



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT  
AND CHIEF OPERATING OFFICER

January 12, 1988

DALLAS, TEXAS 75222

Circular 88-4

**TO:** The Chief Executive Officer of all  
member banks and others concerned in  
the Eleventh Federal Reserve District

**SUBJECT**

**Final rule to Regulation Z and request for public comment on proposed  
amendment to the official staff commentary to Regulation Z - Truth in Lending**

**DETAILS**

The Board of Governors of the Federal Reserve System has approved a final amendment to Regulation Z requiring creditors to provide consumers with more information about the variable-rate feature of closed-end adjustable rate mortgages (ARMs) than is required currently. This final rule becomes effective October 1, 1988, but creditors may comply immediately.

In a separate action, the Board has requested public comment on a proposal to amend its official staff commentary to Regulation Z that requires creditors to provide consumers with more information regarding closed-end variable-rate mortgage loans secured by the consumer's principal dwelling.

Comments should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All correspondence should refer to Docket No. R-0545A and must be received by January 29, 1988.

**ATTACHMENTS**

The Board's press releases and documents as published in the Federal Register are attached.

**MORE INFORMATION**

For further information, please contact Dean A. Pankonien of this Bank's Legal Department at (214) 651-6228.

Sincerely yours,

For additional copies of any circular please contact the Public Affairs Department at (214) 651-6289. Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank (800) 442-7140 (intrastate) and (800) 527-9200 (interstate).

# FEDERAL RESERVE press release



For immediate release

December 22, 1987

The Federal Reserve Board has adopted an amendment to its Regulation Z, Truth in Lending, that will require creditors to provide consumers with more extensive information about the variable-rate feature of closed-end adjustable rate mortgages (ARMs), with longer than a one-year maturity, which are secured by the consumer's principal dwelling. The Board's final rule becomes effective October 1, 1988 but creditors may comply immediately.

The Board's amendment requires creditors to provide consumers with a more detailed description of the variable-rate feature. An historical example that shows the effect that actual changes in index values would have had on payments on a \$10,000 loan must be given to the consumer. And, creditors must provide a statement of the initial and maximum interest rates and payments for a \$10,000 loan originated at the most recent interest rate shown in the historical example.

The amendment to the regulation also requires that prospective borrowers be given an educational brochure about ARMs, either The Consumer Handbook on Adjustable Rate Mortgages published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

All of this information must be given to the consumer at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier.

The Board's notice is attached.

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Attachment

# Rules and Regulations

Federal Register

Vol. 52, No. 247

Thursday, December 24, 1987

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 226

[Reg. Z; Docket No. R-0545]

#### Truth in Lending; Variable-Rate Disclosure Under Regulation Z

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** The Board is publishing a final rule amending Regulation Z (Truth in Lending) to require creditors to provide more information about the variable-rate feature of closed-end adjustable-rate mortgages than is currently required under Regulation Z. The amendments require creditors to distribute to consumers an educational booklet about adjustable-rate mortgages, and to provide a more detailed description of the variable-rate feature, along with an historical example. The information must be provided at the time an application form is given to the consumer or before the consumer pays a non-refundable fee, whichever is earlier. These revisions are intended to address concerns regarding the adequacy of information given to consumers applying for adjustable-rate mortgages and regarding the creditor burden of duplicative federal regulations.

**EFFECTIVE DATE:** December 28, 1987, but optional compliance until October 1, 1988.

**FOR FURTHER INFORMATION:**

Contact Michael S. Bylsma, Senior Attorney, or Sharon T. Bowman or Thomas J. Noto, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC, 20551, (202) 452-3667 or (202) 452-2412. For the hearing impaired *only*, Telecommunications Device for the Deaf

(TDD), Earnestine Hill or Dorothea Thompson, at (202) 452-3544.

**SUPPLEMENTARY INFORMATION:**

**Background**

For some time the Board has been working with the other federal financial regulatory agencies to develop a uniform set of disclosures for adjustable-rate mortgages (ARMs). This effort arose because of concern about the different disclosure requirements imposed by the various federal agencies. Currently, four federal agencies require that lenders subject to their regulations provide specific disclosures about ARMs to borrowers. Under Regulation Z, the Board requires that a variable-rate feature be described briefly to consumers. In contrast to Regulation Z, the regulations of two other federal financial agencies and the Department of Housing and Urban Development (HUD) call for more extensive, detailed information. The Federal Home Loan Bank Board (FHLBB) requires variable-rate disclosures for federally-chartered savings and loan associations and also for certain other lenders that wish to market their loans to federally-chartered savings and loans (12 CFR 545.33). The Office of the Comptroller of the Currency (OCC) mandates variable-rate disclosures for national banks and other lenders that seek to market their loans to national banks (12 CFR Part 29). Under the "Alternative Mortgage Transaction Parity Act of 1982" (12 U.S.C. 3802), state-chartered institutions and other mortgage lenders may take advantage of federal authorization of ARMs by following the rules of the FHLBB or the OCC. Finally, HUD prescribes disclosures for lenders wishing to participate in the Federal Housing Administration (FHA) insurance program (24 CFR Parts 203 and 234).

The federal financial agencies believe that this regulatory structure, which requires different disclosures by different lenders delivered at different times, is causing problems for both consumers and mortgage lenders. The ability of consumers to understand and make important decisions about ARMs before entering into these transactions may be hampered by their receipt of different information about ARM programs depending on what type of lender they have approached. This problem is exacerbated by the variety of

ARM products now being offered as well as the complexity of some of these programs. At the same time, these regulatory requirements have proven burdensome to the mortgage industry, particularly when mortgage lenders must satisfy more than one regulation in order to take full advantage of the secondary market. Under certain circumstances, lenders who wish to originate mortgages for possible sale to either a federal savings and loan association or to a national bank may have to make disclosures under two agencies' rules.

Revisions to federal ARM disclosure requirements were initially requested by members of Congress in a letter to the Board in August 1984. The request called for uniform federal requirements for disclosures that include a "worst-case" statement of the highest interest rate and payment that might apply to an ARM. The Board asked the Federal Financial Institutions Examination Council (FFIEC) to assist in developing a recommendation for uniform requirements for the federal agencies with ARM disclosure regulations. After extensive deliberations by an FFIEC task force, the FFIEC made an initial recommendation to the Board in November 1984. As outlined by the FFIEC, the required disclosures would be specific to each consumer's transaction and include a "worst-case" payment example based on hypothetical index rate increases of two percentage points per year for three years. Based on these recommendations, the Board proposed amendments to Regulation Z on May 15, 1985 (50 FR 20221). Many of the Board's 500 public comments on the 1985 proposal objected to both the potential burden on creditors of requiring transaction-specific disclosures and to the assumptions about index rate movement.

For more than a year following the Board's proposal of the initial disclosure scheme, the FFIEC considered alternative plans for uniform ARM disclosures. In August 1986, the FFIEC approved a proposal requiring that creditors provide two types of disclosures to consumers seeking information about ARMs: (1) The *Consumer Handbook on Adjustable Rate Mortgages*, or a suitable substitute, and (2) disclosures that fully describe each of the creditor's ARM programs, with a 15-year historical example of how

changes in the index or formula values used to compute interest rates would have affected interest rates and payments on a \$10,000 loan. In addition, the maximum interest rate and payment that could result under the program for the \$10,000 loan would be disclosed.

Based on the recommendations by the FFIEC and its own analysis, the Board on November 24, 1986, again proposed to amend Regulation Z (51 FR 42241). On February 5, 1987, the FHLBB proposed amendments to its ARM disclosure regulations which would require disclosures identical to what the Board proposed (52 FR 3665). The FHLBB regulation, as proposed, would cover all loans secured by borrower-occupied property (including open-end equity lines of credit.) Finally, on October 2, 1987, the OCC proposed to delete its ARM disclosure regulation and to defer to revised Regulation Z disclosure requirements (52 FR 36953).

A total of 135 comments were received during the 60-day period for public comments on the Board's proposal. Generally, commenters supported the concept of uniformity in federal ARM disclosure regulations. Most commenters also endorsed the proposal to require disclosures based on the features of the loan program but not specific to an individual consumer's actual loan amount. On the other hand, about one-fifth of the commenters expressed general opposition to the proposal. These commenters questioned the need for expanded disclosure requirements under Regulation Z and stated that the disclosures would be more costly to prepare and to distribute than the existing disclosures. Many commenters also maintained that the coverage of the proposal was too broad. For example, it was asserted that compliance with the proposed advance notice of interest rate adjustments would be difficult with certain short-term loans such as bridge loans. It was also argued that the 15-year index history would not be meaningful to consumers considering short-term loans, and that the disclosures would be difficult to prepare for loans that are custom-tailored to an individual consumer's needs. Many commenters suggested limiting coverage of the amendments to purchase-money and refinancing transactions which are variable-rate and secured by the consumer's principal dwelling. On the other hand, several commenters supported the coverage of the proposal. Some commenters argued that the proposed disclosures should also be required for open-end home equity lines. These commenters noted that home

equity plans have become more prevalent since the Tax Reform Act of 1986 and impose great risks to consumers whose homes are burdened with such indebtedness. Other commenters requested that creditors be allowed to substitute the expanded disclosures for the existing Regulation Z ARM disclosures for all variable-rate transactions, whether or not secured by the consumer's principal dwelling.

Many commenters favored the requirement of an example showing how the payments and loan balance of a \$10,000 loan would have been affected by historical changes in the index for a 15-year period. Other commenters questioned the usefulness of the historical information and argued that the recent interest rate fluctuations would not be repeated in the future. Commenters also maintained that the historical example would be burdensome to prepare. Some commenters recommended a shorter example or even one based on hypothetical index rate increases over a short period. Some commenters, particularly members of the thrift industry, reversed their previously stated opposition to an example based on hypothetical rate increases and recommended that form of example as a substitute for the historical example.

Many commenters supported the requirement that the maximum interest rate and payment be stated. These commenters argued that the statement would be a useful supplement to the historical example which might not reflect a potential worst-case for the loan in the future. HUD recommended that the maximum payment be stated as a schedule of payment increases showing the initial and maximum payments to correspond to its statutory disclosure requirements. Other commenters stated that the information might portray ARMs in a highly negative light. A few of these commenters requested that the disclosure show the lowest rate and payment possible under the program.

Finally, several commenters addressed the proposed requirement for advance notice of interest rate and payment adjustments. The primary criticism was that the advance notice was required at least 30 days before the effective date of an interest rate adjustment and not before a payment at the new level is due, as is currently required by the OCC. The commenters stated that this proposed requirement would cause problems for lenders offering short-term ARMs that closely track changes in the index values. Some commenters recommended reducing the

number of days before an adjustment that notice is required and clarifying that notice should be given before a payment at a new level is due.

After considering all of the comments, the Board has made changes in the final amendments designed to alleviate the burden of compliance without compromising the amount or detail of information recommended by the FFIEC to be disclosed to consumers. For example, in response to the comments, the Board has made a minor change to the coverage of the amendments, a modification of the requirement for a statement of the maximum interest rate and payment, and a change to the timing of the adjustment notice requirements, as explained below. Generally, the Board has not adopted the other changes suggested by commenters which would substantially alter the uniform disclosure provisions developed by the FFIEC.

#### Amendments to Regulation Z

Based on recommendations from the FIEC, the Board is adopting amendments to Regulation Z to provide more information to consumers about adjustable-rate mortgages. These amendments will require a handbook to be distributed to consumers, as well as detailed disclosures about a creditor's ARM loan programs. The new ARM disclosure requirements have been added to the regulation at § 226.19(b) and § 226.18(f)(2) while new subsequent disclosure requirements for ARMs have been added at § 226.20(c).

The amendments apply to closed-end credit transactions secured by the consumer's principal dwelling. This coverage includes purchase-money mortgages, in which the consumer is obtaining a mortgage loan for the purpose of purchasing a home, as well as transactions in which the consumer is using the home as security for a loan. In response to comments received about potential compliance problems for short-term loans, an exemption from the new disclosure requirements has been provided for transactions secured by the consumer's principal dwelling with a term of one year or less. These loans will continue to be covered by the existing disclosure requirements of § 226.18(f)(1) of Regulation Z.

Footnote 43 will allow creditors to substitute the new disclosures for any loan subject to the existing requirements of § 226.18(f)(1) of the regulation. This will allow creditors to treat all variable-rate transactions the same without having to provide different disclosures depending on whether the loan is secured by a consumer's principal

dwelling. Creditors who substitute the disclosures under § 226.19(b) for the disclosures ordinarily required under § 226.18(f)(1) also must comply with the requirements under § 226.18(f)(2), although they need not comply with the requirements under § 226.20(c). The footnote does not permit substitution of disclosures required under § 226.18(f)(1) in transactions subject to § 226.19(b). (Home equity lines, in which an open-end line of credit is secured by the consumer's home, are not subject to the new requirements, which apply only to closed-end mortgages.) All other consumer credit transactions that contain a variable-rate feature would continue to be subject to the existing variable-rate disclosure requirements in Regulation Z.

As recommended by the FFIEC, the amendments will require that ARM disclosures, including both the ARM brochure and the other detailed ARM information, be provided to prospective borrowers when an application form is furnished or before the payment of a non-refundable fee, whichever is earlier. This rule will permit creditors to provide the detailed disclosures to consumers as an insert to the ARM brochure when it is given. Disclosure at this point in time is possible under the amendments because the new rule would require that disclosures reflect ARM loan program features, but not the terms of individual transactions. Footnote 45b provides a special timing rule (replacing the general timing rule) for cases where an ARM application reaches a creditor by telephone, or by way of an intermediary agent or broker. In both such cases, both the ARM brochure and the other detailed ARM information must be placed in the mail or delivered not later than three business days after the creditor receives the consumer's application. The proposed special timing rule for intermediary agents or brokers has been expanded to cover telephone applications in response to comments discussing potential compliance problems with the requirement of pre-application disclosures for transactions in which the application is made by telephone.

Under the new timing rule, the new variable-rate disclosures will be given to consumers earlier than the standard Truth in Lending information required by § 226.18. A sentence has been added to § 226.17(b) to cross-reference the early timing requirements for ARMs. In addition, a new paragraph (f)(2) has been added to § 226.18 to require that the later Truth in Lending disclosures be revised to include a statement that an adjustable-rate feature exists and that

the variable-rate disclosures have been provided to the consumer.

A new paragraph (b)(1) requiring a descriptive ARM brochure has been added to § 226.19. The paragraph requires that creditors give each consumer a brochure when an application form is given to a consumer or before a consumer pays a non-refundable fee, whichever is earlier. The rule ensures that every consumer considering applying for an ARM will receive a brochure at an early stage in the application process. The *Consumer Handbook on Adjustable Rate Mortgages*, developed by the Board and the FHLBB, may be used by creditors to fulfill this requirement if they choose. The amendments would also permit creditors to provide a "suitable substitute" in place of the *Consumer Handbook*. Rather than the Board's evaluating whether an individual creditor's ARM brochure is a "suitable substitute," individual creditors should make a good faith determination of whether a brochure is, in fact, a suitable substitute. The Board envisions that substitutes must be, at a minimum, comparable to the *Consumer Handbook* in substance and comprehensiveness, recognizing that some lenders' brochures may contain more detailed descriptions of their particular ARM programs than contained in the *Consumer Handbook*.

The *Consumer Handbook* has been reprinted for resale by private publications companies, and by various trade organizations such as the American Bankers Association, the Mortgage Bankers Association, the National Council of Savings Institutions and the U.S. League of Savings Institutions.

Amendments also have been made in § 226.19(b)(2). They required that detailed, specific information about major aspects of a variable-rate loan program be clearly disclosed to consumers. To illustrate the requirements, sample form H-14 in Appendix H of the regulation has been revised, and model clauses have been included in a revision to Appendix H-4.

Under the amendments, creditors will be required to identify the index to which interest rate changes are tied, or provide a brief description of the formula used in calculating changes if no index is used. If the interest rate changes are purely discretionary or are made by an internally defined index, the creditor will still need to describe the method of rate changes or state that they are discretionary. A source of information about an index also must be disclosed. For example, if index values

are listed in the *Wall Street Journal*, creditors could make such a statement in disclosing a source of information about their index. The amendments call for an explanation of how the interest rate and payment will be determined, for example, by a statement that the interest rate will be based on a specified index plus a margin and that the payment will be based on the interest rate, the loan balance, and the remaining loan term. Furthermore, creditors will be required to include a statement suggesting that consumers ask for the current margin value and interest rate. The disclosures also will alert consumers about a discount feature when the initial rate is discounted and will contain a statement suggesting that consumers ask for the amount of the applicable interest rate discount. In addition, the frequency of rate and payment adjustments will be disclosed, along with rate and payment caps.

If the presence of rate or payment caps would result in interest rate carryover or negative amortization, the disclosure statement would need to contain a statement about those features. Two other disclosures must be made: the fact that a loan program contains a demand feature, if applicable, and a statement describing the type of information that will be contained in an adjustment notice and when each notice will be provided. Finally, creditors will be required to include a notice to consumers that disclosure forms are available for the creditor's other ARM loan programs if the creditor has other closed-end ARM programs subject to the amendments.

One significant feature of the amendments is the requirement of an example, based on a \$10,000 loan, illustrating how payments and the loan balance would have been affected by historical changes in the index to be used. Because the example will not be based on the actual amount to be borrowed, creditors will be able to pre-print the disclosures for each loan program and give them to consumers with an ARM handbook. The provision that the example be based on the historical performance of individual indices, rather than on assumed rate increases, reflects the revised recommendation of the FFIEC. Creditors also will be required to include a statement on the disclosure form explaining to consumers how to calculate their actual monthly payment amount for a loan amount other than \$10,000. The example based on \$10,000 also reflects the recommendation of the FFIEC, and is premised, in part, on the rationale that figures based on a \$10,000

example provide information that consumers can use with minimal difficulty to calculate their actual monthly payments for a specific transaction. The amendments require that the example shown be based on the history of the specific index or formula to be used in the loan program. The index values used in the example will begin with the value for 1977 and be updated annually to add the values for additional years until a 15-year history is shown. For example, the disclosures for an ARM made in 1988 would include index values for each year from 1977 through 1987. In each subsequent year until 1991, a creditor's disclosures will include the index value for one more year. From that time forward, lenders will show a "rolling" history of index values, updated annually, for the preceding 15 years.

If the values for an index have not been available back to 1977, creditors need only go back as far as the values have been available in giving the history and may start the example at the year in which values are available. The history should reflect the method of choosing values for each program. For instance, if an average of index values is used, averages would be used in the history, but if a single index value is used, a single index value would be shown. The creditor should assume one date within a year (or one period, if an average is used) on which to base the history of index values for each loan program. 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 index history. Only one index value per year need be shown, even if the program provides for adjustments to the interest rate or payment more than once in a year. In such cases, the creditor may assume that the index rate remained constant for the full year for the purpose of calculating the interest rate, payment, and loan balance. Updating will be necessary only once each year to reflect the most recent year's index value. New disclosures would be required when an ARM program changes. (To assist creditors in constructing histories of certain common indices, the Board has included tables of index values in section 3 below.)

The payment and outstanding loan balance figures in the example must reflect all significant loan program terms. For example, features such as rate and payment caps, a discounted interest rate, negative amortization, and interest carryover need to be taken into account by creditors in calculating the payment and outstanding balance

figures. Because disclosures will be given early, creditors will need to assume a value for the margin in order to do the calculations for the example. Creditors may select a margin that they have used during the preceding six months and disclose on the form that the margin is one that they have used recently. The margin selected may be used until a creditor updates the disclosure form to reflect the most recent 15 years of index values. Similarly, to the extent that the ARM program has a discounted initial rate, creditors also will be permitted to assume an amount by which the initial rate will be discounted—which is representative of the amount of discounts by the creditor during the preceding six months—and disclose on the form that the initial rate has been discounted to the extent of other discounts offered by the creditor recently. The provision for a representative discount was added to respond to the concerns expressed by creditors about the need for individual program disclosure forms to reflect the amount of every discount offered by the creditor—amounts which could fluctuate daily depending upon market conditions.

The amendments also require disclosure of the maximum interest rate and payment. These disclosures would be calculated based on a \$10,000 loan that is originated at the most recent interest rate shown in the historical example, and would assume that the interest rate then increases as rapidly as possible under the program. Thus, in a loan with interest rate limitations, or "caps," of 2 percentage points per year, and 5 percentage points for the life of the loan, the maximum interest rate would be 5 percentage points higher than the most recent rate shown in the historical example. Furthermore, the loan would not reach the maximum interest rate increase until the fourth year of the loan because of the 2 percentage points annual limitation. Consequently, the maximum payment disclosed would reflect the amortization of the loan during that period. Finally, to enable FHA lenders to follow the new requirements, this provision has been modified also to require a statement of the initial interest rate and payment for that loan. The Board believes that this requirement will also benefit consumers by providing a point of reference for evaluating the stated maximum levels for an ARM.

The final amendments do not contain the proposed requirement that ARMs without limitations on the maximum increases in the interest and payment contain a "conspicuous" statement to

that effect. That provision is no longer necessary in light of section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, section 1204, and the recent amendment to Regulation Z, which require that all dwelling-secured ARM loans contain the maximum interest rate that may apply during the loan term.

As mentioned earlier, the ARM disclosures given before application will describe the type of information that will be provided in notices of adjustments and the timing for such notices. A paragraph also has been added as § 226.20(c) to require a subsequent disclosure form. The new section will apply, except as provided in footnote 43, to all ARMs that have been disclosed in accordance with the new § 226.19(b) requirements. Regulation Z does not currently require a subsequent disclosure of rate and payment changes, although the existing OCC, FHLBB, and HUD regulations already require it. The new paragraph requires notice of the adjusted payment amount, interest rate, index rate, and loan balance. The creditor also will be required to disclose the extent to which any increase in the interest rate has not been fully implemented at the adjustment date (for example, if the new index plus margin would exceed an interest rate adjustment cap), and the payment that would be required to fully amortize a loan (if different from the payment already disclosed). In transactions providing that payment adjustments may accompany interest rate adjustments, creditors would be required to send borrowers notice at least 25, but not more than 120, days before the due date of a payment at the new level. The final amendment differs from the proposal which called for a notice at least 30 days before the effective date of each scheduled interest rate adjustment. The minimum advance notice was revised to 25 days to track the existing notice requirements of the OCC and to provide creditors more flexibility in giving adjustment notices for the variety of loans that will be subject to the new subsequent disclosure requirements. At the same time, the Board believes that the timing of the disclosures still will provide consumers with adequate advance notice of adjusted payment amounts. The timing requirement was clarified to refer to calendar days and a requirement that the disclosures must be delivered or placed in the mail within the specified period was added for consistency with the requirements for delivery of other disclosures, such as when an application is made by

telephone or through an intermediary agent or broker. Finally, the timing of the provision was tied to the due date of the payment at a new level rather than to the effective date of the interest rate adjustment. Notice is required to be given whenever interest rate adjustments and corresponding payment adjustments can be made periodically under the loan agreement but are not made because, for example, the index values have not changed or an interest rate cap has prevented any such adjustments. However, creditors are required to send borrowers notice only once each year if interest rate adjustments are made without a corresponding payment adjustment. Thus, for example, in transactions where the interest rate may be adjusted more frequently than the payment, the creditor would be required to send at least one notice each year during which there have been interest rate adjustments but no corresponding payment adjustments.

Finally, footnote 43 to Regulation Z has been retained and renumbered footnote 45a. Retention of the footnote will permit creditors who are required to comply with variable-rate disclosure regulations of other federal agencies to substitute those disclosures for the disclosures required under these amendments. Because the FHLBB likely will adopt disclosure requirements identical in substance to the final amendments to Regulation Z, certain creditors will be permitted to give the uniform ARM disclosures under FHLBB rules without being required to make

identical disclosures under Regulation Z. (As proposed, the FHLBB regulations would also require certain other disclosures applicable to the ARM relating to due-on-sale clauses, rate changes and prepayment penalties, escrow payments, call provisions, and conditions of default. Because the FHLBB proposal would permit FHLBB-regulated institutions to purchase from other unaffiliated lenders ARMs for which only the uniform disclosures have been made, the secondary market should not be affected by the FHLBB's retention of these additional disclosures.) The footnote will also benefit lenders originating ARMs insured by the Federal Housing Administration, which has not yet adopted the uniform requirements. Furthermore, FHA lenders may continue to take advantage of the footnote at the time HUD amends its ARM disclosure requirements to adopt the uniform requirements.

Creditors also will be permitted to utilize the subsequent disclosure requirements of other federal agencies in place of the subsequent disclosure requirements of § 226.20(c). The FHLBB likely will adopt subsequent disclosure requirements identical to those required under § 226.20(c). A new footnote 45c has been added to permit this substitution. Changes have also been made to Appendix H by redesignating model clause H-4 as H-4(A); adding model clauses H-4(B), H-4(C) and H-4(D), and substituting sample form H-14 with a new form. (The official staff commentary interpreting these

regulatory changes is being published for comment in this issue of the Federal Register.)

**Tables of Certain Index Values**

To assist creditors in constructing histories of various indices used in their ARM programs, the Board has prepared tables of values for common indices for the years 1977-1987. Table 1 provides the values for United States Treasury securities adjusted to constant maturities of 1, 3, and 5 years. Weekly average values are provided as of the first week ending in January and in July. Table 2 provides the January and July monthly average values for three other indices—the Cost of Funds Ratio to 11th Federal Home Loan Bank District Institutions, the National Average Contract Interest Rate for Major Lenders on the Purchase of Previously Occupied Homes, and the National Monthly Median Cost of Funds Ratio to FSLIC-Insured Institutions. It also includes the semiannual and quarterly average values for the National Average Cost of Funds Ratio to FSLIC-Insured Institutions. Years in which index values were not available are marked "n.a." (Creditors need not use these tables in constructing their index histories. Furthermore, the dates used in these tables were selected merely to provide index values at two or more points within each year. Creditors may choose to use the applicable index values in these tables even if index values as of another date are used in their ARM program.)

**TABLE 1.—CONSTANT MATURITY YIELD ON UNITED STATES TREASURY SECURITIES**

Year	Average for first week ending in January (percent)			Average for first week ending in July (percent)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
1977	5.02	5.83	6.24	5.72	6.32	6.68
1978	7.03	7.40	7.59	8.34	8.51	8.50
1979	10.51	9.58	9.30	9.44	8.78	8.73
1980	12.02	10.75	10.52	8.51	9.15	9.47
1981	13.66	12.81	12.54	14.94	14.56	14.28
1982	13.68	14.09	14.04	14.41	14.81	14.73
1983	8.62	9.65	10.04	9.78	10.47	10.80
1984	10.02	11.04	11.50	12.17	13.38	13.67
1985	9.19	10.58	11.16	7.66	8.98	9.53
1986	7.63	8.25	8.50	6.36	6.99	7.21
1987	5.97	6.54	6.79	6.71	7.72	7.96

**TABLE 2.—MISCELLANEOUS ARM INDICES**

Year	January (percent)	July (percent)
<b>A. Average Cost of Funds Ratio to 11th FHLB District Institutions</b>		
1977	n.a.	n.a.
1978	n.a.	n.a.
1979	n.a.	n.a.
1980	8.76	9.67
1981	10.45	11.85
1982	11.95	12.23

**TABLE 2.—MISCELLANEOUS ARM INDICES—Continued**

Year	January (percent)	July (percent)
1983	10.46	9.68
1984	10.03	10.71
1985	10.22	9.37
1986	8.77	8.20
1987	7.40	7.28

**TABLE 2.—MISCELLANEOUS ARM INDICES—Continued**

Year	January (percent)	July (percent)
<b>B. National Average Contract Interest Rate For Major Lenders on the Purchase of Previously Occupied Homes</b>		
1977	8.84	8.83
1978	8.95	9.41
1979	10.08	10.67
1980	11.78	12.23
1981	13.24	14.77

**TABLE 2.—MISCELLANEOUS ARM INDICES—Continued**

Year	January (per-cent)	July (per-cent)
1982.....	15.37	14.96
1983.....	13.04	12.18
1984.....	11.70	12.03
1985.....	12.09	11.02
1986.....	10.40	9.88
1987.....	9.19	9.05

**TABLE 2.—MISCELLANEOUS ARM INDICES—Continued**

Year	January (per-cent)	July (per-cent)
<b>C. National Monthly Median Cost of Funds Ratio to FSLIC-insured Institutions</b>		
1977.....	n.a.	n.a.
1978.....	n.a.	n.a.
1979.....	n.a.	7.44
1980.....	8.09	9.16

**TABLE 2.—MISCELLANEOUS ARM INDICES—Continued**

Year	January (per-cent)	July (per-cent)
1981.....	9.50	10.92
1982.....	11.44	11.54
1983.....	10.14	9.65
1984.....	9.89	9.90
1985.....	9.75	8.87
1986.....	8.50	7.94
1987.....	7.22	6.96

Year	Quarterly Period				Semiannual Period	
	January—March	April—June	July—September	October—December	January—June	July—December
<b>D. National Average Cost of Funds Ratio to FSLIC-insured institutions (percent)</b>						
1977.....	n.a.	n.a.	n.a.	n.a.	6.39	6.48
1978.....	n.a.	n.a.	n.a.	n.a.	6.54	6.79
1979.....	n.a.	n.a.	n.a.	n.a.	7.23	7.71
1980.....	n.a.	n.a.	n.a.	n.a.	8.77	9.11
1981.....	n.a.	n.a.	n.a.	n.a.	10.31	11.53
1982.....	n.a.	n.a.	n.a.	n.a.	11.49	11.27
1983.....	n.a.	n.a.	n.a.	n.a.	9.81	9.84
1984.....	9.74	9.80	10.27	10.31	9.77	10.29
1985.....	9.58	9.35	9.04	8.79	9.47	8.92
1986.....	8.49	8.21	7.99	7.53	8.35	7.76
1987.....	7.11	7.06			7.09	

**Economic Impact Statement**

The Board's Division of Research and Statistics has prepared an economic impact statement on the proposed revisions to Regulation Z. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, DC. 20551, at (202) 452-3245.

**List of Subjects in 12 CFR Part 226**

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Rate limitations, Truth in lending.

For reasons set out in this notice, and pursuant to the Board's authority under section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board amends Part 226 as follows:

**PART 226—TRUTH IN LENDING**

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

**Authority:** Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96-221, 94 Stat. 170 (15 U.S.C. 1604 *et seq.*); sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552.

2. Section 226.17 is amended by revising paragraph (b) to read as follows:

**§ 226.17 General disclosure requirements.**

(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.

3. Section 226.18 is amended by revising footnote 43 and paragraph (f) to read as follows:

**§ 226.18 Content of disclosures.**

(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: <sup>43</sup>

- (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.

<sup>43</sup> 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.

(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.

**§ 226.22 [Amended]**

4. Section 226.22 is amended by redesignating footnote 45a as 45d.  
5. Section 226.19 is revised to read as follows:

**§ 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 in the consummated transaction varies from the annual percentage rate disclosed under § 226.18(e) by more than 1/8 of 1 percentage point in a regular transaction or more than 1/4 of 1 percentage point in



an irregular transaction, as defined in § 226.22, the creditor shall disclose the changed terms no later than consummation or settlement.

(b) *Certain variable-rate transactions.*<sup>45a</sup> 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:<sup>45b</sup>

(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) 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

<sup>45a</sup> 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.

<sup>45b</sup> 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.

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 payment limitations, that would have been affected by the index movement during the period.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.

(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) The fact that the loan program contains a demand feature.

(xii) The type of information that will be provided in notices of adjustments and the timing of such notices.

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

6. Section 226.20 is amended by adding paragraph (c) to read as follows:

**§ 226.20 Subsequent disclosure requirements.**

(c) *Variable-rate adjustments.*<sup>46c</sup> 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

<sup>46c</sup> 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.

section, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

**Appendix H—[Amended]**

7. Appendix H is amended by redesignating H-4 as H-4(A) and revising the heading in the table of Contents, by adding H-4(B), H-4(C), and H-4(D), and by revising H-14 and the heading in the table of contents to read as follows:

**Appendix H—Closed-end Model Forms and Clauses**

\* \* \* \* \*

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-14 Variable-Rate Mortgage Sample (§ 226.19(b))

\* \* \* \* \*

H-4(A) Variable-Rate Model Clauses

\* \* \* \* \*

*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\_\_\_\_), 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.

**Example**

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1977 to 1991. This does not necessarily indicate how your index will change in the future.

The example is based on the following assumptions:  
 Amount of loan..... \$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 (\$)
1977					
1978					
1979					
1980					
1981					
1982					
1983					
1984					
1985					
1986					
1987					
1988					
1989					
1990					
1991					

To see what your payments would have been during that period, divide your mortgage amount by \$10,000; then multiply the monthly payments by that amount (For example, in 1991 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be: \$60,000 ÷ \$10,000 = 6; 6x\_\_\_\_\_ = \$\_\_\_\_\_ 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 points 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-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 change yearly based on changes in the interest rate.
- For example, on a \$10,000, 30-year loan with an initial interest rate of 9.71% (the rate shown in the interest rate column below for the year 1987), the maximum amount that the interest rate can rise under this program is 5 percentage points, to 14.71%, 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.

**Example**

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1977 to 1987. 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..... 80 years.  
 Payment 1 year.  
 adjustment.

Interest 1 year.  
 adjustment.  
 Margin ..... 3 percentage points.  
 Caps ..... 2 percentage points annual  
 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 (percent)	Margin (percentage points)	Interest rate (percent)	Monthly payment (dollars)	Remaining balance (dollars)
1977 .....	5.72	3	8.72	78.46	9,927.64
1978 .....	8.34	3	10.72**	92.89	9,874.67
1979 .....	9.44	3	12.44	105.67	9,832.70
1980 .....	8.51	3	11.51	98.79	9,776.04
1981 .....	14.94	3	13.51**	113.51	9,731.98
1982 .....	14.41	3	13.72***	115.07	9,683.39
1983 .....	9.78	3	12.78	108.25	9,618.21
1984 .....	12.17	3	13.72***	114.96	9,554.39
1985 .....	7.66	3	11.72**	101.08	9,456.03
1986 .....	6.36	3	9.72**	88.13	9,311.25
1987 .....	6.71	3	9.71	88.07	9,151.55

\*This is a margin we have used recently; your margin may be different.  
 \*\*This interest rate reflects a 2 percentage points annual interest rate cap.  
 \*\*\*This interest rate reflects a 5 percentage points 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 1987 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be:  $\$60,000 \div \$10,000 = 6$ ;  $6 \times \$88.07 = \$528.42$ .)

By order of the Board of Governors of the Federal Reserve System, dated December 21, 1987.

William W. Wiles,  
 Secretary of the Board.

[FR Doc. 87-29555 Filed 12-23-87; 8:45 am]

BILLING CODE 6210-01-M

# FEDERAL RESERVE press release



For immediate release

December 22, 1987

The Federal Reserve Board today issued for public comment proposed changes to its official staff commentary to Regulation Z, Truth in Lending. The proposed commentary interprets an amendment to Regulation Z that requires creditors to provide consumers with more information regarding closed-end variable-rate mortgage loans secured by the consumer's principal dwelling.

Comment is requested by January 29, 1988.

The Board's notice is attached.

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Attachment

**12 CFR Part 226****[Reg. Z; Docket No. R-0545A]****Proposed Update to Official Staff  
Commentary****AGENCY:** Board of Governors of the  
Federal Reserve System.**ACTION:** Proposed official staff  
interpretation.**SUMMARY:** The Board is publishing for  
additional comment proposed changes  
to the official staff commentary to  
Regulation Z (Truth in Lending). The

proposed commentary would offer  
guidance to creditors in complying with  
the provisions of an amendment to  
Regulation Z that is being published in  
final form in this issue of the **Federal  
Register**. The regulatory amendment  
requires creditors to provide more  
information to consumers about certain  
closed-end variable-rate loans than is  
currently required. The proposed  
commentary revisions include new  
material as well as numerous technical  
changes in existing material.

**DATES:** Comments must be received on  
or before January 29, 1988.**ADDRESSES:** Comments should be  
mailed to William W. Wiles, Secretary,  
Board of Governors of the Federal  
Reserve System, Washington, DC, 20551,  
or delivered to the 20th Street courtyard  
entrance, on 20th Street between C  
Street and Constitution Avenue, NW.,  
Washington, DC, between 8:45 a.m. and  
5:15 p.m. weekdays. Comments should  
include a reference to Docket No. R-

0545A. Comments may be inspected in  
Room B-1122 between 8:45 a.m. and 5:15  
p.m. weekdays.

**FOR FURTHER INFORMATION CONTACT:**  
Sharon T. Bowman or Thomas J. Noto,  
Staff Attorneys, or Michael S. Bylsma,  
Senior Attorney, Division of Consumer  
and Community Affairs, Board of  
Governors of the Federal Reserve  
System, Washington, DC, 20551, (202)  
452-3667. For the hearing impaired *only*,  
Telecommunication Device for the Deaf  
(TDD), contact Earnestine Hill or  
Dorothea Thompson at (202) 452-3544.**SUPPLEMENTARY INFORMATION:****(1) Background**

This proposed official staff  
interpretation is being published in  
conjunction with a final amendment to  
Regulation Z that is designed to provide  
more information to consumers about  
closed-end variable-rate transactions  
secured by a consumer's principal  
dwelling with a term greater than one

year. The proposed commentary would apply and interpret the regulatory amendment. Proposed revisions to the commentary were originally published for public comment on November 24, 1986 (51 FR 42248), however to obtain as much input as possible on provisions that will interpret the regulatory amendment, the Board is publishing for additional comment the proposed changes to the commentary. Following public comment, it is anticipated that commentary revisions will be adopted in final form with compliance optional until October 1, 1988.

The comment period for this proposal has been limited to 30 rather than the usual 60 days. The shorter comment period will ensure that final commentary provisions are in place as quickly as possible to assist creditors in complying with the new amendments to Regulation Z. The proposed revisions include material that was originally proposed for comment in November of 1986, with a few additions. Additional material is included, for example, regarding the definition of a variable-rate "program" and the treatment of discount features for disclosure purposes. The major revisions proposed for the commentary begin with comment 18(f)(2). Portions of existing commentary that would undergo only minor changes have been reprinted to assist commenters in understanding the proposed revisions.

## (2) Explanation of Revisions

The following is a brief description of the proposed revisions to the commentary:

### Subpart C—Closed-end Credit

#### *Section 226.17—General disclosure requirements.*

##### 17(a) Form of Disclosures

*Paragraph 17(a)(1).* Comment 17(a)(1)-2 would be amended to clarify that the general segregation requirement in § 226.17(a) does not apply to the disclosures required under new §§ 226.19(b) and 226.20(c). The information contained in the fifth bulleted paragraph under comment 17(a)(1)-5, which discusses disclosure of a variable-rate feature on other documents, would be deleted since similar information would be required under new paragraph (f)(2) of § 226.18. In addition, the ninth bulleted paragraph under comment 17(a)(1)-5, discussing negative amortization, would be revised to change the reference from § 226.18(f)(3) to new § 226.18(f)(1)(iii).

##### 17(b) Time of Disclosures

Comment 17(b)-1 would be expanded by adding a reference to the timing

requirements in new § 226.19(b) for variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year. Comment 17(b)-2 would be amended by adding a reference to the timing rules for additional disclosures required upon the conversion of open-end transactions to certain closed-end variable-rate transactions. 17(c) Basis of Disclosures and Use of Estimates

*Paragraph 17(c)(1).* The first bulleted paragraph in comment 17(c)(1)-2, discussing preferential employee rates, would be revised to change the reference from § 226.18(f) to § 226.19(b). This change would clarify that certain preferred-rate employee loans are variable-rate transactions subject to the disclosure requirements of new § 226.19(b). Material generally relating to the basis of disclosures for variable-rate transactions currently in the commentary to § 226.18(f) would be moved to the commentary to § 226.17(a)(1) and the material currently in the commentary to § 226.17(a)(1) would be reordered to accommodate this change. Comments 17(c)-8 -9 and -10, discussing graduated payment mortgages, Morris plans and number of transactions would be redesignated, respectively, as comments 17(c)-12, -14 and -15. Material currently contained in comments 18(f)-2 and -3, discussing the basis of disclosures and use of estimates for variable-rate transactions, would be added as comments 17(c)(1)-8 and -9. Comment 17(c)(1)-10 would incorporate material on discounted variable-rate transactions currently contained in comment 18(f)-8. Most of the material currently in comment 18(f)-6 relating to the basis of disclosure for certain variable-rate transactions would be incorporated in comment 17(c)(1)-11. Two parts of existing comment 18(f)-6 that do not relate to the basis of disclosure, namely the reference in the second bullet to the conditions for imposition of a shared-appreciation feature and the reference to the hypothetical example in the third bullet, would be deleted in the new comment 17(c)(1)-11. The material currently in comment 18(f)-7, discussing growth-equity mortgages, would be incorporated in new comment 17(c)(1)-13, although detailed discussion of the option of disclosing by analogy to variable-rate disclosures would be deleted in favor of a more general reference in the new comment 17(c)(1)-13.

##### 17(f) Early Disclosures

As a result of the revisions to § 226.19 of the regulation, the reference in

comment 17(f)-3 to § 226.19(b) would be revised to reference § 226.19(a)(2).

#### *Section 226.18—Content of disclosures.*

##### 18(f) Variable Rate

Comment 18(f)-1 would be expanded to explain whether paragraph (f)(1) or (f)(2) of § 226.18 applies to a particular variable-rate transaction. Comment 18(f)-1 would also indicate that variable-rate loans that are for a term longer than one year and are secured by the consumer's principal dwelling are subject to the special early disclosure requirements of new § 226.19(b).

With minor changes, material relating to the basis of disclosures for variable-rate transactions would be moved to the commentary to § 226.17(c)(1). Consequently, comments 18(f)-2 and -3 and comments 18(f)-5 through -8 would be deleted. Present comment 18(f)-4 would be redesignated as comment 18(f)-2. The material currently in comments 18(f)-2 and -3 would be incorporated in comments 17(c)(1)-8 and -9, and the material currently in comments 18(f)-6, -7 and -8 would be incorporated, respectively, in comments 17(c)(1)-11, -13 and -12. The material currently in comment 18(f)-5 would be incorporated in the commentary to new § 226.19(b), which contains the new disclosure requirements. The material currently in comment 18(f)-6 would be incorporated in new comment 19(b)-4 to clarify that the designated transactions are subject to the general disclosure requirements of new § 226.19(b). The material currently in comment 18(f)-6 relating to the basis for disclosures would not be transferred to new comment 19(b)-4, since such information would be incorporated in comment 17(c)(1)-12.

The current headings referring to paragraphs 18(f)(1) through (4) would be changed to reference paragraphs 18(f)(1)(i) through (iv) to reflect the fact that current § 226.18(f) of the regulation has become § 226.18(f)(1).

Comment 18(f)(2)-1 would be added to clarify that where a variable-rate transaction is secured by the consumer's principal dwelling and has a term greater than one year, later Truth in Lending disclosures must state that the variable-rate feature exists and refer to the variable-rate disclosures provided earlier to the consumer under new § 226.19(b).

#### *Section 226.19—Certain residential mortgage transactions.*

The title of this section of the commentary would be revised to read "Certain Residential Mortgage and

Variable-Rate Transactions" to reflect the fact that § 226.19 of the regulation now incorporates disclosure provisions for variable-rate loans secured by the consumer's principal dwelling that have a term greater than one year.

#### 19(a) Time of Disclosure

The current heading referring to 19(a) would be redesignated as 19(a)(1). Existing comments 19(a)-1 through 19(a)-5 would therefore become comments 19(a)(1)-1 through -5.

#### 19(b) Redislosure Required

The current heading referring to 19(b) would be redesignated as 19(a)(2). Existing comments 19(b)-1 through 19(b)-4 would therefore become comments 19(a)(2)-1 through -4.

Comment 19(b)-1 would be added to clarify that the new requirements of § 226.19(b) apply to all variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year.

Comment 19(b)-2 would be added to explain the special timing rules under § 226.19(b) for cases where applications are received through an agent or broker or by telephone, as well as where open-end accounts convert, pursuant to a written agreement, to transactions subject to § 226.19(b).

Comment 19(b)-3 would incorporate material previously contained in comment 18(f)-5 to clarify that creditors may substitute information provided in accordance with the variable-rate regulations of other federal agencies for the disclosures required by § 226.19(b). The reference to footnote 43 and § 226.18(f) in old comment 18(f)-5 would be revised to reference footnote 45a and § 226.19(b), respectively, in the new comment 19(b)-3.

Comment 19(b)-4 would incorporate, with some changes, material previously contained in comment 18(f)-6 clarify that the designated transactions are subject to the general disclosure requirements of § 226.19(b). The last sentence in the first bullet under old comment 18(f)-6 referring to the disclosures that must be given for renegotiable rate mortgages would be deleted in the new comment 19(b)-4, as would the third and fourth sentences in the second bullet dealing with disclosures for shared-equity mortgages. The language in the third bullet under old comment 18(f)-6 would be revised in the new comment 19(b)-4 to take into account transactions where the initial underlying rate is fixed, and the reference to the hypothetical example in the last sentence would be deleted.

*Paragraph 19(b)(1)* Comment 19(b)(1)-1 would be added to clarify what

constitutes a suitable substitute for the *Consumer Handbook on Adjustable Rate Mortgages*.

*Paragraph 19(b)(2).* Comment 19(b)(2)-1 would be added to explain that a creditor must provide disclosures for each of its variable-rate programs in which the consumer expresses an interest.

Comment 19(b)(2)-2 would be added to clarify what constitutes a separate loan program that would require separate program disclosures. Comment 19(b)(2)-3 would be added to clarify that the disclosures required under § 226.19(b)(2) need only be made as applicable, and comment 19(b)(2)-4 would be added to explain the circumstances under which a creditor must revise its loan program disclosures.

Comments to new § 229.19(b)(2)(i) through (xiv) would be added to clarify the requirements imposed by these paragraphs and to illustrate how a creditor may comply with the new provisions.

#### *Section 226.20—Subsequent disclosure requirements.*

##### 20(a) Refinancings

Comment 20(a)-3 would be amended to clarify that the addition of a variable-rate feature to an obligation or an increase in the rate based on a previously undisclosed variable-rate feature are events requiring disclosures under new § 226.19(b)(2) if the variable-rate transaction is secured by the consumer's principal dwelling and has a term greater than one year. The comment explains that, in such cases, disclosures must be given at the time of the addition or increase.

##### 20(b) Assumptions

Comment 20(b)-6 would be amended to provide that assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year may be disclosed in accordance with § 226.18(f)(2)(i) or § 226.18(f)(1).

##### 20(c) Variable-Rate Adjustments

Comment 20(c)-1 would be added to explain what subsequent disclosures are required in cases where a rate adjustment is made in a variable-rate transaction subject to new § 26.19(b). Comment 20(c)-2 would clarify that shared-equity loans and preferred-rate employees loans with an underlying fixed rate would be exempt from the new subsequent disclosure requirements of § 226.20(c).

#### Appendix H—Closed-End Model Forms and Clauses

Commentary would be provided to interpret the new model clauses H-4(B) through H-4(D) in Appendix H of the regulation. These additions would be numbered as comments app. H-5 through -7. In addition commentary describing new Sample H-14 would be added as comment app. H-18. Consequently, existing comments app. H-5 through -14 would be renumbered as comments app. H-8 through -17 and existing comments app. H-16 through -20 would be renumbered as comments app. H-19 through -23.

#### List of Subjects in 12 CFR Part 226

Advertising, Banks, Banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Rate limitations, Truth in lending.

Certain conventions have been used to highlight the proposed revisions. New language is shown inside arrows, while language that would be deleted is set off with brackets. Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board proposes to amend the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

#### PART 226—[AMENDED]

(1) The authority citation for Part 226 continues to read:

Authority: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96-221, 94 Stat. 170 (15 U.S.C. 1604 *et seq.*); sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552.

(2) *Text of proposed revisions.* The proposed revisions to the commentary (12 CFR Part 226 Supp. I) include revising comment 17(a)(1)-2; removing the information contained in the fifth bullet under comment 17(a)(1)-5 and changing the reference in the ninth bullet under this comment from § 226.18(f)(3) to § 226.18(f)(1)(iii); revising comment 17(b)-1; changing the reference in the first bullet under comment 17(c)(1)-2 from § 226.18(f) to § 226.19(b); redesignating existing comment 17(c)(1)-8 as comment 17(c)(1)-12; redesignating existing comments 17(c)(1)-9 and 17(c)(1)-10 as comments 17(c)(1)-14 and 17(c)(1)-15, respectively; adding new comments 17(c)(1)-8 through 17(c)(1)-11 and 17(c)(1)-13; changing the reference in comment 17(f)-3 from § 226.19(b) to § 226.19(a)(2); revising comment 18(f)-1; deleting comment 18(f)-2; redesignating existing comment 18(f)-4 as comment 18(f)-2; deleting comments 18(f)-3

through 18(f)-8; redesignating comments 18(f)(1)-1, 18(f)(2)-1, 18(f)(3)-1, 18(f)(4)-1 and 18(f)(4)-2 as comments 18(f)(1)(i)-1, 18(f)(1)(ii)-1, 18(f)(1)(iii)-1, 18(f)(1)(iv)-1, and 18(f)(1)(iv)-2, respectively; adding new comment 18(f)(2)-1; revising the title to the commentary to § 226.19; redesignating paragraphs 19(a) and 19(b) as paragraphs 19(a)(1) and 19(a)(2), respectively; redesignating comments 19(a)-1 through 19(a)-5 as comments 19(a)(1)-1 through 19(a)(1)-5 and comments 19(b)-1 through 19(b)-4 as 19(a)(2)-1 through 19(a)(2)-4; adding new comments 19(b)-1 through 19(b)(2)(xiv)-1; revising comment 20(a).3; revising comment 20(b)-6 and adding comments 20(c)-1 and 20(c)-2; amending the commentary to Appendix H by redesignating comments app. H-5 through app. H-20 as app. H-8 through H-23, adding new comments app. H-5 through app. H-7, and revising newly redesignated comment app. H-18, to read as follows:

**Supplement I—Official Staff Interpretation**

§ 226.17—General disclosure requirements.

17(a) Form of Disclosures

Paragraph 17(a)(1)

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 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.)◄

5. Directly related. \* \* \*

[• When a variable-rate feature is disclosed on other documents \* \* \*.]

- 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)(3)]►226.18(f)(1)(iii)◄.)

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. 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)(2) 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. \* \* \*

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(1)

2. Modification of obligation. \* \* \*  
 • If the creditor-employer offers a preferential employee rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to section [226.18(f)] ►226.19(b)◄ for an example of a preferred-rate employee transaction that is a variable-rate transaction.)

►8. Basis of disclosures in variable-rate transactions. The disclosures for a variable-rate transaction and must be based on the terms in effect at the time of consummation. However, in a variable-rate transaction with either a seller buydown that is reflected in the credit contract or a consumer buydown, 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 lower rate for the buydown 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 transactions and the commentary to § 226.19(a)(2) for a discussion of the redisclosure of 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 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.

• 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 the index value in effect not more than 45 days before consummation in calculating a composite annual percentage rate.

• 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.

• 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.

• 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) of the regulation.

• Examples of discounted variable-rate transactions include—

—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 scheduled should show 12 payments of \$804.62 and 348 payments of \$1,025.31. The finance charge should be \$226,463.32 and the total of payments \$366,463.32.

—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.

—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 payment should be reflected. The payment schedule should



show 12 payments of \$804.62, 12 payments of \$864.97, 12 payments of \$929.86, 12 payments of \$999.60, and 312 payments of \$1,070.03. The finance charge should be \$277,037.96, and the total of payments \$377,037.96.

This paragraph does not apply to variable-rate loans 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. 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. *Other variable-rate transactions.*

Examples of variable-rate transactions include:

- Renegotiable rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, where the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate. Disclosures must be given for the longer term of the obligation, with all disclosures calculated on the basis of the rate in effect at the time of consummation of the transaction.

- "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 § 226.2, other types of shared-equity arrangements are not considered "credit" and are not subject to Regulation Z.)

- Preferred-rate employee loans where the terms of the legal obligation provide that the rate will increase only if the employee leaves the employ of the creditor and the note reflects the preferred rate. The disclosures are to be based on that rate.

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

[8.] ▶ 12. ◀ *Graduated-payment adjustable-rate mortgages.* \* \* \*

▶ 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.) ◀  
[9.] ▶ 14. ◀ *Morris Plan transactions.* \* \* \*  
[10.] ▶ 15. ◀ *Number of transactions.* \* \* \*

17(f) *Early 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 section [226.29(b)] ▶ 226.19(a)(2).) ◀

Section 226.18—Content of disclosures.

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). 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.) ◀

- [2. *Basis for disclosures.* \* \* \*  
[Use of estimates. \* \* \*  
[4.] ▶ 2. ◀ *Terms used in disclosure.* \* \* \*  
[5. *Other variable-rate regulations.* \* \* \*  
[6. *Examples of variable-rate transactions.* \* \* \*  
[7. *Growth equity mortgages.* \* \* \*  
[8. *Discounted variable-rate transactions.* \* \* \*

Paragraph [18(f)(1)] ▶ 19(f)(91)(i) ◀

Paragraph [18(f)(2)] ▶ 18(f)(1)(ii) ◀

Paragraph [18(f)(3)] ▶ 18(f)(1)(iii) ◀

Paragraph [18(f)(4)] ▶ 18(f)(1)(iv) ◀

▶ Paragraph 18(f)(2)

1. *Disclosure required.* In a variable-rate transaction that is for a term greater than one year and is secured by the consumer's principal dwelling, the creditor must give special early disclosure 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 variable-rate feature exists and that variable-rate disclosures have been provided earlier. ◀

Section 226.19—Certain Residential Mortgage and Variable-Rate Transactions

[19(a) *Time of Disclosure*]

▶ 19(a)(1) *Time of Disclosure* ◀

[19(b) *Redisclosure Required*]

▶ 19(a)(2) *Redisclosure Required* ◀

▶ *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 transactions 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).

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 non-refundable fee, whichever is earlier. In cases where a creditor received 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. This three-day rule also applies where the creditor takes an application over the telephone. If, however, 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. 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. In cases where an open-end credit account is converted to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section should 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.)

*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. 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 footnote 45a 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, if they differ, rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

*4. Examples of variable-rate transactions.*

The following transactions, if they are for 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). (If these variable-rate transactions either are not secured by the consumer's principal dwelling, or have a term of one year or less, § 226.18(f)(1) applies rather than § 226.19(b).)

- Renegotiable rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, where the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate.

- "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 mortgage property. The appreciation share is payable in a lump sum at a specified time. The requirements of § 226.19(b)(2) (iv), (v), (viii), (ix), (x) and (xii) do not apply to shared-equity mortgages, however. (As discussed in § 226.2, other types of shared-equity arrangements are not considered "credit" and are not subject to Regulation Z.)

- Preferred-rate employee loans where the terms of legal obligation provide that the initial underlying rate is fixed, but will increase if the employee leaves the employ of the creditor, and the note reflects the preferred rate. The disclosures under § 226.19(b)(2) (v), (viii), (ix), (x), (xii), and (xiii) do not apply to such loans.

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

*Paragraph 19(b)(1)*

1. *Substitutes.* 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*.

*Paragraph 19(b)(2)*

1. *Disclosure for each variable-rate program.* In variable-rate transactions subject to § 226.19(b) requirements, a creditor must provide disclosures that fully describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier. Moreover, if a consumer requests disclosures for other closed-end variable-rate programs subject to § 226.19(b), a creditor must provide disclosures for as many other of its programs as the consumer requests. The creditor, of course, is permitted to give the consumer information about all of its programs subject to § 226.19(b) initially. In addition, these disclosures may be inserted in the *Consumer Handbook* (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

2. *Variable-rate loan program defined.* 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 program disclosures would be required based on differences in any of the following loan features:

- The index or other formula used to calculate interest rate adjustments
- The rules relating to changes in the index, interest rate, payments, and loan balance
- The presence or absence of, and the amount of, rate or payment caps
- The presence of a balloon or a demand feature
- The possibility of negative amortization
- The possibility of interest rate carryover
- The frequency of interest rate and payment adjustments
- The presence of a discount feature

In addition, if a loan feature must be taken into account in preparing the disclosure required by § 226.19(b)(2)(ix), variable-rate loans that differ as to that feature constitute separate programs and require separate loan program disclosures under § 226.19(b)(2). If, however, a representative value may be given for a loan 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 program disclosures would not be required based on differences in the following loan features:

- The amount of a discount
- The amount of a margin

3. *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)(xii) need not be given.

4. *Revisions.* A creditor must revise the disclosures required under this section once a year when the new index value becomes available. A change in the loan program, however, would require new disclosures.

*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."

*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."

*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, "You should ask us for our current interest rate and margin."

*Paragraph 19(b)(2)(v)*

1. *Discounted 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 contains a discount feature, 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 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." (See the commentary to § 226.19(b)(2)(viii) for a discussion of how to reflect the discount in the historical example.)

*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 reveal 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.

*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, although the absence of such limits need not be stated. 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.)

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." In addition, the creditor must disclose the existence of any interest rate carryover provisions. Interest rate carryover exists when a change in the index rate that is not imposed at the time of an adjustment because, for example, it exceeds an adjustment limitation, is carried over and incorporated into the calculation of future rate adjustments. For example, if the index rates 3 percentage points during the year, the loan contains a 2 percentage point cap on annual changes (increases or decreases) in the interest rate, and the creditor may impose the additional percentage point the following year, the creditor must disclose the fact that changes in the index will be carried over to subsequent interest rate adjustment rates. The disclosure might state, "Changes in the index not passed on as changes in the interest rate will be carried over to subsequent interest rate adjustment dates."

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; any fee that may be charged at conversion; and how the fixed rate will be determined. The creditor should identify any index used and state the margin to be added to determine the fixed rate. (In disclosing the period during which the loan may be converted, the margin, and any fees to be charged at conversion, the creditor may use information applicable to the conversion feature during the six months preceding preparation of the disclosures. That information may be used until the program disclosures are otherwise updated.) 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 employee loans.* Section 226.19(b) applies to preferred-rate employee loans, where the rate will increase if the employee leaves the creditor's employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose 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 employee's preferred-rate, such as any fees that may be charged when the rate is changed and how the new rate will be determined.

*Paragraph 19(b)(2)(viii)*

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.) 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 of index values 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. 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. 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 period, beginning with the initial history of rates starting 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 margin.* For purposes of the disclosure required under § 226.19(b)(2)(viii), a creditor may select a 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 updates the disclosure form to reflect the most recent index values.

3. *Amount of discount.* For purposes of the disclosure required under § 226.19(b)(2)(viii), a creditor may select a discount (amount and term) that has been used during the six months preceding preparation of the disclosures, and should disclose that the discount is one that the creditor has used recently. The discount should be reflected in the historical example for as long as the discount is in effect. A creditor may assume that a discount has been in effect for a full year for purposes of reflecting the discount in the historical example.

*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. 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. *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 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. 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 initial interest rate, the most recent rate shown in the historical example should be discounted by the amount of the discount reflected elsewhere in the disclosure for purposes of calculating the initial and maximum interest rates and payments. If a discount is reflected, the disclosure of the initial and maximum rates and payments should state the amount by which the most recent rate has been discounted. (See comment 19(b)(2)(viii)-3 regarding disclosure of the amount of a discount.)

*Paragraph 19(b)(2)(xi)*

1. *Demand feature.* If a variable-rate loan subject to § 226.19(b) requirements contains a demand feature, 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)(xii)*

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 § 226.20(c) regarding notices of adjustments.) For example, in transactions providing that payment adjustments may accompany each interest rate adjustment, 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)(xiii)*

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). 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." ◀

**Section 226.20—Subsequent disclosure requirements.**

*20(a) Refinancings*

3. *Variable rate.* 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, a renegotiable rate mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. However, 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:

- Increases the rate based on a variable-rate feature that was not previously disclosed, or
- Adds a variable-rate feature to the obligation.

▶ If either of these two events occurs in a variable-rate transaction secured by a principal dwelling with a term longer than one year, the disclosures required under § 226.19(b)(2) also must be given at that time. ◀

*20(b) Assumptions*

6. *Disclosures.* For transactions that are assumptions within this provision, the creditor must make disclosures based on the "remaining obligation." For example:

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) or periodic notices under § 226.20(c). Alternatively, a creditor may disclose the variable-rate feature of such a transaction solely in accordance with § 226.18(f)(1). ◀

▶ *20(c) Variable-Rate Adjustments*

1. *Timing and content of adjustment notices.* This section requires a creditor 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 may accompany interest rate changes. In

transactions where the interest rate may be adjusted more frequently than the payment, a creditor is required to send at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. In transactions providing for payment adjustments to accompany interest rate 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. In all cases, the disclosure must include, as applicable, the new payment amount, the current and prior interest and index rates and the loan balance, and must notify the consumer of the extent to which any increase in the interest rate has been foregone. The disclosure must also state the payment that would be required to fully amortize the loan if this amount is different from the payment already disclosed. (In cases where an open-end account is converted to a 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 loans and preferred-rate employee loans with an underlying fixed rate. ◀

**Appendix H—Closed-End Model Forms and Clauses**

4. *Model H-4(A)* ◀ \* \* \*

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 earlier disclosures were provided under § 226.19(b) in cases where the variable-rate transaction is secured by the consumer's principal dwelling with a term greater than one year. ◀

6. ▶ *Model H-4(C).* This model clause illustrates the early disclosures required generally under § 226.19(b) when the variable-rate transaction is secured by the consumer's principal dwelling and is for a term greater than one year. 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. The model clause also 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. In addition, the model clause illustrates the disclosure of the initial and maximum interest rates and payments for a loan originated at the most recent rate shown in the historical example. ◀

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. ◀

[5.] ▶ 8. ◀ *Model H-5.* \* \* \*

[6.] ▶ 9. ◀ *Model H-6.* \* \* \*

[7.] ▶ 10. ◀ *Model H-7.* \* \* \*

[8.] ▶ 11. ◀ *Models H-8 and H-9.* \* \* \*

[9.] ▶ 12. ◀ *Sample forms.* \* \* \*

[10.] ► 13. ◀ Sample H-10. \* \* \*

[11.] ► 14. ◀ Sample H-11. \* \* \*

[12.] ► 15. ◀ Sample H-12. \* \* \*

[13.] ► 16. ◀ Sample H-13 through H-15. \* \* \*

[14.] ► 17. ◀ Sample H-13. \* \* \*

18. ► Sample H-14K. 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, and 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 of 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 index history in 1988 would contain fewer than 15 years of index values. In making these disclosures in 1992, however, a creditor would need to show a full 15-year index history. In 1993, the index history would cover the years 1978 through 1992. The sample disclosure also illustrates the requirement under § 226.19(b)(2)(x) that the initial and the maximum interest rates and payments be shown for a \$10,000 loan originated at the most recent rate shown in the historical example. In the sample, the loan is assumed to have an initial interest rate of 9.71% (which was the interest rate in 1987 for the example shown) 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 9.71% initial rate to 14.71%, and the monthly payment could rise from \$85.62 to a maximum of \$123.31. 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 would reflect the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method of calculating their actual monthly payment for a loan amount other than \$10,000. ◀

[16.] ► 19. ◀ Sample H-15. \* \* \*

[17.] ► 20. ◀ HRSA-500-1 9-82. \* \* \*

[18.] ► 21. ◀ HRSA-500-2 9-82. \* \* \*

[19.] ► 22. ◀ HRSA-502-1 9-82. \* \* \*

[20.] ► 23. ◀ HRSA-502-2 9-82. \* \* \*

Board of Governors of the Federal Reserve System, December 21, 1987.

William W. Wiles,  
Secretary of the Board.

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