

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: Final rule.

SUMMARY: The Board is publishing 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 to provide 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 amount, in lieu of having to provide a fifteen-year historical example of index values.

DATES: Effective date: This rule is effective November 21, 1997.

Compliance date: Compliance is optional until October 1, 1998.

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 Diane Jenkins at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA) (15 U.S.C. 1601 *et seq.*) is to promote the informed use of consumer credit by 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 as any credit arrangement that does not fall within the definition of open-end credit (§ 226.2(a)(10)). A mortgage loan with a fixed maturity date is an example of closed-end credit.

II. 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 different times--a loan program disclosure when an application is received (or when a nonrefundable fee is paid, whichever occurs earlier), transaction-specific Truth in Lending disclosures prior to consummation, and disclosures 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 comparable substitute) and a loan program disclosure for each variable-rate program in which the consumer has expressed interest. The loan program disclosure consists of twelve separate items, 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 amount in lieu of having to give the fifteen-year historical example.

The Board issued a proposal in January 1997 (62 FR 5183, Feb. 4, 1997). Sixty-nine comments were received. Based on comments and further analysis, the Board has adopted a final rule that implements the statutory changes. The final rule is discussed in detail in the section-by-section analysis 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 in which the APR may increase after consummation (such as when the rate is tied to an index). The 1996 amendment refers to "residential mortgage transactions" to identify when the alternative disclosure option is available, but does not explicitly limit application of the alternative disclosure to loans that exceed a term of one year. "Residential mortgage transaction" is 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. Under this definition, the alternative disclosure option would not extend to refinance and second-mortgage transactions. The Board believes that the amendment was intended to apply to loans where the fifteen-year historical example is currently required, namely loans that exceed one year and are secured by the consumer's principal dwelling. Accordingly, the Board proposed 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 majority of commenters strongly supported the Board's proposal to apply the amendment to loans where the fifteen-year historical example is currently required. Those commenters stated that an interpretation to apply the amendment only to "residential mortgage transactions"--primarily purchase-money mortgages--would result in increased regulatory burden on creditors by requiring two sets of disclosures.

The Board believes that the Congress did not intend to limit the flexibility in the 1996 amendment to purchase-money transactions nor to apply the provision to loans that do not currently require the historical example. The Board believes that the Congress 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 option would be available to lenders in consumer credit transactions under closed-end plans. Pursuant to its authority under section 105(a) of the TILA, the Board has adopted a final rule that makes the alternative disclosure option available for any close-end credit transactions where the term exceeds one year and is secured by the consumer's dwelling. Section 105(a) provides that the Board's regulations "may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith."

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 amount. The proposal revised paragraph 19(b)(2)(viii) to set forth the historical example requirements in paragraph 19(b)(2)(viii)(A); and incorporated the substance of paragraph 19(b)(2)(x) on the maximum interest rate and payment disclosure in paragraph 19(b)(2)(viii)(B). If the creditor chose 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 proposal provided that

the statement requirement may be satisfied by providing the disclosure required by paragraph 19(b)(2)(vi) that states, for example, "your monthly payment can increase or decrease substantially based on annual changes in the interest rate."

A question was raised about whether the proposed wording would allow creditors to provide both the historical example and the maximum interest rate and payment. The Board believes that the 1996 amendment allows creditors to substitute the maximum interest rate and payment for the historical example or to provide both disclosures. The commentary to paragraph 19(b)(2)(viii) has been revised accordingly. The commentary to paragraph 19(b)(2)(viii)(B) provides that the statement that must accompany the maximum rate and payment disclosure is not separately required if a similar disclosure is made pursuant to the requirement in paragraph 19(b)(2)(vi).

Regulation Z currently requires creditors to disclose a maximum interest rate using the most recent interest rate shown in the historical example. Because creditors are not required to provide the historical example under the 1996 amendments, creditors instead must use a "recent" interest rate as determined by the Board. The Board proposed 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. A more frequent basis for updating the index or formula would place greater burden on creditors than currently exists under the regulation, whereas the Congress intended to reduce burden with the alternative. The Board solicited comment on whether there are circumstances in which the consumer benefit from updating the initial interest rate more frequently than annually would outweigh the compliance burden of producing the disclosures more frequently.

The majority of the commenters supported the proposal to base the maximum rate and payment on an interest rate in effect within one year of the disclosure. They believed that this was consistent with the current requirement regarding revisions to the historical example. Several commenters observed, however, that the proposed language would require creditors to update the maximum rate and payment twice a year and suggested adopting one of the timing rules already applicable to variable-rate transactions under § 226.19(b)(2). For example, the timing rules for revising the loan program disclosure in comment 19(b)(2)-5 permit creditors to update once a year, as soon as reasonably possible after the new index value becomes available. Similarly, comments 19(b)(2)(viii)-3 and -4 allow disclosures to use a margin or discount or premium used during the six months preceding preparation of the disclosures. Based on these comments and further analysis, the staff has revised the draft rule for determining the initial interest rate that will be used for the maximum rate and payment disclosure; it defines the initial interest rate as one in effect as of an identified month and year for the particular loan program. The final rule eliminates any requirement for creditors to update the maximum rate and payment disclosure more frequently than the loan program disclosure.

Commenters asked for clarification on whether the amount of a recent discount or premium is reflected in the alternative disclosure. Several commenters requested general clarification on how the initial rate was derived. Several commenters also suggested that all references to "the most recent rate" be deleted since it implies that creditors must continually update the information. Several commenters questioned whether an explanation of how the

consumer may calculate the payments for the loan amount to be borrowed would be required absent the historical example.

Based on comments and further analysis, the Board believes that the initial and maximum interest rates and payments should reflect any offered discount or premium in order to reduce consumer confusion. References to "the most recent rate" have been deleted and replaced by "initial interest rate." A definition of the "initial interest rate" is provided and clarifies that it is based on the index plus margin, adjusted by the amount of any discount or premium.

Since the maximum rate and payment is based on a \$10,000 loan amount, the Board believes that an explanation on how to calculate the payments for another loan amount would allow consumers to better understand the relationship of the maximum rate and payment disclosure to their particular transaction without placing undue burden on the creditors. Section 226.19(b)(2)(ix) has been revised to require the explanation under either alternative.

Appendix H to Part 226 -- Closed-end Model Forms and Clauses

The sample clauses and model forms to appendix H-4 and H-14 have been revised in response to comments.

Supplement I -- Official Staff Interpretation

Revisions have been made to the Official Staff Commentary to conform with the amendments to Regulation Z.

IV. 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 amendments to Regulation Z. Overall, the amendments are not expected to have any significant impact on small entities. The regulatory revisions required to implement the 1996 amendment reduce the number of disclosures required for variable-rate mortgages and ease compliance by providing creditors with the option of disclosing either a fifteen-year historical example or a maximum payment example.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Board has reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. 5 C.F.R. part 1320, Appendix A.1.

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 disclosure requirements revised by this final rule are found in 12 C.F.R. 226.19 and part 226, appendix H.

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

The final rule is expected to decrease the ongoing annual burden of Regulation Z. There are 1,014 state member banks, making an estimated 5,750 closed-end credit disclosures each year on average, at 6.5 minutes per disclosure. The proportion of such loans that are mortgages with an adjustable rate is estimated to be small. It is estimated that the combined annual burden for state member banks under Regulation Z will decrease by approximately 10,000 burden hours to an average 6.4 minutes per disclosure. The Federal Reserve estimates an associated start-up cost of \$160 per respondent to replace the fifteen-year historical example with the maximum rate and payment example. No comments specifically addressing the burden estimate were received.

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.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB control number. The OMB control number for Regulation Z is 7100-0199.

The Federal Reserve has a continuing interest in the public's opinion regarding collections of information. Members of the public may submit comments, at any time, regarding the burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden. Comments may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100-0199), Washington, DC 20503.

List of Subjects in 12 CFR Part 226

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

For the reasons set forth in the preamble, the Board amends 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 is amended by:

- a. Republishing the introductory text of paragraph (b)(2);
- b. Revising paragraph (b)(2)(viii);
- c. Revising paragraph (b)(2)(ix);
- d. Removing paragraph (b)(2)(x); and
- e. Paragraphs (b)(2)(xi), (b)(2)(xii), and (b)(2)(xiii) are redesignated as paragraphs (b)(2)(x), (b)(2)(xi) and (b)(2)(xii) respectively.

The revisions 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:

* * * * *

(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 226.19(b)(2)(viii)(A) of this section; or

(B) The initial interest rate used to calculate the maximum interest rate and payment in paragraph 226.19(b)(2)(viii)(B) of this section.

* * * * *

3. In part 226, Appendix H is amended by revising the appendix heading, H-4(C) Variable-Rate Model Clauses, and H-14 Variable-Rate Mortgage Sample to read as follows:

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

* * * * *

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: $\$60,000 \div \$10,000 = 6$; $6 \times \text{____} = \$ \text{____}$ 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	Caps _____	[periodic interest rate cap]
Term	_____	_____	lifetime interest rate cap
Change date	_____	_____	[payment cap]
Payment adjustment	(frequency)	[Interest rate carryover]	
Interest adjustment	(frequency)	[Negative amortization]	
[Margin]*	_____	[Interest rate discount]**	
		Index	(identification of index or formula)

	<u>Index</u>	<u>Margin</u>	<u>Interest Rate</u>	<u>Monthly Remaining Payment Balance</u>	<u>Year</u>
	(%)	(Percentage points)	(%)	(\$)	(\$)

1982
 1983
 1984
 1985
 1986
 1987
 1988
 1989

1990
1991
1992
1993
1994
1995
1996

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: $\$60,000 \div \$10,000 = 6$; $6 \times \text{___} = \$ \text{___}$ per month.)

* 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.]

* * * * *

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: $\$60,000 \div \$10,000 = 6$; $6 \times 106.03 = \$636.18$ 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	Caps	2 percentage points annual interest rate
Term	30 years	5 percentage points lifetime interest rate
Payment adjustment	1 year	Index	Weekly average yield on U.S. Treasury
Interest adjustment	1 year		securities adjusted to a constant maturity
Margin	3 percentage points		of one year

<u>Year</u> (as of 1st week ending in July)	<u>Index</u> (%)	<u>Margin*</u> (percentage points)	<u>Interest Rate</u> (%)	<u>Monthly Payment</u> (\$)	<u>Remaining Balance</u> (\$)
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.

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: $\$60,000 \div \$10,000 = 6$; $6 \times \$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.]

* * * * *

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 are made:

- a. Paragraph 2, under the heading "Paragraph 19(b)(2)" is revised.
- b. Paragraph 1, under the heading "Paragraph 19(b)(2)(v)" is revised.
- c. The heading "Paragraph 19(b)(2)(viii)" is revised to read "Paragraph 19(b)(2)(viii)(A)."
- d. A new heading "Paragraph 19(b)(2)(viii)" and a new paragraph 1 is added below the new heading, and both are transferred immediately preceding "Paragraph 19(b)(2)(viii)(A)."
- e. The heading "Paragraph 19(b)(2)(x)" is revised to read "Paragraph 19(b)(2)(viii)(B)" and the paragraph heading and text are transferred immediately preceding the heading "Paragraph 19(b)(2)(ix)."
- f. Paragraphs 1 and 2, under the heading "Paragraph 19(b)(2)(viii)(B)" are revised and a new paragraph 5 is added.
- g. Paragraph 1, under the heading "Paragraph 19(b)(2)(ix)" is revised.
- h. The heading "Paragraph 19(b)(2)(xi)" is revised to read "Paragraph 19(b)(2)(x)."
- i. The heading "Paragraph 19(b)(2)(xii)" is revised to read "Paragraph 19(b)(2)(xi)."
- j. The heading "Paragraph 19(b)(2)(xiii)" is revised to read "Paragraph 19(b)(2)(xii)."

The revisions and additions read as follows:

SUPPLEMENT I TO PART 226--OFFICIAL STAFF INTERPRETATIONS

* * * * *

Section 226.19--Certain Residential Mortgage Transactions.

* * * * *

19(b) Certain variable-rate transactions.

* * * * *

Paragraph 19(b)(2).

* * * * *

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.

* * * * *

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)(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).

* * * * *

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.

* * * * *

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).

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Paragraph 19(b)(2)(xi).

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Paragraph 19(b)(2)(xii).

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5. In Supplement I to Part 226, under paragraph heading Paragraph 19(b)(2)(viii)(A), all references in paragraphs 3 and 4 to "§ 226.19(b)(2)(viii)" are revised to read "§ 226.19(b)(2)(viii)(A)."

6. In Supplement I to Part 226, under paragraph heading Paragraph 19(b)(2)(viii)(A), in paragraphs 6 and 7 the words "comment 19(b)(2)(x)" are revised to read "comment 19(b)(2)(viii)(B)" in each place they appear.

7. In Supplement I to Part 226, under paragraph heading Paragraph 19(b)(2)(viii)(B), in paragraphs 2, 3, and 4 the words "comment 19(b)(2)(viii)" are revised to read "comment 19(b)(2)(viii)(A)" in each place they appear.

8. In Supplement I to Part 226, Appendix H--Closed-End Model Forms and Clauses, Paragraphs 6 and 18, are revised to read as follows:

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APPENDIX H -- Closed-End Model Forms and Clauses

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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.

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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.

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By order of the Board of Governors of the Federal Reserve System, November 21, 1997.

William W. Wiles,
Secretary of the Board.