FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

July 22, 1994

DALLAS, TEXAS
75265-5906

Notice 94-74

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

SUBJECT

Extension of Comment Period on Proposed Amendments to Regulation DD (Truth in Savings)

DETAILS

The Board of Governors of the Federal Reserve System has extended the comment period on proposed amendments to Regulation DD (Truth in Savings) dealing with crediting and compounding practices that would produce an annual percentage yield (APY) reflecting the time value of money. The Board is also publishing an alternative approach for APY calculations that would allow institutions to disclose an APY equal to the contract interest rate on time accounts with maturities greater than one year that do not compound interest but pay interest at least annually.

The Board must receive comments for both the proposal and the alternative approach by September 6, 1994. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0836.

ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0836) is attached.

MORE INFORMATION

For more information, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM

12 CFR Part 230

[Regulation DD; Docket No. R-0836]

Truth in Savings

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule and extension of comment period.

SUMMARY: On May 11, 1994, the Board requested comment on a proposal to amend Regulation DD (Truth in Savings) dealing with crediting and compounding practices and having the effect of producing an annual percentage yield (APY) that reflects the time value of money. The Board is extending the comment period for 60 days to give the public additional time to provide comments. In addition, the Board is publishing for comment a further alternative for APY calculations that would allow institutions to disclose an APY equal to the contract interest rate on time accounts with maturities greater than one year that do not compound interest but pay interest at least annually. This alternative would provide the Board with a more modest option as it considers a final resolution to problems with APY calculations.

DATES: Comments must be received on or before September 6, 1994.

ADDRESSES: Comments should refer to Docket No. R-0836, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

FOR FURTHER INFORMATION CONTACT: Jane Ahrens, Senior Attorney, Kyung Cho or Kurt Schumacher, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for questions associated with the regulatory flexibility analysis, Gregory Elliehausen, Economist, Office of the Secretary, at (202) 452-2504; for the hearing impaired only, Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544.

SUPPLEMENTARY INFORMATION: (1) Background. The Truth in Savings Act (12 U.S.C. 4301 et seq.) requires depository institutions to provide disclosures to consumers about their deposit accounts, including an annual percentage yield (APY) on interest-bearing accounts. The act is implemented by the Board's Regulation DD (12 CFR part 230), which became effective June 21, 1993 (see 57 FR 43337 and 58 FR 15077).

Because the current formula for calculating the APY assumes that interest remains on deposit until maturity, the resulting APY may -- but does not always -- reflect the time value of money. The formula produces an APY that is less than the contract interest rate for long-term certificates of deposit (CDs) that are noncompounding but pay interest periodically. On December 6, 1993, the Board published a proposal that called for an additional APY formula that would have factored into the APY calculation the specific time intervals for interest paid on the account -- that is, the time value of money (58 FR 64190). The proposal was withdrawn on May 11, based on considerations of cost and regulatory burden (59 FR 24376).

In the context of deliberations about the December 1993 proposal, the Board considered related issues regarding depository institutions' compounding and crediting practices. On May 11, 1994, the Board proposed amendments to clarify the relationship between compounding and crediting and provide an alternative basis for eliminating anomalies produced by the current APY formula (59 FR 24378). The Board has received requests for an extension of the proposal's comment period, due to end on July 5, 1994; the Board is extending the comment period to September 6, 1994.

Alternative APY resolution

In addition to extending the comment period on the current proposal, the Board has decided to solicit comment on an alternative approach for APY calculations. Under this alternative, the only institutions affected would be those offering noncompounding multi-year CDs that pay interest at least annually. Those institutions would disclose an APY equal to the interest rate, regardless of whether interest payments were made annually or more frequently. The APY for all other accounts would reflect the interest rate paid and any compounding. Interest payments by check or transfer would not be factored into the APY calculation.

This alternative (called Approach B in the December 1993 proposal) was considered by the Board in its deliberations on adding a new APY formula. The Board declined to adopt Approach B at that time, mainly based on concerns about the limited resolution of anomalies associated with the APY and costs associated with its implementation.

A number of factors have led the Board to reopen comments on this alternative. The Congress chose the APY as the primary uniform measurement for comparison shopping among deposit accounts. The Board believes the APY formula should produce a mathematical figure that is easily understood and readily reveals to consumers an account's comparative value. The Board also believes that regulatory compliance should be as simple and cost-effective as possible, and that reductions in product variety and consumer choice due to regulatory requirements should be minimized.

Taking all these factors into account, and recognizing that all formulas contain assumptions that are valid in some circumstances and not in others, the Board seeks comment on whether this limited approach would achieve a satisfactory resolution of the competing interests for accuracy, consumer understanding, product flexibility, and ease of compliance.

The Board also solicits comment on whether adoption of such an alternative would reduce the incentive for institutions to offer compounding multi-year CDs. For example, assume two institutions offer a two-year CD with a 6.00% interest rate; one mandates monthly interest checks, the other offers annual compounding. Both could advertise a 6.00% APY, even though a consumer depositing $1,000 receives $120 if interest checks are paid annually and $123.60 if money is left in the account.

(2) <u>Proposed regulatory revisions: section-by-section analysis</u>. A section-by-section description of proposed amendments follows.

SECTION 230.4 -- Account disclosures

Paragraph (b)(6) -- <u>Features of Time Accounts</u>

The regulation requires a disclosure for institutions offering time accounts that compound interest and permit a consumer to withdraw accrued interest during the account term. The disclosure states that the APY assumes interest remains on deposit until maturity and that a withdrawal of interest will reduce earnings. The Board request comments on whether a similar disclosure would be helpful to consumers purchasing noncompounding multi-year CDs that pay interest at least annually and disclose an APY equal to the interest rate. For example, the disclosure would alert consumers that dollar earnings will be less than for a multi-year CD with the same maturity (and disclosing the same APY) that compounds annually. The Board solicits suggestions for text that would be most helpful to consumers.

SECTION 230.8 -- Advertising

Paragraph (c)(6) -- <u>Features of Time Accounts</u>

The regulation requires institutions advertising APYs to disclose other key features about the account. The Board solicits comment on whether institutions advertising an APY equal to the interest rate on noncompounding multi-year accounts that make interest payments annually should be required also to make a disclosure like the one discussed above. If so, the Board solicits suggestions for text that would be helpful to consumers and take into account the constraints of advertising media.

APPENDIX A to Part 230 -- Annual Percentage Yield Calculation

Part I. <u>Annual percentage yield for account disclosures and advertising purposes</u>

A. <u>General rules</u>

Under the alternative approach, the proposed amendments to Appendix A only affect institutions that offer noncompounding multi-year CDs that pay interest at least annually. A new paragraph E is added to clarify how APYs shall be determined for such accounts. The Board requests comment on the proposed paragraph and accompanying example.

APPENDIX B -- Model clauses and sample forms

The Board solicits comments on model clauses or additional sample forms that may be appropriate if the amendments are adopted.

(3) Form of comment letters. Comment letters should refer to Docket No. R-0836, and, when possible, should use a standard typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text into machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3 1/2 inch or 5 1/4 inch computer diskettes in any IBM-compatible DOS-based format.

(4) Regulatory flexibility analysis and Paperwork Reduction Act. The Board's Office of the Secretary previously prepared an economic impact statement on the proposed alternative dealing with noncompounding multi-year CDs that pay interest at least annually. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3245.

In accordance with section 3507 of the Paperwork Reduction Act of 1980 (44 U.S.C. 35; 5 CFR 1320.13), the proposed revisions will be reviewed by the Board under the authority delegated to the Board by the Office of Management and Budget after consideration of comments received during the public comment period.

List of Subjects in 12 CFR Part 230

Advertising, Banks, banking, Consumer protection, Deposit accounts, Interest, Interest rates, Truth in savings.

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

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 230 as follows:

PART 230 -- TRUTH IN SAVINGS (REGULATION DD)

1. The authority citation for part 230 would continue to read as follows:
Authority: 12 U.S.C. 4301, et seq.

2. In Part 230 Appendix A would be amended by revising the second sentence in the introductory text to Part I, the introductory text to paragraph A, and by adding a new paragraph E as follows:

APPENDIX A to PART 230 -- ANNUAL PERCENTAGE YIELD CALCULATION

* * *

Part I. Annual Percentage Yield for Account Disclosures and Advertising Purposes

* * * Special rules apply to accounts with tiered and stepped interest rates►, and to certain time accounts with a stated maturity greater than one year◄.

A. *General Rules*

►Except as provided in Part I.E. of this appendix, the ◄ [The] annual percentage yield shall be calculated by the formula shown below.

* * *

►E. *Time accounts with a stated maturity greater than one year that compound interest less often than annually*

For time accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, and that require (or permit) the consumer to withdraw interest at least annually, the annual percentage yield shall be equal to the interest rate.

Example:

(1) If an institution offers a $1,000 two-year certificate of deposit that credits interest semi-annually solely by check or transfer, and there is no compounding at a 6.00% interest rate, the annual percentage yield is 6.00%.◄

Board of Governors of the Federal Reserve System, July 5, 1994.

William W. Wiles (signed)

William W. Wiles

Secretary of the Board