

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-0960]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is publishing for comment proposed revisions to Regulation Z. The revisions implement an amendment to the Truth in Lending Act contained in the Economic Growth and Regulatory Paperwork Reduction Act of 1996 affecting the disclosure of a fifteen-year historical example of rates and payments. The amendment applies to variable-rate loans with a term exceeding one year and secured by the consumer's principal dwelling. The amendment allows creditors either to disclose a fifteen-year historical example or to give a statement that the periodic payment may substantially increase or decrease together with a maximum interest rate and payment based on a \$10,000 loan.

DATES: Comments must be received on or before February 28, 1997.

ADDRESSES: Comments should refer to Docket No. R-0960, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m. weekdays, or to the security control room at all other times. The mail room and the security control room are accessible from the courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments will be available for inspection in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

FOR FURTHER INFORMATION CONTACT: Kyung H. Cho-Miller, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for users of Telecommunications Device for the Deaf (TDD) only, contact Dorothea Thompson at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA) (15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (the APR). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. The TILA requires additional disclosures for loans secured by a consumer's home and permits consumers to rescind certain transactions that involve their principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR Part 226).

The credit transactions covered by TILA and Regulation Z fall into two categories--open- or closed-end credit transactions. Open-end credit is defined as a plan under which the creditor reasonably contemplates repeated transactions, which prescribes the terms of such transactions, and which provides for a finance charge that may be computed from time to time on the outstanding unpaid balance, for example, credit extended by means of a credit card (§ 226.2(a)(20)). Closed-end credit is defined by as any credit arrangement that does not fall within the definition of open-end credit (§ 226.2(a)(10)). A mortgage loan with a definite maturity date is an example of closed-end credit.

II. Proposed Regulatory Provisions

Under Regulation Z, the timing and number of disclosures required for variable-rate loans vary depending on the term and security for the loan. For all variable-rate loans, disclosures are generally provided once--prior to consummation. However, if the loan exceeds a term of one year and is secured by the consumer's principal dwelling, creditors are required to provide disclosures at three different times--when an application is received (or when a nonrefundable fee is paid, whichever occurs earlier), prior to consummation, and subsequent to consummation when certain rate or payment changes occur. (See Regulation Z, 12 CFR 226.17(b), 18(f), 19, and 20(c).)

Disclosures provided at application for a variable-rate mortgage include the Board-prescribed Consumer Handbook on Adjustable Rate Mortgages (or a suitable substitute) and a loan program disclosure for each variable-rate program the consumer is interested in. The loan program disclosure consists of twelve separate items as they apply to a variable-rate program, including information such as the identification of the index or formula to be used for adjustments and a fifteen-year historical example of how changes in the index values or formula used to compute interest rates would have affected the interest rates and payments on a \$10,000 loan.

On September 30, 1996, the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. L. 104-208, 110 Stat. 3009) (1996 amendment) amended the TILA by providing creditors the option to give a statement that the periodic payments may increase or

decrease substantially together with the maximum interest rate and payment amount for a \$10,000 loan in lieu of the fifteen-year historical example.

The Board proposes to implement the TILA amendment as discussed below.

III. Section-by-Section Analysis

SUBPART A -- General

SECTION 226.19 -- Certain Residential Mortgage Transactions

19(b) Certain variable-rate transactions

Section 226.19(b) requires the historical example disclosure for loans exceeding a term of one year that are secured by a consumer's principal dwelling and where the APR may increase after consummation (such as when the rate is tied to an index). The 1996 amendment does not explicitly limit application of the alternative disclosure to loans that exceed a term of one year. The Board believes, however, that the amendment was intended to apply only to loans where the fifteen-year historical example is currently required, namely loans that exceed one year. Accordingly, the Board proposes to apply the alternative disclosure option to variable-rate loans with a term greater than one year and secured by the consumer's principal dwelling.

The 1996 amendment uses the term "residential mortgage transactions," a term defined in Regulation Z (§ 226.2(a)(24)) as credit secured by the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling. The Board believes that the Congress did not intend to limit the flexibility in the 1996 amendment to purchase-money transactions, but rather intended to provide this option to all credit transactions secured by the consumer's principal dwelling, given that the committee report to the 1996 amendment broadly states the alternative disclosure would be available to lenders in consumer credit transactions under closed-end plans.

Paragraph 19(b)(2)(viii) currently sets forth the required historical example based on a \$10,000 loan amount and paragraph 19(b)(2)(x) the required disclosure of the maximum interest rate and payment for a \$10,000 loan. To make clear that creditors may elect to provide either of the two disclosures, paragraph 19(b)(2)(viii) would be revised. The historical example requirements are contained in paragraph (19(b)(2)(viii)(A); the substance of paragraph 19(b)(2)(x) is redesignated as 19(b)(2)(viii)(B). The proposal provides that if the creditor chooses to disclose the maximum interest rate and payment in lieu of a historical example, a statement that the periodic payment may increase or decrease substantially must accompany the rate and payment amount. The statement requirement 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."

Regulation Z currently requires creditors to disclose a maximum interest rate using the most recent interest rate shown in the historical example. Because the historical example is

not required under the 1996 amendments, creditors instead must use a "recent" interest rate as determined by the Board. The Board proposes to require creditors to calculate the maximum rate and payment based on an initial rate that was in effect within one year of the disclosure. The Board believes that a more frequent basis for updating the index or formula would place more burden on creditors than currently exists under the regulation and that the Congress intended to reduce burden with the alternative. Creditors would have to calculate the maximum rate and payment on an initial rate in effect within one year of the date the loan program is provided and to disclose the applicable month and year. For example, using the information in appendix H-14, the disclosure could state "the initial interest rate is 9.71 percent, the rate in effect January 1987." The Board solicits comment on whether there are circumstances where there is consumer benefit in updating the initial rate more frequently than annually that would outweigh the compliance burden of producing the disclosures more frequently.

IV. Form of Comment Letters

Comment letters should refer to Docket No. R-0960, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text in machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3 1/2 inch or 5 1/4 inch computer diskettes in any IBM-compatible DOS-based format.

The comment period ends on February 28, 1997. Normally, the Board provides a 60-day comment period, in keeping with the Board's policy statement on rulemaking (44 FR 3957, January 19, 1979). The proposed regulatory revisions implement changes in the law that provide regulatory compliance relief. The Board believes that an abbreviated comment period is desirable to ensure that a final rule is in place as soon as possible to provide guidance to creditors affected.

V. Regulatory Flexibility Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603), the Board's Office of the Secretary has reviewed the proposed amendments to Regulation Z. Overall, the amendments are not expected to have any significant impact on small entities. The proposed regulatory revisions required to implement the 1996 amendment reduce the number of disclosure required for variable-rate mortgages and ease compliance by providing creditors with the option of either providing a fifteen-year historical example or the maximum payment example. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

VI. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Board has reviewed the proposed amendments under the authority delegated to the Board by the Office of Management and Budget. 5 CFR 1320 Appendix A.1. Comments on the

collection or disclosure of information associated with this regulation should be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0199), Washington, DC 20503, with copies of such comments to be sent to Mary M. McLaughlin, Chief, Financial Reports Section, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

The respondents are individuals or businesses that regularly offer or extend consumer credit. The purpose of the TILA and Regulation Z is to promote the informed use of consumer credit by requiring creditors to disclose its terms and cost. Records must be retained by creditors for 24 months. The revisions to the requirements in this proposed regulation are found in 12 CFR 226.19 and appendix H.

The Board's Regulation Z applies to all types of creditors, not just state member banks. Under the Paperwork Reduction Act, however, the Federal Reserve accounts for the paperwork burden associated with Regulation Z only for state member banks. Any estimates of paperwork burden for institutions other than state member banks that would be affected by the proposed amendments are provided by the federal agency or agencies that supervise those lenders.

The proposed changes are not expected to increase the ongoing annual burden of Regulation Z. There are 1,042 state member banks with an estimated 5,750 disclosures, 6.5 minutes for each disclosure, for closed-end credit per state member bank annually. The proportion of such loans that are mortgages with an adjustable rate is estimated to be small. If all state member banks chose to eliminate the fifteen-year historical example from all their disclosures on such loans, the average time required for each disclosure would decrease by 2 minutes. The combined annual burden for all state member banks under Regulation Z is estimated to be 1,975,600 hours; the combined annual cost is estimated to be \$39.5 million (an average of \$37,920 per state member bank). The Federal Reserve estimates that there would be associated start-up cost of \$160 per respondent to eliminate either the fifteen-year historical example or the maximum payment example.

The disclosures made by creditors to consumers under Regulation Z are mandatory. Since the Federal Reserve does not collect any information, no issue of confidentiality arises. Disclosures relating to specific transactions or accounts are not publicly available.

Comments are invited on: (a) whether the proposed revised collection of information is necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; (b) the accuracy of the Federal Reserve's estimate of the burden of the proposed disclosures, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information disclosures; and (d) ways to minimize the burden of information disclosures on respondents, including through the use of automated techniques or other forms of information technology.

An agency may not collect or sponsor the collection or disclosure of information, and an organization is not required to collect or disclose information unless a currently valid OMB control number is displayed. The OMB control number for Regulation Z is 7100-0199.

List of Subjects in 12 CFR Part 226

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

TEXT OF PROPOSED REVISIONS:

Certain conventions have been used to highlight the proposed revisions to the regulation. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets.

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

PART 226 -- TRUTH IN LENDING (REGULATION Z)

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

AUTHORITY: 12 U.S.C. 3806; 15 U.S.C. 1604 and 1637(c)(5).

2. Section 226.19 would be amended by:

- a. Revising paragraph (b)(2)(viii);
- b. Deleting paragraph (b)(2)(x); and
- c. Redesignating paragraphs (b)(2)(xi), (b)(2)(xii), and (b)(2)(xiii) as paragraphs (b)(2)(x), (b)(2)(xi) and (b)(2)(xii) respectively.

The revisions would read as follows:

§ 226.19 Certain residential mortgage and variable-rate transactions.

* * * * *

(b) Certain variable-rate transactions. * * * *

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(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:

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(viii) ►Either of the following:

(A)◄ An 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. The example shall be based upon index values beginning in 1977 and be updated annually until a 15-year history is shown. Thereafter, 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 assuming the maximum periodic increases in rates and payments under the program; the initial interest rate and payment for that loan along with the month and year the rate was in effect (based on a rate in effect within one year of the date the disclosures are provided); and a statement that the periodic payment may increase or decrease substantially depending on changes in the rate. ◀

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[(x) The maximum interest rate and payment for a \$10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan.]

[(xi)] ▶(x)◀ The fact that the loan program contains a demand feature.

[(xii)] ▶(xi)◀ The type of information that will be provided in notices of adjustments and the timing of such notices.

[(xiii)]▶(xii)◀ A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

3. In part 226, Appendix H is amended by revising the H-14 Variable-Rate Mortgage Sample to read as follows:

APPENDIX H TO PART 226 -- CLOSED-END MODEL FORMS AND CLAUSES

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H-14 Variable-Rate Mortgage Sample

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How Your Monthly Payment Can Change

- Your monthly payment can [change yearly]▶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 9.71 percent the rate [shown in the interest rate column below for the year 1987]▶in effect in January 1987◀, the maximum amount that the interest rate can rise under this program is 5 percentage points, to 14.71 percent, and the monthly payment can rise from a first-year payment of \$85.62 to a maximum of \$123.31 in the fourth year.
- 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.

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4. In Supplement I to Part 226, under Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions, under paragraph 19(b) Certain variable-rate transactions, the following amendments would be made:

- a. The heading for "Paragraph 19(b)(2)(viii)" would be revised as "Paragraph 19(b)(2)(viii)(A);"
- b. The heading "Paragraph 19(b)(2)(x)" would be revised as "Paragraph 19(b)(2)(viii)(B)" and the paragraph heading and text are transferred immediately preceding Paragraph 19(b)(2)(ix).
- c. Paragraph 1, under the heading "Paragraph 19(b)(2)(viii)(B)" would be revised.
- d. The heading "Paragraph 19(b)(2)(xi)" would be revised as "Paragraph 19(b)(2)(x)."
- e. The heading "Paragraph 19(b)(2)(xii)" would be revised as "Paragraph 19(b)(2)(xi)."
- f. The heading "Paragraph 19(b)(2)(xiii)" would be revised as "Paragraph 19(b)(2)(xii)."

The revisions would read as follows:

SUBPART C--CLOSED-END CREDIT

Section 226.19--Certain Residential Mortgage Transactions

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19(b) Certain Variable-Rate Transactions

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Paragraph 19(b)(2)(viii)▶(A)◀

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Paragraph 19(b)(2)[(x)]▶(viii)(B)◀

1. Initial and maximum interest rate and payment. The disclosure form must state the initial and maximum interest rates and payments for a \$10,000 loan originated at the most recent interest rate (index value plus margin) [shown in the historical example]▶in effect within one year of the date the disclosure is provided. The month and year the rate is effective must be included in the disclosure◀. In calculating the maximum payments 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 [most recent rate shown in the historical example]▶initial 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 [most recent rate shown in the historical example]▶initial rate◀ should be adjusted by the amount of the discount or premium reflected elsewhere in the disclosure for purposes of the requirements of this paragraph. Furthermore, this disclosure should state the amount by which the most recent rate has been

adjusted. (see the commentary to § 226.19(b)(2)(viii) regarding disclosure of the amount of a discount or premium.) The creditor may use an interest rate applicable to the program that is more recent than the [latest rate shown in the historical example]►initial rate◄.

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Paragraph 19(b)(2)[(xi)]►(x)◄

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Paragraph 19(b)(2)[(xii)]►(xi)◄

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Paragraph 19(b)(2)[(xiii)]►(xii)◄

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5. In Supplement I to Part 226, all references to "section 226.19(b)(2)(viii)" are revised to read "section 226.19(b)(2)(viii)(A)".
6. In Supplement I to Part 226, all references to "comment 19(b)(2)(viii)" are revised to read "comment 19(b)(2)(viii)(A)".
7. In Supplement I to Part 226, all references to "section 226.19(b)(2)(x)" are revised to read "section 226.19(b)(2)(viii)(B)".
8. In Supplement I to Part 226, all references to "comment 19(b)(2)(x)" are revised to read "comment 19(b)(2)(viii)(B)".
9. In Supplement I to Part 226, Appendix H--Closed-End Model Forms and Clauses, Paragraph 18, would be revised to read as follows:

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18. Sample H-14. * * *

It includes information on how the interest rate is determined and how it can change over time[, and]►. Section 226.19(b)(2)(viii) permits creditors to provide either an historical example or an initial rate and maximum rate and payment example; 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 as of the first week ending in July for the years 1977 through 1987. This reflects the requirement that the index history be based on values for the same date or period each year beginning with index values for 1977. The [sample disclosure also illustrates the requirement under § 226.19(b)(2)(x) that the] initial and the maximum interest rates and payments [be]►are◄ shown for a \$10,000 loan originated at the most recent rate [shown in the historical example]►in effect within one year of the date the loan program is provided along with the month and year the rate was in effect◄. In the sample, the loan is assumed to have an initial interest rate of 9.71 percent (which was the interest rate in [1987 for the example shown]►in effect January 1987◄) and to have 2

percentage point annual (and 5 percentage point overall) interest rate limitations or caps. * * *
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By order of the Board of Governors of the Federal Reserve System, January 24, 1997.

William W. Wiles
Secretary of the Board.

BILLING CODE: 6210-01-P