, or money lent.''[1]

(f) The Board noted in its 1967 interpretation that offices that are open to the public and staffed by employees of the bank who regularly engage in soliciting borrowers, negotiating terms, and processing applications for loans (so-called *loan production offices*) constitute branches. (1967 Federal Reserve Bulletin 1334.) The Board also noted that later in that year it considered the question whether a bank holding company may acquire the stock of a so-called *mortgage company* on the basis that the company would be engaged in ''furnishing services to or performing services for such bank holding company or its banking subsidiaries'' (the so-called *servicing exemption* of section 4(c)(1)(C) of the Bank Holding Company Act; 12 U.S.C. 1843). In concluding affirmatively, the Board stated that ''the appropriate test for determining whether the company may be considered as within the servicing exemption is whether the company will perform as principal any banking activities—such as receiving deposits, paying checks, extending credit, conducting a trust department, and the like. In other words, if the mortgage company is to act merely as an adjunct to a bank for the purpose of facilitating the bank's operations, the company may appropriately be considered as within the scope of the servicing exemption.'' (1967 Federal Reserve Bulletin 1911; 12 CFR 225.122.)

(g) The Board believes that the purposes of the branch banking laws and the servicing exemption are related. Generally, what constitutes a branch does not constitute a servicing organization and, vice versa, an office that only performs servicing functions should not be considered a branch. (See 1958 Federal Reserve Bulletin 431, last paragraph; 12 CFR 225.104(e).) When viewed together, the above-cited interpretations on loan production offices and mortgage companies represent a departure from this principle. In reconsidering the laws involved, the Board has concluded that a test similar to that adopted with respect to the servicing exemption under the Bank Holding Company Act is appropriate for use in determining whether or not what constitutes *money [is] lent* at a particular office, for the purpose of the Federal branch banking laws.

(h) Accordingly, the Board considers that the following activities, individually or collectively, do not constitute the lending of money within the meaning of section 5155 of the revised statutes: Soliciting loans on behalf of a bank (or a branch thereof), assembling credit information, making property inspections and appraisals, securing title information, preparing applications for loans (including making recommendations with respect to action thereon), soliciting investors to purchase loans from the bank, seeking to have such investors contract with the bank for the servicing of such loans, and other similar agent-type activities. When loans are approved and funds disbursed solely at the main office or a branch of the bank, an office at which only preliminary and servicing steps are taken is not a place where *money [is] lent*. Because preliminary and servicing steps of the kinds described do not constitute the performance of significant banking functions of the type that Congress contemplated should be performed only at governmentally approved offices, such office is accordingly not a branch.

(i) To summarize the foregoing, the Board has concluded that, insofar as Federal law is concerned, a member bank may purchase for its own account shares of a corporation to perform, at locations at which the bank is authorized to engage in business, functions that the bank is empowered to perform directly. Also, a member bank may establish and operate, at any location in the United States, a *loan production office* of the type described herein. Such offices may be established and operated

[1] In the Board's judgment, the statutory enumeration of three specific functions that establish branch status is not meant to be exclusive but to assure that offices at which any of these functions is performed are regarded as branches by the bank regulatory authorities. In applying the statute the emphasis should be to assure that significant banking functions are made available to the public only at governmentally authorized offices.

by the bank either directly, or indirectly through a wholly-owned subsidiary corporation.

(j) This interpretation supersedes both the Board's 1966 ruling on *operations subsidiaries* and its 1967 ruling on *loan production offices*, referred to above.

(12 U.S.C. 24, 36, 321, 335)

[33 FR 11813, Aug. 21, 1968; 43 FR 53414, Nov. 16, 1978]

### § 250.142 Meaning of "obligor or maker" in determining limitation on securities investments by member State banks.

(a) From time to time the New York State Dormitory Authority offers issues of bonds with respect to each of which a different educational institution enters into an agreement to make *rental* payments to the Authority sufficient to cover interest and principal thereon when due. The Board of Governors of the Federal Reserve System has been asked whether a member State bank may invest up to 10 percent of its capital and surplus in each such issue.

(b) Paragraph Seventh of section 5136 of the U.S. Revised Statutes (12 U.S.C. 24) provides that ''In no event shall the total amount of the investment securities of any one obligor or maker, held by [a national bank] for its own account, exceed at any time 10 per centum of its capital stock * * * and surplus fund''. That limitation is made applicable to member State banks by the 20th paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 335).

(c) The Board considers that, within the meaning of these provisions of law, *obligor* does not include any person that acts solely as a conduit for transmission of funds received from another source, irrespective of a promise by such person to pay principal or interest on the obligation. While an obligor does not cease to be such merely because a third person has agreed to pay the obligor amounts sufficient to cover principal and interest on the obligations when due, a person that promises to pay an obligation, but as a practical matter has no resources with which to assume payment of the obligation except the amounts received from such third person, is not an *obligor* within the meaning of section 5136.

(d) Review of the New York Dormitory Authority Act (N.Y. Public Authorities Law sections 1675–1690), the Authority's interpretation thereof, and materials with respect to the Authority's ''Revenue Bonds, Mills College of Education Issue, Series A'' indicates that the Authority is not an *obligor* on those and similar bonds. Although the Authority promises to make all payments of principal and interest, a bank that invests in such bonds cannot be reasonably considered as doing so in reliance on the promise and responsibility of the Authority. Despite the Authority's obligation to make payments on the bonds, if the particular college fails to perform its agreement to make rental payments to the Authority sufficient to cover all payments of bond principal and interest when due, as a practical matter the sole source of funds for payments to the bondholder is the particular college. The Authority has general borrowing power but no resources from which to assure repayment of any borrowing except from the particular colleges, and rentals received from one college may not be used to service bonds issued for another.

(e) Accordingly, the Board has concluded that each college for which the Authority issues obligations is the sole *obligor* thereon. A member State bank may therefore invest an amount up to 10 percent of its capital and surplus in the bonds of a particular college that are eligible investments under the Investment Securities Regulation of the Comptroller of the Currency (12 CFR Part 1), whether issued directly or indirectly through the Dormitory Authority.

(12 U.S.C. 24, 335)

### § 250.143 Member bank purchase of stock of foreign operations subsidiaries.

(a) In a previous interpretation, the Board determined that a State member bank would not violate the ''stock-purchase prohibition'' of section 5136 of the Revised Statutes (12 U.S.C. 24 ¶7) by purchasing and holding the shares of a corporation which performs ''at locations at which the bank is authorized

to engage in business, functions that the bank is empowered to perform directly''.[1] (1968 *Federal Reserve Bulletin* 681, 12 CFR 250.141). The Board of Governors has been asked by a State member bank whether, under that interpretation, the bank may establish such a so-called *operations subsidiary* outside the United States.

(b) In the above interpretation the Board viewed the creation of a wholly-owned subsidiary which engaged in activities that the bank itself could perform directly as an alternative organizational arrangement that would be permissible for member banks unless ''its use would be inconsistent with other Federal law, either statutory or judicial''.

(c) In the Board's judgment, the use by member banks of operations subsidiaries outside the United States would be clearly inconsistent with the statutory scheme of the Federal Reserve Act governing the foreign investments and operations of member banks. It is clear that Congress has given member banks the authority to conduct operations and make investments outside the United States only through gradually adopting a series of specific statutory amendments to the Federal Reserve Act, each of which has been carefully drawn to give the Board approval, supervisory, and regulatory authority over those operations and investments.

(d) As part of the original Federal Reserve Act, national banks were, with the Board's permission, given the power to establish foreign branches.[2] In 1916, Congress amended the Federal Reserve Act to permit national banks to invest in international or foreign banking corporations known as *Agreement* Corporations, because such corporations were required to enter into an agreement or understanding with the Board to restrict their operations. Subject to such limitations or restrictions as the Board may prescribe, such Agreement corporations may principally engage in international or foreign banking, or banking in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions of the United States. In 1919 the enactment of section 25(a) of the Federal Reserve Act (the ''Edge Act'') permitted national banks to invest in federally chartered international or foreign banking corporations (so-called Edge Corporations) which may engage in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions. Edge Corporations may only purchase and hold stock in certain foreign subsidiaries with the consent of the Board. And in 1966, Congress amended section 25 of the Federal Reserve Act to allow national banks to invest directly in the shares of a foreign bank. In the Board's judgment, the above statutory scheme of the Federal Reserve Act evidences a clear Congressional intent that member banks may only purchase and hold stock in subsidiaries located outside the United States through the prescribed statutory provisions of sections 25 and 25(a) of the Federal Reserve Act. It is through these statutorily prescribed forms of organization that member banks must conduct their operations outside the United States.

[1] National banking associations are prohibited by section 5136 of the Revised Statutes from purchasing and holding shares of any corporation except those corporations whose shares are specifically made eligible by statute. This prohibition is made applicable to State member banks by section 9 ¶20 of the Federal Reserve Act (12 U.S.C. 335).

[2] Under section 9 of the Federal Reserve Act, State member banks, subject, of course, to any necessary approval from their State banking authority, may establish foreign branches on the same terms and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks (12 U.S.C. 321). State member banks may also purchase and hold shares of stock in Edge or Agreement Corporations and foreign banks because national banks, as a result of specific statutory exceptions to the stock purchase prohibitions of section 5136, can purchase and hold stock in these Corporations or banks.

(e) To summarize, the Board has concluded that a member bank may only organize and operate *operations subsidiaries* at locations in the United States. Investments by member banks in foreign subsidiaries must be made either with the Board's permission under section 25 of the Federal Reserve Act or, with the Board's consent, through an Edge Corporation subsidiary under section 25(a) of the Federal Reserve Act or through an Agreement Corporation subsidiary under section 25 of the Federal Reserve Act. In addition, it should be noted that bank holding companies may acquire the shares of certain foreign subsidiaries with the Board's approval under section 4(c)(13) of the Bank Holding Company Act. These statutory sections taken together already give member banks a great deal of organizational flexibility in conducting their operations abroad.

(Interprets and applies 12 U.S.C. 24, 335)

[40 FR 12252, Mar. 18, 1975]

### § 250.160 Federal funds transactions.

(a) It is the position of the Board of Governors of the Federal Reserve System that, for purposes of provisions of law administered by the Board, a transaction in Federal funds involves a loan on the part of the *selling* bank and a borrowing on the part of the *purchasing* bank.

(b) [Reserved]

(12 U.S.C. 371c)

[33 FR 9866, July 10, 1968, as amended at 67 FR 76622, Dec. 12, 2002]

### § 250.163 Inapplicability of amount limitations to "ineligible acceptances."

(a) Since 1923, the Board has been of the view that ''the acceptance power of State member banks is not necessarily confined to the provisions of section 13 (of the Federal Reserve Act), inasmuch as the laws of many States confer broader acceptance powers upon their State banks, and certain State member banks may, therefore, legally make acceptances of kinds which are not eligible for rediscount, but which may be eligible for purchase by Federal reserve banks under section 14.'' 1923 FR bulletin 316, 317.

(b) In 1963, the Comptroller of the Currency ruled that ''[n]ational banks are not limited in the character of acceptances which they may make in financing credit transactions, and bankers' acceptances may be used for such purpose, since the making of acceptances is an essential part of banking authorized by 12 U.S.C. 24.'' *Comptroller's manual* 7.7420. Therefore, national banks are authorized by the Comptroller to make acceptances under 12 U.S.C. 24, although the acceptances are not the type described in section 13 of the Federal Reserve Act.

(c) A review of the legislative history surrounding the enactment of the acceptance provisions of section 13, reveals that Congress believed in 1913, that it was granting to national banks a power which they would not otherwise possess and had not previously possessed. See remarks of Congressmen Phelan, Helvering, Saunders, and Glass, 51 *Cong. Rec.* 4676, 4798, 4885, and 5064 (September 10, 12, 13, and 17 of 1913). Nevertheless, the courts have long recognized the evolutionary nature of banking and of the scope of the ''incidental powers'' clause of 12 U.S.C. 24. See *Merchants Bank* v. *State Bank*, 77 U.S. 604 (1870) (upholding the power of a national bank to certify a check under the ''incidental powers'' clause of 12 U.S.C. 24).

(d) It now appears that, based on the Board's 1923 ruling, and the Comptroller's 1963 ruling, both State member banks and national banks may make acceptances which are not of the type described in section 13 of the Federal Reserve Act. Yet, this appears to be a development that Congress did not contemplate when it drafted the acceptance provisions of section 13.

(e) The question is presented whether the amount limitations of section 13 should apply to acceptances made by a member bank that are not of the type described in section 13. (The amount limitations are of two kinds:

(1) A limitation on the amount that may be accepted for any one customer, and

(2) A limitation on the aggregate amount of acceptances that a member bank may make.)

In interpreting any Federal statutory provision, the primary guide is the intent of Congress, yet, as noted earlier, Congress did not contemplate in 1913, the development of so-called ''ineligible acceptances.'' (Although there is some indication that Congress did contemplate State member banks' making acceptances of a type not described in section 13 [remarks of Congressman Glass, 51 *Cong. Rec.* 5064], the primary focus of congressional attention was on the acceptance powers of national banks.) In the absence of an indication of congressional intent, we are left to reach an interpretation that is in harmony with the language of the statutory provisions and with the purposes of the Federal Reserve Act.

(f) Section 13 authorizes acceptances of two types. The seventh paragraph of section 13 (12 U.S.C. 372) authorizes certain acceptances that arise out of specific transactions in goods. (These acceptances are sometimes referred to as ''commercial acceptances.'') The 12th paragraph of section 13 authorizes member banks to make acceptances ''for the purpose of furnishing dollar exchange as required by the usages of trade'' in foreign transactions. (Such acceptances are referred to as ''dollar exchange acceptances.'') In the 12th paragraph, there is a 10 percent limit on the amount of dollar exchange acceptances that may be accepted for any one customer (unless adequately secured) and a limitation on the aggregate amount of dollar exchange acceptances that a member bank may make. (The 12th paragraph, in imposing these limitations, refers to the acceptance of ''such drafts or bills of exchange referred to (in) this paragraph.'') Similarly, the seventh paragraph imposes on commercial acceptances a parallel 10 percent per-customer limitation, and limitations on the aggregate amount of commercial acceptances. (In the case of the aggregate limitations, the seventh paragraph states that ''no bank shall accept such bills to an amount'' in excess of the aggregate limit; the reference to ''such bills'' makes clear that the limitation is only in respect of drafts or bills of exchange of the specific type described in the seventh paragraph.)

(g) Based on the language and parallel structure of the 7th and 12th paragraphs of section 13, and in the absence of a statement of congressional intent in the legislative history, the Board concludes that the per-customer and aggregate limitations of the 12th paragraph apply only to acceptances of the type described in that paragraph (dollar exchange acceptances), and the per-customer and aggregate limitations of the 7th paragraph (12 U.S.C. 372) apply only to acceptances of the type described in that paragraph.

(Interprets and applies 12 U.S.C. 372 and the 12th paragraph of sec. 13 of the Federal Reserve Act, which paragraph is omitted from the United States Code)

[38 FR 13728, May 25, 1973]

### § 250.164 Bankers' acceptances.

(a) Section 207 of the Bank Export Services Act (title II of Pub. L. 97–290) (''BESA'') raised the limits on the aggregate amount of eligible bankers' acceptances (''BAs'') that may be created by an individual member bank from 50 per cent (or 100 per cent with the permission of the Board) of its paid up and unimpaired capital stock and surplus (''capital'') to 150 per cent (or 200 per cent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 per cent of the institution's capital. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105). The Board is clarifying the proper meaning of the seventh paragraph of section 13 of the Federal Reserve Act, as amended by the BESA.

(b)(1) This section of the BESA provides that any portion of an eligible BA created by an institution subject to the BA limitations contained therein (''covered bank'') that is conveyed through a participation to another covered bank shall not be included in the calculation of the creating bank's BA limits. The amount of the participation is to be applied to the calculation of the BA limits applicable to the covered

bank receiving the participation. Although a covered bank that has reached its 150 or 200 percent limit can continue to create eligible acceptances by conveying participations to other covered banks, Congress has in effect imposed an aggregate limit on the eligible acceptances that may be created by *all* covered banks equal to the sum of 150 or 200 percent of the capital of all covered banks.

(2) The Board has clarified that under the statute an eligible BA created by a covered bank that is conveyed through a participation to an institution that is *not* subject to the limitations of this section of the BESA continues to be included in the calculation of the limits applicable to the creating covered bank. This will ensure that the total amount of eligible BAs that may be created by covered banks does not exceed the limitations established by Congress. In addition, this ensures that participations in acceptances are not used as a device for the avoidance of reserve requirements. Finally, this promotes the Congressional intent, with respect to covered banks, that foreign and domestic banks be on an equal footing and under the same legal requirements.

(3) In addition, the amount of a participation received by a covered bank from an institution not covered by the limitations of the Act is to be included in the calculation of the limits applicable to the covered bank receiving the participation. This result is based upon the language of the statute which includes within a covered bank's limits on eligible BAs outstanding the amount of participations received by the covered bank. This provision reflects Congressional intent that a covered bank not be obligated on eligible bankers' acceptances, and participations therein, for an amount in excess of 150 or 200 percent of the institution's capital.

(c) The statute also provides that eligible acceptances growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for covered banks. The Board has clarified that this 50 percent limitation is applicable to the maximum permissible amount of eligible BAs (150 or 200 percent of capital), regardless of the bank's amount of eligible acceptances outstanding. The statutory language prior to the BESA amendment made clear that covered banks could issue eligible acceptances growing out of domestic transactions up to 50 percent of the amount of the total permissible eligible acceptances the bank could issue. The legislative history of the BESA indicates no intent to change this domestic acceptance limitation.

(d) The statute also provides that for the purpose of the limitations applicable to U.S. branches and agencies of foreign banks, a branch's or agency's capital is to be calculated as the dollar equivalent of the capital stock and surplus of the parent foreign bank as determined by the Board. The Board has clarified that for purposes of calculating the BA limits applicable to U.S. branches and agencies of foreign banks, the identity of the parent foreign bank is generally the same as for reserve requirement purposes; that is, the bank entity that owns the branch or agency most directly. The Board has also clarified that the procedures currently used for purposes of reporting to the Board on the Annual Report of Foreign Banking Organizations, Form FR Y–7, are also to be used in the calculation of the acceptance limits applicable to U.S. branches and agencies of foreign banks. (The FR Y–7 generally requires financial statements prepared in accordance with local accounting practices and an explanation of the accounting terminology and the major features of the accounting standards used in the preparation of the financial statements.) Conversions to the dollar equivalent of the worldwide capital of the foreign bank should be made periodically, but in no event less frequently than quarterly. In this regard, the Board recognizes the need to be flexible in dealing with the effect of foreign exchange rate fluctuations on the calculation of the worldwide capital of the parent foreign bank. Each foreign bank is to be responsible for coordinating the BA activity of its U.S. branches and agencies (including the aggregation of such activity) and establishing procedures that ensure that

examiners will be able readily to determine compliance with the BESA limits.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 28975, June 24, 1983]

### § 250.165 Bankers' acceptances: definition of participations.

(a)(1) Section 207 of the Bank Export Services Act (Title II of Pub. L. 97–290) (''BESA'') raised the limits on the aggregate amount of eligible bankers' acceptances (''BAs'') that may be created by a member bank from 50 percent (or 100 percent with the permission of the Board) of its paid up and unimpaired capital stock and surplus (''capital'') to 150 percent (or 200 percent with the permission of the Board) of its capital. Section 207 also prohibits a member bank from creating eligible BAs for any one person in the aggregate in excess of 10 percent of the institution's capital. Eligible BAs growing out of domestic transactions are not to exceed 50 percent of the aggregate of all eligible acceptances authorized for a member bank. This section of the BESA applies the same limits applicable to member banks to U.S. branches and agencies of foreign banks that are subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).[1]

(2) This section of the BESA also provides that any portion of an eligible BA created by a covered bank (''senior bank'') that is conveyed through a ''participation agreement'' to another covered bank (''junior bank'') shall *not* be included in the calculation of the senior bank's bankers' acceptance limits established by section 207 of BESA.[2] However, the amount of the participation *is* to be included in the BA limits applicable to the junior bank. The language of the statute does not define what constitutes a participation agreement for purposes of the applicability of the BESA limitations. However, the statute does authorize the Board to further define any of the terms used in section 207 of the BESA (12 U.S.C. 372(g)). The Board is clarifying the term participation for purposes of the BA limitations of the BESA.

(b) The legislative history of section 207 of the BESA indicates that Congress intended that the junior bank be obligated to the senior bank in the event that the account party defaults on its obligation to pay, but that the junior bank need not also be obligated to pay the holder of the acceptance at the time the BA is presented for payment. H. Rep. No. 97–629, 97th Cong., 2nd Sess. 15 (1982); 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks by Rep. Barnard): and 128 *Cong. Rec.* H 8462 (daily ed. October 1, 1982) (remarks by Rep. Barnard). The legislative history also indicates that Congress intended that eligible BAs in which participations had been conveyed not be required to indicate the name(s) (or interest(s)) of the junior bank(s) on the acceptance in order for the BA to be excluded from the BESA limitations applicable to the senior bank. 128 *Cong.* Rec. S 12237 (daily ed. September 24, 1982) (remarks of Senators Heinz and Garn): and 128 *Cong. Rec.* H 4647 (daily ed. July 27, 1982) (remarks of Rep. Barnard).

(c)(1) In view of Congressional intent with regard to what constitutes a participation in an eligible BA, the Board has determined that, for purposes of the BESA limits, a participation must satisfy the following two *minimum* requirements:

(i) A written agreement entered into between the junior and senior bank under which the junior bank acquires the senior bank's claim against the account party to the extent of the amount of the participation that is enforceable in the event that the account party fails to perform in accordance with the terms of the acceptance; and

(ii) The agreement between the junior and senior bank provides that the senior bank obtains a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account

[1] The institutions subject to the BA limitations of BESA will hereinafter be referred to as ''covered banks.''

[2] The use of the terms *senior bank* and *junior bank* has no implications regarding priority of claims. These terms merely represent a shorthand method of identifying the depository institution that has created the acceptance and conveyed the participation (senior bank) and the depository institution that has received the participation (junior bank).

party fails to perform in accordance with the terms of the acceptance.

(2) Consistent with Congressional intent, the minimum requirements do not require the junior bank to be obligated to pay the holder of the acceptance at the time the BA is presented for payment. Similarly, the minimum requirements do not require the name(s) or interest(s) of the junior bank(s) to appear on the face of the acceptance.

(3) An eligible BA that is conveyed through a participation that does not satisfy these minimum requirements would continue to be included in the BA limits applicable to the senior bank. Further, an eligible BA conveyed to a covered bank through a participation that provided for additional rights and obligations among the parties would be excluded from the BESA limitations of the senior bank provided the minimum requirements were satisfied.

(4) A participation structured pursuant to these minimum requirements would be as follows: Upon the conveyance of the participation, the senior bank retains its entire obligation to pay the holder of the BA at maturity. The senior bank has a claim against the junior bank to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance. Similarly, the junior bank has a corresponding claim against the account party to the extent of the amount of the participation that is enforceable in the event the account party fails to perform in accordance with the terms of the acceptance.

(d)(1) The Board is not requiring the senior bank and the account party specifically to agree that the senior bank's rights are assignable because the Board believes such rights to be assignable even in the absence of an explicit agreement.

(2) The junior and senior banks may contract among themselves as to which party(ies) have the responsibility for administering the arrangement, enforcing claims, or exercising remedies.

(e) The Board recognizes that both the junior bank's claim on the account party and the senior bank's claim on the junior bank involve risk. Therefore, it is essential that these risks be assessed by the banks involved in accordance with prudent and sound banking practices. The examiners will in the normal course of the examination process review the risk assessment procedures instituted by the banks. The junior bank should review the creditworthiness of each account party when the junior bank acquires a participation and the senior bank should review on an ongoing basis the creditworthiness of the junior bank. Junior bank agreement to rely exclusively upon the credit judgment of the senior bank and purchase on an ongoing basis from the senior bank all participations in BAs regardless of the identity of the account party is not appropriate in view of the risks involved. However, in those cases involving a participation between a parent bank and its Edge affiliate where the credit review for both entities is performed by the parent bank, the Edge Corporation should maintain documentation indicating that it concurs with the parent bank's analysis and that the acceptance participation is appropriate for inclusion in the Edge Corporation's portfolio.

(f) Similarly, the Board has determined that it is appropriate to include the risks incurred by the senior bank in assessing the senior bank's capital and the risks incurred by the junior bank in assessing the junior bank's capital.

(g) In view of this clarification of the issues relating to participations in BAs, the Board encourages the private sector to develop standardized forms for BAs and participations therein that clearly delineate the rights and responsibilities of the relevant parties.

(Sec. 13, Federal Reserve Act (12 U.S.C. 372))

[48 FR 57109, Dec. 28, 1983]

### § 250.166 Treatment of mandatory convertible debt and subordinated notes of state member banks and bank holding companies as "capital".

(a) *General.* Under the Board's risk-based capital guidelines, state member banks and bank holding companies may include in Tier 2 capital subordinated debt and mandatory convertible debt that meets certain criteria. The purpose of this interpretation is to

clarify these criteria. This interpretation should be read with those guidelines, particularly with paragraphs II.c. through II.e. of appendix A of 12 CFR part 208 if the issuer is a state member bank and with paragraphs II.A.2.c. and II.A.2.d. of appendix A of 12 CFR part 225 if the issuer is a bank holding company.

(b) *Criteria for subordinated debt included in capital*—(1) *Characteristics*. To be included in Tier 2 capital under the Board's risk-based capital guidelines for state member banks and bank holding companies, subordinated debt must be subordinated in right of payment to the claims of the issuer's general creditors[1] and, for banks, to the claims of depositors as well; must be unsecured; must state clearly on its face that it is not a deposit and is not insured by a federal agency; must have a minimum average maturity of five years;[2] must not contain provisions that permit debtholders to accelerate payment of principal prior to maturity except in the event of bankruptcy of or the appointment of a receiver for the issuing organization; must not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practice; and must not be credit sensitive.

(2) *Acceleration clauses*—(i) In order to be included in Tier 2 capital, the appendices provide that subordinated debt instruments must have an original weighted average maturity of at least five years. For this purpose, maturity is defined as the earliest possible date on which the holder can put the instrument back to the issuing banking organization. Since acceleration clauses permit the holder to put the debt back upon the occurrence of certain events, which could happen at any time after the instrument is issued, subordinated debt that includes provisions permitting acceleration upon events other than bankruptcy or reorganization under Chapters 7 (Liquidation) and 11 (Reorganization) of the Bankruptcy Code, in the case of a bank holding company, or insolvency—i.e., the appointment of a receiver—in the case of a state member bank, does not qualify for inclusion in Tier 2 capital.

(ii) Further, subordinated debt whose terms provide for acceleration upon the occurrence of events other than bankruptcy or the appointment of a receiver does not qualify as Tier 2 capital. For example, the terms of some subordinated debt issues would permit debtholders to accelerate repayment if the issuer failed to pay principal or interest on the subordinated debt issue when due (or within a certain timeframe after the due date), failed to make mandatory sinking fund deposits, defaulted on any other debt, failed to honor covenants, or if an institution affiliated with the issuer entered into bankruptcy or receivership. Some banking organizations have also issued, or proposed to issue, subordinated debt that would allow debtholders to accelerate repayment if, for example, the banking organization failed to maintain certain prescribed minimum capital ratios or rates of return, or if the amount of nonperforming assets or charge-offs of the banking organization exceeded a certain level.

(iii) These and other similar acceleration clauses raise significant supervisory concerns because repayment of the debt could be accelerated at a time when an organization may be experiencing financial difficulties. Acceleration of the debt could restrict the ability of the organization to resolve its problems in the normal course of business and could cause the organization involuntarily to enter into bankruptcy or receivership. Furthermore, since such acceleration clauses could allow the holders of subordinated debt to be paid ahead of general creditors or depositors, their inclusion in a debt issue throws into question whether the debt is, in fact, subordinated.

(iv) Subordinated debt issues whose terms state that the debtholders may accelerate the repayment of principal only in the event of bankruptcy or receivership of the issuer do not permit

[1] The risk-based capital guidelines for bank holding companies state that bank holding company debt must be subordinated to all senior indebtedness of the company. To meet this requirement, the debt should be subordinated to all general creditors.

[2] The ''average maturity'' of an obligation or issue repayable in scheduled periodic payments shall be the weighted average of the maturities of all such scheduled payments.

the holders of the debt to be paid before general creditors or depositors and do not raise supervisory concerns because the acceleration does not occur until the institution has failed. Accordingly, debt issues that permit acceleration of principal only in the event of bankruptcy (liquidation or reorganization) in the case of bank holding companies and receivership in the case of banks may generally be classified as capital.

(3) *Provisions inconsistent with safe and sound banking practices*—(i) The risk-based capital guidelines state that instruments included in capital may not contain or be covered by any covenants, terms, or restrictions that are inconsistent with safe and sound banking practice. As a general matter, capital instruments should not contain terms that could adversely affect liquidity or unduly restrict management's flexibility to run the organization, particularly in times of financial difficulty, or that could limit the regulator's ability to resolve problem bank situations. For example, some subordinated debt includes covenants that would not allow the banking organization to make additional secured or senior borrowings. Other covenants would prohibit a banking organization from disposing of a major subsidiary or undergoing a change in control. Such covenants could restrict the banking organization's ability to raise funds to meet its liquidity needs. In addition, such terms or conditions limit the ability of bank supervisors to resolve problem bank situations through a change in control.

(ii) Certain other provisions found in subordinated debt may provide protection to investors in subordinated debt without adversely affecting the overall benefits of the instrument to the organization. For example, some instruments include covenants that may require the banking organization to:

(A) Maintain an office or agency where securities may be presented,

(B) Hold payments on the securities in trust,

(C) Preserve the rights and franchises of the company,

(D) Pay taxes and assessments before they become delinquent,

(E) Provide an annual statement of compliance on whether the company has observed all conditions of the debt agreement, or

(F) Maintain its properties in good condition. Such covenants, as long as they do not unduly restrict the activity of the banking organization, generally would be acceptable in qualifying subordinated debt, provided that failure to meet them does not give the holders of the debt the right to accelerate the debt.[3]

(4) *Credit sensitive features*. Credit sensitive subordinated debt (including mandatory convertible securities) where payments are tied to the financial condition of the borrower generally do not qualify for inclusion in capital. Interest rate payments may be linked to the financial condition of an institution through various ways, such as through an auction rate mechanism, a preset schedule that either mandates interest rate increases as the credit rating of the institution declines or automatically increases them over the passage of time,[4] or that raises the interest rate if payment is not made in a

[3] This notice does not attempt to list or address all clauses included in subordinated debt; rather, it is intended to give general supervisory guidance regarding the types of clauses that could raise supervisory concerns. Issuers of subordinated debt may need to consult further with Federal Reserve staff about other subordinated debt provisions not specifically discussed above to determine whether such provisions are appropriate in a debt capital instrument.

[4] Although payments on debt whose interest rate increases over time on the surface may not appear to be directly linked to the financial condition of the issuing organization, such debt (sometimes referred to as expanding or exploding rate debt) has a strong potential to be credit sensitive in substance. Organizations whose financial condition has strengthened are more likely to be able to refinance the debt at a rate lower than that mandated by the preset increase, whereas institutions whose condition has deteriorated are less likely to be able to do so. Moreover, just when these latter institutions would be in the most need of conserving capital, they would be under strong pressure to redeem the debt as an alternative to paying higher rates and, thus, would accelerate depletion of their resources.

timely fashion.[5] As the financial condition of an organization declines, it is faced with higher and higher payments on its credit sensitive subordinated debt at a time when it most needs to conserve its resources. Thus, credit sensitive debt does not provide the support expected of a capital instrument to an institution whose financial condition is deteriorating; rather, the credit sensitive feature can accelerate depletion of the institution's resources and increase the likelihood of default on the debt.

(c) *Criteria for mandatory convertible debt included in capital.* Mandatory convertible debt included in capital must meet all the criteria cited above for subordinated debt with the exception of the minimum maturity requirement.[6] Since mandatory convertible debt eventually converts to an equity instrument, it has no minimum maturity requirement. Such debt, however, is subject to a maximum maturity requirement of 12 years.

(d) *Previously issued subordinated debt.* Subordinated debt including mandatory convertible debt that has been issued prior to the date of this interpretation and that contains provisions permitting acceleration for reasons other than bankruptcy or receivership of the issuing institution; includes other questionable terms or conditions; or that is credit sensitive will not automatically be excluded from capital. Rather, such debt will be considered on a case-by-case basis to determine whether it qualifies as Tier 2 capital. As a general matter, subordinated debt issued prior to the release of this interpretation and containing such provisions or features may qualify as Tier 2 capital so long as these terms:

(1) have been commonly used by banking organizations,

(2) do not provide an unreasonably high degree of protection to the holder in cases not involving bankruptcy or receivership, and

(3) do not effectively allow the holder to stand ahead of the general creditors of the issuing institution in cases of bankruptcy or receivership.

Subordinated debt containing provisions that permit the holders of the debt to accelerate payment of principal when the banking organization begins to experience difficulties, for example, when it fails to meet certain financial ratios, such as capital ratios or rates of return, does not meet these three criteria. Consequently, subordinated debt issued prior to the release of this interpretation containing such provisions may not be included within Tier 2 capital.

(e) *Limitations on the amount of subordinated debt in capital*—(1) *Basic limitation.* The amount of subordinated debt an institution may include in Tier 2 capital is limited to 50 percent of the amount of the institution's Tier 1 capital. The amount of a subordinated debt issue that may be included in Tier 2 capital is discounted as it approaches maturity; one-fifth of the original amount of the instrument, less any redemptions, is excluded each year from Tier 2 capital during the last five years prior to maturity. If the instrument has a serial redemption feature such that, for example, half matures in seven years and half matures in ten years, the issuing organization should begin discounting the seven-year portion after two years and the ten-year portion after five years.

(2) *Treatment of debt with dedicated proceeds.* If a banking organization has issued common or preferred stock and dedicated the proceeds to the redemption of a mandatory convertible debt security, that portion of the security covered by the amount of the proceeds so dedicated is considered to be ordinary subordinated debt for capital purposes, provided the proceeds are not placed in a sinking fund, trust fund, or similar segregated account or are not used in the interim for some other purpose. Thus, dedicated portions of mandatory convertible debt securities are

[5] While such terms may be acceptable in perpetual preferred stock qualifying as Tier 2 capital, it would be inconsistent with safe and sound banking practice to include debt with such terms in Tier 2 capital. The organization does not have the option, as it does with auction rate preferred stock issues, of eliminating the higher payments on the subordinated debt without going into default.

[6] Mandatory convertible debt is subordinated debt that contains provisions committing the issuing organization to repay the principal from the proceeds of future equity issues.

subject, like other subordinated debt, to the 50 percent sublimit within Tier 2 capital, as well as to discounting in the last five years of life. Undedicated portions of mandatory convertible debt may be included in Tier 2 capital without any sublimit and are not subject to discounting.

(3) *Treatment of debt with segregated funds.* In some cases, the provisions in mandatory convertible debt issues may require the issuing banking organization to set up a sinking fund, trust fund, or similar segregated account to hold the proceeds from the sale of equity securities dedicated to pay off the principal of the mandatory convertible debt at maturity. The portion of mandatory convertibles covered by the amount of proceeds deposited in such a segregated fund is considered secured and, thus, may not be included in capital at all, let alone be treated as subordinated debt that is subject to the 50 percent sublimit within Tier 2 capital. The maintenance of such separate segregated funds for the redemption of mandatory convertible debt exceeds the requirements of appendix B to Regulation Y. Accordingly, if a banking organization, with the agreement of its debtholders, seeks Federal Reserve approval to eliminate such a fund, approval normally would be given unless supervisory concerns warrant otherwise.

(f) *Redemption of subordinated debt prior to maturity*—(1) *By state member banks.* State member banks must obtain approval from the appropriate Reserve Bank prior to redeeming before maturity subordinated debt or mandatory convertible debt included in capital.[7] A Reserve Bank will not approve such early redemption unless it is satisfied that the capital position of the bank will be adequate after the proposed redemption.

(2) *By bank holding companies.* While bank holding companies are not formally required to obtain approval prior to redeeming subordinated debt, the risk-based capital guidelines state that bank holding companies should consult with the Federal Reserve before redeeming any capital instruments prior to stated maturity. This also applies to any redemption of mandatory convertible debt with proceeds of an equity issuance that were dedicated to the redemption of that debt. Accordingly, a bank holding company should consult with its Reserve Bank prior to redeeming subordinated debt or dedicated portions of mandatory convertible debt included in capital. A Reserve Bank generally will not acquiesce to such a redemption unless it is satisfied that the capital position of the bank holding company would be adequate after the proposed redemption.

(3) *Special concerns involving mandatory convertible debt.* Consistent with appendix B to Regulation Y, bank holding companies wishing to redeem before maturity undedicated portions of mandatory convertible debt included in capital are required to receive prior Federal Reserve approval, unless the redemption is effected with the proceeds from the sale or common or perpetual preferred stock. An organization planning to effect such a redemption with the proceeds from the sale of common or perpetual preferred stock is advised to consult informally with its Reserve Bank in order to avoid the possibility of taking an action that could result in weakening its capital position. A Reserve Bank will not approve the redemption of mandatory convertible securities, or acquiesce in such a redemption effected with the sale of common or perpetual preferred stock, unless it is satisfied that the capital position of the bank holding company will be satisfactory after the redemption.[8]

[57 FR 40598, Sept. 4, 1992]

[7] Some agreements governing mandatory convertible debt issued prior to the risk-based capital guidelines provide that the bank may redeem the notes if they no longer count as primary capital as defined in appendix B to Regulation Y. Such a provision does not obviate the requirement to receive Federal Reserve approval prior to redemption.

[8] The guidance contained in this paragraph applies to mandatory convertible debt issued prior to the risk-based capital guidelines that state that the banking organization may redeem the notes if they no longer count as primary capital as defined in appendix B to Regulation Y. Such provisions do not obviate the need to consult with, or obtain approval from, the Federal Reserve prior to redemption of the debt.

**§ 250.180 Reports of changes in control of management.**

(a) Under a statute enacted September 12, 1964 (Pub. L. 88–593; 78 Stat. 940) all insured banks are required to report promptly (1) changes in the outstanding voting stock of the bank which will result in control or in a change in control of the bank and (2) any instances where the bank makes a loan or loans, secured, or to be secured, by 25 percent or more of the outstanding voting stock of an insured bank.

(b) Reports concerning changes in control of a State member bank are to be made by the president or other chief executive officer of the bank, and shall be submitted to the Federal Reserve Bank of its district.

(c) Reports concerning loans by an insured bank on the stock of a State member bank are to be made by the president or other chief executive officer of the lending bank, and shall be submitted to the Federal Reserve Bank of the State member bank on the stock of which the loan was made.

(d) Paragraphs 3 and 4 of this legislation specify the information required in the reports which, in cases involving State member banks, should be addressed to the Vice President in Charge of Examinations of the appropriate Federal Reserve Bank.

(12 U.S.C. 1817)

**§ 250.181 Reports of change in control of bank management incident to a merger.**

(a) A State member bank has inquired whether Pub. L. 88–593 (78 Stat. 940) requires reports of change in control of bank management in situations where the change occurs as an incident in a merger.

(b) Under the Bank Merger Act of 1960 (12 U.S.C. 1828(c)), no bank with Federal deposit insurance may merge or consolidate with, or acquire the assets of, or assume the liability to pay deposits in, any other insured bank without prior approval of the appropriate Federal bank supervisory agency. Where the bank resulting from any such transaction is a State member bank, the Board of Governors is the agency that must pass on the transaction. In the course of consideration of such an application, the Board would, of necessity, acquire knowledge of any change in control of management that might result. Information concerning any such change in control of management is supplied with each merger application and, in the circumstances, it is the view of the Board that the receipt of such information in connection with a merger application constitutes compliance with Pub. L. 88–593. However, once a merger has been approved and completely effectuated, the resulting bank would thereafter be subject to the reporting requirements of Pub. L. 88–593.

(12 U.S.C. 1817)

**§ 250.182 Terms defining competitive effects of proposed mergers.**

Under the Bank Merger Act (12 U.S.C. 1828(c)), a Federal Banking agency receiving a merger application must request the views of the other two banking agencies and the Department of Justice on the competitive factors involved. Standard descriptive terms are used by the Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency. The terms and their definitions are as follows:

(a) The term *monopoly* means that the proposed transaction must be disapproved in accordance with 12 U.S.C. 1828(c)(5)(A).

(b) The term *substantially adverse* means that the proposed transaction would have anticompetitive effects which preclude approval unless the anticompetitive effects are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served as specified in 12 U.S.C. 1828(c)(5)(B).

(c) The term *adverse* means that proposed transaction would have anticompetitive effects which would be material to the decision but which would not preclude approval.

(d) The term *no significant effect* means that the anticompetitive effects of the proposed transaction, if any, would not be material to the decision.

(12 U.S.C. 1828(c))

[45 FR 45257, July 3, 1980]

**§ 250.200 Investment in bank premises by holding company banks.**

(a) The Board of Governors has been asked whether, in determining under section 24A of the Federal Reserve Act (12 U.S.C. 371d) how much may be invested in bank premises without prior Board approval, a State member bank, which is owned by a registered bank holding company, is required to include indebtedness of a corporation, wholly owned by the holding company, that is engaged in holding premises of banks in the holding company system.

(b) Section 24A provides, in part, as follows:

> Hereafter * * * no State member bank, without the approval of the Board of Governors of the Federal Reserve System, shall (1) invest in bank premises, or in the stock, bonds, debentures, or other such obligations of any corporation holding the premises of such bank or (2) make loans to or upon the security of the stock of any such corporation, if the aggregate of all such investments and loans, together with the amount of any indebtedness incurred by any such corporation which is an affiliate of the bank, as defined in section 2 of the Banking Act of 1933, as amended [12 U.S.C. 221a], will exceed the amount of the capital stock of such banks.

(c) A corporation that is owned by a holding company is an ''affiliate of each of the holding company's majority-owned banks as that term is defined in said section 2. Therefore, under the explicit provisions of section 24A, each State member bank, any part of whose premises is owned by such an affiliate, must include the affiliate's total indebtedness in determining whether a proposed premises investment by the bank would cause the aggregate figure to exceed the amount of the bank's capital stock, so that the Board's prior approval would be required. Where the affiliate holds the premises of a number of the holding company's banks, the amount of the affiliate's indebtedness may be so large that Board approval is required for every proposed investment in bank premises by each majority-owned State member bank, to which the entire indebtedness of the affiliate is required to be attributed. The Board believes that, in these circumstances, individual approvals are not essential to effectuate the purpose of section 24A, which is to safeguard the soundness and liquidity of member banks, and that the protection sought by Congress can be achieved by a suitably circumscribed general approval.

(d) Accordingly the Board hereby grants general approval for any investment or loan (as described in section 24A) by any State member bank, the majority of the stock of which is owned by a registered bank holding company, if the proposed investment or loan will not cause either (1) all such investments and loans by the member bank (together with the indebtedness of any bank premises subsidiary thereof) to exceed 100 percent of the bank's capital stock, or (2) the aggregate of such investments and loans by all of the holding company's subsidiary banks (together with the indebtedness of any bank premises affiliates thereof) to exceed 100 percent of the aggregate capital stock of said banks.

(12 U.S.C. 221a, 371d)

**§ 250.220 Whether member bank acting as trustee is prohibited by section 20 of the Banking Act of 1933 from acquiring majority of shares of mutual fund.**

(a) The Board recently considered whether section 20 of the Banking Act of 1933 (12 U.S.C. 377) would prohibit a member bank, while acting as trustee of a tax exempt employee benefit trust or trusts, from, under the following circumstances, acquiring a majority of the shares of an open-end investment company (''Fund'') registered under the Investment Company Act of 1940, or more than 50 percent of the number of Fund's shares voted at the preceding election of directors of the Fund.

(b) The bank has acted as trustee, since December 1963, pursuant to a trust agreement with a county medical society to administer its group retirement program, under which individual members of the society could participate in accordance with the provisions of the Self-Employed Individuals Tax Retirement Act of 1962 (commonly referred to as ''H.R. 10'').

(c) Under the trust agreement as presently constituted, each employer, who is a participating member of the medical society, directs the bank to invest his contributions to the retirement plan in such proportions as he

may elect in insurance or annuity contracts or in a diversified portfolio of securities and other property. The diversified portfolio held by the bank is invested and administered by the bank solely at the direction of a committee of the medical society.

(d) It has now been proposed that the trust agreement be amended to provide that all investments constituting the trust fund, apart from insurance and annuity contracts, will be made exclusively in shares of a single open-end investment company to be named in the trust agreement and that the assets constituting the diversified portfolio now held by the bank, as trustee, will be exchanged for the Fund's shares. The bank will, in addition to holding the shares of the Fund, allocate income and dividends to the accounts of the various participants in the retirement program, invest and reinvest income and dividends, and perform other ministerial functions.

(e) In addition, it is proposed to amend the trust agreement so that voting of the shares held by the bank as trustee will be controlled exclusively by the participants. Under the proposed amendment, the bank will sign all proxies prior to mailing them to the participants,

> it being intended that the Participant(s) shall vote the proxies notwithstanding the fact that the Trustee is the owner of the shares * * *.

(f) The bank believes that amendments are now under consideration that will also require investment of the assets of these plans exclusively in the Fund's shares. Accordingly, the bank may eventually own the Fund's shares in several separate trust accounts and in an aggregate amount equal to a majority of the Fund's shares.

(g) Section 20 of the Banking Act of 1933 provides in relevant part that

> no member bank shall be affiliated in any manner described in section 2(b) hereof with any corporation * * * engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks * * * or other securities: * * *.

(h) Section 2(b) defines the term *affiliate* to include

> any corporation, business trust, association or other similar organization (1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; * * *.

(i) The Board has previously taken the position, in an interpretation involving the term *affiliate* under the Banking Act of 1933, that it would not require a member bank to obtain and publish a report of a corporation the majority of the stock of which is held by the member bank as executor or trustee, provided that the member bank holds such stock subject to control by a court or by a beneficiary or other principal and that the member bank may not lawfully exercise control of such stock independently of any order or direction of a court, beneficiary or other principal. 1933 Federal Reserve Bulletin 651. The rationale of that interpretation—which was reaffirmed by the Board in 1957—would appear to be equally applicable to the facts in the present case. In the circumstances, and on the basis of the Board's understanding that the bank will not vote any of Fund's shares or control in any manner the election of any of its directors, trustees, or other persons exercising similar functions, the Board has concluded that the situation in question would not fall within the purpose or coverage of section 20 of the Banking Act of 1933 and, therefore, would not involve a violation of the statute.

### § 250.221 Issuance and sale of short-term debt obligations by bank holding companies.

(a) The opinion of the Board of Governors of the Federal Reserve System has been requested recently with respect to the proposed sale of ''thrift notes'' by a bank holding company for the purpose of supplying capital to its wholly-owned nonbanking subsidiaries.

(b) The thrift notes would bear the name of the holding company, which in the case presented, was substantially similar to the name of its affiliated

banks. It was proposed that they be issued in denominations of $50 to $100 and initially be of 12-month or less maturities. There would be no maximum amount of the issue. Interest rates would be variable according to money market conditions but would presumably be at rates somewhat above those permitted by Regulation Q ceilings. There would be no guarantee or indemnity of the notes by any of the banks in the holding company system and, if required to do so, the holding company would place on the face of the notes a negative representation that the purchase price was not a deposit, nor an indirect obligation of banks in the holding company system, nor covered by deposit insurance.

(c) The notes would be generally available for sale to members of the public, but only at offices of the holding company and its nonbanking subsidiaries. Although offices of the holding company may be in the same building or quarters as its banking offices, they would be physically separated from the banking offices. Sales would be made only by officers or employees of the holding company and its nonbanking subsidiaries. Initially, the notes would only be offered in the State in which the holding company was principally doing business, thereby complying with the exemption provided by section 3(a)(11) of the Securities Act of 1933 (15 U.S.C. 77c) for ''intra-state'' offerings. If it was decided to offer the notes on an interstate basis, steps would be taken to register the notes under the Securities Act of 1933. Funds from the sale of the notes would be used only to supply the financial needs of the nonbanking subsidiaries of the holding company. These nonbank subsidiaries are, at present, a small loan company, a mortgage banking company and a factoring company. In no instance would the proceeds from the sale of the notes be used in the bank subsidiaries of the holding company nor to maintain the availability of funds in its bank subsidiaries.

(d) The sale of the thrift notes, in the specific manner proposed, is an activity described in section 20 of the Banking Act of 1933 (12 U.S.C. 377), that is, ''the issue, flotation, underwriting, public sale or distribution * * * of * * * notes, or other securities''. Briefly stated, this statute prohibits a member bank to be affiliated with a company ''engaged principally'' in such activity. Since the continued issuance and sale of such securities would be necessary to permit maintenance of the holding company's activities without substantial contraction and would be an integral part of its operations, the Board concluded that the issuance and sale of such notes would constitute a principal activity of a holding company within the spirit and purpose of the statute. (For prior Board decisions in this connection, see 1934 Federal Reserve Bulletin 485, 12 CFR 218.104, 12 CFR 218.105 and 12 CFR 218.101.)

(e) In reaching this conclusion, the Board distinguished the proposed activity from the sale of short-term notes commonly known as *commercial paper*, which is a recognized form of financing for bank holding companies. For purposes of this interpretation, *commercial paper* may be defined as notes, with maturities not exceeding nine months, the proceeds of which are to be used for current transactions, which are usually sold to sophisticated institutional investors, rather than to members of the general public, in minimum denominations of $10,000 (although sometimes they may be sold in minimum denominations of $5,000). Commercial paper is exempt from registration under the Securities Act of 1933 by reason of the exemption provided by section 3(a)(3) thereof (15 U.S.C. 77c). That exemption is inapplicable where the securities are sold to the general public (17 CFR 231.4412). The reasons for such exemption, taken together with the abuses that gave rise to the passage of the Banking Act of 1933 (''the Glass-Steagall Act''), have led the Board to conclude that the issuance of commercial paper by a bank holding company is not an activity intended to be included within the scope of section 20.

(Interprets and applies 12 U.S.C. 377 and 1843)

[Reg. Y, 38 FR 35231, Dec. 26, 1973]

### § 250.260 Miscellaneous interpretations; gold coin and bullion.

The Board has received numerous inquiries from member banks relating to the repeal of the ban on ownership of

gold by United States citizens. Listed below are questions and answers which affect member banks and relate to the responsibilities of the Federal Reserve System.

(a) May gold in the form of coins or bullion be counted as vault cash in order to satisfy reserve requirements? No. Section 19(c) of the Federal Reserve Act requires that reserve balances be satisfied either by a balance maintained at the Federal Reserve Bank or by vault cash, consisting of United States currency and coin. Gold in bullion form is not United States currency. Since the bullion value of United States gold coins far exceeds their face value, member banks would not in practice distribute them over the counter at face value to satisfy customer demands.

(b) Will the Federal Reserve Banks perform services for member banks with respect to gold, such as safekeeping or assaying? No.

(c) Will a Federal Reserve Bank accept gold as collateral for an advance to a member bank under section 10(b) of the Federal Reserve Act? No.

[39 FR 45254, Dec. 31, 1974]

INTERPRETATIONS OF SECTION 32 OF THE GLASS-STEAGALL ACT

### § 250.400 Service of open-end investment company.

An open-end investment company is defined in section 5(a)(1) of the Investment Company Act of 1940 as a company ''which is offering for sale or has outstanding any redeemable security of which it is the issuer.'' Section 2(a)(31) of said act provides that a *redeemable security* means ''any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.''

It is customary for such companies to have but one class of securities, namely, capital stock, and it is apparent that the more or less continued process of redemption of the stock issued by such a company would restrict and contract its activities if it did not continue to issue its stock. Thus, the issuance and sale of its stock is essential to the maintenance of the company's size and to the continuance of operations without substantial contraction, and therefore the issue and sale of its stock constitutes one of the primary activities of such a company.

Accordingly, it is the opinion of the Board that if such a company is issuing or offering its redeemable stock for sale, it is ''primarily engaged in the issue * * * public sale, or distribution, * * * of securities'' and that section 32 of the Banking Act of 1933, as amended, prohibits an officer, director or employee of any such company from serving at the same time as an officer, director or employee of any member bank. It is the Board's view that this is true even though the shares are sold to the public through independent organizations with the result that the investment company does not derive any direct profit from the sales.

If, however, the company has ceased to issue or offer any of its stock for sale, the company would not be engaged in the issue or distribution of its stock, and, therefore, the prohibition contained in section 32 would be inapplicable unless the company were primarily engaged in the underwriting, public sale or distribution of securities other than its own stock.

[16 FR 4963, May 26, 1951. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.401 Director serving member bank and closed-end investment company being organized.

(a) The Board has previously expressed the opinion (§ 218.101) that section 32 of the Banking Act of 1933 (12 U.S.C. 78) is applicable to a director of a member bank serving as a director of an open-end investment company, because the more or less continued process of redemption of the stock issued by such company makes the issuance and sale of its stock essential to the maintenance of the company's size and to the continuance of operations, with the result that the issuance and sale of its stock constitutes one of the primary activities of such a company. The Board also stated that if the company

had ceased to issue or offer any of its stock for sale, the company would not be engaged in the issuance or distribution of its stock and therefore the prohibitions of section 32 would not be applicable. Subsequently, the Board expressed the opinion that section 32 would not be applicable in the case of a closed-end investment company.

(b) The Board has recently stated that it believed that a closed-end company which was in process of organization and was actively engaged in issuing and selling its shares was in the same position relative to section 32 as an open-end company, and that the section would be applicable while this activity continued.

[25 FR 3464, Apr. 21, 1960. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.402 Service as officer, director, or employee of licensee corporation under the Small Business Investment Act of 1958.

(a) The Board of Governors has been requested to express an opinion whether § 218.1 would prohibit an officer, director, or employee of a member bank from serving at the same time as an officer, director, or employee of a Licensee corporation under the Small Business Investment Act of 1958 (15 U.S.C. 661 *et seq.*). It is understood that a Licensee would be authorized to engage only in the activities set forth in the statute, namely, to provide capital and long-term loan funds to small business concerns.

(b) In the opinion of the Board, a corporation engaged exclusively in the enumerated activities would not be ''primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities.'' Accordingly, the prohibition of § 218.1 would not apply to serving as an officer, director, or employee of either a small business investment company organized under the Small Business Investment Act of 1958, or an investment company chartered under the laws of a State solely for the purpose of operating under the Small Business Investment Act of 1958.

[25 FR 4427, May 19, 1960. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.403 Service of member bank and real estate investment company.

(a) The Board recently considered two inquiries regarding the question whether proposed real estate investment companies would be subject to the provisions of sections 20 and 32 of the Banking Act of 1933 (12 U.S.C. 377 and 78). These sections relate to affiliations between member banks and companies engaged principally in the issue, flotation, underwriting, public sale or distribution of stocks, bonds, or similar securities, and interlocking directorates between member banks and companies primarily so engaged. In both instances the companies, after their organization, would engage only in the business of financing real estate development or investing in real estate interests, and not in the type of business described in the statute. However, each of the companies, in the process of its organization, would issue its own stock. In one instance, it appeared that the stock would be issued over a period of from 30 to 60 days; in the other instance it was stated that the stock would be sold by a firm of underwriters and that distribution was expected to be completed in not more than a few days.

(b) On the basis of the facts stated, the Board concluded that the companies involved would not be subject to sections 20 and 32 of the Banking Act of 1933, since they would not be principally or primarily engaged in the business of issuing or distributing securities but would only be issuing their own stock for a period ordinarily required for corporate organization. The Board stated, however, that if either of the companies should subsequently issue additional shares frequently and in substantial amounts relative to the size of the company's capital structure, it would be necessary for the Board to reconsider the matter.

(c) Apart from the legal question, the Board noted that an arrangement of the kind proposed could involve some dangers to an affiliated bank because the relationship might tend to impair the independent judgment that should be exercised by the bank in appraising its credits and might cause the company to be so identified in the minds of

the public with the bank that any financial reverses suffered by the company might affect the confidence of the public in the bank.

(d) Because of the foregoing conclusion that the companies would not be subject to sections 20 and 32, it seems advisable to clarify § 218.102, in which the Board took the position that a closed-end investment company which was in process of organization and was actively engaged in issuing and selling its shares was subject to section 32 as long as this activity continued. That interpretation should be regarded as applicable only where the circumstances are such as to indicate that the issuance of the company's stock is a primary or principal activity of the company. For example, such circumstances might exist where the initial stock of a company is actively issued over a period of time longer than that ordinarily required for corporate organization, or where, subsequent to organization, the company issues its own stock frequently and in substantial amounts relative to the total amount of shares outstanding.

[26 FR 868, Jan. 28, 1961. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.404 Serving as director of member bank and corporation selling own stock.

(a) The Board recently considered the question whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) would be applicable to the service of a director of a corporation which planned to acquire or organize, as proceeds from the sale of stock became available, subsidiaries to operate in a wide variety of fields, including manufacturing, foreign trade, leasing of heavy equipment, and real estate development. The corporation had a paid-in capital of about $60,000 and planned to sell additional shares at a price totaling $10 million, with the proviso that if less than $3 million worth were sold by March 1962, the funds subscribed would be refunded. It thus appeared to be contemplated that the sale of stock would take at least a year, and there appeared to be no reason for believing that, if the venture proved successful, additional shares would not be offered so that the corporation could continue to expand.

(b) The Board concluded that section 32 would be applicable, stating that although § 218.102, as clarified by § 218.104, related to closed-end investment companies, the rationale of that interpretation is applicable to corporations generally.

[26 FR 2456, Mar. 23, 1961. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.405 No exception granted a special or limited partner.

(a) The Board has been asked on several occasions whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) is applicable to a director, officer, or employee of a member bank who is a special or limited partner in a firm primarily engaged in the business described in that section.

(b) Since the Board cannot issue an individual permit, it can exempt a limited or special partner only by amending part 218 (Regulation R). After the statute was amended in 1935 so as to make it applicable to a *partner*, the Board carefully considered the desirability of making such an exception. On several subsequent occasions it has reconsidered the question. In each instance the Board has decided that in view of a limited partner's interest in the underwriting and distributing business, it should not make the exception.

[27 FR 7954, Aug. 10, 1962. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.406 Serving member bank and investment advisor with mutual fund affiliation.

(a) The opinion of the Board of Governors of the Federal Reserve System has been requested with respect to service as vice president of a corporation engaged in supplying investment advice and management services to mutual funds and others (''Manager'') and as director of a member bank.

(b) Section 32 of the Banking Act of 1933 (12 U.S.C. 78), forbids any officer, director, or employee of any corporation ''primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities * * *'' to serve at the same time as an officer, director, or employee of a member bank.

(c) Manager has for several years served a number of different open-end or mutual funds, as well as individuals, institutions, and other clients, as an investment advisor and manager. However, it appears that Manager has a close relationship with two of the mutual funds which it serves. A wholly owned subsidiary of Manager (''Distributors''), serves as distributor for the two mutual funds and has no other function. In addition, the chairman and treasurer of Manager, as well as the president, assistant treasurer, and a director of Manager, are officers and directors of Distributors and trustees of both funds. It appears also that a director of Manager is president and director of Distributors, while the clerk of Manager is also clerk of Distributors. Manager, Distributors and both funds are listed at the same address in the local telephone directory.

(d) While the greater part of the total annual income of Manager during the past five years has derived from ''individuals, institutions, and other clients'', it appears that a substantial portion has been attributable to the involvement with the two funds in question. During each of the last four years, that portion has exceeded a third of the total income of Manager, and in 1962 it reached nearly 40 percent.

(e) The Board has consistently held that an open-end or mutual fund is engaged in the activities described in section 32, so long as it is issuing its securities for sale, since it is apparent that the more or less continued process of redemption of the stock issued by such a company would restrict and contract its activities if it did not continue to issue the stock. Clearly, a corporation that is engaged in underwriting or selling open-end shares, is so engaged.

(f) In connection with incorporated manager-advisors to open-end or mutual funds, the Board has expressed the view in a number of cases that where the corporation served a number of different clients, and the corporate structure was not interlocked with that of mutual fund and underwriter in such a way that it could be regarded as being controlled by or substantially one with them, it should not be held to be ''primarily engaged'' in section 32 activities. On the other hand, where a manager-advisor was created for the sole purpose of serving a particular fund, and its activities were limited to that function, the Board has regarded the group as a single entity for purposes of section 32.

(g) In the present case, the selling organization is a wholly-owned subsidiary of the advisor-manager, hence subject to the parent's control. Stock of the subsidiary will be voted according to decisions by the parent's board of directors, and presumably will be voted for a board of directors of the subsidiary which is responsive to policy lines laid down by the parent. Financial interests of the parent are obviously best served by an aggressive selling policy, and, in fact, both the share and the absolute amount of the parent's income provided by the two funds have shown a steady increase over recent years. The fact that dividends from Distributors have represented a relatively small proportion of the income of Manager, and that there were, indeed, no dividends in 1961 or 1962, does not support a contrary argument, in view of the steady increase in total income of Manager from the funds and Distributors taken as a whole.

(h) In view of all these facts, the Board has concluded that the separate corporate entities of Manager and Distributors should be disregarded and Distributors viewed as essentially a selling arm of Manager. As a result of this conclusion, section 32 would forbid interlocking service as an officer of Manager and a director of a member bank.

[28 FR 13437, Dec. 12, 1963. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.407 Interlocking relationship involving securities affiliate of brokerage firm.

(a) The Board of Governors was asked recently whether section 32 of the Banking Act of 1933 (''section 32''), 12 U.S.C. 78, prohibits the interlocking service of X as a director of a member bank of the Federal Reserve System and as a partner in a New York City brokerage firm (''Partnership'') having a corporation affiliate (''Corporation'')

engaged in business of the kinds described in section 32 (''section 32 business'').

(b) Section 32, subject to an exception not applicable here, provides that

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank * * *.

(c) From the information submitted it appears that Partnership, a member firm of the New York Stock Exchange, is the successor of two prior partnerships, in one of which X had been a partner. This prior partnership had been found not to be ''primarily engaged'' in section 32 business. The other prior partnership, however, had been so engaged. By arrangement between the two prior firms, Corporation was formed chiefly for the purpose of carrying on the section 32 business of the prior firm that had been ''primarily engaged'' in that business, which business was transferred to Corporation. The two prior firms were then merged and the stock of Corporation was acquired by all the partners of Partnership, other than X, in proportion to the respective partnership interests of the stockholding partners. The information submitted indicated also that two of the three directors and ''some'' of the principal officers of Corporation are partners in Partnership, although X is not a director or officer of Corporation.

(d) It is understood that the practice of forming corporate affiliates of brokerage firms, in order that the affiliate may carry on the securities business (such as section 32 business) with limited liability and other advantages, has become rather widespread in recent years. Accordingly, other cases may arise where a partner in such a firm may desire to serve at the same time as director of a member bank.

(e) On the basis of the information presented the Board concluded that X in his capacity as an ''individual'', was not engaged in section 32 business. However, as that information showed Corporation to be ''primarily engaged'' in section 32 business, the Board stated that a finding that Partnership and Corporation were one entity for the purposes of the statute would mean that X would be forbidden to serve both the member bank and Partnership, if the one entity were so engaged.

(f) Paragraph .15 of Rule 321 of the New York Stock Exchange governing the formation and conduct of affiliated companies of member organizations states that:

> Since Rule 314 provides that each member and allied member in a member organization must have a fixed interest in its entire business, it follows that the fixed interest of each member and allied member must extend to the member organization's corporate affiliate. When any of the corporate affiliate's participating stock is owned by the members and allied members in the member organization, such holdings must at all times be distributed among such members and allied members in approximately the same proportions as their respective interests in the profits of the member organization. When a member or allied member's interest in the member organization is changed, a corresponding change must be made in his participating interest in the affiliate.

(g) Although it was understood that X had received special permission from the Exchange not to own any of the stock of Corporation, it appeared to the Board that Rule 321.15 would apply to the remaining partners. Moreover, other paragraphs of the rule forbid transfers of the stock, except under certain circumstances to limited classes of persons, such as employees of the organization or estates of decedent partners, without permission of the Exchange.

(h) The information supplied to the Board clearly indicated that Corporation was formed in order to provide Partnership with an ''underwriting arm''. Under Rule 321 of the Exchange, the partners (other than X) are required to own stock in Corporation because of their partnership interest, would be required to surrender that stock on leaving the partnership, and incoming partners would be required to acquire such stock. Furthermore, Rule 321 speaks of a corporate affiliate, such as Corporation, as a part of the ''entire business'' of a member organization.

(i) On the basis of the foregoing, the Board concluded that Partnership and Corporation must be regarded as a single entity or enterprise for purposes of section 32.

(j) The remaining question was whether the enterprise, as a whole, should be regarded as ''primarily engaged'' in section 32 business. The Information presented stated that the total dollar volume of section 32 business of Corporation during the first eleven months of its operation was $89 million. The gross income from section 32 business was less than half a million, and represented about 7.9 percent of the income of Partnership. The Board was advised that the relatively low amount of income from section 32 business of Corporation as due to special costs, and to the condition of the market for municipal and State bonds during the past year, a field in which Corporation specializes. Corporation is listed in a standard directory of securities dealers, and holds itself out as having separate departments to deal with the principal underwriting areas in which it functions.

(k) In view of the above information, the Board concluded that the enterprise consisting of Partnership and Corporation was ''primarily engaged'' in section 32 business. Accordingly, the Board stated that the partners in Partnership, including X, were forbidden by that section and by this part 218 (Reg. R), issued pursuant to the statute, to serve as officers, directors, or employees of any member banks.

[29 FR 5315, Apr. 18, 1964. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.408 Short-term negotiable notes of banks not securities under section 32, Banking Act of 1933.

(a) The Board of Governors has been asked whether short-term unsecured negotiable notes of the kinds issued by some of the large banks in this country as a means of obtaining funds are ''other similar securities'' within the meaning of section 32, Banking Act of 1933 (12 U.S.C. 78) and this part.

(b) Section 32 forbids certain interlocking relationships between banks which are members of the Federal Reserve System and individuals or organizations ''primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities * * *.'' Therefore, if such notes are securities similar to stocks or bonds, any dealing therein would be an activity covered in section 32 and would have to be taken into consideration in determining whether the individual or organization involved was ''primarily engaged'' in such activities.

(c) The Board has concluded that such short-term notes of the kind described above are not ''other similar securities'' within the meaning of section 32 and this part.

[29 FR 16065, Dec. 2, 1964. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.409 Investment for own account affects applicability of section 32.

(a) The Board of Governors has been presented with the question whether a certain firm is primarily engaged in the activities described in section 32 of the Banking Act of 1933. If the firm is so engaged, then the prohibitions of section 32 forbids a limited partner to serve as employee of a member bank.

(b) The firm describes the bulk of its business, producing roughly 60 percent of its income, as ''investing for its own account.'' However, it has a seat on the local stock exchange, and acts as specialist and odd-lot dealer on the floor of the exchange, an activity responsible for some 30 percent of its volume and profits. The firm's ''off-post trading,'' apart from the investment account, gives rise to about 5 percent of its total volume and 10 percent of its profits. Gross volume has risen from $4 to $10 million over the past 3 years, but underwriting has accounted for no more than one-half of 1 percent of that amount.

(c) Section 32 provides that

> No officer, director, or employee of any corporation or unincorporated association, no partner, or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale, or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time (sic) as an officer, director, or employee of any member bank * * *

(d) In interpreting this language, the Board has consistently held that underwriting, acting as a dealer, or generally speaking, selling, or distributing securities as a principal, is covered by the section, while acting as broker or agent is not.

(e) In one type of situation, however, although a firm was engaged in selling securities as principal, on its own behalf, the Board held that section 32 did not apply. In these cases, the firm alleged that it bought and sold securities purely for investment purposes. Typically, those cases involved personal holding companies or small family investment companies. Securities had been purchased only for members of a restricted family group, and had been held for relatively long periods of time.

(f) The question now before the Board is whether a similar exception can apply in the case of the investment account of a professional dealer. In order to answer this question, it is necessary to analyze, in the light of applicable principles under the statute, the three main types of activity in which the firm has been engaged, (1) acting as specialist and odd-lot dealer, (2) off-post trading as an ordinary dealer, and (3) investing for its own account.

(g) On several occasions, the Board has held that, to the extent the trading of a specialist or odd-lot dealer is limited to that required for him to perform his function on the floor of the exchange, he is acting essentially in an agency capacity. In a letter of September 13, 1934, the Board held that the business of a specialist was not of the kind described in the (unamended) section on the understanding that

> * * * in acting as specialists on the New York Curb Exchange, it is necessary for the firm to buy and sell odd lots and * * * in order to protect its position after such transactions have been made, the firm sells or buys shares in lots of 100 or multiples thereof in order to reduce its position in the stock in question to the smallest amount possible by this method. It appears therefore that, in connection with these transactions, the firm is neither trading in the stock in question or taking a position in it except to the extent made necessary by the fact that it deals in odd lots and cannot complete the transactions by purchases and sales on the floor of the exchange except to the nearest 100 share amount.

(h) While subsequent amendments to section 32 to some extent changed the definition of the kinds of securities business that would be covered by the section, the amendments were designed so far as is relevant to the present question, to embody existing interpretations of the Board. Accordingly, to the extent that the firm's business is described by the above letter of the Board, it should not be considered to be of a kind described in section 32.

(i) Turning to the firm's off-post trading, the Board is inclined to agree with the view that this is sufficient to make the case a borderline one under the statute. In the circumstances, the Board might prefer to postpone making a determination until figures for 1965 could be reviewed, particularly in the light of the recent increase in total volume, if it were not for the third category, the firm's own investment account.

(j) While this question has not been squarely presented to it in the past, the Board is of the opinion that when a firm is doing any significant amount of business as a dealer or underwriter, then investments for the firm's own account should be taken into consideration in determining whether the firm is ''primarily engaged'' in the activities described in section 32. The division into dealing for one's own account, and dealing with customers, is a highly subjective one, and although a particular firm or individual may be quite scrupulous in separating the two, the opportunity necessarily exists for the kind of abuse at which the statute is directed. The Act is designed to prevent situations from arising in which a bank director, officer, or employee could influence the bank or its customers to invest in securities in which his firm has an interest, regardless of whether he, as an individual, is likely to do so. In the present case, when these activities are added to the firm's ''off-post trading'', the firm clearly falls within the statutory definition.

(k) For the reasons just discussed, the Board concludes that the firm must be considered to be primarily engaged in activities described in section 32, and that the prohibitions of the section

forbid a limited partner in that firm to serve as employee of a member bank.

(12 U.S.C. 248(i))

[30 FR 7743, June 16, 1965. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.410 Interlocking relationships between bank and its commingled investment account.

(a) The Board of Governors was asked recently whether the establishment of a proposed ''Commingled Investment Account'' (''Account'') by a national bank would involve a violation of section 32 of the Banking Act of 1933 in view of the interlocking relationships that would exist between the bank and Account.

(b) From the information submitted, it was understood that Account would comprise a commingled fund, to be operated under the effective control of the bank, for the collective investment of sums of money that might otherwise be handled individually by the bank as managing agent. It was understood further that the Comptroller of the Currency had taken the position that Account would be an eligible operation for a national bank under his Regulation 9, ''Fiduciary Powers of National Banks and Collective Investment Funds'' (part 9 of this title). The bank had advised the Board that the Securities and Exchange Commission was of the view that Account would be a ''registered investment company'' within the meaning of the Investment Company Act of 1940, and that participating interests in Account would be ''securities'' subject to the registration requirements of the Securities Act of 1933.

(c) The information submitted showed also that the minimum individual participation that would be permitted in Account would be $10,000, while the maximum acceptable individual investment would be half a million dollars; that there would be no ''load'' or payment by customers for the privilege of investing in Account; and that:

The availability of the Commingled Account would not be given publicity by the Bank except in connection with the promotion of its fiduciary services in general and the Bank would not advertise or publicize the Commingled Account as such. Participations in the Commingled Account are to be made available only on the premises of the Bank (including its branches), or to persons who are already customers of the Bank in other connections, or in response to unsolicited requests.

(d) Such information indicated further that participations would be received by the bank as agent, under a broad authorization signed by the customer, substantially equivalent to the power of attorney under which customers currently deposit their funds for individual investment, and that the participations would not be received ''in trust.''

(e) The Board understood that Account would be required to comply with certain requirements of the Federal securities laws not applicable to an ordinary common trust fund operated by a bank. In particular, supervision of Account would be in the hands of a committee to be initially appointed by the bank, but subsequently elected by participants having a majority of the units of participation in Account. At least one member of the committee would be entirely independent of the bank, but the remaining members would be officers in the trust department of the bank.

(f) The committee would make a management agreement with the bank under which the bank would be responsible for managing Account's investments, have custody of its assets, and maintain its books and records. The management agreement would be renewed annually if approved by the committee, including a ''majority'' of the independent members, or by a vote of participants having a majority of the units of participation. The agreement would be terminable on 60 days' notice by the committee, by such a majority of the participants, or by the bank, and would terminate automatically if assigned by the bank.

(g) It was understood also that the bank would receive as annual compensation for its services one-half of one percent of Account's average net assets. Account would also pay for its own independent professional services, including legal, auditing, and accounting services, as well as the cost of

maintaining its registration and qualification under the Federal securities laws.

(h) Initially, the assets of Account would be divided into units of participation of an arbitrary value, and each customer would be credited with a number of units proportionate to his investment. Subsequently, the assets of Account would be valued at regular intervals, and divided by the number of units outstanding. New investors would receive units at their current value, determined in this way, according to the amount invested. Each customer would receive a receipt evidencing the number of units to which he was entitled. The receipts themselves would be nontransferable, but it would be possible for a customer to arrange with Account for the transfer of his units to someone else. A customer could terminate his participation at any time and withdraw the current value of his units.

(i) Section 32 of the Banking Act of 1933 provides in relevant part that:

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve [at] the same time as an officer, director, or employee of any member bank * * *.

(j) The Board concluded, based on its understanding of the proposal and on the general principles that have been developed in respect to the application of section 32, that the bank and Account would constitute a single entity for the purposes of section 32, at least so long as the operation of Account conformed to the representations made by the bank and outlined herein. Accordingly, the Board said that section 32 would not forbid officers of the bank to serve on Account's committee, since Account would be regarded as nothing more than an arm or department of the bank.

(k) In conclusion, the Board called attention to section 21 of the Banking Act of 1933 which, briefly, forbids a securities firm or organization to engage in the business of receiving deposits, subject to certain exceptions. However, since section 21 is a criminal statute, the Board has followed the policy of not expressing views as to its meaning. (1934 Federal Reserve Bulletin 41, 543.) The Board, therefore, expressed no position with respect to whether the section might be held applicable to the establishment and operation of the proposed ''Commingled Investment Account.''

(12 U.S.C. 248(i))

[30 FR 12836, Oct. 8, 1965. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.411 Interlocking relationships between member bank and variable annuity insurance company.

(a) The Board has recently been asked to consider whether section 32 of the Banking Act of 1933 (12 U.S.C. 78) and this part prohibit interlocking service between member banks and (1) the board of managers of an accumulation fund, registered under the Investment Company Act of 1940 (15 U.S.C. 80), that sells variable annuities and (2) the board of directors of the insurance company, of which the accumulation fund is a ''separate account,'' but as to which the insurance company is the sponsor, investment advisor, underwriter, and distributor. Briefly, a variable annuity is one providing for annuity payment varying in accordance with the changing values of a portfolio of securities.

(b) Section 32 provides in relevant part that:

> No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve [at] the same time as an officer, director, or employee of any member bank * * *.

(c) For many years, the Board's position has been that an open-end investment company (or mutual fund) is ''primarily engaged in the issue * * * public sale, or distribution * * * of securities'' since the issuance and sale of its stock is essential to the maintenance of the company's size and to the continuance of its operations without

substantial contraction, and that section 32 of the Banking Act of 1933 prohibits an officer, director, or employee of any such company from serving at the same time as an officer, director, or employee of any member bank. (1951 Federal Reserve Bulletin 645; § 218.101.)

(d) For reasons similar to those stated by the U.S. Supreme Court in Securities and Exchange Commission *v.* Variable Annuity Life Insurance Company of America, 359 U.S. 65 (1959), the Board concluded that there is no meaningful basis for distinguishing a variable annuity interest from a mutual fund share for section 32 purposes and that, therefore, variable annuity interests should also be regarded as ''other similar securities'' within the prohibition of the statute and regulation.

(e) The Board concluded also that, since the accumulation fund, like a mutual fund, must continually issue and sell its investment units in order to avoid the inevitable contraction of its activities as it makes annuity payments or redeems variable annuity units, the accumulation fund is ''primarily engaged'' for section 32 purposes. The Board further concluded that the insurance company was likewise ''primarily engaged'' for the purposes of the statute since it had no significant revenue producing operations other than as underwriter and distributor of the accumulation fund's units and investment advisor to the fund.

(f) Although it was clear, therefore, that section 32 prohibits any officers, directors, and employees of member banks from serving in any such capacity with the insurance company or accumulation fund, the Board also considered whether members of the board of managers of the accumulation fund are ''officers, directors, or employees'' within such prohibition. The functions of the board of managers, who are elected by the variable annuity contract owners, are, with the approval of the variable annuity contract owners, to select annually an independent public accountant, execute annually an agreement providing for investment advisory services, and recommend any changes in the fundamental investment policy of the accumulation fund. In addition, the Board of managers has sole authority to execute an agreement providing for sales and administrative services and to authorize all investments of the assets of the accumulation fund in accordance with its fundamental investment policy. In the opinion of the Board of Governors, the board of managers of the accumulation fund performs functions essentially the same as those performed by classes of persons as to whom the prohibition of section 32 was specifically directed and, accordingly, are within the prohibitions of the statute.

(12 U.S.C. 248(i))

[33 FR 12886, Sept. 12, 1968. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.412 Interlocking relationships between member bank and insurance company-mutual fund complex.

(a) The Board has been asked whether section 32 of the Banking Act of 1933 and this part prohibited interlocking service between member banks and (1) the advisory board of a newly organized open-end investment company (mutual fund), (2) the fund's incorporated investment manager-advisor, (3) the insurance company sponsoring and apparently controlling the fund.

(b) X Fund, Inc. (''Fund''), the mutual fund, was closely related to X Life Insurance Company (''Insurance Company''), as well as to the incorporated manager and investment advisor to Fund (''Advisors''), and the corporation serving as underwriter for Fund (''Underwriters''). The same persons served as principal officers and directors of Insurance Company, Fund, Advisors, and Underwriters. In addition, several directors of member banks served as directors of Insurance Company and of Advisors and as members of the Advisory Board of Fund, and additional directors of member banks had been named only as members of the Advisory Board. All outstanding shares of Advisors and of Underwriters were apparently owned by Insurance Company.

(c) Section 32 provides in relevant part that:

> No officer, director, or employee of any corporation * * * primarily engaged in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve

[at] the same time as an officer, director, or employee of any member bank * * *.

(d) The Board of Governors reaffirmed its earlier position that an open-end investment company is ''primarily engaged'' in activities described in section 32 ''even though the shares are sold to the public through independent organizations with the result that the investment company does not derive any direct profit from the sales.'' (1951 Federal Reserve Bulletin 654, § 218.101.) Accordingly, the Board concluded that Fund must be regarded as so engaged, even though its shares were underwritten and distributed by Underwriters.

(e) As directors of the member banks involved in the inquiry were not officers, directors, or employees of either Fund or Underwriters, the relevant questions were whether—(1) Advisors, and (2) Insurance Company, should be regarded as being functionally and structurally so closely allied with Fund that they should be treated as one with it in determining the applicability of section 32. An additional question was whether members of the Advisory Board are ''officers, directors, or employees'' of Fund within the prohibition of the statute.

(f) Interlocking service with Advisory Board: The function of the Advisory Board was merely to make suggestions and to counsel with Fund's Board of Directors in regard to investment policy. The Advisory Board had no authority to make binding recommendations in any area, and it did not serve in any sense as a check on the authority of the Board of Directors. Indeed, the Fund's bylaws provided that the Advisory Board ''shall have no power or authority to make any contract or incur any liability whatever or to take any action binding upon the Corporation, the Officers, the Board of Directors or the Stockholders.'' Members of the Advisory Board were appointed by the Board of Directors of Fund, which could remove any member of the Advisory Board at any time. None of the principal officers of Fund or of Underwriters were members of the Advisory Board; and the compensation of its members was expected to be nominal.

(g) The Board of Governors concluded that members of the Advisory Board need not be regarded as ''officers, directors, or employees'' of Fund or of Underwriters for purposes of section 32, and that the statute, therefore, did not prohibit officers, directors, or employees of member banks from serving as members of the Advisory Board.

(h) Interlocking service with Advisors: The principal officers and several of the directors of Advisors were identical with both those of Fund and of Underwriters. Entire management and investment responsibility for Fund had been placed, by contract, with Advisors, subject only to a review authority in the Board of Directors of Fund. Advisors also supplied office space for the conduct of Fund's affairs, and compensated members of the Advisory Board who are also officers or directors of Advisors. Moreover, it appeared that Advisors was created for the sole purpose of servicing Fund, and its activities were to be limited to that function.

(i) In the view of the Board of Governors, the structural and functional identity of Fund and Advisors was such that they were to be regarded as a single entity for purposes of section 32, and, accordingly, officers, directors, and employees of member banks were prohibited by section 32 from serving in any such capacity with such entity.

(j) Interlocking service with Insurance Company: It was clear that Insurance Company was not as yet ''primarily engaged'' in business of a kind described in section 32 with respect to the shares of the newly created Fund sponsored by Insurance Company, since the issue and sale of such shares had not yet commenced. Nor did it appear that Insurance Company would be so engaged in the preliminary stages of Fund's existence, when the disproportion between the insurance business of Insurance Company and the sale of Fund shares would be very great. However, it was also clear that if Fund was successfully launched, its activities would rather quickly reach a stage where a serious question would arise as to the applicability of the section 32 prohibition.

(k) An estimate supplied to the Board indicated that 100,000 shares of Fund might be sold annually to produce, based on then current values, annual

gross sales receipts of over $1 million. Insurance Company's total gross income for its last fiscal year was almost $10 million. On this basis, about one-tenth of the annual gross income of the Insurance Company-Fund complex (more than one-tenth, if income from investments of Insurance Company was eliminated) would be derived from sales of Fund shares. Although total sales of shares of Fund during the first year might not approximate expectations, it was assumed that if the estimate or projection was correct, the annual rate of sale might well rise to that level before the end of the first year of operation.

(l) It appeared that net income of Insurance Company from Fund's operations would be minimal for the foreseeable future. However, it was understood that Insurance Company's chief reason for launching Fund was to provide salesmen for Insurance Company (who were to be the only sellers of shares of Fund, and most of whom, Insurance Company hoped, would qualify to sell those shares), with a ''package'' of mutual fund shares and life insurance policies that would provide increased competitive strength in a highly competitive field.

(m) The Board concluded that Insurance Company would be ''primarily engaged'' in issuing or distributing shares of Fund within the meaning of section 32 by not later than the time of realization of the aforementioned estimated annual rate of sale, and possibly before. As indicated in Board of Governors v. Agnew, 329 U.S. 441 at 446, the prohibition of the statute applies if the section 32 business involved is a ''substantial'' activity of the company.

(n) This, the Board observed, was not to suggest that officers, directors, or employees of Insurance Company who are also directors of member banks would be likely, as individuals, to use their positions with the banks to further sales of Fund's shares. However, as the Supreme Court pointed out in the Agnew case, section 32 is a ''preventive or prophylactic measure.'' The fact that the individuals involved ''have been scrupulous in their relationships'' to the banks in question ''is immaterial.''

(12 U.S.C. 248(i))

[33 FR 13001, Sept. 14, 1968. Redesignated at 61 FR 57289, Nov. 6, 1996]

### § 250.413 "Bank-eligible" securities activities.

Section 32 of the Glass-Steagall Act (12 U.S.C. 78) prohibits any officer, director, or employee of any corporation or unincorporated association, any partner or employee of any partnership, and any individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, from serving at the same time as an officer, director, or employee of any member bank of the Federal Reserve System. The Board is of the opinion that to the extent that a company, other entity or person is engaged in securities activities that are expressly authorized for a state member bank under section 16 of the Glass-Steagall Act (12 U.S.C. 24(7), 335), the company, other entity or individual is not engaged in the types of activities described in section 32. In addition, a securities broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32.

[Reg. R, 61 FR 57289, Nov. 6, 1996]

## PART 261—RULES REGARDING AVAILABILITY OF INFORMATION

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AUTHORITY: 5 U.S.C. 552; 12 U.S.C. 248(i) and (k), 321 *et seq.*, 611 *et seq.*, 1442, 1817(a)(2)(A), 1817(a)(8), 1818(u) and (v), 1821(o), 1821(t), 1830, 1844, 1951 *et seq.*, 2601, 2801 *et seq.*, 2901 *et seq.*, 3101 *et seq.*, 3401 *et seq.*; 15 U.S.C. 77uuu(b), 78q(c)(3); 29 U.S.C. 1204; 31 U.S.C. 5301 *et seq.*; 42 U.S.C. 3601; 44 U.S.C. 3510.

SOURCE: 53 FR 20815, June 7, 1988, unless otherwise noted.

## Subpart A—General Provisions

SOURCE: 62 FR 54359, Oct. 20, 1997, unless otherwise noted.

### § 261.1 Authority, purpose, and scope.

(a) *Authority.* (1) This part is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Freedom of Information Act, 5 U.S.C. 552; Sections 9, 11, and 25A of the Federal Reserve Act, 12 U.S.C. 248(i) and (k), 321 *et seq.*, (including 326), 611 *et seq.*; Section 22 of the Federal Home Loan Bank Act, 12 U.S.C 1442; the Federal Deposit Insurance Act, 12 U.S.C. 1817(a)(2)(A), 1817(a)(8), 1818(u) and (v), 1821(o); section 5 of the Bank Holding Company Act, 12 U.S.C. 1844; the Bank Secrecy Act, 12 U.S.C. 1951 *et seq.*, and Chapter 53 of Title 31; the Home Mortgage Disclosure Act, 12 U.S.C. 2801 *et seq.*; the Community Reinvestment Act, 12 U.S.C. 2901 *et seq.*; the International Banking Act, 12 U.S.C. 3101 *et seq.*; the Right to Financial Privacy Act, 12 U.S.C. 3401 *et seq.*; the Securities and Exchange Commission Authorization Act, 15 U.S.C. 77uuu(b), 78q(c)(3); the Employee Retirement Income Security Act, 29 U.S.C. 1204; the Money Laundering Suppression Act, 31 U.S.C. 5301, the Fair Housing Act, 42 U.S.C. 3601; the Paperwork Reduction Act, 44 U.S.C. 3510; and any other applicable law that establishes a basis for the exercise of governmental authority by the Board.

(2) This part establishes mechanisms for carrying out the Board's statutory responsibilities under statutes in paragraph (a)(1) of this section to the extent those responsibilities require the disclosure, production, or withholding of information. In this regard, the Board has determined that the Board, or its delegees, may disclose exempt information of the Board, in accordance with the procedures set forth in this part, whenever it is necessary or appropriate to do so in the exercise of any of the Board's supervisory or regulatory authorities, including but not limited to, authority granted to the Board in the Federal Reserve Act, 12 U.S.C. 221 *et seq.*, the Bank Holding Company Act, 12 U.S.C. 1841 *et seq.*, and the International Banking Act, 12 U.S.C. 3101 *et seq*. The Board has determined that all such disclosures, made in accordance with the rules and procedures specified in this part, are authorized by law.

(3) The Board has also determined that it is authorized by law to disclose information to a law enforcement or other federal or state government agency that has the authority to request and receive such information in carrying out its own statutory responsibilities, or in response to a valid order of a court of competent jurisdiction or of a duly constituted administrative tribunal.

(b) *Purpose.* This part sets forth the categories of information made available to the public, the procedures for obtaining documents and records, the procedures for limited release of exempt and confidential supervisory information, and the procedures for protecting confidential business information.

(c) *Scope.* (1) This subpart A contains general provisions and definitions of terms used in this part.

(2) Subpart B of this part implements the Freedom of Information Act (FOIA) (5 U.S.C. 552).

(3) Subpart C of this part sets forth:

(i) The kinds of exempt information made available to supervised institutions, supervisory agencies, law enforcement agencies, and others in certain circumstances;

(ii) The procedures for disclosure; and

(iii) The procedures with respect to subpoenas, orders compelling production, and other process.

[62 FR 54359, Oct. 20, 1997; 62 FR 62508, Nov. 24, 1997]

### § 261.2 Definitions.

For purposes of this part:

(a) *Board's official files* means the Board's central records.

(b) *Commercial use request* refers to a request from or on behalf of one who seeks information for a use or purpose that furthers the commercial, trade, or profit interests of the requester or the person on whose behalf the request is made.

(c)(1) *Confidential supervisory information* means:

(i) Exempt information consisting of reports of examination, inspection and visitation, confidential operating and condition reports, and any information derived from, related to, or contained in such reports;

(ii) Information gathered by the Board in the course of any investigation, suspicious activity report, cease-and-desist orders, civil money penalty enforcement orders, suspension, removal or prohibition orders, or other orders or actions under the Financial Institutions Supervisory Act of 1966, Pub.L. 89-695, 80 Stat. 1028 (codified as amended in scattered sections of 12 U.S.C.), the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*,the Federal Reserve Act, 12 U.S.C. 221 *et seq.*, the International Banking Act of 1978, Pub.L. 95–369, 92 Stat. 607 (codified as amended in scattered sections of 12 U.S.C.), and the International Lending Supervision Act of 1983, 12 U.S.C. 3901 *et seq.*; except—

(A) Such final orders, amendments, or modifications of final orders, or other actions or documents that are specifically required to be published or made available to the public pursuant to 12 U.S.C. 1818(u), or other applicable law, including the record of litigated proceedings; and

(B) The public section of Community Reinvestment Act examination reports, pursuant to 12 U.S.C. 2906(b); and

(iii) Any documents prepared by, on behalf of, or for the use of the Board, a Federal Reserve Bank, a federal or state financial institutions supervisory agency, or a bank or bank holding company or other supervised financial institution.

(2) *Confidential supervisory information* does not include documents prepared by a supervised financial institution for its own business purposes and that are in its possession.

(d) *Direct costs* mean those expenditures that the Board actually incurs in searching for, reviewing, and duplicating documents in response to a request made under § 261.12.

(e) *Duplication* refers to the process of making a copy of a document in response to a request for disclosure of records or for inspection of original records that contain exempt material or that otherwise cannot be inspected directly. Among others, such copies may take the form of paper, microform, audiovisual materials, or machine-readable documentation (e.g., magnetic tape or disk).

(f) *Educational institution* refers to a preschool, a public or private elementary or secondary school, or an institution of undergraduate higher education, graduate higher education, professional education, or an institution of vocational education, which operates a program of scholarly research.

(g) *Exempt information* means information that is exempt from disclosure under § 261.14.

(h) *Noncommercial scientific institution* refers to an institution that is not operated on a ''commercial'' basis (as that term is used in this section) and that is operated solely for the purpose of conducting scientific research, the results of which are not intended to promote any particular product or industry.

(i)(1) *Records of the Board* include:

(i) In written form, or in nonwritten or machine-readable form; all information coming into the possession and under the control of the Board, any

Board member, any Federal Reserve Bank, or any officer, employee, or agent of the Board or of any Federal Reserve Bank, in the performance of functions for or on behalf of the Board that constitute part of the Board's official files; or

(ii) That are maintained for administrative reasons in the regular course of business in official files in any division or office of the Board or any Federal Reserve Bank in connection with the transaction of any official business.

(2) *Records of the Board* does not include personal files of Board members and employees; tangible exhibits, formulas, designs, or other items of valuable intellectual property; extra copies of documents and library and museum materials kept solely for reference or exhibition purposes; unaltered publications otherwise available to the public in Board publications, libraries, or established distribution systems.

(j) *Report of examination* means the report prepared by the Board, or other federal or state financial institution supervisory agency, concerning the examination of a financial institution, and includes reports of inspection and reports of examination of U.S. branches or agencies of foreign banks and representative offices of foreign organizations, and other institutions examined by the Federal Reserve System.

(k) *Report of inspection* means the report prepared by the Board concerning its inspection of a bank holding company and its bank and nonbank subsidiaries.

(l) *Representative of the news media* refers to any person actively gathering news for an entity that is organized and operated to publish or broadcast news to the public.

(1) The term ''news'' means information that is about current events or that would be of current interest to the public.

(2) Examples of news media entities include, but are not limited to, television or radio stations broadcasting to the public at large, and publishers of periodicals (but only in those instances when they can qualify as disseminators of ''news'') who make their products available for purchase or subscription by the general public.

(3) ''Freelance'' journalists may be regarded as working for a news organization if they can demonstrate a solid basis for expecting publication through that organization, even though they are not actually employed by it.

(m)(1) *Review* refers to the process of examining documents, located in response to a request for access, to determine whether any portion of a document is exempt information. It includes doing all that is necessary to excise the documents and otherwise to prepare them for release.

(2) *Review* does not include time spent resolving general legal or policy issues regarding the application of exemptions.

(n)(1) *Search* means a reasonable search, by manual or automated means, of the Board's official files and any other files containing Board records as seem reasonably likely in the particular circumstances to contain information of the kind requested. For purposes of computing fees under § 261.17, search time includes all time spent looking for material that is responsive to a request, including line-by-line identification of material within documents. Such activity is distinct from ''review'' of material to determine whether the material is exempt from disclosure.

(2) *Search* does not mean or include research, creation of any document, or extensive modification of an existing program or system that would significantly interfere with the operation of the Board's automated information systems.

(o) *Supervised financial institution* includes a bank, bank holding company (including subsidiaries), U.S. branch or agency of a foreign bank, or any other institution that is supervised by the Board.

### § 261.3 Custodian of records; certification; service; alternative authority.

(a) *Custodian of records.* The Secretary of the Board (Secretary) is the official custodian of all Board records, including records that are in the possession or control of the Board, any Federal Reserve Bank, or any Board or Reserve Bank employee.

(b) *Certification of record*. The Secretary may certify the authenticity of any Board record, or any copy of such record, for any purpose, and for or before any duly constituted federal or state court, tribunal, or agency.

(c) *Service of subpoenas or other process*. Subpoenas or other judicial or administrative process, demanding access to any Board records or making any claim against the Board, shall be addressed to and served upon the Secretary of the Board at the Board's office at 20th and C Streets, N.W., Washington, D.C. 20551. Neither the Board nor the Secretary are agents for service of process on behalf of any employee in respect of purely private legal disputes, except as specifically provided by law.

(d) *Alternative authority*. Any action or determination required or permitted by this part to be done by the Secretary, the General Counsel, or the Director of any Division may be done by any employee who has been duly designated for this purpose by the Secretary, General Counsel, or the appropriate Director.

## Subpart B—Published Information and Records Available to Public; Procedures for Requests

SOURCE: 62 FR 54359, 54361, Oct. 20, 1997, unless otherwise noted.

### § 261.10 Published information.

(a) FEDERAL REGISTER. The Board publishes in the FEDERAL REGISTER for the guidance of the public:

(1) Descriptions of the Board's central and field organization;

(2) Statements of the general course and method by which the Board's functions are channeled and determined, including the nature and requirements of procedures;

(3) Rules of procedure, descriptions of forms available and the place where they may be obtained, and instructions on the scope and contents of all papers, reports, and examinations;

(4) Substantive rules, interpretations of general applicability, and statements of general policy;

(5) Every amendment, revision, or repeal of the foregoing in paragraphs (a)(1) through (a)(4) of this section;

(6) Notices of proposed rulemaking;

(7) Notices of applications received under the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*) and the Change in Bank Control Act (12 U.S.C. 1817);

(8) Notices of all Board meetings, pursuant to the Government in the Sunshine Act (5 U.S.C. 552b);

(9) Notices identifying the Board's systems of records, pursuant to the Privacy Act of 1974 (5 U.S.C. 552a); and

(10) Notices of agency data collection forms being reviewed under the Paperwork Reduction Act (5 U.S.C. 3501 *et seq.*).

(b) *Board's Reports to Congress*. The Board's annual report to Congress pursuant to the Federal Reserve Act (12 U.S.C. 247), which is made public upon its submission to Congress, contains a full account of the Board's operations during the year, the policy actions by the Federal Open Market Committee, an economic review of the year, and legislative recommendations to Congress. The Board also makes periodic reports to Congress under certain statutes, including but not limited to the Freedom of Information Act (5 U.S.C. 552); the Government in the Sunshine Act (5 U.S.C. 552b); the Full Employment and Balanced Growth Act of 1978 (12 U.S.C. 225a); and the Privacy Act (5 U.S.C. 552a).

(c) *Federal Reserve Bulletin*. This publication is issued monthly and contains economic and statistical information, articles relating to the economy or Board activities, and descriptions of recent actions by the Board.

(d) *Other published information*. Among other things, the Board publishes the following information:

(1) *Weekly publications*. The Board issues the following publications weekly:

(i) A statement showing the condition of each Federal Reserve Bank and a consolidated statement of the condition of all Federal Reserve Banks, pursuant to 12 U.S.C. 248(a);

(ii) An index of applications received and the actions taken on the applications, as well as other matters issued,

adopted, or promulgated by the Board; and

(iii) A statement showing changes in the structure of the banking industry resulting from mergers and the establishment of branches.

(2) *Press releases.* The Board frequently issues statements to the press and public regarding monetary and credit actions, regulatory actions, actions taken on certain types of applications, and other matters.

(3) *Call Report and other data.* Certain data from Reports of Condition and Income submitted to the Board are available through the National Technical Information Service and may be obtained by the procedure described in § 261.11(c)(2).

(4) *Federal Reserve Regulatory Service.* This is a multivolume looseleaf service published by the Board, containing statutes, regulations, interpretations, rulings, staff opinions, and procedural rules under which the Board operates. Portions of the service are also published as separate looseleaf handbooks relating to consumer and community affairs, monetary policy and reserve requirements, payments systems, and securities credit transactions. The service and each handbook contain subject and citation indexes, are updated monthly, and may be subscribed to on a yearly basis.

(e) *Index to Board actions.* The Board's Freedom of Information Office maintains an index to Board actions, which is updated weekly and provides identifying information about any matters issued, adopted, and promulgated by the Board since July 4, 1967. Copies of the index may be obtained upon request to the Freedom of Information Office subject to the current schedule of fees in § 261.17.

(f) *Obtaining Board publications.* The Publications Services Section maintains a list of Board publications that are available to the public. In addition, a partial list of publications is published in the *Federal Reserve Bulletin.* All publications issued by the Board, including available back issues, may be obtained from Publications Services, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 (pedestrian entrance is on C Street, N.W.). Subscription or other charges may apply to some publications.

### § 261.11 Records available for public inspection and copying.

(a) *Types of records made available.* Unless they were published promptly and made available for sale or without charge, the following records shall be made available for inspection and copying at the Freedom of Information Office:

(1) Final opinions, including concurring and dissenting opinions, as well as final orders and written agreements, made in the adjudication of cases;

(2) Statements of policy and interpretations adopted by the Board that are not published in the FEDERAL REGISTER;

(3) Administrative staff manuals and instructions to staff that affect the public;

(4) Copies of all records released to any person under § 261.12 that, because of the nature of their subject matter, the Board has determined are likely to be requested again;

(5) A general index of the records referred to in paragraph (a)(4) of this section; and

(6) The public section of Community Reinvestment Act examination reports.

(b) *Reading room procedures.* (1) Information available under this section is available for inspection and copying, from 9:00 a.m. to 5:00 p.m. weekdays, at the Freedom of Information Office of the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 (the pedestrian entrance is on C Street, N.W.).

(2) The Board may determine that certain classes of publicly available filings shall be made available for inspection and copying only at the Federal Reserve Bank where those records are filed.

(c) *Electronic records.* (1) Except as set forth in paragraph (c)(2) of this section, information available under this section that was created by the Board on or after November 1, 1996, shall also be available on the Board's internet site (which can be found at *http://www.bog.frb.fed.us*).

(2) *NTIS*. The publicly available portions of Reports of Condition and Income of individual banks and certain other data files produced by the Board are distributed by the National Technical Information Service. Requests for these public reports should be addressed to: Sales Office, National Technical Information Service, U.S. Department of Commerce, 5285 Port Royal Road, Springfield, Virginia 22161, (703) 487–4650.

(3) *Privacy protection*. The Board may delete identifying details from any record to prevent a clearly unwarranted invasion of personal privacy.

### § 261.12 Records available to public upon request.

(a) *Types of records made available*. All records of the Board that are not available under §§ 261.10 and 261.11 shall be made available upon request, pursuant to the procedures and exceptions in this Subpart B.

(b) *Procedures for requesting records*. (1) A request for identifiable records shall reasonably describe the records in a way that enables the Board's staff to identify and produce the records with reasonable effort and without unduly burdening or significantly interfering with any of the Board's operations.

(2) The request shall be submitted in writing to the Freedom of Information Office, Board of Governors of the Federal Reserve System, 20th & C Street, N.W., Washington, D.C. 20551; or sent by facsimile to the Freedom of Information Office, (202) 872–7562 or 7565. The request shall be clearly marked *FREEDOM OF INFORMATION ACT REQUEST*.

(3) A request may not be combined with any other request to the Board except for a request under 12 CFR 261a.3(a) (Rules Regarding Access to and Review of Personal Information under the Privacy Act of 1974) and a request made under § 261.22(b).

(c) *Contents of request*. The request shall contain the following information:

(1) The name and address of the requester, and the telephone number at which the requester can be reached during normal business hours;

(2) Whether the requested information is intended for commercial use, and whether the requester is an educational or noncommercial scientific institution, or news media representative;

(3) A statement agreeing to pay the applicable fees, or a statement identifying any desired fee limitation, or a request for a waiver or reduction of fees that satisfies § 261.17(f); and

(4) If the request is being made in connection with on-going litigation, a statement indicating whether the requester will seek discretionary release of exempt information from the General Counsel upon denial of the request by the Secretary. A requester who intends to make such a request to the General Counsel may also address the factors set forth in § 261.22(b).

(d) *Defective requests*. The Board need not accept or process a request that does not reasonably describe the records requested or that does not otherwise comply with the requirements of this section. The Board may return a defective request, specifying the deficiency. The requester may submit a corrected request, which will be treated as a new request.

(e) *Oral requests*. The Freedom of Information Office may honor an oral request for records, but if the requester is dissatisfied with the Board's response and wishes to seek review, the requester must submit a written request, which shall be treated as an initial request.

[62 FR 54362, Oct. 20, 1997; 62 FR 62508, Nov. 24, 1997]

### § 261.13 Processing requests.

(a) *Receipt of requests*. Upon receipt of any request that satisfies § 261.12(b), the Freedom of Information Office shall assign the request to the appropriate processing schedule, pursuant to paragraph (b) of this section. The date of receipt for any request, including one that is addressed incorrectly or that is referred to the Board by another agency or by a Federal Reserve Bank, is the date the Freedom of Information Office actually receives the request.

(b) *Multitrack processing*. (1) The Board provides different levels of processing for categories of requests under this section. Requests for records that are readily identifiable by the Freedom

of Information Office and that have already been cleared for public release may qualify for fast-track processing. All other requests shall be handled under normal processing procedures, unless expedited processing has been granted pursuant to paragraph (c)(2) of this section.

(2) The Freedom of Information Office will make the determination whether a request qualifies for fast-track processing. A requester may contact the Freedom of Information Office to learn whether a particular request has been assigned to fast-track processing. If the request has not qualified for fast-track processing, the requester will be given an opportunity to limit the request in order to qualify for fast-track processing. Limitations of requests must be in writing.

(c) *Expedited processing*. When a person requesting expedited access to records has demonstrated a compelling need for the records, or when the Board has determined to expedite the response, the Board shall process the request as soon as practicable.

(1) To demonstrate a compelling need for expedited processing, the requester shall provide a certified statement, a sample of which may be obtained from the Freedom of Information Office. The statement, which must be certified to be true and correct to the best of the requester's knowledge and belief, shall demonstrate that:

(i) The failure to obtain the records on an expedited basis could reasonably be expected to pose an imminent threat to the life or physical safety of an individual; or

(ii) The requester is a representative of the news media, as defined in § 261.2, and there is urgency to inform the public concerning actual or alleged Board activity.

(2) In response to a request for expedited processing, the Secretary shall notify a requester of the determination within ten calendar days of receipt of the request. If the Secretary denies a request for expedited processing, the requester may file an appeal pursuant to the procedures set forth in paragraph (i) of this section, and the Board shall respond to the appeal within ten working days after the appeal was received by the Board.

(d) *Priority of responses*. The Secretary will assign responsible staff to process particular requests. The Freedom of Information Office will normally process requests in the order they are received in the separate processing tracks, except when expedited processing is granted. However, in the Secretary's discretion, or upon a court order in a matter to which the Board is a party, a particular request may be processed out of turn.

(e) *Time limits*. The time for response to requests shall be 20 working days, except:

(1) In the case of expedited treatment under paragraph (c) of this section;

(2) Where the running of such time is suspended for payment of fees pursuant to § 261.17(b)(2);

(3) In unusual circumstances, as defined in 5 U.S.C. 552(a)(6)(B). In such circumstances, the time limit may be extended for a period of time not to exceed:

(i) 10 working days as provided by written notice to the requester, setting forth the reasons for the extension and the date on which a determination is expected to be dispatched; or

(ii) Such alternative time period as mutually agreed to by the Freedom of Information Office and the requester when the Freedom of Information Office notifies the requester that the request cannot be processed in the specified time limit.

(f) *Response to request*. In response to a request that satisfies § 261.12(b), an appropriate search shall be conducted of records of the Board in existence on the date of receipt of the request, and a review made of any responsive information located. The Secretary shall notify the requester of:

(1) The Board's determination of the request;

(2) The reasons for the determination;

(3) The amount of information withheld;

(4) The right of the requester to appeal to the Board any denial or partial denial, as specified in paragraph (i) of this section; and

(5) In the case of a denial of a request, the name and title or position of the person responsible for the denial.

(g) *Referral to another agency*. To the extent a request covers documents that were created by, obtained from, or classified by another agency, the Board may refer the request to that agency for a response and inform the requester promptly of the referral.

(h) *Providing responsive records*. (1) Copies of requested records shall be sent to the requester by regular U.S. mail to the address indicated in the request, unless the requester elects to take delivery of the documents at the Freedom of Information Office or makes other acceptable arrangements, or the Board deems it appropriate to send the documents by another means.

(2) The Board shall provide a copy of the record in any form or format requested if the record is readily reproducible by the Board in that form or format, but the Board need not provide more than one copy of any record to a requester.

(i) *Appeal of denial of request*. Any person denied access to Board records requested under § 261.12 may file a written appeal with the Board, as follows:

(1) The appeal shall prominently display the phrase *FREEDOM OF INFORMATION ACT APPEAL* on the first page, and shall be addressed to the Freedom of Information Office, Board of Governors of the Federal Reserve System, 20th & C Street, N.W., Washington, D.C. 20551; or sent by facsimile to the Freedom of Information Office, (202) 872–7562 or 7565.

(2) An initial request for records may not be combined in the same letter with an appeal.

(3) The appeal shall be filed within 10 working days of the date on which the denial was issued, or the date on which documents in partial response to the request were transmitted to the requester, whichever is later. The Board may consider an untimely appeal if:

(i) It is accompanied by a written request for leave to file an untimely appeal; and

(ii) The Board determines, in its discretion and for good and substantial cause shown, that the appeal should be considered.

(4) The Board shall make a determination regarding any appeal within 20 working days of actual receipt of the appeal by the Freedom of Information Office, and the determination letter shall notify the appealing party of the right to seek judicial review.

(5) The Secretary may reconsider a denial being appealed if intervening circumstances or additional facts not known at the time of the denial come to the attention of the Secretary while an appeal is pending.

**§ 261.14 Exemptions from disclosure.**

(a) *Types of records exempt from disclosure*. Pursuant to 5 U.S.C. 552(b), the following records of the Board are exempt from disclosure under this part:

(1) *National defense*. Any information that is specifically authorized under criteria established by an Executive Order to be kept secret in the interest of national defense or foreign policy and is in fact properly classified pursuant to the Executive Order.

(2) *Internal personnel rules and practices*. Any information related solely to the internal personnel rules and practices of the Board.

(3) *Statutory exemption*. Any information specifically exempted from disclosure by statute (other than 5 U.S.C. 552b), if the statute:

(i) Requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue; or

(ii) Establishes particular criteria for withholding or refers to particular types of matters to be withheld.

(4) *Trade secrets; commercial or financial information*. Any matter that is a trade secret or that constitutes commercial or financial information obtained from a person and that is privileged or confidential.

(5) *Inter- or intra-agency memorandums*. Information contained in inter- or intra-agency memorandums or letters that would not be available by law to a party (other than an agency) in litigation with an agency, including, but not limited to:

(i) Memorandums;

(ii) Reports;

(iii) Other documents prepared by the staffs of the Board or Federal Reserve Banks; and

(iv) Records of deliberations of the Board and of discussions at meetings of the Board, any Board committee, or Board staff, that are not subject to 5

U.S.C. 552b (the Government in the Sunshine Act).

(6) *Personnel and medical files.* Any information contained in personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

(7) *Information compiled for law enforcement purposes.* Any records or information compiled for law enforcement purposes, to the extent permitted under 5 U.S.C. 552(b)(7); including information relating to administrative enforcement proceedings of the Board.

(8) *Examination, inspection, operating, or condition reports, and confidential supervisory information.* Any matter that is contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions, including a state financial institution supervisory agency.

(b) *Segregation of nonexempt information.* The Board shall provide any reasonably segregable portion of a record that is requested after deleting those portions that are exempt under this section.

(c) *Discretionary release.* (1) Except where disclosure is expressly prohibited by statute, regulation, or order, the Board may release records that are exempt from mandatory disclosure whenever the Board or designated Board members, the Secretary of the Board, the General Counsel of the Board, the Director of the Division of Banking Supervision and Regulation, or the appropriate Federal Reserve Bank, acting pursuant to this part or 12 CFR part 265, determines that such disclosure would be in the public interest.

(2) The Board may make any exempt information furnished in connection with an application for Board approval of a transaction available to the public in accordance with § 261.12, and without prior notice and to the extent it deems necessary, may comment on such information in any opinion or statement issued to the public in connection with a Board action to which such information pertains.

(d) *Delayed release.* Publication in the FEDERAL REGISTER or availability to the public of certain information may be delayed if immediate disclosure would likely:

(1) Interfere with accomplishing the objectives of the Board in the discharge of its statutory functions;

(2) Interfere with the orderly conduct of the foreign affairs of the United States;

(3) Permit speculators or others to gain unfair profits or other unfair advantages by speculative trading in securities or otherwise;

(4) Result in unnecessary or unwarranted disturbances in the securities markets;

(5) Interfere with the orderly execution of the objectives or policies of other government agencies; or

(6) Impair the ability to negotiate any contract or otherwise harm the commercial or financial interest of the United States, the Board, any Federal Reserve Bank, or any department or agency of the United States.

(e) *Prohibition against disclosure.* Except as provided in this part, no officer, employee, or agent of the Board or any Federal Reserve Bank shall disclose or permit the disclosure of any unpublished information of the Board to any person (other than Board or Reserve Bank officers, employees, or agents properly entitled to such information for the performance of official duties).

### § 261.15 Request for confidential treatment.

(a) *Submission of request.* Any submitter of information to the Board who desires confidential treatment pursuant to 5 U.S.C. 552(b)(4) and § 261.14 (a)(4) shall file a request for confidential treatment with the Board (or in the case of documents filed with a Federal Reserve Bank, with that Federal Reserve Bank) at the time the information is submitted or a reasonable time after submission.

(b) *Form of request.* Each request for confidential treatment shall state in reasonable detail the facts supporting the request and its legal justification. Conclusory statements that release of the information would cause competitive harm generally will not be considered sufficient to justify confidential treatment.

(c) *Designation and separation of confidential material.* All information considered confidential by a submitter shall be clearly designated *CONFIDENTIAL* in the submission and separated from information for which confidential treatment is not requested. Failure to segregate confidential information from other material may result in release of the nonsegregated material to the public without notice to the submitter.

(d) *Exceptions.* This section does not apply to:

(1) Data collected on forms that are approved pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) and are deemed confidential by the Board. Any such form deemed confidential by the Board shall so indicate on the face of the form or in its instructions. The data may, however, be disclosed in aggregate form in such a manner that individual company data is not disclosed or derivable.

(2) Any comments submitted by a member of the public on applications and regulatory proposals being considered by the Board, unless the Board or the Secretary determines that confidential treatment is warranted.

(3) A determination by the Board to comment upon information submitted to the Board in any opinion or statement issued to the public as described in § 261.14(c).

(e) *Special procedures.* The Board may establish special procedures for particular documents, filings, or types of information by express provisions in this part or by instructions on particular forms that are approved by the Board. These special procedures shall take precedence over this section.

### § 261.16 Request for access to confidential commercial or financial information.

(a) *Request for confidential information.* A request by a submitter for confidential treatment of any information shall be considered in connection with a request for access to that information. At their discretion, appropriate Board or staff members (including Federal Reserve Bank staff) may act on the request for confidentiality prior to any request for access to the documents.

(b) *Notice to the submitter.* When a request for access is received pursuant to the Freedom of Information Act (5 U.S.C. 552):

(1) The Secretary shall notify a submitter of the request, if:

(i) The submitter requested confidential treatment of the information pursuant to 5 U.S.C. 552(b)(4); and

(ii) The request by the submitter for confidential treatment was made within 10 years preceding the date of the request for access.

(2) Absent a request for confidential treatment, the Secretary may notify a submitter of a request for access to information provided by the submitter if the Secretary reasonably believes that disclosure of the information may cause substantial competitive harm to the submitter.

(3) The notice given to the submitter shall:

(i) Be given as soon as practicable after receipt of the request for access;

(ii) Describe the request; and

(iii) Give the submitter a reasonable opportunity, not to exceed ten working days from the date of notice, to submit written objections to disclosure of the information.

(c) *Exceptions to notice to submitter.* Notice to the submitter need not be given if:

(1) The Secretary determines that the request for access should be denied;

(2) The requested information lawfully has been made available to the public;

(3) Disclosure of the information is required by law (other than 5 U.S.C. 552); or

(4) The submitter's claim of confidentiality under 5 U.S.C. 552(b)(4) appears obviously frivolous or has already been denied by the Secretary, except that in this last instance the Secretary shall give the submitter written notice of the determination to disclose the information at least five working days prior to disclosure.

(d) *Notice to requester.* At the same time the Secretary notifies the submitter, the Secretary also shall notify the requester that the request is subject to the provisions of this section.

(e) *Written objections by submitter.* Upon receipt of notice of a request for

access to its information, the submitter may provide written objections to release of the information. Such objections shall state whether the information was provided voluntarily or involuntarily to the Board.

(1) If the information was voluntarily provided to the Board, the submitter shall provide detailed facts showing that the information is customarily withheld from the public.

(2) If the information was not provided voluntarily to the Board, the submitter shall provide detailed facts and arguments showing:

(i) The likelihood of substantial harm that would be caused to the submitter's competitive position; or

(ii) That release of the information would impair the Board's ability to obtain necessary information in the future.

(f) *Determination by Secretary*. The Secretary's determination whether or not to disclose any information for which confidential treatment has been requested pursuant to this section shall be communicated to the submitter and the requester immediately. If the Secretary determines to disclose the information and the submitter has objected to such disclosure pursuant to paragraph (e) of this section, the Secretary shall provide the submitter with the reasons for disclosure, and shall delay disclosure for ten working days from the date of the determination.

(g) *Notice of lawsuit*. (1) The Secretary shall promptly notify any submitter of information covered by this section of the filing of any suit against the Board to compel disclosure of such information.

(2) The Secretary shall promptly notify the requester of any suit filed against the Board to enjoin the disclosure of any documents requested by the requester.

### § 261.17 Fee schedules; waiver of fees.

(a) *Fee schedules*. The fees applicable to a request for records pursuant to §§ 261.11 and 261.12 are set forth in appendix A to this section. These fees cover only the full allowable direct costs of search, duplication, and review. No fees will be charged where the average cost of collecting the fee (calculated at $5.00) exceeds the amount of the fee.

(b) *Payment procedures*. The Secretary may assume that a person requesting records pursuant to § 261.12 will pay the applicable fees, unless the request includes a limitation on fees to be paid or seeks a waiver or reduction of fees pursuant to paragraph (f) of this section.

(1) *Advance notification of fees*. If the estimated charges are likely to exceed $100, the Freedom of Information Office shall notify the requester of the estimated amount, unless the requester has indicated a willingness to pay fees as high as those anticipated. Upon receipt of such notice, the requester may confer with the Freedom of Information Office to reformulate the request to lower the costs. The time period for responding to requests under § 261.13(e), and the processing of the request will be suspended until the requester agrees to pay the applicable fees.

(2) *Advance payment*. The Secretary may require advance payment of any fee estimated to exceed $250. The Secretary may also require full payment in advance where a requester has previously failed to pay a fee in a timely fashion. The time period for responding to requests under § 261.13(e), and the processing of the request will be suspended until the Freedom of Information Office receives the required payment.

(3) *Late charges*. The Secretary may assess interest charges when fee payment is not made within 30 days of the date on which the billing was sent. Interest is at the rate prescribed in 31 U.S.C. 3717 and accrues from the date of the billing.

(c) *Categories of uses*. The fees assessed depend upon the intended use for the records requested. In determining which category is appropriate, the Secretary shall look to the intended use set forth in the request for records. Where a requester's description of the use is insufficient to make a determination, the Secretary may seek additional clarification before categorizing the request.

(1) *Commercial use*. The fees for search, duplication, and review apply when records are requested for commercial use.

(2) *Educational, research, or media use.* The fees for duplication apply when records are not sought for commercial use, and the requester is a representative of the news media or an educational or noncommercial scientific institution, whose purpose is scholarly or scientific research. The first 100 pages of duplication, however, will be provided free.

(3) *All other uses.* For all other requests, the fees for document search and duplication apply. The first two hours of search time and the first 100 pages of duplication, however, will be provided free.

(d) *Nonproductive search.* Fees for search and review may be charged even if no responsive documents are located or if the request is denied.

(e) *Aggregated requests.* A requester may not file multiple requests at the same time, solely in order to avoid payment of fees. If the Secretary reasonably believes that a requester is separating a request into a series of requests for the purpose of evading the assessment of fees, the Secretary may aggregate any such requests and charge accordingly. It is considered reasonable for the Secretary to presume that multiple requests of this type made within a 30-day period have been made to avoid fees.

(f) *Waiver or reduction of fees.* A request for a waiver or reduction of the fees, and the justification for the waiver, shall be included with the request for records to which it pertains. If a waiver is requested and the requester has not indicated in writing an agreement to pay the applicable fees if the waiver request is denied, the time for response to the request for documents, as set forth in § 261.13(e), shall not begin until a waiver has been granted; or if the waiver is denied, until the requester has agreed to pay the applicable fees.

(1) *Standards for determining waiver or reduction.* The Secretary shall grant a waiver or reduction of fees where it is determined both that disclosure of the information is in the public interest because it is likely to contribute significantly to public understanding of the operation or activities of the government, and that the disclosure of information is not primarily in the commercial interest of the requester. In making this determination, the following factors shall be considered:

(i) Whether the subject of the records concerns the operations or activities of the government;

(ii) Whether disclosure of the information is likely to contribute significantly to public understanding of government operations or activities;

(iii) Whether the requester has the intention and ability to disseminate the information to the public;

(iv) Whether the information is already in the public domain;

(v) Whether the requester has a commercial interest that would be furthered by the disclosure; and, if so,

(vi) Whether the magnitude of the identified commercial interest of the requester is sufficiently large, in comparison with the public interest in disclosure, that disclosure is primarily in the commercial interest of the requester.

(2) *Contents of request for waiver.* A request for a waiver or reduction of fees shall include:

(i) A clear statement of the requester's interest in the documents;

(ii) The use proposed for the documents and whether the requester will derive income or other benefit for such use;

(iii) A statement of how the public will benefit from such use and from the Board's release of the documents;

(iv) A description of the method by which the information will be disseminated to the public; and

(v) If specialized use of the information is contemplated, a statement of the requester's qualifications that are relevant to that use.

(3) *Burden of proof.* The burden shall be on the requester to present evidence or information in support of a request for a waiver or reduction of fees.

(4) *Determination by Secretary.* The Secretary shall make a determination on the request for a waiver or reduction of fees and shall notify the requester accordingly. A denial may be appealed to the Board in accordance with § 261.13(i).

(g) *Employee requests.* In connection with any request by an employee,

former employee, or applicant for employment, for records for use in prosecuting a grievance or complaint of discrimination against the Board, fees shall be waived where the total charges (including charges for information provided under the Privacy Act of 1974 (5 U.S.C. 552a) are $50 or less; but the Secretary may waive fees in excess of that amount.

(h) *Special services.* The Secretary may agree to provide, and set fees to recover the costs of, special services not covered by the Freedom of Information Act, such as certifying records or information and sending records by special methods such as express mail or overnight delivery.

APPENDIX A TO § 261.17—FREEDOM OF INFORMATION FEE SCHEDULE

| | |
|---|---|
| Duplication: | |
| Photocopy, per standard page | $0.10 |
| Paper copies of microfiche, per frame | .10 |
| Duplicate microfiche, per microfiche | .35 |
| Search and review: | |
| Clerical/Technical, hourly rate | 20.00 |
| Professional/Supervisory, hourly rate | 38.00 |
| Manager/Senior Professional, hourly rate | 65.00 |
| Computer search and production: | |
| Computer operator search, hourly rate | 32.00 |
| Tapes (cassette) per tape | 6.00 |
| Tapes (cartridge), per tape | 9.00 |
| Tapes (reel), per tape | 18.00 |
| Diskettes (3½″), per diskette | 4.00 |
| Diskettes (5¼″), per diskette | 5.00 |
| Computer Output (PC), per minute | .10 |
| Computer Output (mainframe) | ([1]) |

[1] Actual cost.

[62 FR 54365, Oct. 20, 1997; 62 FR 62508, Nov. 24, 1997]

## Subpart C—Confidential Information Made Available to Supervised Institutions, Financial Institution Supervisory Agencies, Law Enforcement Agencies, and Others in Certain Circumstances

### § 261.20 Confidential supervisory information made available to supervised financial institutions and financial institution supervisory agencies.

(a) *Disclosure of confidential supervisory information to supervised financial institutions.* Confidential supervisory information concerning a supervised bank, bank holding company (including subsidiaries), U.S. branch or agency of a foreign bank, or other institution examined by the Federal Reserve System (''supervised financial institution'') may be made available by the Board or the appropriate Federal Reserve Bank to the supervised financial institution.

(b) *Disclosure of confidential supervisory information by supervised financial institution*—(1) *Parent bank holding company, directors, officers, and employees.* Any supervised financial institution lawfully in possession of confidential supervisory information of the Board pursuant to this section may disclose such information, or portions thereof, to its directors, officers, and employees, and to its parent bank holding company and its directors, officers, and employees.

(2) *Certified public accountants and legal counsel.* Any supervised financial institution lawfully in possession of confidential supervisory information of the Board pursuant to this section may disclose such information, or portions thereof, to any certified public accountant or legal counsel employed by the supervised financial institution, subject to the following conditions:

(i) Certified public accountants or legal counsel shall review the confidential supervisory information only on the premises of the supervised financial institution, and shall not make or retain any copies of such information;

(ii) The certified public accountants or legal counsel shall not disclose the confidential supervisory information for any purpose without the prior written approval of the Board's General Counsel except as necessary to provide advice to the supervised financial institution, its parent bank holding company, or the officers, directors, and employees of such supervised financial institution and parent bank holding company.

(c) *Disclosure upon request to Federal financial institution supervisory agencies.* Upon requests, the Director of the Division of Banking Supervision and Regulation or the appropriate Federal Reserve Bank, may make available to the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank

Board and their regional offices and representatives, confidential supervisory information and other appropriate information (such as confidential operating and condition reports) relating to a bank, bank holding company (including subsidiaries), U.S. branch or agency of a foreign bank, or other supervised financial institution.

(d) *Disclosure upon request to state financial institution supervisory agencies.* Upon requests, the Director of the Division of Banking Supervision and Regulation or the appropriate Federal Reserve Bank may make available confidential supervisory information and other appropriate information (such as confidential operating and condition reports) relating to a bank, bank holding company (including subsidiaries), U.S. branch or agency of a foreign bank, or other supervised financial institution to:

(1) A state financial institution supervisory agency having direct supervisory authority over such supervised financial institution; or

(2) A state financial institution supervisory agency not having direct supervisory authority over such supervised financial institution if the requesting agency has entered into an information sharing agreement with the appropriate Federal Reserve Bank and the information to be provided concerns a supervised financial institution that has acquired or has applied to acquire a financial institution subject to that agency's direct supervisory authority.

(e) *Discretionary disclosures.* The Board may determine, from time to time, to authorize other disclosures of confidential information as necessary.

(f) *Conditions and limitations.* The Board may impose any conditions or limitations on disclosure under this section that it determines are necessary to effect the purposes of this regulation.

(g) *Other disclosure prohibited.* All confidential supervisory information or other information made available under this section shall remain the property of the Board. No supervised financial institution, financial institution supervisory agency, person, or any other party to whom the information is made available, or any other officer, director, employee or agent thereof, may disclose such information without the prior written permission of the Board's General Counsel except in published statistical material that does not disclose, either directly or when used in conjunction with publicly available information, the affairs of any individual, corporation, or other entity. No person obtaining access to confidential supervisory information pursuant to this section may make a personal copy of any such information; and no person may remove confidential supervisory information from the premises of the institution or agency in possession of such information except as permitted by specific language in this regulation or by the Board.

(h) *Disclosure of Foreign Bank Confidential Report of Operations*—(1) *Availability of Foreign Bank Confidential Report of Operations to Bank Supervisory Agencies.* Notwithstanding any other provision of this regulation, any Confidential Report of Operations (Form F.R. 2068) of a foreign banking organization may, upon written request to and approval by the Director of the Division of Banking Supervision and Regulation (or his delegee), and with the concurrence of the General Counsel (or his delegee), be made available for inspection to another bank supervisory authority having general supervision of any United States branch, agency, subsidiary bank or commercial lending company of the foreign banking organization, only for use where necessary in the performance of official duties. These reports shall be made available for inspection by authorized persons only on Federal Reserve premises under the same procedures as apply to personnel of the Federal Reserve System. All reports made available under this paragraph shall remain the property of the Board; and no person, agency or authority who obtains access to any such report, or any officer, director, or employee thereof, shall publish, publicize, or otherwise disclose any information contained in the report to any person.

(2) *Restrictions on disclosure by Federal Reserve System employees.* It is the Board's policy that the confidentiality of a foreign banking organization's Confidential Report of Operations

(Form F.R. 2068) should be maintained at all times. Except as provided by paragraph (h)(1) of this section, information submitted to the Board as part of any Confidential Report of Operations is not available for public inspection by any person other than an officer, employee, or agent of the Board or of a Federal Reserve Bank properly entitled to such information in the performance of such person's official duties. Any employee that violates this section by releasing such a report to any unauthorized person may be subject to disciplinary action under 12 CFR 264.735–5 (Rules of Employee Responsibilities and Conduct).

[53 FR 20815, June 7, 1988. Redesignated at 62 FR 54359, Oct. 20, 1997]

### § 261.21 Confidential information made available to law enforcement agencies and other nonfinancial institution supervisory agencies.

(a) *Disclosure upon request.* Upon written request, the Board may make available to appropriate law enforcement agencies and to other nonfinancial institution supervisory agencies for use where necessary in the performance of official duties, reports of examination and inspection, confidential supervisory information, and other confidential documents and information of the Board concerning banks, bank holding companies and their subsidiaries, U.S. branches and agencies of foreign banks, and other examined institutions.

(b) *Eligibility.* Federal, state, and local law enforcement agencies and other nonfinancial institution supervisory agencies may file written requests with the Board for access to confidential documents and information under this section of the regulation. Properly accredited foreign law enforcement agencies and other foreign government agencies may also file written requests with the Board.

(c) *Contents of request.* To obtain access to confidential documents or information under this section of the regulation, the head of the law enforcement agency or nonfinancial institution supervisory agency (or their designees) shall address a letter request to the Board's General Counsel, specifying:

(1) The particular information, kinds of information, and where possible, the particular documents to which access is sought;

(2) The reasons why such information cannot be obtained from the examined institution in question rather than from the Board;

(3) A statement of the law enforcement purpose or other purpose for which the information shall be used;

(4) Whether the requested disclosure is permitted or restricted in any way by applicable law or regulation;

(5) A commitment that the information requested shall not be disclosed to any person outside the agency without the written permission of the Board or its General Counsel; and

(6) If the document or information requested includes customer account information subject to the Right to Financial Privacy Act, as amended (12 U.S.C. 3401 *et seq.*), a statement that such customer account information need not be provided, or a statement as to why the Act does not apply to the request, or a certification that the requesting agency has complied with the requirements of the Act.

(d) *Action on request.* (1) The General Counsel shall review each request and may approve the request upon determining that:

(i) The request complies with this section;

(ii) The information is needed in connection with a formal investigation or other official duties of the requesting agency;

(iii) Satisfactory assurances of confidentiality have been given; and

(iv) No law prohibits the requested disclosure.

(2) The General Counsel may impose any conditions or limitations on disclosure that the General Counsel determines to be necessary to effect the purposes of this regulation or to insure compliance with applicable laws or regulations.

(e) *Federal and state grand jury, criminal trial, and government administrative subpoenas.* The Board's General Counsel shall review and may approve the disclosure of confidential information pursuant to Federal and state grand jury, criminal trial, and government administrative subpoenas. The General

Counsel may impose such conditions or limitations on disclosure under this section that the General Counsel determines are necessary to effect the purposes of this regulation, to insure compliance with applicable laws or regulations, or to protect the confidentiality of the Board's information.

(f) *Requests for testimony or interviews.* Government agencies seeking to obtain testimony or interviews from current and former Federal Reserve System staff concerning any confidential information of the Board shall use the procedures set out in paragraph (c) of this section.

(g) *Other disclosure prohibited.* All reports and information made available under this section remain the property of the Board, and except as otherwise provided in this regulation, no person, agency, or authority to whom the information is made available, or any officer, director, or employee thereof, may disclose any such information except in published statistical material that does not disclose, either directly or when used in conjunction with publicly available information, the affairs of any individual or corporation.

[53 FR 20815, June 7, 1988. Redesignated at 62 FR 54359, Oct. 20, 1997]

### § 261.22 Other disclosure of confidential supervisory information.

(a) *Board policy.* It is the Board's policy regarding confidential supervisory information that such information is confidential and privileged. Accordingly, the Board will not normally disclose this information to the public. The Board, when considering a request for disclosure of confidential supervisory information under this section, will not authorize disclosure unless the person requesting disclosure is able to show a substantial need for such information that outweighs the need to maintain confidentiality.

(b) *Requests for disclosure*—(1) *Requests from litigants for information or testimony.* Any person (except agencies identified in §§ 261.20 and 261.21 of this regulation) seeking access to confidential supervisory information or seeking to obtain the testimony of present or former Board or Reserve Bank employees on matters involving confidential supervisory information of the Board, whether by deposition or otherwise, for use in litigation before a court, board, commission, or agency, shall file a written request with the General Counsel of the Board. The request shall describe:

(i) The particular information, kinds of information, and where possible, the particular documents to which access is sought;

(ii) The judicial or administrative action for which the confidential supervisory information is sought;

(iii) The relationship of the confidential supervisory information to the issues or matters raised by the judicial or administrative action;

(iv) The requesting person's need for the information;

(v) The reason why the requesting person cannot obtain the information sought from any other source; and

(vi) A commitment to obtain a protective order acceptable to the Board from the judicial or administrative tribunal hearing the action preserving the confidentiality of any information that is provided.

(2) *All other requests.* Any other person (except agencies identified in §§ 261.20 and 261.21 of this regulation) seeking access to confidential supervisory information for any other purpose shall file a written request with the General Counsel of the Board. A request under this paragraph (b)(2) shall describe the purpose for which such disclosure is sought.

(c) *Action on request*—(1) *Determination of approval.* The General Counsel of the Board may approve a request made under this section provided that he or she determines that:

(i) The person making the request has shown a substantial need for confidential supervisory information that outweighs the need to maintain confidentiality; and

(ii) Disclosure is consistent with the supervisory and regulatory responsibilities and policies of the Board.

(2) *Conditions or limitations.* The General Counsel of the Board may, in approving a request, impose such conditions or limitations on use of any information disclosed as is deemed necessary to protect the confidentiality of the Board's information.

(d) *Exhaustion of administrative remedies for discovery purposes in civil, criminal, or administrative action.* Action on a request under this section by the General Counsel of the Board shall exhaust administrative remedies for discovery purposes in any civil, criminal, or administrative proceeding. A request made pursuant to § 261.12 of this regulation does not exhaust administrative remedies for discovery purposes. Therefore, it is not necessary to file a request pursuant to § 261.12 to exhaust administrative remedies under this section.

(e) *Other disclosure prohibited.* All confidential supervisory information made available under this section shall remain the property of the Board. Any person in possession of such information shall not use or disclose such information for any purpose other than that authorized by the General Counsel of the Board without his or her prior written approval.

[53 FR 20815, June 7, 1988. Redesignated at 62 FR 54359, Oct. 20, 1997; corrected at 62 FR 62508, Nov. 24, 1997]

### § 261.23 Subpoenas, orders compelling production, and other process.

(a) *Advice by person served.* Any person (including any officers, employee, or agent of the Board or any Federal Reserve Bank) who has documents or information of the Board that may not be disclosed and who is served with a subpoena, order, or other judicial or administrative process requiring his or her personal attendance as a witness or requiring the production of documents or information in any proceeding, shall:

(1) Promptly inform the Board's General Counsel of the service and all relevant facts, including the documents and information requested, and any facts of assistance to the Board in determining whether the material requested should be made available; and

(2) At the appropriate time inform the court or tribunal that issued the process and the attorney for the party at whose instance the process was issued of the substance of these rules.

(b) *Appearance by person served.* Unless the Board has authorized disclosure of the information requested, any person who has Board information that may not be disclosed, and who is required to respond to a subpoena or other legal process, shall attend at the time and place required and decline to disclose or to give any testimony with respect to the information, basing such refusal upon the provisions of this regulation. If the court or other body orders the disclosure of the information or the giving of testimony, the person having the information shall continue to decline to disclose the information and shall promptly report the facts to the Board for such action as the Board may deem appropriate.

[53 FR 20815, June 7, 1988. Redesignated at 62 FR 54359, Oct. 20, 1997]

## PART 261a—RULES REGARDING ACCESS TO PERSONAL INFORMATION UNDER THE PRIVACY ACT OF 1974

### Subpart A—General Provisions

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261a.1 Authority, purpose and scope.
261a.2 Definitions.
261a.3 Custodian of records; delegations of authority.
261a.4 Fees.

### Subpart B—Procedures for Requests by Individual to Whom Record Pertains

261a.5 Request for access to record.
261a.6 Board procedures for responding to request for access.
261a.7 Special procedures for medical records.
261a.8 Request for amendment of record.
261a.9 Board review of request for amendment of record.
261a.10 Appeal of adverse determination of request for access or amendment.

### Subpart C—Disclosure to Person Other Than Individual to Whom Record Pertains

261a.11 Restrictions on disclosure.
261a.12 Exceptions.

### Subpart D—Exempt Records

261a.13 Exemptions.

AUTHORITY: 5 U.S.C. 552a.

SOURCE: 60 FR 3341, Jan. 17, 1995, unless otherwise noted.

## Subpart A—General Provisions

### §261a.1 Authority, purpose and scope.

(a) *Authority*. This part is issued by the Board of Governors of the Federal Reserve System (the Board) pursuant to the Privacy Act of 1974 (5 U.S.C. 552a).

(b) *Purpose*. The purpose of this part is to implement the provisions of the Privacy Act of 1974 (5 U.S.C. 552a) with regard to the maintenance, protection, disclosure, and amendment of records contained within systems of records maintained by the Board.

(c) *Scope*. This part covers requests for access to, or amendment of, records concerning individuals that are contained in systems of records maintained by the Board.

### §261a.2 Definitions.

For the purposes of this part, the following definitions apply:

(a) *Business day* means any day except Saturday, Sunday or a legal Federal holiday.

(b) *Designated system of records* means a system of records maintained by the Board that has been listed in the FEDERAL REGISTER pursuant to the requirements of 5 U.S.C. 552a(e).

(c) *Guardian* means the parent of a minor, or the legal guardian of any individual who has been declared to be incompetent due to physical or mental incapacity or age by a court of competent jurisdiction.

(d) *Individual* means a natural person who is either a citizen of the United States or an alien lawfully admitted for permanent residence.

(e) *Maintain* includes maintain, collect, use, disseminate, or control.

(f) *Record* means any item, collection, or grouping of information about an individual maintained by the Board that contains the individual's name, or the identifying number, symbol, or other identifying particular assigned to the individual, such as a fingerprint, voice print, or photograph.

(g) *Routine use* means, with respect to disclosure of a record, the use of such record for a purpose that is compatible with the purpose for which it was collected or created.

(h) *System of records* means a group of any records under the control of the Board from which information is retrieved by the name of the individual or by some identifying number, symbol, or other identifying particular assigned to the individual.

### §261a.3 Custodian of records; delegations of authority.

(a) *Custodian of records*. The Secretary of the Board is the official custodian of all records of the Board in the possession or control of the Board.

(b) *Delegated authority of Secretary*. With regard to this regulation, the Secretary of the Board is delegated the authority to:

(1) Respond to requests for access or amendment to records contained in a system of records, except for such requests regarding systems of records maintained by the Board's Office of the Inspector General (OIG);

(2) Approve the publication of new systems of records and amend existing systems of records, except systems of records exempted pursuant to §§261a.13(b), (c) and (d);

(3) File the biennial reports required by the Privacy Act.

(c) *Delegated authority of designee*. Any action or determination required or permitted by this part to be done by the Secretary of the Board may be done by an Associate Secretary or other responsible employee of the Board who has been duly designated for this purpose by the Secretary.

(d) *Delegated authority of Inspector General*. With regard to systems of records maintained by the OIG, the Inspector General is delegated the authority to respond to requests for access or amendment.

### §261a.4 Fees.

(a) *Copies of records*. Copies of records requested pursuant to §261a.5 of this part shall be provided at the same cost charged for duplication of records and/or production of computer output under the Board's Rules Regarding Availability of Information, §261.10 of this part.

(b) *No fee*. Documents may be furnished without charge where total charges are less than $5.

(c) *Waiver of fees*. In connection with any request by an employee, former

employee, or applicant for employment, for records for use in prosecuting a grievance or complaint of discrimination against the Board, fees shall be waived where the total charges (including charges for information provided under the Freedom of Information Act) are $50 or less; but the Secretary may waive fees in excess of that amount.

## Subpart B—Procedures for Requests by Individual to Whom Record Pertains

### § 261a.5 Request for access to record.

(a) *Procedures for making request.* (1) Any individual (or guardian of an individual) other than a current Board employee desiring to learn of the existence of, or to gain access to, his or her record in a designated system of records shall submit a request in writing to the Secretary of the Board, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue NW., Washington, DC 20551.

(2) A request by a current Board employee for that employee's own personnel records may be made in person during regular business hours at the Division of Human Resources, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue NW., Washington, DC 20551.

(3) A request by a current Board employee for information other than personnel information may be made in person during regular business hours at the Freedom of Information Office, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue NW., Washington, DC 20551.

(4) Requests for information contained in a system of records maintained by the Board's OIG shall be submitted in writing to the Inspector General, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue NW., Washington, DC 20551.

(b) *Contents of request.* A request made pursuant to paragraph (a) of this section shall include the following:

(1) A statement that it is made pursuant to the Privacy Act of 1974;

(2) The name of the system of records expected to contain the record requested or a concise description of such system of records.

(3) Necessary information to verify the identity of the requester pursuant to paragraph (c) of this section; and

(4) Any other information that may assist in the rapid identification of the record for which access is being requested (e.g., maiden name, dates of employment, etc.).

(c) *Verification of identity.* The Board shall require proof of identity from a requester and reserves the right to determine the adequacy of such proof. In general, the following shall be considered adequate proof of identity:

(1) For a current Board employee, his or her Board identification card; or

(2) For an individual other than a current Board employee, either:

(i) Two forms of identification, one of which has a picture of the individual requesting access; or

(ii) A notarized statement attesting to the identity of the requester.

(d) *Verification of identity not required.* No verification of identity shall be required of individuals seeking access to records that are otherwise available to any person under 5 U.S.C. 552, Freedom of Information Act.

(e) *Request for accounting of previous disclosures.* An individual making a request pursuant to paragraph (a) of this section may also include a request for an accounting (pursuant to 5 U.S.C. 552a(c)) of previous disclosures of records pertaining to such individual in a designated system of records.

### § 261a.6 Board procedures for responding to request for access.

(a) *Compliance with Freedom of Information Act.* Every request made pursuant to § 261a.5 of this part shall also be handled by the Board as a request for information pursuant to the Freedom of Information Act (5 U.S.C. 552), except that the time limits set forth in paragraph (b) of this section and the fees specified in § 261a.4 of this part shall apply to such requests.

(b) *Time limits.* Every request made pursuant to § 261a.5 of this part shall be acknowledged or, where practicable, substantially responded to within 10 business days from receipt of the request.

(c) *Disclosure.* (1) Information to be disclosed pursuant to this part and the Privacy Act, except for information

maintained by the Board's OIG, shall be made available for inspection and copying during regular business hours at the Board's Freedom of Information Office.

(2) Information to be disclosed that is maintained by the Board's OIG shall be made available for inspection and copying at the OIG.

(3) When the requested record cannot reasonably be put into a form for individual inspection (e.g., computer tapes), or when the requester asks that the information be forwarded, copies of such information shall be mailed to the requester.

(4) Access to or copies of requested information shall be promptly provided after the acknowledgement as provided in paragraph (b) of this section, unless good cause for delay is communicated to the requester.

(d) *Other authorized presence*. The requester of information may be accompanied in the inspection of that information by a person of the requester's own choosing upon the requester's submission of a written and signed statement authorizing the presence of such person.

(e) *Denial of request*. A denial of a request made pursuant to § 261a.5 of this part shall include a statement of the reason(s) for denial and the procedures for appealing the denial.

### § 261a.7 Special procedures for medical records.

Medical or psychological records requested pursuant to § 261a.5 of this part shall be disclosed directly to the requester unless such disclosure could, in the judgment of the Privacy Officer, in consultation with the Board's physician, have an adverse effect upon the requester. Upon such determination, the information shall be transmitted to a licensed physician named by the requester, who will disclose those records to the requester in a manner the physician deems appropriate.

### § 261a.8 Request for amendment of record.

(a) *Procedures for making request*. (1) An individual desiring to amend a record in a designated system of records that pertains to him or her shall submit a request in writing to the Secretary of the Board (or to the Inspector General for records in a system of records maintained by the OIG) in an envelope clearly marked ''Privacy Act Amendment Request.''

(2) Each request for amendment of a record shall:

(i) Identify the system of records containing the record for which amendment is requested;

(ii) Specify the portion of that record requested to be amended; and

(iii) Describe the nature of and reasons for each requested amendment.

(3) Each request for amendment of a record shall be subject to verification of identity under the procedures set forth in § 261a.5(c) of this part, unless such verification has already been made in a related request for access or amendment.

(b) *Burden of proof*. The request for amendment of a record shall set forth the reasons the individual believes the record is not accurate, relevant, timely, or complete. The burden of proof for demonstrating the appropriateness of the requested amendment rests with the requester, and the requester shall provide relevant and convincing evidence in support of the request.

### § 261a.9 Board review of request for amendment of record.

(a) *Time limits*. The Board shall acknowledge a request for amendment of a record within 10 business days of receipt of the request. Such acknowledgement may request additional information necessary for a determination on the request for amendment. To the extent possible, a determination upon a request to amend a record shall be made within 10 business days after receipt of the request.

(b) *Contents of response to request for amendment*. The response to a request for amendment shall include the following:

(1) The decision to grant or deny, in whole or in part, the request for amendment; and

(2) If the request is denied:

(i) The reasons for denial of any portion of the request for amendment;

(ii) The requester's right to appeal any denial; and

(iii) The procedures for appealing the denial to the appropriate official.

### § 261a.10 Appeal of adverse determination of request for access or amendment.

(a) *Appeal.* A requester may appeal a denial of a request made pursuant to § 261a.5 or § 261a.8 of this part to the Board, or any official designated by the chairman of the Board, within 10 business days of issuance of notification of denial. The appeal shall:

(1) Be made in writing to the Secretary of the Board, with the words ''PRIVACY ACT APPEAL'' written prominently on the first page;

(2) Specify the previous background of the request; and

(3) Provide reasons why the initial denial is believed to be in error.

(b) *Determination.* The Board or an official designated by the Chairman of the Board shall make a determination with respect to such appeal not later than 30 business days from its receipt, unless the time is extended for good cause shown.

(1) If the Board or designated official grants an appeal regarding a request for amendment, the Board shall take the necessary steps to amend the record, and, when appropriate and possible, notify prior recipients of the record of the Board's action.

(2) If the Board or designated official denies an appeal, the Board shall inform the requester of such determination, give a statement of the reasons therefor, and inform the requester of the right of judicial review of the determination.

(c) *Statement of disagreement.* (1) Upon receipt of a denial of an appeal regarding a request for amendment, the requester may file a concise statement of disagreement with the denial. Such statement shall be maintained with the record the requester sought to amend, and any disclosure of the record shall include a copy of the statement of disagreement.

(2) When practicable and appropriate, the Board shall provide a copy of the statement of disagreement to any person or other agency to whom the record was previously disclosed.

## Subpart C—Disclosure to Person Other Than Individual to Whom Record Pertains

### § 261a.11 Restrictions on disclosure.

No record contained in a designated system of records shall be disclosed to any person or agency without the prior written consent of the individual to whom the record pertains unless the disclosure is authorized by § 261a.12 of this part.

### § 261a.12 Exceptions.

The restrictions on disclosure in § 261a.11 of this part do not apply to any disclosure:

(a) To those officers and employees of the Board who have a need for the record in the performance of their duties;

(b) That is required under the Freedom of Information Act (5 U.S.C. 552);

(c) For a routine use listed with respect to a designated system of records;

(d) To the Bureau of the Census for purposes of planning or carrying out a census or survey or related activity pursuant to the provisions of title 13 of the United States Code;

(e) To a recipient who has provided the Board with advance adequate written assurance that the record will be used solely as a statistical research or reporting record, and the record is to be transferred in a form that is not individually identifiable;

(f) To the National Archives of the United States as a record that has sufficient historical or other value to warrant its continued preservation by the United States government, or for evaluation by the administrator of General Services or his designee to determine whether the record has such value;

(g) To another agency or to an instrumentality of any governmental jurisdiction within or under the control of the United States for a civil or criminal law enforcement activity if the activity is authorized by law, and if the head of the agency or instrumentality has made a written request to the Board specifying the particular portion desired and the law enforcement activity for which the record is sought;

(h) To a person pursuant to a showing of compelling circumstances affecting the health or safety of an individual if upon such disclosure notification is transmitted to the last known address of such individual;

(i) To either House of Congress, or, to the extent of matter within its jurisdiction, any committee or subcommittee thereof, any joint committee of Congress or subcommittee of any such joint committee;

(j) To the Comptroller General, or any of his authorized representatives, in the course of the performance of the duties of the General Accounting Office;

(k) Pursuant to the order of a court of competent jurisdiction; or

(l) To a consumer reporting agency in accordance with 31 U.S.C. 3711(f).

## Subpart D—Exempt Records

### §261a.13 Exemptions.

(a) *Information compiled for civil action*. Nothing in this regulation shall allow an individual access to any information compiled in reasonable anticipation of a civil action or proceeding.

(b) *Law enforcement information*. Pursuant to section (k)(2) of the Privacy Act of 1974 (5 U.S.C. 552a(k)(2)), the Board has deemed it necessary to exempt certain designated systems of records maintained by the Board from the requirements of the Privacy Act concerning access to accountings of disclosures and to records, maintenance of only relevant and necessary information in files, and certain publication provisions, respectively, 5 U.S.C. 552a (c)(3), (d), (e)(1), (e)(4)(G), (H) and (I), and (f), and §§261a.5, 261a.7 and 261a.8 of this part. Accordingly, the following designated systems of records are exempt from these provisions, but only to the extent that they contain investigatory materials compiled for law enforcement purposes:

(1) BGFRS–1 Recruiting and Placement Records.

(2) BGFRS–2 Personnel Background Investigation Reports.

(3) BGFRS–4 General Personnel Records.

(4) BGFRS–5 EEO Discrimination Complaint File.

(5) BGFRS–9 Consultant and Staff Associate File.

(6) BGFRS–18 Consumer Complaint Information System.

(7) BGFRS–21 Supervisory Tracking and Reference System.

(8) BGFRS/OIG–1 OIG Investigatory Records.

(9) BGFRS–31 Protective Information System.

(10) BGFRS—32 Visitor Log.

(c) *Confidential references*. Pursuant to section (k)(5) of the Privacy Act of 1974 (5 U.S.C. 552a(k)(5)), the Board has deemed it necessary to exempt certain designated systems of records maintained by the Board from the requirements of the Privacy Act concerning access to accountings of disclosures and to records, maintenance of only relevant and necessary information in files, and certain publication provisions, respectively 5 U.S.C. 552a(c)b(3), (d), (e)(1), (e)(4)(G), (H) and (I), and (f), and §§261a.5, 261a.7 and 261a.8 of this part. Accordingly, the following systems of records are exempt from these provisions, but only to the extent that they contain investigatory material compiled to determine an individual's suitability, eligibility, and qualifications for Board employment or access to classified information, and the disclosure of such material would reveal the identity of a source who furnished information to the Board under a promise of confidentiality.

(1) BGFRS–1 Recruiting and Placement Records.

(2) BGFRS–2 Personnel Background Investigation Reports.

(3) BGFRS–4 General Personnel Records.

(4) BGFRS–9 Consultant and Staff Associate File.

(5) BGFRS–10 General File on Board Members.

(6) BGFRS–11 Official General Files.

(7) BGFRS–13 General File of Examiners and Assistant Examiners at Federal Reserve Banks.

(8) BGFRS–14 General File of Federal Reserve Bank and Branch Directors.

(9) BGFRS–15 General Files of Federal Reserve Agents, Alternates and Representatives at Federal Reserve Banks.

(10) BGFRS/OIG–2 OIG Personnel Records.

(11) BGFRS–25 Multi-rater Feedback Records.

(d) *Criminal law enforcement information*. Pursuant to 5 U.S.C. 552a(j)(2), the Board has determined that portions of the OIG Investigatory Records (BGFRS/OIG–1) shall be exempt from any part of the Privacy Act (5 U.S.C. 552a), except the provisions regarding disclosure, the requirement to keep an accounting, certain publication requirements, certain requirements regarding the proper maintenance of systems of records, and the criminal penalties for violation of the Privacy Act, respectively, 5 U.S.C. 552a (b), (c)(1), and (2), (e)(4) (A) through (F), (e)(6), (e)(7), (e)(9), (e)(10), (e)(11) and (i). This designated system of records is maintained by the OIG, a Board component that performs as its principal function an activity pertaining to the enforcement of criminal laws. The exempt portions of the records consist of:

(1) Information compiled for the purpose of identifying individual criminal offenders and alleged offenders;

(2) Information compiled for the purpose of a criminal investigation, including reports of informants and investigators, and associated with an identifiable individual; or

(3) Reports identifiable to an individual compiled at any stage of the process of enforcement of the criminal laws from arrest or indictment through release from supervision.

[60 FR 3341, Jan. 17, 1995, as amended at 65 FR 34392, May 30, 2000; 66 FR 19718, Apr. 17, 2001; 66 FR 20863, Apr. 25, 2001; 67 FR 44526, July 3, 2002]

# PART 261b—RULES REGARDING PUBLIC OBSERVATION OF MEETINGS

Sec.

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261b.13 Fees.

AUTHORITY: 5 U.S.C. 552b.

SOURCE: 42 FR 13297, Mar. 10, 1977, unless otherwise noted.

## § 261b.1 Basis and scope.

This part is issued by the Board of Governors of the Federal Reserve System (''the Board'') under section 552b of title 5 of the United States Code, the Government in the Sunshine Act (''the Act''), to carry out the policy of the Act that the public is entitled to the fullest practicable information regarding the decision making processes of the Board while at the same time preserving the rights of individuals and the ability of the Board to carry out its responsibilities. These regulations fulfill the requirement of subsection (g) of the Act that each agency subject to the provisions of the Act shall promulgate regulations to implement the open meeting requirements of subsections (b) through (f) of the Act.

## § 261b.2 Definitions.

For purposes of this part, the following definitions shall apply:

(a) The term *agency* means the Board and subdivisions thereof.

(b) The term *subdivision* means any group composed of two or more Board members that is authorized to act on behalf of the Board.

(c) The term *meeting* means the deliberations of at least the number of individual agency members required to take action on behalf of the agency where such deliberations determine or result in the joint conduct or disposition of official Board business, but does not include (1) deliberations required or permitted by subsections (d) or (e) of the Act, or (2) the conduct or disposition of official agency business by circulating written material to individual members.

(d) The term *number of individual agency members required to take action on behalf of the agency* means in the case of the Board, a majority of its

members except that (1) Board determination of the ratio of reserves against deposits under section 19(b) of the Federal Reserve Act requires the vote of four members, (2) Board action with respect to advances, discounts and rediscounts under sections 10(a), 11(b), and 13(3) of the Federal Reserve Act requires the vote of five members and (3) Board action with respect to the percentage of individual member bank capital and surplus which may be represented by loans secured by stock and bond collateral under section 11(m) of the Federal Reserve Act requires the vote of six members. In the case of subdivisions of the Board, the term means the number of members constituting a quorum of the designated subdivision.

(e) The term *member* means a member of the Board appointed under section 10 of the Federal Reserve Act. In the case of certain Board proceedings pursuant to 12 U.S.C. 1818(e), the Comptroller of the Currency is entitled to sit as a member of the Board and for these proceedings he shall be deemed a *member* for the purposes of this part. In the case of any subdivision of the Board, the term *member* means a member of the Board designated to serve on that subdivision.

(f) The term *public observation* means that the public shall have the right to listen and observe but not to record any of the meetings by means of cameras or electronic or other recording devices unless approval in advance is obtained from the Public Affairs Office of the Board and shall not have the right to participate in the meeting, unless participation is provided for in the Board's Rules of Procedure.

(g) The term *Federal agency* means an *agency* as defined in 5 U.S.C. 551(1).

(h) *Committee* means the Action Committee established pursuant to 12 CFR 265.1a(c).

[42 FR 13297, Mar. 10, 1977, as amended at 43 FR 34481, Aug. 4, 1978]

### § 261b.3 Conduct of agency business.

Members shall not jointly conduct or dispose of official agency business other than in accordance with this part.

### § 261b.4 Meetings open to public observation.

(a) Except as provided in § 261b.5, every portion of every meeting of the agency shall be open to public observation.

(b) Copies of staff documents considered in connection with agency discussion of agenda items for a meeting that is open to public observation shall be made available for distribution to members of the public attending the meeting, in accordance with the provisions of 12 CFR part 261.

(c) The agency will maintain a complete electronic recording adequate to record fully the proceedings of each meeting or portion of a meeting open to public observation. Cassettes will be available for listening in the Freedom of Information Office, and copies may be ordered for $5 per cassette by telephoning or by writing Freedom of Information Office, Board of Governors of the Federal Reserve System, Washington, DC 20551.

(d) The agency will maintain mailing lists of names and addresses of all persons who wish to receive copies of agency announcements of meetings open to public observation. Requests for announcements may be made by telephoning or by writing Freedom of Information Office, Board of Governors of the Federal Reserve System, Washington, DC 20551.

[44 FR 11750, Mar. 2, 1979]

### § 261b.5 Exemptions.

(a) Except in a case where the agency finds that the public interest requires otherwise, the agency may close a meeting or a portion or portions of a meeting under the procedures specified in § 261b.7 or § 261b.8 of this part, and withhold information under the provisions of §§ 261b.6, 261b.7, 261b.8, or 261b.11 of this part, where the agency properly determines that such meeting or portion or portions of its meeting or the disclosure of such information is likely to:

(1) Disclose matters that are (i) specifically authorized under criteria established by an Executive order to be kept secret in the interests of national defense or foreign policy, and (ii) in

fact properly classified pursuant to such Executive order;

(2) Relate solely to internal personnel rules and practices;

(3) Disclose matters specifically exempted from disclosure by statute (other than section 552 of title 5 of the United States Code), provided that such statute (i) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (ii) establishes particular criteria for withholding or refers to particular types of matters to be withheld;

(4) Disclose trade secrets and commercial or financial information obtained from a person and privileged or confidential;

(5) Involve accusing any person of a crime, or formally censuring any person;

(6) Disclose information of a personal nature where disclosure would constitute a clearly unwarranted invasion of personal privacy;

(7) Disclose investigatory records compiled for law enforcement purposes, or information which if written would be contained in such records, but only to the extent that the production of such records or information would—

(i) Interfere with enforcement proceedings,

(ii) Deprive a person of a right to a fair trial or an impartial adjudication,

(iii) Constitute an unwarranted invasion of personal privacy,

(iv) Disclose the identity of a confidential source and, in the case of a record compiled by a criminal law enforcement authority in the course of a criminal investigation, or by a Federal agency conducting a lawful national security intelligence investigation, confidential information furnished only by the confidential source,

(v) Disclose investigative techniques and procedures, or

(vi) Endanger the life or physical safety of law enforcement personnel;

(8) Disclose information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of the Board or other Federal agency responsible for the regulation or supervision of financial institutions;

(9) Disclose information the premature disclosure of which would—

(i) Be likely to (A) lead to significant speculation in currencies, securities, or commodities, or (B) significantly endanger the stability of any financial institution; or

(ii) Be likely to significantly frustrate implementation of a proposed action, except that paragraph (a)(9)(ii) of this section shall not apply in any instance where the Board has already disclosed to the public the content or nature of its proposed action, or where the Board is required by law to make such disclosure on its own initiative prior to taking final action on such proposal; or

(10) Specifically concern the issuance of a subpoena, participation in a civil action or proceeding, an action in a foreign court or international tribunal, or an arbitration, or the initiation, conduct, or disposition of a particular case of formal agency adjudication pursuant to the procedures in section 554 of title 5 of the United States Code or otherwise involving a determination on the record after opportunity for a hearing.

### § 261b.6 Public announcement of meetings.

(a) Except as otherwise provided by the Act, public announcement of meetings open to public observation and meetings to be partially or completely closed to public observation pursuant to § 261b.8 of this part will be made at least one week in advance of the meeting. Except to the extent such information is determined to be exempt from disclosure under § 261b.5 of this part, each such public announcement will state the time, place and subject matter of the meeting, whether it is to be open or closed to the public, and the name and phone number of the official designated to respond to requests for information about the meeting.

(b) If a majority of the members of the agency determines by a recorded vote that agency business requires that a meeting covered by paragraph (a) of this section be called at a date earlier than that specified in paragraph (a) of this section, the agency will make a public announcement of the information specified in paragraph (a) of this

section at the earliest practicable time.

(c) Changes in the subject matter of a publicly announced meeting, or in the determination to open or close a publicly announced meeting or any portion of a publicly announced meeting to public observation, or in the time or place of a publicly announced meeting made in accordance with the procedures specified in §261b.9 of this part will be publicly announced at the earliest practicable time.

(d) Public announcements required by this section will be posted at the Board's Public Affairs Office and Freedom of Information Office and may be made available by other means or at other locations as may be desirable.

(e) Immediately following each public announcement required by this section, notice of the time, place and subject matter of a meeting, whether the meeting is open or closed, any change in one of the preceding announcements and the name and telephone number of the official designated by the Board to respond to requests about the meeting, shall also be submitted for publication in the FEDERAL REGISTER.

### §261b.7 Meetings closed to public observation under expedited procedures.

(a) Since the Board and the Committee qualifies for the use of expedited procedures under subsection (d)(4) of the Act, meetings or portions thereof exempt under paragraph (a)(4), (a)(8), (a)(9)(i) or (a)(10) of §261b.5 of this part, will be closed to public observation under the expedited procedures of this section. Following are examples of types of items that, absent compelling contrary circumstances, will qualify for these exemptions: Matters relating to a specific bank or bank holding company, such as bank branches or mergers, bank holding company formations, or acquisition of an additional bank or acquisition or de novo undertaking of a permissible nonbanking activity; bank regulatory matters, such as applications for membership, issuance of capital notes and investment in bank premises; foreign banking matters; bank supervisory and enforcement matters, such as cease-and-desist and officer removal proceedings; monetary policy matters, such as discount rates, use of the discount window, changes in the limitations on payment of interest on time and savings accounts, and changes in reserve requirements or margin regulations.

(b) At the beginning of each meeting, a portion or portions of which is closed to public observation under expedited procedures pursuant to this section, a recorded vote of the members present will be taken to determine whether a majority of the members of the agency votes to close such meeting of portions of such meeting to public observation.

(c) A copy of the vote, reflecting the vote of each member, and except to the extent such information is determined to be exempt from disclosure under §261b.5, a public announcement of the time, place and subject matter of the meeting or each closed portion thereof, will be made available at the earliest practicable time at the Board's Public Affairs Office and Freedom of Information Office.

[42 FR 13297, Mar. 10, 1977, as amended at 43 FR 34481, Aug. 4, 1978]

### §261b.8 Meetings closed to public observation under regular procedures.

(a) A meeting or a portion of a meeting will be closed to public observation under regular procedures, or information as to such meeting or portion of a meeting will be withheld only by recorded vote of a majority of the members of the agency when it is determined that the meeting or the portion of the meeting or the withholding of information qualifies for exemption under §261b.5. Votes by proxy are not allowed.

(b) Except as provided in subsection (c) of this section, a separate vote of the members of the agency will be taken with respect to the closing or the withholding of information as to each meeting or portion thereof which is proposed to be closed to public observation or with respect to which information is proposed to be withheld pursuant to this section.

(c) A single vote may be taken with respect to a series of meetings, a portion or portions of which are proposed to be closed to public observation or

with respect to any information concerning such series of meetings proposed to be withheld, so long as each meeting or portion thereof in such series involves the same particular matters and is scheduled to be held no more than thirty days after the initial meeting in such series.

(d) Whenever any person's interests may be directly affected by a portion of a meeting for any of the reasons referred to in exemption (a)(5), (a)(6) or (a)(7) of § 261b.5 of this part, such person may request in writing to the Secretary of the Board that such portion of the meeting be closed to public observation. The Secretary, or in his or her absence, the Acting Secretary of the Board, will transmit the request to the members and upon the request of any one of them a recorded vote will be taken whether to close such meeting to public observation.

(e) Within one day of any vote taken pursuant to paragraphs (a) through (d) of this section, the agency will make publicly available at the Board's Public Affairs Office and Freedom of Information Office a written copy of such vote reflecting the vote of each member on the question. If a meeting or a portion of a meeting is to be closed to public observation, the agency, within one day of the vote taken pursuant to paragraphs (a) through (d) of this section, will make publicly available at the Board's Public Affairs Office and Freedom of Information Office a full, written explanation of its action closing the meeting or portion of the meeting together with a list of all persons expected to attend the meeting and their affiliation, except to the extent such information is determined by the agency to be exempt from disclosure under subsection (c) of the Act and § 261b.5 of this part.

(f) Any person may request in writing to the Secretary of the Board that an announced closed meeting, or portion of the meeting, be held open to public observation. The Secretary, or in his or her absence, the Acting Secretary of the Board, will transmit the request to the members of the Board and upon the request of any member a recorded vote will be taken whether to open such meeting to public observation.

[42 FR 13297, Mar. 10, 1977, as amended at 44 FR 11750, Mar. 2, 1979]

### § 261b.9 Changes with respect to publicly announced meeting.

The subject matter of a meeting or the determination to open or close a meeting or a portion of a meeting to public observation may be changed following public announcement under § 261b.6 only if a majority of the members of the agency determines by a recorded vote that agency business so requires and that no earlier announcement of the change was possible. Public announcement of such change and the vote of each member upon such change will be made pursuant to § 261b.6(c). Changes in time, including postponements and cancellations of a publicly announced meeting or portion of a meeting or changes in the place of a publicly announced meeting will be publicly announced pursuant to § 261b.6(c) by the Secretary of the Board or, in the Secretary's absence, the Acting Secretary of the Board.

### § 261b.10 Certification of General Counsel.

Before every meeting or portion of a meeting closed to public observation under § 261b.7 or 261b.8 of this part, the General Counsel, or in the General Counsel's absence, the Acting General Counsel, shall publicly certify whether or not in his or her opinion the meeting may be closed to public observation and shall state each relevant exemptive provision. A copy of such certification, together with a statement from the presiding officer of the meeting setting forth the time and place of the meeting and the persons present, will be retained for the time prescribed in § 261b.11(d).

### § 261b.11 Transcripts, recordings, and minutes.

(a) The agency will maintain a complete transcript or electronic recording or transcription thereof adequate to record fully the proceedings of each meeting or portion of a meeting closed to public observation pursuant to exemption (a)(1), (a)(2), (a)(3), (a)(4), (a)(5), (a)(6), (a)(7) or (a)(9)(ii) of § 261b.5

of this part. Transcriptions of recordings will disclose the identity of each speaker.

(b) The agency will maintain either such a transcript, recording or transcription thereof, or a set of minutes that will fully and clearly describe all matters discussed and provide a full and accurate summary of any actions taken and the reasons therefor, including a description of each of the views expressed on any item and the record of any roll call vote (reflecting the vote of each member on the question), for meetings or portions of meetings closed to public observation pursuant to exemptions (a)(8), (a)(9)(A) or (a)(10) of § 261b.5 of this part. The minutes will identify all documents considered in connection with any action taken.

(c) Transcripts, recordings or transcriptions thereof, or minutes will promptly be made available to the public in the Freedom of Information Office except for such item or items of such discussion or testimony as may be determined to contain information that may be withheld under subsection (c) of the Act and § 261b.5 of this part.

(d) A complete verbatim copy of the transcript, a complete copy of the minutes, or a complete electronic recording or verbatim copy of a transcription thereof of each meeting or portion of a meeting closed to public observation will be maintained for a period of at least two years or one year after the conclusion of any agency proceeding with respect to which the meeting or portion thereof was held, whichever occurs later.

### § 261b.12 Procedures for inspection and obtaining copies of transcriptions and minutes.

(a) Any person may inspect or copy a transcript, a recording or transcription of a recording, or minutes described in § 261b.11(c) of this part.

(b) Requests for copies of transcripts, recordings or transcriptions of recordings, or minutes described in § 261b.11(c) of this part shall specify the meeting or the portion of meeting desired and shall be submitted in writing to the Secretary of the Board, Board of Governors of the Federal Reserve System, Washington, DC 20551. Copies of documents identified in minutes may be made available to the public upon request under the provisions of 12 CFR part 261 (Rules Regarding Availability of Information).

### § 261b.13 Fees.

(a) Copies of transcripts, recordings or transcriptions of recordings, or minutes requested pursuant to section § 261b.12(b) of this part will be provided at the cost of 10¢ per standard page for photocopying or at a cost not to exceed the actual cost of printing, typing, or otherwise preparing such copies.

(b) Documents may be furnished without charge where total charges are less than $2.

## PART 262—RULES OF PROCEDURE

Sec.
262.1 Basis and scope.
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262.7–262.24 [Reserved]
262.25 Policy statement regarding notice of applications; timeliness of comments; informal meetings.

AUTHORITY: 5 U.S.C. 552, 12 U.S.C. 321, 1828(c), and 1842.

SOURCE: 38 FR 6807, Mar. 13, 1973, unless otherwise noted.

### § 262.1 Basis and scope.

This part is issued pursuant to section 552 of title 5 of the United States Code, which requires that every agency shall publish in the FEDERAL REGISTER statements of the general course and method by which its functions are channeled and determined, rules of procedure, and descriptions of forms available or the places at which forms may be obtained.

### § 262.2 Procedure for regulations.

(a) *Notice.* Notices of proposed regulations of the Board of Governors of the Federal Reserve System (the ''Board'') or amendments thereto are published in the FEDERAL REGISTER, except as specified in paragraph (e) of this section or otherwise excepted by law. Such notices include a statement of the terms of the proposed regulations or amendments and a description of the

subjects and issues involved; but the giving of such notices does not necessarily indicate the Board's final approval of any feature of any such proposal. The notices also include a reference to the authority for the proposed regulations or amendments and a statement of the time, place, and nature of public participation.

(b) *Public participation.* The usual method of public submission of data, views, or arguments is in writing. It is ordinarily preferable that they be sent to the Secretary of the Board, Washington, DC 20551, with copies to the appropriate Federal Reserve Bank. The locations of the 12 Federal Reserve Banks and the boundaries of the Federal Reserve districts are shown in the appendix to the Board's rules of organization. Such material will be made available for inspection and copying upon request, except as provided in § 261.6(b) of this chapter regarding availability of information.

(c) *Preparation of draft and action by Board.* In the light of consideration of all relevant matter presented or ascertained, the appropriate division of the Board's staff, in collaboration with other divisions, prepares drafts of proposed regulations or amendments, and the staff submits them to the Board. The Board takes such action as it deems appropriate in the public interest. Any other documents that may be necessary to carry out any decision by the Board in the matter are usually prepared by the Legal Division, in collaboration with the other divisions of the staff.

(d) *Effective dates.* Any substantive regulation or amendment thereto issued by the Board is published not less than 30 days prior to the effective date thereof, except as specified in paragraph (e) of this section or as otherwise excepted by law.

(e) *Exceptions as to notice or effective date.* In certain situations, notice and public participation with respect to proposed regulations may be impracticable, unnecessary, contrary to the public interest, or otherwise not required in the public interest, or there may be reason and good cause in the public interest why the effective date should not be deferred for 30 days. The reason or reasons in such cases usually are that such notice, public participation, or deferment of effective date would prevent the action from becoming effective as promptly as necessary in the public interest, would permit speculators or others to reap unfair profits or to interfere with the Board's actions taken with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country, would provoke other consequences contrary to the public interest, would unreasonably interfere with the Board's necessary functions with respect to management or personnel, would not aid the persons affected, or would otherwise serve no useful purpose. The following may be mentioned as some examples of situations in which advance notice or deferred effective date, or both, will ordinarily be omitted in the public interest: The review and determination of discount rates established by Federal Reserve Banks, and changes in general requirements regarding reserves of member banks, maximum interest rates on time and savings deposits, or credit for purchasing or carrying securities.

[38 FR 6807, Mar. 13, 1973, as amended at 54 FR 33183, Aug. 14, 1989]

### § 262.3 Applications.

(a) *Forms.* Any application, request, or petition (hereafter referred to as ''application'') for the approval, authority, determination, or permission of the Board with respect to any action for which such approval, authority, determination, or permission is required by law or regulation of the Board (including actions authorized to be taken by a Federal Reserve Bank or others on behalf of the Board pursuant to authority delegated under Part 265 of this chapter) shall be submitted in accordance with the pertinent form, if any, prescribed by the Board. Copies of any such form and details regarding information to be included therein may be obtained from any Federal Reserve Bank. Any application for which no form is prescribed should be signed by the person making the application or by his duly authorized agent, should state the facts involved, the action requested, and the applicant's interest in the matter, and should indicate the

reasons why the application should be granted. Applications for access to, or copying of, records of the Board should be submitted as provided in § 261.9(a) of this chapter.

(b) *Notice of applications.* (1)(i) In the case of applications,

(A) By a State member bank for the establishment of a domestic branch or other facility that would be authorized to receive deposits,

(B) To become a bank holding company (except as provided in 12 CFR 225.15), and

(C) By a bank holding company to acquire ownership or control of shares or assets of a bank, or to merge or consolidate with any other bank holding company,

the applicant shall cause to be published a notice in the form prescribed by the Board.

(ii) The notice shall be placed in the classified advertising legal notices section of the newspaper, and must provide an opportunity for the public to give written comment on the application to the appropriate Federal Reserve Bank for the period specified in Regulation H (12 CFR part 208) in the case of applications specified in § 262.3(b)(1)(i)(A), and for at least thirty days after the date of publication in the case of applications specified in § 262.3(b)(1)(i)(B) and (C). Within 7 days of publication, the applicant shall submit its application to the appropriate Reserve Bank for acceptance along with a copy of the notice. If the Reserve Bank has not accepted the application as complete within ninety days of the date of publication of the notice, the applicant may be required to republish notice of the application. Such notice shall be published in a newspaper of general circulation in—

(A) [Reserved]

(B) The community or communities in which the head office of the bank and the proposed branch or other facility (other than an electronic funds transfer facility) are located in the case of an application for the establishment of a domestic branch or other facility that would be authorized to receive deposits, other than an application incidental to an application by a bank for merger, consolidation, or acquisition of assets or assumption of liabilities,

(C) The community or communities in which the head office of the bank, the office to be closed, and the office to be opened are located in the case of an application for the relocation of a domestic branch office,

(D) The community or communities in which the head office of each of the banks to be party to the merger, consolidation, or acquisition of assets or assumption of liabilities are located in the case of an application by a bank for merger, consolidation, or acquisition of assets or assumption of liabilities, or

(E) The community or communities in which the head offices of the largest subsidiary bank, if any, or an applicant and of each bank, shares of which are to be directly or indirectly acquired, are located in the case of applications under section 3 of the Bank Holding Company Act.

(2) In addition to the foregoing notice, an applicant, in the case of an application to relocate a domestic branch office or other facility that would be authorized to receive deposits, shall post in a conspicuous public place in the lobby of the office to be closed a notice containing the information specified in § 262.3(b)(1). Such notice should be posted on the date of the notice required by § 262.3(b)(1).

(3) In the case of an application for a merger, consolidation, or acquisition of assets or assumption of liabilities, if the acquiring, assuming, or resulting bank is to be a State member bank, the applicant shall cause to be published notice in the form prescribed by the Board. The notice shall be published in a newspaper of general circulation in the community or communities in which the head office of each of the banks to be a party to the merger, consolidation, or acquisition of assets or assumption of liabilities is located. The notice shall be published on at least three occasions at appropriate intervals. The last publication of the notice shall appear at least thirty days after the first publication. The notice must provide an opportunity for the public to give written comment on the application to the appropriate Federal Reserve Bank for at least thirty days after the date of the first publication of

the notice. Within seven days of publication of notice for the first time, the applicant shall submit its application to the appropriate Reserve Bank for acceptance, along with a copy of the notice. If the Reserve Bank has not accepted the application as complete within ninety days of the date of the first publication of the notice, the applicant may be required to republish notice of the application.

(c) *Filing of applications.* Any application should be sent to the Federal Reserve Bank of the district in which the head office of the parent banking organization is located, except as otherwise specified on application forms, and that Bank will forward it to the Board when appropriate; however, in the case of foreign banking organization, as defined in § 211.23(a)(2) of this chapter, applications shall be sent to the Federal Reserve Bank of the district in which the operations of the organization's subsidiary banks are principally conducted. In the case of a foreign banking organization that is not a bank holding company but that has one or more branches, agencies, or commercial lending companies in any State of the United States or the District of Columbia, applications shall be sent to the Federal Reserve Bank of the district in which the organization's banking assets are the largest. Applications of a member bank subsidiary, however, should be filed with the Reserve Bank of the district in which the member bank is located.

(d) *Analysis by staff.* In every case, the Reserve Bank makes such investigation as may be necessary, and, except when acting pursuant to delegated authority, reports the relevant facts, with its recommendation, to the Board. In the light of consideration of all relevant matter presented or ascertained, the Board's staff prepares and submits to the Board comments on the subject.

(e) *Submission of comments and requests for hearing.* The Board is only required to consider a comment or a request for a hearing with respect to an application or notice if it is in writing and received by the Secretary of the Board or the appropriate Federal Reserve Bank on or before the latest date prescribed in any notice with respect to the application or notice, or where no such date is prescribed, on or before the 30th day after the date notice is first published. Similarly, the Board will consider comments on an application from the Attorney General or a banking supervisory authority to which notification of receipt of an application has been given, only if such comment is received by the Secretary of the Board within 30 days of the date of the letter giving such notification. Any comment on an application or notice that requests a hearing must include a statement of why a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute and summarizing the evidence that would be presented at a hearing. In every case where a timely comment or request for hearing is received as provided herein, a copy of such comment or request shall be forwarded promptly to the applicant for its response. The Board will consider the applicant's response only if it is in writing and sent to the Secretary of the Board on or before eight business days after the date of the letter by which it is forwarded to the applicant. At the same time it transmits its response to the Board, the applicant should transmit a copy of its response to the person or supervisory authority making such comment or requesting a hearing. Notwithstanding the foregoing, the Board may, in its sole discretion and without notifying the parties, take into consideration the substance of comments with respect to an application, (but not requests for hearing) that are not received within the time periods provided herein.

(f) *Action on applications.* The Board takes such action as it deems appropriate in the public interest. Such documents as may be necessary to carry out any decision by the Board are prepared by the Board's staff. With respect to actions taken by a Federal Reserve Bank on behalf of the Board under delegated authority, statements and necessary documents are prepared by the staff of such Federal Reserve Bank.

(g) *Notice of action.* Prompt notice is given to the applicant of the granting or denial in whole or in part of any application. In the case of a denial, except in affirming a prior denial or

where the denial is self-explanatory, such notice is accompanied by a simple statement of the grounds for such action.

(h) *Action at Board's initiative.* When the Board, without receiving an application, takes action with respect to any matter as to which opportunity for hearing is not required by statute or Board regulation, similar procedure is followed, including investigations, reports, and recommendations by the Board's staff and by the Reserve Banks, where appropriate.

(i) *General procedures for bank holding company and merger applications.* In addition to procedures applicable under other provisions of this part, the following procedures are applicable in connection with the Board's consideration of applications under sections 3 and 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842 and 1843), hereafter referred to as ''section 3 applications'' or ''section 4 applications,'' and of applications under section 18(c) of the Federal Deposit Insurance Act (12 U.S.C. 1823), hereafter called ''merger applications.'' Except as otherwise indicated, the following procedures apply to all such applications.

(1) The Board issues each week a list that identifies section 3 and section 4 and merger applications received and acted upon during the preceding week by the Board or the Reserve Banks pursuant to delegated authority. Notice of receipt of all section 3 applications and of section 4(c)(8) applications acted on by the Board is published in the FEDERAL REGISTER.

(2) If a hearing is required by law or if the Board determines that a formal hearing for the purpose of taking evidence is desirable, the Board issues an order for such a hearing, and a notice thereof is published in the FEDERAL REGISTER. Any such formal hearing is conducted by an administrative law judge in accordance with subparts A and B of the Board's Rules of Practice for Hearings (part 263 of this chapter).

(3) In any case in which a formal hearing is not ordered by the Board, the Board may afford the applicant and other properly interested persons (including Governmental agencies) an opportunity to present views orally before the Board or its designated representative. Unless otherwise ordered by the Board, any such oral presentation is public and notice of such public proceeding is published in the FEDERAL REGISTER.

(4) Each action taken by the Board on an application is embodied in an order that indicates the votes of members of the Board. The order either contains reasons for the Board's action (i.e., an expanded order) or is accompanied by a statement of the reasons for the Board's action. Both the order and any accompanying statement are released to the press. Each order accompanied by a statement and any order of general interest, together with a list of other orders, are published in the Federal Reserve Bulletin. Action by a Reserve Bank under delegated authority as provided for under part 265 of this chapter is reflected in a letter of notification to the applicant.

(5) Unless the Board shall otherwise direct, each section 3 and section 4 and merger application is made available for inspection by the public except for portions thereof as to which the Board determines that nondisclosure is warranted under section 552(b) of title 5 of the United States Code.

(j) *Special procedures for certain applications.* The following types of applications require procedures exclusive of, or in addition to, those described in paragraphs (i)(1) through (5) of this section.

(1) Special rules pertaining to section 3 and merger applications follow:

(i) Each order of the Board and each letter of notification by a Reserve Bank acting pursuant to delegated authority approving a section 3 application includes, pursuant to the Act approved July 1, 1966 (12 U.S.C. 1849(b)), a requirement that the transaction approved shall not be consummated before the 30th calendar day following the date of such order.

(ii) Each order of the Board approving a merger application includes, pursuant to the Act approved February 21, 1966 (12 U.S.C. 1828(c)(6)), a requirement that the transaction approved shall not be consummated before the 30th calendar day following the date of such order, except as the Board may otherwise determine pursuant to emergency

situations as to which the Act permits consummation at earlier dates.

(iii) Each order or each letter of notification approving an application also includes, as a condition of approval, a requirement that the transaction approved shall be consummated within 3 months and, in the case of acquisition by a holding company of stock of a newly organized bank, a requirement that such bank shall be opened for business within 6 months, but such periods may be extended for good cause by the Board (or by the appropriate Federal Reserve Bank where authority to grant such extensions is delegated to the Reserve Bank).

(2) For special rules governing procedures for section 4 applications, refer to § 225.23 of this chapter.

(3)–(4) [Reserved]

(5) For special rules governing procedures for section 4(c)(13) applications, refer to § 225.4(f) of this chapter.

(k) *Reconsideration of certain Board actions.* The Board may reconsider any action taken by it on an application upon receipt by the Secretary of the Board of a written request for reconsideration from any party to such application, on or before the 15th day after the effective date of the Board's action. Such request should specify the reasons why the Board should reconsider its action, and present relevant facts that for good cause shown, were not previously presented to the Board. Within 10 days of receipt of such a request, the General Counsel, acting pursuant to delegated authority (12 CFR 265.2(b)(7)), shall determine whether or not the request for reconsideration should be granted, and shall notify all parties to the application orally by telephone of this determination within 10 days. Such notification will be confirmed promptly in writing. In the exercise of this authority, the General Counsel shall confer with the Directors of other interested Divisions of the Board or their designees. Notwithstanding the foregoing, the Board may, on its own motion if it deems reconsideration appropriate, elect to reconsider its action with respect to any application, and the parties to such application shall be notified by the Secretary of the Board of its election as provided above. If it is determined that the Board should reconsider its action with respect to an application, such action will be stayed and will not be final until the Board has acted on the application upon reconsideration. If appropriate, notice of reconsideration of an application will be published promptly in the FEDERAL REGISTER.

(l) *Waiver.* The Board, or the officer or Reserve Bank authorized to approve an application, may waive or modify any procedural requirements for that application prescribed or cited in this section and may excuse any failure to comply with them upon a finding that immediate action on the application is necessary to prevent the probable failure of a bank or company or that an emergency exists requiring expeditious action.

(12 U.S.C. 1842(a), 1843, and 1844(b), 12 U.S.C. 1828(c), 321 and 248(i))

[38 FR 6807, Mar. 13, 1973]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 262.3, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

### § 262.4 Adjudication with formal hearing.

In connection with adjudication with respect to which a formal hearing is required by law or is ordered by the Board, the procedure is set forth in part 263 of this chapter, entitled ''Rules of Practice for Formal Hearings.''

### § 262.5 Appearance and practice.

Appearance and practice before the Board in all matters are governed by § 263.3 of this chapter.

### § 262.6 Forms.

Necessary forms to be used in connection with applications and other matters are available at the Federal Reserve Banks. A list of all such forms, which is reviewed and revised periodically, may be obtained from any Federal Reserve Bank.

(a) This action is taken pursuant to and in accordance with the provisions of section 552 of title 5 of the United States Code.

(b) The provisions of section 553 of title 5, United States Code, relating to notice and public participation and to

deferred effective dates, are not followed in connection with the adoption of this action, because the rules involved are procedural in nature and accordingly do not constitute substantive rules subject to the requirements of such section.

**§§ 262.7–262.24 [Reserved]**

**§ 262.25 Policy statement regarding notice of applications; timeliness of comments; informal meetings.**

(a) *Notice of applications.* A bank or company applying to the Board for a deposit-taking facility must first publish notice of its application in local newspapers. This requirement, found in § 262.3(b)(1) of the Board's Rules of Procedure covers applications under the Bank Holding Company Act and Bank Merger Act, as well as applications for membership in the Federal Reserve System and for new branches of State member banks. Notices of these applications are published in newspapers of general circulation in the communities where the applicant intends to do business as well as in the community where the applicant's head office is located. These notices are important in calling the public's attention to an applicant's plans and giving the public a chance to comment on these plans. To improve the effectiveness of the notices, the Board has supplemented its notice procedures as follows.

(1) The Board has adopted standard forms of notice for use by applicants that will specify the exact date on which the comment period on the application ends, which may not be less than thirty calendar days from the date of publication of the notice. The newspaper forms also provide the name and telephone number of the Community Affairs Officer of the appropriate Reserve Bank as the person to call to obtain more information about submitting comments on an application. In general, the Community Affairs Officer will be available to answer questions of a general nature concerning the submission of comments and the processing of applications.

(2) The Board also publishes notice of bank holding company applications for bank acquisitions (but not for bank mergers or branches) in the FEDERAL REGISTER after the application is received and the Community Affairs Officer can provide the exact date on which this comment period ends. (The FEDERAL REGISTER comment period will generally end after the date specified in the newspaper notice.)

(3) In addition to the formal newspaper and FEDERAL REGISTER notices discussed above, each Reserve Bank publishes a weekly list of applications submitted to the Reserve Bank for which newspaper notices have been published. Any person or organization may arrange to have the list mailed to them regularly, or may request particular lists, by contacting the Reserve Bank's Community Affairs Officer. Each Reserve Bank's list includes only applications submitted to that particular Reserve Bank, and persons or groups should request lists from each Reserve Bank having jurisdiction over applications in which they may be interested. Since the lists are prepared as a courtesy by the Reserve Bank, and are not intended to replace any formal notice required by statute or regulation, the Reserve Banks and the Board do not assume responsibility for errors or omissions. In addition, the weekly lists prepared by Reserve Banks include certain applications by bank holding companies for nonbank acquisitions filed with the Reserve Bank.

(4) With respect to applications by bank holding companies to engage *de novo* in nonbank activities or make acquisitions of nonbank firms, the Board publishes notice of most of these applications in the FEDERAL REGISTER when the applications are filed. Notice of certain small acquisitions may be published in a newspaper of general circulation in the area(s) to be served. While applications for nonbanking activities are not covered by the provisions of the Community Reinvestment Act or the notice provisions of § 262.3 of the Board's Rules of Procedure, the provisions of this Statement apply to such applications.

(b) *Timeliness of comments.* (1) All comments must be actually received by the Board or the Reserve Bank on or before the last date of the comment period specified in the notice. Where more than one notice is published with respect to an application, comments must be received on or before the last

date of the latest comment period. The Board's Rules allow it to disregard comments received after the comment period expires. In particular, § 262.3(e) of the Board's Rules of Procedure states that the Board will not consider comments on an application that are not received on or before the expiration of the comment period. Thus, a commenter who fails to comment on an application within the specified comment period (or any extension) may be precluded from participating in the consideration of the application.

(2) In cases where a commenter for good cause is unable to send its comment within the specified comment period, § 265.2(a)(10) of the Board's Rules Regarding Delegation of Authority (12 CFR 265.2(a)(10)) allows the Secretary of the Board to grant requests for an extension of the period. Under this provision, upon receipt of a request received on or before the expiration of the comment period, the Secretary may grant a brief extension upon clear demonstration of hardship or other meritorious reason for seeking additional time.

(c) *Private meetings.* When a timely protest to approval of an application is received, the Reserve Bank may arrange a meeting between the applicant and the protestant to clarify and narrow the issues, and to provide a forum for the resolution of differences between the protestant and the applicant. If the Reserve Bank decides that a private meeting would be appropriate, the Reserve Bank will arrange a private meeting soon after the receipt of a protest and the applicant's response, if any, to the protest. In scheduling the meeting, the Reserve Bank will consider convenience to the parties with respect to the time and place of the meeting. A decision to hold a private meeting will not preclude the Reserve Bank or the Board from holding a public meeting or other proceeding if it is deemed appropriate.

(d) *Public meetings.* The Board's General Counsel (in consultation with the Reserve Bank and the directors of other interested divisions of the Board) may order that a public meeting or other proceeding be held if requested by the applicant or a protestant who files a timely protest, or if such a proceeding appears appropriate. In most instances, the determination to order a public meeting will be made after a private meeting has been held; however, where appropriate a public meeting may be convened immediately after receipt of the protest and the applicant's response, if any. Additional information may be requested prior to making a determination to convene a public meeting. In these cases, a determination will be made within ten days from the date all relevant information is received. The public meeting will be scheduled as soon as possible, but in no event, later than 30 days after the decision to hold the proceeding is made. The purpose of the public meeting will be to elicit information, to clarify factual issues related to the application and to provide an opportunity for interested individuals to provide testimony. The Board has adopted the following guidelines to be used for convening public meetings, although specific provisions may be altered by the General Counsel if circumstances warrant.

(1) *Requesting a public meeting.* A meeting may be requested by a person or an organization objecting to the application during the comment period, and by the applicant during the period within which it must respond to comments. Such a request must be timely and in writing.

(i) A protest does not have to be filed in a legal brief or other format in order for a public meeting to be granted. The Community Affairs Officer at the Reserve Bank will be available to assist any member of the public regarding the types of information generally included in protests; the format generally used by protestants; and any other specific questions about the procedures of the Federal Reserve System regarding protested applications.

(ii) In general, a protest should identify the protestant, state the basis for objection to approval of the application, and provide available written evidence to support the objection. Objections to approval of an application must relate to the factors that the Board is authorized to consider in acting on an application. Generally, these factors relate to the financial and managerial resources of the companies and

banks involved, the effects of the proposal on competition, and the convenience and needs of the communities to be served by the companies and banks involved. If a public meeting is requested, the protest should indicate that there are members of the public who wish to speak on the issues in a public forum.

(iii) The protest will be transmitted by the Reserve Bank to the applicant, and the applicant will generally be allowed eight business days to respond in writing to the protest.

(2) *Arranging the public meeting.* Public meetings will be arranged and presided over by a representative of the Federal Reserve System (''Presiding Officer''). In determining the time and place for the public meeting, such factors as convenience to the parties, the number of people expected to attend the meeting, access to public transportation and possible after-hour security problems will be taken into account.

(3) *Conducting the public meeting.* Prior to the meeting, all necessary steps will be taken to ensure that the meeting is conducted appropriately, including scheduling of witnesses, submission of written materials and other arrangements. In conducting the public meeting the Presiding Officer will have the authority and discretion to ensure that the meeting proceeds in a fair and orderly manner. Generally, the public meeting will consist of opening and closing remarks by the Presiding Officer, a presentation by the protestant and a presentation by the applicant. An official transcript will be made of the proceedings and entered into the record. The conclusion of the public meeting normally marks the close of the public portion of the record on the application.

(4) *Notification of Board decision on the application.* After a decision is made on the application, and the applicant is notified of the decision, staff will notify the protestant by telephone. This notification will be confirmed promptly in writing. As set forth in §262.3(k) of the Board's Rules of Procedure (12 CFR 262.3(k)) or §265.3 of the Board's Rules Regarding Delegation of Authority (12 CFR 265.3), a party to the application may request reconsideration of the Board's order, or review of the Reserve Bank's decision.

[49 FR 5603, Feb. 14, 1984, as amended at 57 FR 41642, Sept. 11, 1992]

# PART 263—RULES OF PRACTICE FOR HEARINGS

## Subpart A—Uniform Rules of Practice and Procedure

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AUTHORITY: 5 U.S.C. 504; 12 U.S.C. 248, 324, 504, 505, 1817(j), 1818, 1820(k), 1828(c), 1831o, 1831p–1, 1847(b), 1847(d), 1884(b), 1972(2)(F), 3105, 3107, 3108, 3907, 3909; 15 U.S.C. 21, 78o–4, 78o–5, 78u–2; and 28 U.S.C. 2461 *note*.

SOURCE: 56 FR 38052, Aug. 9, 1991, unless otherwise noted.

## Subpart A—Uniform Rules of Practice and Procedure

### § 263.1 Scope.

This subpart prescribes Uniform Rules of practice and procedure applicable to adjudicatory proceedings required to be conducted on the record after opportunity for hearing under the following statutory provisions:

(a) Cease-and-desist proceedings under section 8(b) of the Federal Deposit Insurance Act (''FDIA'') (12 U.S.C. 1818(b));

(b) Removal and prohibition proceedings under section 8(e) of the FDIA (12 U.S.C. 1818(e));

(c) Change-in-control proceedings under section 7(j)(4) of the FDIA (12 U.S.C. 1817(j)(4)) to determine whether the Board of Governors of the Federal Reserve System (''Board'') should issue an order to approve or disapprove a person's proposed acquisition of a state member bank or bank holding company;

(d) Proceedings under section 15C(c)(2) of the Securities Exchange Act of 1934 (''Exchange Act'') (15 U.S.C. 78o-5), to impose sanctions upon any government securities broker or dealer or upon any person associated or seeking to become associated with a government securities broker or dealer for which the Board is the appropriate agency;

(e) Assessment of civil money penalties by the Board against institutions, institution-affiliated parties, and certain other persons for which the Board is the appropriate agency for any violation of:

(1) Any provision of the Bank Holding Company Act of 1956, as amended (''BHC Act''), or any order or regulation issued thereunder, pursuant to 12 U.S.C. 1847(b) and (d);

(2) Sections 19, 22, 23A and 23B of the Federal Reserve Act (''FRA''), or any regulation or order issued thereunder and certain unsafe or unsound practices or breaches of fiduciary duty, pursuant to 12 U.S.C. 504 and 505;

(3) Section 9 of the FRA pursuant to 12 U.S.C. 324;

(4) Section 106(b) of the Bank Holding Company Act Amendments of 1970 and certain unsafe or unsound practices or breaches of fiduciary duty, pursuant to 12 U.S.C. 1972(2)(F);

(5) Any provision of the Change in Bank Control Act of 1978, as amended, or any regulation or order issued thereunder and certain unsafe or unsound practices or breaches of fiduciary duty, pursuant to 12 U.S.C. 1817(j)(16);

(6) Any provision of the International Lending Supervision Act of 1983 (''ILSA'') or any rule, regulation or order issued thereunder, pursuant to 12 U.S.C. 3909;

(7) Any provision of the International Banking Act of 1978 (''IBA'') or any rule, regulation or order issued thereunder, pursuant to 12 U.S.C. 3108;

(8) Certain provisions of the Exchange Act, pursuant to section 21B of the Exchange Act (15 U.S.C. 78u-2);

(9) Section 1120 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3349), or any order or regulation issued thereunder;

(10) The terms of any final or temporary order issued under section 8 of the FDIA or of any written agreement executed by the Board, the terms of any condition imposed in writing by the Board in connection with the grant of an application or request, and certain unsafe or unsound practices or breaches of fiduciary duty or law or regulation pursuant to 12 U.S.C. 1818(i)(2);

(11) Any provision of law referenced in section 102(f) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(f)) or any order or regulation issued thereunder; and

(12) Any provision of law referenced in 31 U.S.C. 5321 or any order or regulation issued thereunder;

(f) Remedial action under section 102(g) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(g));

(g) Removal, prohibition, and civil monetary penalty proceedings under section 10(k) of the FDI Act (12 U.S.C. 1820(k)) for violations of the special post-employment restrictions imposed by that section; and

(h) This subpart also applies to all other adjudications required by statute to be determined on the record after

opportunity for an agency hearing, unless otherwise specifically provided for in the Local Rules.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20341, May 6, 1996; 70 FR 69638, Nov. 17, 2005]

### § 263.2 Rules of construction.

For purposes of this subpart:

(a) Any term in the singular includes the plural, and the plural includes the singular, if such use would be appropriate;

(b) Any use of a masculine, feminine, or neuter gender encompasses all three, if such use would be appropriate;

(c) The term *counsel* includes a non-attorney representative; and

(d) Unless the context requires otherwise, a party's counsel of record, if any, may, on behalf of that party, take any action required to be taken by the party.

### § 263.3 Definitions.

For purposes of this subpart, unless explicitly stated to the contrary:

(a) *Administrative law judge* means one who presides at an administrative hearing under authority set forth at 5 U.S.C. 556.

(b) *Adjudicatory proceeding* means a proceeding conducted pursuant to these rules and leading to the formulation of a final order other than a regulation.

(c) *Decisional employee* means any member of the Board's or administrative law judge's staff who has not engaged in an investigative or prosecutorial role in a proceeding and who may assist the Agency or the administrative law judge, respectively, in preparing orders, recommended decisions, decisions, and other documents under the Uniform Rules.

(d) *Enforcement Counsel* means any individual who files a notice of appearance as counsel on behalf of the Board in an adjudicatory proceeding.

(e) *Final order* means an order issued by the Board with or without the consent of the affected institution or the institution-affiliated party, that has become final, without regard to the pendency of any petition for reconsideration or review.

(f) *Institution* includes: (1) Any bank as that term is defined in section 3(a) of the FDIA (12 U.S.C. 1813(a));

(2) Any bank holding company or any subsidiary (other than a bank) of a bank holding company as those terms are defined in the BHC Act (12 U.S.C. 1841 *et seq.*);

(3) Any organization operating under section 25 of the FRA (12 U.S.C. 601 *et seq.*);

(4) Any foreign bank or company to which section 8 of the IBA (12 U.S.C. 3106), applies or any subsidiary (other than a bank) thereof; and

(5) Any Federal agency as that term is defined in section 1(b) of the IBA (12 U.S.C. 3101(5)).

(g) *Institution-affiliated party* means any institution-affiliated party as that term is defined in section 3(u) of the FDIA (12 U.S.C. 1813(u)).

(h) *Local Rules* means those rules promulgated by the Board in this part other than subpart A.

(i) *OFIA* means the Office of Financial Institution Adjudication, the executive body charged with overseeing the administration of administrative enforcement proceedings for the Board, the Office of Comptroller of the Currency (the *OCC*), the Federal Deposit Insurance Corporation (the *FDIC*), the Office of Thrift Supervision (the *OTS*), and the National Credit Union Administration (the *NCUA*).

(j) *Party* means the Board and any person named as a party in any notice.

(k) *Person* means an individual, sole proprietor, partnership, corporation, unincorporated association, trust, joint venture, pool, syndicate, agency or other entity or organization, including an institution as defined in paragraph (f) of this section.

(l) *Respondent* means any party other than the Board.

(m) *Uniform Rules* means those rules in subpart A of this part that are common to the Board, the OCC, the FDIC, the OTS and the NCUA.

(n) *Violation* includes any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

**§ 263.4 Authority of the Board.**

The Board may, at any time during the pendency of a proceeding, perform, direct the performance of, or waive performance of, any act which could be done or ordered by the administrative law judge.

**§ 263.5 Authority of the administrative law judge.**

(a) *General rule.* All proceedings governed by this part shall be conducted in accordance with the provisions of chapter 5 of title 5 of the United States Code. The administrative law judge shall have all powers necessary to conduct a proceeding in a fair and impartial manner and to avoid unnecessary delay.

(b) *Powers.* The administrative law judge shall have all powers necessary to conduct the proceeding in accordance with paragraph (a) of this section, including the following powers:

(1) To administer oaths and affirmations;

(2) To issue subpoenas, subpoenas duces tecum, and protective orders, as authorized by this part, and to quash or modify any such subpoenas and orders;

(3) To receive relevant evidence and to rule upon the admission of evidence and offers of proof;

(4) To take or cause depositions to be taken as authorized by this subpart;

(5) To regulate the course of the hearing and the conduct of the parties and their counsel;

(6) To hold scheduling and/or prehearing conferences as set forth in § 263.31;

(7) To consider and rule upon all procedural and other motions appropriate in an adjudicatory proceeding, provided that only the Board shall have the power to grant any motion to dismiss the proceeding or to decide any other motion that results in a final determination of the merits of the proceeding;

(8) To prepare and present to the Board a recommended decision as provided herein;

(9) To recuse himself or herself by motion made by a party or on his or her own motion;

(10) To establish time, place and manner limitations on the attendance of the public and the media for any public hearing; and

(11) To do all other things necessary and appropriate to discharge the duties of a presiding officer.

**§ 263.6 Appearance and practice in adjudicatory proceedings.**

(a) *Appearance before the Board or an administrative law judge*—(1) *By attorneys.* Any member in good standing of the bar of the highest court of any state, commonwealth, possession, territory of the United States, or the District of Columbia may represent others before the Board if such attorney is not currently suspended or debarred from practice before the Board.

(2) *By non-attorneys.* An individual may appear on his or her own behalf; a member of a partnership may represent the partnership; a duly authorized officer, director, or employee of any government unit, agency, institution, corporation or authority may represent that unit, agency, institution, corporation or authority if such officer, director, or employee is not currently suspended or debarred from practice before the Board.

(3) *Notice of appearance.* Any individual acting as counsel on behalf of a party, including the Board, shall file a notice of appearance with OFIA at or before the time that individual submits papers or otherwise appears on behalf of a party in the adjudicatory proceeding. The notice of appearance must include a written declaration that the individual is currently qualified as provided in paragraph (a)(1) or (a)(2) of this section and is authorized to represent the particular party. By filing a notice of appearance on behalf of a party in an adjudicatory proceeding, the counsel agrees and represents that he or she is authorized to accept service on behalf of the represented party and that, in the event of withdrawal from representation, he or she will, if required by the administrative law judge, continue to accept service until new counsel has filed a notice of appearance or until the represented party indicates that he or she will proceed on a *pro se* basis.

(b) *Sanctions.* Dilatory, obstructionist, egregious, contemptuous or contumacious conduct at any phase of

any adjudicatory proceeding may be grounds for exclusion or suspension of counsel from the proceeding.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20341, May 6, 1996]

### § 263.7 Good faith certification.

(a) *General requirement*. Every filing or submission of record following the issuance of a notice shall be signed by at least one counsel of record in his or her individual name and shall state that counsel's address and telephone number. A party who acts as his or her own counsel shall sign his or her individual name and state his or her address and telephone number on every filing or submission of record.

(b) *Effect of signature*. (1) The signature of counsel or a party shall constitute a certification that: the counsel or party has read the filing or submission of record; to the best of his or her knowledge, information, and belief formed after reasonable inquiry, the filing or submission of record is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and the filing or submission of record is not made for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

(2) If a filing or submission of record is not signed, the administrative law judge shall strike the filing or submission of record, unless it is signed promptly after the omission is called to the attention of the pleader or movant.

(c) *Effect of making oral motion or argument*. The act of making any oral motion or oral argument by any counsel or party constitutes a certification that to the best of his or her knowledge, information, and belief formed after reasonable inquiry, his or her statement is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and is not made for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

### § 263.8 Conflicts of interest.

(a) *Conflict of interest in representation*. No person shall appear as counsel for another person in an adjudicatory proceeding if it reasonably appears that such representation may be materially limited by that counsel's responsibilities to a third person or by the counsel's own interests. The administrative law judge may take corrective measures at any stage of a proceeding to cure a conflict of interest in representation, including the issuance of an order limiting the scope of representation or disqualifying an individual from appearing in a representative capacity for the duration of the proceeding.

(b) *Certification and waiver*. If any person appearing as counsel represents two or more parties to an adjudicatory proceeding or also represents a non-party on a matter relevant to an issue in the proceeding, counsel must certify in writing at the time of filing the notice of appearance required by § 263.6(a):

(1) That the counsel has personally and fully discussed the possibility of conflicts of interest with each such party and non-party; and

(2) That each such party and non-party waives any right it might otherwise have had to assert any known conflicts of interest or to assert any non-material conflicts of interest during the course of the proceeding.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20342, May 6, 1996]

### § 263.9 *Ex parte* communications.

(a) *Definition*—(1) *Ex parte communication* means any material oral or written communication relevant to the merits of an adjudicatory proceeding that was neither on the record nor on reasonable prior notice to all parties that takes place between:

(i) An interested person outside the Board (including such person's counsel); and

(ii) The administrative law judge handling that proceeding, a member of the Board, or a decisional employee.

(2) *Exception*. A request for status of the proceeding does not constitute an *ex parte* communication.

(b) *Prohibition of ex parte communications*. From the time the notice is

issued by the Board until the date that the Board issues its final decision pursuant to § 263.40(c):

(1) No interested person outside the Federal Reserve System shall make or knowingly cause to be made an *ex parte* communication to a member of the Board, the administrative law judge, or a decisional employee; and

(2) A member of the Board, administrative law judge, or decisional employee shall not make or knowingly cause to be made to any interested person outside the Federal Reserve System any *ex parte* communication.

(c) *Procedure upon occurrence of ex parte communication*. If an *ex parte* communication is received by the administrative law judge, a member of the Board or any other person identified in paragraph (a) of this section, that person shall cause all such written communications (or, if the communication is oral, a memorandum stating the substance of the communication) to be placed on the record of the proceeding and served on all parties. All other parties to the proceeding shall have an opportunity, within ten days of receipt of service of the *ex parte* communication, to file responses thereto and to recommend any sanctions, in accordance with paragraph (d) of this section, that they believe to be appropriate under the circumstances.

(d) *Sanctions*. Any party or his or her counsel who makes a prohibited *ex parte* communication, or who encourages or solicits another to make any such communication, may be subject to any appropriate sanction or sanctions imposed by the Board or the administrative law judge including, but not limited to, exclusion from the proceedings and an adverse ruling on the issue which is the subject of the prohibited communication.

(e) *Separation of functions*. Except to the extent required for the disposition of *ex parte* matters as authorized by law, the administrative law judge may not consult a person or party on any matter relevant to the merits of the adjudication, unless on notice and opportunity for all parties to participate. An employee or agent engaged in the performance of investigative or prosecuting functions for the Board in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review of the recommended decision under § 263.40, except as witness or counsel in public proceedings.

[56 FR 38052, Aug. 9, 1991, as amended at 59 FR 65245, Dec. 19, 1994]

### § 263.10 Filing of papers.

(a) *Filing*. Any papers required to be filed, excluding documents produced in response to a discovery request pursuant to §§ 263.25 and 263.26, shall be filed with OFIA, except as otherwise provided.

(b) *Manner of filing*. Unless otherwise specified by the Board or the administrative law judge, filing may be accomplished by:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if expressly authorized, and upon any conditions specified, by the Board or the administrative law judge. All papers filed by electronic media shall also concurrently be filed in accordance with paragraph (c) of this section.

(c) *Formal requirements as to papers filed*—(1) *Form*. All papers filed must set forth the name, address, and telephone number of the counsel or party making the filing and must be accompanied by a certification setting forth when and how service has been made on all other parties. All papers filed must be double-spaced and printed or typewritten on 8 1/2 × 11 inch paper, and must be clear and legible.

(2) *Signature*. All papers must be dated and signed as provided in § 263.7.

(3) *Caption*. All papers filed must include at the head thereof, or on a title page, the name of the Board and of the filing party, the title and docket number of the proceeding, and the subject of the particular paper.

(4) *Number of copies*. Unless otherwise specified by the Board, or the administrative law judge, an original and one copy of all documents and papers shall be filed, except that only one copy of transcripts of testimony and exhibits shall be filed.

**§ 263.11 Service of papers.**

(a) *By the parties.* Except as otherwise provided, a party filing papers shall serve a copy upon the counsel of record for all other parties to the proceeding so represented, and upon any party not so represented.

(b) *Method of service.* Except as provided in paragraphs (c)(2) and (d) of this section, a serving party shall use one or more of the following methods of service:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if the parties mutually agree. Any papers served by electronic media shall also concurrently be served in accordance with the requirements of § 263.10(c).

(c) *By the Board or the administrative law judge.* (1) All papers required to be served by the Board or the administrative law judge upon a party who has appeared in the proceeding in accordance with § 263.6, shall be served by any means specified in paragraph (b) of this section.

(2) If a party has not appeared in the proceeding in accordance with § 263.6, the Board or the administrative law judge shall make service by any of the following methods:

(i) By personal service;

(ii) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(iii) If the person to be served is a corporation or other association, by delivery to an officer, managing or general agent, or to any other agent authorized by appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(iv) By registered or certified mail addressed to the person's last known address; or

(v) By any other method reasonably calculated to give actual notice.

(d) *Subpoenas.* Service of a subpoena may be made:

(1) By personal service;

(2) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(3) By delivery to an agent, which, in the case of a corporation or other association, is delivery to an officer, managing or general agent, or to any other agent authorized by appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(4) By registered or certified mail addressed to the person's last known address; or

(5) By any other method as is reasonably calculated to give actual notice.

(e) *Area of service.* Service in any state, territory, possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, possession of the United States, or the District of Columbia, or on any person as otherwise provided by law, is effective without regard to the place where the hearing is held, provided that if service is made on a foreign bank in connection with an action or proceeding involving one or more of its branches or agencies located in any state, territory, possession of the United States, or the District of Columbia, service shall be made on at least one branch or agency so involved.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20342, May 6, 1996]

**§ 263.12 Construction of time limits.**

(a) *General rule.* In computing any period of time prescribed by this subpart, the date of the act or event that commences the designated period of time is not included. The last day so computed is included unless it is a Saturday, Sunday, or Federal holiday. When the last day is a Saturday, Sunday, or Federal holiday, the period runs until the end of the next day that is not a Saturday, Sunday, or Federal holiday. Intermediate Saturdays, Sundays, and Federal holidays are included in the computation of time. However, when the time period within which an act is to

be performed is ten days or less, not including any additional time allowed for in paragraph (c) of this section, intermediate Saturdays, Sundays, and Federal holidays are not included.

(b) *When papers are deemed to be filed or served.* (1) Filing and service are deemed to be effective:

(i) In the case of personal service or same-day commercial courier delivery, upon actual service;

(ii) In the case of overnight commercial delivery service, U.S. Express Mail delivery, or first class, registered, or certified mail, upon deposit in or delivery to an appropriate point of collection;

(iii) In the case of transmission by electronic media, as specified by the authority receiving the filing, in the case of filing, and as agreed among the parties, in the case of service.

(2) The effective filing and service dates specified in paragraph (b)(1) of this section may be modified by the Board or administrative law judge in the case of filing or by agreement of the parties in the case of service.

(c) *Calculation of time for service and filing of responsive papers.* Whenever a time limit is measured by a prescribed period from the service of any notice or paper, the applicable time limits are calculated as follows:

(1) If service is made by first class, registered, or certified mail, add three calendar days to the prescribed period;

(2) If service is made by express mail or overnight delivery service, add one calendar day to the prescribed period; or

(3) If service is made by electronic media transmission, add one calendar day to the prescribed period, unless otherwise determined by the Board or the administrative law judge in the case of filing, or by agreement among the parties in the case of service.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20342, May 6, 1996]

### § 263.13 Change of time limits.

Except as otherwise provided by law, the administrative law judge may, for good cause shown, extend the time limits prescribed by the Uniform Rules or by any notice or order issued in the proceedings. After the referral of the case to the Board pursuant to § 263.38, the Board may grant extensions of the time limits for good cause shown. Extensions may be granted at the motion of a party after notice and opportunity to respond is afforded all non-moving parties or *sua sponte* by the Board or the administrative law judge.

### § 263.14 Witness fees and expenses.

Witnesses subpoenaed for testimony or depositions shall be paid the same fees for attendance and mileage as are paid in the United States district courts in proceedings in which the United States is a party, provided that, in the case of a discovery subpoena addressed to a party, no witness fees or mileage need be paid. Fees for witnesses shall be tendered in advance by the party requesting the subpoena, except that fees and mileage need not be tendered in advance where the Board is the party requesting the subpoena. The Board shall not be required to pay any fees to, or expenses of, any witness not subpoenaed by the Board.

### § 263.15 Opportunity for informal settlement.

Any respondent may, at any time in the proceeding, unilaterally submit to Enforcement Counsel written offers or proposals for settlement of a proceeding, without prejudice to the rights of any of the parties. No such offer or proposal shall be made to any Board representative other than Enforcement Counsel. Submission of a written settlement offer does not provide a basis for adjourning or otherwise delaying all or any portion of a proceeding under this part. No settlement offer or proposal, or any subsequent negotiation or resolution, is admissible as evidence in any proceeding.

### § 263.16 The Board's right to conduct examination.

Nothing contained in this subpart limits in any manner the right of the Board or any Federal Reserve Bank to conduct any examination, inspection, or visitation of any institution or institution-affiliated party, or the right of the Board or any Federal Reserve Bank to conduct or continue any form of investigation authorized by law.

[56 FR 38052, Aug. 9, 1991; 56 FR 60056, Nov. 27, 1991]

### § 263.17 Collateral attacks on adjudicatory proceeding.

If an interlocutory appeal or collateral attack is brought in any court concerning all or any part of an adjudicatory proceeding, the challenged adjudicatory proceeding shall continue without regard to the pendency of that court proceeding. No default or other failure to act as directed in the adjudicatory proceeding within the times prescribed in this subpart shall be excused based on the pendency before any court of any interlocutory appeal or collateral attack.

### § 263.18 Commencement of proceeding and contents of notice.

(a) *Commencement of proceeding.* (1)(i) Except for change-in-control proceedings under section 7(j)(4) of the FDIA (12 U.S.C. 1817(j)(4)), a proceeding governed by this subpart is commenced by issuance of a notice by the Board.

(ii) The notice must be served by the Board upon the respondent and given to any other appropriate financial institution supervisory authority where required by law.

(iii) The notice must be filed with OFIA.

(2) Change-in-control proceedings under section 7(j)(4) of the FDIA (12 U.S.C. 1817(j)(4)) commence with the issuance of an order by the Board.

(b) *Contents of notice.* The notice must set forth:

(1) The legal authority for the proceeding and for the Board's jurisdiction over the proceeding;

(2) A statement of the matters of fact or law showing that the Board is entitled to relief;

(3) A proposed order or prayer for an order granting the requested relief;

(4) The time, place, and nature of the hearing as required by law or regulation;

(5) The time within which to file an answer as required by law or regulation;

(6) The time within which to request a hearing as required by law or regulation; and

(7) That the answer and/or request for a hearing shall be filed with OFIA.

### § 263.19 Answer.

(a) *When.* Within 20 days of service of the notice, respondent shall file an answer as designated in the notice. In a civil money penalty proceeding, respondent shall also file a request for a hearing within 20 days of service of the notice.

(b) *Content of answer.* An answer must specifically respond to each paragraph or allegation of fact contained in the notice and must admit, deny, or state that the party lacks sufficient information to admit or deny each allegation of fact. A statement of lack of information has the effect of a denial. Denials must fairly meet the substance of each allegation of fact denied; general denials are not permitted. When a respondent denies part of an allegation, that part must be denied and the remainder specifically admitted. Any allegation of fact in the notice which is not denied in the answer must be deemed admitted for purposes of the proceeding. A respondent is not required to respond to the portion of a notice that constitutes the prayer for relief or proposed order. The answer must set forth affirmative defenses, if any, asserted by the respondent.

(c) *Default*—(1) *Effect of failure to answer.* Failure of a respondent to file an answer required by this section within the time provided constitutes a waiver of his or her right to appear and contest the allegations in the notice. If no timely answer is filed, Enforcement Counsel may file a motion for entry of an order of default. Upon a finding that no good cause has been shown for the failure to file a timely answer, the administrative law judge shall file with the Board a recommended decision containing the findings and the relief sought in the notice. Any final order issued by the Board based upon a respondent's failure to answer is deemed to be an order issued upon consent.

(2) *Effect of failure to request a hearing in civil money penalty proceedings.* If respondent fails to request a hearing as required by law within the time provided, the notice of assessment constitutes a final and unappealable order.

### § 263.20 Amended pleadings.

(a) *Amendments.* The notice or answer may be amended or supplemented at

any stage of the proceeding. The respondent must answer an amended notice within the time remaining for the respondent's answer to the original notice, or within ten days after service of the amended notice, whichever period is longer, unless the Board or administrative law judge orders otherwise for good cause.

(b) *Amendments to conform to the evidence.* When issues not raised in the notice or answer are tried at the hearing by express or implied consent of the parties, they will be treated in all respects as if they had been raised in the notice or answer, and no formal amendments are required. If evidence is objected to at the hearing on the ground that it is not within the issues raised by the notice or answer, the administrative law judge may admit the evidence when admission is likely to assist in adjudicating the merits of the action and the objecting party fails to satisfy the administrative law judge that the admission of such evidence would unfairly prejudice that party's action or defense upon the merits. The administrative law judge may grant a continuance to enable the objecting party to meet such evidence.

[61 FR 20342, May 6, 1996]

### § 263.21 Failure to appear.

Failure of a respondent to appear in person at the hearing or by a duly authorized counsel constitutes a waiver of respondent's right to a hearing and is deemed an admission of the facts as alleged and consent to the relief sought in the notice. Without further proceedings or notice to the respondent, the administrative law judge shall file with the Board a recommended decision containing the findings and the relief sought in the notice.

### § 263.22 Consolidation and severance of actions.

(a) *Consolidation.* (1) On the motion of any party, or on the administrative law judge's own motion, the administrative law judge may consolidate, for some or all purposes, any two or more proceedings, if each such proceeding involves or arises out of the same transaction, occurrence or series of transactions or occurrences, or involves at least one common respondent or a material common question of law or fact, unless such consolidation would cause unreasonable delay or injustice.

(2) In the event of consolidation under paragraph (a)(1) of this section, appropriate adjustment to the prehearing schedule shall be made to avoid unnecessary expense, inconvenience, or delay.

(b) *Severance.* The administrative law judge may, upon the motion of any party, sever the proceeding for separate resolution of the matter as to any respondent only if the administrative law judge finds that:

(1) Undue prejudice or injustice to the moving party would result from not severing the proceeding; and

(2) Such undue prejudice or injustice would outweigh the interests of judicial economy and expedition in the complete and final resolution of the proceeding.

### § 263.23 Motions.

(a) *In writing.* (1) Except as otherwise provided herein, an application or request for an order or ruling must be made by written motion.

(2) All written motions must state with particularity the relief sought and must be accompanied by a proposed order.

(3) No oral argument may be held on written motions except as otherwise directed by the administrative law judge. Written memoranda, briefs, affidavits or other relevant material or documents may be filed in support of or in opposition to a motion.

(b) *Oral motions.* A motion may be made orally on the record unless the administrative law judge directs that such motion be reduced to writing.

(c) *Filing of motions.* Motions must be filed with the administrative law judge, except that following the filing of the recommended decision, motions must be filed with the Board.

(d) *Responses.* (1) Except as otherwise provided herein, within ten days after service of any written motion, or within such other period of time as may be established by the administrative law judge or the Board, any party may file a written response to a motion. The administrative law judge shall not rule on any oral or written motion before

each party has had an opportunity to file a response.

(2) The failure of a party to oppose a written motion or an oral motion made on the record is deemed a consent by that party to the entry of an order substantially in the form of the order accompanying the motion.

(e) *Dilatory motions.* Frivolous, dilatory or repetitive motions are prohibited. The filing of such motions may form the basis for sanctions.

(f) *Dispositive motions.* Dispositive motions are governed by §§ 263.29 and 263.30.

### § 263.24 Scope of document discovery.

(a) *Limits on discovery.* (1) Subject to the limitations set out in paragraphs (b), (c), and (d) of this section, a party to a proceeding under this subpart may obtain document discovery by serving a written request to produce documents. For purposes of a request to produce documents, the term ''documents'' may be defined to include drawings, graphs, charts, photographs, recordings, data stored in electronic form, and other data compilations from which information can be obtained, or translated, if necessary, by the parties through detection devices into reasonably usable form, as well as written material of all kinds.

(2) Discovery by use of deposition is governed by § 263.53 of subpart B of this part.

(3) Discovery by use of interrogatories is not permitted.

(b) *Relevance.* A party may obtain document discovery regarding any matter, not privileged, that has material relevance to the merits of the pending action. Any request to produce documents that calls for irrelevant material, that is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or that seeks to obtain privileged documents will be denied or modified. A request is unreasonable, oppressive, excessive in scope or unduly burdensome if, among other things, it fails to include justifiable limitations on the time period covered and the geographic locations to be searched, the time provided to respond in the request is inadequate, or the request calls for copies of documents to be delivered to the requesting party and fails to include the requestor's written agreement to pay in advance for the copying, in accordance with § 263.25.

(c) *Privileged matter.* Privileged documents are not discoverable. Privileges include the attorney-client privilege, work-product privilege, any government's or government agency's deliberative-process privilege, and any other privileges the Constitution, any applicable act of Congress, or the principles of common law provide.

(d) *Time limits.* All discovery, including all responses to discovery requests, shall be completed at least 20 days prior to the date scheduled for the commencement of the hearing. No exceptions to this time limit shall be permitted, unless the administrative law judge finds on the record that good cause exists for waiving the requirements of this paragraph.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20342, May 6, 1996]

### § 263.25 Request for document discovery from parties.

(a) *General rule.* Any party may serve on any other party a request to produce for inspection any discoverable documents that are in the possession, custody, or control of the party upon whom the request is served. The request must identify the documents to be produced either by individual item or by category, and must describe each item and category with reasonable particularity. Documents must be produced as they are kept in the usual course of business or must be organized to correspond with the categories in the request.

(b) *Production or copying.* The request must specify a reasonable time, place, and manner for production and performing any related acts. In lieu of inspecting the documents, the requesting party may specify that all or some of the responsive documents be copied and the copies delivered to the requesting party. If copying of fewer than 250 pages is requested, the party to whom the request is addressed shall bear the cost of copying and shipping charges. If a party requests 250 pages or more of copying, the requesting party shall pay for the copying and shipping charges. Copying charges are the current per-

page copying rate imposed by 12 CFR Part 261 implementing the Freedom of Information Act (5 U.S.C. 552). The party to whom the request is addressed may require payment in advance before producing the documents.

(c) *Obligation to update responses.* A party who has responded to a discovery request with a response that was complete when made is not required to supplement the response to include documents thereafter acquired, unless the responding party learns that:

(1) The response was materially incorrect when made; or

(2) The response, though correct when made, is no longer true and a failure to amend the response is, in substance, a knowing concealment.

(d) *Motions to limit discovery.* (1) Any party that objects to a discovery request may, within ten days of being served with such request, file a motion in accordance with the provisions of § 263.23 to strike or otherwise limit the request. If an objection is made to only a portion of an item or category in a request, the portion objected to shall be specified. Any objections not made in accordance with this paragraph and § 263.23 are waived.

(2) The party who served the request that is the subject of a motion to strike or limit may file a written response within five days of service of the motion. No other party may file a response.

(e) *Privilege.* At the time other documents are produced, the producing party must reasonably identify all documents withheld on the grounds of privilege and must produce a statement of the basis for the assertion of privilege. When similar documents that are protected by deliberative process, attorney-work-product, or attorney-client privilege are voluminous, these documents may be identified by category instead of by individual document. The administrative law judge retains discretion to determine when the identification by category is insufficient.

(f) *Motions to compel production.* (1) If a party withholds any documents as privileged or fails to comply fully with a discovery request, the requesting party may, within ten days of the assertion of privilege or of the time the failure to comply becomes known to the requesting party, file a motion in accordance with the provisions of § 263.23 for the issuance of a subpoena compelling production.

(2) The party who asserted the privilege or failed to comply with the request may file a written response to a motion to compel within five days of service of the motion. No other party may file a response.

(g) *Ruling on motions.* After the time for filing responses pursuant to this section has expired, the administrative law judge shall rule promptly on all motions filed pursuant to this section. If the administrative law judge determines that a discovery request, or any of its terms, calls for irrelevant material, is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or seeks to obtain privileged documents, he or she may deny or modify the request, and may issue appropriate protective orders, upon such conditions as justice may require. The pendency of a motion to strike or limit discovery or to compel production is not a basis for staying or continuing the proceeding, unless otherwise ordered by the administrative law judge. Notwithstanding any other provision in this part, the administrative law judge may not release, or order a party to produce, documents withheld on grounds of privilege if the party has stated to the administrative law judge its intention to file a timely motion for interlocutory review of the administrative law judge's order to produce the documents, and until the motion for interlocutory review has been decided.

(h) *Enforcing discovery subpoenas.* If the administrative law judge issues a subpoena compelling production of documents by a party, the subpoenaing party may, in the event of noncompliance and to the extent authorized by applicable law, apply to any appropriate United States district court for an order requiring compliance with the subpoena. A party's right to seek court enforcement of a subpoena shall not in any manner limit the sanctions that may be imposed by the administrative

law judge against a party who fails to produce subpoenaed documents.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20343, May 6, 1996]

### § 263.26 Document subpoenas to nonparties.

(a) *General rules.* (1) Any party may apply to the administrative law judge for the issuance of a document discovery subpoena addressed to any person who is not a party to the proceeding. The application must contain a proposed document subpoena and a brief statement showing the general relevance and reasonableness of the scope of documents sought. The subpoenaing party shall specify a reasonable time, place, and manner for making production in response to the document subpoena.

(2) A party shall only apply for a document subpoena under this section within the time period during which such party could serve a discovery request under § 263.24(d). The party obtaining the document subpoena is responsible for serving it on the subpoenaed person and for serving copies on all parties. Document subpoenas may be served in any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law.

(3) The administrative law judge shall promptly issue any document subpoena requested pursuant to this section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon such conditions as may be consistent with the Uniform Rules.

(b) *Motion to quash or modify.* (1) Any person to whom a document subpoena is directed may file a motion to quash or modify such subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant shall serve the motion on all parties, and any party may respond to such motion within ten days of service of the motion.

(2) Any motion to quash or modify a document subpoena must be filed on the same basis, including the assertion of privilege, upon which a party could object to a discovery request under § 263.25(d), and during the same time limits during which such an objection could be filed.

(c) *Enforcing document subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with so much of the document subpoena as the administrative law judge has not quashed or modified. A party's right to seek court enforcement of a document subpoena shall in no way limit the sanctions that may be imposed by the administrative law judge on a party who induces a failure to comply with subpoenas issued under this section.

### § 263.27 Deposition of witness unavailable for hearing.

(a) *General rules.* (1) If a witness will not be available for the hearing, a party desiring to preserve that witness's testimony for the record may apply in accordance with the procedures set forth in paragraph (a)(2) of this section, to the administrative law judge for the issuance of a subpoena, including a subpoena duces tecum, requiring the attendance of the witness at a deposition. The administrative law judge may issue a deposition subpoena under this section upon a showing that:

(i) The witness will be unable to attend or may be prevented from attending the hearing because of age, sickness or infirmity, or will otherwise be unavailable;

(ii) The witness's unavailability was not procured or caused by the subpoenaing party;

(iii) The testimony is reasonably expected to be material; and

(iv) Taking the deposition will not result in any undue burden to any other party and will not cause undue delay of the proceeding.

(2) The application must contain a proposed deposition subpoena and a

brief statement of the reasons for the issuance of the subpoena. The subpoena must name the witness whose deposition is to be taken and specify the time and place for taking the deposition. A deposition subpoena may require the witness to be deposed at any place within the country in which that witness resides or has a regular place of employment or such other convenient place as the administrative law judge shall fix.

(3) Any requested subpoena that sets forth a valid basis for its issuance must be promptly issued, unless the administrative law judge on his or her own motion, requires a written response or requires attendance at a conference concerning whether the requested subpoena should be issued.

(4) The party obtaining a deposition subpoena is responsible for serving it on the witness and for serving copies on all parties. Unless the administrative law judge orders otherwise, no deposition under this section shall be taken on fewer than ten days' notice to the witness and all parties. Deposition subpoenas may be served in any state, territory, possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, possession of the United States, or the District of Columbia, or as otherwise permitted by law.

(b) *Objections to deposition subpoenas.* (1) The witness and any party who has not had an opportunity to oppose a deposition subpoena issued under this section may file a motion with the administrative law judge to quash or modify the subpoena prior to the time for compliance specified in the subpoena, but not more than ten days after service of the subpoena.

(2) A statement of the basis for the motion to quash or modify a subpoena issued under this section must accompany the motion. The motion must be served on all parties.

(c) *Procedure upon deposition.* (1) Each witness testifying pursuant to a deposition subpoena must be duly sworn, and each party shall have the right to examine the witness. Objections to questions or documents must be in short form, stating the grounds for the objection. Failure to object to questions or documents is not deemed a waiver except where the ground for the objection might have been avoided if the objection had been timely presented. All questions, answers, and objections must be recorded.

(2) Any party may move before the administrative law judge for an order compelling the witness to answer any questions the witness has refused to answer or submit any evidence the witness has refused to submit during the deposition.

(3) The deposition must be subscribed by the witness, unless the parties and the witness, by stipulation, have waived the signing, or the witness is ill, cannot be found, or has refused to sign. If the deposition is not subscribed by the witness, the court reporter taking the deposition shall certify that the transcript is a true and complete transcript of the deposition.

(d) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any order of the administrative law judge which directs compliance with all or any portion of a deposition subpoena under paragraph (b) or (c)(3) of this section, the subpoenaing party or other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with the portions of the subpoena that the administrative law judge has ordered enforced. A party's right to seek court enforcement of a deposition subpoena in no way limits the sanctions that may be imposed by the administrative law judge on a party who fails to comply with, or procures a failure to comply with, a subpoena issued under this section.

### § 263.28 Interlocutory review.

(a) *General rule.* The Board may review a ruling of the administrative law judge prior to the certification of the record to the Board only in accordance with the procedures set forth in this section and § 263.23.

(b) *Scope of review.* The Board may exercise interlocutory review of a ruling of the administrative law judge if the Board finds that:

(1) The ruling involves a controlling question of law or policy as to which

substantial grounds exist for a difference of opinion;

(2) Immediate review of the ruling may materially advance the ultimate termination of the proceeding;

(3) Subsequent modification of the ruling at the conclusion of the proceeding would be an inadequate remedy; or

(4) Subsequent modification of the ruling would cause unusual delay or expense.

(c) *Procedure.* Any request for interlocutory review shall be filed by a party with the administrative law judge within ten days of his or her ruling and shall otherwise comply with § 263.23. Any party may file a response to a request for interlocutory review in accordance with § 263.23(d). Upon the expiration of the time for filing all responses, the administrative law judge shall refer the matter to the Board for final disposition.

(d) *Suspension of proceeding.* Neither a request for interlocutory review nor any disposition of such a request by the Board under this section suspends or stays the proceeding unless otherwise ordered by the administrative law judge or the Board.

### § 263.29 Summary disposition.

(a) *In general.* The administrative law judge shall recommend that the Board issue a final order granting a motion for summary disposition if the undisputed pleaded facts, admissions, affidavits, stipulations, documentary evidence, matters as to which official notice may be taken, and any other evidentiary materials properly submitted in connection with a motion for summary disposition show that:

(1) There is no genuine issue as to any material fact; and

(2) The moving party is entitled to a decision in its favor as a matter of law.

(b) *Filing of motions and responses.* (1) Any party who believes that there is no genuine issue of material fact to be determined and that he or she is entitled to a decision as a matter of law may move at any time for summary disposition in its favor of all or any part of the proceeding. Any party, within 20 days after service of such a motion, or within such time period as allowed by the administrative law judge, may file a response to such motion.

(2) A motion for summary disposition must be accompanied by a statement of the material facts as to which the moving party contends there is no genuine issue. Such motion must be supported by documentary evidence, which may take the form of admissions in pleadings, stipulations, depositions, investigatory depositions, transcripts, affidavits and any other evidentiary materials that the moving party contends support his or her position. The motion must also be accompanied by a brief containing the points and authorities in support of the contention of the moving party. Any party opposing a motion for summary disposition must file a statement setting forth those material facts as to which he or she contends a genuine dispute exists. Such opposition must be supported by evidence of the same type as that submitted with the motion for summary disposition and a brief containing the points and authorities in support of the contention that summary disposition would be inappropriate.

(c) *Hearing on motion.* At the request of any party or on his or her own motion, the administrative law judge may hear oral argument on the motion for summary disposition.

(d) *Decision on motion.* Following receipt of a motion for summary disposition and all responses thereto, the administrative law judge shall determine whether the moving party is entitled to summary disposition. If the administrative law judge determines that summary disposition is warranted, the administrative law judge shall submit a recommended decision to that effect to the Board. If the administrative law judge finds that no party is entitled to summary disposition, he or she shall make a ruling denying the motion.

### § 263.30 Partial summary disposition.

If the administrative law judge determines that a party is entitled to summary disposition as to certain claims only, he or she shall defer submitting a recommended decision as to those claims. A hearing on the remaining issues must be ordered. Those claims for which the administrative law judge

has determined that summary disposition is warranted will be addressed in the recommended decision filed at the conclusion of the hearing.

### § 263.31 Scheduling and prehearing conferences.

(a) *Scheduling conference.* Within 30 days of service of the notice or order commencing a proceeding or such other time as parties may agree, the administrative law judge shall direct counsel for all parties to meet with him or her in person at a specified time and place prior to the hearing or to confer by telephone for the purpose of scheduling the course and conduct of the proceeding. This meeting or telephone conference is called a ''scheduling conference.'' The identification of potential witnesses, the time for and manner of discovery, and the exchange of any prehearing materials including witness lists, statements of issues, stipulations, exhibits and any other materials may also be determined at the scheduling conference.

(b) *Prehearing conferences.* The administrative law judge may, in addition to the scheduling conference, on his or her own motion or at the request of any party, direct counsel for the parties to meet with him or her (in person or by telephone) at a prehearing conference to address any or all of the following:

(1) Simplification and clarification of the issues;

(2) Stipulations, admissions of fact, and the contents, authenticity and admissibility into evidence of documents;

(3) Matters of which official notice may be taken;

(4) Limitation of the number of witnesses;

(5) Summary disposition of any or all issues;

(6) Resolution of discovery issues or disputes;

(7) Amendments to pleadings; and

(8) Such other matters as may aid in the orderly disposition of the proceeding.

(c) *Transcript.* The administrative law judge, in his or her discretion, may require that a scheduling or prehearing conference be recorded by a court reporter. A transcript of the conference and any materials filed, including orders, becomes part of the record of the proceeding. A party may obtain a copy of the transcript at his or her expense.

(d) *Scheduling or prehearing orders.* At or within a reasonable time following the conclusion of the scheduling conference or any prehearing conference, the administrative law judge shall serve on each party an order setting forth any agreements reached and any procedural determinations made.

### § 263.32 Prehearing submissions.

(a) Within the time set by the administrative law judge, but in no case later than 14 days before the start of the hearing, each party shall serve on every other party, his or her:

(1) Prehearing statement;

(2) Final list of witnesses to be called to testify at the hearing, including name and address of each witness and a short summary of the expected testimony of each witness;

(3) List of the exhibits to be introduced at the hearing along with a copy of each exhibit; and

(4) Stipulations of fact, if any.

(b) Effect of failure to comply. No witness may testify and no exhibits may be introduced at the hearing if such witness or exhibit is not listed in the prehearing submissions pursuant to paragraph (a) of this section, except for good cause shown.

### § 263.33 Public hearings.

(a) *General rule.* All hearings shall be open to the public, unless the Board, in the Board's discretion, determines that holding an open hearing would be contrary to the public interest. Within 20 days of service of the notice or, in the case of change-in-control proceedings under section 7(j)(4) of the FDIA (12 U.S.C. 1817(j)(4)), within 20 days from service of the hearing order, any respondent may file with the Board a request for a private hearing, and any party may file a reply to such a request. A party must serve on the administrative law judge a copy of any request or reply the party files with the Board. The form of, and procedure for, these requests and replies are governed by § 263.23. A party's failure to file a request or a reply constitutes a waiver of any objections regarding

whether the hearing will be public or private.

(b) *Filing document under seal.* Enforcement Counsel, in his or her discretion, may file any document or part of a document under seal if disclosure of the document would be contrary to the public interest. The administrative law judge shall take all appropriate steps to preserve the confidentiality of such documents or parts thereof, including closing portions of the hearing to the public.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20343, May 6, 1996]

### § 263.34 Hearing subpoenas.

(a) *Issuance.* (1) Upon application of a party showing general relevance and reasonableness of scope of the testimony or other evidence sought, the administrative law judge may issue a subpoena or a subpoena duces tecum requiring the attendance of a witness at the hearing or the production of documentary or physical evidence at the hearing. The application for a hearing subpoena must also contain a proposed subpoena specifying the attendance of a witness or the production of evidence from any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law at any designated place where the hearing is being conducted. The party making the application shall serve a copy of the application and the proposed subpoena on every other party.

(2) A party may apply for a hearing subpoena at any time before the commencement of a hearing. During a hearing, a party may make an application for a subpoena orally on the record before the administrative law judge.

(3) The administrative law judge shall promptly issue any hearing subpoena requested pursuant to this section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon any conditions consistent with this subpart. Upon issuance by the administrative law judge, the party making the application shall serve the subpoena on the person named in the subpoena and on each party.

(b) *Motion to quash or modify.* (1) Any person to whom a hearing subpoena is directed or any party may file a motion to quash or modify the subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant must serve the motion on each party and on the person named in the subpoena. Any party may respond to the motion within ten days of service of the motion.

(2) Any motion to quash or modify a hearing subpoena must be filed prior to the time specified in the subpoena for compliance, but not more than ten days after the date of service of the subpoena upon the movant.

(c) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may seek enforcement of the subpoena pursuant to § 263.26(c).

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20343, May 6, 1996]

### § 263.35 Conduct of hearings.

(a) *General rules.* (1) Hearings shall be conducted so as to provide a fair and expeditious presentation of the relevant disputed issues. Each party has the right to present its case or defense by oral and documentary evidence and to conduct such cross examination as may be required for full disclosure of the facts.

(2) *Order of hearing.* Enforcement Counsel shall present its case-in-chief first, unless otherwise ordered by the administrative law judge, or unless otherwise expressly specified by law or regulation. Enforcement Counsel shall be the first party to present an opening statement and a closing statement, and may make a rebuttal statement after the respondent's closing statement. If there are multiple respondents, respondents may agree among themselves as to their order of presentation of their cases, but if they do not agree

the administrative law judge shall fix the order.

(3) *Examination of witnesses*. Only one counsel for each party may conduct an examination of a witness, except that in the case of extensive direct examination, the administrative law judge may permit more than one counsel for the party presenting the witness to conduct the examination. A party may have one counsel conduct the direct examination and another counsel conduct re-direct examination of a witness, or may have one counsel conduct the cross examination of a witness and another counsel conduct the re-cross examination of a witness.

(4) *Stipulations*. Unless the administrative law judge directs otherwise, all stipulations of fact and law previously agreed upon by the parties, and all documents, the admissibility of which have been previously stipulated, will be admitted into evidence upon commencement of the hearing.

(b) *Transcript*. The hearing must be recorded and transcribed. The reporter will make the transcript available to any party upon payment by that party to the reporter of the cost of the transcript. The administrative law judge may order the record corrected, either upon motion to correct, upon stipulation of the parties, or following notice to the parties upon the administrative law judge's own motion.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20343, May 6, 1996]

### § 263.36 Evidence.

(a) *Admissibility*. (1) Except as is otherwise set forth in this section, relevant, material, and reliable evidence that is not unduly repetitive is admissible to the fullest extent authorized by the Administrative Procedure Act and other applicable law.

(2) Evidence that would be admissible under the Federal Rules of Evidence is admissible in a proceeding conducted pursuant to this subpart.

(3) Evidence that would be inadmissible under the Federal Rules of Evidence may not be deemed or ruled to be inadmissible in a proceeding conducted pursuant to this subpart if such evidence is relevant, material, reliable and not unduly repetitive.

(b) *Official notice*. (1) Official notice may be taken of any material fact which may be judicially noticed by a United States district court and any material information in the official public records of any Federal or state government agency.

(2) All matters officially noticed by the administrative law judge or Board shall appear on the record.

(3) If official notice is requested or taken of any material fact, the parties, upon timely request, shall be afforded an opportunity to object.

(c) *Documents*. (1) A duplicate copy of a document is admissible to the same extent as the original, unless a genuine issue is raised as to whether the copy is in some material respect not a true and legible copy of the original.

(2) Subject to the requirements of paragraph (a) of this section, any document, including a report of examination, supervisory activity, inspection or visitation, prepared by an appropriate Federal financial institution regulatory agency or state regulatory agency, is admissible either with or without a sponsoring witness.

(3) Witnesses may use existing or newly created charts, exhibits, calendars, calculations, outlines or other graphic material to summarize, illustrate, or simplify the presentation of testimony. Such materials may, subject to the administrative law judge's discretion, be used with or without being admitted into evidence.

(d) *Objections*. (1) Objections to the admissibility of evidence must be timely made and rulings on all objections must appear on the record.

(2) When an objection to a question or line of questioning propounded to a witness is sustained, the examining counsel may make a specific proffer on the record of what he or she expected to prove by the expected testimony of the witness, either by representation of counsel or by direct interrogation of the witness.

(3) The administrative law judge shall retain rejected exhibits, adequately marked for identification, for the record, and transmit such exhibits to the Board.

(4) Failure to object to admission of evidence or to any ruling constitutes a waiver of the objection.

(e) *Stipulations*. The parties may stipulate as to any relevant matters of fact or the authentication of any relevant documents. Such stipulations must be received in evidence at a hearing, and are binding on the parties with respect to the matters therein stipulated.

(f) *Depositions of unavailable witnesses*. (1) If a witness is unavailable to testify at a hearing, and that witness has testified in a deposition to which all parties in a proceeding had notice and an opportunity to participate, a party may offer as evidence all or any part of the transcript of the deposition, including deposition exhibits, if any.

(2) Such deposition transcript is admissible to the same extent that testimony would have been admissible had that person testified at the hearing, provided that if a witness refused to answer proper questions during the depositions, the administrative law judge may, on that basis, limit the admissibility of the deposition in any manner that justice requires.

(3) Only those portions of a deposition received in evidence at the hearing constitute a part of the record.

### § 263.37 Post-hearing filings.

(a) *Proposed findings and conclusions and supporting briefs*. (1) Using the same method of service for each party, the administrative law judge shall serve notice upon each party, that the certified transcript, together with all hearing exhibits and exhibits introduced but not admitted into evidence at the hearing, has been filed. Any party may file with the administrative law judge proposed findings of fact, proposed conclusions of law, and a proposed order within 30 days following service of this notice by the administrative law judge or within such longer period as may be ordered by the administrative law judge.

(2) Proposed findings and conclusions must be supported by citation to any relevant authorities and by page references to any relevant portions of the record. A post-hearing brief may be filed in support of proposed findings and conclusions, either as part of the same document or in a separate document. Any party who fails to file timely with the administrative law judge any proposed finding or conclusion is deemed to have waived the right to raise in any subsequent filing or submission any issue not addressed in such party's proposed finding or conclusion.

(b) *Reply briefs*. Reply briefs may be filed within 15 days after the date on which the parties' proposed findings, conclusions, and order are due. Reply briefs must be strictly limited to responding to new matters, issues, or arguments raised in another party's papers. A party who has not filed proposed findings of fact and conclusions of law or a post-hearing brief may not file a reply brief.

(c) *Simultaneous filing required*. The administrative law judge shall not order the filing by any party of any brief or reply brief in advance of the other party's filing of its brief.

[56 FR 38052, Aug. 9, 1991, as amended at 61 FR 20344, May 6, 1996]

### § 263.38 Recommended decision and filing of record.

(a) *Filing of recommended decision and record*. Within 45 days after expiration of the time allowed for filing reply briefs under § 263.37(b), the administrative law judge shall file with and certify to the Board, for decision, the record of the proceeding. The record must include the administrative law judge's recommended decision, recommended findings of fact, recommended conclusions of law, and proposed order; all prehearing and hearing transcripts, exhibits, and rulings; and the motions, briefs, memoranda, and other supporting papers filed in connection with the hearing. The administrative law judge shall serve upon each party the recommended decision, findings, conclusions, and proposed order.

(b) *Filing of index*. At the same time the administrative law judge files with and certifies to the Board for final determination the record of the proceeding, the administrative law judge shall furnish to the Board a certified index of the entire record of the proceeding. The certified index shall include, at a minimum, an entry for each paper, document or motion filed with the administrative law judge in the proceeding, the date of the filing, and the identity of the filer. The certified index shall also include an exhibit index containing, at a minimum, an

entry consisting of exhibit number and title or description for: Each exhibit introduced and admitted into evidence at the hearing; each exhibit introduced but not admitted into evidence at the hearing; each exhibit introduced and admitted into evidence after the completion of the hearing; and each exhibit introduced but not admitted into evidence after the completion of the hearing.

[61 FR 20344, May 6, 1996]

### § 263.39 Exceptions to recommended decision.

(a) *Filing exceptions.* Within 30 days after service of the recommended decision, findings, conclusions, and proposed order under § 263.38, a party may file with the Board written exceptions to the administrative law judge's recommended decision, findings, conclusions or proposed order, to the admission or exclusion of evidence, or to the failure of the administrative law judge to make a ruling proposed by a party. A supporting brief may be filed at the time the exceptions are filed, either as part of the same document or in a separate document.

(b) *Effect of failure to file or raise exceptions.* (1) Failure of a party to file exceptions to those matters specified in paragraph (a) of this section within the time prescribed is deemed a waiver of objection thereto.

(2) No exception need be considered by the Board if the party taking exception had an opportunity to raise the same objection, issue, or argument before the administrative law judge and failed to do so.

(c) *Contents.* (1) All exceptions and briefs in support of such exceptions must be confined to the particular matters in, or omissions from, the administrative law judge's recommendations to which that party takes exception.

(2) All exceptions and briefs in support of exceptions must set forth page or paragraph references to the specific parts of the administrative law judge's recommendations to which exception is taken, the page or paragraph references to those portions of the record relied upon to support each exception, and the legal authority relied upon to support each exception.

### § 263.40 Review by the Board.

(a) *Notice of submission to the Board.* When the Board determines that the record in the proceeding is complete, the Board shall serve notice upon the parties that the proceeding has been submitted to the Board for final decision.

(b) *Oral argument before the Board.* Upon the initiative of the Board or on the written request of any party filed with the Board within the time for filing exceptions, the Board may order and hear oral argument on the recommended findings, conclusions, decision, and order of the administrative law judge. A written request by a party must show good cause for oral argument and state reasons why arguments cannot be presented adequately in writing. A denial of a request for oral argument may be set forth in the Board's final decision. Oral argument before the Board must be on the record.

(c) *Agency final decision.* (1) Decisional employees may advise and assist the Board in the consideration and disposition of the case. The final decision of the Board will be based upon review of the entire record of the proceeding, except that the Board may limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties.

(2) The Board shall render a final decision within 90 days after notification of the parties that the case has been submitted for final decision, or 90 days after oral argument, whichever is later, unless the Board orders that the action or any aspect thereof be remanded to the administrative law judge for further proceedings. Copies of the final decision and order of the Board shall be served upon each party to the proceeding, upon other persons required by statute, and, if directed by the Board or required by statute, upon any appropriate state or Federal supervisory authority.

### § 263.41 Stays pending judicial review.

The commencement of proceedings for judicial review of a final decision and order of the Board may not, unless specifically ordered by the Board or a reviewing court, operate as a stay of any order issued by the Board. The

Board may, in its discretion, and on such terms as it finds just, stay the effectiveness of all or any part of its order pending a final decision on a petition for review of that order.

## Subpart B—Board Local Rules Supplementing the Uniform Rules

### § 263.50 Purpose and scope.

(a) This subpart prescribes the rules of practice and procedure governing formal adjudications set forth in § 263.50(b) of this subpart, and supplements the rules of practice and procedure contained in subpart A of this part.

(b) The rules and procedures of this subpart and subpart A of this part shall apply to the formal adjudications set forth in § 263.1 of subpart A and to the following adjudications:

(1) Suspension of a member bank from use of credit facilities of the Federal Reserve System under section 4 of the FRA (12 U.S.C. 301);

(2) Termination of a bank's membership in the Federal Reserve System under section 9 of the FRA (12 U.S.C. 327);

(3) Issuance of a cease-and-desist order under section 11 of the Clayton Act (15 U.S.C. 21);

(4) Adjudications under sections 2, 3, or 4 of the BHC Act (12 U.S.C. 1841, 1842, or 1843);

(5) Formal adjudications on bank merger applications under section 18(c) of the FDIA (12 U.S.C. 1828(c));

(6) Issuance of a divestiture order under section 5(e) of the BHC Act (12 U.S.C. 1844(e));

(7) Imposition of sanctions upon any municipal securities dealer for which the Board is the appropriate regulatory agency, or upon any person associated or seeking to become associated with such a municipal securities dealer, under section 15B(c)(5) of the Exchange Act (15 U.S.C. 78o-4);

(8) Proceedings where the Board otherwise orders that a formal hearing be held;

(9) Termination of the activities of a state branch, state agency, or commercial lending company subsidiary of a foreign bank in the United States, pursuant to section 7(e) of the IBA (12 U.S.C. 3105(d));

(10) Termination of the activities of a representative office of a foreign bank in the United States, pursuant to section 10(b) of the IBA (12 U.S.C. 3107(b));

(11) Issuance of a prompt corrective action directive to a member bank under section 38 of the FDI Act (12 U.S.C. 1831o);

(12) Reclassification of a member bank on grounds of unsafe or unsound condition under section 38(g)(1) of the FDI Act (12 U.S.C. 1831o(g)(1));

(13) Reclassification of a member bank on grounds of unsafe and unsound practice under section 38(g)(1) of the FDI Act (12 U.S.C. 1831o(g)(1)); and

(14) Issuance of an order requiring a member bank to dismiss a director or senior executive officer under section 38 (e)(5) and 38(f)(2) (F)(ii) of the FDI Act (12 U.S.C. 1831o(e)(5) and 1831o(f)(2) (F)(ii)).

[56 FR 38052, Aug. 9, 1991, as amended at 57 FR 13001, Apr. 15, 1992; 57 FR 44888, Sept. 29, 1992]

### § 263.51 Definitions.

As used in subparts B through G of this part:

(a) *Secretary* means the Secretary of the Board of Governors of the Federal Reserve System;

(b) *Member bank* means any bank that is a member of the Federal Reserve System.

(c) *Institution* has the same meaning as that assigned to it in § 263.3(f) of subpart A, and includes any foreign bank with a representative office in the United States.

[56 FR 38052, Aug. 9, 1991, as amended at 57 FR 13001, Apr. 15, 1992; 58 FR 6363, Jan. 28, 1993]

### § 263.52 Address for filing.

All papers to be filed with the Board shall be filed with the Secretary of the Board of Governors of the Federal Reserve System, Washington, DC 20551.

### § 263.53 Discovery depositions.

(a) *In general.* In addition to the discovery permitted in subpart A of this part, limited discovery by means of depositions shall be allowed for individuals with knowledge of facts material to the proceeding that are not protected from discovery by any applicable privilege, and of identified expert

witnesses. Except in unusual cases, accordingly, depositions will be permitted only of individuals identified as hearing witnesses, including experts. All discovery depositions must be completed within the time set forth in § 263.24(d).

(b) *Application.* A party who desires to take a deposition of any other party's proposed witnesses, shall apply to the administrative law judge for the issuance of a deposition subpoena or subpoena duces tecum. The application shall state the name and address of the proposed deponent, the subject matter of the testimony expected from the deponent and its relevancy to the proceeding, and the address of the place and the time, no sooner than ten days after the service of the subpoena, for the taking of the deposition. Any such application shall be treated as a motion subject to the rules governing motions practice set forth in § 263.23.

(c) *Issuance of subpoena.* The administrative law judge shall issue the requested deposition subpoena or subpoena duces tecum upon a finding that the application satisfies the requirements of this section and of § 263.24. If the administrative law judge determines that the taking of the deposition or its proposed location is, in whole or in part, unnecessary, unreasonable, oppressive, excessive in scope or unduly burdensome, he or she may deny the application or may grant it upon such conditions as justice may require. The party obtaining the deposition subpoena or subpoena duces tecum shall be responsible for serving it on the deponent and all parties to the proceeding in accordance with § 263.11.

(d) *Motion to quash or modify.* A person named in a deposition subpoena or subpoena duces tecum may file a motion to quash or modify the subpoena or for the issuance of a protective order. Such motions must be filed within ten days following service of the subpoena, but in all cases at least five days prior to the commencement of the scheduled deposition. The motion must be accompanied by a statement of the reasons for granting the motion and a copy of the motion and the statement must be served on the party which requested the subpoena. Only the party requesting the subpoena may file a response to a motion to quash or modify, and any such response shall be filed within five days following service of the motion.

(e) *Enforcement of a deposition subpoena.* Enforcement of a deposition subpoena shall be in accordance with the procedures set forth in § 263.27(d).

(f) *Conduct of the deposition.* The deponent shall be duly sworn, and each party shall have the right to examine the deponent with respect to all nonprivileged, relevant and material matters. Objections to questions or evidence shall be in the short form, stating the ground for the objection. Failure to object to questions or evidence shall not be deemed a waiver except where the grounds for the objection might have been avoided if the objection had been timely presented. The discovery deposition shall be transcribed or otherwise recorded as agreed among the parties.

(g) *Protective orders.* At any time during the taking of a discovery deposition, on the motion of any party or of the deponent, the administrative law judge may terminate or limit the scope and manner of the deposition upon a finding that grounds exist for such relief. Grounds for terminating or limiting the taking of a discovery deposition include a finding that the discovery deposition is being conducted in bad faith or in such a manner as to:

(1) Unreasonably annoy, embarrass, or oppress the deponent;

(2) Unreasonably probe into privilege, irrelevant or immaterial matters; or

(3) Unreasonably attempt to pry into a party's preparation for trial.

### § 263.54 Delegation to the Office of Financial Institution Adjudication.

Unless otherwise ordered by the Board, administrative adjudications subject to subpart A of this part shall be conducted by an administrative law judge of OFIA.

### § 263.55 Board as Presiding Officer.

The Board may, in its discretion, designate itself, one or more of its members, or an authorized officer, to act as presiding officer in a formal hearing. In such a proceeding, proposed findings and conclusions, briefs, and other submissions by the parties permitted in

subpart A shall be filed with the Secretary for consideration by the Board. Sections 263.38 and 263.39 of subpart A will not apply to proceedings conducted under this section.

### § 263.56 Initial Licensing Proceedings.

Proceedings with respect to applications for initial licenses shall include, but not be limited to, applications for Board approval under section 3 of the BHC Act and such proceedings as may be ordered by the Board with respect to applications under section 18(c) of the FDIA. In such initial licensing proceedings, the procedures set forth in subpart A of this part shall apply, except that the Board may designate a Board Counsel to represent the Board in a nonadversary capacity for the purpose of developing for the record information relevant to the issues to be determined by the Presiding Officer and the Board. In such proceedings, Board Counsel shall be considered to be a decisional employee for purposes of §§ 263.9 and 263.40 of subpart A.

## Subpart C—Rules and Procedures for Assessment and Collection of Civil Money Penalties

### § 263.60 Scope.

The Uniform Rules set forth in subpart A of this part shall govern the procedures for assessment of civil money penalties, except as otherwise provided in this subpart.

### § 263.61 Opportunity for informal proceeding.

In the sole discretion of the Board's General Counsel, the General Counsel may, prior to the issuance by the Board of a notice of assessment of civil penalty, advise the affected person that the issuance of a notice of assessment of civil penalty is being considered and the reasons and authority for the proposed assessment. The General Counsel may provide the person an opportunity to present written materials or request a conference with members of the Board's staff to show that the penalty should not be assessed or, if assessed, should be reduced in amount.

### § 263.62 Relevant considerations for assessment of civil penalty.

In determining the amount of the penalty to be assessed, the Board shall take into account the appropriateness of the penalty with respect to the financial resources and good faith of the person charged, the gravity of the misconduct, the history of previous misconduct, the economic benefit derived by the person from the misconduct, and such other matters as justice may require.

### § 263.63 Assessment order.

(a) In the event of consent to an assessment by the person concerned, or if, upon the record made at an administrative hearing, the Board finds that the grounds for having assessed the penalty have been established, the Board may issue a final order of assessment of civil penalty. In its final order, the Board may modify the amount of the penalty specified in the notice of assessment.

(b) An assessment order is effective immediately upon issuance, or upon such other date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, terminated, or set aside by action of the Board or a reviewing court.

### § 263.64 Payment of civil penalty.

(a) The date designated in the notice of assessment for payment of the civil penalty will normally be 60 days from the issuance of the notice. If, however, the Board finds in a specific case that the purposes of the authorizing statute would be better served if the 60-day period is changed, the Board may shorten or lengthen the period or make the civil penalty payable immediately upon receipt of the notice of assessment. If a timely request for a formal hearing to challenge an assessment of civil penalty is filed, payment of the penalty shall not be required unless and until the Board issues a final order of assessment following the hearing. If an assessment order is issued, it will specify the date by which the civil penalty should be paid or collected.

(b) Checks in payment of civil penalties should be made payable to the ''Board of Governors of the Federal Reserve System.'' Upon collection, the

Board shall forward the amount of the penalty to the Treasury of the United States.

### § 263.65 Civil penalty inflation adjustments.

(a) *Inflation adjustments.* In accordance with the Federal Civil Penalties Inflation Adjustment Act of 1990 (28 U.S.C. 2461 *note*), the Board has set forth in paragraph (b) of this section adjusted maximum penalty amounts for each civil money penalty provided by law within its jurisdiction. The adjusted civil penalty amounts provided in paragraph (b) of this section replace only the amounts published in the statutes authorizing the assessment of penalties and the previously-adjusted amounts adopted as of October 12, 2004, October 12, 2000, and October 24, 1996. The authorizing statutes contain the complete provisions under which the Board may seek a civil money penalty. The increased penalty amounts apply only to violations occurring after the effective date of this rule.

(b) *Maximum civil money penalties.* The maximum civil money penalties as set forth in the referenced statutory sections are as follows:

(1) 12 U.S.C. 324:

(i) Inadvertently late or misleading reports, *inter alia*—$2,200.

(ii) Other late or misleading reports, *inter alia*—$32,000.

(iii) Knowingly or recklessly false or misleading reports, *inter alia*—$1,375,000.

(2) 12 U.S.C. 504, 505, 1817(j)(16), 1818(i)(2) and 1972(2)(F):

(i) First tier—$7,500.

(ii) Second tier—$37,500.

(iii) Third tier—$1,375,000.

(3) 12 U.S.C. 1820(k)(6)(A)(ii)—$275,000.

(4) 12 U.S.C. 1832(c)—$1,100.

(5) 12 U.S.C. 1847(b), 3110(a)—$37,500.

(6) 12 U.S.C. 1847(d), 3110(c):

(i) First tier—$2,200.

(ii) Second tier—$32,000.

(iii) Third tier—$1,375,000.

(7) 12 U.S.C. 334, 374a, 1884—$110.

(8) 12 U.S.C. 3909(d)—$1,100.

(9) 15 U.S.C. 78u–2:

(i) 15 U.S.C. 78u–2(b)(1)—$7,500 for a natural person and $70,000 for any other person.

(ii) 15 U.S.C. 78u–2(b)(2)—$70,000 for a natural person and $350,000 for any other person.

(iii) 15 U.S.C. 78u–2(b)(3)—$140,000 for a natural person and $675,000 for any other person.

(10) 42 U.S.C. 4012a(f)(5):

(i) For each violation—$385.

(ii) For the total amount of penalties assessed under 42 U.S.C 4012a(f)(5) against an institution or enterprise during any calendar year—$135,000.

[73 FR 58032, Oct. 6, 2008]

## Subpart D—Rules and Procedures Applicable to Suspension or Removal of an Institution-Affiliated Party Where a Felony is Charged or Proven

### § 263.70 Purpose and scope.

The rules and procedures set forth in this subpart apply to informal hearings afforded to any institution-affiliated party for whom the Board is the appropriate regulatory agency, who has been suspended or removed from office or prohibited from further participation in any manner in the conduct of the institution's affairs by a notice or order issued by the Board upon the grounds set forth in section 8(g) of the FDIA (12 U.S.C. 1818(g)).

### § 263.71 Notice or order of suspension, removal, or prohibition.

(a) *Grounds.* The Board may suspend an institution-affiliated party from office or prohibit an institution-affiliated party from further participation in any manner in the conduct of an institution's affairs when the person is charged in any information, indictment, or complaint authorized by a United States attorney with the commission of, or participation in, a crime involving dishonesty or breach of trust that is punishable by imprisonment for a term exceeding one year under State or Federal law. The Board may remove an institution-affiliated party from office or prohibit an institution-affiliated party from further participation in any manner in the conduct of an institution's affairs when the person is convicted of such an offense and the conviction is not subject to further direct appellate review. The Board may

suspend or remove an institution-affiliated party or prohibit an institution-affiliated party from participation in an institution's affairs in these circumstances if the Board finds that continued service to the financial institution or participation in its affairs by the institution-affiliated party may pose a threat to the interests of the institution's depositors or may threaten to impair public confidence in the financial institution.

(b) *Contents.* The Board commences a suspension, removal, or prohibition action under this subpart with the issuance, and service upon an institution-affiliated party, of a notice of suspension from office, or order of removal from office, or notice or order of prohibition from participation in the financial institution's affairs. Such a notice or order shall indicate the basis for the suspension, removal, or prohibition and shall inform the institution-affiliated party of the right to request in writing, within 30 days of service of the notice or order, an opportunity to show at an informal hearing that continued service to, or participation in the conduct of the affairs of, the financial institution does not and is not likely to pose a threat to the interests of the financial institution's depositors or threaten to impair public confidence in the financial institution. Failure to file a timely request for an informal hearing shall be deemed to be a waiver of the right to request such a hearing. A notice of suspension or prohibition shall remain in effect until the criminal charge upon which the notice is based is finally disposed of or until the notice is terminated by the Board.

(c) *Service.* The notice or order shall be served upon the affiliated financial institution concerned, whereupon the institution-affiliated party shall immediately cease service to the financial institution or further participation in any manner in the conduct of the affairs of the financial institution. A notice or order of suspension, removal, or prohibition may be served by any of the means authorized for service under § 263.11(c)(2) of subpart A.

### § 263.72 Request for informal hearing.

An institution-affiliated party who is suspended or removed from office or prohibited from participation in the institution's affairs may request an informal hearing within 30 days of service of the notice or order. The request shall be filed in writing with the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. The request shall state with particularity the relief desired and the grounds therefor and shall include, when available, supporting evidence in the form of affidavits. If the institution-affiliated party desires to present oral testimony or witnesses at the hearing, the institution-affiliated party must include a request to do so with the request for informal hearing. The request to present oral testimony or witnesses shall specify the names of the witnesses and the general nature of their expected testimony.

### § 263.73 Order for informal hearing.

(a) *Issuance of hearing order.* Upon receipt of a timely request for an informal hearing, the Secretary shall promptly issue an order directing an informal hearing to commence within 30 days of the receipt of the request. At the request of the institution-affiliated party, the Secretary may order the hearing to commence at a time more than 30 days after the receipt of the request for hearing. The hearing shall be held in Washington, DC, or at such other place as may be designated by the Secretary, before presiding officers designated by the Secretary to conduct the hearing. The presiding officers normally will include representatives from the Board's Legal Division and the Division of Banking Supervision and Regulation and from the appropriate Federal Reserve Bank.

(b) *Waiver of oral hearing.* A institution-affiliated party may waive in writing his or her right to an oral hearing and instead elect to have the matter determined by the Board solely on the basis of written submissions.

(c) *Hearing procedures.* (1) The institution-affiliated party may appear at the hearing personally, through counsel, or personally with counsel. The institution-affiliated party shall have the right to introduce relevant written materials and to present an oral argument. The institution-affiliated party may introduce oral testimony and

present witnesses only if expressly authorized by the Board or the Secretary. Except as provided in § 263.11, the adjudicative procedures of the Administrative Procedure Act (5 U.S.C. 554-557) and of subpart A of this part shall not apply to the informal hearing ordered under this subpart unless the Board orders that subpart A of this part applies.

(2) The informal hearing shall be recorded and a transcript shall be furnished to the institution-affiliated party upon request and after the payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officers. The presiding officers may ask questions of any witness.

(3) The presiding officers may order the record to be kept open for a reasonable period following the hearing (normally five business days), during which time additional submissions to the record may be made. Thereafter, the record shall be closed.

(d) *Authority of presiding officers*. In the course of or in connection with any proceeding under this subpart, the Board or the presiding officers are authorized to administer oaths and affirmations, to take or cause to be taken depositions, to issue, quash or modify subpoenas and subpoenas duces tecum, and, for the enforcement thereof, to apply to an appropriate United States district court. All action relating to depositions and subpoenas shall be in accordance with the rules provided in §§ 263.34 and 263.53.

(e) *Recommendation of presiding officers*. The presiding officers shall make a recommendation to the Board concerning the notice or order of suspension, removal, or prohibition within 20 calendar days following the close of the record on the hearing.

### § 263.74 Decision of the Board.

(a) Within 60 days following the close of the record on the hearing, or receipt of written submissions where a hearing has been waived, the Board shall notify the institution-affiliated party whether the notice of suspension or prohibition will be continued, terminated, or otherwise modified, or whether the order of removal or prohibition will be rescinded or otherwise modified. The notification shall contain a statement of the basis for any adverse decision by the Board. In the case of a decision favorable to the institution-affiliated party, the Board shall take prompt action to rescind or otherwise modify the order of suspension, removal or prohibition.

(b) In deciding the question of suspension, removal, or prohibition under this subpart, the Board shall not rule on the question of the guilt or innocence of the individual with respect to the crime with which the individual has been charged.

## Subpart E—Procedures for Issuance and Enforcement of Directives To Maintain Adequate Capital

### § 263.80 Purpose and scope.

This subpart establishes procedures under which the Board may issue a directive or take other action to require a state member bank or a bank holding company to achieve and maintain adequate capital.

### § 263.81 Definitions.

(a) *Bank holding company* means any company that controls a bank as defined in section 2 of the BHC Act, 12 U.S.C. 1841, and in the Board's Regulation Y (12 CFR 225.2(b)) or any direct or indirect subsidiary thereof other than a bank subsidiary as defined in section 2(c) of the BHC Act, 12 U.S.C. 1841(c), and in the Board's Regulation Y (12 CFR 225.2(a)).

(b) *Capital Adequacy Guidelines* means those guidelines for bank holding companies and state member banks contained in appendices A and D to the Board's Regulation Y (12 CFR part 225), and in appendix A to the Board's Regulation H (12 CFR part 208), or any succeeding capital guidelines promulgated by the Board.

(c) *Directive* means a final order issued by the Board pursuant to ILSA (12 U.S.C. 3907(b)(2)) requiring a state member bank or bank holding company to increase capital to or maintain capital at the minimum level set forth in the Board's Capital Adequacy Guidelines or as otherwise established under procedures described in § 263.85 of this subpart.

(d) *State member bank* means any state-chartered bank that is a member of the Federal Reserve System.

### § 263.82 Establishment of minimum capital levels.

The Board has established minimum capital levels for state member banks and bank holding companies in its Capital Adequacy Guidelines. The Board may set higher capital levels as necessary and appropriate for a particular state member bank or bank holding company based upon its financial condition, managerial resources, prospects, or similar factors, pursuant to the procedures set forth in § 263.85 of this subpart.

### § 263.83 Issuance of capital directives.

(a) *Notice of intent to issue directive.* If a state member bank or bank holding company is operating with less than the minimum level of capital established in the Board's Capital Adequacy Guidelines, or as otherwise established under the procedures described in § 263.85 of this subpart, the Board may issue and serve upon such state member bank or bank holding company written notice of the Board's intent to issue a directive to require the bank or bank holding company to achieve and maintain adequate capital within a specified time period.

(b) *Contents of notice.* The notice of intent to issue a directive shall include:

(1) The required minimum level of capital to be achieved or maintained by the institution;

(2) Its current level of capital;

(3) The proposed increase in capital needed to meet the minimum requirements;

(4) The proposed date or schedule for meeting these minimum requirements;

(5) When deemed appropriate, specific details of a proposed plan for meeting the minimum capital requirements; and

(6) The date for a written response by the bank or bank holding company to the proposed directive, which shall be at least 14 days from the date of issuance of the notice unless the Board determines a shorter period is necessary because of the financial condition of the bank or bank holding company.

(c) *Response to notice.* The bank or bank holding company may file a written response to the notice within the time period set by the Board. The response may include:

(1) An explanation why a directive should not be issued;

(2) Any proposed modification of the terms of the directive;

(3) Any relevant information, mitigating circumstances, documentation or other evidence in support of the institution's position regarding the proposed directive; and

(4) The institution's plan for attaining the required level of capital.

(d) *Failure to file response.* Failure by the bank or bank holding company to file a written response to the notice of intent to issue a directive within the specified time period shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of such directive.

(e) *Board consideration of response.* After considering the response of the bank or bank holding company, the Board may:

(1) Issue the directive as originally proposed or in modified form;

(2) Determine not to issue a directive and so notify the bank or bank holding company; or

(3) Seek additional information or clarification of the response by the bank or bank holding company.

(f) *Contents of directive.* Any directive issued by the Board may order the bank or bank holding company to:

(1) Achieve or maintain the minimum capital requirement established pursuant to the Board's Capital Adequacy Guidelines or the procedures in § 263.85 of this subpart by a certain date;

(2) Adhere to a previously submitted plan or submit for approval and adhere to a plan for achieving the minimum capital requirement by a certain date;

(3) Take other specific action as the Board directs to achieve the minimum capital levels, including requiring a reduction of assets or asset growth or restriction on the payment of dividends; or

(4) Take any combination of the above actions.

(g) *Request for reconsideration of directive.* Any state member bank or bank holding company, upon a change in circumstances, may request the Board to reconsider the terms of a directive and may propose changes in the plan under which it is operating to meet the required minimum capital level. The directive and plan continue in effect while such request is pending before the Board.

**§ 263.84 Enforcement of directive.**

(a) *Judicial and administrative remedies.* (1) Whenever a bank or bank holding company fails to follow a directive issued under this subpart, or to submit or adhere to a capital adequacy plan as required by such directive, the Board may seek enforcement of the directive, including the capital adequacy plan, in the appropriate United State district court, pursuant to section 908 (b)(2)(B)(ii) of ILSA (12 U.S.C. 3907(b)(2)(B)(ii)) and to section 8(i) of the FDIA (12 U.S.C. 1818(i)), in the same manner and to the same extent as if the directive were a final cease-and-desist order.

(2) The Board, pursuant to section 910(d) of ILSA (12 U.S.C. 3909(d)), may also assess civil money penalties for violation of the directive against any bank or bank holding company and any institution-affiliated party of the bank or bank holding company, in the same manner and to the same extent as if the directive were a final cease-and-desist order.

(b) *Other enforcement actions.* A directive may be issued separately, in conjunction with, or in addition to any other enforcement actions available to the Board, including issuance of cease-and-desist orders, the approval or denial of applications or notices, or any other actions authorized by law.

(c) *Consideration in application proceedings.* In acting upon any application or notice submitted to the Board pursuant to any statute administered by the Board, the Board may consider the progress of a state member bank or bank holding company or any subsidiary thereof in adhering to any directive or capital adequacy plan required by the Board pursuant to this subpart, or by any other appropriate banking supervisory agency pursuant to ILSA. The Board shall consider whether approval or a notice of intent not to disapprove would divert earnings, diminish capital, or otherwise impede the bank or bank holding company in achieving its required minimum capital level or complying with its capital adequacy plan.

**§ 263.85 Establishment of increased capital level for specific institutions.**

(a) *Establishment of capital levels for specific institutions.* The Board may establish a capital level higher than the minimum specified in the Board's Capital Adequacy Guidelines for a specific bank or bank holding company pursuant to:

(1) A written agreement or memorandum of understanding between the Board or the appropriate Federal Reserve Bank and the bank or bank holding company;

(2) A temporary or final cease-and-desist order issued pursuant to section 8(b) or (c) of the FDIA (12 U.S.C. 1818(b) or (c));

(3) A condition for approval of an application or issuance of a notice of intent not to disapprove a proposal;

(4) Or other similar means; or

(5) The procedures set forth in paragraph (b) of this section.

(b) *Procedure to establish higher capital requirement*—(1) *Notice.* When the Board determines that capital levels above those in the Board's Capital Adequacy Guidelines may be necessary and appropriate for a particular bank or bank holding company under the circumstances, the Board shall give the bank or bank holding company notice of the proposed higher capital requirement and shall permit the bank or bank holding company an opportunity to comment upon the proposed capital level, whether it should be required and, if so, under what time schedule. The notice shall contain the Board's reasons for proposing a higher level of capital.

(2) *Response.* The bank or bank holding company shall be allowed at least 14 days to respond, unless the Board determines that a shorter period is necessary because of the financial condition of the bank or bank holding company. Failure by the bank or bank

holding company to file a written response to the notice within the time set by the Board shall constitute a waiver of the opportunity to respond and shall constitute consent to issuance of a directive containing the required minimum capital level.

(3) *Board decision.* After considering the response of the institution, the Board may issue a written directive to the bank or bank holding company setting an appropriate capital level and the date on which this capital level will become effective. The Board may require the bank or bank holding company to submit and adhere to a plan for achieving such higher capital level as the Board may set.

(4) *Enforcement of higher capital level.* The Board may enforce the capital level established pursuant to the procedures described in this section and any plan submitted to achieve that capital level through the procedures set forth in § 263.84 of this subpart.

## Subpart F—Practice Before the Board

### § 263.90 Scope.

This subpart prescribes rules relating to general practice before the Board on one's own behalf or in a representational capacity, including the circumstances under which disciplinary sanctions—censure, suspension, or debarment—may be imposed upon persons appearing in a representational capacity, including attorneys and accountants, but not including employees of the Board. These disciplinary sanctions, which continue in effect beyond the duration of a specific proceeding, supplement the provisions of § 263.6(b) of subpart A, which address control of a specific proceeding.

### § 263.91 Censure, suspension or debarment.

The Board may censure an individual or suspend or debar such individual from practice before the Board if he or she engages, or has engaged, in conduct warranting sanctions as set forth in § 263.94; refuses to comply with the rules and regulations in this part; or with intent to defraud in any manner, willfully and knowingly deceives, misleads, or threatens any client or prospective client. The suspension or debarment of an individual shall be initiated only upon a finding by the Board that the conduct that forms the basis for the disciplinary action is egregious.

### § 263.92 Definitions.

(a) As used in this subpart, the following terms shall have the meaning given in this section unless the context otherwise requires.

(b)(1) *Practice before the Board* includes any matters connected with presentations to the Board or to any of its officers or employees relating to a client's rights, privileges or liabilities under laws or regulations administered by the Board. Such matters include, but are not limited to, the preparation of any statement, opinion or other paper or document by an attorney, accountant, or other licensed professional which is filed with, or submitted to, the Board, on behalf of another person in, or in connection with, any application, notification, report or document; the representation of a person at conferences, hearings and meetings; and the transaction of other business before the Board on behalf of another person.

(2) *Practice before the Board* does not include work prepared for an institution solely at its request for use in the ordinary course of its business.

(c) *Attorney* means any individual who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia.

(d) *Accountant* means any individual who is duly qualified to practice as a certified public accountant or a public accountant in any state, possession, territory, commonwealth, or the District of Columbia.

### § 263.93 Eligibility to practice.

(a) *Attorneys.* Any attorney who is qualified to practice as an attorney and is not currently under suspension or debarment pursuant to this subpart may practice before the Board.

(b) *Accountants.* Any accountant who is qualified to practice as a certified public accountant or public accountant and is not currently under suspension or debarment by the Board may practice before the Board.

**§ 263.94 Conduct warranting sanctions.**

Conduct for which an individual may be censured, debarred or suspended from practice before the Board includes, but is not limited to:

(a) Willfully or recklessly violating or willfully or recklessly aiding and abetting the violation of any provision of the Federal banking or applicable securities laws or the rules and regulations thereunder or conviction of any offense involving dishonesty or breach of trust;

(b) Knowingly or recklessly giving false or misleading information, or participating in any way in the giving of false information to the Board or to any Board officer or employee, or to any tribunal authorized to pass upon matters administered by the Board in connection with any matter pending or likely to be pending before it. The term ''information'' includes facts or other statements contained in testimony, financial statements, applications, affidavits, declarations, or any other document or written or oral statement;

(c) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Board by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of advantage or by the bestowing of any gift, favor, or thing of value;

(d) Disbarment or suspension from practice as an attorney, or debarment or suspension from practice as a certified public accountant or public accountant, by any duly constituted authority of any state, possession, commonwealth, or the District of Columbia for the conviction of a felony or misdemeanor involving personal dishonesty or breach of trust in matters relating to the supervisory responsibilities of the Board, where the conviction has not been reversed on appeal;

(e) Knowingly aiding or abetting another individual to practice before the Board during that individual's period of suspension, debarment, or ineligibility;

(f) Contemptuous conduct in connection with practice before the Board, and knowingly making false accusations and statements, or circulating or publishing malicious or libelous matter;

(g) Suspension or debarment from practice before the OCC, the FDIC, the OTS, the Securities and Exchange Commission, the NCUA, or any other Federal agency based on matters relating to the supervisory responsibilities of the Board;

(h) Willful or knowing violation of any of the regulations contained in this part.

[56 FR 38052, Aug. 9, 1991, as amended at 68 FR 48267, Aug. 13, 2003]

**§ 263.95 Initiation of disciplinary proceeding.**

(a) *Receipt of information.* An individual, including any employee of the Board, who has reason to believe that an individual practicing before the Board in a representative capacity has engaged in any conduct that would serve as a basis for censure, suspension or debarment under § 263.94, may make a report thereof and forward it to the Board.

(b) *Censure without formal proceeding.* Upon receipt of information regarding an individual's qualification to practice before the Board, the Board may, after giving the individual notice and opportunity to respond, censure such individual.

(c) *Institution of formal disciplinary proceeding.* When the Board has reason to believe that any individual who practices before the Board in a representative capacity has engaged in conduct that would serve as a basis for censure, suspension or debarment under § 263.94 the Board may, after giving the individual notice and opportunity to respond, institute a formal disciplinary proceeding against such individual. The proceeding shall be conducted pursuant to § 263.97 and shall be initiated by a complaint issued by the Board that names the individual as a respondent. Except in cases when time, the nature of the proceeding, or the public interest do not permit, a proceeding under this section shall not be instituted until the respondent has been informed, in writing, of the facts or conduct which warrant institution of a proceeding and the respondent has been accorded the opportunity to comply with all lawful requirements or

take whatever action may be necessary to remedy the conduct that is the basis for the initiation of the proceeding.

### § 263.96 Conferences.

(a) *General*. The Board's staff may confer with a proposed respondent concerning allegations of misconduct or other grounds for censure, debarment or suspension, regardless of whether a proceeding for debarment or suspension has been instituted. If a conference results in a stipulation in connection with a proceeding in which the individual is the respondent, the stipulation may be entered in the record at the request of either party to the proceeding.

(b) *Resignation or voluntary suspension*. In order to avoid the institution of, or a decision in, a debarment or suspension proceeding, a person who practices before the Board may consent to suspension from practice. At the discretion of the Board, the individual may be suspended or debarred in accordance with the consent offered.

### § 263.97 Proceedings under this subpart.

Except as otherwise provided in this subpart, any hearing held under this subpart shall be held before an administrative law judge of the OFIA pursuant to procedures set forth in subparts A and B of this part. The Board shall appoint a person to represent the Board in the hearing. Any person having prior involvement in the matter which is the basis for the suspension or debarment proceeding shall be disqualified from representing the Board in the hearing. The hearing shall be closed to the public unless the Board, sua sponte or on the request of a party, otherwise directs. The administrative law judge shall refer a recommended decision to the Board, which shall issue the final decision and order. In its final decision and order, the Board may censure, debar or suspend an individual, or take such other disciplinary action as the Board deems appropriate.

### § 263.98 Effect of suspension, debarment or censure.

(a) *Debarment*. If the final order against the respondent is for debarment, the individual will not thereafter be permitted to practice before the Board unless otherwise permitted to do so by the Board pursuant to § 263.99 of this subpart.

(b) *Suspension*. If the final order against the respondent is for suspension, the individual will not thereafter be permitted to practice before the Board during the period of suspension.

(c) *Censure*. If the final order against the respondent is for censure, the individual may be permitted to practice before the Board, but such individual's future representations may be subject to conditions designed to promote high standards of conduct. If a written letter of censure is issued, a copy will be maintained in the Board's files.

(d) *Notice of debarment or suspension*. Upon the issuance of a final order for suspension or debarment, the Board shall give notice of the order to appropriate officers and employees of the Board, to interested departments and agencies of the Federal Government, and to the appropriate authorities of the State in which any debarred or suspended individual is or was licensed to practice.

### § 263.99 Petition for reinstatement.

The Board may entertain a petition for reinstatement from any person debarred from practice before the Board. The Board shall grant reinstatement only if the Board finds that the petitioner is likely to act in accordance with the regulations in this part, and that granting reinstatement would not be contrary to the public interest. Any request for reinstatement shall be limited to written submissions unless the Board, in its discretion, affords the petitioner an informal hearing.

## Subpart G—Rules Regarding Claims Under the Equal Access to Justice Act

### § 263.100 Authority and scope.

This subpart implements the provisions of the Equal Access to Justice Act (5 U.S.C. 504) as they apply to formal adversary adjudications before the Board. The types of proceedings covered by this subpart are listed in §§ 263.1 and 263.50.

**§ 263.101 Standards for awards.**

A respondent in a covered proceeding that prevails on the merits of that proceeding against the Board, and that is eligible under this subpart as defined in § 263.103, may receive an award for fees and expenses incurred in the proceeding unless the position of the Board during the proceeding was substantially justified or special circumstances make an award unjust. The position of the Board includes, in addition to the position taken by the Board in the adversary proceeding, the action or failure to act by the Board upon which the adversary proceeding was based. An award will be reduced or denied if the applicant has unduly or unreasonably protracted the proceedings.

**§ 263.102 Prevailing party.**

Only an eligible applicant that prevailed on the merits of an adversary proceeding may qualify for an award under this subpart.

**§ 263.103 Eligibility of applicants.**

(a) *General rule.* To be eligible for an award under this subpart, an applicant must have been named as a party to the adjudicatory proceeding and show that it meets all other conditions of eligibility set forth in paragraphs (b) and (c) of this section.

(b) *Types of eligible applicant.* An applicant is eligible for an award only if it meets at least one of the following descriptions:

(1) An individual with a net worth of not more than $2 million at the time the adversary adjudication was initiated;

(2) Any sole owner of an unincorporated business, or any partnership, corporation, associations, unit of local government or organization, the net worth of which did not exceed $7,000,000 and which did not have more than 500 employees at the time the adversary adjudication was initiated;

(3) A charitable or other tax-exempt organization described in section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)) with not more than 500 employees at the time the adversary proceeding was initiated; or

(4) A cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. 1141j(a)) with not more than 500 employees at the time the adversary proceeding was initiated.

(c) *Factors to be considered.* In determining the eligibility of an applicant:

(1) An applicant who owns an unincorporated business shall be considered as an *individual* rather than a *sole owner of an unincorporated business* if the issues on which he or she prevailed are related to personal interests rather than to business interests.

(2) An applicant's net worth includes the value of any assets disposed of for the purpose of meeting an eligibility standard and excludes the value of any obligations incurred for this purpose. Transfers of assets or obligations incurred for less than reasonably equivalent value will be presumed to have been made for this purpose.

(3) The net worth of a financial institution shall be established by the net worth information reported in conformity with applicable instructions and guidelines on the financial institution's financial report to its supervisory agency for the last reporting date before the initiation of the adversary proceeding. A bank holding company's net worth will be considered on a consolidated basis even if the bank holding company is not required to file its regulatory reports to the Board on a consolidated basis.

(4) The employees of an applicant include all those persons who were regularly providing services for remuneration for the applicant, under its direction and control, on the date the adversary proceeding was initiated. Part-time employees are counted on a proportional basis.

(5) The net worth and number of employees of the applicant and all of its affiliates shall be aggregated to determine eligibility. As used in this subpart, *affiliates* are: Individuals, corporations, and entities that directly or indirectly or acting through one or more entities control at least 25% of the voting shares of the applicant, and corporations and entities of which the applicant directly or indirectly owns or controls at least 25% of the voting shares. The Board may determine, in light of the actual relationship among the affiliated entities, that aggregation

with regard to one or more of the applicant's affiliates would be unjust and contrary to the purposes of this subpart and decline to aggregate the net worth and employees of such affiliate; alternatively, the Board may determine that financial relationships of the applicant other than those described in this paragraph constitute special circumstances that would make an award unjust.

**§ 263.104 Application for awards.**

(a) *Time to file.* An application and any other pleading or document related to the application may be filed with the Board whenever the applicant has prevailed in the proceeding within 30 days after service of the final order of the Board disposing of the proceeding.

(b) *Contents.* An application for an award of fees and expenses under this subpart shall contain:

(1) The name of the applicant and an identification of the proceeding;

(2) A showing that the applicant has prevailed, and an identification of the way in which the applicant believes that the position of the Board in the proceeding was not substantially justified;

(3) If the applicant is not an individual, a statement of the number of its employees on the date the proceeding was initiated;

(4) A description of any affiliated individuals or entities, as defined in § 263.103(c)(5), or a statement that none exist;

(5) A declaration that the applicant, together with any affiliates, had a net worth not more than the maximum set forth in § 263.103(b) as of the date the proceeding was initiated, supported by a net worth statement conforming to the requirements of § 263.105;

(6) A statement of the amount of fees and expenses for which an award is sought conforming to § 263.107; and

(7) Any other matters that the applicant wishes the Board to consider in determining whether and in what amount an award should be made.

(c) *Verification.* The application shall be signed by the applicant or an authorized officer of or attorney for the applicant. It shall also contain or be accompanied by a written verification under oath or under penalty of perjury that the information provided in the application and supporting documents is true and correct.

(d) *Service.* The application and related documents shall be served on all parties to the adversary proceeding in accordance with § 263.11, except that statements of net worth shall be served only on counsel for the Board.

(e) *Presiding officer.* Upon receipt of an application, the Board shall, if feasible, refer the matter to the administrative law judge who heard the underlying adversary proceeding.

**§ 263.105 Statement of net worth.**

(a) *General rule.* A statement of net worth shall be filed with the application for an award of fees. The statement shall reflect the net worth of the applicant and all affiliates of the applicant, as specified in § 263.103(c)(5). In all cases, the administrative law judge or the Board may call for additional information needed to establish the applicant's net worth as of the initiation of the proceeding.

(b) *Contents.* (1) Except as otherwise provided herein, the statement of net worth may be in any form convenient to the applicant which fully discloses all the assets and liabilities of the applicant and all the assets and liabilities of its affiliates, as of the time of the initiation of the adversary adjudication. Unaudited financial statements are acceptable for individual applicants as long as the statement provides a reliable basis for evaluation, unless the administrative law judge or the Board otherwise requires. Financial statements or reports filed with or reported to a Federal or State agency, prepared before the initiation of the adversary proceeding for other purposes, and accurate as of a date not more than three months prior to the initiation of the proceeding, shall be acceptable in establishing net worth as of the time of the initiation of the proceeding, unless the administrative law judge or the Board otherwise requires.

(2) In the case of applicants or affiliates that are not banks, net worth shall be considered for the purposes of this subpart to be the excess of total assets over total liabilities, as of the date the underlying proceeding was initiated, except as adjusted under

§ 263.103(c)(5). The net worth of a bank holding company shall be considered on a consolidated basis. Assets and liabilities of individuals shall include those beneficially owned.

(3) If the applicant or any of its affiliates is a bank, the portion of the statement of net worth which relates to the bank shall consist of a copy of the bank's last Consolidated Report of Condition and Income filed before the initiation of the adversary adjudication. Net worth shall be considered for the purposes of this subpart to be the total equity capital (or, in the case of mutual savings banks, the total surplus accounts) as reported, in conformity with applicable instructions and guidelines, on the bank's Consolidated Report of Condition and Income filed for the last reporting date before the initiation of the proceeding.

(c) *Statement confidential.* Unless otherwise ordered by the Board or required by law, the statement of net worth shall be for the confidential use of the Board, counsel for the Board, and the administrative law judge.

**§ 263.106 Measure of awards.**

(a) *General rule.* Awards shall be based on rates customarily charged by persons engaged in the business of acting as attorneys, agents, and expert witnesses, provided that no award under this subpart for the fee of an attorney or agent shall exceed $75 per hour. No award to compensate an expert witness shall exceed the highest rate at which the Board pays expert witnesses. An award may include the reasonable expenses of the attorney, agent, or expert witness as a separate item, if the attorney, agent, or expert witness ordinarily charges clients separately for such expenses.

(b) *Determination of reasonableness of fees.* In determining the reasonableness of the fee sought for an attorney, agent, or expert witness, subject to the limits set forth above, the administrative law judge shall consider the following:

(1) If the attorney, agent, or expert witness is in private practice, his or her customary fee for like services;

(2) The prevailing rate for similar services in the community in which the attorney, agent, or expert witness ordinarily performs services;

(3) The time actually spent in the representation of the applicant;

(4) The time reasonably spent in light of the difficulty or complexity of the issues in the proceeding; and

(5) Such other factors as may bear on the value of the services provided.

(c) *Awards for studies.* The reasonable cost of any study, analysis, test, project, or similar matter prepared on behalf of an applicant may be awarded to the extent that the charge for the service does not exceed the prevailing rate payable for similar services, and the study or other matter was necessary solely for preparation of the applicant's case and not otherwise required by law or sound business or financial practice.

**§ 263.107 Statement of fees and expenses.**

The application shall be accompanied by a statement fully documenting the fees and expenses for which an award is sought. A separate itemized statement shall be submitted for each professional firm or individual whose services are covered by the application, showing the hours spent in work in connection with the proceeding by each individual, a description of the specific services performed, the rate at which each fee has been computed, any expenses for which reimbursement is sought, the total amount claimed, and the total amount paid or payable by the applicant or by any other person or entity for the services performed. The administrative law judge or the Board may require the applicant to provide vouchers, receipts, or other substantiation for any expenses claimed.

**§ 263.108 Responses to application.**

(a) *By counsel for the Board.* (1) Within 20 days after service of an application, counsel for the Board may file an answer to the application.

(2) The answer shall explain in detail any objections to the award requested and identify the facts relied on in support of the Board's position. If the answer is based on any alleged facts not already in the record of the proceeding,

the answer shall include either supporting affidavits or a request for further proceedings under § 263.109, or both.

(b) *Reply to answer*. The applicant may file a reply only if the Board has addressed in its answer any of the following issues: that the position of the agency was substantially justified, that the applicant unduly protracted the proceedings, or that special circumstances make an award unjust. Any reply authorized by this section shall be filed within 15 days of service of the answer. If the reply is based on any alleged facts not already in the record of the proceeding, the reply shall include either supporting affidavits or a request for further proceedings under § 263.109, or both.

(c) *Additional response*. Additional filings in the nature of pleadings may be submitted only by leave of the administrative law judge.

**§ 263.109 Further proceedings.**

(a) *General rule*. The determination of a recommended award shall be made by the administrative law judge on the basis of the written record of the adversary adjudication, including any supporting affidavits submitted in connection with the application, unless, on the motion of either the applicant or Board counsel, or sua sponte, the administrative law judge or the Board orders further proceedings to amplify the record such as an informal conference, oral argument, additional written submissions, or an evidentiary hearing. Such further proceedings shall be held only when necessary for full and fair resolution of the issues arising from the application and shall be conducted promptly and expeditiously.

(b) *Request for further proceedings*. A request for further proceedings under this section shall specifically identify the information sought or the issues in dispute and shall explain why additional proceedings are necessary.

(c) *Hearing*. The administrative law judge shall hold an oral evidentiary hearing only on disputed issues of material fact which cannot be adequately resolved through written submissions.

**§ 263.110 Recommended decision.**

The administrative law judge shall file with the Board a recommended decision on the fee application not later than 30 days after the submission of all pleadings and evidentiary material concerning the application. The recommended decision shall include written proposed findings and conclusions on the applicant's eligibility and its status as a prevailing party and, if applicable, an explanation of the reasons for any difference between the amount requested and the amount of the recommended award. The recommended decision shall also include, if at issue, proposed findings as to whether the Board's position was substantially justified, whether the applicant unduly protracted the proceedings, or whether special circumstances make an award unjust. The administrative law judge shall file the record of the proceeding on the fee application upon the filing of the recommended decision and, at the same time, serve upon each party a copy of the recommended decision, findings, conclusions, and proposed order.

**§ 263.111 Action by the Board.**

(a) *Exceptions to recommended decision*. Within 20 days after service of the recommended decision, findings, conclusions, and proposed order, the applicant or counsel for the Board may file written exceptions thereto. A supporting brief may also be filed.

(b) *Decision by the Board*. The Board shall render its decision within 90 days after it has notified the parties that the matter has been received for decision. The Board shall serve copies of the decision and order of the Board upon the parties. Judicial review of the decision and order may be obtained as provided in 5 U.S.C. 504(c)(2).

## Subpart H—Issuance and Review of Orders Pursuant to Prompt Corrective Action Provisions of the Federal Deposit Insurance Act

SOURCE: 57 FR 44888, Sept. 29, 1992, unless otherwise noted.

**§ 263.201 Scope.**

(a) The rules and procedures set forth in this subpart apply to state member banks, companies that control state member banks or are affiliated with such banks, and senior executive officers and directors of state member banks that are subject to the provisions of section 38 of the Federal Deposit Insurance Act (section 38) and subpart D of part 208 of this chapter.

(b) [Reserved]

[57 FR 44888, Sept. 29, 1992, as amended at 63 FR 58621, Nov. 2, 1998]

**§ 263.202 Directives to take prompt regulatory action.**

(a) *Notice of intent to issue directive*—(1) *In general.* The Board shall provide an undercapitalized, significantly undercapitalized, or critically undercapitalized state member bank or, where appropriate, any company that controls the bank, prior written notice of the Board's intention to issue a directive requiring such bank or company to take actions or to follow proscriptions described in section 38 that are within the Board's discretion to require or impose under section 38 of the FDI Act, including sections 38(e)(5), (f)(2), (f)(3), or (f)(5). The bank shall have such time to respond to a proposed directive as provided by the Board under paragraph (c) of this section.

(2) *Immediate issuance of final directive.* If the Board finds it necessary in order to carry out the purposes of section 38 of the FDI Act, the Board may, without providing the notice prescribed in paragraph (a)(1) of this section, issue a directive requiring a state member bank or any company that controls a state member bank immediately to take actions or to follow proscriptions described in section 38 that are within the Board's discretion to require or impose under section 38 of the FDI Act, including section 38(e)(5), (f)(2), (f)(3), or (f)(5). A bank or company that is subject to such an immediately effective directive may submit a written appeal of the directive to the Board. Such an appeal must be received by the Board within 14 calendar days of the issuance of the directive, unless the Board permits a longer period. The Board shall consider any such appeal, if filed in a timely matter, within 60 days of receiving the appeal. During such period of review, the directive shall remain in effect unless the Board, in its sole discretion, stays the effectiveness of the directive.

(b) *Contents of notice.* A notice of intention to issue a directive shall include:

(1) A statement of the bank's capital measures and capital levels;

(2) A description of the restrictions, prohibitions, or affirmative actions that the Board proposes to impose or require;

(3) The proposed date when such restrictions or prohibitions would be effective or the proposed date for completion of such affirmative actions; and

(4) The date by which the bank or company subject to the directive may file with the Board a written response to the notice.

(c) *Response to notice*—(1) *Time for response.* A bank or company may file a written response to a notice of intent to issue a directive within the time period set by the Board. The date shall be at least 14 calendar days from the date of the notice unless the Board determines that a shorter period is appropriate in light of the financial condition of the bank or other relevant circumstances.

(2) *Content of response.* The response should include:

(i) An explanation why the action proposed by the Board is not an appropriate exercise of discretion under section 38;

(ii) Any recommended modification of the proposed directive; and

(iii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank or company regarding the proposed directive.

(d) *Board consideration of response.* After considering the response, the Board may:

(1) Issue the directive as proposed or in modified form;

(2) Determine not to issue the directive and so notify the bank or company; or

(3) Seek additional information or clarification of the response from the

bank or company, or any other relevant source.

(e) *Failure to file response.* Failure by a bank or company to file with the Board, within the specified time period, a written response to a proposed directive shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of the directive.

(f) *Request for modification or rescission of directive.* Any bank or company that is subject to a directive under this subpart may, upon a change in circumstances, request in writing that the Board reconsider the terms of the directive, and may propose that the directive be rescinded or modified. Unless otherwise ordered by the Board, the directive shall continue in place while such request is pending before the Board.

### § 263.203 Procedures for reclassifying a state member bank based on criteria other than capital.

(a) *Reclassification based on unsafe or unsound condition or practice*—(1) *Issuance of notice of proposed reclassification*—(i) *Grounds for reclassification.* (A) Pursuant to § 208.43(c) of Regulation H (12 CFR 208.43(c)), the Board may reclassify a well capitalized bank as adequately capitalized or subject an adequately capitalized or undercapitalized institution to the supervisory actions applicable to the next lower capital category if:

(*1*) The Board determines that the bank is in unsafe or unsound condition; or

(*2*) The Board deems the bank to be engaged in an unsafe or unsound practice and not to have corrected the deficiency.

(B) Any action pursuant to this paragraph (a)(1)(i) shall hereinafter be referred to as ''reclassification.''

(ii) *Prior notice to institution.* Prior to taking action pursuant to § 208.33(c) of this chapter, the Board shall issue and serve on the bank a written notice of the Board's intention to reclassify the bank.

(2) *Contents of notice.* A notice of intention to reclassify a bank based on unsafe or unsound condition shall include:

(i) A statement of the bank's capital measures and capital levels and the category to which the bank would be reclassified;

(ii) The reasons for reclassification of the bank;

(iii) The date by which the bank subject to the notice of reclassification may file with the Board a written appeal of the proposed reclassification and a request for a hearing, which shall be at least 14 calendar days from the date of service of the notice unless the Board determines that a shorter period is appropriate in light of the financial condition of the bank or other relevant circumstances.

(3) *Response to notice of proposed reclassification.* A bank may file a written response to a notice of proposed reclassification within the time period set by the Board. The response should include:

(i) An explanation of why the bank is not in unsafe or unsound condition or otherwise should not be reclassified;

(ii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank or company regarding the reclassification.

(4) *Failure to file response.* Failure by a bank to file, within the specified time period, a written response with the Board to a notice of proposed reclassification shall constitute a waiver of the opportunity to respond and shall constitute consent to the reclassification.

(5) *Request for hearing and presentation of oral testimony or witnesses.* The response may include a request for an informal hearing before the Board or its designee under this section. If the bank desires to present oral testimony or witnesses at the hearing, the bank shall include a request to do so with the request for an informal hearing. A request to present oral testimony or witnesses shall specify the names of the witnesses and the general nature of their expected testimony. Failure to request a hearing shall constitute a waiver of any right to a hearing, and failure to request the opportunity to present oral testimony or witnesses shall constitute a waiver of any right to present oral testimony or witnesses.

(6) *Order for informal hearing.* Upon receipt of a timely written request that includes a request for a hearing, the Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the bank requests a later date. The hearing shall be held in Washington, DC or at such other place as may be designated by the Board, before a presiding officer(s) designated by the Board to conduct the hearing.

(7) *Hearing procedures.* (i) The bank shall have the right to introduce relevant written materials and to present oral argument at the hearing. The bank may introduce oral testimony and present witnesses only if expressly authorized by the Board or the presiding officer(s). Neither the provisions of the Administrative Procedure Act (5 U.S.C. 554–557) governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure in subpart A of this part apply to an informal hearing under this section unless the Board orders that such procedures shall apply.

(ii) The informal hearing shall be recorded, and a transcript shall be furnished to the bank upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer(s). The presiding officer(s) may ask questions of any witness.

(iii) The presiding officer(s) may order that the hearing be continued for a reasonable period (normally five business days) following completion of oral testimony or argument to allow additional written submissions to the hearing record.

(8) *Recommendation of presiding officers.* Within 20 calendar days following the date the hearing and the record on the proceeding are closed, the presiding officer(s) shall make a recommendation to the Board on the reclassification.

(9) *Time for decision.* Not later than 60 calendar days after the date the record is closed or the date of the response in a case where no hearing was requested, the Board will decide whether to reclassify the bank and notify the bank of the Board's decision.

(b) *Request for rescission of reclassification.* Any bank that has been reclassified under this section, may, upon a change in circumstances, request in writing that the Board reconsider the reclassification, and may propose that the reclassification be rescinded and that any directives issued in connection with the reclassification be modified, rescinded, or removed. Unless otherwise ordered by the Board, the bank shall remain subject to the reclassification and to any directives issued in connection with that reclassification while such request is pending before the Board.

[57 FR 44888, Sept. 29, 1992, as amended at 63 FR 58621, Nov. 2, 1998]

### § 263.204 Order to dismiss a director or senior executive officer.

(a) *Service of notice.* When the Board issues and serves a directive on a state member bank pursuant to § 263.202 requiring the bank to dismiss from office any director or senior executive officer under section 38(f) (2) (F) (ii) of the FDI Act, the Board shall also serve a copy of the directive, or the relevant portions of the directive where appropriate, upon the person to be dismissed.

(b) *Response to directive*—(1) *Request for reinstatement.* A director or senior executive officer who has been served with a directive under paragraph (a) of this section (Respondent) may file a written request for reinstatement. The request for reinstatement shall be filed within 10 calendar days of the receipt of the directive by the Respondent, unless further time is allowed by the Board at the request of the Respondent.

(2) *Contents of request; informal hearing.* The request for reinstatement shall include reasons why the Respondent should be reinstated, and may include a request for an informal hearing before the Board or its designee under this section. If the Respondent desires to present oral testimony or witnesses at the hearing, the Respondent shall include a request to do so with the request for an informal hearing. The request to present oral testimony or witnesses shall specify the names of the witnesses and the general nature of their expected testimony. Failure to request a hearing shall constitute a waiver of any right to a hearing and failure to request the opportunity to

present oral testimony or witnesses shall constitute a waiver of any right or opportunity to present oral testimony or witnesses.

(3) *Effective date*. Unless otherwise ordered by the Board, the dismissal shall remain in effect while a request for reinstatement is pending.

(c) *Order for informal hearing*. Upon receipt of a timely written request from a Respondent for an informal hearing on the portion of a directive requiring a bank to dismiss from office any director or senior executive officer, the Board shall issue an order directing an informal hearing to commence no later than 30 days after receipt of the request, unless the Respondent requests a later date. The hearing shall be held in Washington, DC, or at such other place as may be designated by the Board, before a presiding officer(s) designated by the Board to conduct the hearing.

(d) *Hearing procedures*. (1) A Respondent may appear at the hearing personally or through counsel. A Respondent shall have the right to introduce relevant written materials and to present oral argument. A Respondent may introduce oral testimony and present witnesses only if expressly authorized by the Board or the presiding officer(s). Neither the provisions of the Administrative Procedure Act governing adjudications required by statute to be determined on the record nor the Uniform Rules of Practice and Procedure in subpart A of this part apply to an informal hearing under this section unless the Board orders that such procedures shall apply.

(2) The informal hearing shall be recorded, and a transcript shall be furnished to the Respondent upon request and payment of the cost thereof. Witnesses need not be sworn, unless specifically requested by a party or the presiding officer(s). The presiding officer(s) may ask questions of any witness.

(3) The presiding officer(s) may order that the hearing be continued for a reasonable period (normally five business days) following completion of oral testimony or argument to allow additional written submissions to the hearing record.

(e) *Standard for review*. A Respondent shall bear the burden of demonstrating that his or her continued employment by or service with the bank would materially strengthen the bank's ability:

(1) To become adequately capitalized, to the extent that the directive was issued as a result of the bank's capital level or failure to submit or implement a capital restoration plan; and

(2) To correct the unsafe or unsound condition or unsafe or unsound practice, to the extent that the directive was issued as a result of classification of the bank based on supervisory criteria other than capital, pursuant to section 38(g) of the FDI Act.

(f) *Recommendation of presiding officers*. Within 20 calendar days following the date the hearing and the record on the proceeding are closed, the presiding officer(s) shall make a recommendation to the Board concerning the Respondent's request for reinstatement with the bank.

(g) *Time for decision*. Not later than 60 calendar days after the date the record is closed or the date of the response in a case where no hearing was requested, the Board shall grant or deny the request for reinstatement and notify the Respondent of the Board's decision. If the Board denies the request for reinstatement, the Board shall set forth in the notification the reasons for the Board's action.

### § 263.205 Enforcement of directives.

(a) *Judicial remedies*. Whenever a state member bank or company that controls a state member bank fails to comply with a directive issued under section 38, the Board may seek enforcement of the directive in the appropriate United States district court pursuant to section 8(i) (1) of the FDI Act.

(b) *Administrative remedies*—(1) *Failure to comply with directive*. Pursuant to section 8(i) (2) (A) of the FDI Act, the Board may assess a civil money penalty against any state member bank or company that controls a state member bank that violates or otherwise fails to comply with any final directive issued under section 38 and against any institution-affiliated party who participates in such violation or noncompliance.

(2) *Failure to implement capital restoration plan.* The failure of a bank to implement a capital restoration plan required under section 38, subpart D of Regulation H (12 CFR part 208, subpart D), or this subpart, or the failure of a company having control of a bank to fulfill a guarantee of a capital restoration plan made pursuant to section 38 (e) (2) of the FDI Act shall subject the bank or company to the assessment of civil money penalties pursuant to section 8(i) (2) (A) of the FDI Act.

(c) *Other enforcement action.* In addition to the actions described in paragraphs (a) and (b) of this section, the Board may seek enforcement of the provisions of section 38 or subpart B of Regulation H (12 CFR part 208, subpart B) through any other judicial or administrative proceeding authorized by law.

[57 FR 44888, Sept. 29, 1992, as amended at 63 FR 58621, Nov. 2, 1998]

## Subpart I—Submission and Review of Safety and Soundness Compliance Plans and Issuance of Orders To Correct Safety and Soundness Deficiencies

SOURCE: 60 FR 35682, July 10, 1995, unless otherwise noted.

### § 263.300 Scope.

The rules and procedures set forth in this subpart apply to State member banks that are subject to the provisions of section 39 of the Federal Deposit Insurance Act (section 39) (12 U.S.C. 1831p–1).

### § 263.301 Purpose.

Section 39 of the FDI Act requires the Board to establish safety and soundness standards. Pursuant to section 39, a bank may be required to submit a compliance plan if it is not in compliance with a safety and soundness standard established by guideline under section 39(a) or (b). An enforceable order under section 8 may be issued if, after being notified that it is in violation of a safety and soundness standard established under section 39, the bank fails to submit an acceptable compliance plan or fails in any material respect to implement an accepted plan. This subpart establishes procedures for requiring submission of a compliance plan and issuing an enforceable order pursuant to section 39.

### § 263.302 Determination and notification of failure to meet safety and soundness standard and request for compliance plan.

(a) *Determination.* The Board may, based upon an examination, inspection, or any other information that becomes available to the Board, determine that a bank has failed to satisfy the safety and soundness standards contained in the Interagency Guidelines Establishing Standards for Safety and Soundness or the Interagency Guidelines Establishing Standards for Safeguarding Customer Information, set forth in appendices D–1 and D–2 to part 208 of this chapter, respectively.

(b) *Request for compliance plan.* If the Board determines that a State member bank has failed a safety and soundness standard pursuant to paragraph (a) of this section, the Board may request, by letter or through a report of examination, the submission of a compliance plan, and the bank shall be deemed to have notice of the request three days after mailing of the letter by the Board or delivery of the report of examination.

[60 FR 35682, July 10, 1995, as amended at 63 FR 55488, Oct. 15, 1998; 66 FR 8637, Feb. 1, 2001]

### § 263.303 Filing of safety and soundness compliance plan.

(a) *Schedule for filing compliance plan*—(1) *In general.* A State member bank shall file a written safety and soundness compliance plan with the Board within 30 days of receiving a request for a compliance plan pursuant to § 263.302(b), unless the Board notifies the bank in writing that the plan is to be filed within a different period.

(2) *Other plans.* If a State member bank is obligated to file, or is currently operating under, a capital restoration plan submitted pursuant to section 38 of the FDI Act (12 U.S.C. 1831o), a cease-and-desist order entered into pursuant to section 8 of the FDI Act, a formal or informal agreement, or a response to a report of examination or

report of inspection, it may, with the permission of the Board, submit a compliance plan under this section as part of that plan, order, agreement, or response, subject to the deadline provided in paragraph (a)(1) of this section.

(b) *Contents of plan.* The compliance plan shall include a description of the steps the State member bank will take to correct the deficiency and the time within which those steps will be taken.

(c) *Review of safety and soundness compliance plans.* Within 30 days after receiving a safety and soundness compliance plan under this subpart, the Board shall provide written notice to the bank of whether the plan has been approved or seek additional information from the bank regarding the plan. The Board may extend the time within which notice regarding approval of a plan will be provided.

(d) *Failure to submit or implement a compliance plan*—(1) *Supervisory actions.* If a State member bank fails to submit an acceptable plan within the time specified by the Board or fails in any material respect to implement a compliance plan, then the Board shall, by order, require the bank to correct the deficiency and may take further actions provided in section 39(e)(2)(B). Pursuant to section 39(e)(3), the Board may be required to take certain actions if the bank commenced operations or experienced a change in control within the previous 24-month period, or the bank experienced extraordinary growth during the previous 18-month period.

(2) *Extraordinary growth.* For purposes of paragraph (d)(1) of this section, *extraordinary growth* means an increase in assets of more than 7.5 percent during any quarter within the 18-month period preceding the issuance of a request for submission of a compliance plan, by a bank that is not well capitalized for purposes of section 38 of the FDI Act. For purposes of calculating an increase in assets, assets acquired through merger or acquisition approved pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) will be excluded.

(e) *Amendment of compliance plan.* A State member bank that has filed an approved compliance plan may, after prior written notice to and approval by the Board, amend the plan to reflect a change in circumstance. Until such time as a proposed amendment has been approved, the bank shall implement the compliance plan as previously approved.

### § 263.304 Issuance of orders to correct deficiencies and to take or refrain from taking other actions.

(a) *Notice of intent to issue order*—(1) *In general.* The Board shall provide a bank prior written notice of the Board's intention to issue an order requiring the bank to correct a safety and soundness deficiency or to take or refrain from taking other actions pursuant to section 39 of the FDI Act. The bank shall have such time to respond to a proposed order as provided by the Board under paragraph (c) of this section.

(2) *Immediate issuance of final order.* If the Board finds it necessary in order to carry out the purposes of section 39 of the FDI Act, the Board may, without providing the notice prescribed in paragraph (a)(1) of this section, issue an order requiring a bank immediately to take actions to correct a safety and soundness deficiency or take or refrain from taking other actions pursuant to section 39. A State member bank that is subject to such an immediately effective order may submit a written appeal of the order to the Board. Such an appeal must be received by the Board within 14 calendar days of the issuance of the order, unless the Board permits a longer period. The Board shall consider any such appeal, if filed in a timely matter, within 60 days of receiving the appeal. During such period of review, the order shall remain in effect unless the Board, in its sole discretion, stays the effectiveness of the order.

(b) *Contents of notice.* A notice of intent to issue an order shall include:

(1) A statement of the safety and soundness deficiency or deficiencies that have been identified at the bank;

(2) A description of any restrictions, prohibitions, or affirmative actions that the Board proposes to impose or require;

(3) The proposed date when such restrictions or prohibitions would be effective or the proposed date for completion of any required action; and

(4) The date by which the bank subject to the order may file with the Board a written response to the notice.

(c) *Response to notice*—(1) *Time for response*. A bank may file a written response to a notice of intent to issue an order within the time period set by the Board. Such a response must be received by the Board within 14 calendar days from the date of the notice unless the Board determines that a different period is appropriate in light of the safety and soundness of the bank or other relevant circumstances.

(2) *Contents of response*. The response should include:

(i) An explanation why the action proposed by the Board is not an appropriate exercise of discretion under section 39;

(ii) Any recommended modification of the proposed order; and

(iii) Any other relevant information, mitigating circumstances, documentation, or other evidence in support of the position of the bank regarding the proposed order.

(d) *Agency consideration of response*. After considering the response, the Board may:

(1) Issue the order as proposed or in modified form;

(2) Determine not to issue the order and so notify the bank; or

(3) Seek additional information or clarification of the response from the bank, or any other relevant source.

(e) *Failure to file response*. Failure by a bank to file with the Board, within the specified time period, a written response to a proposed order shall constitute a waiver of the opportunity to respond and shall constitute consent to the issuance of the order.

(f) *Request for modification or rescission of order*. Any bank that is subject to an order under this subpart may, upon a change in circumstances, request in writing that the Board reconsider the terms of the order, and may propose that the order be rescinded or modified. Unless otherwise ordered by the Board, the order shall continue in place while such request is pending before the Board.

### § 263.305 Enforcement of orders.

(a) *Judicial remedies*. Whenever a State member bank fails to comply with an order issued under section 39, the Board may seek enforcement of the order in the appropriate United States district court pursuant to section 8(i)(1) of the FDI Act.

(b) *Failure to comply with order*. Pursuant to section 8(i)(2)(A) of the FDI Act, the Board may assess a civil money penalty against any State member bank that violates or otherwise fails to comply with any final order issued under section 39 and against any institution-affiliated party who participates in such violation or noncompliance.

(c) *Other enforcement action*. In addition to the actions described in paragraphs (a) and (b) of this section, the Board may seek enforcement of the provisions of section 39 or this part through any other judicial or administrative proceeding authorized by law.

## Subpart J—Removal, Suspension, and Debarment of Accountants From Performing Audit Services

SOURCE: 68 FR 48267, Aug. 13, 2003, unless otherwise noted.

### § 263.400 Scope.

This subpart, which implements section 36(g)(4) of the Federal Deposit Insurance Act (FDIA)(12 U.S.C. 1831m(g)(4)), provides rules and procedures for the removal, suspension, or debarment of independent public accountants and their accounting firms from performing independent audit and attestation services for insured state member banks and for bank holding companies required by section 36 of the FDIA (12 U.S.C. 1831m).

### § 263.401 Definitions.

As used in this subpart, the following terms shall have the meaning given below unless the context requires otherwise:

(a) *Accounting firm* means a corporation, proprietorship, partnership, or other business firm providing audit services.

(b) *Audit services* means any service required to be performed by an independent public accountant by section

36 of the FDIA and 12 CFR part 363, including attestation services. Audit services include any service performed with respect to the holding company of an insured bank that is used to satisfy requirements imposed by section 36 or part 363 on that bank.

(c) *Banking organization* means an insured state member bank or a bank holding company that obtains audit services that are used to satisfy requirements imposed by section 36 or part 363 on an insured subsidiary bank of that holding company.

(d) *Independent public accountant* (accountant) means any individual who performs or participates in providing audit services.

### § 263.402 Removal, suspension, or debarment.

(a) *Good cause for removal, suspension, or debarment*—(1) *Individuals.* The Board may remove, suspend, or debar an independent public accountant from performing audit services for banking organizations that are subject to section 36 of the FDIA, if, after notice of and opportunity for hearing in the matter, the Board finds that the accountant:

(i) Lacks the requisite qualifications to perform audit services;

(ii) Has knowingly or recklessly engaged in conduct that results in a violation of applicable professional standards, including those standards and conflict of interest provisions applicable to accountants through the Sarbanes-Oxley Act of 2002, Pub. L. 107–204, 116 Stat. 745 (2002) (Sarbanes-Oxley Act), and developed by the Public Company Accounting Oversight Board and the Securities and Exchange Commission;

(iii) Has engaged in negligent conduct in the form of:

(A) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or

(B) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to perform audit services;

(iv) Has knowingly or recklessly given false or misleading information, or knowingly or recklessly participated in any way in the giving of false or misleading information, to the Board or any officer or employee of the Board;

(v) Has engaged in, or aided and abetted, a material and knowing or reckless violation of any provision of the Federal banking or securities laws or the rules and regulations thereunder, or any other law;

(vi) Has been removed, suspended, or debarred from practice before any Federal or state agency regulating the banking, insurance, or securities industries, other than by an action listed in § 263.403, on grounds relevant to the provision of audit services; or

(vii) Is suspended or debarred for cause from practice as an accountant by any duly constituted licensing authority of any state, possession, commonwealth, or the District of Columbia.

(2) *Accounting firms.* If the Board determines that there is good cause for the removal, suspension, or debarment of a member or employee of an accounting firm under paragraph (a)(1) of this section, the Board also may remove, suspend, or debar such firm or one or more offices of such firm. In considering whether to remove, suspend, or debar a firm or an office thereof, and the term of any sanction against a firm under this section, the Board may consider, for example:

(i) The gravity, scope, or repetition of the act or failure to act that constitutes good cause for removal, suspension, or debarment;

(ii) The adequacy of, and adherence to, applicable policies, practices, or procedures for the accounting firm's conduct of its business and the performance of audit services;

(iii) The selection, training, supervision, and conduct of members or employees of the accounting firm involved in the performance of audit services;

(iv) The extent to which managing partners or senior officers of the accounting firm have participated, directly, or indirectly through oversight or review, in the act or failure to act; and

(v) The extent to which the accounting firm has, since the occurrence of the act or failure to act, implemented

corrective internal controls to prevent its recurrence.

(3) *Limited scope orders.* An order of removal, suspension (including an immediate suspension), or debarment may, at the discretion of the Board, be made applicable to a particular banking organization or class of banking organizations.

(4) *Remedies not exclusive.* The remedies provided in this subpart are in addition to any other remedies the Board may have under any other applicable provisions of law, rule, or regulation.

(b) *Proceedings to remove, suspend, or debar*—(1) *Initiation of formal removal, suspension, or debarment proceedings.* The Board may initiate a proceeding to remove, suspend, or debar an accountant or accounting firm from performing audit services by issuing a written notice of intention to take such action that names the individual or firm as a respondent and describes the nature of the conduct that constitutes good cause for such action.

(2) *Hearing under paragraph (b) of this section.* An accountant or firm named as a respondent in the notice issued under paragraph (b)(1) of this section may request a hearing on the allegations in the notice. Hearings conducted under this paragraph shall be conducted in the same manner as other hearings under the Uniform Rules of Practice and Procedure (12 CFR part 263, subpart A).

(c) *Immediate suspension from performing audit services*—(1) *In general.* If the Board serves a written notice of intention to remove, suspend, or debar an accountant or accounting firm from performing audit services, the Board may, with due regard for the public interest and without a preliminary hearing, immediately suspend such accountant or firm from performing audit services for banking organizations, if the Board:

(i) Has a reasonable basis to believe that the accountant or firm has engaged in conduct (specified in the notice served on the accountant or firm under paragraph (b) of this section) that would constitute grounds for removal, suspension, or debarment under paragraph (a) of this section;

(ii) Determines that immediate suspension is necessary to avoid immediate harm to an insured depository institution or its depositors or to the depository system as a whole; and

(iii) Serves such respondent with written notice of the immediate suspension.

(2) *Procedures.* An immediate suspension notice issued under this paragraph will become effective upon service. Such suspension will remain in effect until the date the Board dismisses the charges contained in the notice of intention, or the effective date of a final order of removal, suspension, or debarment issued by the Board to the respondent.

(3) *Petition to stay.* Any accountant or firm immediately suspended from performing audit services in accordance with paragraph (c)(1) of this section may, within 10 calendar days after service of the notice of immediate suspension, file with the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551 for a stay of such immediate suspension. If no petition is filed within 10 calendar days, the immediate suspension shall remain in effect.

(4) *Hearing on petition.* Upon receipt of a stay petition, the Secretary will designate a presiding officer who shall fix a place and time (not more than 10 calendar days after receipt of the petition, unless extended at the request of petitioner) at which the immediately suspended party may appear, personally or through counsel, to submit written materials and oral argument. Any Board employee engaged in investigative or prosecuting functions for the Board in a case may not, in that or a factually related case, serve as a presiding officer or participate or advise in the decision of the presiding officer or of the Board, except as witness or counsel in the proceeding. In the sole discretion of the presiding officer, upon a specific showing of compelling need, oral testimony of witnesses may also be presented. In hearings held pursuant to this paragraph there shall be no discovery and the provisions of §§ 263.6 through 263.12, 263.16, and 263.21 of this part shall apply.

(5) *Decision on petition.* Within 30 calendar days after the hearing, the presiding officer shall issue a decision. The presiding officer will grant a stay

upon a demonstration that a substantial likelihood exists of the respondent's success on the issues raised by the notice of intention and that, absent such relief, the respondent will suffer immediate and irreparable injury, loss, or damage. In the absence of such a demonstration, the presiding officer will notify the parties that the immediate suspension will be continued pending the completion of the administrative proceedings pursuant to the notice.

(6) *Review of presiding officer's decision.* The parties may seek review of the presiding officer's decision by filing a petition for review with the presiding officer within 10 calendar days after service of the decision. Replies must be filed within 10 calendar days after the petition filing date. Upon receipt of a petition for review and any reply, the presiding officer shall promptly certify the entire record to the Board. Within 60 calendar days of the presiding officer's certification, the Board shall issue an order notifying the affected party whether or not the immediate suspension should be continued or reinstated. The order shall state the basis of the Board's decision.

**§ 263.403 Automatic removal, suspension, and debarment.**

(a) An independent public accountant or accounting firm may not perform audit services for banking organizations if the accountant or firm:

(1) Is subject to a final order of removal, suspension, or debarment (other than a limited scope order) issued by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, or the Office of Thrift Supervision under section 36 of the FDIA;

(2) Is subject to a temporary suspension or permanent revocation of registration or a temporary or permanent suspension or bar from further association with any registered public accounting firm issued by the Public Company Accounting Oversight Board or the Securities and Exchange Commission under sections 105(c)(4)(A) or (B) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(c)(4)(A) or (B)); or

(3) Is subject to an order of suspension or denial of the privilege of appearing or practicing before the Securities and Exchange Commission.

(b) Upon written request, the Board, for good cause shown, may grant written permission to such accountant or firm to perform audit services for banking organizations. The request shall contain a concise statement of the action requested. The Board may require the applicant to submit additional information.

**§ 263.404 Notice of removal, suspension, or debarment.**

(a) *Notice to the public.* Upon the issuance of a final order for removal, suspension, or debarment of an independent public accountant or accounting firm from providing audit services, the Board shall make the order publicly available and provide notice of the order to the other Federal banking agencies.

(b) *Notice to the Board by accountants and firms.* An accountant or accounting firm that provides audit services to a banking organization must provide the Board with written notice of:

(1) Any currently effective order or other action described in §§ 263.402(a)(1)(vi) through (a)(1)(vii) or §§ 263.403(a)(2) through (a)(3); and

(2) Any currently effective action by the Public Company Accounting Oversight Board under sections 105(c)(4)(C) or (G) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(c)(4)(C) or (G)).

(c) *Timing of notice.* Written notice required by this paragraph shall be given no later than 15 calendar days following the effective date of an order or action, or 15 calendar days before an accountant or firm accepts an engagement to provide audit services, whichever date is earlier.

**§ 263.405 Petition for reinstatement.**

(a) *Form of petition.* Unless otherwise ordered by the Board, a petition for reinstatement by an independent public accountant, an accounting firm, or an office of a firm that was removed, suspended, or debarred under § 263.402 may be made in writing at any time. The request shall contain a concise statement of the action requested. The Board may require the petitioner to submit additional information.

(b) *Procedure.* A petitioner for reinstatement under this section may, in the sole discretion of the Board, be afforded a hearing. The accountant or firm shall bear the burden of going forward with a petition and proving the grounds asserted in support of the petition. The Board may, in its sole discretion, direct that any reinstatement proceeding be limited to written submissions. The removal, suspension, or debarment shall continue until the Board, for good cause shown, has reinstated the petitioner or until the suspension period has expired. The filing of a petition for reinstatement shall not stay the effectiveness of the removal, suspension, or debarment of an accountant or firm.

## PART 264—EMPLOYEE RESPONSIBILITIES AND CONDUCT

AUTHORITY: 5 U.S.C. 7301; 12 U.S.C. 244.

### § 264.101 Cross-reference to employees' ethical conduct standards and financial disclosure regulations.

Employees of the Board of Governors of the Federal Reserve System (Board) are subject to the executive branch-wide standards of ethical conduct at 5 CFR part 2635 and the Board's regulation at 5 CFR part 6801, which supplements the executive branch-wide standards, and the executive branch-wide financial disclosure regulation at 5 CFR part 2634.

[61 FR 53830, Oct. 16, 1996]

## PART 264a—POST-EMPLOYMENT RESTRICTIONS FOR SENIOR EXAMINERS

Sec.

264a.1 What is the purpose and scope of this part?
264a.2 Who is considered a senior examiner of the Federal Reserve?
264a.3 What special post-employment restrictions apply to senior examiners?
264a.4 When do these special restrictions become effective and may they be waived?
264a.5 What are the penalties for violating these special post-employment restrictions?
264a.6 What other definitions and rules of construction apply for purposes of this part?

AUTHORITY: 12 U.S.C. 1820(k).

SOURCE: 70 FR 69638, Nov. 17, 2005, unless otherwise noted.

### § 264a.1 What is the purpose and scope of this part?

This part identifies those officers and employees of the Federal Reserve that are subject to the special post-employment restrictions set forth in section 10(k) of the Federal Deposit Insurance Act (FDI Act) and implements those restrictions as they apply to officers and employees of the Federal Reserve.

### § 264a.2 Who is considered a senior examiner of the Federal Reserve?

For purposes of this part, an officer or employee of the Federal Reserve is considered to be the ''senior examiner'' for a particular state member bank, bank holding company or foreign bank if—

(a) The officer or employee has been authorized by the Board to conduct examinations or inspections on behalf of the Board;

(b) The officer or employee has been assigned continuing, broad and lead responsibility for examining or inspecting the state member bank, bank holding company or foreign bank; and

(c) The officer's or employee's responsibilities for examining, inspecting and supervising the state member bank, bank holding company or foreign bank—

(1) Represent a substantial portion of the officer's or employee's assigned responsibilities; and

(2) Require the officer or employee to interact routinely with officers or employees of the state member bank, bank holding company or foreign bank or its affiliates.

### § 264a.3 What special post-employment restrictions apply to senior examiners?

(a) *Senior Examiners of State Member Banks.* An officer or employee of the Federal Reserve who serves as the senior examiner of a state member bank for two or more months during the last twelve months of such individual's employment with the Federal Reserve may not, within one year after leaving the employment of the Federal Reserve, knowingly accept compensation

as an employee, officer, director or consultant from—

(1) The state member bank; or

(2) Any company (including a bank holding company) that controls the state member bank.

(b) *Senior Examiners of Bank Holding Companies.* An officer or employee of the Federal Reserve who serves as the senior examiner of a bank holding company for two or more months during the last twelve months of such individual's employment with the Federal Reserve may not, within one year of leaving the employment of the Federal Reserve, knowingly accept compensation as an employee, officer, director or consultant from—

(1) The bank holding company; or

(2) Any depository institution that is controlled by the bank holding company.

(c) *Senior Examiners of Foreign Banks.* An officer or employee of the Federal Reserve who serves as the senior examiner of a foreign bank for two or more months during the last twelve months of such individual's employment with the Federal Reserve may not, within one year of leaving the employment of the Federal Reserve, knowingly accept compensation as an employee, officer, director or consultant from—

(1) The foreign bank; or

(2) Any branch or agency of the foreign bank located in the United States; or

(3) Any other depository institution controlled by the foreign bank.

### § 264a.4 When do these special restrictions become effective and may they be waived?

The post-employment restrictions set forth in section 10(k) of the FDI Act and § 264a.3 do not apply to any officer or employee of the Federal Reserve, or any former officer or employee of the Federal Reserve, if—

(a) The individual ceased to be an officer or employee of the Federal Reserve before December 17, 2005; or

(b) The Chairman of the Board of Governors certifies, in writing and on a case-by-case basis, that granting the individual a waiver of the restrictions would not affect the integrity of the Federal Reserve's supervisory program.

### § 264a.5 What are the penalties for violating these special post-employment restrictions?

(a) *Penalties under section 10(k) of FDI Act.*—A senior examiner of the Federal Reserve who, after leaving the employment of the Federal Reserve, violates the restrictions set forth in § 264a.3 shall, in accordance with section 10(k)(6) of the FDI Act, be subject to one or both of the following penalties—

(1) An order—

(i) Removing the individual from office or prohibiting the individual from further participation in the affairs of the relevant state member bank, bank holding company, foreign bank or other depository institution or company for a period of up to five years; and

(ii) Prohibiting the individual from participating in the affairs of any insured depository institution for a period of up to five years; and/or

(2) A civil monetary penalty of not more than $250,000.

(b) *Imposition of penalties.* The penalties described in paragraph (a) of this section shall be imposed by the appropriate Federal banking agency as determined under section 10(k)(6) of the FDI Act, which may be an agency other than the Federal Reserve.

(c) *Scope of prohibition orders.* Any senior examiner who is subject to an order issued under paragraph (a) of this section shall, as required by section 10(k)(6)(B) of the FDI Act, be subject to paragraphs (6) and (7) of section 8(e) of the FDI Act in the same manner and to the same extent as a person subject to an order issued under section 8(e).

(d) *Procedures.* The procedures applicable to actions under paragraph (a) of this section are provided in section 10(k)(6) of the FDI Act.

(e) *Other penalties.* The penalties set forth in paragraph (a) of this section are not exclusive, and a senior examiner who violates the restrictions in § 264a.3 also may be subject to other administrative, civil or criminal remedies or penalties as provided in law.

### § 264a.6 What other definitions and rules of construction apply for purposes of this part?

For purposes of this part—

(a) *Bank holding company* means any company that controls a bank (as provided in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*)).

(b) A person shall be deemed to act as a *consultant* for a bank or other company only if such person works directly on matters for, or on behalf of, such bank or other company.

(c) *Control* has the meaning given in section 2 of the Bank Holding Company Act.

(d) *Depository institution* has the meaning given in section 3 of the FDI Act and includes an uninsured branch or agency of a foreign bank, if such branch or agency is located in any State.

(e) *Federal Reserve* means the Board of Governors of the Federal Reserve System and the Federal Reserve Banks.

(f) *Foreign bank* means any foreign bank or company described in section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a)).

(g) *Insured depository institution* has the meaning given in section 3 of the FDI Act.

## PART 264b—RULES REGARDING FOREIGN GIFTS AND DECORATIONS

Sec.

264b.1 Purpose and scope.
264b.2 Definitions.
264b.3 Restrictions on acceptance of gifts and decorations.
264b.4 Gifts of minimal value.
264b.5 Gifts of more than minimal value.
264b.6 Requirements for gifts of more than minimal value.
264b.7 Decorations.
264b.8 Disposition or retention of gifts and decorations deposited with the Office of the Secretary.
264b.9 Enforcement.
264b.10 Certain grants excluded.

AUTHORITY: 5 U.S.C. 552, 7342; 12 U.S.C. 248(i).

SOURCE: 68 FR 68721, Dec. 10, 2003, unless otherwise noted.

### § 264b.1 Purpose and scope.

These rules govern when Board employees, their spouses, and their dependents may accept and retain gifts and decorations from foreign governments under the Foreign Gifts and Decorations Act of 1966, as amended (5 U.S.C. 7342) (''Act'').

### § 264b.2 Definitions.

When used in this part, the following terms have the meanings indicated:

(a) *Board employees* means:

(1) Members of the Board of Governors of the Federal Reserve System (''Board''), officers, and other employees of the Board, including experts or consultants while employed by, and acting on behalf of, the Board; and

(2) Spouses (unless separated) or dependents (within the meaning of section 152 of the Internal Revenue Code of 1986 (26 U.S.C. 152)) of such persons.

(b) *Foreign government* means:

(1) Any unit of foreign governmental authority, including any foreign national, State, local, or municipal government;

(2) Any international or multinational organization whose membership is composed of any unit of foreign government as described in paragraph (b)(1) of this section; and

(3) Any agent or representative of any such unit or organization, while acting as such.

(c) *Gift* means a tangible or intangible present (other than a decoration) tendered by, or received from, a foreign government.

(d) *Decoration* means an order, device, medal, badge, insignia, emblem, or award tendered by, or received from, a foreign government.

(e) *Minimal value* means retail value in the United States at the time of acceptance of $285 or less as of January 1, 2002, and at 3-year intervals thereafter, as redefined in regulations prescribed by the Administrator of General Services, in consultation with the Secretary of State, to reflect changes in the consumer price index for the immediately preceding 3-year period.

(f) *Administrative Governor* means the Board member serving as the Administrative Governor and includes persons designated by the Administrative Governor to exercise the authority granted under this part in the governor's absence.

### § 264b.3 Restrictions on acceptance of gifts and decorations.

(a) Board employees are prohibited from requesting or otherwise encouraging the tender of a gift or decoration from a foreign government.

(b) Board employees are prohibited from accepting a gift or decoration from a foreign government, except in accordance with this part.

### § 264b.4 Gifts of minimal value.

(a) Board employees may accept and retain a gift of minimal value tendered and received as a souvenir or mark of courtesy. If more than one tangible gift is presented at or marks an event, the value of all such gifts must not exceed ''minimal value.'' If tangible gifts are presented at or mark separate events, their value must not exceed ''minimal value'' for each event, but may exceed ''minimal value'' for all events, even if the events occur on the same day.

(b) Board employees may determine at the time a gift is offered whether it is of minimal value, or they may submit an accepted gift as soon as practicable to the Office of the Secretary for valuation.

(c) Disagreements over whether a gift is of minimal value will be resolved by an independent appraisal under procedures established by the Office of the Secretary.

### § 264b.5 Gifts of more than minimal value.

(a) *Educational scholarships or medical treatment.* Board employees may accept and retain gifts of more than minimal value when such gifts are in the nature of an educational scholarship or medical treatment.

(b) *Travel or travel expenses.* Board employees may accept gifts of travel or expenses for travel taking place entirely outside the United States (such as transportation, food, and lodging) of more than minimal value if appropriate, consistent with the interests of the United States, and permitted by the Board under paragraph (b)(1) or (b)(2) of this section.

(1) Board employees may accept gifts of travel or expenses for travel under paragraph (b) of this section in accordance with specific instructions of the Board, as evidenced by the prior approval of the Administrative Governor. Board employees must request prior approval under procedures established by the Office of the Secretary.

(2) Board employees may accept gifts of travel or expenses for travel under paragraph (b) of this section without the prior approval of the Administrative Governor if such expenses are reported under § 264b.6(b) and the Administrative Governor approves their acceptance after the fact. Board employees must personally repay gifts of travel or expenses for travel of more than minimal value that are not approved by the Administrative Governor.

(c) *Other gifts.* (1) Board employees may typically regard the refusal of gifts of more than minimal value at the inception (when offered or received without a prior offer) as consistent with the interests and general policy of the United States.

(2) Board employees may accept gifts of more than minimal value when it appears that refusal would likely cause offense or embarrassment or otherwise adversely affect the foreign relations of the United States. Tangible gifts are considered to have been accepted on behalf of the United States and become the property of the United States on acceptance. Accordingly, they must be deposited and documented in accordance with § 264b.6(a) and can only be returned or otherwise processed by the Office of the Secretary under § 264b.8.

### § 264b.6 Requirements for gifts of more than minimal value.

(a) *Tangible gifts.* Board employees must deposit tangible gifts of more than minimal value with the Office of the Secretary within 60 days of acceptance and assist in preparing a statement that contains the following information for each gift:

(1) The name and position of the Board employee;

(2) A brief description of the gift and the circumstances justifying acceptance;

(3) The identity, if known, of the foreign government and the name and position of the individual who presented the gift;

(4) The date of acceptance of the gift;

(5) The estimated value in the United States of the gift at the time of acceptance; and

(6) The disposition or current location of the gift.

(b) *Travel or travel expenses without prior approval.* Board employees who accept a gift of travel or expenses for travel under §264b.5(b)(2) without the prior approval of the Administrative Governor must submit a report to the Office of the Secretary within 30 days of acceptance that contains the following information:

(1) The name and position of the Board employee;

(2) A brief description of the gift, including its estimated value, and the circumstances justifying acceptance; and

(3) The identity, if known, of the foreign government and the name and position of the individual who presented the gift.

(c) *Reports to the Secretary of State.* The Office of the Secretary must report the information contained in the statements described in paragraphs (a) and (b) of this section to the Secretary of State, who must publish in the FEDERAL REGISTER not later than January 31 of each year a comprehensive listing of all such statements for gifts of more than minimal value that were received by federal employees during the preceding year.

### §264b.7 Decorations.

(a) Board employees may accept, retain, and wear a decoration tendered or awarded by a foreign government in recognition of active field service in time of combat operations or for other outstanding or unusually meritorious performance, subject to the approval of the Administrative Governor. Requests for approval must be submitted to the Office of the Secretary and contain a statement of the circumstances surrounding the award and include any accompanying documentation. The recipient may retain the decoration pending action on the request.

(b) Decorations accepted by Board employees without the approval of the Administrative Governor are considered to have been accepted on behalf of the United States and must be deposited within 60 days of the decoration's acceptance with the Office of the Secretary for disposition or retention under §264b.8.

### §264b.8 Disposition or retention of gifts and decorations deposited with the Office of the Secretary.

(a) The Office of the Secretary may dispose of gifts and decorations deposited under §§264b.6(a) and 264b.7(b) by returning them to the donors or by handling them in accordance with instructions from the General Services Administration under applicable law.

(b) The Office of the Secretary may approve and retain gifts and decorations deposited under §§264b.6(a) and 264b.7(b) for official use. The Office of the Secretary must dispose of a gift within 30 days of the termination of its official use in accordance with instructions from the General Services Administration under applicable law.

### §264b.9 Enforcement.

(a) The Administrative Governor, after consultation with the General Counsel, must report to the Attorney General cases in which there is reason to believe that a Board employee has violated the Act.

(b) The Attorney General may bring a civil action in any district court of the United States against a Board employee who knowingly solicits or accepts a gift from a foreign government in violation of the Act, or who fails to deposit or report such a gift as required by the Act. The court may assess a maximum penalty of the retail value of a gift improperly solicited or received plus $5,000.

### §264b.10 Certain grants excluded.

This part does not apply to grants and other forms of assistance to which §108A of the Mutual Educational and Cultural Exchange Act of 1961 applies. *See* 22 U.S.C. 2458a.

## PART 265—RULES REGARDING DELEGATION OF AUTHORITY

Sec.
265.1 Authority, purpose, and scope.
265.2 Delegation of functions generally.
265.3 Board review of delegated actions.
265.4 Functions delegated to Board members.

265.5 Functions delegated to Secretary of the Board.
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265.8 Functions delegated to the Staff Director of the Division of International Finance.
265.9 Functions delegated to the Director of Division of Consumer and Community Affairs.
265.10 Functions delegated to Secretary of Federal Open Market Committee.
265.11 Functions delegated to Federal Reserve Banks.

AUTHORITY: 12 U.S.C. 248(i) and (k).

SOURCE: 56 FR 25619, June 5, 1991, unless otherwise noted.

### § 265.1 Authority, purpose, and scope.

(a) Pursuant to section 11(k) of the Federal Reserve Act (12 U.S.C. 248(k)), the Board of Governors of the Federal Reserve System (the ''Board'') may delegate, by published order or rule, any of its functions other than those relating to rulemaking or pertaining principally to monetary and credit policies to Board members and employees, Reserve Banks, or administrative law judges. Pursuant to section 11(i) of the Federal Reserve Act (12 U.S.C. 248(i)), the Board may make all rules and regulations necessary to enable it to effectively perform the duties, functions, or services specified in that Act. Pursuant to section 5(b) of the Bank Holding Company Act (12 U.S.C. 1844(b)), the Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof. Other provisions of Federal law also may authorize specific delegations by the Board.

(b) The Board's Rules Regarding Delegation of Authority (12 CFR part 265) detail the responsibilities that the Board has delegated. The table of contents, titles, and headings that appear in these rules are used solely for their descriptive convenience. Section 265.4 addresses the specific functions delegated to Board members. The functions that have been delegated to Board employees are set forth in §§ 265.5, 265.6, 265.7, 265.8, and 265.9. The functions that have been delegated to the Secretary of the Federal Open Market Committee are set forth in § 265.10. The functions that have been delegated to the Reserve Banks are set forth in § 265.11. Provisions for review of any action taken pursuant to delegated authority are found in § 265.3. Except as otherwise indicated in these rules, the Board will review a delegated action only if a Board member, at his or her own initiative, requests a review.

### § 265.2 Delegation of functions generally.

(a) The Board has determined to delegate authority to exercise the functions described in this part.

(b) The Chairman of the Board shall assign responsibility for performing such delegated functions.

### § 265.3 Board review of delegated actions.

(a) *Request by Board member*. The Board shall review any action taken at a delegated level upon the vote of one member of the Board, either on the member's own initiative or on the basis of a petition for review by any person claiming to be adversely affected by the delegated action.

(b) *Petition for review*. A petition for review of a delegated action must be received by the Secretary of the Board not later than the fifth day following the date of the delegated action.

(c) *Notice of review*. The Secretary shall give notice of review by the Board of a delegated action to any person with respect to whom the action was taken not later than the tenth day following the date of the delegated action. Upon receiving notice, such person may not proceed further in reliance upon the delegated action until notified of the outcome of the review by the Board.

(d) *By action of a delegee*. A delegee may submit any matter to the Board for determination if the delegee considers it appropriate because of the importance or complexity of the matter.

### § 265.4 Functions delegated to Board members.

(a) *Individual members*. Any Board member designated by the Chairman is authorized:

(1) *Review of denial of access to Board records; FOIA*. To review and determine

an appeal of denial of access to Board records under the Freedom of Information Act (5 U.S.C. 552), the Privacy Act (5 U.S.C. 552a), and the Board's rules regarding such access (12 CFR parts 261 and 261a, respectively).

(2) *Approval of amendments to notice of charges or cease and desist orders.* To approve (after receiving recommendations of the Director of the Division of Banking Supervision and Regulation and the General Counsel) amendments to any notice, temporary order, or proposed order previously approved by the Board in a specific formal enforcement matter (including a notice of charges or removal notice) or any proposed or temporary cease and desist order previously approved by the Board under 12 U.S.C. 1818 (b) and (c).

(3) *Requests for permission to appeal rulings.* (i) To act, when requested by the Secretary, upon any request under § 263.10(e) of the Board's Rules of Practice for Hearings (12 CFR part 263) for special permission to appeal from a ruling of the presiding officer on any motion made at a hearing conducted under the rules, and if special permission is granted, the merits of the appeal shall be presented to the Board for decision.

(ii) Notwithstanding § 265.3 of this part, the denial of special permission to appeal a ruling may be reviewed by the Board only if a Board member requests a review within two days of the denial. No person claiming to be adversely affected by the denial shall have any right to petition the Board or any Board member for review or reconsideration of the denial.

(4) *Extension of time period for final Board action.* To extend for an additional 180 days the 180-day period within which final Board action is required on an application pursuant to section 7(d) of the International Banking Act.

(b) *Three member Action Committee.* Any three Board members designated from time to time by the Chairman (the ''Action Committee'') are authorized:

(1) *Absence of quorum.* To act, upon certification by the Secretary of the Board of an absence of a quorum of the Board present in person, by unanimous vote on any matter that the Chairman has certified must be acted upon promptly in order to avoid delay that would be inconsistent with the public interest except for matters:

(i) Relating to rulemaking;

(ii) Pertaining principally to monetary and credit policies; and

(iii) For which a statute expressly requires the affirmative vote of more than three Board members.

(2) [Reserved]

[56 FR 25619, June 5, 1991, as amended at 56 FR 67154, Dec. 30, 1991; 62 FR 14793, Mar. 28, 1997]

### § 265.5 Functions delegated to Secretary of the Board.

The Secretary of the Board (or the Acting Secretary) is authorized:

(a) *Procedure*—(1) *Extension of time period for public participation in proposed regulations.* To extend, when appropriate under the Board's Rules of Procedure (12 CFR 262.2 (a) and (b)), the time period for public participation with respect to proposed regulations of the Board.

(2) *Extension of time period in notices, orders, rules, or regulations.* (i) To grant or deny requests to extend any time period in any notice, order, rule, or regulation of the Board relating to filing information, comments, opposition, briefs, exceptions, or other matters, in connection with any application, request or petition for the Board's approval, authority, determination, or permission, or any other action by the Board.

(ii) Notwithstanding § 265.3 of this part, no person claiming to be adversely affected by any such extension of time by the Secretary shall have the right to petition the Board or any Board member for review or reconsideration of the extension.

(3) *Conforming citations and references in Board rules and regulations.* (i) To conform references to administrative positions or units in Board rules and regulations with changes in the administrative structure of the Board and in the government and agencies of the United States.

(ii) To conform citations and references in Board rules and regulations with other regulatory or statutory changes adopted or promulgated by the Board or by the government or agencies of the United States.

(4) *Technical corrections in Board rules and regulations.* To make technical corrections, such as spelling, grammar, construction, and organization (including removal of obsolete provisions and consolidation of related provisions), to the Board's rules, regulations, and orders and other records of Board action but only with the concurrence of the Board's General Counsel.

(b) *Availability of information*—(1) *FOIA requests.* To make available, upon request, information in Board records and consider requests for confidential treatment of information in Board records under the Freedom of Information Act (5 U.S.C. 552) and under the Board's Rules Regarding Availability of Information (12 CFR part 261).

(2) *Annual reports on Privacy Act.* To approve annual reports required by the Privacy Act (5 U.S.C. 552a(p)) from the Board to the Office of Management and Budget for inclusion in the President's annual consolidated report to Congress.

(3) *Report on prime rate of commercial banks.* To determine and report, under 26 U.S.C. (IRC) 6621, to the Secretary of the Treasury the average predominant prime rate quoted by commercial banks to large businesses.

(c) *Bank holding companies; Change in bank control; Mergers*—(1) *Reports on competitive factors in bank mergers.* To furnish reports on competitive factors involved in a bank merger to the Comptroller of the Currency and the Federal Deposit Insurance Corporation under the provisions of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)); The Bank Holding Company Act (12 U.S.C. 1842(a), 1843(c)(14)); the Bank Service Corporation Act (12 U.S.C. 1865(a), (b), 1867(d)); the Change in Bank Control Act (12 U.S.C. 1817(j)); and the Federal Reserve Act (12 U.S.C. 321 *et seq.*, 601–604a, 611 *et seq.*).

(2) *Reserve Bank director interlocks.* To take actions the Reserve Bank could take except for the fact that the Reserve Bank may not act because a director, senior officer, or principal shareholder of any holding company, bank, or company involved in the transaction is a director of that Reserve Bank or branch of the Reserve Bank.

(3) *Application approval under section 5(d)(3) of the FDI Act.* To approve applications pursuant to section 5(d)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1815(d)(3)), in those cases in which the appropriate Federal Reserve Bank concludes that, because of unusual considerations, or for other good cause, it should not take action.

(d) *International banking*—(1) *Establishment of foreign branch or foreign agency or of Edge or Agreement Corporations.* To approve, under sections 25 and 25A of the Federal Reserve Act (12 U.S.C. 601 and 604) and Regulation K (12 CFR part 211), the establishment, directly or indirectly, of a foreign branch or agency by a member bank or an Edge or Agreement Corporation if all of the following conditions are met:

(i) The appropriate Reserve Bank and relevant divisions of the Board's staff recommend approval;

(ii) No significant policy issue is raised on which the Board has not expressed its view; and

(iii) The application is not for the applicant's first full-service branch in a foreign country.

(2) *Acquisition of foreign company or U.S. company financing exports.* To grant, under sections 25 and 25A of the Federal Reserve Act (12 U.S.C. 601 and 604) and section 4(c)(13) of the Bank Holding Company Act (12 U.S.C. 1843(c)(13)) and the Board's Regulations K and Y (12 CFR parts 211 and 225), specific consent to the acquisition, either directly or indirectly, by a member bank, an Edge or Agreement corporation, or a bank holding company of stock of a company chartered under the laws of a foreign country or a company chartered under the laws of a state of the United States that is organized and operated for the purpose of financing exports from the United States, and to approve any such acquisition that may exceed the limitations of section 25A of the Federal Reserve Act based on the company's capital and surplus, if all of the following conditions are met:

(i) The appropriate Reserve Bank and all relevant divisions of the Board's staff recommend approval;

(ii) No significant policy issue is raised on which the Board has not expressed its view;

(iii) The acquisition does not result, either directly or indirectly, in the bank, corporation, or bank holding company acquiring effective control of the company, except that this condition need not be met if:

(A) The company is to perform nominee, fiduciary, or other services incidental to the activities of a foreign branch or affiliate of the bank holding company, or corporation; or

(B) The stock is being acquired from the parent bank or bank holding company, or subsidiary Edge or Agreement corporation, as the case may be, and the selling parent or subsidiary holds the stock with the consent of the Board pursuant to Regulations K and Y (12 CFR parts 211 and 225).

(3) *Investments in Edge and Agreement Corporations.* To approve an application by a member bank to invest more than 10 percent of capital and surplus in Edge and agreement corporation subsidiaries, provided that:

(i) The member bank's total investment, including the retained earnings of the Edge and agreement corporation subsidiaries, does not exceed 20 percent of the bank's capital and surplus or would not exceed that level as a result of the proposal; and

(ii) The proposal raises no significant policy or supervisory issues.

(e) *Member banks*—(1) *Waiver of penalty for early withdrawals of time deposits.* To permit depository institutions to waive the penalty for early withdrawal of time deposits under section 19(j) of the Federal Reserve Act (12 U.S.C. 371b) and § 204.2 of Regulation D (12 CFR part 204) if the following conditions are met:

(i) The President declares an area of major disaster or emergency area pursuant to section 301 of the Disaster Relief Act of 1974 (42 U.S.C. 5141);

(ii) The waiver is limited to depositors suffering disaster or emergency related losses in the officially designated area; and

(iii) The appropriate Reserve Bank and all relevant divisions of the Board's staff recommend approval.

(2) [Reserved]

(f) *Location of institution.* To determine the Federal Reserve District in which an institution is located pursuant to § 204.3(b)(2)(ii) of Regulation D (12 CFR part 204) or § 209.15(b) of Regulation I (12 CFR part 209) if:

(1) The relevant Federal Reserve Banks and the institution agree on the specific Reserve Bank in which the institution should hold stock or with which the institution should maintain reserve balances; and

(2) The agreed-upon location does not raise any significant policy issues.

[56 FR 25619, June 5, 1991, as amended at 56 FR 67153, 67154, Dec. 30, 1991; 58 FR 26509, May 4, 1993; 62 FR 34617, June 27, 1997; 66 FR 58655, Nov. 23, 2001]

### § 265.6 Functions delegated to General Counsel.

The Board's general counsel (or the general counsel's delegee) is authorized:

(a) *Procedure*—(1) *Reconsideration of Board action.* Pursuant to § 262.3(i) of this chapter (Rules of Procedure) to determine whether or not to grant a request for reconsideration or whether to deny a request for stay of the effective date of any action taken by the Board with respect to an action as provided in that part.

(2) *Public meetings.* To order, after consulting with the directors of other interested divisions of the Board and the appropriate Reserve Bank, that a public meeting or other proceeding be held, under § 262.25 of the Board's Rules of Procedure (12 CFR part 262), in connection with any application or notice filed with the Board, and to designate the presiding officer in the proceeding under terms and conditions the General Counsel deems appropriate.

(3) *Designation of Board counsel for hearings.* To designate Board staff attorneys as Board counsel in any proceeding ordered by the Board in accordance with § 263.6 of the Board's Rules of Practice for Hearings (12 CFR part 263).

(4) *Oaths, depositions, subpoenas.* To take, or authorize designated persons to take, with the concurrence of the Director of the Division of Banking Supervision and Regulation, actions permitted under 12 U.S.C. 1818(n), 1820(c), and 12 U.S.C. 1844(f), including administering oaths and affirmations, taking depositions, and issuing, revoking, quashing, or modifying subpoenas duces tecum.

(b) *Availability of Information*—(1) *FOIA requests.* To make available information of the Board of the nature and in the circumstances described in the Board's Rules Regarding Availability of Information (12 CFR part 261).

(2) *Disclosure to foreign authorities.* To make the determinations required for disclosure of information to a foreign bank regulatory or supervisory authority, and to obtain, to the extent necessary, the agreement of such authority to maintain the confidentiality of such information to the extent possible under applicable law.

(3) *Assistance to foreign authorities.* To approve requests for assistance from any foreign bank regulatory or supervisory authority that is conducting an investigation regarding violations of any law or regulation relating to banking matters or currency transactions administered or enforced by such authority, and to make the determinations required for any investigation or collection of information and evidence pertinent to such request. In deciding whether to approve requests for assistance under this paragraph, the General Counsel shall consider:

(i) Whether the requesting authority has agreed to provide reciprocal assistance with respect to banking matters within the jurisdiction of any appropriate Federal banking agency;

(ii) Whether compliance with the request would prejudice the public interest of the United States; and

(iii) Whether the request is consistent with the requirement that the Board conduct any such investigation in compliance with the laws of the United States and the policies and procedures of the Board.

(c) *Bank holding companies; Change in bank control; Mergers*—(1) *Control determinations under section 2(g) of BHC Act.* To determine whether a company that transfers shares under section 2(g) of the Bank Holding Company Act (12 U.S.C. 1841(g)) is incapable of controlling the transferee.

(2) *Control determinations under section 4(c)(8) of BHC Act.* To determine, or issue an order for a hearing to determine, whether a company engaged in financial, fiduciary, or insurance activities falls within the exemption in section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)), permitting retention or acquisition of control thereof by a bank holding company.

(3) *Notices under CBC Act.* To revoke acceptance of and return as incomplete a notice filed under the Change in Bank Control Act (12 U.S.C. 1817(j)) or to extend the time during which action must be taken on a notice where the General Counsel determines, with the concurrence of the Director of the Division of Banking Supervision and Regulation, that the notice is materially incomplete under that Act or Regulation Y (12 CFR part 225) or contains material information that is substantially inaccurate.

(4) *Tax certifications.* To make prior and final certification for federal tax purposes (26 U.S.C. (IRC) 1101–1103, 6158) with respect to distributions pursuant to the Bank Holding Company Act (12 U.S.C. 1841 *et seq.*).

(d) *Management interlocks*—(1) *General exceptions.* To grant exceptions from the prohibitions of Regulation L (12 CFR part 212) when the primary federal supervisor of the depository institution in need of management assistance approves.

(2) *Temporary exceptions.* To grant requests, after consultation with the Director for the Division of Banking Supervision and Regulation, for temporary director interlocks under Regulation L (12 CFR part 212) for newly chartered banks, banks in low income areas, minority banks, women's banks, organizations experiencing conditions endangering their safety or soundness, organizations sponsoring a credit union, and organizations that lose thirty percent or more of their directors or management officials due to changes in circumstances.

(e) *Consent enforcement orders.* With the concurrence of the director of the Board's Division of Banking Supervision and Regulation (or the Director's delegee):

(1) To enter into a cease-and-desist order, removal and prohibition order, or civil money penalty assessment order with a bank holding company or any nonbanking subsidiary thereof, with a state member bank, or with any other person or entity subject to the Board's jurisdiction, when the order

has been consented to by the institution or individual subject to the order;

(2) To stay, modify, terminate, or suspend an order issued pursuant to paragraph (e)(1) of this section.

(f) *International banking*—(1) *After-the-fact applications.* With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request by a foreign bank to establish a branch, agency, commercial lending company, or representative office through certain acquisitions, mergers, consolidations, or similar transactions, in conjunction with which:

(i) The foreign bank would be required to file an after-the-fact application for the Board's approval under § 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)); or

(ii) The General Counsel may waive the requirement for an after-the-fact application if:

(A) The surviving foreign bank commits to wind down the U.S. operations of the acquired foreign bank; and

(B) The merger or consolidation raises no significant policy or supervisory issues.

(2) To modify the requirement that a foreign bank that has submitted an application or notice to establish a branch, agency, commercial lending company, or representative office pursuant to § 211.24(a)(6) of Regulation K (12 CFR 211.24(a)(6)) shall publish notice of the application or notice in a newspaper of general circulation in the community in which the applicant or notificant proposes to engage in business, as provided in § 211.24(b)(2) of Regulation K (12 CFR 211.24(b)(2)).

(3) With the concurrence of the Board's Director of the Division of Banking Supervision and Regulation, to grant a request for an exemption under section 4(c)(9) of the Bank Holding Company Act (12 U.S.C. 1843(c)(9)), provided that the request raises no significant policy or supervisory issues that the Board has not already considered.

(4) To return applications and notices filed under the International Banking Act for informational deficits.

(5) To determine that an entity qualifies as a ''special-purpose foreign government-owned bank'' for purposes of § 211.24(d)(3) (12 CFR 211.24(d)(3)).

(g) *Conflicts of interest waivers.* To issue individual conflicts of interest waivers under 18 U.S.C. 208(b)(1) to employees and officials other than Board members.

[56 FR 25619, June 5, 1991, as amended at 56 FR 67154, Dec. 30, 1991; 57 FR 6789, Feb. 28, 1992; 57 FR 13002, Apr. 15, 1992; 58 FR 6363, Jan. 28, 1993; 58 FR 26509, May 4, 1993; 58 FR 53394, Oct. 15, 1993; 60 FR 10307, Feb. 24, 1995; 61 FR 13395, Mar. 27, 1996; 62 FR 45150, Aug. 26, 1997; 66 FR 54397, Oct. 26, 2001]

### § 265.7 Functions delegated to Director of Division of Banking Supervision and Regulation.

The Board's Director of the Division of Banking Supervision and Regulation (or the Director's delegee) is authorized:

(a) *Procedure*—(1) *Cease and desist orders.* To refuse, with the prior concurrence of the appropriate Reserve Bank and the Board's General Counsel, an application to the Board to stay, modify, terminate, or set aside any effective cease and desist order previously issued by the Board under section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)), or any written agreement between the Board or the Reserve Bank and a bank holding company or any nonbanking subsidiary thereof or a state member bank.

(2) *Modification of commitments or conditions.* To grant or deny requests for modifying, including extending the time for, performing a commitment or condition relied on by the Board or its delegee in taking any action under the Bank Holding Company Act, the Bank Merger Act, the Change in Bank Control Act of 1978, the Federal Reserve Act, or the International Banking Act. In acting on such requests, the Board's Director may take into account changed circumstances and good faith efforts to fulfill the commitments or conditions, and shall consult with the directors of other interested divisions where appropriate. The Board's Director may not take any action that would be inconsistent with or result in an evasion of the provisions of the Board's original action.

(3) *Notice of insufficient capital.* To issue, with the concurrence of the Board's General Counsel, a notice that

a state member bank or bank holding company has insufficient capital and which directs the bank or company to file with its regional Reserve Bank a capital improvement plan under subpart D of the Board's Rules of Practice for Hearings (12 CFR part 263).

(4) *Obtaining possession or control of securities; extending time period.* To approve, under § 403.5(g) of the Treasury Department regulations (17 CFR part 403) implementing the Government Securities Act of 1986, as amended (Pub. L. 95–571), the application of a member bank, a state branch or agency of a foreign bank, a foreign bank, or a commercial lending company owned or controlled by a foreign bank, to extend for one or more limited periods commensurate with the circumstances the 30-day time period specified in 17 CFR 403.5(c)(1)(iii), provided the Director is satisfied that the applicant is acting in good faith and that exceptional circumstances warrant such action.

(b) *Availability of Information*—(1) *FOIA requests.* To make available information of the Board of the nature and in the circumstances described in § 261.11 of the Board's Rules Regarding Availability of Information (12 CFR part 261).

(2) *FOIA; Availability of information.* To make available, under the Board's Rules Regarding Availability of Information (12 CFR part 261), reports and other information of the Board acquired pursuant to the Board's Regulations G, T, U, and X (12 CFR parts 207, 220, 221, 224) of the nature and in circumstances described in §§ 261.8(a) (2) and (3) of these rules.

(c) *Bank holding companies; Change in bank control; Mergers*—(1) *Bank holding company registration forms and annual reports.* To promulgate registration forms and annual reports and other forms for use in connection with the Bank Holding Company Act, after receiving clearance from the Office of Management and Budget (where necessary), under section 5 of the Bank Holding Company Act (12 U.S.C. 1844) and in accordance with 5 U.S.C. 553.

(2) *Emergency action.* To take actions the Reserve Bank could take under this part at §§ 265.11(c)(2)(ii) and 265.11(c)(3)(iii) if immediate or expeditious action is required to avert failure of a bank or savings association or because of an emergency pursuant to sections 3(a) and 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1842(a), 1843(c)(8)) on the Change in Bank Control Act (12 U.S.C. 1817(j)).

(3) *Waiver of notice.* To waive, dispense with, modify or excuse the failure to comply with the requirement for publication and solicitation of public comment regarding a notice filed under the Change in Bank Control Act (12 U.S.C. 1817(j)), with the concurrence of the Board's General Counsel, provided a written finding is made that such disclosure would seriously threaten the safety or soundness of a bank holding company or a bank.

(4) *Notices for addition or change of directors or officers.* Under section 914(a) of the Financial Institutions Reform, Recovery and Enforcement Act (12 U.S.C. 1831i) and subpart H of Regulation Y (12 CFR part 225), provided that no senior officer or director or proposed senior officer or director of the notificant is also a director of the Reserve Bank or a branch of the Reserve Bank:

(i) To determine the informational sufficiency of notices filed pursuant to § 225.72 of Regulation Y (12 CFR part 225); and

(ii) To waive the prior notice requirements of that section.

(5) *ERISA violations.* To provide the Department of Labor written notification of possible significant violations of the Employee Retirement Income Security Act (ERISA) by bank holding companies, in accordance with section 3004(b) of ERISA and the Interagency Agreement adopted to implement its provisions.

(6) *Appraisal not required.* To determine pursuant to 12 CFR 225.63(b)(12) that the services of an appraiser are not necessary in order to protect Federal financial and public policy interests in real estate-related financial transactions or to protect the safety and soundness of an institution.

(d) *International banking*—(1) *Foreign bank reports.* To require submission of a report of condition respecting any foreign bank in which a member bank holds stock acquired under § 211.5(b) of

Regulation K (12 CFR part 211) and section 25 of the Federal Reserve Act (12 U.S.C. 602).

(2) *Edge corporation reports.* To require submission and publication of reports by an Edge corporation under section 25A of the Federal Reserve Act (12 U.S.C. 625).

(3) *Capital stock of Edge corporation; articles of association; additional investments in Agreement corporation.* To approve under sections 25 and 25A as of the Federal Reserve Act (12 U.S.C. 601 and 604), increases and decreases in the capital stock of and amendments to the articles of association of an Edge corporation and additional investments by a member bank in the stock of an Agreement corporation.

(4) *Authority under general-consent and prior-notice procedures.* (i) With regard to a prior notice to establish a branch in a foreign country under § 211.3 of Regulation K (12 CFR 211.3):

(A) To waive the notice period;

(B) To suspend the notice period;

(C) To determine not to object to the notice; or

(D) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice to make an investment under § 211.9(f) of Regulation K (12 CFR 211.9(f)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To waive the notice period;

(B) To suspend the notice period; or

(C) To require the notificant to file an application for the Board's specific consent.

(iv) To suspend the ability:

(A) Of a foreign banking organization to establish an office under the prior-notice procedures in § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)) or the general-consent procedures in § 211.24(a)(3) of Regulation K (12 CFR 211.24(a)(3));

(B) Of a U.S. banking organization to establish a foreign branch under the prior-notice or general-consent procedures in § 211.3(b) of Regulation K (12 CFR 211.3(b));

(C) Of an investor to make investments under the general-consent or prior-notice procedures in § 211.9 of Regulation K (12 CFR 211.9); and

(D) Of an eligible investor to make an investment in an export trading company under the general-consent procedures in § 211.34(b) of Regulation K (12 CFR 211.34(b)).

(5) *Investment by foreign subsidiaries in U.S. affiliates.* To permit, after consultation with the Board's General Counsel, a foreign subsidiary of a bank holding company to invest in shares of a U.S. affiliate of the bank holding company where the investment is made as part of an internal corporate reorganization or an internal transfer of funds, subject to any conditions and terms the Director and General Counsel deem appropriate and consistent with the purposes of Regulation K (12 CFR part 211).

(6) *Allocated transfer risk reserves.* To determine the need for establishing and the amount of any allocated transfer risk reserve against specific international assets, and notify the banking institutions of the determination and the amount of the reserve and whether the reserve may be reduced under subpart D of Regulation K (12 CFR part 211).

(7) *Underwriting and dealing authority outside the United States; hedging techniques.* To approve, under § 211.5(d)(14) of Regulation K (12 CFR part 211):

(i) Requests for authority to engage in the activities of underwriting, distributing, and dealing in shares outside the United States, provided that the Director has determined that the internal procedures and operations of the organization and the effect of the proposed activities on capital adequacy are consistent with approval.

(ii) Hedging methods authorized under § 211.5(d)(14)(iii)(A) of Regulation K (12 CFR part 211).

(8) *Conduct and coordination of examinations.* To authorize the conduct of examinations of the U.S. offices and affiliates of foreign banks as provided in sections 7(c) and 10(c) of the IBA (12 U.S.C. 3105(c), 3107(c)), and, where appropriate, to coordinate those examinations with examinations of the Office

of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the state entity that is authorized to supervise or regulate a state branch, state agency, commercial lending company, or representative office.

(9) *Allowing use of general-consent procedures.* To allow an investor that is not well-capitalized and well-managed to make investments under the general-consent procedures in § 211.9 or 211.34(b) of Regulation K (12 CFR 211.9 or 211.34(b)), provided that:

(i) The investor has implemented measures to become well-capitalized and well-managed;

(ii) Granting such authority raises no significant policy or supervisory concerns; and

(iii) Authority granted by the Director under this paragraph (d)(9) expires after one year, but may be renewed.

(10) *Exceeding general-consent investment limits.* To allow an investor to exceed the general-consent investment limits under § 211.9 of Regulation K (12 CFR 211.9), provided that:

(i) The investor demonstrates adequate financial and managerial strength;

(ii) The investor's investment strategy is not unsafe or unsound;

(iii) Granting such authority raises no significant policy or supervisory concerns; and

(iv) Authority granted by the Director under this paragraph (d)(10) expires after one year, but may be renewed.

(11) *Approval of temporary U.S. offices.* To allow a foreign bank to operate a temporary office in the United States, pursuant to § 211.24 of Regulation K (12 CFR 211.24), provided that:

(i) There is no direct public access to such office, with respect to any branch or agency function; and

(ii) The proposal raises no significant policy or supervisory issues.

(12) With the concurrence of the General Counsel, to approve applications, notices, exemption requests, waivers and suspensions, and other related matters under Regulation K (12 CFR part 211), where such matters do not raise any significant policy or supervisory issues.

(13) With the concurrence of the General Counsel, to approve:

(i) The establishment by a bank holding company or member bank of an agreement corporation under section 25 of the Federal Reserve Act; and

(ii) Any initial investment associated with the establishment of such agreement corporation.

(14) With the concurrence of the General Counsel, to determine that an election by a foreign bank to become or to be treated as a financial holding company is effective, provided that:

(i) The foreign bank meets the criteria for becoming or being treated as a financial holding company; and

(ii) The election raised no significant policy or supervisory issues.

(e) *Member banks*—(1) *Membership certification to FDIC.* Tocertify, under section 4(b) of the Federal Deposit Insurance Act (12 U.S.C. 1814(b)), to the Federal Deposit Insurance Corporation that the factors specified in section 6 of the Act (12 U.S.C. 1816) were considered with respect to the admission of a state-chartered bank to Federal Reserve membership.

(2) *Dollar exchange.* To permit any member bank to accept drafts or bill of exchange drawn upon it for the purpose of furnishing dollar exchange under section 13(12) of the Federal Reserve Act (12 U.S.C. 373).

(3) *ERISA violations.* To provide to the Department of Labor written notification of possible significant violations of the Employee Retirement Income Security Act (ERISA) by member banks, in accordance with section 3004(b) of ERISA and the Interagency Agreement adopted to implement its provisions.

(4) *Examiners.* To select or approve the appointment of Federal Reserve examiners, assistant examiners, and special examiners for the purpose of making examinations for or by the direction of the Board under 12 U.S.C. 325, 338, 625, 1844(c), and 3105(b)(1).

(5) *Capital stock reduction; branch applications; declaration of dividends; investment in bank premises.* To exercise the functions described in § 265.11(e)(5), (11), and (12) of this part (reductions in capital, issuance of subordinated debt, and early retirement of subordinated debt) when the conditions specified in those sections preclude a Reserve Bank

from acting on a member bank's request for action or when the Reserve Bank concludes that it should not take action, and to exercise the functions in § 265.11(e)(3), (4), and (7) of this part (approving branch applications, declaration of dividends, and investment in bank premises) in cases in which the Reserve Bank concludes that it should not take action.

(6) *Security devices; Regulation P.* To exercise the functions described in § 265.11(e)(8) of this part in those cases in which the appropriate Reserve Bank concludes that it should not take action for good cause.

(f) *Securities*—(1) *Registration statements by member banks.* Under section 12(g) of the Securities Exchange Act (15 U.S.C. 78*l*(g)):

(i) To accelerate the effective date of a registration statement filed by a member bank with respect to its securities;

(ii) To accelerate termination of the registration of a security that is no longer held of record by 300 persons; and

(iii) To extent the time for filing a registration statement by a member bank.

(2) *Exemption from registration.* To issue notices with respect to application by a statement member bank for exemption from registration under section 12(h) of the Securities Exchange Act (15 U.S.C. 78*l*(h)).

(3) *Accelerating registration of security on national securities exchange.* To accelerate the effective date of an application by a state member bank for registration of a security on a national securities exchange under section 12(d) of the Securities Exchange Act (15 U.S.C. 78*l*(d)).

(4) *Unlisted trading in security of state member bank.* To issue notices with respect to an application by a national securities exchange for unlisted trading privileges in a security of a state member bank under section 12(f) of the Securities Exchange Act (15 U.S.C. 78*l*(f)).

(5) *Transfer agent registration; acceleration; withdrawal or cancellation.* (i) To accelerate, under section 17A(c)(2) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78q–1), the effective date of a registration statement for transfer agent activities filed by a member bank or a subsidiary thereof, a bank holding company or a subsidiary thereof that is a bank as defined in section 3(a)(6) of the Act other than a bank specified in clause (i) or (iii) of section 3(a)(34)(B) of the Act (15 U.S.C. 78c).

(ii) To withdraw or cancel, under section 17A(c)(3)(C) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78q–1(c)(3)(C)), the transfer agent registration of a member bank or a subsidiary thereof, a bank holding company, or a subsidiary thereof that is a bank as defined in section 3(a)(6) of that Act other than a bank specified in clause (i) or (iii) of section 3(a)(34)(B) of the Act (15 U.S.C. 78c), that has filed a written notice of withdrawal with the Board or upon a finding that such transfer agent is no longer in existence or has ceased to do business as a transfer agent.

(6) *Proxy solicitation; financial statements.* (i) To permit the mailing of proxy and other soliciting materials by a state member bank before the expiration of the time prescribed therein under § 208.36 of Regulation H (12 CFR part 208).

(ii) To permit the omission of financial statements from reports by a state member bank, or to require other financial statements in addition to, or in substitution for, the statements required therein under § 208.36 of Regulation H (12 CFR part 208).

(7) *Municipal securities dealers.* Under section 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78w).

(i) To grant or deny requests for waiver of examination and waiting period requirements for municipal securities principals and representatives under Municipal Securities Rulemaking Board Rule G–3;

(ii) To grant or deny requests for a determination that a natural person or municipal securities dealer subject to a statutory disqualification is qualified to act as a municipal securities representative or dealer under Municipal Securities Rulemaking Board Rule G–4;

(iii) To approve or disapprove clearing arrangements under Municipal Securities Rulemaking Board Rule G-8, in connection with the administration of these rules for municipal securities

dealers for which the Board is the appropriate regulatory agency under section 3(a)(34) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)).

(8) *Making reports available to SEC.* To make available, upon request, to the Securities and Exchange Commission reports of examination of transfer agents, clearing agencies, and municipal securities dealers for which the Board is the appropriate regulatory agency for use by the Commission in exercising its supervisory responsibilities under the Act under section 17(c)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(c)(3)).

(9) *Issuing examination manuals, forms, and other materials.* To issue examination or inspection manuals, registration, report, agreement, and examination forms, guidelines, instructions, and other similar materials for use in administering sections 7, 8, 15B, and 17A(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78g, 78h, 78o–4, and 78q–1).

(10) *Lists of OTC and foreign margin stocks.* To approve issuance of the lists of OTC margin stocks and foreign margin stocks and add, omit, or remove any stock in circumstances indicating that such change is necessary or appropriate in the public interest under § 207.6(d) of Regulation G (12 CFR part 207), § 220.17(f) of Regulation T (12 CFR part 220), or § 221.7(d) of Regulation U (12 CFR part 221).

[56 FR 25619, June 5, 1991, as amended at 56 FR 67153, 67154, Dec. 30, 1991; 57 FR 13002, Apr. 15, 1992; 58 FR 6363, Jan. 28, 1993; 58 FR 26509, May 4, 1993; 62 FR 64996, Dec. 9, 1997; 63 FR 58621, Nov. 2, 1998; 66 FR 54397, Oct. 26, 2001]

### § 265.8 Functions delegated to the Staff Director of the Division of International Finance.

The Board's Staff Director of the Division of International Finance (or the Director's delegee) is authorized:

(a) *Establishment of foreign accounts.* To approve the establishment of foreign accounts and the terms of any account-related agreements with the Federal Reserve Bank of New York under section 14(e) of the Federal Reserve Act (12 U.S.C. 358).

(b) [Reserved]

### § 265.9 Functions delegated to the Director of Division of Consumer and Community Affairs.

The Director of the Board's Division of Consumer and Community Affairs (or the Director's delegee) is authorized:

(a) *Issuing examination manuals, forms, and other materials.* To issue examination or inspection manuals; report, agreement, and examination forms; examination procedures, guidelines, instructions, and other similar materials pursuant to: section 11(a) of the Federal Reserve Act (12 U.S.C. 248(a)); sections 108(b), 621(c), 704(b), 814(c), and 917(b) of the Consumer Credit Protection Act (15 U.S.C. 1607(b), 1681s(b), 1691c(b), 1692*l*(c) and 1693o(b)); section 305(c) of the Home Mortgage Disclosure Act (12 U.S.C. 2804(c)); section 18(f)(3) of the Federal Trade Commission Act (15 U.S.C. 57a(f)(3)); section 808(c) of the Civil Rights Act of 1968 (42 U.S.C. 3608(c)); section 270(b) of the Truth in Savings Act (12 U.S.C. 4309); and section 5 of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)). The foregoing manuals, forms, and other materials are for use within the Federal Reserve System in the administration of enforcement responsibilities in connection with:

(1) Sections 1–200 and 501–921 of the Consumer Credit Protection Act (15 U.S.C. 1601–1693r), in regard to the Truth in Lending Act, the Consumer Leasing Act, the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Fair Credit Reporting Act and the Fair Debt Collection Practices Act;

(2) Sections 301–312 of the Home Mortgage Disclosure Act (12 U.S.C. 2801–2811);

(3) Section 18(f)(1)–(3) of the Federal Trade Commission Act (15 U.S.C. 57a(f)(1)–(3));

(4) Section 805 of the Civil Rights Act of 1968 (42 U.S.C. 3605) and rules and regulations issued thereunder;

(5) Section 1364 of the National Flood Insurance Act of 1968 (42 U.S.C. 4101(a)), and sections 105(b) and 202(b) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(b), 4106(b));

(6) Section 19(j) of the Federal Reserve Act (12 U.S.C. 371b); and

(7) Sections 801–806 of the Community Reinvestment Act (12 U.S.C. 2901–2905).

(8) Sections 261–274 of the Truth in Savings Act (12 U.S.C. 4301–4313).

(b) *Consumer Advisory Council.* Pursuant to section 703(b) of the Consumer Credit Protection Act (15 U.S.C. 1691b(b)), to call meetings of and consult with the Consumer Advisory Council established under that section, approve the agenda for such meetings, and accept any resignations from Consumer Advisory Council members.

(c) *Determining inconsistencies between state and federal laws.* To determine whether a state law is inconsistent with the following federal acts and regulations:

(1) Sections 111, 171(a) and 186(a) of the Truth in Lending Act (15 U.S.C. 1610(a), 1666j(a), 1667e(a)) and § 226.28 of Regulation Z (12 CFR part 226) and § 213.7 of Regulation M (12 CFR part 213);

(2) Section 919 of the Electronic Fund Transfer Act (15 U.S.C. 1693q), § 205.12 of Regulation E (12 CFR part 205);

(3) Section 705(f) of the Equal Credit Opportunity Act (15 U.S.C. 1691d(f) and § 202.11 of Regulation B (12 CFR part 202);

(4) Section 306(a) of the Home Mortgage Disclosure Act (12 U.S.C. 2805(a)) and § 203.3 of Regulation C (12 CFR part 203); and

(5) Section 273 of the Truth in Savings Act (12 U.S.C. 4312) and § 230.1 of Regulation DD (12 CFR part 230).

(d) *Interpreting the Fair Credit Reporting Act.* To issue interpretations pursuant to section 621(e) of the Fair Credit Reporting Act (15 U.S.C. 1681s(e));

(e) *Annual adjustments.* To adjust as required by law:

(1) The amount specified in section 103(aa)(1)(B)(ii) of the Truth in Lending Act and § 226.32(a)(1)(ii) of Regulation Z (12 CFR part 226), relating to mortgages bearing fees above a certain amount in accord with section 103(aa)(3) of that act (15 U.S.C. 1602(aa)); and

(2) The amount specified in section 309(b)(1) of the Home Mortgage Disclosure Act (12 U.S.C. 2808(b)(1)) and § 203.3(a)(1)(ii) of Regulation C (12 CFR part 203) relating to the asset threshold above which a depository institution must collect and report data.

(f) *Community Reinvestment Act determinations.* To make determinations, pursuant to section 804 of the Community Reinvestment Act (12 U.S.C. 2903), approving or disapproving:

(1) Strategic plans and any amendments thereto pursuant to § 228.27(g) and (h) of Regulation BB (12 CFR part 228); and

(2) Requests for designation as a wholesale or limited purpose bank or the revocation of such designation, pursuant to § 228.25(b) of Regulation BB (12 CFR part 228).

(g) *Public hearings.* To conduct hearings or other proceedings required by law, concerning consumer law or other matters within the responsibilities of the Division of Consumer and Community Affairs, in consultation with other interested divisions of the Board where appropriate.

[56 FR 25619, June 5, 1991, as amended at 56 FR 67154, Dec. 30, 1991; 58 FR 65540, Dec. 15, 1993; 63 FR 65044, Nov. 25, 1998]

### § 265.10 Functions delegated to Secretary of Federal Open Market Committee.

The Secretary of the Federal Open Market Committee (or the Deputy Secretary in the Secretary's absence) is authorized:

(a) Records of policy actions. To approve for inclusion in the Board's Annual Report to Congress, records of policy actions of the Federal Open Market Committee.

(b) [Reserved]

### § 265.11 Functions delegated to Federal Reserve Banks.

Each Federal Reserve Bank is authorized as to a member bank or other indicated organization for which the Reserve Bank is reponsible for receiving applications or registration statements or to take other actions as indicated:

(a) *Procedure*—(1) *Member bank affiliate's reports.* To extend the time for good cause shown, within which an affiliate of a state member bank must file reports under section 9(17) of the Federal Reserve Act (12 U.S.C. 334).

(2) *Edge corporation's divestiture of stock.* To extend the time in which an Edge Act corporation must divest itself of stock acquired in satisfaction of a

debt previously contracted under section 25A(9) of the Federal Reserve Act (12 U.S.C. 615).

(3) *Edge corporation's corporate existence.* To extend the period of corporate existence of an Edge corporation under section 25A(22) of the Federal Reserve Act (12 U.S.C. 628).

(4) *Bank holding company registration statement.* To extend the time within which a bank holding company must file a registration statement under section 5(a) of the Bank Holding Company Act (12 U.S.C. 1844(a)).

(5) *Bank holding company divestiture of nonbanking interests.* To extend the time within which a bank holding company must divest itself of interests in nonbanking organizations under section 4(a) of the Bank Holding Company Act (12 U.S.C. 1843(a)).

(6) *Bank holding company divestiture of dpc interests.* To extend the time within which a bank holding company or any of its subsidiaries must divest itself of interests acquired in satisfaction of a debt previously contracted:

(i) Under section 4(c)(2) of the Bank Holding Company Act (12 U.S.C. 1843(c)(2)) or § 225.22(c)(1) of Regulation Y (12 CFR part 225); or

(ii) Under sections 2(a)(5)(D) and 3(a) of the Bank Holding Company Act (12 U.S.C. 1841(a)(5)(D) and 1842(a)).

(7) *Member bank's surrender of Reserve Bank stock upon withdrawal from membership.* To extend the time within which a member bank that has given notice of intention to withdraw from membership must surrender its Federal Reserve Bank stock and its certificate of membership under Regulation H (12 CFR 209.3(e)).

(8) *Members bank's reports of condition.* To extend the time for publication of reports of condition under Regulation H (12 CFR part 208) for good cause shown.

(9) *Bank holding company's annual reports.* To grant to a bank holding company a 90-day extension of time in which to file an annual report, and for good cause shown grant an additional extension of time not to exceed 90 days under section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844(c)).

(10) *Regulation K—Divestiture of foreign portfolio investment, joint venture, or subsidiary acquired through debt previously contracted.* To extend the time within which an investor must divest itself of interests in a foreign portfolio investment, joint venture, or subsidiary acquired in satisfaction of a debt previously contracted under Regulation K (12 CFR 211.5(e)).

(11) *Bank holding company's acquisition of shares, opening new bank, consummating merger.* To extend the time within which a bank holding company may acquire shares, open a new bank to be acquired, or consummante a merger in connection with an application approved by the Board, if no material change relevant to the proposal has occurred since its approval.

(12) *Member bank's establishing domestic or foreign branch; Edge or agreement corporation's establishing branch or agency.* To extend the times within which:

(i) A member bank may establish a domestic branch;

(ii) A member bank may establish a foreign branch; or

(iii) An Edge or agreement corporation may establish a branch or agency, if no material change has occurred in the bank's (or corporation's) general condition since the application was approved.

(13) *Purchase of stock by Edge or Agreement Corporation, member bank, or bank holding company.* To extend the time within which an Edge or Agreement corporation, member bank, or a bank holding company may accomplish a purchase of stock if no material change has occurred in the general condition of the corporation, the member bank, or bank holding company since such authorization under sections 25 or 25A of the Federal Reserve Act or section 4(c)(13) of the Bank Holding Company Act (12 U.S.C. 615, 628, 1843).)

(14) *Federal Reserve Membership.* To extend the time within which Federal Reserve membership must be accomplished, if no material change has occurred in the bank's general condition since the application was approved.

(15) *Enforcement actions; written agreements; cease and desist orders.* With the prior approval of both the Board's Director of the Division of Banking Supervision and Regulation and the Board's General Counsel;

(i) To enter into a written agreement with a bank holding company or any

nonbanking subsidiary thereof, with a state member bank, or with any other person or entity subject to the Board's supervisory jurisdiction under 12 U.S.C. 1818(b) concerning the prevention or correction of an unsafe or unsound practice in conducting the business of the bank holding company, nonbanking subsidiary, or state member bank or other entity, or concerning the correction or prevention of any violation of law, rule, or regulation, or any condition imposed in writing by the Board in connection with the granting of any application or other request by the bank or company or any other appropriate matter;

(ii) To stay, modify, terminate, or suspend an agreement entered into pursuant to this paragraph;

(iii) To stay, modify, terminate, or suspend an outstanding cease and desist order that has become final pursuant to 12 U.S.C. 1818 (b) and (k). Any agreement authorized under this paragraph may, by its terms, be enforceable to the same extent and in the same manner as an effective and outstanding cease and desist order that has become final pursuant to 12 U.S.C. 1818 (b) and (k).

(16) *Appointment of assistant Federal Reserve agents.* To approve the appointment of assistant Federal Reserve agents (including representatives or alternate representatives of such agents) under section 4, paragraph 21 of the Federal Reserve Act (12 U.S.C. 306).

(b) *Availability of Information*—(1) *Availability of Information; Board records.* To make available information of the Board of the nature and in the circumstances described in the Board's Rules Regarding Availability of Information (12 CFR 261.11).

(2) [Reserved]

(c) *Bank holding companies; Change in bank control; Mergers*—(1) *Require reports under oath.* To require reports under oath to determine whether a company is complying with section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844(c)).

(2) *Acquisition of going concern—authorization of consummation; early consummation.* (i) To notify a bank holding company that, because the circumstances surrounding the application to acquire a going concern indicate that additional information is required or that the acquisition should be considered by the Board, the acquisition should not be consummated until specifically authorized by the Reserve Bank or by the Board.

(ii) To permit a bank holding company to make a proposed acquisition of a going concern before the expiration of the 30-day period referred to in Regulation Y (12 CFR 225.23(a)(2)) because exigent circumstances justify consummation of the acquisition at an earlier time.

(3) *Petition for review of decision that adverse comments are not substantive; permit proposed de novo activities; authorization of consummation; early consummation.* Under § 225.4(b)(1) of Regulation Y (12 CFR part 225) and subject to § 265.3 of this part, if a person submitting adverse comments that the Reserve Bank had decided are not substantive files a petition for review by the Board of that decision:

(i) To permit a bank holding company to engage *de novo* in activities specified in § 225.25 of Regulation Y (12 CFR part 225), or retain shares in a company established *de novo* and engaging in such activities, if the Reserve Bank's evaluation of the considerations specified in section 4(c)(8) of the Bank Holding Company Act leads it to conclude that the proposal can reasonably be expected to produce benefits to the public.

(ii) To notify a bank holding company that the proposal should not be consummated until specifically authorized by the Reserve Bank or by the Board or that the proposal should be processed in accordance with the procedures in § 225.23(a)(2) of Regulation Y (12 CFR part 225).

(iii) To permit a bank holding company to consummate the proposal before the expiration of the 45-day period referred to in § 225.23(a)(1) of Regulation Y because exigent circumstances justify consummation at an earlier time under § 225.4(b)(1) of Regulation Y (12 CFR part 225).

(4) *Permit or stay of modification or location of activities.* To permit or stay a proposed *de novo* modification or relocation of activities engaged in by a bank holding company on the same

basis as *de novo* proposals under § 265.11(d)(3) of this part.

(5) *Notices under change in Bank Control Act.* With respect to the bank holding company or a state member bank:

(i) To determine the informational sufficiency of notices and reports filed under the Change in Bank Control Act;

(ii) To extend periods for consideration of notices;

(iii) To determine whether a person who is or will be subject to a presumption described in § 225.41(b) of Regulation Y (12 CFR part 225) should file a notice regarding a proposed transaction; and

(iv) To issue a notice of intention not to disapprove a proposed change in control if all the following conditions are met:

(A) No member of the Board has indicated an objection prior to the Reserve Bank's action;

(B) No senior officer or director of an involved party is also a director of a Federal Reserve Bank or branch;

(C) All relevant departments of the Reserve Bank concur;

(D) If the proposal involves shares of a state member bank or a bank holding company controlling a state member bank, the appropriate bank supervisory authorities have indicated that they have no objection to the proposal, or no objection has been received from them within the time allowed by the act; and

(E) No significant policy issue under the change in Bank Control Act, 12 U.S.C. 1817(j) or § 225.41 of Regulation Y (12 CFR part 225) is raised by the proposal as to which the Board has not expressed its view.

(6) *Failure to comply with publication requirement under change in Bank Control Act.* To waive, dispense with, modify, or excuse the failure to comply with the requirement for publication and solicitation of public comment regarding a notice filed under the Change in Bank Control Act, with the concurrence of the Board's Director of the Division of Banking Supervision and Regulation and the Board's General Counsel, provided that a written finding is made that such disclosure or solicitation would seriously threaten the safety or soundness of a bank holding company or bank under the Change in Bank Control Act (12 U.S.C. 1817(j)(2)).

(7) *Grandfathered nonbanking activities.* To determine under section 4(a)(2) of the Bank Holding Company Act (12 U.S.C. 1843(a)(2)) that termination of grandfathered nonbanking activities of a particular bank holding company is not warranted, provided the Reserve Bank is satisfied all of the following conditions are met:

(i) The company or its successor is ''a company covered in 1970'';

(ii) The nonbanking activities for which indefinite grandfather privileges are being sought do not present any significant unsettled policy issues; and

(iii) The bank holding company was lawfully engaged in such activities as of June 30, 1968 and has been engaged in such activities continuously thereafter.

(8) *Opening of additional nonbanking offices.* To approve applications by a bank holding company under sections 4(c)(8) and 5(b) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8), 1844(b)) and § 225.23(b) of Regulation Y (12 CFR part 225) to open additional offices to engage in nonbanking activities for which the bank holding company previously received approval pursuant to Board order, unless one of the conditions specified in § 265.11(f) (1), (2), (3), or (4), of this part is present.

(9) *Notices for addition or change of directors or officers.* Under section 914(a) of the Financial Institutions Reform, Recovery and Enforcement Act (12 U.S.C. 1831i) and subpart H of Regulation Y (12 CFR part 225), provided that no senior officer or director or proposed senior officer or director of the notificant is also a director of the Reserve Bank or a branch of the Reserve Bank:

(i) To determine the informational sufficiency of notices filed pursuant to § 225.72 of Regulation Y; and

(ii) To waive the prior notice requirements of that section.

(10) *Acquisition approvals under section 5(d)(3) of the FDI Act.* To approve, under section 5(d)(3)(E) of the Federal Deposit Insurance Act, requests by a bank holding company to engage in any transaction described in section 5(d)(3)(A) of that Act.

(11) *Applications requiring Board approval; competitive factors reports for bank mergers.* To approve applications requiring prior approval of the Board and furnish to the Comptroller of the Currency and the Federal Deposit Insurance Corporation reports on competitive factors involved in a bank merger required to be approved by one of those agencies, unless one or more of the following conditions is present.

(i) A member of the Board has indicated an objection prior to the Reserve Bank's action; or

(ii) The Board has indicated that such delegated authority shall not be exercised by the Reserve Bank in whole or in part; or

(iii) A written substantive objection to the application has been properly made; or

(iv) The application raises a significant policy issue or legal question on which the Board has not established its position; or

(v) With respect to bank holding company formations, bank acquisitions or mergers, the proposed transaction involves two or more banking organizations that, upon consummation of the proposal, would control over 35 percent of total deposits (including 50 percent of thrift deposits) in banking offices in the relevant geographic market, or would result in an increase of at least 200 points in the Herfindahl-Hirschman Index (HHI) in a highly concentrated market (a market with a post-merger HHI of at least 1800); or

(vi) With respect to nonbank acquisitions, the nonbanking activities involved do not clearly fall within activities that the Board has designated as permissible for bank holding companies under § 225.25(b) of Regulation Y.

(d) *International banking*—(1) *Application to establish Edge Corporation.* To approve the application by a U.S. banking organization to establish an Edge corporation under section 25 of the Federal Reserve Act (12 U.S.C. 611) and the Board's Regulation K (12 CFR part 211) if all of the following criteria are met:

(i) The U.S. banking organization meets the capital adequacy guidelines and is otherwise in satisfactory condition;

(ii) The proposed Edge corporation will be a wholly-owned subsidiary of a single banking organization; and

(iii) No other significant policy issue is raised on which the Board has not previously expressed its view.

(2) *Issuance of permit to Edge corporation to commence business.* To issue to an Edge corporation under section 25A of the Federal Reserve Act (12 U.S.C. 612) and Regulation K, § 211.4(a) (12 CFR part 211) a final permit to commence business and to approve amendments to the articles of association of any Edge corporation to reflect the following:

(i) Any increase in capital stock where all additional shares are to be acquired by existing shareholders;

(ii) Any change in the location of the home office in the city where the Edge corporation is presently located;

(iii) Any change in the number of members of the board of directors;

(iv) Any change in the name; and

(v) Deletion of the requirements that all directors and shareholders must be U.S. citizens.

(3) *Edge corporation establishing branch abroad.* To approve, under § 211.3(a) Regulation K (12 CFR part 211), an Edge corporation application to establish a branch abroad, provided that no senior officer or director of the involved parties is also a director of a Reserve Bank or branch and that no significant policy issue is raised by the proposal as to which the Board has not expressed its view.

(4) *Member bank establishing foreign branch.* To approve under § 211.3(a) of Regulation K (12 CFR part 211) a member bank's establishing, directly or indirectly, a foreign branch where the application is not one for a full-service branch in a foreign country, provided that no senior officer or director of the involved parties is also a director of a Reserve Bank or branch and that no significant policy issue is raised by the proposal as to which the Board has not expressed its view.

(5) *Agreement with foreign bank concerning deposits of out-of-home-state branch.* To enter into an agreement or undertaking with a foreign bank that it shall receive only such deposits at its out-of-home-state branch as would be permissible for an Edge corporation

under section 5 of the International Banking Act (12 U.S.C. 3103).

(6) *Waiver of 30-day prior notification period.* To waive the 30-day prior notification period with respect to a foreign bank's change of home state under § 211.22(c)(1) of Regulation K (12 CFR part 211).

(7) *Granting specific consent.* To grant prior specific consent to an investor for an investment in its first subsidiary or its first joint venture, where such investment does not exceed the general consent limitations under 211.5(c) of Regulation K (12 CFR part 211).

(8) *Authority under prior-notice procedures.* (i) With regard to a prior notice to make an investment under § 211.9(f) of Regulation K (12 CFR 211.9(f)):

(A) To suspend the notice period; or

(B) To require the notificant to file an application for the Board's specific consent.

(ii) With regard to a prior notice of a foreign bank to establish certain U.S. offices under § 211.24(a)(2)(i) of Regulation K (12 CFR 211.24(a)(2)(i)):

(A) To suspend the notice period; or

(B) To require that the foreign bank file an application for the Board's specific consent.

(9) *Investment in export trading company.* To issue a notice of intention not to disapprove a proposed investment in an export trading company if all the following criteria are met:

(i) The proposed export trading company will be a wholly-owned subsidiary of a single investor, or ownership will be shared with an individual or individuals involved in the operation of the export trading company;

(ii) A bank holding company investor and its lead bank meet the minimum capital adequacy guidelines of the Board, the Comptroller of the Currency, or the Federal Deposit Insurance Corporation or have enacted capital enhancement plans that have been determined by the appropriate supervisory authority to be acceptable.

(iii) The proposed activities of the export trading company do not include product research or design, product modification, or activities not specifically covered by the list of services contained in 4(c)(14)(F)(ii) of the Bank Holding Company Act (12 U.S.C. 1843(c)(14)(F)(ii));

(iv) No other significant policy issue is raised on which the Board has not previously expressed its view under section 4(c)(14) of the Bank Holding Company Act (12 U.S.C. 1843(c)(14) and Regulation K (12 CFR 211.31–211.34).

(10) *Futures commission merchant activities.* To approve, under § 211.5(d)(17) of Regulation K (12 CFR part 211), applications to engage in futures commission merchant activities on an exchange that requires members to guarantee or otherwise contract to cover losses suffered by the other members, provided that the Board has previously approved the exchange and the application is on the same terms and conditions on which the Board based its approval of the exchange.

(11) *Investments in Edge and agreement Corporation subsidiaries.* To approve an application by a member bank to invest more than 10 percent of capital and surplus in Edge and agreement corporation subsidiaries, provided that:

(i) The member bank's total investment, including the retained earnings of the Edge and agreement corporation subsidiaries, does not exceed 20 percent of the bank's capital and surplus or would not exceed that level as a result of the proposal; and

(ii) The proposal raises no significant policy or supervisory issues.

(12) *Amendments to Edge corporation charters.* To approve amendments to Edge corporation charters.

(e) *Member banks*—(1) *Approval of membership applications.* To approve applications for membership in the Federal Reserve System under section 9 of the Federal Reserve Act (12 USC 321 *et seq.*) and Regulation H (12 CFR part 208) if the Reserve Bank is satisfied that approval is warranted after considering the factors set forth in 12 CFR 208.3(b).

(2) *Waiver of notice of intention to withdraw from membership.* To approve or deny applications by state banks for waiver of the required six months' notice of intention to withdraw from Federal Reserve membership under section 9(10) of the Federal Reserve Act (12 U.S.C. 328).

(3) *Approval of branch applications.* To approve a state member bank's establishment of a domestic branch under section 9 of the Federal Reserve Act (12

USC 321 *et seq.*) and Regulation H (12 CFR part 208) if the Reserve Bank is satisfied that approval is warranted after considering the factors set forth in 12 CFR 208.6(b).

(4) *Declaration of dividends in excess of net profits.* To permit a state member bank under section 9(6) of the Federal Reserve Act (12 USC 324 and 60) to declare dividends in excess of the amounts allowed in 12 CFR 208.5(c) if the Reserve Bank is satisfied that approval is warranted after giving consideration to:

(i) The banks capitalization in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the volume of its risk assets and of its marginal and inferior quality assets, all considered in relation to the strength of its management; and

(ii) The bank's capitalization after payment of the proposed dividends.

(5) *Reduction of capital stock.* To permit a state member bank under section 9(11) of the Federal Reserve Act (12 USC 239) to reduce its capital stock below the amounts set forth in 12 CFR 208.5(d) if the state member bank's capitalization thereafter will be:

(i) In conformity with the requirements of federal law; and

(ii) Adequate in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the volume of its risk assets and of its marginal and inferior quality assets, all considered in relation to the strength of its management.

(6) *Acceptance of drafts and bills of exchange.* To permit a member bank or a federal or state branch or agency of a foreign bank that is subject to reserve requirements under section 7 of the International Banking Act of 1978 (12 U.S.C. 3105) to accept drafts or bills of exchange under section 13(7) of the Federal Reserve Act (12 U.S.C. 372) in an aggregate amount at any one time up to 200 percent of its paid-up and unimpaired capital stock and surplus, if the Reserve Bank is satisfied that such permission is warranted after giving consideration to the institution's capitalization in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the volume of its risk assets and of its marginal and inferior-quality assets, all considered in relation to the strength of its management.

(7) *Investment in bank premises in excess of capital stock.* To permit a state member bank to invest in bank premises under section 24A of the Federal Reserve Act (12 USC 371a) in an amount in excess of that set forth in 12 CFR 208.21(a), if the Reserve Bank is satisfied that approval is warranted after giving consideration to the bank's capitalization in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the volume of its risk assets and of its marginal and inferior quality assets, all considered in relation to the strength of its management.

(8) *Security devices.* To determine whether security devices and procedures of state member banks are deficient in meeting the requirements of Regulation H (12 CFR part 208) and whether such requirements should be varied in the circumstances of a particular banking office, and whether to require corrective action.

(9) *Classifying member banks for election of directors.* To classify member banks for the purposes of electing Federal Reserve Bank class A and class B directors under section 4(16) of the Federal Reserve Act (12 U.S.C. 304), giving consideration to:

(i) The statutory requirement that each of the three groups shall consist as nearly as may be of banks of similar capitalization; and

(ii) The desirability that every member bank have the opportunity to vote for a class A or a class B director at least once every three years.

(10) *Waiver of penalty for deficient reserves.* To waive the penalty for deficient reserves by a member bank if, after a review of all the circumstances relating to the deficiency, the Reserve Bank concludes that waiver is warranted, except that in no case may a penalty be waived if the deficiency in reserves arises out of the bank's gross negligence or conduct inconsistent with the principles and purposes of reserve requirements.

(11) *Retirement of subordinated debt.* To approve the retirement prior to maturity of capital notes described in §204.2(a)(1)(vii)(C) of Regulation D (12 CFR part 204) and issued by a state member bank, provided the Reserve Bank is satisfied that the capital position of the bank will be adequate after the proposed redemption.

(12) *Public welfare investments.* To permit a state member bank to make a public welfare investment that meets the conditions of 12 CFR 208.22(b)(1)–(3), (b)(5) and (b)(7), if the Reserve Bank is satisfied that:

(i) The state member bank received at least an overall rating of ''3'' as of its most recent consumer compliance examination; and

(ii) The aggregate of all such investments of the state member bank does not exceed 10 percent of its capital stock and surplus as defined under 12 CFR 208.2(d).

(f) *Securities.* To approve applications by a registered lender for termination of the registration under §221.3(b)(2) of Regulation U (12 CFR 221.3(b)(2)).

(g) *Management interlocks*—(1) *Change in circumstances requiring termination of management interlocks; Regulation L.* To grant time for compliance with §121.6 of Regulation L (12 CFR part 212) of up to an aggregate of 15 months from the date on which the change in circumstances as specified in that section occurs when the additional time appears to be appropriate to avoid undue disruption to the depository organizations involved in the management interlocks.

(2) *Depository Institutions Management Interlocks Act.* After consultation with the General Counsel of the Board, to decide not to disapprove notices to establish director interlocks with diversified savings and loan holding companies. (12 U.S.C. 3204(8)).

[56 FR 25619, June 5, 1991, as amended at 56 FR 67154, Dec. 30, 1991; 57 FR 11907, Apr. 8, 1992; 57 FR 40600, Sept. 4, 1992; 58 FR 6363, Jan. 28, 1993; 59 FR 22968, May 4, 1994; 60 FR 22257, May 5, 1995; 63 FR 2839, Jan. 16, 1998; 63 FR 58622, Nov. 2, 1998; 66 FR 54398, Oct. 26, 2001; 66 FR 58656, Nov. 23, 2001]

# PART 266—LIMITATIONS ON ACTIVITIES OF FORMER MEMBERS AND EMPLOYEES OF THE BOARD

Sec.
266.1 Basis and scope.
266.2 Definitions.
266.3 Limitations.
266.4 Suspension of appearance privilege.
266.5 Criminal penalties.

AUTHORITY: Sec. 11(i), Federal Reserve Act (12 U.S.C. 248(i)); 5 U.S.C. 552.

SOURCE: 38 FR 31672, Nov. 16, 1973, unless otherwise noted.

## §266.1 Basis and scope.

This part, issued under authority of section 11(i) of the Federal Reserve Act (12 U.S.C. 248(i)), and pursuant to section 552 of title 5 of the United States Code, which requires that every agency shall publish in the FEDERAL REGISTER its rules of procedure, relates to limitations on former members and employees of the Board with respect to participation in matters connected with their former duties and official responsibilities while serving with the Board.[1]

## §266.2 Definitions.

(a) *Employee* means a regular officer or employee of the Board; it does not include a consultant to the Board.[2]

(b) *Official responsibility*, with respect to a matter, means administrative, supervisory, or decisional authority, whether intermediate or final, exercisable alone or with others, personally or through subordinates, to approve, disapprove, decide, or recommend

[1] While the Board has not adopted rules with regard to the disclosure of unpublished information by former Board members and employees, it advises such persons not to disclose unpublished information of the Board obtained in the course of their work. Questions in this regard may be addressed to the General Counsel or the Secretary of the Board.

[2] While former consultants to the Board are not covered by these Rules, they appear to fall within the coverage of section 207 of the United States Criminal Code (18 U.S.C. 207) that provides criminal penalties for engaging in activities similar, although not identical, to those described in paragraphs (a) and (b) of §266.3.

Board action or to express staff opinions in dealings with the public.

(c) *Appear personally* includes personal appearance or attendance before, or personal communication, either written or oral, with the Board or a Federal Reserve Bank of any member or employee thereof, or personal participation in the formulation or preparation of any material presented or communicated to, or filed with, the Board, in connection with any application or interpretation arising under the statutes or regulations administered by the Board or the Federal Reserve Banks, except that requests for general information or explanations of Board policy or interpretation shall not be construed to be a personal appearance.

**§ 266.3 Limitations.**

(a) *Matters on which Board member or employee worked.* No former member or employee of the Board shall appear personally before the Board or a Federal Reserve Bank on behalf of anyone other than the United States, an agency thereof, or a Federal Reserve Bank, in connection with any judicial or other proceedings, application, request for ruling or determination, or other particular matter involving a specific party or parties in which the United States, an agency thereof, or a Federal Reserve Bank is also a party or has a direct and substantial interest and in which he participated personally and substantially as a member or employee of the Board through approval, disapproval, decision, recommendation, advice, investigation or otherwise.

(b) *Matters within Board member or employee's official responsibility.* No former member or employee of the Board shall appear personally before the Board or a Federal Reserve Bank on behalf of anyone other than the United States, an agency thereof, or a Federal Reserve Bank, in connection with any judicial or other proceeding, application, request for ruling or determination, or other particular matter involving a specific party or parties in which the United States, an agency thereof, or a Federal Reserve Bank is also a party or has a direct and substantial interest, and which matter was in process during his tenure of office or period of employment and under his official Board responsibility, at any time within a period of one year after the termination of such responsibility.

(c) *Consultation as to propriety of appearance before the Board.* Any former member or employee of the Board who wishes to personally appear before the Board or a Federal Reserve Bank on behalf of any party other than the United States or an agency thereof or a Federal Reserve Bank at any time within two years from termination of employment with the Board is advised to consult the General Counsel or the Secretary of the Board as to the propriety of such appearance.

(d) *Rulemaking proceedings.* Nothing in this section shall preclude a former member or employee of the Board from representing another person in any Board or Federal Reserve Bank proceeding governed by a rule, regulation, standard, or policy of the Board solely by reason of the fact that such former member or employee participated in or had official responsibility in the formation or adoption of such rule, regulation, standard, or policy.

(e) *Effective date.* This part shall become effective November 6, 1973. Notwithstanding the foregoing, the limitations of this part shall not apply to any activities with respect to a specific matter before the Board in which any former Board member or employee may be engaged on September 21, 1973, the date of publication of this part, until the expiration of 60 days following the effective date of this part or of such additional period as the Secretary of the Board may determine to be appropriate in order to avoid inequity.

**§ 266.4 Suspension of appearance privilege.**

If any person knowingly and willfully fails to comply with the provisions of this part, the Board may decline to permit such person to appear personally before it or a Federal Reserve Bank for such periods of time as it may determine and may impose such other sanctions as the Board may deem just and proper.

**§ 266.5 Criminal penalties.**

Any former member or employee of the Board who engages in actions in

contravention of paragraph (a) or (b) of § 266.3 may be subject to criminal penalties for violation of section 207 of the United States Criminal Code (18 U.S.C. 207).

# PART 267—RULES OF ORGANIZATION AND PROCEDURE OF THE CONSUMER ADVISORY COUNCIL

Sec.
267.1 Statutory authority.
267.2 Purposes and objectives of the Council.
267.3 Members.
267.4 Officers.
267.5 Meetings.
267.6 Amendments.

AUTHORITY: Sec. 703, Equal Credit Opportunity Act, as amended in Pub. L. 94–239.

SOURCE: 41 FR 49802, Nov. 11, 1976, unless otherwise noted.

## § 267.1 Statutory authority.

Section 703 of the Equal Credit Opportunity Act, as amended, provides:

The Board [of Governors of the Federal Reserve System] shall establish a Consumer Advisory Council to advise and consult with it in the exercise of its functions under the Consumer Credit Protection Act and to advise and consult with it concerning other consumer related matters it may place before the Council. In appointing the members of the Council, the Board shall seek to achieve a fair representation of the interests of creditors and consumers. The Council shall meet from time to time at the call of the Board. Members of the Council who are not regular full-time employees of the United States shall, while attending meetings of such Council, be entitled to receive compensation at a rate fixed by the Board, but not exceeding $100 per day, including travel time. Such members may be allowed travel expenses, including transportation and subsistence, while away from their homes or regular place of business.

## § 267.2 Purposes and objectives of the Council.

The Council shall advise and consult with the Board in the exercise of the Board's functions under the Consumer Credit Protection Act and with regard to other matters the Board may place before the Council.

## § 267.3 Members.

(a) The Council shall consist of not more than 30 members appointed by the Board. The term of office of each member of the Council shall be three years. However, the initial terms of the members first taking office shall expire as follows: approximately one-third on December 31, 1977, and approximately one-third at the end of each of the two succeeding calendar years. After the expiration of any member's term of office, such member may continue to serve until a successor has been appointed by the Board. The Board shall have the authority to appoint persons to fill vacancies on the Council.

(b) *Resignation*. Any member may resign at any time by giving notice to the Board. Any such resignation shall take effect upon its acceptance by the Board.

(c) *Compensation*. Members who are not regular full-time employees of the United States shall be paid travel expenses, including transportation and subsistence, and compensation of $100 for each day devoted to attending and traveling to and from meetings.

## § 267.4 Officers.

(a) *Chairman*. The Board shall appoint a Chairman and a Vice Chairman from among the members of the Council, who shall serve at the pleasure of the Board. The Chairman, or in the Chairman's absence the Vice Chairman, shall preside at all meetings of the Council. The Board may appoint a Chairman pro tem who shall preside at a meeting of the Council in the absence of the Chairman and Vice Chairman.

(b) *Secretary*. The Board shall designate a member of its staff, who may but need not be the representative described in § 267.5(c), to act as Secretary of the Council. The Secretary shall record and maintain minutes of the meetings of the Council. Minutes of each meeting shall contain, among other things, a record of the persons present, a description of the matters discussed, and recommendations made. The person acting as Secretary at a meeting shall certify to the accuracy of the minutes of that meeting.

**§ 267.5 Meetings.**

(a) *Time.* Meetings of the Council shall be held at least once each year and may be held more frequently at the call of the Board.

(b) *Agenda.* Each meeting of the Council shall be conducted in accordance with an agenda formulated or approved by the Board.

(c) *Board representation.* Each meeting of the Council shall be attended by a representative of the Board who is either a member of the Board or of the Board's staff. The Board representative shall have authority to and shall adjourn any meeting of the Council when such representative considers adjournment to be in the public interest.

(d) *Public nature.* (1) Each meeting of the Council shall, to the extent of reasonably available facilities, be open to public observation unless the Board, in accordance with paragraph (d)(6), of this section, determines that the meeting shall be closed.

(2) Notice of the time, place and purpose of each meeting, as well as a summary of the proposed agenda, shall be published in the FEDERAL REGISTER not more than 45 or less than 15 days prior to the scheduled meeting date. Insofar as is practicable, a list of persons and organizations interested in the Council shall be maintained, and a notice of each meeting shall be mailed to such persons and organizations at least 15 days in advance of the scheduled meeting date. Shorter notice may be given when the Board determines that its business so requires; in such event, the public, including persons and organizations described in the preceding sentence, will be given notice at the earliest practicable time.

(3) Members of the public may file written statements with the Council prior to the meeting concerning matters on the Council's agenda. The person presiding at the Council meeting may permit members of the public to submit written statements on such matters within a specified time after the Council meeting. All such submissions shall be circulated to the Council members as soon as is practicable.

(4) Oral presentations at the Council meetings by members of the public shall not be permitted except upon invitation of the Council. However, if the Council and the Board determine that public hearings regarding a matter or matters of concern to the Council are warranted, members of the public may make presentations at such hearings in accordance with procedures established therefor.

(5) Minutes of meetings, records, reports, studies, and agenda of the Council shall be available to the public for copying at the Board's offices in Washington, DC, in accordance with the provisions of 12 CFR part 261 Rules Regarding Availability of Information. Requests for copies of such documents should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551.

(6) The Board may close to the public any meeting, or any portion of any meeting, of the Council if it determines that such meeting or portion thereof is likely to:

(i) Disclose matters that relate solely to internal personnel rules and practices of the Council;

(ii) Disclose trade secrets and commercial or financial information obtained from a person and privileged or confidential;

(iii) Involve accusing any person of a crime, or formally censuring any person;

(iv) Disclose information of a personal nature where disclosure would constitute a clearly unwarranted invasion of personal privacy;

(v) Disclose information contained in or related to examination, operating or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions;

(vi) Disclose information the premature disclosure of which would be likely to lead to significant financial speculation in currencies, securities, or commodities or significantly endanger the stability of any financial institution;

(vii) Disclose information the premature disclosure of which would be likely to frustrate significantly implementation of a proposed Board action, unless the Board has already disclosed to the public the content or nature of its proposed action, or where the Board

is required by law to make such disclosure on its own initiative prior to taking final action on the proposal; or

(viii) Which relate to any legal proceedings, agency adjudicatory proceeding or arbitration involving the Board or the Council.

(e) If the Board closes a meeting or any portion of a meeting, the Council will issue, at least annually, a report containing a summary, consistent with 5 U.S.C. 552(b) (1970), of the Council's activities during such closed meetings or portions of meetings.

### § 267.6 Amendments.

These rules of organization and procedure may be amended or repealed at any time by action of the Board, provided, however, that members of the Council shall be promptly notified by the Board of any such action.

## PART 268—RULES REGARDING EQUAL OPPORTUNITY

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AUTHORITY: 12 U.S.C. 244 and 248(i), (k) and (1).

SOURCE: 68 FR 18085, Apr. 15, 2003, unless otherwise noted.

## Subpart A—General Provisions and Administration

### § 268.1 Authority, purpose and scope.

(a) *Authority*. The regulations in this part (12 CFR part 268) are issued by the Board of Governors of the Federal Reserve System (Board) under the authority of sections 10(4) and 11(i), (k), and (l) of the Federal Reserve Act (partially codified in 12 U.S.C. 244 and 248(i), (k) and (1)).

(b) *Purpose and scope*. This part sets forth the Board's policy, program and procedures for providing equal opportunity to Board employees and applicants for employment without regard to race, color, religion, sex, national origin, age, or physical or mental disability. It also sets forth the Board's policy, program and procedures for prohibiting discrimination on the basis of physical or mental disability in programs and activities conducted by the Board. It also specifies the circumstances under which the Board will hire or decline to hire persons who are not citizens of the United States, consistent with the Board's operational needs and applicable law.

### § 268.2 Definitions.

The definitions contained in this section shall have the following meanings throughout this part unless otherwise stated.

(a) *Commission or EEOC* means the Equal Employment Opportunity Commission.

(b) *Title VII* means Title VII of the Civil Rights Act (42 U.S.C. 2000e *et seq.*).

## Subpart B—Board Program To Promote Equal Opportunity

### § 268.101 General policy for equal opportunity.

(a) It is the policy of the Board to provide equal opportunity in employment for all persons, to prohibit discrimination in employment because of race, color, religion, sex, national origin, age or disability, and to promote the full realization of equal opportunity in employment through a continuing affirmative program.

(b) No person shall be subject to retaliation for opposing any practice made unlawful by Title VII of the Civil Rights Act (title VII) (42 U.S.C. 2000e *et seq.*), the Age Discrimination in Employment Act (ADEA) (29 U.S.C. 621 *et seq.*), the Equal Pay Act (29 U.S.C. 206(d)), or the Rehabilitation Act (29 U.S.C. 791 *et seq.*) or for participating in any stage of administrative or judicial proceedings under those statutes.

### § 268.102 Board program for equal employment opportunity.

(a) The Board shall maintain a continuing affirmative program to promote equal opportunity and to identify and eliminate discriminatory practices and policies. In support of this program, the Board shall:

(1) Provide sufficient resources to its equal opportunity program to ensure efficient and successful operation;

(2) Provide for the prompt, fair and impartial processing of complaints in accordance with this part and the instructions contained in the Commission's Management Directives;

(3) Conduct a continuing campaign to eradicate every form of prejudice or discrimination from the Board's personnel policies, practices and working conditions;

(4) Communicate the Board's equal employment opportunity policy and program and its employment needs to all sources of job candidates without regard to race, color, religion, sex, national origin, age or disability, and solicit their recruitment assistance on a continuing basis;

(5) Review, evaluate and control managerial and supervisory performance in such a manner as to insure a continuing affirmative application and vigorous enforcement of the policy of equal opportunity, and provide orientation, training and advice to managers and supervisors to assure their understanding and implementation of the equal employment opportunity policy and program;

(6) Take appropriate disciplinary action against employees who engage in discriminatory practices;

(7) Make reasonable accommodation to the religious needs of employees and applicants for employment when those accommodations can be made without undue hardship on the business of the Board;

(8) Make reasonable accommodation to the known physical or mental limitations of qualified applicants and employees with a disability unless the accommodation would impose an undue hardship on the operations of the Board's program;

(9) Provide recognition to employees, supervisors, managers and units demonstrating superior accomplishment in equal employment opportunity;

(10) Establish a system for periodically evaluating the effectiveness of the Board's overall equal employment opportunity effort;

(11) Provide the maximum feasible opportunity to employees to enhance their skills through on-the-job training, work-study programs and other training measures so that they may perform at their highest potential and advance in accordance with their abilities;

(12) Inform its employees and recognized labor organizations of the Board's affirmative equal opportunity policy and program and enlist their cooperation; and

(13) Participate at the community level with other employers, with schools and universities and with other public and private groups in cooperative action to improve employment opportunities and community conditions that affect employability.

(b) In order to implement its program, the Board shall:

(1) Develop the plans, procedures and regulations necessary to carry out its program;

(2) Establish or make available an alternative dispute resolution program. Such program must be available for both the precomplaint process and the formal complaint process.

(3) Appraise its personnel operations at regular intervals to assure their conformity with the Board's program, this part 268 and the instructions contained in the Commission's management directives;

(4) Designate a Director for Equal Employment Opportunity (EEO Programs Director), EEO Officer(s), and such Special Emphasis Program Managers/Coordinators (*e.g.*, People with Disabilities Program, Federal Women's Program and Hispanic Employment Program), clerical and administrative support as may be necessary to carry out the functions described in this part in all organizational units of the Board and at all Board installations. The EEO Programs Director shall be under the immediate supervision of the Chairman.

(5) Make written materials available to all employees and applicants informing them of the variety of equal employment opportunity programs and administrative and judicial remedial procedures available to them and prominently post such written materials in all personnel and EEO offices and throughout the workplace;

(6) Ensure that full cooperation is provided by all Board employees to EEO Counselors and Board EEO personnel in the processing and resolution of pre-complaint matters and complaints within the Board and that full cooperation is provided to the Commission in the course of appeals, including, granting the Commission routine access to personnel records of the Board when required in connection with an investigation;

(7) Publicize to all employees and post at all times the names, business telephone numbers and business addresses of the EEO Counselors (unless the counseling function is centralized, in which case only the telephone number and address need be publicized and posted), a notice of the time limits and necessity of contacting a Counselor before filing a complaint and the telephone numbers and addresses of the EEO Programs Director, EEO Officer(s) and the Special Emphasis Program Managers/Coordinators.

(c) The EEO Programs Director shall be responsible for:

(1) Advising the Board of Governors with respect to the preparation of national and regional equal employment opportunity plans, procedures, regulations, reports and other matters pertaining to the policy in § 268.101 and the Board's program;

(2) Evaluating from time to time the sufficiency of the total Board program for equal employment opportunity and reporting to the Board of Governors with recommendations as to any improvement or correction needed, including remedial or disciplinary action

with respect to managerial, supervisory or other employees who have failed in their responsibilities;

(3) When authorized by the Board of Governors, making changes in programs and procedures designed to eliminate discriminatory practices and to improve the Board's program for equal employment opportunity;

(4) Providing for counseling of aggrieved individuals and for the receipt and processing of individual and class complaints of discrimination; and

(5) Assuring that individual complaints are fairly and thoroughly investigated and that final action is taken in a timely manner in accordance with this part.

(d) Directives, instructions, forms and other Commission materials referenced in this part may be obtained in accordance with the provisions of 29 CFR 1610.7.

### § 268.103 Complaints of discrimination covered by this part.

(a) Individual and class complaints of employment discrimination and retaliation prohibited by title VII (discrimination on the basis of race, color, religion, sex and national origin), the ADEA (discrimination on the basis of age when the aggrieved person is at least 40 years of age), the Rehabilitation Act (discrimination on the basis of disability), or the Equal Pay Act (sex-based wage discrimination) shall be processed in accordance with this part. Complaints alleging retaliation prohibited by these statutes are considered to be complaints of discrimination for purposes of this part.

(b) This part applies to all Board employees and applicants for employment at the Board, and to all employment policies or practices affecting Board employees or applicants for employment.

(c) This part does not apply to Equal Pay Act complaints of employees whose services are performed within a foreign country or certain United States territories as provided in 29 U.S.C. 213(f).

### § 268.104 Pre-complaint processing.

(a) Aggrieved persons who believe they have been discriminated against on the basis of race, color, religion, sex, national origin, age or disability must consult a Counselor prior to filing a complaint in order to try to informally resolve the matter.

(1) An aggrieved person must initiate contact with a Counselor within 45 days of the date of the matter alleged to be discriminatory or, in the case of a personnel action, within 45 days of the effective date of the action.

(2) The Board or the Commission shall extend the 45-day time limit in paragraph (a)(1) of this section when the individual shows that he or she was not notified of the time limits and was not otherwise aware of them, that he or she did not know and reasonably should not have known that the discriminatory matter or personnel action occurred, that despite due diligence he or she was prevented by circumstances beyond his or her control from contacting the counselor within the time limits, or for other reasons considered sufficient by the Board or the Commission.

(b)(1) At the initial counseling session, Counselors must advise individuals in writing of their rights and responsibilities, including the right to request a hearing or an immediate final decision after an investigation by the Board in accordance with § 268.107(f), election rights pursuant to § 268.302, the right to file a notice of intent to sue pursuant to § 268.201(a) and a lawsuit under the ADEA instead of an administrative complaint of age discrimination under this part, the duty to mitigate damages, administrative and court time frames, and that only the claims raised in precomplaint counseling (or issues or claims like or related to issues or claims raised in precomplaint counseling) may be alleged in a subsequent complaint filed with the Board. Counselors must advise individuals of their duty to keep the Board and the Commission informed of their current address and to serve copies of appeal papers on the Board. The notice required by paragraphs (d) or (e) of this section shall include a notice of the right to file a class complaint. If the aggrieved person informs the Counselor that he or she wishes to file a class complaint, the Counselor shall explain the class complaint procedures

and the responsibilities of a class agent.

(2) Counselors shall advise aggrieved persons that, where the Board agrees to offer ADR in the particular case, they may choose between participation in the alternative dispute resolution program and the counseling activities provided for in paragraph (c) of this section.

(c) Counselors shall conduct counseling activities in accordance with instructions contained in Commission Management Directives. When advised that a complaint has been filed by an aggrieved person, the Counselor shall submit a written report within 15 days to the EEO Programs Director and the aggrieved person concerning the issues discussed and actions taken during counseling.

(d) Unless the aggrieved person agrees to a longer counseling period under paragraph (e) of this section, or the aggrieved person chooses an alternative dispute resolution procedure in accordance with paragraph (b)(2) of this section, the Counselor shall conduct the final interview with the aggrieved person within 30 days of the date the aggrieved person contacted the Board's EEO Programs Office to request counseling. If the matter has not been resolved, the aggrieved person shall be informed in writing by the Counselor, not later than the thirtieth day after contacting the Counselor, of the right to file a discrimination complaint with the Board. This notice shall inform the complainant of the right to file a discrimination complaint within 15 days of receipt of the notice, of the appropriate official with whom to file a complaint and of the complainant's duty to assure that the EEO Programs Director is informed immediately if the complainant retains counsel or a representative.

(e) Prior to the end of the 30-day period, the aggrieved person may agree in writing with the Board to postpone the final interview and extend the counseling period for an additional period of no more than 60 days. If the matter has not been resolved before the conclusion of the agreed extension, the notice described in paragraph (d) of this section shall be issued.

(f) Where the aggrieved person chooses to participate in an alternative dispute resolution procedure in accordance with paragraph (b)(2) of this section, the pre-complaint processing period shall be 90 days. If the claim has not been resolved before the 90th day, the notice described in paragraph (d) of this section shall be issued.

(g) The Counselor shall not attempt in any way to restrain the aggrieved person from filing a complaint. The Counselor shall not reveal the identity of an aggrieved person who consulted the Counselor, except when authorized to do so by the aggrieved person, or until the Board has received a discrimination complaint under this part from that person involving the same matter.

**§ 268.105 Individual complaints.**

(a) A complaint must be filed with the agency that allegedly discriminated against the complainant.

(b) A complaint must be filed within 15 days of receipt of the notice required by § 268.104 (d), (e) or (f).

(c) A complaint must contain a signed statement from the person claiming to be aggrieved or that person's attorney. This statement must be sufficiently precise to identify the aggrieved individual and the Board and to describe generally the action(s) or practice(s) that form the basis of the complaint. The complaint must also contain a telephone number and address where the complainant or the representative can be contacted.

(d) A complainant may amend a complaint at any time prior to the conclusion of the investigation to include issues or claims like or related to those raised in the complaint. After requesting a hearing, a complainant may file a motion with the administrative judge to amend a complaint to include issues or claims like or related to those raised in the complaint.

(e) The Board shall acknowledge receipt of a complaint or an amendment to a complaint in writing and inform the complainant of the date on which the complaint or amendment was filed. The Board shall advise the complainant in the acknowledgment of the EEOC office and its address where a request for a hearing shall be sent. Such

acknowledgment shall also advise the complainant that:

(1) The complainant has the right to appeal the final action on or dismissal of a complaint; and

(2) The Board is required to conduct an impartial and appropriate investigation of the complaint within 180 days of the filing of the complaint unless the parties agree in writing to extend the time period. When a complaint has been amended, the Board shall complete its investigation within the earlier of 180 days after the last amendment to the complaint or 360 days after the filing of the original complaint, except that the complainant may request a hearing from an administrative judge on the consolidated complaints any time after 180 days from the date of the first filed complaint.

**§ 268.106 Dismissals of complaints.**

(a) Prior to a request for a hearing in a case, the Board shall dismiss an entire complaint:

(1) That fails to state a claim under § 268.103 or § 268.105(a), or states the same claim that is pending before or has been decided by the Board or the Commission;

(2) That fails to comply with the applicable time limits contained in §§ 268.104, 268.105 and 268.204(c), unless the Board extends the time limits in accordance with § 268.604(c), or that raises a matter that has not been brought to the attention of a Counselor and is not like or related to a matter that has been brought to the attention of a Counselor;

(3) That is the basis of a pending civil action in a United States District Court in which the complainant is a party provided that at least 180 days have passed since the filing of the administrative complaint, or that was the basis of a civil action decided by a United States District Court in which the complainant was a party;

(4) Where a complainant has raised the matter in an appeal to the Merit Systems Protection Board and § 268.302 indicates that the complainant has elected to pursue the non-EEO process;

(5) That is moot or alleges that a proposal to take a personnel action, or other preliminary step to taking a personnel action, is discriminatory;

(6) Where the complainant cannot be located, provided that reasonable efforts have been made to locate the complainant and the complainant has not responded within 15 days to a notice of proposed dismissal sent to his or her last known address;

(7) Where the Board has provided the complainant with a written request to provide relevant information or otherwise proceed with the complaint, and the complainant has failed to respond to the request within 15 days of its receipt or the complainant's response does not address the Board's request, provided that the request included a notice of the proposed dismissal. Instead of dismissing for failure to cooperate, the complaint may be adjudicated if sufficient information for that purpose is available;

(8) That alleges dissatisfaction with the processing of a previously filed complaint; or

(9) Where the Board, strictly applying the criteria set forth in Commission decisions, finds that the complaint is part of a clear pattern of misuse of the EEO process for a purpose other than the prevention and elimination of employment discrimination. A clear pattern of misuse of the EEO process requires:

(i) Evidence of multiple complaint filings; and

(ii) Allegations that are similar or identical, lack specificity or involve matters previously resolved; or

(iii) Evidence of circumventing other administrative processes, retaliating against the Board's in-house administrative processes or overburdening the EEO complaint system.

(b) Where the Board believes that some but not all of the claims in a complaint should be dismissed for the reasons contained in paragraphs (a)(1) through (9) of this section, the Board shall notify the complainant in writing of its determination, the rationale for that determination and that those claims will not be investigated, and shall place a copy of the notice in the investigative file. A determination under this paragraph is reviewable by an administrative judge if a hearing is requested on the remainder of the complaint, but is not appealable until final

action is taken on the remainder of the complaint.

**§ 268.107 Investigation of complaints.**

(a) The investigation of complaints filed against the Board shall be conducted by the Board.

(b) In accordance with instructions contained in Commission Management Directives, the Board shall develop an impartial and appropriate factual record upon which to make findings on the claims raised by the written complaint. An appropriate factual record is one that allows a reasonable fact finder to draw conclusions as to whether discrimination occurred. The Board may use an exchange of letters or memoranda, interrogatories, investigations, fact-finding conferences or any other fact-finding methods that efficiently and thoroughly address the matters at issue. The Board may incorporate alternative dispute resolution techniques into its investigative efforts in order to promote early resolution of complaints.

(c) The procedures in paragraphs (c)(1) through (3) of this section apply to the investigation of complaints:

(1) The complainant, the Board, and any employee of the Board shall produce such documentary and testimonial evidence as the investigator deems necessary.

(2) Investigators are authorized to administer oaths. Statements of witnesses shall be made under oath or affirmation or, alternatively, by written statement under penalty of perjury.

(3) When the complainant, or the Board or its employees fail without good cause shown to respond fully and in timely fashion to requests for documents, records, comparative data, statistics, affidavits or the attendance of witness(es), the investigator may note in the investigative record that the decisionmaker should, or the Commission on appeal may, in appropriate circumstances:

(i) Draw an adverse inference that the requested information, or the testimony of the requested witness, would have reflected unfavorably on the party refusing to provide the requested information;

(ii) Consider the matters to which the requested information or testimony pertains to be established in favor of the opposing party;

(iii) Exclude other evidence offered by the party failing to produce the requested information or witness;

(iv) Issue a decision fully or partially in favor of the opposing party; or

(v) Take such other actions as it deems appropriate.

(d) Any investigation will be conducted by investigators with appropriate security clearances.

(e)(1) The Board shall complete its investigation within 180 days of the date of filing of an individual complaint or within the time period contained in an order from the Office of Federal Operations on an appeal from a dismissal pursuant to § 268.106. By written agreement within those time periods, the complainant and the Board may voluntarily extend the time period for not more than an additional 90 days. The Board may unilaterally extend the time period or any period of extension for not more than 30 days where it must sanitize a complaint file that may contain information classified pursuant to Executive Order No. 12356, or successor orders, as secret in the interest of national defense or foreign policy, provided the Board notifies the complainant of the extension.

(2) Confidential supervisory information, as defined in 12 CFR 261.2(c), and other confidential information of the Board may be included in the investigative file by the investigator, the EEO Programs Director, or another appropriate officer of the Board, where such information is relevant to the complaint. Neither the complainant nor the complainant's personal representative may make further disclosure of such information, however, except in compliance with the Board's Rules Regarding Availability of Information, 12 CFR part 261, and where applicable, the Board's Rules Regarding Access to Personal Information under the Privacy Act of 1974, 12 CFR part 261a.

(f) Within 180 days from the filing of the complaint, or where a complaint was amended, within the earlier of 180 days after the last amendment to the complaint or 360 days after the filing of the original complaint, within the time period contained in an order from the

Office of Federal Operations on an appeal from a dismissal, or within any period of extension provided for in paragraph (e) of this section, the Board shall provide the complainant with a copy of the investigative file, and shall notify the complainant that, within 30 days of receipt of the investigative file, the complainant has the right to request a hearing and decision from an administrative judge or may request an immediate final decision pursuant to § 268.109(b) from the Board.

(g) Where the complainant has received the notice required in paragraph (f) of this section or at any time after 180 days have elapsed from the filing of the complaint, the complainant may request a hearing by submitting a written request for a hearing directly to the EEOC office indicated in the Board's acknowledgment letter. The complainant shall send a copy of the request for a hearing to the Board's EEO Programs Office. Within 15 days of receipt of the request for a hearing, the Board's EEO Programs Office shall provide a copy of the complaint file to EEOC and, if not previously provided, to the complainant.

**§ 268.108 Hearings.**

(a) When a complainant requests a hearing, the Commission shall appoint an administrative judge to conduct a hearing in accordance with this section. Upon appointment, the administrative judge shall assume full responsibility for the adjudication of the complaint, including overseeing the development of the record. Any hearing will be conducted by an administrative judge or hearing examiner with appropriate security clearances.

(b) *Dismissals*. Administrative judges may dismiss complaints pursuant to § 268.106, on their own initiative, after notice to the parties, or upon the Board's motion to dismiss a complaint.

(c) *Offer of resolution*. (1) Any time after the filing of the written complaint but not later than the date an administrative judge is appointed to conduct a hearing, the Board may make an offer of resolution to a complainant who is represented by an attorney.

(2) Any time after the parties have received notice that an administrative judge has been appointed to conduct a hearing, but not later than 30 days prior to the hearing, the Board may make an offer of resolution to the complainant, whether represented by an attorney or not.

(3) The offer of resolution shall be in writing and shall include a notice explaining the possible consequences of failing to accept the offer. The Board's offer, to be effective, must include attorney's fees and costs and must specify any non-monetary relief. With regard to monetary relief, the Board may make a lump sum offer covering all forms of monetary liability, or it may itemize the amounts and types of monetary relief being offered. The complainant shall have 30 days from receipt of the offer of resolution to accept it. If the complainant fails to accept an offer of resolution and the relief awarded in the administrative judge's decision, the Board's final decision, or the Commission's decision on appeal is not more favorable than the offer, then, except where the interest of justice would not be served, the complainant shall not receive payment from the Board of attorney's fees or costs incurred after the expiration of the 30-day acceptance period. An acceptance of an offer must be in writing and will be timely if postmarked or received within the 30-day period. Where a complainant fails to accept an offer of resolution, the Board may make other offers of resolution and either party may seek to negotiate a settlement of the complaint at any time.

(d) *Discovery*. The administrative judge shall notify the parties of the right to seek discovery prior to the hearing and may issue such discovery orders as are appropriate. Unless the parties agree in writing concerning the methods and scope of discovery, the party seeking discovery shall request authorization from the administrative judge prior to commencing discovery. Both parties are entitled to reasonable development of evidence on matters relevant to the issues raised in the complaint, but the administrative judge may limit the quantity and timing of discovery. Evidence may be developed through interrogatories, depositions, and requests for admissions,

stipulations or production of documents. It shall be grounds for objection to producing evidence that the information sought by either party is irrelevant, overburdensome, repetitious, or privileged.

(e) *Conduct of hearing.* The Board shall provide for the attendance at a hearing of all employees approved as witnesses by an administrative judge. Attendance at hearings will be limited to persons determined by the administrative judge to have direct knowledge relating to the complaint. Hearings are part of the investigative process and are thus closed to the public. The administrative judge shall have the power to regulate the conduct of a hearing, limit the number of witnesses where testimony would be repetitious, and exclude any person from the hearing for contumacious conduct or misbehavior that obstructs the hearing. The administrative judge shall receive into evidence information or documents relevant to the complaint. Rules of evidence shall not be applied strictly, but the administrative judge shall exclude irrelevant or repetitious evidence. The administrative judge or the Commission may refer to the Disciplinary Committee of the appropriate Bar Association any attorney or, upon reasonable notice and an opportunity to be heard, suspend or disqualify from representing complainants or agencies in EEOC hearings any representative who refuses to follow the orders of an administrative judge, or who otherwise engages in improper conduct.

(f) *Procedures.* (1) The complainant, the Board and any employee of the Board shall produce such documentary and testimonial evidence as the administrative judge deems necessary. The administrative judge shall serve all orders to produce evidence on both parties.

(2) Administrative judges are authorized to administer oaths. Statements of witnesses shall be made under oath or affirmation or, alternatively, by written statement under penalty of perjury.

(3) When the complainant, or the Board, or its employees fail without good cause shown to respond fully and in timely fashion to an order of an administrative judge, or requests for the investigative file, for documents, records, comparative data, statistics, affidavits, or the attendance of witness(es), the administrative judge shall, in appropriate circumstances:

(i) Draw an adverse inference that the requested information, or the testimony of the requested witness, would have reflected unfavorably on the party refusing to provide the requested information;

(ii) Consider the matters to which the requested information or testimony pertains to be established in favor of the opposing party;

(iii) Exclude other evidence offered by the party failing to produce the requested information or witness;

(iv) Issue a decision fully or partially in favor of the opposing party; or

(v) Take such other actions as appropriate.

(g) *Decisions without hearing.* (1) If a party believes that some or all material facts are not in genuine dispute and there is no genuine issue as to credibility, the party may, at least 15 days prior to the date of the hearing or at such earlier time as required by the administrative judge, file a statement with the administrative judge prior to the hearing setting forth the fact or facts and referring to the parts of the record relied on to support the statement. The statement must demonstrate that there is no genuine issue as to any such material fact. The party shall serve the statement on the opposing party.

(2) The opposing party may file an opposition within 15 days of receipt of the statement in paragraph (g)(1) of this section. The opposition may refer to the record in the case to rebut the statement that a fact is not in dispute or may file an affidavit stating that the party cannot, for reasons stated, present facts to oppose the request. After considering the submissions, the administrative judge may order that discovery be permitted on the fact or facts involved, limit the hearing to the issues remaining in dispute, issue a decision without a hearing or make such other ruling as is appropriate.

(3) If the administrative judge determines upon his or her own initiative

that some or all facts are not in genuine dispute, he or she may, after giving notice to the parties and providing them an opportunity to respond in writing within 15 calendar days, issue an order limiting the scope of the hearing or issue a decision without holding a hearing.

(h) *Record of hearing*. The hearing shall be recorded and the Board shall arrange and pay for verbatim transcripts. All documents submitted to, and accepted by, the administrative judge at the hearing shall be made part of the record of the hearing. If the Board submits a document that is accepted, it shall furnish a copy of the document to the complainant. If the complainant submits a document that is accepted, the administrative judge shall make the document available to the Board's representative for reproduction.

(i) *Decisions by administrative judges*. Unless the administrative judge makes a written determination that good cause exists for extending the time for issuing a decision, an administrative judge shall issue a decision on the complaint, and shall order appropriate remedies and relief where discrimination is found, within 180 days of receipt by the administrative judge of the complaint file from the Board. The administrative judge shall send copies of the hearing record, including the transcript, and the decision to the parties. If the Board does not issue a final order within 40 days of receipt of the administrative judge's decision in accordance with § 268.109(a), then the decision of the administrative judge shall become the final action of the Board.

### § 268.109 Final action by the Board.

(a) *Final action by the Board following a decision by an administrative judge*. When an EEOC administrative judge has issued a decision under §§ 268.108(b), (g), or (i), the Board shall take final action on the complaint by issuing a final order within 40 days of receipt of the hearing file and the administrative judge's decision. The final order shall notify the complainant whether or not the Board will fully implement the decision of the administrative judge and shall contain notice of the complainant's right to appeal to the Equal Employment Opportunity Commission, the right to file a civil action in federal district court, the name of the proper defendant in any such lawsuit and the applicable time limits for appeals and lawsuits. If the final order does not fully implement the decision of the administrative judge, then the Board shall simultaneously file an appeal in accordance with § 268.403 and append a copy of its appeal to the final order. A copy of EEOC Form 573 shall be attached to the final order.

(b) *Final action by the Board in all other circumstances*. When the Board dismisses an entire complaint under § 268.106, receives a request for an immediate final decision or does not receive a reply to the notice issued under § 268.107(f), the Board shall take final action by issuing a final decision. The final decision shall consist of findings by the Board on the merits of each issue in the complaint, or, as appropriate, the rationale for dismissing any claims in the complaint and, when discrimination is found, appropriate remedies and relief in accordance with subpart F of this part. The Board shall issue the final decision within 60 days of receiving notification that a complainant has requested an immediate decision from the Board, or within 60 days of the end of the 30-day period for the complainant to request a hearing or an immediate final decision where the complainant has not requested either a hearing or a decision. The final action shall contain notice of the right to appeal the final action to the Equal Employment Opportunity Commission, the right to file a civil action in federal district court, the name of the proper defendant in any such lawsuit and the applicable time limits for appeals and lawsuits. A copy of EEOC Form 573 shall be attached to the final action. The Board may issue a final decision within 30 days after receiving a decision of the Commission pursuant to § 268.405(c) of this part.

## Subpart C—Provisions Applicable to Particular Complaints

### § 268.201 Age Discrimination in Employment Act.

(a) As an alternative to filing a complaint under this part, an aggrieved individual may file a civil action in a United States district court under the ADEA against the Chairman of the Board of Governors after giving the Commission not less than 30 days' notice of the intent to file such an action. Such notice must be filed in writing with EEOC, at PO Box 19848, Washington, DC 20036, or by personal delivery or facsimile within 180 days of the occurrence of the alleged unlawful practice.

(b) The Commission may exempt a position from the provisions of the ADEA if the Commission establishes a maximum age requirement for the position on the basis of a determination that age is a bona fide occupational qualification necessary to the performance of the duties of the position.

(c) When an individual has filed an administrative complaint alleging age discrimination that is not a mixed case, administrative remedies will be considered to be exhausted for purposes of filing a civil action:

(1) 180 days after the filing of an individual complaint if the Board has not taken final action and the individual has not filed an appeal or 180 days after the filing of a class complaint if the Board has not issued a final decision;

(2) After final action on an individual or class complaint if the individual has not filed an appeal; or

(3) After the issuance of a final decision by the Commission on an appeal or 180 days after the filing of an appeal, if the Commission has not issued a final decision.

### § 268.202 Equal Pay Act.

Complaints alleging violations of the Equal Pay Act shall be processed under this part.

### § 268.203 Rehabilitation Act.

(a) *Model employer*. The Board shall be a model employer of individuals with disabilities. The Board shall give full consideration to the hiring, placement, and advancement of qualified individuals with disabilities.

(b) *ADA standards*. The standards used to determine whether section 501 of the Rehabilitation Act of 1973, as amended (29 U.S.C. 791), has been violated in a complaint alleging non-affirmative action employment discrimination under this part shall be the standards applied under Titles I and V (sections 501 through 504 and 510) of the Americans with Disabilities Act of 1990, as amended (42 U.S.C. 12101, 12111, 12201), as such sections relate to employment. These standards are set forth in the Commission's ADA regulation at 29 CFR part 1630.

### § 268.204 Class complaints.

(a) *Definitions*—(1) *Class* is a group of Board employees, former employees or applicants for employment who, it is alleged, have been or are being adversely affected by a Board personnel management policy or practice that discriminates against the group on the basis of their race, color, religion, sex, national origin, age or disability.

(2) *Class complaint* is a written complaint of discrimination filed on behalf of a class by the agent of the class alleging that:

(i) The class is so numerous that a consolidated complaint of the members of the class is impractical;

(ii) There are questions of fact common to the class;

(iii) The claims of the agent of the class are typical of the claims of the class;

(iv) The agent of the class, or, if represented, the representative, will fairly and adequately protect the interests of the class.

(3) An *agent of the class* is a class member who acts for the class during the processing of the class complaint.

(b) *Pre-complaint processing*. An employee or applicant who wishes to file a class complaint must seek counseling and be counseled in accordance with § 268.104. A complainant may move for class certification at any reasonable point in the process when it becomes apparent that there are class implications to the claim raised in an individual complaint. If a complainant

moves for class certification after completing the counseling process contained in § 268.104, no additional counseling is required. The administrative judge shall deny class certification when the complainant has unduly delayed in moving for certification.

(c) *Filing and presentation of a class complaint.* (1) A class complaint must be signed by the agent or representative and must identify the policy or practice adversely affecting the class as well as the specific action or matter affecting the class agent.

(2) The complaint must be filed with the Board not later than 15 days after the agent's receipt of the notice of right to file a class complaint.

(3) The complaint shall be processed promptly; the parties shall cooperate and shall proceed at all times without undue delay.

(d) *Acceptance or dismissal.* (1) Within 30 days of the Board's receipt of a complaint, the Board shall: Designate an agency representative who shall not be one of the individuals referenced in § 268.102(b)(4), and forward the complaint, along with a copy of the Counselor's report and any other information pertaining to timeliness or other relevant circumstances related to the complaint, to the Commission. The Commission shall assign the complaint to an administrative judge or complaints examiner with a proper security clearance when necessary. The administrative judge may require the complainant or the Board to submit additional information relevant to the complaint.

(2) The administrative judge may dismiss the complaint, or any portion, for any of the reasons listed in § 268.106 or because it does not meet the prerequisites of a class complaint under § 268.204(a)(2).

(3) If an allegation is not included in the Counselor's report, the administrative judge shall afford the agent 15 days to state whether the matter was discussed with the Counselor and, if not, explain why it was not discussed. If the explanation is not satisfactory, the administrative judge shall dismiss the allegation. If the explanation is satisfactory, the administrative judge shall refer the allegation to the Board for further counseling of the agent. After counseling, the allegation shall be consolidated with the class complaint.

(4) If an allegation lacks specificity and detail, the administrative judge shall afford the agent 15 days to provide specific and detailed information. The administrative judge shall dismiss the complaint if the agent fails to provide such information within the specified time period. If the information provided contains new allegations outside the scope of the complaint, the administrative judge shall advise the agent how to proceed on an individual or class basis concerning these allegations.

(5) The administrative judge shall extend the time limits for filing a complaint and for consulting with a Counselor in accordance with the time limit extension provisions contained in §§ 268.104(a)(2) and 268.604.

(6) When appropriate, the administrative judge may decide that a class be divided into subclasses and that each subclass be treated as a class, and the provisions of this section then shall be construed and applied accordingly.

(7) The administrative judge shall transmit his or her decision to accept or dismiss a complaint to the Board and the agent. The Board shall take final action by issuing a final order within 40 days of receipt of the hearing record and administrative judge's decision. The final order shall notify the agent whether or not the Board will implement the decision of the administrative judge. If the final order does not implement the decision of the administrative judge, the Board shall simultaneously appeal the administrative judge's decision in accordance with § 268.403 and append a copy of the appeal to the final order. A dismissal of a class complaint shall inform the agent either that the complaint is being filed on that date as an individual complaint of discrimination and will be processed under subpart B or that the complaint is also dismissed as an individual complaint in accordance with § 268.106. In addition, it shall inform the agent of the right to appeal the dismissal of the class complaint to the Equal Employment Opportunity Commission or to file a civil action and

shall include EEOC Form 573, Notice of Appeal/Petition.

(e) *Notification.* (1) Within 15 days of receiving notice that the administrative judge has accepted a class complaint or a reasonable time frame specified by the administrative judge, the Board shall use reasonable means, such as delivery, mailing to last known address or distribution, to notify all class members of the acceptance of the class complaint.

(2) Such notice shall contain:

(i) An identification of the Board as the named agency, its location, and the date of acceptance of the complaint;

(ii) A description of the issues accepted as part of the class complaint;

(iii) An explanation of the binding nature of the final decision or resolution of the class complaint on class members; and

(iv) The name, address and telephone number of the class representative.

(f) Obtaining evidence concerning the complaint. (1) The administrative judge shall notify the agent and the Board's representative of the time period that will be allowed both parties to prepare their cases. This time period will include at least 60 days and may be extended by the administrative judge upon the request of either party. Both parties are entitled to reasonable development of evidence on matters relevant to the issues raised in the complaint. Evidence may be developed through interrogatories, depositions, and requests for admissions, stipulations or production of documents. It shall be grounds for objection to producing evidence that the information sought by either party is irrelevant, overburdensome, repetitious, or privileged.

(2) If mutual cooperation fails, either party may request the administrative judge to rule on a request to develop evidence. If a party fails without good cause shown to respond fully and in timely fashion to a request made or approved by the administrative judge for documents, records, comparative data, statistics or affidavits, and the information is solely in the control of one party, such failure may, in appropriate circumstances, cause the administrative judge:

(i) To draw an adverse inference that the requested information would have reflected unfavorably on the party refusing to provide the requested information;

(ii) To consider the matters to which the requested information pertains to be established in favor of the opposing party;

(iii) To exclude other evidence offered by the party failing to produce the requested information;

(iv) To recommend that a decision be entered in favor of the opposing party; or

(v) To take such other actions as the administrative judge deems appropriate.

(3) During the period for development of evidence, the administrative judge may, in his or her discretion, direct that an investigation of facts relevant to the class complaint or any portion be conducted by an agency certified by the Commission.

(4) Both parties shall furnish to the administrative judge copies of all materials that they wish to be examined and such other material as may be requested.

(g) *Opportunity for resolution of the complaint.* (1) The administrative judge shall furnish the agent and the Board's representative a copy of all materials obtained concerning the complaint and provide opportunity for the agent to discuss the materials with the Board's representative and attempt resolution of the complaint.

(2) The complaint may be resolved by agreement of the Board and the agent at any time pursuant to the notice and approval procedure contained in paragraph (g)(4) of this section.

(3) If the complaint is resolved, the terms of the resolution shall be reduced to writing and signed by the agent and the Board.

(4) Notice of the resolution shall be given to all class members in the same manner as notification of the acceptance of the class complaint and to the administrative judge. It shall state the relief, if any, to be granted by the Board and the name and address of the EEOC administrative judge assigned to the case. It shall state that within 30

days of the date of the notice of resolution, any member of the class may petition the administrative judge to vacate the resolution because it benefits only the class agent, or is otherwise not fair, adequate and reasonable to the class as a whole. The administrative judge shall review the notice of resolution and consider any petitions to vacate filed. If the administrative judge finds that the proposed resolution is not fair, adequate and reasonable to the class as a whole, the administrative judge shall issue a decision vacating the agreement and may replace the original class agent with a petitioner or some other class member who is eligible to be the class agent during further processing of the class complaint. The decision shall inform the former class agent or the petitioner of the right to appeal the decision to the Equal Employment Opportunity Commission and include EEOC Form 573, Notice of Appeal/Petition. If the administrative judge finds that the resolution is fair, adequate and reasonable to the class as a whole, the resolution shall bind all members of the class.

(h) *Hearing*. On expiration of the period allowed for preparation of the case, the administrative judge shall set a date for hearing. The hearing shall be conducted in accordance with 12 CFR 268.108(a) through (f).

(i) *Report of findings and recommendations*. (1) The administrative judge shall transmit to the Board a report of findings and recommendations on the complaint, including a recommended decision, systemic relief for the class and any individual relief, where appropriate, with regard to the personnel action or matter that gave rise to the complaint.

(2) If the administrative judge finds no class relief appropriate, he or she shall determine if a finding of individual discrimination is warranted and, if so, shall recommend appropriate relief.

(3) The administrative judge shall notify the agent of the date on which the report of findings and recommendations was forwarded to the Board.

(j) *Board decision*. (1) Within 60 days of receipt of the report of findings and recommendations issued under § 268.204(i), the Board shall issue a final decision, which shall accept, reject, or modify the findings and recommendations of the administrative judge.

(2) The final decision of the Board shall be in writing and shall be transmitted to the agent by certified mail, return receipt requested, along with a copy of the report of findings and recommendations of the administrative judge.

(3) When the Board's final decision is to reject or modify the findings and recommendations of the administrative judge, the decision shall contain specific reasons for the Board's action.

(4) If the Board has not issued a final decision within 60 days of its receipt of the administrative judge's report of findings and recommendations, those findings and recommendations shall become the final decision. The Board shall transmit the final decision to the agent within five days of the expiration of the 60-day period.

(5) The final decision of the Board shall require any relief authorized by law and determined to be necessary or desirable to resolve the issue of discrimination.

(6) The final decision on a class complaint shall, subject to subpart E of this part, be binding on all members of the class and the Board.

(7) The final decision shall inform the agent of the right to appeal or to file a civil action in accordance with subpart E of this part and of the applicable time limits.

(k) *Notification of decision*. The Board shall notify class members of the final decision and relief awarded, if any, through the same media employed to give notice of the existence of the class complaint. The notice, where appropriate, shall include information concerning the rights of class members to seek individual relief, and of the procedures to be followed. Notice shall be given by the Board within 10 days of the transmittal of its final decision to the agent.

(l) *Relief for individual class members*. (1) When discrimination is found, the Board must eliminate or modify the employment policy or practice out of which the complaint arose and provide individual relief, including an award of attorney's fees and costs, to the agent in accordance with § 268.501.

(2) When class-wide discrimination is not found, but it is found that the class agent is a victim of discrimination, § 268.501 shall apply. The Board shall also, within 60 days of the issuance of the final decision finding no class-wide discrimination, issue the acknowledgment of receipt of an individual complaint as required by § 268.105(d) and process in accordance with the provisions of subpart B of this part, each individual complaint that was subsumed into the class complaint.

(3) When discrimination is found in the final decision and a class member believes that he or she is entitled to individual relief, the class member may file a written claim with the Board or the Board's EEO Programs Director within 30 days of receipt of notification by the Board of its final decision. Administrative judges shall retain jurisdiction over the complaint in order to resolve any disputed claims by class members. The claim must include a specific, detailed showing that the claimant is a class member who was affected by the discriminatory policy or practice, and that this discriminatory action took place within the period of time for which the Board found class-wide discrimination in its final decision. Where a finding of discrimination against a class has been made, there shall be a presumption of discrimination as to each member of the class. The Board must show by clear and convincing evidence that any class member is not entitled to relief. The administrative judge may hold a hearing or otherwise supplement the record on a claim filed by a class member. The Board or the Commission may find class-wide discrimination and order remedial action for any policy or practice in existence within 45 days of the agent's initial contact with the Counselor. Relief otherwise consistent with this Part may be ordered for the time the policy or practice was in effect. The Board shall issue a final decision on each such claim within 90 days of filing. Such decision must include a notice of the right to file an appeal or a civil action in accordance with subpart E of this part and the applicable time limits.

**§ 268.205 Employment of aliens; Access to sensitive information.**

(a) *Definitions*. The definitions contained in this paragraph (a) apply only to this section:

(1) *Classified Information* means information that is classified for national security purposes under Executive Order No. 12958, entitled ''Classified National Security Information,'' including any amendments or superseding orders that the President of the United States may issue from time to time.

(2) *Confidential Supervisory Information* means confidential supervisory information of the Board, as defined in 12 CFR 261.2(c). Three internal security designations, which are subject to change by the Board, apply to Confidential Supervisory Information. Those designations are:

(i) *Restricted-Controlled FR* generally applies to information that, if disclosed to or modified by unauthorized individuals, might result in the risk of serious monetary loss, serious productivity loss or serious embarrassment to the Federal Reserve System. Examples of Confidential Supervisory Information designated as Restricted-Controlled FR include, but are not limited to, certain significant lists of financial institution supervisory ratings and nonpublic advance information regarding bank mergers or failures.

(ii) *Restricted FR* covers information that is less sensitive than Restricted-Controlled FR information and, in general, is the largest category of Confidential Supervisory Information. This information, if disclosed to or modified by unauthorized individuals, might result in the risk of significant monetary loss, significant productivity loss, or significant embarrassment to the Federal Reserve System. Examples of Confidential Supervisory Information designated as Restricted FR include, but are not limited to, single supervisory ratings (e.g., CAMELS, BOPEC, etc.), Federal Reserve examination and inspection reports and workpapers, Interagency Country Exposure Review Committee (ICERC) country exposure determinations, and shared national credit data or listings.

(iii) *Internal FR* covers information that is less sensitive than Restricted

FR or Restricted-Controlled FR and generally applies to information that, if disclosed to or modified by unauthorized individuals, might result in the risk of some monetary loss, some productivity loss, or some embarrassment to the Federal Reserve System. Examples of Confidential Supervisory Information designated as Internal FR include, but are not limited to, foreign banking organization country studies and Federal Reserve risk assessments.

(3) *Country List* refers to the list contained in the annual federal appropriations laws of specific countries, including a general category of ''countries allied with the United States in a current defense effort,'' from which particular categories of persons who are exempt from a ban on the use of appropriated funds are eligible to be hired as Federal employees in the excepted service or in the senior executive service. The appropriations ban is codified at 5 U.S.C. 3101 note. The list of eligible countries and persons is subject to legislative and other change.

(4) *Eligible Position* refers to a position or job family requiring access to Sensitive Information for which the Board determines that hiring a Non-Citizen is appropriate.

(5) *Employee* means an individual who works full-time or part-time and is appointed into Board service for a period of more than 90 days. The term ''Employee'' does not include members of the Board.

(6) *FOMC Information* means confidential information of the Federal Open Market Committee (FOMC) regardless of the form or format in which it is created, conveyed, or maintained. FOMC Information includes information derived from confidential FOMC materials. Three internal security designations, which are subject to change by the FOMC, apply to FOMC Information as follows:

(i) *Class I FOMC* generally applies to materials containing policymaker input, such as that related to monetary policy decisions at meetings, views expressed by policy makers on future policy, and identification of meeting participants who express particular views. Examples of Class I FOMC Information include, but are not limited to, the ''Bluebook,'' drafts of meeting minutes, unreleased meeting transcripts, documents reflecting the preparation of semi-annual forecasts and related testimony, and certain sensitive internal memorandums and reports.

(ii) *Class II FOMC* covers information that is less sensitive than Class I FOMC. This designation generally applies to staff forecasts prepared for the FOMC and to information about open market operations. Examples of Class II FOMC Information include, but are not limited to, Part I of the ''Greenbook,'' reports of the Manager on domestic and foreign open market operations, and other materials on economic and financial developments.

(iii) *Class III FOMC* covers information that is less sensitive than either Class II or Class I. This designation generally applies to background information supporting policy discussions and includes, but is not limited to, Part II of the Greenbook.

(7) *National* refers to any individual who meets the requirements described in 8 U.S.C. 1408.

(8) *Non-Citizen* refers to any individual who is not a Protected Individual.

(9) *Protected Individual* means—

(i) A citizen or National of the United States,

(ii) An alien who:

(A) Meets the conditions set forth in 8 U.S.C. 1324b(a)(3)(B), as amended, and

(B) Has filed with the Board or the appropriate Federal Reserve Bank a declaration of intention to become a citizen of the United States, or

(iii) An alien who:

(A) Is lawfully admitted for permanent residence, is admitted for temporary residence under 8 U.S.C. 1160(a) or section 1255a(a)(1), is admitted as a refugee under 8 U.S.C. 1157, or is granted asylum under 8 U.S.C. 1158;

(B) Was an Employee of the Board or a Federal Reserve Bank on January 1, 2006;

(C) Before requesting access to Sensitive Information filed an application for U.S. citizenship;

(D) Has had his or her application for citizenship pending for two years or less, unless in the case of an application pending for a longer period, the alien can establish that the alien is actively pursuing naturalization. Time

consumed by the Department of Homeland Security, Citizenship and Immigration Services (or its predecessor or successor agency) in processing the application shall not be counted toward the 2-year period; and

(E) Has completed a background investigation acceptable to the Board.

(10) *Sensitive Information* means FOMC Information, Classified Information, and Confidential Supervisory Information.

(b) *Hiring and access*—(1) *Prohibition against hiring unauthorized aliens.* An individual is eligible for employment with the Board only if he or she satisfies the requirements of Section 101 of the Immigration Reform and Control Act of 1986, 8 U.S.C. 1324a.

(2) *Preference.* Consistent with applicable law, where two applicants for employment at the Board are equally qualified for a position, the Board shall prefer the citizen or National of the United States over the equally qualified person who is not a citizen or National of the United States.

(3) *Protected Individuals' access to Sensitive Information.* The Board may hire a person as an Employee into a position that requires access to Sensitive Information if the person is a Protected Individual.

(4) *Non-Citizens' access to Sensitive Information.* The Board shall not hire a Non-Citizen into a position that requires access to Sensitive Information unless the Non-Citizen:

(i) Is in an Eligible Position; and

(ii) Meets the requirements of paragraph (c) of this section allowing access to Sensitive Information.

(c) *Access to Sensitive Information*—(1) *Generally.* The Board will grant access to Sensitive Information only in accordance with the Board's rules and policies regarding access to Sensitive Information and, if applicable, the rules and policies of the FOMC. Access to any level of Sensitive Information includes access to all lower levels of that type of Sensitive Information. An Employee who is not a Protected Individual may not have access to FOMC Information or Confidential Supervisory Information unless otherwise permitted by this paragraph (c).

(2) *FOMC Information*—(i) *Access by a Non-Citizen from a country on the Country List.* An Employee in an Eligible Position who is a Non-Citizen from a country that, on the date the Employee begins employment with the Federal Reserve System or on the date access is granted, is on the Country List shall be granted access to Class I FOMC Information only if the Employee:

(A) Has been recommended for such access by the Employee's Division Director;

(B) Has been resident in the United States for at least six years, at least two of which include satisfactory employment with the Board and/or one or more of the Federal Reserve Banks; and

(C) Has completed a background investigation acceptable to the Board.

(ii) *Access by a Non-Citizen from a country not on the Country List.* An Employee in an Eligible Position who is a Non-Citizen from a country that, on the date the Employee begins employment with the Federal Reserve System and on the date access is granted, is not on the Country List:

(A) Shall not be granted access to Class I FOMC Information, and

(B) Shall be granted access to Class II FOMC Information only upon:

(*1*) The recommendation of the Employee's Division Director;

(*2*) Six years of residence in the United States, at least two of which include satisfactory employment by the Board and/or one or more of the Federal Reserve Banks; and

(*3*) Completion of a background investigation acceptable to the Board.

(iii) *Changes to the Country List.* If the Employee's country is deleted from the Country List after the date the Employee begins employment with the Federal Reserve System, the Employee's existing access to Class I or Class II FOMC information will not be affected by the change in the Country List. Similarly, the Employee would continue to be eligible for access to Class I information and may be granted such access if he or she meets the remaining conditions outlined in paragraph (c)(2)(i) for employees from a country on the Country List.

(3) *Confidential Supervisory Information*—(i) *Access by a Non-Citizen from a*

*country on the Country List*. An Employee in an Eligible Position who is a Non-Citizen from a country that, on the date the Employee begins employment with the Federal Reserve System or on the date access is granted, is on the Country List shall be granted access to Confidential Supervisory Information designated as Restricted-Controlled FR only if the Employee:

(A) Has been recommended for such access by the Employee's Division Director;

(B) Has been resident in the United States for at least six years, at least two of which include satisfactory employment with the Board and/or one or more of the Federal Reserve Banks; and

(C) Has completed a background investigation acceptable to the Board.

(ii) *Access by a Non-Citizen from a country not on the Country List*. An Employee in an Eligible Position who is a Non-Citizen from a country that, on the date the Employee begins employment with the Federal Reserve System and on the date access is granted, is not on the Country List:

(A) Shall not be granted access to Confidential Supervisory Information designated as Restricted-Controlled FR; and

(B) Shall be granted access to Confidential Supervisory Information designated as Restricted FR only upon:

(*1*) The recommendation of the Employee's Division Director;

(*2*) Six years of residence in the United States, at least two of which include satisfactory employment by the Board and/or one or more of the Federal Reserve Banks; and

(*3*) Completion of a background investigation acceptable to the Board.

(iii) *Changes to the Country List*. If the Employee's country is deleted from the Country List after the date the Employee begins employment with the Federal Reserve System, the Employee's existing access to Confidential Supervisory Information designated as Restricted FR or Restricted-Controlled FR will not be affected by the change in the Country List. Similarly, the Employee would continue to be eligible for access to Confidential Supervisory Information designated as Restricted-Controlled FR information and may be granted such access if he or she meets the remaining conditions outlined in paragraph (c)(3)(i) for employees from a country on the Country List.

(4) *Access to Sensitive Information by Reserve Bank employees*—(i) *FOMC Information*. By action of the FOMC, a Reserve Bank employee may access FOMC Information in accordance with these rules.

(ii) *Confidential Supervisory Information*. A Reserve Bank employee will be granted access to Confidential Supervisory Information only to the extent the employee meets all of the requirements for access to Confidential Supervisory Information provided in this paragraph (c) and the employee has received approval for such access from the Board's Director for Banking Supervision and Regulation. Notwithstanding the foregoing, this rule does not affect access that has been granted to employees hired before the effective date of this rule.

(5) *Exceptions for access to Confidential Supervisory Information*. A Board or Reserve Bank employer may request an exception for access to Confidential Supervisory Information. The requester must demonstrate that unusual circumstances exist and that the Board or Reserve Bank employee for whom access is being requested has a strong and particularized need for access to the information. All exceptions for access to Confidential Supervisory Information must be approved by the Chairman of the Board's Committee on Supervisory and Regulatory Affairs.

(6) *Classified Information*. Access to Classified Information is limited to those persons who are permitted access to Classified Information pursuant to the applicable executive orders and any subsequent amendments or superseding orders that the President of the United States may issue from time to time.

[71 FR 44558, Aug. 7, 2006, as amended at 73 FR 17887, Apr. 2, 2008]

## Subpart D—Related Processes

### § 268.301 Negotiated grievance procedure.

When an employee of the Board, which is not an agency subject to 5 U.S.C. 7121(d), is covered by a negotiated grievance procedure, allegations

of discrimination shall be processed as complaints under this part, except that the time limits for processing the complaint contained in § 268.105 and for appeal to the Commission contained in § 268.402 may be held in abeyance during processing of a grievance covering the same matter as the complaint if the Board notifies the complainant in writing that the complaint will be held in abeyance pursuant to this section.

### § 268.302 Mixed case complaints.

A *mixed case complaint* is a complaint of employment discrimination filed with the Board based on race, color, religion, sex, national origin, age or disability related to or stemming from an action that can be appealed to the Merit System Protection Board (MSPB). The complaint may contain only an allegation of employment discrimination or it may contain additional allegations that the MSPB has jurisdiction to address. A *mixed case appeal* is an appeal filed with the MSPB that alleges that an appealable Board action was effected, in whole or in part, because of discrimination on the basis of race, color, religion, sex, national origin, disability or age. Only a Board employee who is a preference eligible employee as defined by the Veterans Preference Act can file a mixed case complaint with the Board or a mixed case appeal with the MSPB. A mixed case complaint or mixed case appeal may only be filed for action(s) over which the MSPB has jurisdiction. The Board will apply sections 1614.302 to 1614.310 of 29 CFR to the processing of a mixed case complaint or mixed case appeal.

## Subpart E—Appeals to the Equal Employment Opportunity Commission

### § 268.401 Appeals to the Equal Employment Opportunity Commission.

(a) A complainant may appeal the Board's final action or dismissal of a complaint.

(b) The Board may appeal as provided in § 268.109(a).

(c) A class agent or the Board may appeal an administrative judge's decision accepting or dismissing all or part of a class complaint; a class agent may appeal a final decision on a class complaint; a class member may appeal a final decision on a claim for individual relief under a class complaint; and a class member, a class agent or the Board may appeal a final decision on a petition pursuant to § 268.204(g)(4).

(d) A complainant, agent of the class or individual class claimant may appeal to the Commission the Board's alleged noncompliance with a settlement agreement or final decision in accordance with § 268.504.

### § 268.402 Time for appeals to the Equal Employment Opportunity Commission.

(a) Appeals described in § 268.401(a) and (c) must be filed within 30 days of receipt of the dismissal, final action or decision. Appeals described in § 268.401(b) must be filed within 40 days of receipt of the hearing file and decision. Where a complainant has notified the Board's EEO Programs Director of alleged noncompliance with a settlement agreement in accordance with § 268.504, the complainant may file an appeal 35 days after service of the allegations of noncompliance, but no later than 30 days after receipt of the Board's determination.

(b) If the complainant is represented by an attorney of record, then the 30-day time period provided in paragraph (a) of this section within which to appeal shall be calculated from the receipt of the required document by the attorney. In all other instances, the time within which to appeal shall be calculated from the receipt of the required document by the complainant.

### § 268.403 How to appeal.

(a) The complainant, the Board, agent or individual class claimant (hereinafter appellant) must file an appeal with the Director, Office of Federal Operations, Equal Employment Opportunity Commission, at PO Box 19848, Washington, DC 20036, or by personal delivery or facsimile. The appellant should use EEOC Form 573, Notice of Appeal/Petition, and should indicate what is being appealed.

(b) The appellant shall furnish a copy of the appeal to the opposing party at the same time it is filed with the Commission. In or attached to the appeal to

the Commission, the appellant must certify the date and method by which service was made on the opposing party.

(c) If an appellant does not file an appeal within the time limits of this subpart, the appeal shall be dismissed by the Commission as untimely.

(d) Any statement or brief on behalf of a complainant in support of the appeal must be submitted to the Office of Federal Operations within 30 days of filing the notice of appeal. Any statement or brief on behalf of the Board in support of its appeal must be submitted to the Office of Federal Operations within 20 days filing the notice of appeal. The Office of Federal Operations will accept statements or briefs in support of an appeal by facsimile transmittal, provided they are no more than 10 pages long.

(e) The Board must submit the complaint file to the Office of Federal Operations within 30 days of initial notification that the complainant has filed an appeal or within 30 days of submission of an appeal by the Board.

(f) Any statement or brief in opposition to an appeal must be submitted to the Commission and served on the opposing party within 30 days of receipt of the statement or brief supporting the appeal, or, if no statement or brief supporting the appeal is filed, within 60 days of receipt of the appeal. The Office of Federal Operations will accept statements or briefs in opposition to an appeal by facsimile provided they are no more than 10 pages long.

### § 268.404 Appellate Procedure.

(a) On behalf of the Commission, the Office of Federal Operations shall review the complaint file and all written statements and briefs from either party. The Commission may supplement the record by an exchange of letters or memoranda, investigation, remand to the Board or other procedures.

(b) If the Office of Federal Operations requests information from one or both of the parties to supplement the record, each party providing information shall send a copy of the information to the other party.

(c) When either party to an appeal fails without good cause shown to comply with the requirements of this section or to respond fully and in timely fashion to requests for information, the Office of Federal Operations shall, in appropriate circumstances:

(1) Draw an adverse inference that the requested information would have reflected unfavorably on the party refusing to provide the requested information;

(2) Consider the matters to which the requested information or testimony pertains to be established in favor of the opposing party;

(3) Issue a decision fully or partially in favor of the opposing party; or

(4) Take such other actions as appropriate.

### § 268.405 Decisions on appeals.

(a) The Office of Federal Operations, on behalf of the Commission, shall issue a written decision setting forth its reasons for the decision. The Commission shall dismiss appeals in accordance with §§ 268.106, 268.403(c) and 268.408. The decision on an appeal from the Board's final action shall be based on a de novo review, except that the review of the factual findings in a decision by an administrative judge issued pursuant to § 268.108(i) shall be based on a substantial evidence standard of review. If the decision contains a finding of discrimination, appropriate remedy(ies) shall be included and, where appropriate, the entitlement to interest, attorney's fees or costs shall be indicated. The decision shall reflect the date of its issuance, inform the complainant of his or her civil action rights, and be transmitted to the complainant and the Board by first class mail.

(b) A decision issued under paragraph (a) of this section is final, subject to paragraph (c) of this section, within the meaning of § 268.406 unless the Commission reconsiders the case. A party may request reconsideration within 30 days of receipt of a decision of the Commission, which the Commission in its discretion may grant, if the party demonstrates that:

(1) The appellate decision involved a clearly erroneous interpretation of material fact or law; or

(2) The decision will have a substantial impact on the policies, practices or operations of the Board.

(c) The Board, within 30 days of receiving the decision of the Commission, shall issue a final decision based upon that decision.

### § 268.406 Civil action: Title VII, Age Discrimination in Employment Act and Rehabilitation Act.

A complainant who has filed an individual complaint, an agent who has filed a class complaint or a claimant who has filed a claim for individual relief pursuant to a class complaint is authorized under title VII, the ADEA and the Rehabilitation Act to file a civil action in an appropriate United States District Court:

(a) Within 90 days of receipt of the final action on an individual or class complaint if no appeal has been filed;

(b) After 180 days from the date of filing an individual or class complaint if an appeal has not been filed and final action has not been taken;

(c) Within 90 days of receipt of the Commission's final decision on an appeal; or

(d) After 180 days from the date of filing an appeal with the Commission if there has been no final decision by the Commission.

### § 268.407 Civil action: Equal Pay Act.

A complainant is authorized under section 16(b) of the Fair Labor Standards Act (29 U.S.C. 216(b)) to file a civil action in a court of competent jurisdiction within two years or, if the violation is willful, three years of the date of the alleged violation of the Equal Pay Act regardless of whether he or she pursued any administrative complaint processing. Recovery of back wages is limited to two years prior to the date of filing suit, or to three years if the violation is deemed willful; liquidated damages in an equal amount may also be awarded. The filing of a complaint or appeal under this part shall not toll the time for filing a civil action.

### § 268.408 Effect of filing a civil action.

Filing a civil action under §§ 268.406 or 268.407 shall terminate Commission processing of the appeal. If private suit is filed subsequent to the filing of an appeal, the parties are requested to notify the Commission in writing.

## Subpart F—Remedies and Enforcement

### § 268.501 Remedies and relief.

(a) When the Board, or the Commission, in an individual case of discrimination, finds that an applicant or an employee has been discriminated against, the Board shall provide full relief which shall include the following elements in appropriate circumstances:

(1) Notification to all employees of the Board in the affected facility of their right to be free of unlawful discrimination and assurance that the particular types of discrimination found will not recur;

(2) Commitment that corrective, curative or preventive action will be taken, or measures adopted, to ensure that violations of the law similar to those found unlawful will not recur;

(3) An unconditional offer to each identified victim of discrimination of placement in the position the person would have occupied but for the discrimination suffered by that person, or a substantially equivalent position;

(4) Payment to each identified victim of discrimination on a make whole basis for any loss of earnings the person may have suffered as a result of the discrimination; and

(5) Commitment that the Board shall cease from engaging in the specific unlawful employment practice found in the case.

(b) *Relief for an applicant.* (1)(i) When the Board, or the Commission, finds that an applicant for employment has been discriminated against, the Board shall offer the applicant the position that the applicant would have occupied absent discrimination or, if justified by the circumstances, a substantially equivalent position unless clear and convincing evidence indicates that the applicant would not have been selected even absent the discrimination. The offer shall be made in writing. The individual shall have 15 days from receipt of the offer within which to accept or decline the offer. Failure to accept the offer within the 15-day period will be considered a declination of the offer, unless the individual can show that circumstances beyond his or her control prevented a response within the time limit.

(ii) If the offer is accepted, appointment shall be retroactive to the date the applicant would have been hired. Back pay, computed in the manner prescribed in 5 CFR 550.805, shall be awarded from the date the individual would have entered on duty until the date the individual actually enters on duty unless clear and convincing evidence indicates that the applicant would not have been selected even absent discrimination. Interest on back pay shall be included in the back pay computation where sovereign immunity has been waived. The individual shall be deemed to have performed service for the Board during this period for all purposes except for meeting service requirements for completion of a required probationary or trial period.

(iii) If the offer of employment is declined, the Board shall award the individual a sum equal to the back pay he or she would have received, computed in the manner prescribed in 5 CFR 550.805, from the date he or she would have been appointed until the date the offer was declined, subject to the limitation of paragraph (b)(3) of this section. Interest on back pay shall be included in the back pay computation. The Board shall inform the applicant, in its offer of employment, of the right to this award in the event the offer is declined.

(2) When the Board, or the Commission, finds that discrimination existed at the time the applicant was considered for employment but also finds by clear and convincing evidence that the applicant would not have been hired even absent discrimination, the Board shall nevertheless take all steps necessary to eliminate the discriminatory practice and ensure it does not recur.

(3) Back pay under this paragraph (b) for complaints under title VII or the Rehabilitation Act may not extend from a date earlier than two years prior to the date on which the complaint was initially filed by the applicant.

(c) *Relief for an employee.* When the Board, or the Commission, finds that an employee of the Board was discriminated against, the Board shall provide relief, which shall include, but need not be limited to, one or more of the following actions:

(1) Nondiscriminatory placement, with back pay computed in the manner prescribed in 5 CFR 550.805, unless clear and convincing evidence contained in the record demonstrates that the personnel action would have been taken even absent the discrimination. Interest on back pay shall be included in the back pay computation where sovereign immunity has been waived. The back pay liability under title VII or the Rehabilitation Act is limited to two years prior to the date the discrimination complaint was filed.

(2) If clear and convincing evidence indicates that, although discrimination existed at the time the personnel action was taken, the personnel action would have been taken even absent discrimination, the Board shall nevertheless eliminate any discriminatory practice and ensure it does not recur.

(3) Cancellation of an unwarranted personnel action and restoration of the employee.

(4) Expunction from the Board's records of any adverse materials relating to the discriminatory employment practice.

(5) Full opportunity to participate in the employee benefit denied (*e.g.*, training, preferential work assignments, overtime scheduling).

(d) The Board has the burden of proving by a preponderance of the evidence that the complainant has failed to mitigate his or her damages.

(e) *Attorney's fees or costs*—(1) *Awards of attorney's fees or costs.* The provisions of this paragraph relating to the award of attorney's fees or costs shall apply to allegations of discrimination prohibited by title VII and the Rehabilitation Act. In a decision or final action, the Board, administrative judge, or Commission may award the applicant or employee or reasonable attorney's fees (including expert witness fees) and other costs incurred in the processing of the complaint.

(i) A finding of discrimination raises a presumption of entitlement to an award of attorney's fees.

(ii) Any award of attorney's fees or costs shall be paid by the Board.

(iii) Attorney's fees are allowable only for the services of members of the Bar and law clerks, paralegals or law

students under the supervision of members of the Bar, except that no award is allowable for the services of any employee of the Federal Government.

(iv) Attorney's fees shall be paid for services performed by an attorney after the filing of a written complaint, provided that the attorney provides reasonable notice of representation to the Board, administrative judge or Commission, except that fees are allowable for a reasonable period of time prior to the notification of representation for any services performed in reaching a determination to represent the complainant. The Board is not required to pay attorney's fees for services performed during the pre-complaint process, except that fees are allowable when the Commission affirms on appeal an administrative judge's decision finding discrimination after the Board takes final action by not implementing an administrative judge's decision. Written submissions to the Board that are signed by the representative shall be deemed to constitute notice of representation.

(2) *Amount of awards.* (i) When the Board, administrative judge or the Commission determines an entitlement to attorney's fees or costs, the complainant's attorney shall submit a verified statement of attorney's fees (including expert witness fees) and other costs, as appropriate, to the Board or administrative judge within 30 days of receipt of the decision and shall submit a copy of the statement to the Board. A statement of attorney's fees and costs shall be accompanied by an affidavit executed by the attorney of record itemizing the attorney's charges for legal services. The Board may respond to a statement of attorney's fees and costs within 30 days of its receipt. The verified statement, accompanying affidavit and any Board response shall be made a part of the complaint file.

(ii)(A) The Board or administrative judge shall issue a decision determining the amount of attorney's fees or costs due within 60 days of receipt of the statement and affidavit. The decision shall include a notice of right to appeal to the EEOC along with EEOC Form 573, Notice of Appeal/Petition and shall include the specific reasons for determining the amount of the award.

(B) The amount of attorney's fees shall be calculated using the following standards: The starting point shall be the number of hours reasonably expended multiplied by a reasonable hourly rate. There is a strong presumption that this amount represents the reasonable fee. In limited circumstances, this amount may be reduced or increased in consideration of the degree of success, quality of representation, and long delay caused by the Board.

(C) The costs that may be awarded are those authorized by 28 U.S.C. 1920 to include: Fees of the reporter for all or any of the stenographic transcript necessarily obtained for use in the case; fees and disbursements for printing and witnesses; and fees for exemplification and copies necessarily obtained for use in the case.

(iii) Witness fees shall be awarded in accordance with the provisions of 28 U.S.C. 1821, except that no award shall be made for a Federal employee who is in a duty status when made available as a witness.

### § 268.502 Compliance with final Commission decisions.

(a) Relief ordered in a final Commission decision, if accepted pursuant to § 268.405(c) as a final decision, or not acted upon the Board within the time periods of § 268.405(c), is mandatory and binding on the Board except as provided in this section. Failure to implement ordered relief shall be subject to judicial enforcement as specified in § 268.503(f).

(b) Notwithstanding paragraph (a) of this section, when the Board requests reconsideration and the case involves removal, separation, or a suspension continuing beyond the date of the request for reconsideration, and when the decision orders retroactive restoration, the Board shall comply with the decision to the extent of the temporary or conditional restoration of the employee to duty status in the position specified by the Commission, pending the outcome of the Board's request for reconsideration.

(1) Service under the temporary or conditional restoration provisions of

this paragraph (b) shall be credited toward the completion of a probationary or trial period or the completion of the service requirement for career tenure, if the Commission upholds its decision after reconsideration.

(2) When the Board requests reconsideration, it may delay the payment of any amounts ordered to be paid to the complainant until after the request for reconsideration is resolved. If the Board delays payment of any amount pending the outcome of the request to reconsider and the resolution of the request requires the Board to make the payment, then the Board shall pay interest from the date of the original appellate decision until payment is made.

(3) The Board shall notify the Commission and the employee in writing at the same time it requests reconsideration that the relief it provides is temporary or conditional and, if applicable, that it will delay the payment of any amounts owed but will pay interest as specified in paragraph (b)(2) of this section. Failure of the Board to provide notification will result in the dismissal of the Board's request.

(c) When no request for reconsideration is filed or when a request for reconsideration is denied, the Board shall provide the relief ordered and there is no further right to delay implementation of the ordered relief. The relief shall be provided in full not later than 60 days after receipt of the final decision unless otherwise ordered in the decision.

### § 268.503 Enforcement of final EEOC decisions.

(a) *Petition for enforcement.* A complainant may petition the Commission for enforcement of a decision issued under the Commission's appellate jurisdiction. The petition shall be submitted to the Office of Federal Operations. The petition shall specifically set forth the reasons that lead the complainant to believe that the Board is not complying with the decision.

(b) *Compliance.* On behalf of the Commission, the Office of Federal Operations shall take all necessary action to ascertain whether the Board is implementing the decision of the Commission. If the Board is found not to be in compliance with the decision, efforts shall be undertaken to obtain compliance.

(c) *Clarification.* On behalf of the Commission, the Office of Federal Operations may, on its own motion or in response to a petition for enforcement or in connection with a timely request for reconsideration, issue a clarification of a prior decision. A clarification cannot change the result of a prior decision or enlarge or diminish the relief ordered but may further explain the meaning or intent of the prior decision.

(d) *Referral to the Commission.* Where the Director, Office of Federal Operations, is unable to obtain satisfactory compliance with the final decision, the Director shall submit appropriate findings and recommendations for enforcement to the Commission, or, as directed by the Commission, refer the matter to another appropriate agency.

(e) *Commission notice to show cause.* The Commission may issue a notice to the Chairman of the Board to show cause why there is noncompliance. Such notice may request the Chairman of the Board or a representative to appear before the Commission or to respond to the notice in writing with adequate evidence of compliance or with compelling reasons for noncompliance.

(f) *Notification to complainant of completion of administrative efforts.* Where the Commission has determined that the Board is not complying with a prior decision, or where the Board has failed or refused to submit any required report of compliance, the Commission shall notify the complainant the right to file a civil action for enforcement of the decision pursuant to title VII, the ADEA, the Equal Pay Act or the Rehabilitation Act and to seek judicial review of the Board's refusal to implement the ordered relief pursuant to the Administrative Procedures Act, 5 U.S.C. 701 *et seq.*, and the mandamus statute, 28 U.S.C. 1361, or to commence *de novo* proceedings pursuant to the appropriate statutes.

### § 268.504 Compliance with settlement agreements and final actions.

(a) Any settlement agreement knowingly and voluntarily agreed to by the parties, reached at any stage of the complaint process, shall be binding on

both parties. Final action that has not been the subject of an appeal or a civil action shall be binding on the Board. If the complainant believes that the Board has failed to comply with the terms of a settlement agreement or decision, the complainant shall notify the Board's EEO Programs Director, in writing, of the alleged noncompliance within 30 days of when the complainant knew or should have known of the alleged noncompliance. The complainant may request that the terms of the settlement agreement be specifically implemented or, alternatively, that the complaint be reinstated for further processing from the point processing ceased.

(b) The Board shall resolve the matter and respond to the complainant, in writing. If the Board has not responded to the complainant, in writing, or if the complainant is not satisfied with the Board's attempt to resolve the matter, the complainant may appeal to the Commission for a determination as to whether the Board has complied with the terms of the settlement agreement or decision. The complainant may file such an appeal 35 days after he or she has served the Board with the allegations of noncompliance, but must file an appeal within 30 days of his or her receipt of the Board's determination. The complainant must serve a copy of the appeal on the Board and the Board may submit a response to the Commission within 30 days of receiving notice of the appeal.

(c) Prior to rendering its determination, the Commission may request that the parties submit whatever additional information or documentation it deems necessary or may direct that an investigation or hearing on the matter be conducted. If the Commission determines that the Board is not in compliance and the noncompliance is not attributable to acts or conduct of the complainant, it may order such compliance or it may order that the complaint be reinstated for further processing from the point processing ceased. Allegations that subsequent acts of discrimination violate a settlement agreement shall be processed as separate complaints under §§ 268.105 or 268.204, as appropriate, rather than under this section.

**§ 268.505 Interim relief.**

(a)(1) When the Board appeals and the case involves removal, separation, or suspension continuing beyond the date of the appeal, and when the administrative judge orders retroactive restoration, the Board shall comply with the decision to the extent of the temporary or conditional restoration of the employee to duty status in the position specified in the decision, pending the outcome of the Board appeal. The employee may decline the offer of interim relief.

(2) Service under the temporary or conditional restoration provisions of paragraph (a)(1) of this section shall be credited toward the completion of a probationary or trial period, eligibility for a within-grade increase, or the completion of the service requirement for career tenure, if the Commission upholds the decision on appeal. Such service shall not be credited toward the completion of any applicable probationary or trial period or the completion of the service requirement for career tenure if the Commission reverses the decision on appeal.

(3) When the Board appeals, it may delay the payment of any amount, other than prospective pay and benefits, ordered to be paid to the complainant until after the appeal is resolved. If the Board delays payment of any amount pending the outcome of the appeal and the resolution of the appeal requires the Board to make the payment, then the Board shall pay interest from the date of the original decision until payment is made.

(4) The Board shall notify the Commission and the employee in writing at the same time it appeals that the relief it provides is temporary or conditional and, if applicable, that it will delay the payment of any amounts owed but will pay interest as specified in paragraph (b)(2) of this section. Failure of the Board to provide notification will result in the dismissal of the Board's appeal.

(5) The Board may, by notice to the complainant, decline to return the complainant to his or her place of employment if it determines that the return or presence of the complainant will be unduly disruptive to the work environment. However, prospective pay

and benefits must be provided. The determination not to return the complainant to his or her place of employment is not reviewable. A grant of interim relief does not insulate a complainant from subsequent disciplinary or adverse action.

(b) If the Board files an appeal and has not provided required interim relief, the complainant may request dismissal of the Board's appeal. Any such request must be filed with the Office of Federal Operations within 25 days of the date of service of the Board's appeal. A copy of the request must be served on the Board at the same time it is filed with EEOC. The Board may respond with evidence and argument to the complainant's request to dismiss within 15 days of the date of service of the request.

## Subpart G—Matters of General Applicability

### § 268.601 EEO group statistics.

(a) The Board shall establish a system to collect and maintain accurate employment information on the race, national origin, sex and disability(ies) of its employees.

(b) Data on race, national origin and sex shall be collected by voluntary self-identification. If an employee does not voluntarily provide the requested information, the Board shall advise the employee of the importance of the data and of the Board's obligation to report it. If the employee still refuses to provide the information, the Board must make a visual identification and inform the employee of the data it will be reporting. If the Board believes that information provided by an employee is inaccurate, the Board shall advise the employee about the solely statistical purpose for which the data is being collected, the need for accuracy, the Board's recognition of the sensitivity of the information and the existence of procedures to prevent its unauthorized disclosure. If, thereafter, the employee declines to change the apparently inaccurate self identification, the Board must accept it.

(c) Subject to applicable law, the information collected under paragraph (b) of this section shall be disclosed only in the form of gross statistics. The Board shall not collect or maintain any information on the race, national origin or sex of individual employees except in accordance with applicable law and when an automated data processing system is used in accordance with standards and requirements prescribed by the Commission to insure individual privacy and the separation of that information from personnel records.

(d) The Board's system is subject to the following controls:

(1) Only those categories of race and national origin prescribed by the Commission may be used;

(2) Only the specific procedures for the collection and maintenance of data that are prescribed or approved by the Commission may be used.

(e) The Board may use the data only in studies and analyses which contribute affirmatively to achieving the objectives of the Board's equal employment opportunity program. The Board shall not establish a quota for the employment of persons on the basis of race, color, religion, sex, or national origin.

(f) Data on disabilities shall also be collected by voluntary self-identification. If an employee does not voluntarily provide the requested information, the Board shall advise the employee of the importance of the data and of the Board's obligation to report it. If an employee who has been appointed pursuant to a special Board program for hiring individuals with a disability still refuses to provide the requested information, the Board must identify the employee's disability based upon the records supporting the appointment. If any other employee still refuses to provide the requested information or provides information that the Board believes to be inaccurate, the Board should report the employee's disability status as unknown.

(g) The Board shall report to the Commission on employment by race, national origin, sex and disability in the form and at such times as the Board and Commission shall agree.

### § 268.602 Reports to the Commission.

(a) The Board shall report to the Commission information concerning

pre-complaint counseling and the status, processing, and disposition of complaints under this part at such times and in such manner as the Board and Commission shall agree.

(b) The Board shall advise the Commission whenever it is served with a Federal court complaint based upon a complaint that is pending on appeal at the Commission.

(c) The Board shall submit annually for the review and approval of the Commission written equal employment opportunity plans of action. Plans shall be submitted in the format prescribed by the Commission and shall include, but not be limited to:

(1) Provision for the establishment of training and education programs designed to provide maximum opportunity for employees to advance so as to perform at their highest potential;

(2) Description of the qualifications, in terms of training and experience relating to equal employment opportunity, of the principal and operating officials concerned with administration of the Board's equal employment opportunity program; and

(3) Description of the allocation of personnel and resources proposed by the Board to carry out its equal employment opportunity program.

### § 268.603 Voluntary settlement attempts.

The Board shall make reasonable efforts to voluntarily settle complaints of discrimination as early as possible in, and throughout, the administrative processing of complaints, including the pre-complaint counseling stage. Any settlement reached shall be in writing and signed by both parties and shall identify the claims resolved.

### § 268.604 Filing and computation of time.

(a) All time periods in this part that are stated in terms of days are calendar days unless otherwise stated.

(b) A document shall be deemed timely if it is received or postmarked before the expiration of the applicable filing period, or, in the absence of a legible postmark, if it is received by mail within five days of the expiration of the applicable filing period.

(c) The time limits in this part are subject to waiver, estoppel and equitable tolling.

(d) The first day counted shall be the day after the event from which the time period begins to run and the last day of the period shall be included, unless it falls on a Saturday, Sunday or Federal holiday, in which case the period shall be extended to include the next business day.

### § 268.605 Representation and official time.

(a) At any stage in the processing of a complaint, including the counseling stage under § 268.104, the complainant shall have the right to be accompanied, represented, and advised by a representative of complainant's choice.

(b) If the complainant is an employee of the Board, he or she shall have a reasonable amount of official time, if otherwise on duty, to prepare the complaint and to respond to Board and EEOC requests for information. If the complainant is an employee of the Board and he designates another employee of the Board as his or her representative, the representative shall have a reasonable amount of official time, if otherwise on duty, to prepare the complaint and respond to Board and EEOC requests for information. The Board is not obligated to change work schedules, incur overtime wages, or pay travel expenses to facilitate the choice of a specific representative or to allow the complainant and representative to confer. The complainant and the representative, if employed by the Board and otherwise in a pay status, shall be on official time, regardless of their tour of duty, when their presence is authorized or required by the Board or the Commission during the investigation, informal adjustment, or hearing on the complaint.

(c) In cases where the representation of a complainant or the Board would conflict with the official or collateral duties of the representative, the Commission or the Board may, after giving the representative an opportunity to respond, disqualify the representative.

(d) Unless the complainant states otherwise in writing, after the Board has received written notice of the name, address and telephone number of

a representative for the complainant, all official correspondence shall be with the representative with copies to the complainant. When the complainant designates an attorney as representative, service of all official correspondence shall be made on the attorney and the complainant, but time frames for receipt of material shall be computed from the time of receipt by the attorney. The complainant must serve all official correspondence on the designated representative of the Board.

(e) The complainant shall at all times be responsible for proceeding with the complaint whether or not he or she has designated a representative.

(f) Witnesses who are Board employees shall be in a duty status when their presence is authorized or required by Commission or Board officials in connection with a complaint.

### § 268.606 Joint processing and consolidation of complaints.

Complaints of discrimination filed by two or more complainants consisting of substantially similar allegations of discrimination or relating to the same matter may be consolidated by the Board or the Commission for joint processing after appropriate notification to the parties. Two or more complaints of discrimination filed by the same complainant shall be consolidated by the Board for joint processing after appropriate notification to the complainant. When a complaint has been consolidated with one or more earlier filed complaints, the Board shall complete its investigation within the earlier of 180 days after the filing of the last complaint or 360 days after the filing of the original complaint, except that the complainant may request a hearing from an administrative judge on the consolidated complaints any time after 180 days from the date of the first filed complaint. Administrative judges or the Commission may, in their discretion, consolidate two or more complaints of discrimination filed by the same complainant.

### § 268.607 Delegation of authority.

The Board of Governors may delegate authority under this part, to one or more designees.

## Subpart H—Prohibition Against Discrimination in Board Programs and Activities Because of Physical or Mental Disability

### § 268.701 Purpose and application.

(a) *Purpose.* The purpose of this subpart H is to prohibit discrimination on the basis of a disability in programs or activities conducted by the Board.

(b) *Application.* (1) This subpart H applies to all programs and activities conducted by the Board. Such programs and activities include:

(i) Holding open meetings of the Board or other meetings or public hearings at the Board's office in Washington, DC;

(ii) Responding to inquiries, filing complaints, or applying for employment at the Board's office;

(iii) Making available the Board's library facilities; and

(iv) Any other lawful interaction with the Board or its staff in any official matter with people who are not employees of the Board.

(2) This subpart H does not apply to Federal Reserve Banks or to financial institutions or other companies supervised or regulated by the Board.

### § 268.702 Definitions.

For purposes of this subpart, the following definitions apply:

(a) *Auxiliary aids* means services or devices that enable persons with impaired sensory, manual, or speaking skills to have an equal opportunity to participate in, and enjoy the benefits of, programs or activities conducted by the Board. For example, auxiliary aids useful for persons with impaired vision include readers, Brailled materials, audio recordings, telecommunications devices and other similar services and devices. Auxiliary aids useful for persons with impaired hearing include telephone handset amplifiers, telephones compatible with hearing aids, telecommunication devices for deaf persons (TDD's), interpreters, notetakers, written materials, and other similar services and devices.

(b) *Complete complaint* means a written statement that contains the complainant's name and address and describes the Board's alleged discriminatory action in sufficient detail to inform the Board of the nature and date of the alleged violation. It shall be signed by the complainant or by someone authorized to do so on his or her behalf. Complaints filed on behalf of classes or third parties shall describe or identify (by name, if possible) the alleged victims of discrimination.

(c) *Facility* means all or any portion of buildings, structures, equipment, roads, walks, parking lots, rolling stock or other conveyances, or other real or personal property.

(d) *Person with a disability* means any person who has a physical or mental impairment that substantially limits one or more major life activities, has a record of such an impairment, or is regarded as having such an impairment. As used in this definition, the phrase:

(1) Physical or mental impairment includes—

(i) Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one of more of the following body systems: Neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genitourinary; hemic and lymphatic; skin; and endocrine; or

(ii) Any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term physical or mental impairment includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech, and hearing impairments, cerebral palsy, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, mental retardation, emotional illness, and drug addiction and alcoholism.

(2) Major life activities includes functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working.

(3) Has a record of such an impairment means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities.

(4) Is regarded as having an impairment means—

(i) Has a physical or mental impairment that does not substantially limit major life activities but is treated by the Board as constituting such a limitation;

(ii) Has a physical or mental impairment that substantially limits major life activities only as a result of the attitudes of others toward such impairment; or

(iii) Has none of the impairments defined in paragraph (d)(1) of this section but is treated by Board as having such an impairment.

(e) *Qualified person with a disability* means—

(1) With respect to any Board program or activity under which a person is required to perform services or to achieve a level of accomplishment, a person with a disability who meets the essential eligibility requirements and who can achieve the purpose of the program or activity without modifications in the program or activity that the Board can demonstrate would result in a fundamental alteration in its nature; or

(2) With respect to any other program or activity, a person with a disability who meets the essential eligibility requirements for participation in, or receipt of benefits from, that program or activity.

(3) Qualified individual with a disability is defined for purposes of employment in § 268.203 of this part, which is made applicable to this subpart by § 268.705.

### § 268.703 Notice.

The Board shall make available to employees, applicants for employment, participants, beneficiaries, and other interested persons information regarding the provisions of this subpart and its applicability to the programs and activities conducted by the Board, and make this information available to them in such manner as the Board finds necessary to apprise such persons of the protections against discrimination assured them by this subpart.

**§ 268.704 General prohibitions against discrimination.**

(a) No qualified individual with a disability shall, on the basis of a disability, be excluded from participation in, be denied the benefits of, or otherwise be subjected to discrimination in any program or activity conducted by the Board.

(b)(1) The Board, in providing any aid, benefit, or service, may not, directly or through contractual, licensing, or other arrangements, on the basis of a disability:

(i) Deny a qualified individual with a disability the opportunity to participate in or benefit from the aid, benefit, or service that is not equal to that provided to others;

(ii) Afford a qualified individual with a disability an opportunity to participate in or benefit from the aid, benefit, or service that is not equal to that afforded others;

(iii) Provide a qualified individual with a disability with an aid, benefit, or service that is not as effective in affording equal opportunity to obtain the same result, to gain the same benefit, or to reach the same level of achievement as that provided to others;

(iv) Provide different or separate aid, benefits, or services to individuals with a disability or to any class of individuals with a disability than is provided to others unless such action is necessary to provide qualified individuals with a disability with aid, benefits, or services that are as effective as those provided to others;

(v) Deny a qualified individual with a disability the opportunity to participate as a member of planning or advisory boards; or

(vi) Otherwise limit a qualified individual with a disability in the enjoyment of any right, privilege, advantage, or opportunity enjoyed by others receiving the aid, benefit, or service.

(2) The Board may not deny a qualified individual with a disability the opportunity to participate in programs or activities that are not separate or different, despite the existence of permissibly separate or different programs or activities.

(3) The Board may not, directly or through contractual or other arrangements, utilize criteria or methods of administration, the purpose or effect of which would:

(i) Subject qualified individuals with a disability to discrimination on the basis of a disability; or

(ii) Defeat or substantially impair accomplishment of the objectives of a program or activity with respect to individuals with a disability.

(4) The Board may not, in determining the site or location of a facility, make selections the purpose or effect of which would:

(i) Exclude individuals with a disability from, deny them the benefits of, or otherwise subject them to discrimination under any program or activity conducted by the Board; or

(ii) Defeat or substantially impair the accomplishment of the objectives or a program or activity with respect to individuals with a disability.

(5) The Board, in the selection of procurement contractors, may not use criteria that subject qualified individuals with a disability to discrimination on the basis of a disability.

(6) The Board may not administer a licensing or certification program in a manner that subjects qualified individuals with a disability to discrimination on the basis of a disability, nor may the Board establish requirements for the programs and activities of licensees or certified entities that subject qualified individuals with a disability to discrimination on the basis of a disability. However, the programs and activities of entities that are licensed or certified by the Board are not, themselves, covered by this subpart.

(c) The exclusion of individuals who do not have a disability from the benefits of a program limited by Federal statute or Board order to individuals with a disability or the exclusion of a specific class of individuals with a disability from a program limited by Federal statute or Board order to a different class of individuals with a disability is not prohibited by this subpart.

(d) The Board shall administer programs and activities in the most integrated setting appropriate to the needs of qualified individuals with a disability.

**§ 268.705 Employment.**

No qualified individual with a disability shall, on the basis of a disability, be subjected to discrimination in employment under any program or activity conducted by the Board. The definitions, requirements and procedures of § 268.203 of this part shall apply to discrimination in employment in federally conducted programs or activities.

**§ 268.706 Program accessibility: Discrimination prohibited.**

Except as otherwise provided in § 268.707 of this subpart, no qualified individual with a disability shall, because the Board's facilities are inaccessible to or unusable by individuals with a disability, be denied the benefits of, be excluded from participation in, or otherwise be subjected to discrimination under any program or activity conducted by the Board.

**§ 268.707 Program accessibility: Existing facilities.**

(a) *General*. The Board shall operate each program or activity so that the program or activity, when viewed in its entirety, is readily accessible to and usable by individuals with a disability. This paragraph (a) does not:

(1) Necessarily require the Board to make each of its existing facilities accessible to and usable by individuals with a disability; or

(2) Require the Board to take any action that it can demonstrate would result in a fundamental alteration in the nature of a program or activity or in undue financial and administrative burdens. In those circumstances where the Board believes that the proposed action would fundamentally alter the program or activity or would result in undue financial and administrative burdens, the Board has the burden of proving that compliance with this paragraph (a) would result in such alterations or burdens. The decision that compliance would result in such alterations or burdens shall be made by the Board of Governors or their designee after considering all Board resources available for use in the funding and operation of the conducted program or activity, and must be accompanied by a written statement of the reasons for reaching that conclusion. If an action would result in such an alteration or such burdens, the Board shall take any other action that would not result in such an alteration or such burdens but would nevertheless ensure that individuals with a disability receive the benefits and services of the program or activity.

(b) *Methods*. The Board may comply with the requirements of this subpart H through such means as redesign of equipment, reassignment of services to accessible buildings, assignment of aides to individuals with a disability, home visits, delivery of service at alternate accessible sites, alteration of existing facilities and construction of new facilities, use of accessible rolling stock, or any other methods that result in making its programs or activities readily accessible to and usable by individuals with a disability. The Board is not required to make structural changes in existing facilities where other methods are effective in achieving compliance with this section. In choosing among available methods for meeting the requirements of this section, the Board shall give priority to those methods that offer programs and activities to qualified individuals with a disability in the most integrated setting appropriate.

(c) *Time period for compliance*. The Board shall comply with any obligations established under this section as expeditiously as possible.

**§ 268.708 Program accessibility: New construction and alterations.**

Each building or part of a building that is constructed or altered by, on behalf of, or for the use of the Board shall be designed, constructed, or altered so as to be readily accessible to and usable by individuals with a disability.

**§ 268.709 Communications.**

(a) The Board shall take appropriate steps to ensure effective communication with applicants, participants, personnel of other Federal entities, and members of the public.

(1) The Board shall furnish appropriate auxiliary aids where necessary to afford an individual with a disability an equal opportunity to participate in,

and enjoy the benefits of, a program or activity conducted by the Board.

(i) In determining what type of auxiliary aid is necessary, the Board shall give primary consideration to the requests of the individual with a disability.

(ii) The Board need not provide individually prescribed devices, readers for personal use or study, or other devices of a personal nature.

(2) Where the Board communicates with employees and others by telephone, telecommunication devices for deaf persons (TDD's) or equally effective telecommunication systems shall be used.

(b) The Board shall ensure that interested persons, including persons with impaired vision or hearing, can obtain information as to the existence and location of accessible services, activities, and facilities.

(c) The Board shall provide signage at a primary entrance to each of its inaccessible facilities, directing users to a location at which they can obtain information about accessible facilities. The international symbol for accessibility shall be used at each primary entrance of an accessible facility.

(d) This section does not require the Board to take any action that would result in a fundamental alteration in the nature of a program or activity or in undue financial and administrative burdens. In those circumstances where the Board believes that the proposed action would fundamentally alter the program or activity or would result in undue financial and administrative burdens, the Board has the burden of proving that compliance with section 268.709 would result in such alterations or burdens. The determination that compliance would result in such alteration or burdens must be made by the Board of Governors or their designee after considering all Board resources available for use in the funding and operation of the conducted program or activity, and must be accompanied by a written statement of the reasons for reaching that conclusion. If an action required to comply with this section would result in such an alteration or such burdens, the Board shall take any other action that would not result in such an alteration or such burdens but would nevertheless ensure that, to the maximum extent possible, individuals with a disability receive the benefits and services of the program or activity.

**§ 268.710 Compliance procedures.**

(a) *Applicability*. Except as provided in paragraph (b) of this section, this section, rather than subpart B and § 268.203 of this part, applies to all allegations of discrimination on the basis of a disability in programs or activities conducted by the Board.

(b) *Employment complaints*. The Board shall process complaints alleging discrimination in employment on the basis of a disability in accordance with subparts A through G of this part.

(c) *Responsible official*. The EEO Programs Director shall be responsible for coordinating implementation of this section.

(d) *Filing the complaint*—(1) *Who may file*. Any person who believes that he or she has been subjected to discrimination prohibited by this subpart may, personally or by his or her authorized representative, file a complaint of discrimination with the EEO Programs Director.

(2) *Confidentiality*. The EEO Programs Director shall not reveal the identity of any person submitting a complaint, except when authorized to do so in writing by the complainant, and except to the extent necessary to carry out the purposes of this subpart , including the conduct of any investigation, hearing, or proceeding under this subpart.

(3) *When to file*. Complaints shall be filed within 180 days of the alleged act of discrimination. The EEO Programs Director may extend this time limit for good cause shown. For the purpose of determining when a complaint is timely filed under this paragraph (d), a complaint mailed to the Board shall be deemed filed on the date it is postmarked. Any other complaint shall be deemed filed on the date it is received by the Board.

(4) *How to file*. Complaints may be delivered or mailed to the Administrative Governor, the Staff Director for Management, the EEO Programs Director, the Federal Women's Program Manager, the Hispanic Employment Program Coordinator, or the People with Disabilities Program Coordinator.

Complaints should be sent to the EEO Programs Director, Board of Governors of the Federal Reserve System, 20th and C Street NW., Washington, DC 20551. If any Board official other than the EEO Programs Director receives a complaint, he or she shall forward the complaint to the EEO Programs Director.

(e) *Acceptance of complaint.* (1) The EEO Programs Director shall accept a complete complaint that is filed in accordance with paragraph (d) of this section and over which the Board has jurisdiction. The EEO Programs Director shall notify the complainant of receipt and acceptance of the complaint.

(2) If the EEO Programs Director receives a complaint that is not complete, he or she shall notify the complainant, within 30 days of receipt of the incomplete complaint, that additional information is needed. If the complainant fails to complete the complaint within 30 days of receipt of this notice, the EEO Programs Director shall dismiss the complaint without prejudice.

(3) If the EEO Programs Director receives a complaint over which the Board does not have jurisdiction, the EEO Programs Director shall notify the complainant and shall make reasonable efforts to refer the complaint to the appropriate government entity.

(f) *Investigation/conciliation.* (1) Within 180 days of the receipt of a complete complaint, the EEO Programs Director shall complete the investigation of the complaint, attempt informal resolution of the complaint, and if no informal resolution is achieved, the EEO Programs Director shall forward the investigative report to the Staff Director for Management.

(2) The EEO Programs Director may request Board employees to cooperate in the investigation and attempted resolution of complaints. Employees who are requested by the EEO Programs Director to participate in any investigation under this section shall do so as part of their official duties and during the course of regular duty hours.

(3) The EEO Programs Director shall furnish the complainant with a copy of the investigative report promptly after completion of the investigation and provide the complainant with an opportunity for informal resolution of the complaint.

(4) If a complaint is resolved informally, the terms of the agreement shall be reduced to writing and made a part of the complaint file, with a copy of the agreement provided to the complainant. The written agreement may include a finding on the issue of discrimination and shall describe any corrective action to which the complainant has agreed.

(g) *Letter of findings.* (1) If an informal resolution of the complaint is not reached, the EEO Programs Director shall transmit the complaint file to the Staff Director for Management. The Staff Director for Management shall, within 180 days of the receipt of the complete complaint by the EEO Programs Director, notify the complainant of the results of the investigation in a letter sent by certified mail, return receipt requested, containing:

(i) Findings of fact and conclusions of law;

(ii) A description of a remedy for each violation found;

(iii) A notice of right of the complainant to appeal the letter of findings under paragraph (k) of this section; and

(iv) A notice of right of the complainant to request a hearing.

(2) If the complainant does not file a notice of appeal or does not request a hearing within the times prescribed in paragraph (h)(1) and (j)(1) of this section, the EEO Programs Director shall certify that the letter of findings under this paragraph (g) is the final decision of the Board at the expiration of those times.

(h) *Filing an appeal.* (1) Notice of appeal, with or without a request for hearing, shall be filed by the complainant with the EEO Programs Director within 30 days of receipt from the Staff Director for Management of the letter of findings required by paragraph (g) of this section.

(2) If the complainant does not request a hearing, the EEO Programs Director shall notify the Board of Governors of the appeal by the complainant and that a decision must be made under paragraph (k) of this section.

(i) *Acceptance of appeal.* The EEO Programs Director shall accept and process any timely appeal. A complainant

may appeal to the Administrative Governor from a decision by the EEO Programs Director that an appeal is untimely. This appeal shall be filed within 15 calendar days of receipt of the decision from the EEO Programs Director.

(j) *Hearing*. (1) Notice of a request for a hearing, with or without a request for an appeal, shall be filed by the complainant with the EEO Programs Director within 30 days of receipt from the Staff Director for Management of the letter of findings required by paragraph (g) of this section. Upon a timely request for a hearing, the EEO Programs Director shall request that the Board of Governors, or its designee, appoint an administrative law judge to conduct the hearing. The administrative law judge shall issue a notice to the complainant and the Board specifying the date, time, and place of the scheduled hearing. The hearing shall be commenced no earlier than 15 calendar days after the notice is issued and no later than 60 days after the request for a hearing is filed, unless all parties agree to a different date.

(2) The hearing, decision, and any administrative review thereof shall be conducted in conformity with 5 U.S.C. 554–557. The administrative law judge shall have the duty to conduct a fair hearing, to take all necessary actions to avoid delay, and to maintain order. He or she shall have all powers necessary to these ends, including (but not limited to) the power to:

(i) Arrange and change the dates, times, and places of hearings and prehearing conferences and to issue notice thereof;

(ii) Hold conferences to settle, simplify, or determine the issues in a hearing, or to consider other matters that may aid in the expeditious disposition of the hearing;

(iii) Require parties to state their positions in writing with respect to the various issues in the hearing and to exchange such statements with all other parties;

(iv) Examine witnesses and direct witnesses to testify;

(v) Receive, rule on, exclude, or limit evidence;

(vi) Rule on procedural items pending before him or her; and

(vii) Take any action permitted to the administrative law judge as authorized by this subpart G or by the provisions of the Administrative Procedures Act (5 U.S.C. 554–557).

(3) Technical rules of evidence shall not apply to hearings conducted pursuant to this paragraph (j), but rules or principles designed to assure production of credible evidence and to subject testimony to cross-examination shall be applied by the administrative law judge wherever reasonably necessary. The administrative law judge may exclude irrelevant, immaterial, or unduly repetitious evidence. All documents and other evidence offered or taken for the record shall be open to examination by the parties, and opportunity shall be given to refute facts and arguments advanced on either side of the issues. A transcript shall be made of the oral evidence except to the extent the substance thereof is stipulated for the record. All decisions shall be based upon the hearing record.

(4) The costs and expenses for the conduct of a hearing shall be allocated as follows:

(i) Employees of the Board shall, upon the request of the administrative law judge, be made available to participate in the hearing and shall be on official duty status for this purpose. They shall not receive witness fees.

(ii) Employees of other Federal agencies called to testify at a hearing, at the request of the administrative law judge and with the approval of the employing agency, shall be on official duty status during any absence from normal duties caused by their testimony, and shall not receive witness fees.

(iii) The fees and expenses of other persons called to testify at a hearing shall be paid by the party requesting their appearance.

(iv) The administrative law judge may require the Board to pay travel expenses necessary for the complainant to attend the hearing.

(v) The Board shall pay the required expenses and charges for the administrative law judge and court reporter.

(vi) All other expenses shall be paid by the parties incurring them.

(5) The administrative law judge shall submit in writing recommended

findings of fact, conclusions of law, and remedies to the complainant and the EEO Programs Director within 30 days, after the receipt of the hearing transcripts, or within 30 days after the conclusion of the hearing if no transcripts are made. This time limit may be extended with the permission of the EEO Programs Director.

(6) Within 15 calendar days after receipt of the recommended decision of the administrative law judge, the complainant may file exceptions to the recommended decision with the EEO Programs Director. On behalf of the Board, the EEO Programs Director may, within 15 calendar days after receipt of the recommended decision of the administrative law judge, take exception to the recommended decision of the administrative law judge and shall notify the complainant in writing of the Board's exception. Thereafter, the complainant shall have 10 calendar days to file reply exceptions with the EEO Programs Director. The EEO Programs Director shall retain copies of the exceptions and replies to the Board's exception for consideration by the Board. After the expiration of the time to reply, the recommended decision shall be ripe for a decision under paragraph (k) of this section.

(k) *Decision*. (1) The EEO Programs Director shall notify the Board of Governors when a complaint is ripe for decision under this paragraph (k). At the request of any member of the Board of Governors made within 3 business days of such notice, the Board of Governors shall make the decision on the complaint. If no such request is made, the Administrative Governor, or the Staff Director for Management if he or she is delegated the authority to do so, shall make the decision on the complaint. The decision shall be made based on information in the investigative record and, if a hearing is held, on the hearing record. The decision shall be made within 60 days of the receipt by the EEO Programs Director of the notice of appeal and investigative record pursuant to paragraph (h)(1) of this section or 60 days following the end of the period for filing reply exceptions set forth in paragraph (j)(6) of this section, whichever is applicable. If the decision-maker under this paragraph (k) determines that additional information is needed from any party, the decision-maker shall request the information and provide the other party or parties an opportunity to respond to that information. The decision-maker shall have 60 days from receipt of the additional information to render the decision on the appeal. The decision-maker shall transmit the decision by letter to all parties. The decision shall set forth the findings, any remedial actions required, and the reasons for the decision. If the decision is based on a hearing record, the decision-maker shall consider the recommended decision of the administrative law judge and render a final decision based on the entire record. The decision-maker may also remand the hearing record to the administrative law judge for a fuller development of the record.

(2) The Board shall take any action required under the terms of the decision promptly. The decision-maker may require periodic compliance reports specifying:

(i) The manner in which compliance with the provisions of the decision has been achieved;

(ii) The reasons any action required by the final Board decision has not been taken; and

(iii) The steps being taken to ensure full compliance.

(3) The decision-maker may retain responsibility for resolving disputes that arise between parties over interpretation of the final Board decision, or for specific adjudicatory decisions arising out of implementation.

## PART 269—POLICY ON LABOR RELATIONS FOR THE FEDERAL RESERVE BANKS

Sec.

269.1 Definition of a labor organization.
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269.11 Federal Reserve System Labor Relations Panel.
269.12 Amendment.

AUTHORITY: Sec. 11, 38 Stat. 261; 12 U.S.C. 248.

SOURCE: 48 FR 32331, July 15, 1983, unless otherwise noted.

### § 269.1 Definition of a labor organization.

When used in this part, the term *labor organization* means any lawful organization of any kind, or any employee representation group, which exists for the purpose, in whole or in part, of dealing with any Federal Reserve Bank concerning grievances, personnel policies and practices, or other matters affecting the working conditions of its employees, but the term shall not include any organization:

(a) Which asserts the right to strike against the government of the United States, the Board of Governors of the Federal Reserve System, or any Federal Reserve Bank, or to assist or participate in any such strike, or which imposes a duty or obligation to conduct, assist or participate in any such strike; or

(b) Which fails to agree to refrain from seeking or accepting support from any organization which employs coercive tactics affecting any Federal Reserve Bank's operations; or

(c) Which advocates the overthrow of the constitutional form of the government of the United States; or

(d) Which discriminates with regard to the terms or conditions of membership because of race, color, sex, creed, age or national origin.

### § 269.2 Membership in a labor organization.

(a) Any employee of a Federal Reserve Bank (hereinafter referred to as ''Bank'') is free to join and assist any existing labor organization or to participate in the formation of a new labor organization, or to refrain from any such activities except that officers and their administrative or confidential assistants, managers and other supervisory personnel, secretaries to all such persons and all employees engaged in Bank personnel work shall not be represented by any labor organization.

(b) The rights described in paragraph (a) of this section for employees do not extend to participation in the management of a labor organization, or acting as a representative of any such organization, where such participation or activity would conflict with law or the duties of an employee.

(c) Notwithstanding anything stated in paragraph (a) of this section, professional employees of a Bank shall not be represented by a labor organization which represents other employees of the Bank unless a majority of the professional employees eligible to vote specifically elect to be represented by such labor organization. However, the professional employees of a Bank may, if they so choose, be represented by a separate labor organization of their own, or by no labor organization at all.

(d) Notwithstanding anything stated in paragraph (a) of this section, the guards of a Bank shall not be members of a labor organization which represents other categories of employees of the Bank. However, the guards of a Bank may, if they so choose, be represented by a separate labor organization of their own, or by no labor organization at all.

### § 269.3 Recognition of a labor organization and its relationship to a Federal Reserve Bank.

(a) Any labor organization shall be recognized as the exclusive bargaining representative of the employees in an appropriate unit of a Bank when that organization has been selected by the employees in said unit pursuant to the procedure set forth in § 269.5. A unit may be established in a Bank on any basis which will ensure a clear and identifiable community of interest among the employees concerned, and will promote effective relationships and the efficiency of the Bank's operations, but no unit shall be established solely on the basis of the extent to which a labor organization or employees in the proposed unit may have sought organization.

(b) When a labor organization has been recognized as the exclusive representative of employees in an appropriate unit, it shall be entitled to act

for and to negotiate agreements in good faith covering all employees in the unit, and it shall be responsible for representing the interests of all such employees without discrimination and without regard to whether they are members of that labor organization or not, provided that nothing in this Policy shall prevent an employee from adjusting his or her grievance without the intervention of the recognized labor organization. The labor organization shall be given notice of the adjustment and a reasonable opportunity to object on the sole ground that it is in conflict with the terms of the collective bargaining agreement.

(c) A Bank, through appropriate officials, shall have the obligation to meet at reasonable times with representatives of a recognized labor organization to negotiate, in good faith, with respect to personnel policies and practices affecting working conditions for employees, provided that they do not involve matters in any of the following areas:

(1) The purposes and functions of the Bank; the compensation of and hours worked by employees; any classification system used to evaluate positions; the budget of the Bank; the retirement system; any insurance or other benefit plans; internal security operations; maintenance of the efficiency of Bank operations including the determination of work methods; the right to contract out; the determination as to manpower requirements; use of technology and organization of work; and action to meet emergency situations;

(2) Management rights as to the direction of employees, including hiring, promotion, transfer, classification, assignment, layoffs, retention, suspension, demotion, discipline and discharge, provided that on matters involving the procedures to be followed by a Bank for the exercise of its rights under this subparagraph, a Bank shall, upon request, discuss such procedures with a recognized labor organization, but shall not be required to negotiate for an agreement as to them;

(3) All Bank matters specifically governed by applicable laws or regulations.

The obligation under this paragraph to negotiate with regard to certain matters shall include the execution of a written contract incorporating any agreement reached, but does not compel either a Bank or a labor organization to agree to a particular proposal or to make any concession during such negotiations.

(d) At the time it requests an election to be held, any labor organization seeking recognition shall submit to a Bank a roster of its officers and representatives, a copy of its constitution and bylaws, and a statement of its objectives.

(e) Subject to the provisions of § 269.8, the exclusive recognition of a labor organization shall not preclude any employee, regardless of labor organization membership, from bringing matters of personal concern not governed by a collective bargaining agreement to the attention of appropriate officers, managers or supervisory personnel in accordance with applicable law, rule, regulation, or established Bank policy, or from choosing his or her own representative in such matters.

### § 269.4 Determination of appropriate bargaining unit.

(a) If a labor organization asserts in writing to a Bank that it holds cards requesting a representation election signed by at least thirty percent (30%) of the employees in a unit which that organization considers to be an appropriate bargaining unit, the labor organization and the Bank shall each designate a representative who together shall request the American Arbitration Association (hereinafter referred to as ''Association'') to submit to them from its National Panel of Professional Labor Arbitrators a list of seven (7) impartial, qualified professional arbitrators. The two designated representatives shall meet promptly and, by alternately striking names from the list, arrive at the remaining person who, together with the two representatives, shall constitute a Special Tribunal to rule on the labor organization's request for an election. The impartial arbitrator shall always act as the Chairperson of any Special Tribunal duly constituted under this section.

(b) In the absence of an agreement between the labor organization and the

Bank on the appropriate unit, the Tribunal shall investigate the facts, hold hearings if necessary, and issue a decision as to the appropriateness of the unit for the purposes of conducting a representation election for exclusive recognition and as to related issues submitted for consideration. The expenses for this proceeding, including the fees of the association and of the arbitrator, shall be borne equally by the labor organization and the Bank. If either the Bank or the labor organization should disagree with the Special Tribunal's decision, the party in disagreement may appeal within thirty (30) calendar days to the Federal Reserve System Labor Relations Panel referred to in § 269.11, and the decision of the System Panel shall be final and binding on the parties.

(c) If there is any dispute as to whether a labor organization holds cards signed by at least thirty percent (30%) of the employees in a unit claimed by a labor organization as appropriate or subsequently determined by the Special Tribunal as appropriate, the dispute shall be resolved by the Chairperson of the Special Tribunal, acting as a single impartial arbitrator. The expenses of such procedure, including the impartial arbitrator's fee, shall be borne equally by the labor organization and the Bank. The decision of the Chairperson of the Special Tribunal shall be final and binding and shall not be subject to appeal to the Federal Reserve System Labor Relations Panel.

**§ 269.5 Elections.**

(a) Once there has been a final determination of the existence of an appropriate bargaining unit under the procedure in § 269.4, and a showing by a labor organization that it has cards signed by at least thirty percent (30%) of the employees in such unit requesting a representation election, an election shall be ordered by the Special Tribunal. A labor organization shall be recognized as the exclusive bargaining representative of the unit if it is selected by a majority of the employees in the unit actually voting.

(b) The election shall be held under the auspices of the Association and shall be subject to its election rules and regulations. However, if there should be any conflict between such rules and regulations and the provisions of this Policy, the latter shall prevail. The fees charged by the Association for its election service shall be borne equally by the labor organization and the Bank.

(c) An election to determine whether a labor organization should continue as the exclusive bargaining representative of a particular unit shall be held when requested by a petition or other bona fide showing by at least thirty percent (30%) of the employees of that unit. Any dispute as to whether thirty percent (30%) of the employees requested such an election shall be resolved by the same procedure as that set forth in § 269.4(b). The election shall be held under the auspices of the Association in the same manner described in paragraph (b) of this section. The recognition of a labor organization as the exclusive bargaining representative of a unit shall be revoked if a majority of the employees in the unit who actually vote signify approval of such revocation.

(d) Only one election may be held in any unit in a twelve (12) month period to determine whether a labor organization should become, or continue to be recognized as, the exclusive representative of the employees in that unit.

(e) Upon receipt of a request for an election from a labor organization under § 269.4(a), it shall be incumbent on the Bank, labor organization and all others to refrain from any conduct, action or policy that interferes with or restrains employees from making a fair and free choice in selecting or rejecting a bargaining representative consistent with the right of the Bank, labor organization or employees to exercise privileges of free speech in the expression of any views, argument or opinion, or the dissemination thereof, whether in oral, written, printed, graphic or visual form.

(f) The Special Tribunal shall hear and decide any post-election objections of a Bank or labor organization filed with it claiming that a violation of paragraph (e) of this section has improperly affected the outcome of the election. Such objections must be filed with the Special Tribunal no later than five (5) business days after the date of

election. In the event of such violation by a Bank, labor organization or other individuals or organizations which the Special Tribunal finds sufficient to have prejudiced the outcome of an election, appropriate remedial action shall be taken in the form of setting aside the election results and ordering a new election, provided, however, that an appeal from the order of the Special Tribunal may be taken within thirty (30) calendar days to the Federal Reserve System Labor Relations Panel by either the affected Bank or labor organization. The ruling of the System Panel shall be final and binding. Neither the Special Tribunal nor the Federal Reserve System Labor Relations Panel shall have the authority to direct a Bank to recognize a labor organization as the exclusive collective bargaining representative without a valid election being held in which a majority of the employees actually voting have so designated such labor organization.

(g) The Special Tribunal and the Federal Reserve System Labor Relations Panel will adhere to any rules and regulations promulgated by the Board of Governors for the administration of the provisions of paragraphs (e) and (f) of this section.

### § 269.6 Unfair labor practices.

(a) It shall be an unfair labor practice for a Bank to: (1) Interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in § 269.2(a); (2) dominate or interfere with the formation or administration of any labor organization, or to contribute financial or other support to it; (3) encourage or discourage membership in any labor organization by discrimination in regard to hire or tenure of employment or any term or condition of employment; (4) refuse to bargain collectively with the representatives of its employees subject to the provisions of § 269.3 (b) and (c).

(b) It shall be an unfair labor practice for a labor organization, its agents or representatives to: (1) Restrain or coerce employees in the exercise of the rights guaranteed in § 269.2(a); (2) cause or attempt to cause a Bank to Discriminate against an employee in violation of paragraph (a)(3) of this section; (3) refuse to bargain collectively with a Bank, provided the labor organization is the exclusive representative of a unit of employees.

(c) Notwithstanding anything previously stated in this section, the expression of any view, argument or opinion, or the dissemination thereof, whether in oral, written, printed, graphic or visual form, shall not constitute or be evidence of an unfair labor practice, if such expression contains no threat of reprisal or force, or promise of benefit.

(d) The Federal Reserve System Labor Relations Panel will adhere to the rules and regulations promulgated by the Board of Governors for the prevention and remedy of the unfair labor practices listed herein.

### § 269.7 Approval of agreement and required contents.

Any agreement entered into with a labor organization as the exclusive representative of employees in a unit must be approved by the President of the Bank or a designated officer representative. All agreements with labor organizations shall also be subject to the requirement that the administration of all matters covered by the agreement shall be governed by the provisions of applicable laws and Federal Reserve System rules and regulations, and the agreement shall at all times be applied subject to such laws and regulations.

### § 269.8 Grievance procedures.

(a) Subject to the provisions of § 269.3(b), an agreement entered into with a labor organization as the exclusive representative of employees in a unit may contain a grievance procedure, applicable only to employees in such unit and which shall be the exclusive means for a labor organization and/or an employee to obtain resolution of a grievance arising under such agreement.

(b) Grievance procedures established by a labor agreement may also include provisions for arbitration of unresolved grievances by a tripartite panel under the Voluntary Labor Arbitration Rules of the Association with the impartial arbitrator selected by the Bank and labor organization representatives on

the arbitration panel to be the Chairperson. In such event, arbitration shall extend only to grievances which involve the interpretation and application of specific provisions of a labor agreement and not to any other matters or to changes in or proposed changes in the agreement. Arbitration may only be invoked by labor organization on behalf of individual employees with their concurrence.

### § 269.9 Mediation of negotiation impasses.

In the event of an impasse in negotiations between the parties for a collective bargaining agreement, either the labor organization or the Bank may request the appointment of a qualified neutral person as a mediator to assist the parties in attempting to resolve the impasse. The parties will meet promptly with the mediator, and all matters discussed, as well as any documents submitted, shall not be publicly divulged for any reason. The cost of the mediator shall be borne equally by the parties.

### § 269.10 Time for internal labor organization business, consultations and negotiations.

Solicitation of memberships, dues or other internal labor organization business shall be conducted during the nonduty hours of the employees concerned. Officially requested or approved consultation between management executives and representatives of a labor organization shall, whenever practicable, be conducted on official time, but the President or a duly authorized officer of a Bank may require that negotiations with a labor organization be conducted during the nonduty hours of the Bank.

### § 269.11 Federal Reserve System Labor Relations Panel.

There shall be established a Federal Reserve System Labor Relations Panel, which shall consist of three members: one member of the Board of Governors of the Federal Reserve System, who shall be Chairperson of the Panel, and two public members. Each member shall be selected by the Board of Governors; provided, however, that the public members shall not have any present or past affiliation with the Federal Reserve System. Initially, one of the two public members shall be appointed for a term of two years, and the other for a term of three years. Thereafter, each public member shall be appointed for a term of three years, except that in the case of an unexpired term of a former member, the successor shall be appointed to fill such unexpired term. Upon the expiration of their term of office, public members may continue to serve until their successors are appointed and have qualified. A public member may be removed by the Board only upon notice and hearing, and only for neglect of duty or malfeasance in office. The Panel shall be responsible for the duties assigned to it as set forth in this Policy.

### § 269.12 Amendment.

This policy may be amended upon appropriate legal notice to all Federal Reserve Banks and labor organizations recognized, or seeking recognition, at any such Bank under this Policy. In no instance shall an amendment be applied retroactively.

## PART 269a—DEFINITIONS

Sec.

269a.1 Party.
269a.2 Party in interest.
269a.3 Intervenor.
269a.4 Investigator.
269a.5 Hearing officer.

AUTHORITY: Sec. 11, 38 Stat. 261 (12 U.S.C. 248).

SOURCE: 35 FR 8919, June 10, 1970, unless otherwise noted. Redesignated at 48 FR 32334, July 15, 1983.

### § 269a.1 Party.

The term *Party* means any person, employee, group of employees, labor organization, or bank as defined in § 269.2 of this chapter (a) filing a charge, petition, application, or rquest pursuant to these rules and regulations, (b) named as a party in a charge, complaint, petition, application, or request, or (c) whose intervention has been permitted or directed by the investigator, the hearing officer, or the panel, as the case may be, but nothing shall be construed to prevent the panel, or any officer designated by it, from

limiting any party's participation in the proceedings to the extent of his interest as determined by the investigator, hearing officer, or panel.

### § 269a.2 Party in interest.

The term *party in interest* means any person, employee, group of employees, labor organization, or bank that will be or is directly affected by the resolution of any charge, complaint, petition, application, or request presented to or being considered by the panel or its designated officers. Any (a) labor organization (not a charging party nor a charged party) attempting to organize the employees of a bank or that is or was recently a party to a collective bargaining agreement with a bank named as a party in a charge, complaint, petition, application, or a request, or (b) bank (not a charging party nor a charged party) that acts as the employer of any person named in a charge, complaint, petition, or request shall be deemed to be also a party in interest and shall be entitled to notification and service of all relevant procedures and documents.

### § 269a.3 Intervenor.

The term *intervenor* means the party in a proceeding whose intervention has been permitted or directed by the panel or its designated officer.

### § 269a.4 Investigator.

The term *investigator* means the officer designated by the panel to investigate and determine whether or not a complainant has established a prima facie case, as defined in § 269b.210 of this subchapter.

[35 FR 8919, June 10, 1970. Redesignated at 48 FR 32334, July 15, 1983, as amended at 65 FR 2530, Jan. 18, 2000.

### § 269a.5 Hearing officer.

The term *hearing officer* means the officer designated by the panel to conduct hearings pursuant to § 269b.420 *et seq.* of this subchapter and whose duties and power are enumerated in § 269b.442 of this subchapter.

[35 FR 8919, June 10, 1970. Redesignated at 48 FR 32334, July 15, 1983, as amended at 65 FR 2530, Jan. 18, 2000.

## PART 269b—CHARGES OF UNFAIR LABOR PRACTICES

CHARGES OF VIOLATIONS OF § 269.6 (OF THE POLICY)

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AUTHORITY: Sec. 11, 38 Stat. 261 (12 U.S.C. 248).

SOURCE: 35 FR 8920, June 10, 1970, unless otherwise noted. Redesignated at 48 FR 32334, July 15, 1983.

CHARGES OF VIOLATIONS OF § 269.6 (OF THE POLICY)

### § 269b.110 Charges.

A charge that any bank or labor organization, or agents or representatives of a bank or labor organization, has engaged in or is engaging in any act prohibited under § 269.6 of the policy or has failed to take any action required by § 269.6 of the policy may be filed by any party in interest, or its representative, within 60 days after the alleged violations or within 60 days after the charging party has become or should have become aware of the alleged violation.

### § 269b.111 Filing of charges.

Any charge pursuant to § 269b.110 shall be in writing and signed. An original and three copies of such charge, together with one copy for each charged party named, shall be transmitted to the Secretary of the Federal Reserve System Labor Relations Panel, 20th Street and Constitution Avenue NW., Washington, DC 20551. Within 5 days after receipt of a properly filed charge that meets the formal requirements set forth in § 269b.112, the Secretary will cause a copy of such charge to be served on each party against whom the charge is made and upon all other potential parties in interest.

### § 269b.112 Contents of the charge.

A charge shall contain the following:

(a) The full name, address, and telephone number of the person, bank, or labor organization making the charge (hereinafter referred to as the charging party) and of the person signing the charge who shall state also his relation to or his capacity with the complainant. Where discrimination is alleged, all known discriminatees shall be named;

(b) The name, address, and telephone number of the bank or labor organization against whom the charge is made (hereinafter referred to as the respondent) and of any parties in interest;

(c) A clear and concise statement of the facts constituting the alleged unfair labor practice, including the time and place of occurrence of the particular acts, and a statement of the portion or portions of the policy alleged to have been violated. A charge shall not incorporate by reference affidavits or other documents submitted in support of the charge;

(d) A statement of the relief sought;

(e) A statement of any other remedies invoked for the redress of the alleged violations of the policy and the results, if any, of their invocation. If the issue in such charge is subject to an established grievance procedure, the complainant must irrevocably elect, prior to the completion of the first applicable step of the grievance procedure, whether he will invoke the grievance procedure or whether he will invoke the unfair labor practice procedures of the panel. A charge which is withdrawn or rejected by the panel as defective prior to the institution of any formal proceedings by the panel shall not prejudice the filing of a grievance on the same matter, unless the parties otherwise so provide;

(f) A declaration by the person signing the charge, that its contents are true and correct to the best of his knowledge and belief, such declaration to be subject to applicable provisions of the Federal Criminal Code (18 U.S.C. 1001).

### § 269b.113 Withdrawal or settlement.

A charge may be withdrawn or settlement of the matter may be reached without consent of the panel at any time. In connection with any such settlement the parties in interest shall prepare and sign a settlement agreement which shall record that the settlement is mutually satisfactory, shall stipulate any occurrences which constituted unfair labor practices and shall set forth the terms of the settlement.

### § 269b.120 Answer to a charge.

The respondent shall file an answer to the charge with the Secretary of the panel within 15 days after service of the charge. Upon application and for good cause shown, the panel may extend the time within which the answer

shall be filed. One copy of the answer shall be served on each party with proof of service furnished to the Secretary, and the original, which shall be signed, and four copies shall be filed with the Secretary.

### § 269b.121 Contents of answer.

The answer shall contain:

(a) A specific admission or denial, and where appropriate, explanation thereof; or if the respondent is without knowledge of the allegation, he shall so state and such statement shall operate as a denial. Admissions or denials may be to all or part of an allegation but shall be responsive to the substance of the allegation;

(b) A specified, detailed statement of any affirmative defense;

(c) A clear and concise statement of the facts and matters of law relied upon constituting the grounds of defense.

Any allegation of the charge not denied in the answer may be deemed admitted and may be so found by the panel.

## PRELIMINARY INVESTIGATION

### § 269b.210 Referral to National Center for Dispute Settlement.

(a) Within 5 days after the answer to the charge has been or should have been filed, the panel may refer the matter, accompanied by a general or particularized request, to the National Center for Dispute Settlement of the American Arbitration Association (hereinafter referred to as the Center) to make an investigation and to determine whether the charging party has established a prima facie case.

(b) For the purposes of this part, a *prima facie case* means a case where allegations of an unfair labor practice that have been presented give reasonable cause to believe that such practice may have occurred, but where evidentiary proceedings are necessary for determination of whether the allegations are substantiated.

(c) The Center may use its own personnel or may hire individuals on a contract basis to conduct such investigations. The panel may consolidate or sever proceedings conducted pursuant to this part.

(d) Any party may request the Center or other appointing authority to withdraw appointment of the investigator within 3 days after designation on the basis of previously demonstrated personal bias, conflict of interest, or prejudice. Such a request shall set forth in detail the matter alleged to constitute grounds for disqualification. Denial of a request by the Center or other appointing authority shall be substantiated in writing and transmitted to the requesting party, and shall be submitted to the panel together with the complete report of the investigator required in § 269b.240(b).

### § 269b.220 Priority; acceleration of proceedings.

(a) A charge of ''refusal to bargain'' or a charge that, if sustained, would require the setting aside of an election or the conduct of a new election shall be given priority.

(b) The parties, individually or jointly, may petition the panel at any time to invoke immediately the formal hearing procedures set forth in § 269b.410. They may also petition the panel to entertain the matter itself without prior investigation and/or without the formal hearing procedure set forth in § 269b.410. The panel is empowered also on its own motion to so accelerate disposition of the case.

(c) Before accelerating a case the panel may utilize whatever proceedings it may deem appropriate and timely to allow parties in interest to comment on the proposed course of action.

### § 269b.230 Assessment of costs; posting of bond.

(a) The panel shall normally bear the costs of an investigation conducted pursuant to § 269b.210, but the panel may require that the charging party, the respondent, and/or other parties in interest or intervenors, or several of them, shall bear a portion or all of the costs therefor. With respect to each case where an investigation is directed by the panel, the charging party may, in the discretion of the panel, be required to file a cost bond, or equivalent security, of $500, unless the panel fixes a different amount.

(b) Among the circumstances that may be the basis for payment of costs

by other than the panel are cases where a clearly spurious charge has been filed or where the filing of a charge was necessary to redress the respondent's flagrant misconduct.

(c) The bond or equivalent security shall be to secure the payment of the costs of the investigation as may be assessed by the panel. In those cases where the panel does not assess such costs, the bond posted and the cost thereof shall be reimbursed to the charging party. The panel may require also the posting of a cost bond by the respondent or other party to the proceeding, who shall be entitled to reimbursement of the cost of the bond in the event that no costs of investigation are assessed upon such party by the panel.

(d) Notification of the panel's decision that a bond shall be required shall be effected by registered mail, such notice to advise of the amount of the bond required and the period by which it shall be posted.

(e) Absent good cause shown, failure of a party to file timely such cost bond or equivalent security may be ground for dismissal or other administrative sanctions deemed appropriate by the Panel.

### § 269b.240 The investigation.

(a) The purpose of the investigation is (1) to ascertain, analyze, and apply the relevant facts in order to determine whether or not formal proceedings are warranted and (2) to assist, by mediation and other appropriate means, the parties to reach a mutually satisfactory resolution of the issues as an alternative to the hearing process. In so doing, the investigator is not limited to the allegations set forth in the charge and may advise the charging party to amend his charge. In addition, he should adduce facts pertaining to the remedy as well as to the alleged violation. Investigation should also adduce facts pertaining to the jurisdiction of the panel and the timeliness of the charge. If the charge is untimely on its face, no investigation shall be required except to determine whether or not attending circumstances warrant waiving the time requirements, set forth in § 269b.110. The investigator may request the appearance of parties and witnesses, may cause, the production of relevant document, and may take or cause depositions to be taken.

(b) When the investigation has been completed, the Center shall issue a written determination whether the charging party has established a prima facie case, whether the charge was timely filed, and whether the charge is within the jurisdiction of the panel, and reasons therefor. This determination shall be served upon the panel and all parties. The panel shall receive also the complete report of the investigator.

## APPEAL FROM THE CENTER'S DETERMINATION

### § 269b.310 Appeal rights.

Where the investigator has found that a prima facie case does not exist, a party, including an intervenor but excluding the respondent or other parties having the same interest as the respondent, within 5 days after receiving the Center's determination may petition the panel to set aside the determination and to cause formal proceedings, set forth in § 269b.410, to be invoked. The panel may grant such petition only on grounds that the Center or its agents were arbitrary, capricious, or acted contrary to law or the policy, or that the investigator's determination is clearly erroneous. The filing requirements for such a petition shall be the same as that for the filing of a charge, as set forth in § 269b.111.

### § 269b.320 Proceedings before the panel.

The panel shall issue its decision within 15 days after the receipt of the petition provided for in § 269b.310 or by the end of that period shall announce that it will require briefs by the parties. Such announcement shall specify the requirements as to contents of the briefs, and the time for submission, which shall vary to meet the circumstances of the matter appealed. The panel, at such time, may also require oral argument or the production of evidence or may so order oral argument and/or the production of evidence after examination of the briefs. The panel shall issue its final decision

within 20 days after briefs have been filed, evidence has been produced, or oral argument has been conducted.

FORMAL PROCEEDINGS

### § 269b.410 Notice of hearing.

If formal proceedings are found to be needed under the above procedures, and if no satisfactory settlement has been reached within 5 days after finding that a prima facie case exists, the Secretary of the panel, unless there is cause for granting an extension of time, shall issue and cause to be served upon the parties a notice of hearing. The panel shall appoint, pursuant to § 269b.420, a hearing officer to hold a hearing and issue a report to the panel containing findings of fact, conclusions of law, and recommendations including, where appropriate, remedial action to be taken and notices to be posted. The Secretary shall furnish to the hearing officer the investigator's report and all other relevant information in the panel's possession.

### § 269b.420 Designation of hearing officer.

(a) The panel, absent special circumstances, shall employ the center to select the hearing officer to conduct the hearing at a site most convenient to the parties and witnesses. The individual who performed the investigation, pursuant to § 269b.210, shall be barred from acting as a hearing officer on the same matter, unless all parties in interest agree to his participation. The selection of the hearing officer, to the extent practicable, shall be done with the concurrence of the parties.

(b) Any party may request the hearing officer, at any time following his designation and before the filing of his decision, to withdraw on grounds of previously demonstrated personal bias, conflict of interest, or prejudice by filing with him promptly upon the discovery of the alleged facts a timely affidavit setting forth in detail the matters alleged to constitute grounds for disqualification. If, in the opinion of the hearing officer, such affidavit is filed with due diligence and is sufficient on its face, he shall forthwith disqualify himself and withdraw from the proceeding. If he does not so withdraw, he shall so rule upon the record, stating the grounds for his ruling and proceed with the hearing, or, if the hearing has closed, he shall proceed with the issuance of his decision, and his ruling shall be subject to the same review by the panel that is given to the rest of his decision.

(c) The costs of conducting the hearing and of the hearing officer shall be borne by the panel. Witness fees and expenses shall be paid by the party at whose instance the witnesses appear.

### § 269b.430 Contents of notice of hearing.

The notice of hearing shall include:

(a) A copy of the charge;

(b) A statement of the time of the hearing which shall be not less than 10 days after service of the notice of hearing, except in extraordinary circumstances. All charges involving a ''refusal to bargain'' allegation and all charges, if sustained, that would require the setting aside of an election, or the conducting of a new election shall be given first priority;

(c) A statement of the place and nature of hearing;

(d) A statement of the legal authority and jurisdiction under which the hearing is to be held;

(e) A reference to the particular section of the policy and rules and regulations of this chapter involved;

(f) A copy of the determination, if any, made causing the invocation of these formal proceedings.

### § 269b.440 Conduct of hearing.

(a) Hearing shall be public unless otherwise ordered by the hearing officer or the panel. An official reporter shall make the only official transcript of such proceedings.

(b) Copies of the official transcript will not be provided to the parties, but may be purchased by arrangement with the official reporter or with such costs as the panel may otherwise assess, or may be examined in the offices of the panel and/or the hearing officer subject to such conditions as the panel may prescribe.

(c) A charging party in asserting that an unfair labor practice has been committed within the meaning of the policy, shall have the burden of proving

the allegations of the charge, or the amended charge, by a preponderance of the evidence.

(d) The parties shall not be bound by the technical rules of evidence, but the hearing officer, may, in his discretion, exclude any evidence or offer of proof if he finds that its probative value is substantially outweighed by the risk that its admission will either necessitate undue consumption of time or create substantial danger of undue prejudice or confusion.

**§ 269b.441 Rights of parties.**

(a) Any party shall have the right to appear at such hearing in person, by counsel, or by other representative, to call, examine, and cross-examine witnesses as may be required for a full and true disclosure of the facts, and to introduce into the record documentary or other relevant evidence, except that the participation of any party shall be limited to the extent permitted by the hearing officer. Five copies of such documentary evidence shall be submitted unless the hearing officer permits a reduced number for good cause shown.

(b) Any party shall be entitled, upon request, to a reasonable period at the close of the hearing for oral argument, which shall be included in the stenographic report of the hearing.

(c) Any party shall be entitled to file a brief to the hearing officer within 10 days after the close of the hearing, but no reply brief may be filed except upon special permission of the hearing officer. A party filing a brief must file the original and one copy with the hearing officer along with proof of service of a copy of such brief to all parties. Requests for extension of time to file briefs must be made to the hearing officer who must receive the request at least 3 days prior to the expiration of time fixed for filing of briefs and notice of the request shall be served simultaneously on all other parties, and proof of service shall be furnished. If a request for extension of time is based on the need for a copy of the transcript prior to filing a brief, such request must be made to the hearing officer before the hearing is closed and must be ruled on prior to the close of the hearing.

**§ 269b.442 Duties and powers of the hearing officer.**

The hearing officer shall inquire fully into the facts as to whether the respondent has engaged or is engaging in an unfair labor practice as set forth in the charge or the amended charge. The hearing officer shall have authority, with respect to cases assigned to him, between the time he is designated and transfer of the case to the panel, subject to the rules and regulations in this subchapter, to:

(a) Grant requests for attendance of witnesses and production of documents;

(b) Rule upon petitions to quash requests made pursuant to paragraph (a) of this section;

(c) Call, examine, and cross-examine parties and witnesses as may be required for a full and true disclosure of the facts and to introduce into the record documentary or other evidence;

(d) Rule upon offers of proof and receive relevant evidence;

(e) Take or cause depositions to be taken whenever the ends of justice would be served thereby;

(f) Limit lines of questioning or testimony which are repetitive, cumulative, or irrelevant;

(g) Regulate the course of the hearing and, if appropriate or necessary, exclude persons or counsel from the hearing for contemptuous conduct and strike all related testimony of witnesses refusing to answer any proper question;

(h) Hold such prehearing conferences as may be necessary to expedite proceedings and hold such other conferences for the settlement or simplification of the issues by consent of the parties or upon his own motion;

(i) Dispose of procedural requests, motions, or similar matters which shall be made part of the record of the proceeding, including motions referred to the hearing officer by the panel, and motions to amend pleadings, also to recommend dismissal of cases or portions thereof, and to order hearings reopened or, upon motion, consolidated prior to issuance of the hearing officer's report and recommendations;

(j) Request the parties at any time during the hearing to state their respective positions concerning any issue

in the case or theory in support thereof;

(k) Require the parties, if necessary, to file written briefs in support of their positions;

(l) Take any other action necessary under the foregoing and authorized by the rules and regulations in this subchapter.

In the event the hearing officer designated to conduct the hearing becomes unavailable, the panel may designate another hearing officer for the purpose of further hearing or issuance of a report and recommendation on the record as made, or both.

### § 269b.443 Motions before or after a hearing.

All motions (including motions for intervention), other than those made during a hearing, shall be made in writing to the Secretary of the panel, shall briefly state the relief sought, shall set forth the grounds for such motion, and shall be accompanied 3 days thereafter by proof of service on all parties. Answering statements, if any, must be served on all parties and the original thereof, together with two copies and statement of service, shall be filed with the Secretary within 5 days after service of the moving papers, unless the Secretary directs otherwise. Motions may be referred to the hearing officer whose ruling shall be made upon the record or the motion may be stayed until such time as the panel reviews the hearing officer's report and recommendations.

### § 269b.444 Objection to conduct of hearing; other motions during hearing.

Any objection with respect to the conduct of the hearing, including any objection to the introduction of evidence, or any other motion during the course of the hearing, including a request to allow intervention, may be stated orally or in writing accompanied by a short statement of the grounds for such objection, and included in the record. No such objection shall be deemed waived by further participation in the hearing and such objection shall not stay the conduct of the hearing. Automatic exceptions will be allowed to all adverse rulings and shall be considered by the panel upon its review of the hearing officer's report and recommendations, if exception to the ruling is included in a statement of exceptions submitted to the panel after the close of the hearing, subject to the requirements of § 269b.520.

### § 269b.450 Submission of hearing officer's report to the panel.

After the close of the hearing, and the receipt of briefs, if any, the hearing officer shall prepare a report and recommendations, containing findings of fact, conclusions of law, including judgments as to the credibility of witnesses where appropriate, and the reasons or basis therefor, and recommendations as to the disposition of the case, and, where appropriate, including the remedial action and notices to be posted. After he has caused his report and recommendations to be served promptly on all parties to the proceeding, he shall transfer the case to the panel including his report and recommendations and the complete record. Such submission shall be made within 20 days after the close of the hearing and the receipt of briefs, if any, unless otherwise extended by the panel. The record shall include the charge, notice of hearing, service sheet, motions, rulings, orders, official transcript of the hearing, stipulations, objections, depositions, documentary evidence, exhibits, and any briefs or other documents submitted to the parties.

## PANEL REVIEW OF HEARING OFFICER'S REPORT AND RECOMMENDED DECISION

### § 269b.510 Review by panel.

The panel shall review the report and recommendations of each hearing officer, the record of the hearing, and such other documents as enumerated in § 269b.450, whether or not any party files an appeal, unless the parties file with the panel a settlement agreement within 10 days after service of the hearing officer's report upon them. In the course of such review, the panel may require oral argument or written briefs on any relevant issue within such time limits as the panel may prescribe, and may reopen the record in any case and receive further evidence.

**§ 269b.520 Exceptions to hearing officer's report.**

(a) Any party may file with the panel exceptions to the hearing officer's report and recommendations, and any ruling contained therein, if made within 10 days after service of the report and recommendations. The Panel may, for good cause shown, extend the time for filing such exceptions upon written request, with copies served simultaneously on the other parties, received not later than 3 days before the date exceptions are due. Requests for oral argument will not be considered unless filed with exceptions.

(b) Any exception to a ruling, finding, conclusion, or recommendation which is not specifically urged shall be deemed to have been waived, although the panel may on its own motion rule upon any matter in the report and recommendations.

(c) Any exception which fails to comply with the following requirements may be disregarded:

(1) The exceptions shall set forth specifically the questions of procedure, fact, law, or policy to which exceptions are taken;

(2) The exceptions shall identify the part of the hearing officer's report to which objection is made;

(3) The exceptions shall designate by precise citation of page the portions of the record relied on, shall state the grounds for the exceptions, and shall include the citation of authorities unless set forth in a supporting brief.

(d) Any brief in support of exceptions shall contain no matter not included within the scope of the exceptions and shall contain in the order indicated, the following:

(1) A concise statement of the case containing all that is material to the consideration of the questions presented;

(2) A specification of the questions involved and to be argued;

(3) The argument, presenting clearly the points of fact and law relied on in support of the position taken on each question, with specific page reference to the transcript and the legal or other material relied on.

(e) Answering briefs to the exceptions, and cross-exceptions and supporting briefs will not be permitted without special leave of the panel. Requests for oral argument will not be considered unless accompanying such petition for special leave.

(f) Five copies of exceptions and briefs must be filed with the panel along with a statement of service of copies of the exceptions and supporting briefs upon all parties.

**§ 269b.530 Briefs in support of the hearing officer's report.**

Any party may file a brief in support of the hearing officer's report and recommendations subject to the same time limits and rules pertaining to filing exceptions and briefs in support thereof, as set forth in § 269b.520.

**§ 269b.540 Action by the panel.**

After considering the hearing officer's report and recommendations, the record, any other documents, any exceptions filed, and any oral argument permitted, the panel shall issue its written decision. Upon finding that the respondent is engaging in or has engaged in an unfair labor practice, the panel shall order the respondent to cease and desist from such conduct and may require the respondent to take such affirmative corrective action as the panel deems appropriate to effectuate the Policy. Such action by the panel may include, but shall not be limited to, orders to provide back pay, provide reinstatement, set aside an election, bargain, and award recognition. Upon finding no violation of the policy, the panel shall dismiss the case. The panel's decision and order setting forth the remedial action, if any, required shall be conspicuously posted by the parties.

COMPLIANCE

**§ 269b.610 Procedures.**

Where remedial action is ordered or provided for in a settlement agreement, a report to the panel that such action has been taken and that compliance with the decision and orders of the panel has been effected shall be submitted within the period of time specified in the panel's decision. The panel is empowered to utilize whatever administrative procedures it deems necessary to ascertain compliance.

### § 269b.620 Action by panel.

In any case where it is found, after a hearing, that the respondent has failed to comply with the final decision and order of the panel, the panel shall be empowered to take whatever action may be appropriate and shall expect the full cooperation of the Board of Governors of the Federal Reserve System in obtaining such compliance. Among the actions that may be taken by the panel against a noncomplying respondent labor organization, after a show cause hearing, may be suspension of that labor organization's checkoff privileges or recognition as exclusive bargaining representative for such period of time as determined by the panel.

GENERAL RULES

### § 269b.710 Rules to be liberally construed.

(a) Whenever the panel finds that unusual circumstances or good cause exist and that strict compliance with the terms of the rules and regulations in this subchapter will work an injustice or unfairness, it shall construe the rules and regulations in this subchapter liberally to prevent injustices and to effectuate the purposes of the policy.

(b) When an act is required or allowed to be done at or within a specified time, the panel may at any time, in its discretion, order the period altered where it shall be manifest that strict adherence will work surprise or injustice or interfere with the proper effectuation of the policy.

### § 269b.720 Computation of time for filing papers.

In computing any period of time prescribed by or allowed by the panel, the day of the act, event, or default after which the designated period of time begins to run, shall not be included. The last day of the period so computed is to be included, unless it is a Saturday, Sunday, or the applicable local legal holiday in which event the period shall run until the end of the next day which is neither a Saturday, Sunday, or legal holiday. When the period of time prescribed, or allowed, is seven days or less, intermediate Saturdays, Sundays, and legal holidays shall be excluded from the computations. When the rules and regulations in this subchapter require the filing of any paper, such document must be received by the panel or the officer or agent designated by it to receive such matter before the close of business of the last day of the time limit, if any, for such filing or extension of the time that may have been granted.

### § 269b.730 Number of copies; form.

Except as otherwise provided in the regulations in this subchapter, any documents or papers shall be filed with four copies in addition to the original. All matters filed shall be printed, typed, or otherwise legibly duplicated; carbon copies of typewritten matter will be accepted if they are clearly legible.

### § 269b.731 Signature.

The original of each document filed shall be signed by the party or by an attorney or representative of record for the party, or by an officer of the party and shall contain the address and telephone number of the person signing it.

### § 269b.740 Service of pleading and other paper; statement of service.

(a) *Method of service.* Notices of hearings, decisions, orders, and other papers may be served personally or by registered or certified mail or by telegraph.

(b) *Upon whom served.* Unless otherwise provided in the rules and regulations in this subchapter, all papers except complaints, petitions, and papers relating to requests for appearance or production of documents, shall be served upon all counsel of record and upon parties not represented by counsel or by their agents designated by them or by law and upon the panel, or its designated officers or agents, where appropriate. Service upon such counsel or representative shall constitute service upon the party, but a copy also shall be transmitted to the party.

(c) *Proof of service.* The party or person serving the papers or process shall submit simultaneously to the panel or its designated representative, or the individual conducting the proceeding, a written statement of such service.

Failure to file a statement of service shall not affect the validity of the service. Proof of service, except where otherwise provided, shall be required only if subsequent to the receipt of a statement of service a question is raised with respect to proper service.

**§ 269b.750 Requests for appearance of witnesses and production of documents.**

Parties may request appearance of witnesses and production of documents by filing application therefor, depending upon the stage of the proceedings at which the request is made, with the officer conducting the investigation or hearing, or with the panel. Such application shall name and identify the witnesses or documents sought and shall briefly state the need for such appearance or production. The officer with whom such request is filed shall rule upon each such request and the record of the proceeding shall contain a record of that ruling and the basis therefor. The record shall also contain a statement of reasons for any request for the appearance of witnesses or production of documents initiated by a presiding officer.

# SUBCHAPTER B—FEDERAL OPEN MARKET COMMITTEE

## PART 270—OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

REGULATIONS RELATING TO OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

Sec.
270.1 Authority.
270.2 Definitions.
270.3 Governing principles.
270.4 Transactions in obligations.

AUTHORITY: Sec. 8, 48 Stat. 168, as amended (12 U.S.C. 263).

SOURCE: 38 FR 2753, Jan. 30, 1973, unless otherwise noted.

REGULATIONS RELATING TO OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

### § 270.1 Authority.

This part is issued by the Federal Open Market Committee (the ''Committee'') pursuant to authority conferred upon it by sections 12A and 14 of the Federal Reserve Act (12 U.S.C. 263, 355).

### § 270.2 Definitions.

(a) The term *obligations* means Government securities, U.S. agency securities, bankers' acceptances, bills of exchange, cable transfers, bonds, notes, warrants, debentures, and other obligations that Federal Reserve banks are authorized by law to purchase and sell.

(b) The term *Government securities* means direct obligations of the United States (i.e., U.S. bonds, notes, certificates of indebtedness, and Treasury bills) and obligations fully guaranteed as to principal and interest by the United States.

(c) The term *U.S. agency securities* means obligations that are direct obligations of, or are fully guaranteed as to principal and interest by, any agency of the United States.

(d) The term *System Open Market Account* means the obligations acquired pursuant to authorizations and directives issued by the Committee and held on behalf of all Federal Reserve banks.

### § 270.3 Governing principles.

As required by section 12A of the Federal Reserve Act, the time, character, and volume of all purchases and sales of obligations in the open market by Federal Reserve banks are governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

### § 270.4 Transactions in obligations.

(a) Each Federal Reserve bank shall engage in open market operations under section 14 of the Federal Reserve Act only in accordance with this part and with the authorizations and directives issued by the Committee from time to time, and no Reserve bank shall decline to engage in open market operations as directed by the Committee.

(b) Transactions for the System Open Market Account shall be executed by a Federal Reserve bank selected by the Committee. The participations of the several Federal Reserve banks in such account and in the profits and losses on transactions for the account shall be allocated in accordance with principles determined by the Committee from time to time.

(c) In accordance with such limitations, terms, and conditions as are prescribed by law and in authorizations and directives issued by the Committee, the Reserve bank selected by the Committee is authorized and directed—

(1) To buy and sell Government securities and U.S. agency securities in the open market for the System Open Market Account, and to exchange maturing securities with the issuer;

(2) To buy and sell banker's acceptances in the open market for its own account;

(3) To buy Government securities, U.S. agency securities, and banker's acceptances of the kinds described above, under agreements for repurchase of such obligations, in the open market for its own account; and

(4) To buy and sell foreign currencies in the form of cable transfers in the

open market for the System Open Market Account and to maintain for such account reciprocal currency arrangements with foreign banks among those designated by the Board of Governors of the Federal Reserve System under § 214.5 of this chapter (Regulation N).

(d) The Federal Reserve banks are authorized and directed to engage in such other operations as the Committee may from time to time determine to be reasonably necessary to the effective conduct of open market operations and the effectuation of open market policies.

[38 FR 2753, Jan. 30, 1973, as amended at 39 FR 11873, Apr. 1, 1974; 48 FR 32336, July 15, 1983]

## PART 271—RULES REGARDING AVAILABILITY OF INFORMATION

Sec.

271.1 Authority and purpose.
271.2 Definitions.
271.3 Published information.
271.4 Records available for public inspection and copying.
271.5 Records available to the public on request.
271.6 Processing requests.
271.7 Exemptions from disclosure.
271.8 Subpoenas.
271.9 Fee schedules; waiver of fees.

AUTHORITY: 5 U.S.C. 552; 12 U.S.C. 263.

SOURCE: 62 FR 61218, Nov. 17, 1997, unless otherwise noted.

### § 271.1 Authority and purpose.

(a) *Authority*. This part is issued by the Federal Open Market Committee (the Committee) pursuant to the Freedom of Information Act, 5 U.S.C. 552, and also pursuant to the Committee's authority under section 12A of the Federal Reserve Act, 12 U.S.C. 263, to issue regulations governing the conduct of its business.

(b) *Purpose*. This part sets forth the categories of information made available to the public and the procedures for obtaining documents and records.

### § 271.2 Definitions.

(a) *Board* means the Board of Governors of the Federal Reserve System established by the Federal Reserve Act of 1913 (38 Stat. 251).

(b) *Commercial use request* refers to a request from or on behalf of one who seeks information for a use or purpose that furthers the commercial, trade, or profit interests of the requester or the person on whose behalf the request is made.

(c) *Direct costs* mean those expenditures that the Committee actually incurs in searching for, reviewing, and duplicating documents in response to a request made under § 271.5.

(d) *Duplication* refers to the process of making a copy of a document in response to a request for disclosure of records or for inspection of original records that contain exempt material or that otherwise cannot be inspected directly. Among others, such copies may take the form of paper, microform, audiovisual materials, or machine-readable documentation (*e.g.*, magnetic tape or disk).

(e) *Educational institution* refers to a preschool, a public or private elementary or secondary school, or an institution of undergraduate higher education, graduate higher education, professional education, or an institution of vocational education that operates a program of scholarly research.

(f) *Federal Reserve Bank* means one of the district Banks authorized by the Federal Reserve Act, 12 U.S.C. 222, including any branch of any such Bank.

(g) *Information of the Committee* means all information coming into the possession of the Committee or of any member thereof or of any officer, employee, or agent of the Committee, the Board, or any Federal Reserve Bank, in the performance of duties for, or pursuant to the direction of, the Committee.

(h) *Noncommercial scientific institution* refers to an institution that is not operated on a ''commercial'' basis (as that term is used in this section) and which is operated solely for the purpose of conducting scientific research, the results of which are not intended to promote any particular product or industry.

(i) *Records of the Committee* includes rules, statements, decisions, minutes, memoranda, letters, reports, transcripts, accounts, charts, and other written material, as well as any materials in machine readable form that

constitute a part of the Committee's official files.

(j) *Representative of the news media* refers to any person actively gathering news for an entity that is organized and operated to publish or broadcast news to the public.

(1) The term ''news'' means information about current events or that would be of current interest to the public.

(2) Examples of news media entities include, but are not limited to, television or radio stations broadcasting to the public at large, and publishers of newspapers and other periodicals (but only in those instances when they can qualify as disseminators of ''news'') who make their products available for purchase or subscription by the general public.

(3) ''Freelance'' journalists may be regarded as working for a news organization if they can demonstrate a solid basis for expecting publication through that organization, even though not actually employed by it.

(k)(1) *Review* refers to the process of examining documents, located in response to a request for access, to determine whether any portion of a document is exempt information. It includes doing all that is necessary to excise the documents and otherwise to prepare them for release.

(2) *Review* does not include time spent resolving general legal or policy issues regarding the application of exemptions.

(l)(1) *Search* means a reasonable search, by manual or automated means, of the Committee's official files and any other files containing records of the Committee as seem reasonably likely in the particular circumstances to contain documents of the kind requested. For purposes of computing fees under § 271.9, search time includes all time spent looking for material that is responsive to a request, including line-by-line identification of material within documents. Such activity is distinct from ''review'' of material to determine whether the material is exempt from disclosure.

(2) *Search* does not mean or include research, creation of any document, or extensive modification of an existing program or system that would significantly interfere with the operation of the Committee's automated information system.

### § 271.3 Published information.

(a) FEDERAL REGISTER. The Committee publishes in the FEDERAL REGISTER, in addition to this part:

(1) A description of its organization;

(2) Statements of the general course and method by which its functions are channeled and determined;

(3) Rules of procedure;

(4) Substantive rules of general applicability, and statements of general policy and interpretations of general applicability formulated and adopted by the Committee;

(5) Every amendment, revision, or repeal of the foregoing; and

(6) General notices of proposed rulemaking.

(b) *Annual Report to Congress.* Each annual report made to Congress by the Board includes a complete record of the actions taken by the Committee during the preceding year upon all matters of policy relating to open market operations, showing the reasons underlying the actions, and the votes taken.

(c) *Other published information.* From time to time, other information relating to open market operations of the Federal Reserve Banks is published in the *Federal Reserve Bulletin*, in the Board's annual report to Congress, and in announcements and statements released to the press. Copies of issues of the Bulletin and of annual reports of the Board may be obtained from the Publications Services of the Federal Reserve Board, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 (pedestrian entrance is on C Street, N.W.). Subscription or other charges may apply.

[62 FR 61218, Nov. 17, 1997, as amended at 70 FR 7840, Feb. 16, 2005]

### § 271.4 Records available for public inspection and copying.

(a) *Types of records made available.* Unless they were published promptly and made available for sale or without charge, certain records shall be made available for inspection and copying at the Board's Freedom of Information Office pursuant to 5 U.S.C. 552(a)(2).

(b) *Reading room procedures.* (1) Information available under this section is available for inspection and copying, from 9:00 a.m. to 5:00 p.m. weekdays, at the Freedom of Information Office of the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551 (the pedestrian entrance is on C Street, N.W.).

(2) The Committee may determine that certain classes of publicly available filings shall be made available for inspection and copying only at the Federal Reserve Bank where those records are maintained.

(c) *Electronic records.* Information available under this section that was created on or after November 1, 1996, shall also be available on the Board's Web site, found at *http://www.federalreserve.gov*.

(d) *Privacy protection.* The Committee may delete identifying details from any record to prevent a clearly unwarranted invasion of personal privacy.

[62 FR 61218, Nov. 17, 1997, as amended at 70 FR 7840, Feb. 16, 2005]

### § 271.5 Records available to the public on request.

(a) *Types of records made available.* All records of the Committee that are not available under §§ 271.3 and 271.4 shall be made available upon request, pursuant to the procedures in this section and the exceptions in § 271.7.

(b) *Procedures for requesting records.* (1) A request for identifiable records shall reasonably describe the records in a way that enables the Committee's staff to identify and produce the records with reasonable effort and without unduly burdening or significantly interfering with any of the Committee's operations.

(2) The request shall be submitted in writing to the Secretary of the Committee, Federal Open Market Committee, 20th & C Street, N.W., Washington, D.C. 20551; or sent by facsimile to the Secretary of the Committee, (202) 452–2921. The request shall be clearly marked *FREEDOM OF INFORMATION ACT REQUEST*.

(c) *Contents of request.* The request shall contain the following information:

(1) The name and address of the requester, and the telephone number at which the requester can be reached during normal business hours;

(2) Whether the requested information is intended for commercial use, and whether the requester represents an educational or noncommercial scientific institution, or news media;

(3) A statement agreeing to pay the applicable fees, or a statement identifying any fee limitation desired, or a request for a waiver or reduction of fees that satisfies § 271.9(f).

(d) *Defective requests.* The Committee need not accept or process a request that does not reasonably describe the records requested or that does not otherwise comply with the requirements of this section. The Committee may return a defective request, specifying the deficiency. The requester may submit a corrected request, which will be treated as a new request.

### § 271.6 Processing requests.

(a) *Receipt of requests.* The date of receipt for any request, including one that is addressed incorrectly or that is referred to the Committee by another agency or by a Federal Reserve Bank, is the date the Secretary of the Committee actually receives the request.

(b) *Priority of responses.* The Committee shall normally process requests in the order they are received. However, in the Secretary's discretion, or upon a court order in a matter to which the Committee is a party, a particular request may be processed out of turn.

(c) *Expedited processing.* Where a person requesting expedited access to records has demonstrated a compelling need for the records, or where the Committee has determined to expedite the response, the Committee shall process the request as soon as practicable.

(1) To demonstrate a compelling need for expedited processing, the requester shall provide a certified statement, a sample of which may be obtained from the Board's Freedom of Information Office. The statement, certified to be true and correct to the best of the requester's knowledge and belief, shall demonstrate that:

(i) The failure to obtain the records on an expedited basis could reasonably

be expected to pose an imminent threat to the life or physical safety of an individual; or

(ii) The requester is a representative of the news media, as defined in § 271.2, and there is urgency to inform the public concerning actual or alleged Committee activity.

(2) In response to a request for expedited processing, the Secretary of the Committee shall notify a requester of the determination within ten working days of receipt of the request. In exceptional situations, the Secretary of the Committee has the discretion to waive the formality of certification. If the Secretary of the Committee denies a request for expedited processing, the requester may file an appeal pursuant to the procedures set forth in paragraph (i) of this section, and the Committee shall respond to the appeal within ten working days after the appeal was received by the Committee.

(d) *Time limits*. The time for response to requests shall be 20 working days, except:

(1) In the case of expedited treatment under paragraph (c) of this section;

(2) Where the running of such time is suspended for payment of fees pursuant to § 271.9(b)(2);

(3) In unusual circumstances, as defined in 5 U.S.C. 552(a)(6)(B). In such circumstances, the time limit may be extended for a period of time not to exceed:

(i) 10 working days as provided by written notice to the requester, setting forth the reasons for the extension and the date on which a determination is expected to be dispatched; or

(ii) Such alternative time period as mutually agreed to by the Secretary of the Committee and the requester when the Secretary of the Committee notifies the requester that the request cannot be processed in the specified time limit.

(e) *Response to request*. In response to a request that satisfies § 271.5, an appropriate search shall be conducted of records of the Committee in existence on the date of receipt of the request, and a review made of any responsive information located. The Secretary shall notify the requester of:

(1) The Committee's determination of the request;

(2) The reasons for the determination;

(3) The amount of information withheld;

(4) The right of the requester to appeal to the Committee any denial or partial denial, as specified in paragraph (i) of this section; and

(5) In the case of a denial of a request, the name and title or position of the person responsible for the denial.

(f) *Referral to another agency*. To the extent a request covers documents that were created by, obtained from, or classified by another agency, the Committee may refer the request to that agency for a response and inform the requester promptly of the referral.

(g) *Providing responsive records*. (1) Copies of requested records shall be sent to the requester by regular U.S. mail to the address indicated in the request, unless the requester elects to take delivery of the documents at the Board's Freedom of Information Office or makes other acceptable arrangements, or the Committee deems it appropriate to send the documents by another means.

(2) The Committee shall provide a copy of the record in any form or format requested if the record is readily reproducible by the Committee in that form or format, but the Committee need not provide more than one copy of any record to a requester.

(h) *Appeal of denial of request*. Any person denied access to Committee records requested under § 271.5 may file a written appeal with the Committee, as follows:

(1) The appeal shall prominently display the phrase *FREEDOM OF INFORMATION ACT APPEAL* on the first page, and shall be addressed to the Secretary of the Committee, Federal Open Market Committee, 20th and C Street, N.W., Washington, D.C. 20551; or sent by facsimile to the Secretary of the Committee, (202) 452–2921.

(2) An initial request for records may not be combined in the same letter with an appeal.

(3) The Committee, or such member of the Committee as is delegated the authority, shall make a determination regarding any appeal within 20 working days of actual receipt of the appeal by the Secretary, and the determination

letter shall notify the appealing party of the right to seek judicial review of such denial.

**§ 271.7 Exemptions from disclosure.**

(a) *Types of records exempt from disclosure.* Pursuant to 5 U.S.C. 552(b), the following records of the Committee are exempt from disclosure under this part:

(1) *National defense.* Any information that is specifically authorized under criteria established by an Executive Order to be kept secret in the interest of national defense or foreign policy and is in fact properly classified pursuant to the Executive Order.

(2) *Internal personnel rules and practices.* Any information related solely to the internal personnel rules and practices of the Board.

(3) *Statutory exemption.* Any information specifically exempted from disclosure by statute (other than 5 U.S.C. 552b), if the statute:

(i) Requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue; or

(ii) Establishes particular criteria for withholding or refers to particular types of matters to be withheld.

(4) *Trade secrets; commercial or financial information.* Any matter that is a trade secret or that constitutes commercial or financial information obtained from a person and that is privileged or confidential.

(5) *Inter- or intra-agency memorandums.* Information contained in inter- or intra-agency memorandums or letters that would not be available by law to a party (other than an agency) in litigation with an agency, including, but not limited to:

(i) Memorandums;

(ii) Reports;

(iii) Other documents prepared by the staffs of the Committee, Board or Federal Reserve Banks; and

(iv) Records of deliberations of the Committee and of discussions at meetings of the Committee or its staff.

(6) *Personnel and medical files.* Any information contained in personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

(7) *Information compiled for law enforcement purposes.* Any records or information compiled for law enforcement purposes, to the extent permitted under 5 U.S.C. 552(b)(7).

(8) *Examination, inspection, operating, or condition reports, and confidential supervisory information.* Any matter that is contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions, including a state financial institution supervisory agency.

(b) *Segregation of nonexempt information.* The Committee shall provide any reasonably segregable portion of a record that is requested after deleting those portions that are exempt under this section.

(c) *Discretionary release.* Except where disclosure is expressly prohibited by statute, regulation, or order, the Committee may authorize the release of records that are exempt from mandatory disclosure whenever the Committee or designated Committee members determines that such disclosure would be in the public interest.

(d) *Delayed release.* Publication in the FEDERAL REGISTER or availability to the public of certain information may be delayed if immediate disclosure would likely:

(1) Interfere with accomplishing the objectives of the Committee in the discharge of its statutory functions;

(2) Interfere with the orderly conduct of the foreign affairs of the United States;

(3) Permit speculators or others to gain unfair profits or other unfair advantages by speculative trading in securities or otherwise;

(4) Result in unnecessary or unwarranted disturbances in the securities markets;

(5) Interfere with the orderly execution of the objectives or policies of other government agencies; or

(6) Impair the ability to negotiate any contract or otherwise harm the commercial or financial interest of the United States, the Committee, the Board, any Federal Reserve Bank, or any department or agency of the United States.

(e) *Prohibition against disclosure.* Except as provided in this part, no officer, employee, or agent of the Committee or any Federal Reserve Bank shall disclose or permit the disclosure of any unpublished information of the Committee to any person (other than Committee officers, employees, or agents properly entitled to such information for the performance of official duties).

### § 271.8 Subpoenas.

(a) *Advice by person served.* If any person, whether or not an officer or employee of the Committee, of the Board of Governors of the Federal Reserve System, or of a Federal Reserve Bank, has information of the Committee that may not be disclosed by reason of § 271.7 and in connection therewith is served with a subpoena, order, or other process requiring the person's personal attendance as a witness or the production of documents or information upon any proceeding, the person should promptly inform the Secretary of the Committee of such service and of all relevant facts, including the documents and information requested and any facts that may be of assistance in determining whether such documents or information should be made available; and the person should take action at the appropriate time to inform the court or tribunal that issued the process, and the attorney for the party at whose instance the process was issued, if known, of the substance of this part.

(b) *Appearance by person served.* Except as disclosure of the relevant information is authorized pursuant to this part, any person who has information of the Committee and is required to respond to a subpoena or other legal process shall attend at the time and place therein mentioned and decline to disclose such information or give any testimony with respect thereto, basing such refusal upon this part. If, notwithstanding, the court or other body orders the disclosure of such information, or the giving of such testimony, the person having such information of the Committee shall continue to decline to disclose such information and shall promptly report the facts to the Committee for such action as the Committee may deem appropriate.

[62 FR 61218, Nov. 17, 1997, as amended at 70 FR 7840, Feb. 16, 2005]

### § 271.9 Fee schedules; waiver of fees.

(a) *Fee schedules.* The fees applicable to a request for records pursuant to §§ 271.4 and 271.5 are set forth in appendix A to this section. These fees cover only the full allowable direct costs of search, duplication, and review. No fees will be charged where the average cost of collecting the fee (calculated at $5.00) exceeds the amount of the fee.

(b) *Payment procedures.* The Secretary may assume that a person requesting records pursuant to § 271.5 will pay the applicable fees, unless the request includes a limitation on fees to be paid or seeks a waiver or reduction of fees pursuant to paragraph (f) of this section.

(1) *Advance notification of fees.* If the estimated charges are likely to exceed $100, the Secretary of the Committee shall notify the requester of the estimated amount, unless the requester has indicated a willingness to pay fees as high as those anticipated. Upon receipt of such notice, the requester may confer with the Secretary to reformulate the request to lower the costs.

(2) *Advance payment.* The Secretary may require advance payment of any fee estimated to exceed $250. The Secretary may also require full payment in advance where a requester has previously failed to pay a fee in a timely fashion. The time period for responding to requests under § 271.6(d), and the processing of the request shall be suspended until the Secretary receives the required payment.

(3) *Late charges.* The Secretary may assess interest charges when fee payment is not made within 30 days of the date on which the billing was sent. Interest is at the rate prescribed in 31 U.S.C. 3717 and accrues from the date of the billing.

(c) *Categories of uses.* The fees assessed depend upon the intended use for the records requested. In determining which category is appropriate, the Secretary shall look to the intended use set forth in the request for records. Where a requester's description of the

use is insufficient to make a determination, the Secretary may seek additional clarification before categorizing the request.

(1) *Commercial use.* The fees for search, duplication, and review apply when records are requested for commercial use.

(2) *Educational, research, or media use.* The fees for duplication apply when records are not sought for commercial use, and the requester is a representative of the news media or an educational or noncommercial scientific institution, whose purpose is scholarly or scientific research. The first 100 pages of duplication, however, will be provided free.

(3) *All other uses.* For all other requests, the fees for document search and duplication apply. The first two hours of search time and the first 100 pages of duplication, however, will be provided free.

(d) *Nonproductive search.* Fees for search and review may be charged even if no responsive documents are located or if the request is denied.

(e) *Aggregated requests.* A requester may not file multiple requests at the same time, solely in order to avoid payment of fees. If the Secretary reasonably believes that a requester is separating a request into a series of requests for the purpose of evading the assessment of fees, the Secretary may aggregate any such requests and charge accordingly. It is considered reasonable for the Secretary to presume that multiple requests of this type made within a 30-day period have been made to avoid fees.

(f) *Waiver or reduction of fees.* A request for a waiver or reduction of the fees, and the justification for the waiver, shall be included with the request for records to which it pertains. If a waiver is requested and the requester has not indicated in writing an agreement to pay the applicable fees if the waiver request is denied, the time for response to the request for documents, as set forth in § 271.6(d), shall not begin until a determination has been made on the request for a waiver or reduction of fees.

(1) *Standards for determining waiver or reduction.* The Secretary shall grant a waiver or reduction of fees where it is determined both that disclosure of the information is in the public interest because it is likely to contribute significantly to public understanding of the operation or activities of the government, and that the disclosure of information is not primarily in the commercial interest of the requester. In making this determination, the following factors shall be considered:

(i) Whether the subject of the records concerns the operations or activities of the government;

(ii) Whether disclosure of the information is likely to contribute significantly to public understanding of government operations or activities;

(iii) Whether the requester has the intention and ability to disseminate the information to the public;

(iv) Whether the information is already in the public domain;

(v) Whether the requester has a commercial interest that would be furthered by the disclosure; and, if so,

(vi) Whether the magnitude of the identified commercial interest of the requester is sufficiently large, in comparison with the public interest in disclosure, that disclosure is primarily in the commercial interest of the requester.

(2) *Contents of request for waiver.* A request for a waiver or reduction of fees shall include:

(i) A clear statement of the requester's interest in the documents;

(ii) The use proposed for the documents and whether the requester will derive income or other benefit for such use;

(iii) A statement of how the public will benefit from such use and from the Committee's release of the documents;

(iv) A description of the method by which the information will be disseminated to the public; and

(v) If specialized use of the information is contemplated, a statement of the requester's qualifications that are relevant to that use.

(3) *Burden of proof.* The burden shall be on the requester to present evidence or information in support of a request for a waiver or reduction of fees.

(4) *Determination by Secretary.* The Secretary shall make a determination

on the request for a waiver or reduction of fees and shall notify the requester accordingly. A denial may be appealed to the Committee in accordance with § 271.6(h).

(g) *Employee requests.* In connection with any request by an employee, former employee, or applicant for employment, for records for use in prosecuting a grievance or complaint of discrimination against the Committee, fees shall be waived where the total charges (including charges for information provided under the Privacy Act of 1974 (5 U.S.C. 552a) are $50 or less; but the Secretary may waive fees in excess of that amount.

(h) *Special services* The Secretary may agree to provide, and set fees to recover the costs of, special services not covered by the Freedom of Information Act, such as certifying records or information and sending records by special methods such as express mail or overnight delivery.

APPENDIX A TO § 271.9—FREEDOM OF INFORMATION FEE SCHEDULE

| | |
|---|---|
| Duplication: | |
| Photocopy, per standard page | $.10 |
| Paper copies of microfiche, per frame | .10 |
| Duplicate microfiche, per microfiche | .35 |
| Search and review: | |
| Clerical/Technical, hourly rate | 20.00 |
| Professional/Supervisory, hourly rate | 38.00 |
| Manager/Senior Professional, hourly rate | 65.00 |
| Computer search and production: | |
| Computer operator search, hourly rate | 32.00 |
| Tapes (cassette), per tape | 6.00 |
| Tapes (cartridge), per tape | 9.00 |
| Tapes (reel), per tape | 18.00 |
| Diskettes (3½″), per diskette | 4.00 |
| Diskettes (5¼″), per diskette | 5.00 |
| Computer Output (PC), per minute | .10 |
| Computer Output (mainframe) | actual cost |

# PART 272—RULES OF PROCEDURE

Sec.
272.1 Authority.
272.2 Functions of the Committee.
272.3 Meetings.
272.4 Committee actions.
272.5 Notice and public procedure.

AUTHORITY: 5 U.S.C. 552.

SOURCE: 38 FR 2754, Jan. 30, 1973, unless otherwise noted.

## § 272.1 Authority.

This part is issued by the Federal Open Market Committee (the Committee) pursuant to the requirement of section 552 of title 5 of the United States Code that every agency shall publish in the FEDERAL REGISTER its rules of procedure.

## § 272.2 Functions of the Committee.

The procedures followed by the Committee are designed to facilitate the effective performance of the Committee's statutory functions with respect to the regulation and direction of open market operations conducted by the Federal Reserve banks and with respect to certain direct transactions between the Reserve banks and the United States. In determining the policies to be followed in such operations, the Committee considers information regarding business and credit conditions and domestic and international economic and financial developments, and other pertinent information gathered and submitted by its staff and the staffs of the Board of Governors of the Federal Reserve System (the Board) and the Federal Reserve banks. Against the background of such information, the Committee takes actions from time-to-time to regulate and direct the open market operations of the Reserve banks. Such policy actions ordinarily are taken through the adoption and transmission to the Federal Reserve banks of regulations, authorizations, and directives.

### § 272.3 Meetings.

(a) *Place and frequency*. The Committee meets in Washington, DC, at least four times each year and oftener if deemed necessary. Meetings are held upon the call of the Chairman of the Board or at the request of any three members of the Committee. Notices of calls by the Chairman of the Board to other members are given by the Secretary of the Committee in writing, by telephone, or electronic means. Requests of any three members for the calling of a meeting shall state the time therefor and shall be filed in writing, by telephone, or electronic means with the Secretary who shall forthwith notify all members of the Committee in writing, by telephone, or electronic means. When the Secretary has sent notices to all members of the Committee that a meeting has been requested by three members and of the time therefor, a meeting is deemed to have been called. If, in the judgment of the Chairman, circumstances require that a meeting be called at such short notice that one or more members cannot be present in person, such members may participate in the meeting by telephone conference arrangements or by electronic means.

(b) *Alternates*. Whenever any member of the Committee representing Federal Reserve banks shall find that the member will be unable to attend a meeting of the Committee, the member shall promptly notify the member's alternate and the Secretary of the Committee in writing, by telephone, or electronic means, and upon receipt of such notice such alternate shall advise the Secretary whether the alternate will attend such meeting.

(c) *Quorum*. Seven members constitute a quorum of the Committee for purposes of transacting business except that, if there are fewer than seven members in office, then the number of members in office constitute a quorum. For purposes of this paragraph (c), members of the Committee include alternates acting in the absence of members. Less than a quorum may adjourn a meeting of the Committee from time to time until a quorum is in attendance.

(d) *Attendance at meetings*. Attendance at Committee meetings is restricted to members and alternate members of the Committee, the Presidents of Federal Reserve Banks who are not at the time members or alternates, staff officers of the Committee, the Manager, and such other advisers as the Committee may invite from time to time.

(e) *Meeting agendas*. The Secretary, in consultation with the Chairman, prepares an agenda of matters to be discussed at each meeting and the Secretary transmits the agenda to the members of the Committee within a reasonable time in advance of such meeting. In general, the agendas include reports by the Manager on open market operations since the previous meeting, and ratification by the Committee of such operations; reports by Economists on, and Committee discussion of, the economic and financial situation and outlook; Committee discussion of monetary policy and action with respect thereto; and such other matters as may be considered necessary.

[38 FR 2754, Jan. 30, 1973, as amended at 44 FR 52823, Sept. 11, 1979; 65 FR 6320, Feb. 9, 2000; 68 FR 6061, Feb. 6, 2003; 70 FR 7840, Feb. 16, 2005]

### § 272.4 Committee actions.

(a) *Actions at meetings*. Actions are taken at meetings of the Committee except as described below.

(b) *Actions between meetings*. Special circumstances may make it desirable in the public interest for Committee members to consider an action to modify an outstanding Committee authorization or directive at a time when it is not feasible to call a meeting. Whenever, in the judgment of the Chairman, such circumstances have arisen, the relevant information and recommendations for action are transmitted to the members by the Secretary, and the members communicate their votes to the Secretary. If the action is approved by a majority of the members, advice to that effect is promptly given by the Secretary to the members of the Committee and to the Reserve bank selected to execute transactions for the System Open Market Account. All communications of recommended actions and votes under this paragraph shall be in writing, by telephone, or

electronic means; if the communication is made orally, the Secretary shall cause a written record to be made without delay. An action taken between meetings has the force and effect of an action at a meeting: *Provided, however,* That if a meeting is held before the execution of any operations pursuant to the action, the action is null and void unless it is ratified and confirmed by the Committee at such meeting.

(c) *Delegations of authority.* In special circumstances, the Committee may delegate authority to take an action, subject to such instructions or guidelines as the Committee deems proper. Such delegations of authority may be made to the Chairman; to a subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board (or in the absence of the Chairman or of the Vice Chairman of the Board the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee the alternate for the Vice Chairman); or to any other member or members of the Committee. An action taken pursuant to such a delegation of authority has the force and effect of an action taken by the Committee.

(d) *Technical changes to Committee rules.* The Secretary of the Committee (or the acting secretary) is authorized to make technical corrections, such as spelling, grammar, construction, and organization (including removal of obsolete provisions and references), to the Committee's rules, regulations, and orders and other records of Committee action but only with the concurrence of the Committee's General Counsel.

(e) *Effective date.* Committee action ordinarily is made effective as of the time it is taken because the nature of the subject matter and the action taken is such that the public interest and the proper discharge of the Committee's responsibilities so require. Occasionally, however, the Committee may specify that an action is to be effective at some different time.

[38 FR 2754, Jan. 30, 1973, as amended at 65 FR 6320, Feb. 9, 2000; 70 FR 7841, Feb. 16, 2005]

### § 272.5 Notice and public procedure.

There ordinarily is no published notice of proposed action by the Committee or public procedure thereon, as described in section 553 of title 5 of the United States Code, because such notice and procedure are impracticable, unnecessary, or contrary to the public interest.

## PART 281—STATEMENTS OF POLICY

### § 281.1 Policy regarding the Government in the Sunshine Act.

On September 13, 1976, there was enacted into law the Government in the Sunshine Act, Pub. L. No. 94–409, 90 Stat. 1241 (''Sunshine Act''), established for the purpose of providing the public with the ''fullest practicable information regarding the decision-making processes of the Federal Government * * * while protecting the rights of individuals and the ability of the Government to carry out its responsibilities.''[1] The Sunshine Act applies only to those Federal agencies that are defined in section 552(e) of Title 5 of the United States Code and ''headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate, and any subdivision thereof authorized to act on behalf of the agency.''[2]

The Federal Open Market Committee (''FOMC'') is a separate and independent statutory body within the Federal Reserve System. In no respect is it an agent or ''subdivision'' of the Board of Governors of the Federal Reserve System (''Board of Governors''). It was originally established by the Banking Act of 1933 and restructured in its present form by the Banking Act of 1935 and subsequent legislation in 1942 (generally see 12 U.S.C. 263(a)). The FOMC's membership is composed of the seven members of the Board of Governors and five representatives of the Federal Reserve Banks who are selected annually in accordance with the procedures set forth in Section 12A of the Federal Reserve Act, 12 U.S.C. 263(a). Members of the Board of Governors serve in an ex officio capacity on the FOMC by reason of their appointment as Members of the Board of Governors, not as a result of an appointment ''to such position'' (the FOMC) by the President. Representatives of the Reserve Banks serve on the FOMC not as a result of an appointment ''to such position'' by the President, but rather by virtue of their positions with the

[1] Government in the Sunshine Act, Pub. L. 94–409, sec. 2, 90 Stat. 1241 (1976).

[2] Government in the Sunshine Act, Pub. L. 94–409, sec. 3(a), 90 Stat. 1241 (1976).

Reserve Banks and their selection pursuant to Section 12A of the Federal Reserve Act. It is clear therefore that the FOMC does not fall within the scope of an ''agency'' or ''subdivision'' as defined in the Sunshine Act and consequently is not subject to the provisions of that Act.

As explained below, the Act would not require the FOMC to hold its meetings in open session even if the FOMC were covered by the Act. However, despite the conclusion reached that the Sunshine Act does not apply to the FOMC, the FOMC has determined that its procedures and timing of public disclosure already are conducted in accordance with the spirit of the Sunshine Act, as that Act would apply to deliberations of the nature engaged in by the FOMC.

In the foregoing regard, the FOMC has noted that while the Act calls generally for open meetings of multi-member Federal agencies, 10 specific exemptions from the open meeting requirement are provided to assure the ability of the Government to carry out its responsibilities. Among the exemptions provided is that which authorizes any agency operating under the Act to conduct closed meetings where the subject of a meeting involves information ''the premature disclosure of which would—in the case of an agency which regulates currencies, securities, commodities, or financial institutions, be likely to lead to significant financial speculation in currencies, securities, or commodities.''[3]

As to meetings closed under such exemption, the Act requires the maintenance of either a transcript, electronic recording or minutes and sets forth specified, detailed requirements as to the contents and timing of disclosure of certain portions or all of such minutes. The Act permits the withholding from the public of the minutes where disclosure would be likely to produce adverse consequences of the nature described in the relevant exemptions.

The FOMC has reviewed the agenda of its monthly meetings for the past three years and has determined that all such meetings could have been closed pursuant to the exemption dealing with finanical speculation or other exemptions set forth in the Sunshine Act. The FOMC has further determined that virtually all of its substantive deliberations could have been preserved pursuant to the Act's minutes requirements and that such minutes could similarly have been protected against premature disclosure under the provisions of the Act.

The FOMC's deliberations are currently reported by means of a document entitled ''Record of Policy Actions'' which is released to the public approximately one month after the meeting to which it relates. The Record of Policy Actions complies with the Act's minutes requirements in that it contains a full and accurate report of all matters of policy discussed and views presented, clearly sets forth all policy actions taken by the FOMC and the reasons therefor, and includes the votes by individual members on each policy action. The timing of release of the Record of Policy Actions is fully consistent with the Act's provisions assuring against premature release of any item of discussion in an agency's minutes that contains information of a sensitive financial nature. In fact, by releasing the comprehensive Record of Policy Actions to the public approximately a month after each meeting, the FOMC exceeds the publication requirements that would be mandated by the letter of the Sunshine Act.

Recognizing the Congressional purpose underlying the enactment of the Sunshine Act, the FOMC has determined to continue its current practice and timing of public disclosures in the conviction that its operations thus conducted are consistent with the intent and spirit of the Sunshine Act.

(12 U.S.C. 263; 5 U.S.C. 552)

[42 FR 13300, Mar. 10, 1977. Redesignated at 70 FR 7841, Feb. 16, 2005]

[3] Government in the Sunshine Act, Pub. L. 94–409, sec. 3(a), 90 Stat. 1242 (1976).

## SUBCHAPTER C—FEDERAL RESERVE SYSTEM LABOR RELATIONS PANEL

### PARTS 290–299 [RESERVED]

# FINDING AIDS

A list of CFR titles, subtitles, chapters, subchapters and parts and an alphabetical list of agencies publishing in the CFR are included in the CFR Index and Finding Aids volume to the Code of Federal Regulations which is published separately and revised annually.

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