FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

DALLAS, TEXAS 75222

April 6, 1988

Circular 88-27

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

SUBJECT

Regulation B (Equal Credit Opportunity); Regulation E (Electronic Funds Transfers); and Regulation Z (Truth in Lending)

DETAILS

Attached for your information are the Board of Governors' press releases announcing changes to the official staff commentary for three of the Board's consumer credit regulations -- Regulation B, Regulation E and Regulation Z.

The final revisions to the staff commentary for Regulation B address issues concerning consideration of age in evaluating creditworthiness, signature requirements, record retention and collection of monitoring information.

The revisions to the staff commentary for Regulation E include clarification of the amendments adopted by the Board in August 1987 concerning point-of-sale/automated clearinghouse services.

The Regulation Z staff commentary has been amended to include interpretations of the Board's rule that adjustable rate mortgages contain a maximum interest rate. The changes to the commentary also provide guidance to creditors in complying with the amendment to Regulation that was adopted by the Board in December 1987 to provide more information to consumers about certain variable rate loans.

ATTACHMENTS

The Board's press releases and text of changes are attached.

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).

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MORE INFORMATION

Questions regarding the changes to the commentaries should be directed to Dean A. Pankonien at (214) 651-6228. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

William H. Wallace

FEDERAL RESERVE press release

For immediate release April 1, 1988

The Federal Reserve Board today published an official staff commentary for three of its consumer credit protection regulations--Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers) and Regulation Z (Truth in Lending).

The final revisions to the staff commentary for Regulation B address issues concerning consideration of age in evaluating creditworthiness, signature requirements, record retention and collection of monitoring information.

The final revisions to the staff commentary for Regulation E clarify the amendments adopted by the Board in August 1987 concerning point-of-sale/automated clearinghouse services. The revisions deal with issues such as institutions' responsibilities concerning periodic statements, card issuance and error resolution.

Revisions to the Regulation Z staff commentary address disclosure questions raised by the emergence of conversion features in adjustable-rate mortgages and the imposition of fees that are considered finance charges at the time a credit card plan is renewed. Commentary is also included which interprets the Board's rule implementing the requirement of the Competitive Equality Banking Act that adjustable-rate mortgages contain a maximum interest rate.

The Board's notices are attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 202

[Reg. B; EC-1]

EQUAL CREDIT OPPORTUNITY

Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form revisions to the official staff commentary to Regulation B (Equal Credit Opportunity). The commentary applies and interprets the requirements of Regulation B and is a substitute for individual staff interpretations of the regulation. The revisions address issues concerning consideration of age in evaluating creditworthiness, signature requirements, record retention and collection of monitoring information.

EFFECTIVE DATE: April 1, 1988.

FOR FURTHER INFORMATION CONTACT: Kathleen S. Brueger or Leonard N. Chanin, Staff Attorneys, or Adrienne D. Hurt, Senior Attorney, Division of Consumer and Community Affairs, at (202) 452-2412 or 452-3667; for the hearing impaired only, contact Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) General

The Equal Credit Opportunity Act (ECOA) (15 U.S.C. 1691 et seq.) makes it unlawful for creditors to discriminate in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise of rights under the Consumer Credit Protection Act. This statute is implemented by the Board's Regulation B (12 CFR Part 202).

On November 20, 1985, an official staff commentary (EC-1, Supp. I to 12 CFR Part 202) was published to interpret the regulation (50 FR 48018). The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions. The commentary is updated periodically to address significant questions that arise. The previous update was published in April 1987 (52 FR 10732). This notice contains the second update, which was proposed for comment on December 10, 1987 (52 FR 47589). The revisions are effective April 1, 1988.

(2) Revisions

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

SECTION 202.6 -- Rules Concerning Evaluation of Applications

6(b) Specific Rules Concerning Use of Information

Paragraph 6(b)(2)

Comment 6(b)(2)-1 is amended to clarify that while section 202.6(b)(2)(iv) permits favoring persons age 62 and older

both in evaluating creditworthiness and in the credit terms offered, that paragraph does not permit offering more favorable credit terms to an age group that includes persons under age 62 (such as persons age 55 and older). To offer a program favoring a larger age group, the creditor must rely on the special purpose credit provisions of section 202.8. The additional language does not, of course, affect consideration of age in evaluating creditworthiness in a credit scoring system, as described in comment 6(b)(2)-2.

Comment 6(b)(2)-3 is amended to clarify that, in a judgmental system, age or age-related information about an applicant may be considered only in connection with other relevant information about the particular applicant or transaction.

SECTION 202.7 -- Rules Concerning Extensions of Credit

7(d) Signature of Spouse or Other Person

Paragraph 7(d)(5)

Comment 7(d)(5)-2 is revised in light of United States v. ITT Consumer Financial Corp., 816 F.2d 487 (9th Cir. 1987) to clarify the rules about when a creditor may require additional signatures on a credit obligation in a community property state. In the ITT case, the U.S. Court of Appeals for the Ninth Circuit held that the future earnings of a spouse cannot be characterized as community property until they are earned. Therefore, when an applicant relies on the spouse's future earnings to establish creditworthiness, a creditor may condition the extension of

credit on the nonapplicant spouse's signing the credit obligation.

Whether an applicant is relying on the future earnings of a nonapplicant spouse is for the creditor to determine. Because section 202.5(c)(2)(iv) permits a creditor routinely to request information about a nonapplicant spouse, the mere fact that the nonapplicant spouse's income is listed on an application form is insufficient to show that the applicant is relying on the spouse's income.

In addition to revisions to the first and second sentence of comment 7(d)(5)-2, a third sentence has been added to incorporate the holding of ITT and to address questions raised by creditors. Some creditors have asked whether, given the ITT ruling, they are required to obtain the signature of the applicant's spouse whose future earnings are relied on for an extension of credit. Creditors also have asked whether they may take marital status into consideration when future earnings are relied on -- that is, whether a creditor may follow the practice of not requiring the signature of an applicant's spouse if it is the creditor's practice to require a signature when it is a person not married to the applicant whose future earnings are relied on. They explain that, in the case of a spouse, the creditor is assuming the spouse's future earnings -- unlike the future earnings of a nonspouse -- will become community property once earned, under state property law. The third sentence of the comment addresses both of these points. A reference to section

202.6(c), which allows the consideration of state property laws, has also been added.

SECTION 202.12 -- Record Retention

12(b) Preservation of Records

Comment 12(b)-1 is revised to clarify the rules for record retention of documents (for example, notifications of action taken) in computerized systems.

SECTION 202.13 -- Information for Monitoring Purposes

13(a) Information to Be Requested

Comment 13(a)-5 is revised to clarify the monitoring information rules regarding open-end lines of credit.

List of Subjects in 12 CFR 202

Banks, Banking, Civil rights, Consumer protection, Credit, Federal Reserve System, Marital status discrimination, Minority groups, Penalties, Religious discrimination, Sex discrimination, Women.

Certain conventions have been used to highlight the revisions to the commentary. New language is shown inside bold-faced arrows and underlined, while language that has been removed is set off with brackets.

(3) Text of revisions

Pursuant to authority granted in section 703 of the Equal Credit Opportunity Act (15 U.S.C. 1691b), the Board amends the official staff commentary to Regulation B (12 CFR 202 Supp. I) as follows:

1. The authority citation for Part 202 continues to read:

AUTHORITY: 15 U.S.C. 1691 et seq.

2. The revisions amend the commentary (12 CFR Part 202, Supp. I) by revising comments 6(b)(2)-1, 6(b)(2)-3, 7(d)(5)-2, 12(b)-1 and 13(a)-5 to read as follows:

SUPPLEMENT I - Official Staff Commentary

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SECTION 202.6 -- Rules Concerning Evaluation of Applications

* * * * *

6(b) Specific Rules Concerning Use of Information

* * * * *

Paragraph 6(b)(2)

1. Favoring the elderly. Any system of evaluating credit-worthiness may favor a credit applicant who is age 62 or older. ►A credit program that offers more favorable credit terms to applicants age 62 or older is also permissible; a program that offers more favorable credit terms to applicants at an age lower than 62 is permissible only if it meets the special-purpose credit requirements of section 202.8.◄

* * * * *

3. Consideration of age in a judgmental system. In a judgmental system, defined in section 202.2(t), a creditor may not take age directly into account in any aspect of the credit transaction. For example, the creditor may not reject an application or terminate an account because the applicant is 60 years old. But

a creditor that uses a judgmental system may relate the applicant's age to other information about the applicant that the creditor considers in evaluating creditworthiness. For example:

- A creditor may consider the applicant's occupation and length of time to retirement to ascertain whether the applicant's income (including retirement income) will support the extension of credit to its maturity.
- A creditor may consider the adequacy of any security offered when the term of the credit extension exceeds the life expectancy of the applicant and the cost of realizing on the collateral could exceed the applicant's equity. (An elderly applicant might not qualify for a 5 percent down, 30-year mortgage loan but might qualify with a larger downpayment or a shorter loan maturity.)
- A creditor may consider the applicant's age to assess the significance of the length of the applicant's employment (a young applicant may have just entered the job market) or length of time at an address (an elderly applicant may recently have retired and moved from a long-term residence).

▶As the examples above illustrate, the evaluation must be made in an individualized, case-by-case manner; and it is impermissible for a creditor, in deciding whether to extend credit or in setting the terms and conditions, to base its decision on age or

information related exclusively to age. Age or age-related information may be considered only in evaluating other "pertinent elements of creditworthiness" that are drawn from the particular facts and circumstances concerning the applicant.◄

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SECTION 202.7 -- Rules Concerning Extensions of Credit

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7(d) Signature of Spouse or Other Person

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Paragraph 7(d)(5)

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2. Reliance on income of another person -- individual credit. An applicant who requests individual credit relying on the income of another person ([such as] ►including◄ a spouse ►in a noncommunity property state◄) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature ►of a spouse◄ may be required if the applicant relies on the ►spouse's◄ separate income ►.◄ [of another person, i.e., income] ►If the applicant relies on the spouse's future earnings◄ that as a matter of state law [is not] ►cannot be characterized as◄ community property [.] ►until earned, the creditor may require the spouse's signature, but need not do so -- even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See section 202.6(c) on consideration of state property laws.)◄

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SECTION 202.12 -- Record Retention

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12(b) Preservation of Records

1. Copies. A copy of the original record includes carbon copies, photocopies, microfilm or microfiche copies, or copies produced by any other accurate retrieval system, such as documents stored and reproduced by computer. ▸A creditor that uses a computerized or mechanized system need not keep a written copy of a document (for example, an adverse action notice) if it can regenerate all pertinent information in a timely manner for examination or other purposes.◂

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SECTION 202.13 -- Information for Monitoring Purposes

13(a) Information to Be Requested

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5. Transactions not covered. The information-collection requirements of ▸this◂ section [202.13(a)] apply to applications for credit primarily for the purchase or refinancing of a dwelling that is or will become the applicant's principal residence. Therefore, [applications for home-equity lines and other] applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not subject to information-collection requirements [of section

202.13(a)]. ▸An application for an open-end home equity line of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the line is for the purchase or refinancing of a principal dwelling.◂

Board of Governors of the Federal Reserve System, March 30, 1988.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

FEDERAL RESERVE SYSTEM

12 CFR Part 205

[Reg. E; EFT-2]

ELECTRONIC FUND TRANSFERS

Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form revisions to the official staff commentary to Regulation E (Electronic Fund Transfers). The commentary applies and interprets the requirements of Regulation E and is a substitute for individual staff interpretations of the regulation. The revisions address questions that have arisen about the regulation, including amendments adopted by the Board in August 1987 dealing with POS/ACH services. The revisions deal with, for example, the responsibilities of a service-providing institution concerning periodic statements, card issuance, and error resolution.

EFFECTIVE DATE: April 1, 1988.

FOR FURTHER INFORMATION: Contact Thomas J. Noto, Staff Attorney, or John C. Wood, Senior Attorney, Division of Consumer and Community Affairs, at (202) 452-2412; for the hearing-impaired only, contact Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: **(1) General**. The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) governs any transfer of funds that is electronically initiated and that debits or credits a consumer's account. This statute is implemented by the Board's Regulation E (12 CFR Part 205).

Effective September 24, 1981, an official staff commentary (EFT-2, Supp. II to 12 CFR Part 205) was published to interpret the regulation. The commentary is designed to provide guidance to financial institutions in applying the regulation to specific situations. The commentary is updated periodically to address significant questions that arise. The previous updates were published on April 6, 1983 (48 FR 14880), October 18, 1984 (49 FR 40794), April 3, 1985 (50 FR 13180), April 21, 1986 (51 FR 13484), and April 3, 1987 (52 FR 10734). This notice contains the sixth update, which was proposed for comment on December 10, 1987 (52 FR 47591). The revisions are effective April 1, 1988.

(2) Description of revisions. The following is a brief description of the revisions to the commentary:

SECTION 205.3 -- Exemptions

Question 3-6

Question 3-6 is revised to make clear that section 913 of the EFT Act does not require an employer to give its employees the option of receiving their salary by check or cash as an alternative to direct deposit; an employer also complies with section 913 by allowing employees to choose the institutions to receive their direct deposits.

SECTION 205.14 -- Services Offered by Financial Institutions Not Holding Consumer's Account

Question 14-4

Question 14-4 is revised to make clear that a service provider need not furnish a periodic statement if it complies with the conditions set forth in the August 1987 amendments to the regulation (52 FR 30904).

Question 14-5

This question is added to clarify that, in a POS/ACH program, if the service provider does not issue the debit card that is actually used to initiate transfers, or does not issue a debit card at all, the service provider must send periodic statements to consumers.

Question 14-6

This question is also new. It deals with the responsibility of a service provider for error resolution. It clarifies that the service provider must reimburse the consumer for any fees or charges incurred as a result of the error, including those imposed by the account-holding institution.

Question 14-7

This question is added to address an issue concerning the periodic statement provided by the account-holding institution. Specifically, the question makes clear that the statement need not show, with respect to POS/ACH transactions, information other than the transaction description set forth in § 205.9(b)(1).

List of Subjects in 12 CFR Part 205

Banks, banking; Consumer protection; Electronic fund transfers; Federal Reserve System; Penalties.

Certain conventions have been used to highlight the revisions. New language is shown inside bold-faced arrows and underlined, while language to be removed is set off with brackets.

(3) Text of revisions. Pursuant to authority granted in section 904 of the Electronic Fund Transfer Act, 15 U.S.C. 1693b, the Board amends the official staff commentary to Regulation E (12 CFR Part 205, Supp. II) as follows:

1. The authority citation for Part 205 continues to read: AUTHORITY: Pub. L. 95-630, 92 Stat. 3730 (15 U.S.C. 1693b).

2. The revisions amend the official staff commentary on Regulation E (EFT-2, Supp. II to 12 CFR Part 205) by revising questions 3-6 and 14-4 and by adding questions 14-5, 14-6, and 14-7, and read as follows:

SUPPLEMENT II -- Official Staff Interpretations

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SECTION 205.3 -- Exemptions

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Q 3-6: Compulsory use -- salary payments. Preauthorized transfers from a financial institution to a consumer's account at the same institution are exempt from the act and regulation generally but are subject to the statutory prohibition against requiring an employee (as a condition of employment) to receive payroll deposits by electronic means at a particular institution.

Does this prohibition apply to a financial institution as an employer?

A: Yes. The prohibition applies to all employers, including financial institutions. To comply with the law, an employer could, for example, give its employees a choice of the method of receiving payment -- [such as having their] ▶letting the employee choose between having◀ pay deposited at a particular institution, or receiving payment by check or cash. ▶Or, an employer could mandate payment by electronic means, but allow the employee to choose the institution to receive direct deposits.◀

As in the case of preauthorized loan payments, the compulsory-use prohibition does not require an employer to offer alternative means of payment to employees who agreed to electronic deposits at a particular financial institution before May 10, 1980. However, if an employee asks to terminate this arrangement, the employer should honor the request.
(§205.3(d)(2), §913)

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SECTION 205.14 -- Services Offered by Financial Institutions Not Holding Consumer's Account

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Q 14-4: Periodic statement -- service-providing institution. Does the service-providing institution have to provide to the consumer a periodic statement showing transfers other than electronic fund transfers made with the service provider's access device?

A: No. ▸Moreover, if the service provider complies with the conditions set forth in the regulation, it need not provide any periodic statement.◂ (§205.14(a)(2)▸(i)-(v)◂)

▸Q 14-5: Periodic statement -- issuance of card. If a service provider issues its own card but then allows the consumer to use another card (such as a bank-issued debit or credit card) to initiate transfers through the POS/ACH system, must it send periodic statements?

A: Yes. To qualify for the periodic statement exception, the service provider must issue the debit card that will actually be used to initiate transfers. Similarly, a service provider that does not issue any debit card remains subject to the requirement to send periodic statements. (§205.14(a)(2)(i))◂

▸Q 14-6: Error resolution -- responsibility of service-providing institution. In a POS/ACH transaction, the consumer properly notifies the service-providing institution of an alleged error. What is the service provider's responsibility?

A: The service provider must investigate and resolve the error as set forth in the regulation. If an error in fact occurred, any fees or charges imposed as a result of the error, either by the service provider or by the account-holding institution (for example, overdraft or dishonor fees) must be reimbursed to the consumer by the service provider. (§§ 205.11 and 205.14(a)(3)-(a)(6))◂

►Q 14-7: Content of periodic statement -- account-holding institution. For POS/ACH transactions initiated by the service provider, is the account-holding institution required to disclose all the items specified in section 205.9(b) on its periodic statement?

A: No. Its periodic statement need contain only the information specified in section 205.9(b)(1). (§205.14(b)(1))◄

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Board of Governors of the Federal Reserve System, March 30, 1988.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; TIL-1]

TRUTH IN LENDING

Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material. The changes address, for example, disclosure questions raised by the emergence of conversion features in adjustable-rate mortgages, as well as the imposition of fees that are considered finance charges at the time an open-end credit account is renewed or continued. Commentary also is included which interprets the Board's recent rule implementing the requirement of the Competitive Equality Banking Act that adjustable-rate mortgages contain a maximum interest rate. (The Board is also publishing in this issue of the Federal Register official staff interpretations on the recent amendments to Regulation Z requiring special disclosures for adjustable-rate

mortgages secured by a consumer's principal dwelling and having a term greater than one year.)

DATES: Effective April 1, 1988, but compliance optional until October 1, 1988.

FOR FURTHER INFORMATION CONTACT: The following attorneys in the Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412:

Subparts A and B -- Kathleen S. Brueger, Gerald P. Hurst, John C. Wood

Subpart C -- Michael S. Bylsma, Leonard N. Chanin, Thomas J. Noto

Subpart D -- Adrienne D. Hurt, Sharon T. Bowman

For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: **(1) General.** The Truth in Lending Act (15 U.S.C. 1601 et seq.) governs consumer credit transactions and is implemented by the Board's Regulation Z (12 CFR Part 226). Effective October 13, 1981, an official staff commentary (TIL-1, Supp. I to 12 CFR Part 226) was published to interpret the regulation. The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions and is updated periodically to address significant questions that arise. There have been six general updates: the first in September 1982 (47 FR 41338), the second in April 1983 (48 FR

14882), the third in April 1984 (49 FR 13482), the fourth in April 1985 (50 FR 13181), the fifth in April 1986 (51 FR 11422), and the sixth in April 1987 (52 FR 10875). There was also a limited update concerning fees for the use of automated teller machines, which was adopted in October 1984 (49 FR 40560). This notice contains the seventh general update. Creditors are free to rely on the revised provisions as of April 1, 1988, although they need not follow the revisions until October 1, 1988.

(2) Revisions. The following is a brief description of the revisions to the commentary:

SUBPART A -- GENERAL

SECTION 226.4 -- Finance Charge

4(c) Charges Excluded from the Finance Charge

Paragraph 4(c)(4)

A cross-reference is added to comment 4(c)(4)-2 addressing participation fees. The cross-reference is to the commentary to section 226.14(c), concerning computation of the annual percentage rate on periodic statements. Comment 14(c)-7, which currently discusses the exclusion of fees related to the opening of the account from the computation of the annual percentage rate for periodic statements, is being revised to also exclude certain account renewal fees from the computation of the annual percentage rate on periodic statements.

SUBPART B -- OPEN-END CREDIT

SECTION 226.6 -- Initial Disclosure Statement

6(a) Finance Charge

Paragraph 6(a)(2)

Comment 6(a)(2)-7 is revised to include a reference to section 226.30 and the commentary to that section. Section 226.30 requires creditors to include a provision setting a maximum interest rate in their dwelling-secured credit contracts that provide for changes in the interest rate.

SECTION 226.7 -- Periodic Statement

7(h) Other Charges

Comment 7(h)-1 is revised to clarify the treatment of taxes and filing or notary fees that are excluded from the finance charge under section 226.4(e). Even though the section 226.4(e) items are not required to be disclosed as "other charges" under section 226.6(b), creditors may include such charges in a disclosure of "other charges" on the initial disclosures. Similarly, these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the closing or settlement costs on the initial disclosure statement.

SECTION 226.14 -- Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements

Comment 14(c)-7 discusses the exclusion of finance charges related to opening an account from inclusion in the annual percentage rate computation. This comment is revised to also exclude fees that are imposed for renewal of an account or continued participation in an open-end credit plan, provided the

fees are not imposed as a result of specific transactions or specific account activity. For example, charges that are imposed only on consumers that do not charge a certain amount on their credit card annually, or annual fees that are a percentage of the consumer's credit limit, need not be included in the computation of the annual percentage rate. This change recognizes that such charges, when they are not related to specific transactions or specific activity, result in the same problems already identified in this comment with respect to fees related to the opening of an account. Including such fees in the computation of the annual percentage rate would result, in many cases, in significant distortions of the annual percentage rate and the delivery of potentially misleading information to consumers.

SUBPART C -- CLOSED-END CREDIT

SECTION 226.17 -- General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

Comment 17(a)(1)-5 is revised to explain that in variable-rate transactions subject to section 226.18(f)(1) with more than one variable-rate feature, more than one hypothetical example is information that is directly related to the disclosure required under section 226.18(f)(1)(iv).

SECTION 226.18 -- Content of Disclosures

18(b) Amount Financed

Paragraph 18(b)(3)

Comment 18(b)(3)-1, addressing the treatment of prepaid finance charges in calculations of the amount financed, is deleted and a new comment 18(b)(3)-1 substituted in its place. The new comment clarifies and more fully explains the treatment of prepaid finance charges, which has been the source of considerable confusion. Several changes have been made to the version originally proposed. First, additional examples have been added to illustrate a transaction where the creditor withholds the amount of a finance charge from the amount advanced to the consumer but does not increase the amount of the note by the amount of the charge. The additional examples clarify that the same rules are applicable in both situations. Second, additional material has been included to clarify that while a finance charge need not, in some circumstances, be subtracted as a prepaid finance charge, the charge nevertheless remains a finance charge.

The new comment is not intended to change the existing rules under section 226.18(b), but merely to clarify when creditors have an option to treat certain fees as prepaid finance charges and what the implications of that choice are under section 226.18(b).

<u>18(c) Itemization of Amount Financed</u>

<u>Paragraph 18(c)(1)(iv)</u>

Comment 18(c)(1)(iv)-1, addressing the itemization of prepaid finance charges, is supplemented by a new sentence at the beginning which clarifies that only those finance charges

deducted from the principal loan amount under section 226.18(b)(3) should be itemized as prepaid finance charges under section 226.18(c)(1)(iv). The revision is made in conjunction with the clarification to comment 18(b)(3)-1 and is not intended to change the substance of existing rules.

18(f) Variable Rate

Paragraph 18(f)(1)

Comment 18(f)(1)-2 is added to discuss the disclosure requirements under this section for variable-rate transactions containing an option permitting consumers to convert to a fixed rate. The conversion option is a variable-rate feature that must be disclosed. The comment explains how the disclosures should be given. It explains that only those limitations on, and effects of, an increase that differ from other variable-rate features need to be stated. Consistent with the revision being made to comment 18(f)(1)(iv)-1, described below, it also clarifies that only one hypothetical example need be disclosed, such as an example of payment terms resulting from changes in the index. The comment applies only to variable-rate transactions that are not secured by a consumer's dwelling, or that are secured by a principal dwelling but have a term of one year or less. The comment number reflects the redesignation of the regulatory section applicable to such variable-rate transactions from section 226.18(f) to section 226.18(f)(1). All other closed-end variable-rate transactions are subject to sections 226.18(f)(2) and 226.19(b), rather than section 226.18(f)(1).

Paragraph 18(f)(1)(ii)

Comment 18(f)(1)(ii)-1 is revised by adding a cross-reference to the requirement in new section 226.30 that a maximum interest rate limitation be included in certain variable-rate transactions.

Paragraph 18(f)(1)(iv)

Comment 18(f)(1)(iv)-1 is revised to clarify that section 226.18(f)(1)(iv) requires only one example of the effects of a rate increase on payment terms. The comment states that in transactions with more than one variable-rate feature, only one hypothetical example need be included in the disclosures. It also adds a cross-reference to the commentary to section 226.17(a)(1), which permits inclusion of more than one example as "directly related" information.

SUBPART D -- MISCELLANEOUS

SECTION 226.28 -- Effect on State Laws

28(a) Inconsistent Disclosure Requirements

Comments 28(a)-13 and -14 are added to reflect the Board's 1985 and 1988 determinations of the effect of the Truth in Lending Act on provisions of the consumer credit laws of Arizona and Indiana, respectively. The comment on Arizona law has been revised to indicate that the preempted provision has since been repealed.

SECTION 226.30 -- Limitations on Rates

On November 9, 1987, the Board published a final rule amending Regulation Z to incorporate the substance of section

1204 of the Competitive Equality Banking Act (CEBA) into the regulation (52 FR 43178; technical corrections to original notice at 52 FR 45611 (1987)). The rule requires creditors who offer dwelling-secured loans with an adjustable interest rate to include a maximum rate in their credit obligations entered into on or after December 9, 1987. The following comments are included in the commentary to section 226.30.

Comments 30-1 through 30-5 explain the scope of the rule's coverage, including examples of what types of obligations are covered and not covered. Generally stated, the rule is that any post-effective date credit obligation is subject to the interest rate ceiling requirement if it: (1) is secured by a dwelling, (2) contractually allows for interest rate increases, and (3) requires initial Truth in Lending Act (TILA) disclosures. A credit obligation subject to the TILA may also become subject to section 226.30 in two other instances: (1) if a security interest in a dwelling is added to an obligation that allows for interest rate increases, or (2) a variable rate feature is added to a dwelling-secured credit obligation.

The scope of the substantive requirement of section 1204 of CEBA is limited to obligations subject to the TILA and Regulation Z. Comment 30-6 generally explains that the other provisions of the regulation relating to TILA disclosures and their corresponding commentaries apply to section 226.30 where appropriate (such as definitions and exemptions), unless otherwise specified in the commentary to section 226.30. For

example, for purposes of coverage, the refinancing and assumption rules of section 226.20(a) and (b) apply. On the other hand, for purposes of increasing a maximum interest rate originally imposed under section 226.30 only the refinancing and assumption rules in comments 11 and 12 to this section apply.

Comments 30-7 through 30-9 explain the requirement to specify the maximum interest rate in credit contracts, including how the rate may be stated and that multiple rates may be set.

Comment 30-10 explains that a maximum rate must be applicable to increases after default. This comment applies only in situations in which a post-default agreement is considered part of the original obligation subject to Regulation Z.

Comments 30-11 and 30-12 explain when the maximum rate originally set on an obligation may be increased. Comment 30-13 further explains the relief provided in footnote 50 to section 226.30.

The final commentary provisions differ from the proposal in that editorial revisions have been made to eliminate unnecessary language and to provide further clarification. For example, a cross reference to the definition of a dwelling has been added to the first sentence in comment 30-1, while other cross references have been deleted as unnecessary. In that comment's second example of transactions not subject to section 226.30, the word "contractual" before the words "legal obligation" has been deleted. There is no intent to modify the term "legal obligation," as discussed in the commentary to

section 226.17(c)(1), or section 226.5(c), when used in section 226.30. A fixed rate, closed-end multiple advance transaction secured by a dwelling, in which each advance is disclosed as a separate transaction, has been added to that comment as a third example of transactions not covered by section 226.30. This example was contained in the supplemental information to the final rule, section 226.30, published in November 1987; some commenters asked that it be included in the commentary.

A substantive revision from the proposal has been made to comment 30-7. The requirement that the maximum rate set forth in the credit contract meet the Regulation Z "clear and conspicuous" standard has been eliminated as unnecessary.

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 revisions. New language is shown inside arrows and underlined, while language that has been deleted is set off with brackets.

(3) **Text of revisions**. Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended) and section 1204 of the Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552, the Board amends the official staff commentary on Regulation Z (12 CFR Part 226 Supp. I) as follows:

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. The revisions amend the commentary (TIL-1, 12 CFR Part 226 Supp. I) by revising comments 4(c)(4)-2, 6(a)(2)-7, 7(h)-1, 14(c)-7, 17(a)(1)-5, 18(b)(3)-1, and 18(c)(1)(iv)-1; adding comment 18(f)-9; revising comments 18(f)(2)-1 and 18(f)(4)-1; and adding comments 28(a)-13, 28(a)-14, and 30-1 through 30-13 to read as follows:

SUBPART A -- GENERAL

* * * * *

SECTION 226.4 -- Finance Charge

* * * * *

4(c) Charges Excluded from the Finance Charge

* * * * *

Paragraph 4(c)(4)

* * * * *

2. Participation fees -- exclusions. * * * (See the commentary to section 226.4(b)(2). ▶Also, see comment 14(c)-7 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.◀)

* * * * *

SUBPART B -- OPEN-END CREDIT

* * * * *

SECTION 226.6 -- Initial Disclosure Statement

* * * * *

6(a) Finance Charge

* * * * *

Paragraph 6(a)(2)

* * * * *

7. Variable-rate plan -- limitations on increase. In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. ▸(A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See section 226.30 and the commentary to that section.)◂ * * *

* * * * *

SECTION 226.7 -- Periodic Statement

* * * * *

7(h) Other Charges

1. Identification. In identifying any "other charges" actually imposed during the billing cycle, the type is adequately described as "late charge" or "membership fee," for example. Similarly, "closing costs" or "settlement costs," for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under section 226.4(c)(7), if the same term (such as "closing costs") was used in the initial disclosures and if the creditor

chose to itemize and individually disclose the costs included in that term. ▸Even though the taxes and filing or notary fees excluded from the finance charge under section 226.4(e) are not required to be disclosed as "other charges" under section 226.6(b), these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the "closing costs" or "settlement costs" on the initial disclosure statement.◂ (See comment 6(b)-1 for examples of "other charges.")

* * * * *

SECTION 226.14 -- Determination of Annual Percentage Rate

* * * * *

14(c) Annual Percentage Rate for Periodic Statements

* * * * *

7. Charges related to opening ▸, renewing, or continuing an ◂ account. Footnote 33 is applicable to section 226.14(c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to ▸specific◂ activity on the account, but relate solely to the opening ▸, renewing, or continuing◂ of the account. ▸For example, an annual fee to renew an open-end credit account that is a percentage of the credit limit on the account, or that is charged only to consumers that have not used their credit card for a certain dollar amount in transactions during the preceding year, would not be included in the calculation of the annual percentage rate, even though the fee may not be excluded from the

finance charge under section 226.4(c)(4). (See comment 4(c)(4)-2).◄ Inclusion of these charges in the annual percentage rate calculation results in significant distortions of the annual percentage rate and delivery of a possibly misleading disclosure to consumers. The rule in footnote 33 applies even if the loan fee, points, or similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

* * * * *

SUBPART C -- CLOSED-END CREDIT

SECTION 226.17 -- General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

5. Directly related. * * *

► • More than one hypothetical example under section 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.◄

* * * * *

SECTION 226.18 -- Content of Disclosures

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18(b) Amount Financed

*   *   *   *   *

Paragraph 18(b)(3)

1. Prepaid finance charges. ▶Prepaid finance charges that are paid separately in cash or by check should be deducted under section 226.18(b)(3) in calculating the amount financed. To illustrate:

- A consumer applies for a loan of $2,500 with a $40 loan fee. The face amount of the note is $2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of section 226.18(b)(1) is $2,500 and $40 should be deducted under section 226.18(b)(3), thereby yielding an amount financed of $2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the note. Creditors have the option, when the charges are not add-on or discount charges, of determining a principal loan amount under section 226.18(b)(1) that either includes or does not include the amount of the finance charges. (Thus the principal loan amount may, but need not, be determined to equal the face amount of the note.) When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under section 226.18(b)(3). When the finance charges are not included in the principal loan amount,

they should not be deducted under section 226.18(b)(3). The following examples illustrate the application of section 226.18(b) to this type of transaction. Each example assumes a loan request of $2,500 with a loan fee of $40; the creditor assesses the loan fee by increasing the face amount of the note to $2,540.

- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,540, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under section 226.18(b)(3), thereby obtaining an amount financed of $2,500.
- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under section 226.18(b)(3), thereby obtaining an amount financed of $2,500.

The same rules apply when the creditor does not increase the face amount of the note by the amount of the charge but collects the charge by withholding it from the amount advanced to the consumer. To illustrate, the following examples assume a loan request of $2,500 with a loan fee of $40; the creditor prepares a note for $2,500 and advances $2,460 to the consumer.

- If the creditor determines the principal loan amount

under section 226.18(b)(1) to be $2,500, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under section 226.18(b)(3), thereby obtaining an amount financed of $2,460.

- If the creditor determines the principal loan amount under section 226.18(b)(1) to be $2,460, it has not included the loan fee in the principal loan amount and should not deduct any amount under section 226.18(b)(3), thereby obtaining an amount financed of $2,460.

Thus in the examples where the creditor derives the net amount of credit by determining a principal loan amount that does not include the amount of the finance charge, no subtraction is appropriate. Creditors should note, however, that although the charges are not subtracted as prepaid finance charges in those examples, they are nonetheless finance charges and must be treated as such.◄

* * * * *

18(c) Itemization of Amount Financed

* * * * *

Paragraph 18(c)(1)(iv)

1. Prepaid finance charge. ►Prepaid finance charges that are deducted under section 226.18(b)(3) must be disclosed under this section.◄ * * *

* * * * *

18(f) Variable Rate

*   *   *   *   *

Paragraph 18(f)(1)

*   *   *   *   *

►2. Conversion feature. In variable-rate transactions with an option permitting consumers to convert to a fixed-rate transaction, the conversion option is a variable-rate feature that must be disclosed. In making disclosures under section 226.18(f)(1), creditors should disclose the fact that the rate may increase upon conversion; identify the index or formula used to set the fixed rate; and state any limitations on and effects of an increase resulting from conversion that differ from other variable-rate features. Because section 226.18(f)(1)(iv) requires only one hypothetical example (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example need not be given.◄

*   *   *   *   *

Paragraph 18(f)(1)(ii)

1. Limitations. This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. When there are no limitations, the creditor may, but need not, disclose that fact. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. ►(See section 226.30 for the rule requiring that a

maximum interest rate be included in certain variable-rate transactions.)◄

* * * * *

Paragraph 18(f)(1)(iv)

1. Hypothetical example. The example may, at the creditor's option appear apart from the other disclosures. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. ►In transactions with more than one variable-rate feature, only one hypothetical example need be provided. (See the commentary to section 226.17(a)(1) regarding disclosure of more than one hypothetical example as directly related information.)◄

* * * * *

SUBPART D -- MISCELLANEOUS

* * * * *

SECTION 226.28 -- Effect on State Laws

28(a) Inconsistent Disclosure Requirements

* * * * *

►13. Preemption determination -- Arizona. Effective October 1, 1986, the Board has determined that the following provision in the state law of Arizona is preempted by the federal law:

- Section 6-621A.2 -- Use of the term "the total sum of $ __" in certain notices provided to borrowers. This term describes the same item that is disclosed under

federal law as the "total of payments." Since the state law requires the use of a different term than federal law to describe the same item, the state-required term is preempted. The notice itself is not preempted.

(Note: The state disclosure notice that incorporated the above preempted term was amended on May 4, 1987, to provide that disclosures must now be made pursuant to the federal disclosure provisions.)

14. Preemption determination -- Indiana. Effective October 1, 1988, the Board has determined that the following provision in the state law of Indiana is preempted by the federal law:

- Section 23-2-5-8 -- Inclusion of the loan broker's fees and charges in the calculation of, among other items, the finance charge and annual percentage rate disclosed to potential borrowers. This disclosure is inconsistent with sections 106(a) and 226.4(a) of the federal statute and regulation, respectively, and is preempted in those instances where the use of the same term would disclose a different amount than that required to be disclosed under federal law.◄

* * * * *

►**SECTION 226.30 - Limitation on Rates**

1. Scope of coverage. The requirement of this section applies to consumer credit obligations secured by a dwelling (as dwelling is defined in section 226.2(a)(19)) in which the annual

percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge -- whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of credit obligations subject to this section include:

- Dwelling-secured credit obligations that require variable-rate disclosures under the regulation because the interest rate may increase during the term of the obligation.
- Dwelling-secured open-end credit plans that are not considered variable-rate obligations for purposes of disclosure under the regulation but where the creditor reserves the contractual right to increase the interest rate -- periodic rate and corresponding annual percentage rate -- during the term of the plan.

In contrast, credit obligations in which there is no contractual right to increase the interest rate during the term of the obligation are not subject to this section. Examples include:

- "Shared-equity" or "shared-appreciation" mortgage loans that have a fixed rate of interest and a shared-appreciation feature based on the consumer's equity in the mortgaged property. (The appreciation share is payable in a lump sum at a specified time.)

- Dwelling-secured fixed rate closed-end balloon payment mortgage loans and dwelling-secured fixed rate open-end plans with a stated term that the creditor may, but does not have a legal obligation to, renew at maturity. (Contrast with the renegotiable rate instrument described in comment 17(c)(1)-11.)
- Dwelling-secured fixed rate closed-end multiple advance transactions in which each advance is disclosed as a separate transaction.

The requirement of this section does not apply to credit obligations entered into prior to December 9, 1987. Consequently, new advances under open-end credit plans existing prior to December 9, 1987, are not subject to this section.

2. Refinanced obligations. On or after December 9, 1987, when a credit obligation is refinanced, as defined in section 226.20(a), the new obligation is subject to this section if it is dwelling-secured and allows for increases in the interest rate.

3. Assumptions. On or after December 9, 1987, when a credit obligation is assumed, as defined in section 226.20(b), the obligation becomes subject to this section if it is dwelling-secured and allows for increases in the interest rate.

4. Modifications of obligations. The modification of an obligation, regardless of when the obligation was entered into, is generally not covered by this section. For example, increasing the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective

date of the rule does not make the obligation subject to this section. If, however, a security interest in a dwelling is added on or after December 9, 1987, to a credit obligation that allows for interest rate increases, the obligation becomes subject to this section. Similarly, if a variable interest rate feature is added to a dwelling-secured credit obligation, the obligation becomes subject to this section.

5. Land trusts. In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)-8).) If a consumer-purpose loan that allows for interest rate increases is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to this section.

6. Relationship to other sections. Unless otherwise provided for in the commentary to this section, other provisions of the regulation such as definitions, exemptions, rules and interpretations also apply to this section where appropriate. To illustrate:

- An adjustable interest rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally section 226.3(a).)
- Creditors subject to this section are only those that fall within the definition of a creditor in section 226.2(a)(17).

7. Consumer credit contract. Creditors are required to specify a lifetime maximum interest rate in their credit contracts -- the instrument that creates personal liability and generally contains the terms and conditions of the agreement (for example, a promissory note or home-equity line of credit agreement). In some states, the signing of a commitment letter may create a binding obligation, for example, constituting "consummation" as defined in section 226.2(a)(13). The maximum interest rate must be included in the credit contract, but a creditor may include the rate ceiling in the commitment instrument as well.

8. Manner of stating the maximum interest rate. The maximum interest rate must be stated either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the rate ceiling will be over the term of the obligation. For example, the following statements would be sufficiently specific:

- The maximum interest rate will not exceed X%.
- The interest rate will never be higher than X percentage points above the initial rate of Y%.
- The interest rate will not exceed X%, or X percentage points above [a rate to be determined at some future point in time], whichever is less.
- The maximum interest rate will not exceed X%, or the state usury ceiling, whichever is less.

The following statements would not comply with this section:

- The interest rate will never be higher than X

percentage points over the prevailing market rate.

- The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].
- The interest rate will not exceed the state usury ceiling which is currently X%.

A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under an open-end credit plan, this normally would be the corresponding annual percentage rate. (See generally section 226.6(a)(2).)

9. Multiple interest rate ceilings. Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable-rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable-rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable-rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. Interest rate charged after default. State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default is subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. Increasing the maximum interest rate - general rule. Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation subject to this section unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan, a creditor may not increase the rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan has a fixed maturity and a creditor renews the plan at maturity, or converts the plan to closed-end credit, without having a legal obligation to renew or convert, a new maximum interest rate may be set at that time. If, under the initial agreement, the creditor is obligated to renew or convert the plan, the maximum interest rate originally imposed cannot be increased upon renewal or conversion (unless, of course, a new obligation is entered into). For a closed-end credit transaction, a new maximum interest rate may be set only if the transaction is satisfied and replaced by a new obligation. (The exceptions in section 226.20(a)(1)-(5) which limit what transactions are considered refinancings for purposes of disclosure do not apply with respect to increasing a rate ceiling that has been imposed; if a transaction is satisfied and replaced, the rate ceiling may be increased.)

12. Increasing the maximum interest rate - assumption of an obligation. If an obligation subject to this section is assumed by a new obligor and the original obligor is released from

liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule applies whether or not the transaction constitutes an assumption as defined in section 226.20(b).)

13. Transition rules. Under footnote 50, if creditors properly include the maximum rate in their credit contracts, creditors need not revise their Truth in Lending disclosure statement forms to add the disclosures about limitations on rate increases as part of the variable-rate disclosures, until October 1, 1988. On or after that date, creditors must have the maximum rate set forth in their credit contracts and, where applicable, as part of their Truth in Lending disclosures.

References

Statute: Competitive Equality Banking Act of 1987, Pub. L. No 100-86, 101 Stat. 552

Other sections: §§ 226.6, 226.18, and 226.19

Previous regulation: None

1987 changes: This section implements section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552 which provides that, effective December 9, 1987, adjustable-rate mortgages must include a limitation on the interest rate that may apply during the term of the mortgage loan. An adjustable-rate mortgage loan is defined in section 1204 as "any loan secured by a lien on a one-to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an

agreement under which the creditor may, from time to time, adjust the rate of interest." The rule in this section incorporates section 1204 into Regulation Z and limits the scope of section 1204 to dwelling-secured consumer credit subject to the Truth in Lending Act, in which a creditor has the contractual right to increase the interest rate during the term of the credit obligation.◄

Board of Governors of the Federal Reserve System, March 30, 1988.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

FEDERAL RESERVE press release

For immediate release April 1, 1988

The Federal Reserve Board today issued its official staff commentary to Regulation Z, Truth in Lending, that interprets an amendment, issued December 22, 1987, requiring creditors to provide consumers with more information regarding closed-end variable-rate mortgage loans secured by the consumer's principal dwelling.

The Board's notice is attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 226

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

Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

SUMMARY: The Board is publishing in final form changes to the official staff commentary to Regulation Z (Truth in Lending). The commentary provides guidance to creditors in complying with an amendment to Regulation Z that was adopted by the Board in December of 1987 (52 FR 48665). The regulatory amendment requires creditors to provide more information to consumers about certain closed-end variable-rate loans than was previously required under Regulation Z. The commentary revisions include new material and technical changes in existing material. The Board is also publishing changes to the official staff commentary on other provisions of Regulation Z elsewhere in this issue of the Federal Register.

EFFECTIVE DATE: April 1, 1988, but compliance optional until October 1, 1988.

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, D.C., 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 official staff interpretation applies and interprets 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 amendment to the regulation was published on December 24, 1987 (52 FR 48665) with a mandatory compliance date of October 1, 1988. Proposed revisions to the commentary were first published for public comment on November 24, 1986 (51 FR 42248). Upon adoption of the regulatory amendment, the Board published the commentary for additional comment on December 24, 1987 (52 FR 48707). The Board is now adopting the commentary revisions in final form with compliance optional until October 1, 1988. The major revisions to the commentary begin with comment 18(f)(2)-1. Portions of existing commentary that have undergone only minor changes have been reprinted to clarify the revisions. With the exception of the provisions interpreting the new disclosure rules, many of the changes reflect either renumbering of existing paragraphs or shifting of existing general commentary regarding variable-rate disclosures from the commentary to section 226.18(f) to the commentary to section 226.17(c).

(2) Explanation of revisions. The following is a brief description of the 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 is amended to clarify that the general segregation requirement in section 226.17(a)(1) does not apply to the disclosures required under new sections 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, has been deleted since similar information will be required under new paragraph (f)(2) of section 226.18. In addition, the ninth bulleted paragraph under comment 17(a)(1)-5, discussing negative amortization, has been revised to change the reference from section 226.18(f)(3) to new section 226.18(f)(1)(iii).

17(b) Time of Disclosures

Comment 17(b)-1 has been expanded by adding a reference to the timing requirements in new section 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 has been 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 has been revised to clarify that preferred-rate loans are variable-rate transactions (while retaining the employee's loan

as an example) and to change the reference from section 226.18(f) to section 226.19(b).

Material generally relating to the basis of disclosures for variable-rate transactions currently in the commentary to section 226.18(f) has been moved to the commentary to section 226.17(c)(1) and the material currently in the commentary to section 226.17(c)(1) has been reordered to accommodate this change. Comments 17(c)(1)-8, -9 and -10, discussing graduated payment mortgages, Morris Plans and number of transactions have been redesignated, respectively, as comments 17(c)(1)-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, has been added as comments 17(c)(1)-8 and -9.

Comment 17(c)(1)-10 incorporates material on discounted variable-rate transactions currently contained in comment 18(f)-8, and the heading of the comment has been changed to clarify that it applies to transactions in which the initial rate is either lower or higher than the fully indexed rate. In addition, an error in the figures in the example of a transaction with a 7 1/2 percent payment cap has been corrected.

Most of the material currently in comment 18(f)-6 relating to the basis of disclosure for certain variable-rate transactions has been incorporated in comment 17(c)(1)-11. Revisions have been made to clarify that preferred-rate transactions can include transactions other than employee

preferred-rate loans. For example, variable-rate rules apply where a preferential rate is offered so long as the consumer permits loan payments to be debited from a deposit account. 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, have been deleted in the new comment 17(c)(1)-11.

The material currently in comment 18(f)-7, discussing growth-equity mortgages, has been incorporated in new comment 17(c)(1)-13, although detailed discussion of the option of disclosing by analogy to variable-rate disclosures has been deleted in favor of a more general reference in the new comment 17(c)(1)-13.

17(d) Multiple Creditors; Multiple Consumers

Comment 17(d)-2 has been amended to clarify that the disclosures required under section 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program, and not to every consumer who may be entitled to rescind the transaction.

17(f) Early Disclosures

As a result of the revisions to section 226.19 of the regulation, the reference in comment 17(f)-3 to section 226.19(b) has been revised to reference section 226.19(a)(2).

SECTION 226.18 - Content of Disclosures

18(f) Variable Rate

Comment 18(f)-1 has been expanded to explain whether paragraph (f)(1) or (f)(2) of section 226.18 applies to a particular variable-rate transaction. Comment 18(f)-1 indicates that variable-rate loans that are for a term greater than one year and are secured by the consumer's principal dwelling are subject to the special early disclosure requirements of new section 226.19(b). The comment states that "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) regardless of the general coverage of sections 226.18(f)(1) and 226.19(b). The comment also explains that, under new footnote 43, creditors may substitute the new disclosures under section 226.19(b) and 226.18(f)(2) for any closed-end variable-rate transaction.

With minor changes, material relating to the basis of disclosures for variable-rate transactions has been moved to the commentary to section 226.17(c)(1). Consequently, comments 18(f)-2 and -3 and comments 18(f)-5 through -8 have been deleted. Present comment 18(f)-4 has been redesignated as comment 18(f)(1)-1. The material currently in comments 18(f)-2 and -3 has been incorporated, respectively, in comments 17(c)(1)-8 and -9, and the material currently in comments 18(f)-6 and -7 has been incorporated in comments 17(c)(1)-11 and -13. The material currently in comment 18(f)-8, discussing discounted transactions, has been incorporated in comment 17(c)(1)-10 and the heading has been changed to clarify that the comment also applies to transactions where the initial rate is higher than the fully

indexed rate. The material currently in comment 18(f)-5 has been incorporated in the commentary to new section 226.19(b). Some of the material currently in comment 18(f)-6 has been incorporated in new comment 19(b)-4 to clarify that the designated transactions are subject to the general disclosure requirements of new section 226.19(b). The material currently in comment 18(f)-6 relating to the basis for disclosures has not been transferred to new comment 19(b)-4, since such information has been incorporated in comment 17(c)(1)-11.

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

Comment 18(f)(2)-1 has been 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, the later disclosures required under section 226.18 must state that the variable-rate feature exists and refer to the variable-rate disclosures provided earlier to the consumer under new section 226.19(b).

SECTION 226.19 - Certain Residential Mortgage Transactions

The title of this section of the commentary has been revised to read "Certain Residential Mortgage and Variable-Rate Transactions" to reflect the fact that section 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) has been redesignated as 19(a)(1) Existing comments 19(a)-1 through 19(a)-5 therefore have become comments 19(a)(1)-1 through -5.

19(b) Redisclosure Required

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

Comment 19(b)-1 has been added to clarify that the new requirements of section 226.19(b) apply to variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year. The comment states that "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) regardless of the general coverage of sections 226.18(f)(1) and 226.19(b). The comment also explains that the term of a demand loan is to be determined in accordance with the rules set forth in the commentary to section 226.17(c)(5).

Comment 19(b)-2 explains the special timing rules under section 226.19(b) for cases where applications are received through an agent or broker or by telephone. The comment also explains that where open-end accounts convert, pursuant to a written agreement, to transactions subject to section 226.19(b), the required disclosures may be given at the time of conversion.

Comment 19(b)-3 incorporates 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 section 226.19(b). The references to footnote 43 and section 226.18(f) in old comment 18(f)-5 have been revised to reference footnote 45a and section 226.19(b), respectively, in the new comment 19(b)-3.

Comment 19(b)-4 incorporates, with changes, some of the material previously contained in comment 18(f)-6 to clarify that the designated transactions are subject to certain or all of the general disclosure requirements of section 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 has been deleted in the new comment 19(b)-4. The language in the third bullet under old comment 18(f)-6 has been revised in the new comment 19(b)-4 to clarify that preferred-rate loans where the rate can increase upon some occurrence are variable-rate transactions even where the initial underlying rate is fixed, and the reference to the hypothetical example in the last sentence has been deleted.

Paragraph 19(b)(1)

Comment 19(b)(1)-1 clarifies what constitutes a suitable substitute for the Consumer Handbook on Adjustable Rate Mortgages. New comment 19(b)(1)-2 explains that the Consumer Handbook requirement is not applicable to loan programs where the

underlying interest rate is fixed. Thus the Consumer Handbook need not be provided, for example, in certain preferred-rate transactions or when variable-rate mortgage insurance or required credit life insurance is offered in connection with an otherwise fixed-rate transaction.

Paragraph 19(b)(2)

Comment 19(b)(2)-1 explains that a creditor must provide disclosures for each of its variable-rate programs in which the consumer expresses an interest. The final comment has been expanded from the proposal to also indicate that a creditor need only provide disclosures for programs that are available to the consumer. Thus if an application is denied within the three-day period following receipt through a broker, disclosures need not be provided under footnote 45b of the regulation. In addition, if a program is made available only to certain customers of an institution, the creditor need not provide disclosures for that program to other consumers who express a general interest in the creditor's ARM programs. The final comment also indicates that a creditor should provide additional loan program disclosures in response to subsequent expressions of interest by the consumer. Finally, material has been included to clarify that program disclosures may consist of more than one page.

Comment 19(b)(2)-2 has been added to clarify what constitutes a separate loan program that would require separate

program disclosures. The final comment also clarifies that loans with a different term constitute distinct programs.

Comment 19(b)(2)-3 has been added to clarify that the disclosures required under section 226.19(b)(2) need only be made as applicable. The final comment has been expanded to clarify that disclosures relating to payments are only applicable to payments based on the interest rate, loan balance and loan term.

Comment 19(b)(2)-4 has been added to explain the circumstances under which a creditor must revise its loan program disclosures.

Comments to new section 226.19(b)(2)(i) through (xiii) have been added to clarify the requirements imposed by these paragraphs and to illustrate how a creditor may comply with the new provisions. Additional commentary has been added to explain, for example, how to select index values to be used in the historical index table and how to illustrate discounted and premium rates.

SECTION 226.20 - Subsequent Disclosure Requirements

20(a) Refinancings

Comment 20(a)-3 has been 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 section 226.19(b) 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 has been 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 solely in accordance with section 226.18(f)(1) and that disclosures under sections 226.18(f)(2)(ii) and 226.19(b) need not be provided.

20(c) Variable-Rate Adjustments

Comment 20(c)-1 has been added to explain what subsequent disclosures are required to be made by a creditor or a subsequent holder in cases where an interest rate adjustment is made in a variable-rate transaction subject to new section 226.19(b). Comment 20(c)-2 has been added to clarify that shared-equity or shared-appreciation mortgages are exempt from the subsequent disclosure requirements of section 226.20(c). Comment 20(c)(1)-1 and comment 20(c)(2)-1 have been added to clarify the requirements that current and prior interest rates and index values be disclosed on adjustment notices. Comment 20(c)(3)-1 has been added to clarify that section 226.20(c)(3) is applicable only when interest rate carryover occurs at an adjustment. Comment 20(c)(4)-1 has been added to clarify the disclosure of contractual effects of an adjustment, and comment 20(c)(5)-1 has been added to clarify when the disclosure of fully amortizing payments is required.

APPENDIX H - Closed-End Model Forms and Clauses

Comment app. H-4 has been revised to clarify that the model clauses set forth in Appendix H-4(A) of the regulation apply to transactions subject to section 226.18(f)(1). In addition, commentary has been provided to interpret the new model clauses H-4(B) through H-4(D) in Appendix H. These additions are numbered as comments app. H-5 through -7. Commentary describing new Sample H-14 has been added as comment app. H-18. Consequently, existing comments app. H-5 through -14 have been renumbered as comments app. H-8 through -17 and existing comments app. H-16 through -20 have been 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 revisions to the commentary. New language is shown inside arrows, while language that has been 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 amends the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

(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 revisions. The commentary (12 CFR Part 226 Supp. I) is amended by 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 section 226.18(f)(3) to section 226.18(f)(1)(iii); revising comments 17(b)-1 and 17(b)-2; revising the information contained in the first bullet under comment 17(c)(1)-2; redesignating comment 17(c)(1)-8 as comment 17(c)(1)-12; redesignating comments 17(c)(1)-9 and 17(c)(1)-10 as comments 17(c)(1)-14 and 17(c)(1)-15, respectively; adding comments 17(c)(1)-8 through 17(c)(1)-11 and 17(c)(1)-13; revising comment 17(d)-2; changing the reference in comment 17(f)-3 from section 226.19(b) to section 226.19(a)(2); revising comment 18(f)-1; removing comments 18(f)-2 and 18(f)-3; removing comments 18(f)-5 through 18(f)-8; adding a heading "Paragraph 18(f)(1)(i)" under the heading "Paragraph 18(f)(1)" and redesignating comment 18(f)(1)-1 as comment 18(f)(1)(i)-1; redesignating comment 18(f)-4 as comment 18(f)(1)-1; revising the heading "Paragraph 18(f)(2)" to read "Paragraph 18(f)(1)(ii)" and redesignating comment 18(f)(2)-1 as comment 18(f)(1)(ii)-1; revising the heading "Paragraph 18(f)(3)" to read "Paragraph 18(f)(1)(iii)" and redesignating comment 18(f)(3)-1 as comment 18(f)(1)(iii)-1;

revising the heading "Paragraph 18(f)(4)" to read "Paragraph 18(f)(1)(iv)" and redesignating comments 18(f)(4)-1 and 18(f)(4)-2 as comments 18(f)(1)(iv)-1 and 18(f)(1)(iv)-2, respectively; adding a heading to read "Paragraph 18(f)(2)"; adding comment 18(f)(2)-1; revising the title to the commentary to section 226.19; revising the heading "19(a) Time of Disclosure" to read "19(a)(1) Time of Disclosure" and redesignating comments 19(a)-1 through 19(a)-5 as comments 19(a)(1)-1 through 19(a)(1)-5, respectively; revising the heading "19(b) Redisclosure Required" to read "19(a)(2) Redisclosure Required" and redesignating comments 19(b)-1 through 19(b)-4 as comments 19(a)(2)-1 through 19(a)(2)-4, respectively; adding a heading "19(b) Certain Variable-Rate Transactions"; adding comments 19(b)-1 through 19(b)(2)(xiii)-1; revising comment 20(a)-3; revising comment 20(b)-6; adding a heading to read "20(c) Variable-Rate Adjustments" and adding comments 20(c)-1, 20(c)-2, 20(c)(1)-1, 20(c)(2)-1, 20(c)(3)-1, 20(c)(4)-1 and 20(c)(5)-1; revising the heading and the first sentence of comment app. H-4; redesignating comments app. H-5 through app. H-20 as comments app. H-8 through app. H-23, respectively; adding 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

* * * * *

SECTION 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 a box
- By bold print dividing lines
- By a different color background
- By a different type style

►(The general segregation requirement described in this subparagraph does not apply to the disclosures required under sections 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 section [226.18(f)(3)] ►226.18(f)(1)(iii)◄.)

* * * * *

17(b) Time of Disclosures

1. <u>Consummation</u>. 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 section 226.19. (See the commentary to section 226.2(a)(13) regarding the definition of consummation.)

2. <u>Converting open-end to closed-end credit</u>. 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 section 226.19(b) for the timing rules for additional disclosures required upon the conversion to a variable-rate transaction secured by a consumer's principal dwelling with a term greater than one year.)◂ If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to section 226.5 regarding conversion of closed-end to open-end credit.)

17(c) Basis of Disclosures and Use of Estimates

<u>Paragraph 17(c)(1)</u>

* * * * *

2. Modification of obligation. * * *

• If the creditor[-employer] offers a preferential [employee] rate, ▶such as an employee preferred 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 must be given for the full term of the 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 section 226.17(c) for a discussion of buydown transactions and the commentary to section 226.19(a)(2) for a discussion of the redisclosure in certain residential mortgage transactions with a variable-rate feature).

9. <u>Use of estimates in variable-rate transactions</u>. The variable-rate feature does not, by itself, make the disclosures estimates.

10. <u>Discounted and premium variable-rate transactions</u>. 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 1/4 of 1 percent applies, in accordance with section 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 schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $266,463.32 and the total of payments $366,463.32.

-- 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 7 1/2 percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62,

12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

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

- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures are to be based on the preferred rate.

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

[8.] ►12.◄ <u>Graduated-payment adjustable-rate mortgages</u>. * * *

►13. <u>Growth-equity mortgages</u>. 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 section 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(d) Multiple Creditors; Multiple Consumers

* * * * *

2. Multiple consumers. When two consumers are joint obligors with primary liability on an obligation, the disclosures may be given to either one of them. If one consumer is merely a surety or guarantor, the disclosures must be given to the principal debtor. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under section 226.23[.]►, although the disclosures required under section 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program.◄

* * * * *

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 [226.19(b)] ▶226.19(a)(2)◀.)

* * * * *

SECTION 226.18 - Content of Disclosures

* * * * *

18(f) Variable Rate

1. Coverage. The requirements of section 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 section 226.18(f)(2) are subject to the special early disclosure requirements of section 226.19(b). (However, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) and not to the requirements of sections 226.18(f)(2) and 226.19(b) regardless of the general coverage of those sections.) Creditors are permitted under footnote 43 to substitute in any variable-rate transaction the disclosures required under section 226.19(b) for those disclosures ordinarily required under section 226.18(f)(1). Creditors who provide variable-rate disclosures under section 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 section 226.18(f)(2). Creditors utilizing footnote 43 may, but need not, also provide disclosures pursuant to section 226.20(c). (Substitution of disclosures under section 226.18(f)(1) in transactions subject to section 226.19(b) is not permitted under the footnote.)◄

[2. Basis for disclosures. * * *]

[3. Use of estimates. * * *]

[4. 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)

►1. Terms used in disclosure. * * *◄

►Paragraph 18(f)(1)(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 variable-rate transactions that have a term greater than one year and are secured by the consumer's principal dwelling, the creditor must give special early disclosures under section 226.19(b) in addition to the later disclosures required under section 226.18(f)(2). The disclosures under section 226.18(f)(2) must state that the transaction has a variable-rate feature 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◄

*   *   *   *   *

►19(b) Certain Variable-Rate Transactions

1. Coverage. Section 226.19(b) applies to all closed-end variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. The requirements of this section apply not only to transactions financing the initial acquisition of the consumer's principal dwelling, but also to any other closed-end variable-rate transaction secured by the principal dwelling. Closed-end variable-rate transactions that are not secured by the principal dwelling, or are secured by the principal dwelling but have a term of one year or less, are subject to the disclosure requirements of section 226.18(f)(1) rather than those of section 226.19(b). (Furthermore, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of section 226.18(f)(1) rather than those of section 226.19(b) regardless of the general coverage of those sections.) For purposes of this section, the term of a variable-rate demand loan is determined in accordance with the commentary to section 226.17(c)(5).

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 receives a written application through an intermediary agent or broker, however, footnote 45b provides a substitute timing rule requiring the

creditor to deliver the disclosures or place them in the mail not later than three business days after the creditor receives the consumer's written application. 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 will convert to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section may be given at the time of conversion. (See the commentary to section 226.20(a) for information on the timing requirements for section 226.19(b)(2) disclosures when a variable-rate feature is later added to a transaction.)

3. 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 section 226.19(b), by virtue of footnote 45a, and are exempt from the requirements of section 226.20(c), by virtue of footnote 45c. Those variable-rate regulations include the regulations issued by the Federal Home Loan Bank Board and those issued by the Department of Housing and Urban Development. The exception in

footnotes 45a and 45c is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (12 USC 3801 *et seq.*) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

4. Examples of variable-rate transactions. The following transactions, if they have a term greater than one year and are secured by the consumer's principal dwelling, constitute variable-rate transactions subject to the disclosure requirements of section 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.
- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures under section 226.19(b)(1) and

226.19(b)(2)(v), (viii), (ix), (x) and (xiii) are not applicable 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.

2. Applicability. The Consumer Handbook need not be given for variable-rate transactions subject to this section in which the underlying interest rate is fixed. (See comment 19(b)-4 for an example of a variable-rate transaction where the underlying interest rate is fixed.)

Paragraph 19(b)(2)

1. Disclosure for each variable-rate program. A creditor must provide disclosures to the consumer that fully and separately describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers

who express a general interest in a creditor's ARM programs. These disclosures must be given at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier. If the consumer subsequently expresses an interest in other available variable-rate loan programs subject to section 226.19(b)(2), the creditor must provide disclosures for such additional programs. The creditor, of course, is permitted to give the consumer information about additional programs subject to section 226.19(b) initially. An individual program disclosure may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for the particular program. In addition, these disclosures may be inserted or printed in the Consumer Handbook (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

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 value, interest rate, payments, and loan balance
- The presence or absence of, and the amount of,

rate or payment caps

- The presence of 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 such as the term of the loan must be taken into account in preparing the disclosures required by section 226.19(b)(2)(viii) and (x), variable-rate loans that differ as to that feature constitute separate programs and require separate loan program disclosures under section 226.19(b)(2). If, however, a representative value may be given for a loan feature or the feature need not be disclosed under section 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 section 226.19(b)(2)(xi) need not be given. As used in this section, "payment" refers only to a payment based on

the interest rate, loan balance and loan term, and does not refer to payment of other elements such as mortgage insurance premiums.

4. Revisions. A creditor must revise the disclosures required under this section once a year as soon as reasonably possible after the new index value becomes available. Revisions to the disclosures also are required when the loan program changes.

Paragraph 19(b)(2)(i)

1. Change in interest rate, payment, or term. A creditor must disclose the fact that the terms of the legal obligation permit the creditor, after consummation of the transaction, to increase (or decrease) the interest rate, payment, or term of the loan initially disclosed to the consumer. For example, the disclosures for a variable-rate program in which the interest rate and payment (but not loan term) can change might read, "Your interest rate and payment can change yearly." In transactions where the term of the loan may change due to rate fluctuations, the creditor must state that fact.

Paragraph 19(b)(2)(ii)

1. Identification of index or formula. If a creditor ties interest rate changes to a particular index, this fact must be disclosed, along with a source of information about the index. For example, if a creditor uses the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity as its index, the disclosure might read, "Your index is the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year published weekly in the Wall Street Journal." If no

particular index is used, the creditor must briefly describe the formula used to calculate interest rate changes.

2. Changes at creditor's discretion. If interest rate changes are at the creditor's discretion, this fact must be disclosed. If an index is internally defined, such as by a creditor's prime rate, the creditor should either briefly describe that index or state that interest rate changes are at the creditor's discretion.

Paragraph 19(b)(2)(iii)

1. Determination of interest rate and payment. This provision requires an explanation of how the creditor will determine the consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, "Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term." If applicable, the creditor should also disclose that the rate and payment will be rounded.

Paragraph 19(b)(2)(iv)

1. Current margin value and interest rate. Because the disclosures can be prepared in advance, the interest rate and margin may be several months old when the disclosures are delivered. A statement, therefore, is required alerting consumers to the fact that they should inquire about the current margin value applied to the index and the current interest rate.

For example, the disclosure might state, "Ask us for our current interest rate and margin."

Paragraph 19(b)(2)(v)

1. Discounted and premium interest rate. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact. For example, if a creditor discounted a consumer's initial rate, the disclosure might state, "Your initial interest rate is not based on the index used to make later adjustments." (See the commentary to section 226.17(c)(1) for a further discussion of discounted and premium variable-rate transactions.) In addition, the disclosure must suggest that consumers inquire about the amount that the program is currently discounted. For example, the disclosure might state, "Ask us for the amount our adjustable rate mortgages are currently discounted." (See the commentary to section 226.19(b)(2)(viii) for a discussion of how to reflect the discount or premium 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 disclose the frequency and timing of both types of changes. For example, in a variable-rate transaction where interest rate changes are made monthly, but payment changes occur on an annual basis, this fact must be disclosed.

Paragraph 19(b)(2)(vii)

1. Rate and payment caps. The creditor must disclose limits on changes (increases or decreases) in the interest rate or payment. If an initial discount is not taken into account in applying overall or periodic rate limitations, that fact must be disclosed. If separate overall or periodic limitations apply to interest rate increases resulting from other events, such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations must also be stated. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See section 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 rises 3 percentage points during the year and the loan contains a 2 percentage point cap on annual changes (increases or decreases) in the interest rate, interest rate carryover exists if the creditor may impose the additional percentage point the following year as an addition to the rate derived by using the index or formula. In such cases, the creditor must disclose the fact that changes in the index will be carried over to subsequent interest rate adjustment dates. The disclosure might state, "Changes in the index not passed on as changes in the interest rate will be carried over and applied to subsequent interest rate adjustments."

3. Conversion option. If a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the creditor must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The creditor must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined. The creditor should identify any index or other measure or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the creditor may use

information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the creditor. The information may be used until the program disclosures are otherwise revised. Although the rules relating to the conversion option must be disclosed, the effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rate and payments.

4. Preferred-rate loans. Section 226.19(b) applies to preferred-rate loans, where the rate will increase upon the occurrence of some event, such as an employee leaving the creditor´s employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose the event that would allow the creditor to increase the rate such as that the rate may increase if the employee leaves the creditor´s employ. The creditor must also disclose the rules relating to termination of the preferred rate, such as that fees may be charged when the rate is changed and how the new rate will be determined.

Paragraph 19(b)(2)(viii)

1. Index movement. This section requires a creditor to provide an historical example, based on a $10,000 loan amount originating in 1977, showing how interest rate changes implemented according to the terms of the loan program would have affected payments and

the loan balance at the end of each year during a 15-year period. (In all cases, the creditor need only calculate the payments and loan balance for the term of the loan. For example, in a five-year loan, a creditor would show the payments and loan balance for the five-year term, from 1977 to 1981, with a zero loan balance reflected for 1981. For the remaining ten years, 1982-1991, the creditor need only show the remaining index values, margin and interest rate.) Pursuant to this section, the creditor must provide a history of index values for the preceding 15 years. Initially, the disclosures would give the index values from 1977 to the present. Each year thereafter, the revised program disclosures should include an additional year's index value until 15 years of values are shown. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values are available in giving a history and payment example. In all cases, only one index value per year need be shown. Thus, in transactions where interest rate adjustments are implemented more frequently than once per year, a creditor may assume that the interest rate and payment resulting from the index value chosen will stay in effect for the entire year for purposes of calculating the loan balance as of the end of the year and for reflecting other loan program terms. In cases where interest rate changes are at the creditor's discretion (see the commentary to section 226.19(b)(2)(ii)), the creditor must provide a history of the rates imposed for the preceding 15 years, beginning with the rates in 1977. In giving

this history, the creditor need only go back as far as the creditor's rates can reasonably be determined.

2. Selection of index values. The historical example must reflect the method by which index values are determined under the program. If a creditor uses an average of index values or any other index formula, the history given should reflect those values. The creditor should select one date or, when an average of single values is used as an index, one period and should base the example on index values measured as of that same date or period for each year shown in the history. A date or period at any time during the year may be selected, but the same date or period must be used for each year in the historical example. For example, a creditor could use values for the first business day in July or for the first week ending in July for each of the 15 years shown in the example.

3. Selection of margin. For purposes of the disclosure required under section 226.19(b)(2)(viii), a creditor may select a representative margin that has been used during the six months preceding preparation of the disclosures, and should disclose that the margin is one that the creditor has used recently. The margin selected may be used until a creditor revises the disclosure form.

4. Amount of discount or premium. For purposes of the disclosure required under section 226.19(b)(2)(viii), a creditor may select a discount or premium (amount and term) that has been used during the six months preceding preparation of the

disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the historical example for as long as the discount or premium is in effect. A creditor may assume that a discount that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example. For example, a 3-month discount may be treated as being in effect for the entire first year of the example; a 15-month discount may be treated as being in effect for the first two years of the example. In illustrating the effect of the discount or premium, creditors should adjust the value of the interest rate in the historical example, and should not adjust the margin or index values. For example, if during the six months preceding preparation of the disclosures the fully indexed rate would have been 10% but the first year's rate under the program was 8%, the creditor would discount the first interest rate in the historical example by 2 percentage points.

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 or premium initial interest rate, the most recent rate shown in the historical example should be adjusted by the amount of the discount or premium reflected elsewhere in the disclosure for purposes of the requirements of this paragraph. Furthermore, this disclosure should state the amount by which the most recent rate has been adjusted. (See the commentary to section 226.19(b)(2)(viii) regarding disclosure of the amount of a discount or premium.) The creditor may use an interest rate applicable to the program that is more recent than the latest rate shown in the historical example.

Paragraph 19(b)(2)(xi)

1. Demand feature. If a variable-rate loan subject to section 226.19(b) requirements contains a demand feature, this fact must be disclosed. (Pursuant to section 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 the commentary to section 226.20(c) regarding notices of adjustments.) For example, the disclosure might state, "You will be notified at least 25, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the index and interest rates, payment amount, and loan balance." In transactions where there may be interest rate adjustments without accompanying payment adjustments in a year, the disclosure might read, "You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance."

Paragraph 19(b)(2)(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 section 226.19(b)(2)

Unless disclosures for all of its variable-rate programs are provided initially, the creditor must inform the consumer that other closed-end variable-rate programs exist, and that disclosure forms are available for these additional loan programs. For example, the disclosure form might state, "Information on other adjustable rate mortgage programs is available upon request."◀

SECTION 226.20 - Subsequent Disclosure Requirements

20(a) Refinancings

* * * * *

3. <u>Variable-rate</u>. 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 transaction secured by a principal dwelling with a term longer than one year, the disclosures required under section 226.19(b) also must be given at that time.◀

* * * * *

20(b) Assumptions

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

- The amount financed is the remaining principal balance plus any arrearages or other accrued charges from the original transaction.
- If the finance charge is computed from time to time by application of a percentage rate to an unpaid balance, in determining the amount of the finance charge and the annual percentage rate to be disclosed, the creditor should disregard any prepaid finance charges paid by the original obligor, but must include in the finance charge any prepaid finance charge imposed in connection with the assumption.
- If the creditor requires the assuming consumer to pay any charges as a condition of the assumption, those sums are prepaid finance charges as to that consumer, unless exempt from the finance charge under section 226.4.

If a transaction involves add-on or discount finance charges, the creditor may make abbreviated disclosures, as outlined in section 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 sections 226.18(f)(2)(ii) or 226.19(b). In such transactions, a creditor may disclose the variable-rate feature solely in accordance with section 226.18(f)(1).◄

* * * * *

►20(c) Variable-Rate Adjustments

1. Timing of adjustment notices. This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to section 226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to section 226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to section 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" or "shared-appreciation" mortgages.

Paragraph 20(c)(1)

1. Current and prior interest rates. The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount ("current rate") and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice ("prior rates"). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.

Paragraph 20(c)(2)

1. Current and prior index values. This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in section

226.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.

Paragraph 20(c)(3)

1. Unapplied index increases. The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate is applicable only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

Paragraph 20(c)(4)

1. Contractual effects of the adjustment. The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under

section 226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

Paragraph 20(c)(5)

1. Fully-amortizing payment. A disclosure is required if the payment disclosed in section 226.20(c)(4) is not sufficient to pay off the loan balance (including capitalized interest) in the remaining term of the loan at the adjusted interest rate. In such cases, the adjustment notice must state the payment required to fully amortize the loan over the remainder of the term. (This paragraph does not apply if the new payment disclosed in section 226.20(c)(4) is fully amortizing but the final payment will be a different amount due to rounding.)◄

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APPENDIX H - Closed-End Model Forms and Clauses

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4. Model H-4►(A)◄. This model contains the variable rate model clauses ►applicable to transactions subject to section 226.18(f)(1)◄ and is intended to give creditors considerable flexibility in structuring variable rate disclosures to fit individual plans. * * *

5. ►Model H-4(B). This model clause illustrates the variable-rate disclosure required under section 226.18(f)(2), which would alert consumers to the fact that the transaction contains a variable-rate feature and that disclosures were provided earlier.◄

6. ▸Model H-4(C). This model clause illustrates the early disclosures required generally under section 226.19(b). It includes information on how the consumer's interest rate is determined and how it can change over the term of the loan, and explains changes that may occur in the borrower's monthly payment. 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 section 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.◂ Samples H-13 through H-15. * * *

[14.] ▸17.◂ Sample H-13. * * *

[15.] ►18.◄ Sample H-14. ►This sample disclosure form illustrates the disclosures under section 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 for the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. Index values are measured as of the first week ending in July for the years 1977 through 1987. This reflects the requirement that the index history be based on values for the same date or period each year beginning with index values for 1977. The sample disclosure also illustrates the requirement under section 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 reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

[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. * * *

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Board of Governors of the Federal Reserve System, March 30, 1988.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board