



FEDERAL RESERVE BANK  
OF DALLAS

WILLIAM H. WALLACE  
FIRST VICE PRESIDENT  
AND CHIEF OPERATING OFFICER

November 16, 1989

DALLAS, TEXAS 75222

Circular 89-71

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

**SUBJECT**

**Slip sheets with amendments to the Official  
Staff Commentary on Regulation Z -- Truth in Lending**

**DETAILS**

The Board of Governors of the Federal Reserve System has published amendments in slip-sheet form to Regulation Z, effective September 1989. Also, enclosed is an amended slip-sheet to Sections 226.5 and 226.9. The new slip sheets should be inserted in Volume 2 of your Regulations Binders.

**ATTACHMENTS**

The slip sheets are enclosed.

**MORE INFORMATION**

For more information, please contact Dean A.  
Pankonien at (214) 651-6228.

Sincerely yours,

A handwritten signature in cursive script that reads "William H. Wallace".

## Corrections to Regulation Z Truth in Lending\*

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1. Section 226.5a (a) (3) is corrected by adding the words "of the type" before the words "subject to the requirements of section 226.5b".
2. Section 226.5a (g) (2) is corrected by deleting "and is figured in the same way as the first balance" from the last sentences of subparagraphs (i) and (ii).
3. Section 226.9 (e) (1) and (f) (1) are corrected by adding the words "of the type" before the words "subject to section 226.5a".

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\* A complete Regulation Z, as amended and corrected effective June 7, 1989 consists of —

- the pamphlet dated July 1989 (see inside cover) and
- this slip sheet

# Amendments to the Official Staff Commentary on Regulation Z Truth in Lending September 1989\*

The following amendments are effective February 28, 1989, or, at the creditor's option, October 1, 1989.

## SECTION 226.2—Definitions and Rules of Construction

### 2(a) Definitions

\* \* \* \* \*

#### 2(a) (25) "Security Interest"

\* \* \* \* \*

6. *Specificity of disclosure.* A creditor need not separately disclose multiple security interests that it may hold in the same collateral. The creditor need only disclose that the transaction is secured by the collateral, even when security interests from prior transactions remain of record and a new security interest is taken in connection with the transaction.

\* \* \* \* \*

## SECTION 226.4—Finance Charge

### 4(a) Definition

\* \* \* \* \*

3. *Charges by third parties.* \* \* \* in contrast, charges imposed on the consumer by someone other than the creditor are finance charges (unless otherwise excluded) if the creditor requires the services of the third party. For example:

- A fee charged by a loan broker if the consumer cannot obtain the same credit terms from the creditor without using a broker.

\* \* \* \* \*

### 4(b) Examples of Finance Charges

\* \* \* \* \*

#### Paragraphs 4(b)(7) and (8)

\* \* \* \* \*

2. *Insurance written in connection with a transaction.* Insurance sold after consummation in closed-end credit transactions or after the opening of a plan in open-end credit transactions is not "written in connection with" the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because the consumer requests insurance after consummation or the opening of a plan (although credit sale disclosures may be required for the insurance sold after consummation if it is financed).

\* \* \* \* \*

## SUBPART C—CLOSED-END CREDIT

### SECTION 226.17—General Disclosure Requirements

#### 17(a) Form of Disclosures

##### Paragraph 17(a)(1)

\* \* \* \* \*

5. *Directly related.* \* \* \* The disclosures set forth under section 226.18(f)(1) for variable-rate transactions subject to section 226.18(f)(2).

\* \* \* \* \*

#### 17(c) Basis of Disclosures and Use of Estimates

\* The complete Regulation Z commentary, as amended effective February 28, 1989, consists of—  
• the commentary pamphlet dated June 1988 and  
• this slip sheet.

*Paragraph 17(c)(1)*

\* \* \* \* \*

8. *Basis of disclosures in variable-rate transactions.* The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at the time of consummation. Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer buydown, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to section 226.17(c) for a discussion of buydown, discounted, and premium transactions and the commentary to section 226.19(a)(2) for a discussion of the redisclosure in certain residential mortgage transactions with a variable-rate feature).

\* \* \* \* \*

[Comments 14 and 15 are redesignated 15 and 16.]

14. *Reverse mortgages.* Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, typically involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer's death. Repayment of the loan (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these transactions, creditors must apply the following rules, as applicable:

- If the reverse mortgage has a specified peri-

od for disbursements but repayment is due only upon the occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as "The disclosures assume that you will repay the loan at the time our payments to you end. As provided in your agreement, your repayment may be required at a different time."

- If the reverse mortgage has neither a specified period for disbursements nor a specified repayment date and these terms will be determined solely by reference to future events including the consumer's death, the creditor may assume that the disbursements will end upon the consumer's death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures upon the occurrence of the event estimated to be most likely to occur first.)
- In making the disclosures, the creditor must assume that all disbursements and accrued interest will be paid by the consumer. For example, if the note has a nonrecourse provision providing that the consumer is not obligated for an amount greater than the value of the house, the creditor must nonetheless assume that the full amount to be disbursed will be repaid. In this case, however, the creditor may include a statement such as "The disclosures assume full repayment of the amount advanced plus accrued

interest, although the amount you may be required to pay is limited by your agreement.”

- Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. Such loans are considered variable-rate mortgages, as described in comment 17(c)(1)-11, and the appreciation feature must be disclosed in accordance with section 226.18(f)(1). If the reverse mortgage has a variable interest rate, is written for a term greater than one year, and is secured by the consumer's principal dwelling, the shared-appreciation feature must be described under section 226.19(b)(2)(vii).

\* \* \* \* \*

#### SECTION 226.18—Content of Disclosures

\* \* \* \* \*

##### 18(f) Variable Rate

\* \* \* \* \*

###### Paragraph 18(f)(2)

1. *Disclosure required.* \* \* \* (See the commentary to section 226.17(a)(1) regarding the disclosure of certain directly related information in addition to the variable-rate disclosures required under section 226.18(f)(2).)

\* \* \* \* \*

#### SECTION 226.19—Certain Residential Mortgage Transactions

\* \* \* \* \*

##### 19(b) Certain Variable-Rate Transactions

1. *Coverage.* \* \* \* In determining whether a construction loan that may be permanently financed by the same creditor is covered under this section, the creditor may treat the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction. For purposes of the disclosures required under section 226.18, the creditor may nevertheless

treat the two phases either as separate transactions or as a single combined transaction in accordance with section 226.17(c)(6). Finally, in any assumption of a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year, disclosures need not be provided under sections 226.18(f)(2)(ii) or 226.19(b).

\* \* \* \* \*

###### Paragraph 19(b)(2)

1. *Disclosure for each variable-rate program.* A creditor must provide disclosures to the consumer that fully describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers who express a general interest in a creditor's ARM programs. Disclosures must be given at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier. If program disclosures cannot be provided because a consumer expresses an interest in individually negotiating loan terms that are not generally offered, disclosures reflecting those terms may be provided as soon as reasonably possible after the terms have been decided upon, but not later than the time a nonrefundable fee is paid. If a consumer who has received program disclosures subsequently expresses an interest in other available variable-rate programs subject to section 226.19(b)(2), or the creditor and consumer decide on a program for which the consumer has not received disclosures, the creditor must provide appropriate disclosures as soon as reasonably possible. The creditor, of course, is permitted to give the consumer information about additional programs subject to section 226.19(b) initially.

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 programs would exist based on differences in any of the following loan features: \* \* \*

In addition, if a loan feature 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 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 loan programs would not exist based on differences in the following loan features: \* \* \*

[Comments 3 and 4 are redesignated 4 and 5.]

3. *Form of program disclosures.* A creditor may provide separate program disclosure forms for each ARM program it offers or a single disclosure form that describes multiple programs. A disclosure form may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for a particular program. A disclosure form describing more than one program need not repeat information applicable to each program that is described. For example, a form describing multiple programs may disclose the information applicable to all of the programs in one place with the various program features (such as options permitting conversion to a fixed rate) disclosed separately. The form, however, must state if any program feature that is described is available only in conjunction with certain other program features. Both the separate and multiple program disclosures may illustrate more than one loan maturity or payment amortization—for example, by including multiple-payment and loan-balance columns in the historical payment example. Disclosures may be inserted or printed in the *Consumer Handbook* (or a suitable substitute) as long as they are identified as the creditor's loan-program disclosures.

\* \* \* \* \*

*Paragraph 19(b)(2)(iii)*

1. *Determination of interest rate and payment.* This provision requires an explanation of how the creditor will determine the

consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, "Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term." In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor must disclose this fact. For example, the disclosure might read, "Your periodic payments will not fully amortize your loan and you will be required to make a single payment of the periodic payment plus the remaining unpaid balance at the end of the loan term." The creditor, however, need not reflect any irregular final payment in the historical example or in the disclosure of the initial and maximum rates and payments. If applicable, the creditor should also disclose that the rate and payment will be rounded.

\* \* \* \* \*

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

1. *Discounted and premium interest rate.* \* \* \* In a transaction with a consumer buydown or with a third-party buydown that will be incorporated in the legal obligation, the creditor should disclose the program as a discounted variable-rate transaction, but need not disclose additional information regarding the buydown in its program disclosures. \* \* \*

*Paragraph 19(b)(2)(vi)*

1. *Frequency.* \* \* \* In certain ARM transactions, the interval between loan closing and the initial adjustment is not known and may be different from the regular interval for adjustments. In such cases, the creditor may disclose the initial adjustment period as a range of the minimum and maximum amount of time from consummation or closing. For example, the creditor might state: "The first adjustment to your interest rate and payment will occur no sooner than 6 months and no later than 18 months after closing. Subsequent

adjustments may occur once each year after the first adjustment." (See comments 19(b)(2)(viii)-7 and 19(b)(2)(x)-4 for guidance on other disclosures when this alternative disclosure rule is used.)

*Paragraph 19(b)(2)(vii)*

1. *Rate and payment caps.* \* \* \* The creditor need not disclose each periodic or overall rate limitation that is currently available. As an alternative, the creditor may disclose the range of the lowest and highest periodic and overall rate limitations that may be applicable to the creditor's ARM transactions. For example, the creditor might state: "The limitation on increases to your interest rate at each adjustment will be set at an amount in the following range: between 1 and 2 percentage points at each adjustment. The limitation on increases to your interest rate over the term of the loan will be set at an amount in the following range: between 4 and 7 percentage points above the initial interest rate." A creditor using this alternative rule must include a statement in its program disclosures suggesting that the consumer ask about the overall rate limitations currently offered for the creditor's ARM programs. (See comments 19(b)(2)(viii)-6 and 19(b)(2)(x)-3 for an explanation of the additional requirements for a creditor using this alternative rule for disclosure of periodic and overall rate limitations.

\* \* \* \* \*

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

1. *Index movement.* \* \* \* For the remaining ten years, 1982-1991, the creditor need only show the remaining index values, margin and interest rate and must continue to reflect all significant loan program terms such as rate limitations affecting them. \* \* \*

\* \* \* \* \*

5. *Term of the loan.* In calculating the payments and loan balances in the historical example, a creditor need not base the disclosures on each term to maturity or payment amortization that it offers. Instead, disclosures for ARMs may be based upon terms to maturity or payment amortizations of 5, 15 and 30 years, as follows: ARMs with terms or amor-

tizations from over 1 year to 10 years may be based on a 5-year term or amortization; ARMs with terms or amortizations from over 10 years to 20 years may be based on a 15-year term or amortization; and ARMs with terms or amortizations over 20 years may be based on a 30-year term or amortization. Thus, disclosures for ARMs offered with any term from over 1 year to 40 years may be based solely on terms of 5, 15 and 30 years. Of course, a creditor may always base the disclosures on the actual terms or amortizations offered. If the creditor bases the disclosures on 5-, 15- or 30-year terms or payment amortizations as provided above, the term or payment amortization used in making the disclosure must be stated.

6. *Rate caps.* A creditor using the alternative rule described in comment 19(b)(2)(vii)-1 for disclosure of rate limitations must base the historical example upon the highest periodic and overall rate limitations disclosed under section 226.19(b)(2)(vii). In addition, the creditor must state the limitations used in the historical example. (See comment 19(b)(2)(x)-3 for an explanation of the use of the highest rate limitation in other disclosures.)

7. *Frequency of adjustments.* In certain transactions, creditors may use the alternative rule described in comment 19(b)(2)(vi)-1 for disclosure of the frequency of rate and payment adjustments. In such cases, the creditor may assume for purposes of the historical example that the first adjustment occurred at the end of the first full year in which the adjustment could occur. For example, in an ARM in which the first adjustment may occur between 6 and 18 months after closing and annually thereafter, the creditor may assume that the first adjustment occurred at the end of the first year in the historical example. (See comment 19(b)(2)(x)-4 for an explanation of how to compute the maximum interest rate and payment when the initial adjustment period is not known.)

*Paragraph 19(b)(2)(ix)*

1. *Calculation of payments.* A creditor is required to include a statement on the disclo-

sure 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. However, in transactions in which the latest payment is shown in the historical example is not for the latest year of index values shown (such as in a five-year loan), a creditor may provide additional examples based on the initial and maximum payments disclosed under section 226.19(b)(2)(x). 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)*

\* \* \* \* \*

2. *Term of the loan.* In calculating the initial and maximum payments, the creditor need not base the disclosures on each term to maturity or payment amortization offered under the program. Instead, the creditor may follow the rules set out in comment 19(b)(2)(viii)-5. In calculating the initial and maximum payment, the terms to maturity or payment amortizations selected for the purpose of making disclosures under section 226.19(b)(2)(viii) must be used. In addition, creditors must state the term or payment amortization used in making the disclosures under this section.

3. *Rate caps.* A creditor using the alternative rule for disclosure of interest rate limitations described in comment 19(b)(2)(vii)-1 must calculate the maximum interest rate and payment based upon the highest periodic and overall rate limitations disclosed under section 226.19(b)(2)(vii). In addition, the creditor must state the rate limitations used in calculating the maximum interest rate and payment. (See comment 19(b)(2)(viii)-6 for an explanation of the use of the highest rate limitation in other disclosures.)

4. *Frequency of adjustments.* In certain transactions, a creditor may use the alternative rule for disclosure of the frequency of rate and payment adjustments described in comment 19(b)(2)(vi)-1. In such cases, the creditor must base the calculations of the initial

and maximum rates and payments upon the earliest possible first adjustment disclosed under section 226.19(b)(2)(vi). (See comment 19(b)(2)(viii)-7 for an explanation of how to disclose the historical example when the initial adjustment period is not known.)

\* \* \* \* \*

**SECTION 226.20—Subsequent Disclosure Requirements**

\* \* \* \* \*

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

\* \* \* \* \*

*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. In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the amount of the adjusted payment must be disclosed if such payment has changed as a result of the rate adjustment. A contractual effect of a rate adjustment would include, for example,

\* \* \*

*Paragraph 20(c)(5)*

1. *Fully amortizing payment.* This paragraph requires a disclosure only when negative amortization occurs as a result of the adjustment. A disclosure is not required simply because a loan calls for non-amortizing or partially amortizing payments. For example, in a transaction with a five-year term and payments based on a longer amortization schedule, and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five-year term. A disclosure is required, however, if the payment disclosed under section 226.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice



must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in section 226.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.)

\* \* \* \* \*