FEDERAL RESERVE BANK
OF DALLAS

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

DALLAS, TEXAS
75265-5906

August 15, 1998

Notice 98-73

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

SUBJECT

Final Amendments to Regulation DD (Truth in Savings)

DETAILS

The Board of Governors of the Federal Reserve System has made final an interim rule amending Regulation DD (*Truth in Savings*). The amendment permits institutions to disclose an annual percentage yield equal to the contract interest rate for certain time accounts. The rule applies only to time accounts with maturities greater than one year that, rather than compound, require interest distributions at least annually.

The final rule becomes effective August 28, 1998.

ATTACHMENT

A copy of the Board's notice as it appears on pages 40635–38, Vol. 63, No. 146 of the *Federal Register* dated July 30, 1998, is attached.

MORE INFORMATION

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

Sincerely yours,

Robert D. McTeer, Jr.

For additional copies, bankers and others are encouraged to use one of the following toll-free numbers in contacting the Federal Reserve Bank of Dallas: Dallas Office (800) 333-4460; El Paso Branch *Intrastate* (800) 592-1631, *Interstate* (800) 351-1012; Houston Branch *Intrastate* (800) 392-4162, *Interstate* (800) 221-0363; San Antonio Branch *Intrastate* (800) 292-5810.

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FEDERAL RESERVE SYSTEM

12 CFR Part 230

[Regulation DD; Docket No. R–0869]

Truth in Savings

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board has adopted a rule amending Regulation DD (Truth in Savings); the action makes final an interim rule adopted in January 1995. The amendment permits institutions to disclose an annual percentage yield (APY) equal to the contract interest rate for time accounts with maturities greater than one year that do not compound but that require interest distributions at least annually.

EFFECTIVE DATE: August 28, 1998.

FOR FURTHER INFORMATION CONTACT: Jane Ahrens, Senior Attorney, or Obrea Otey Poindexter, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System at (202) 452–2412 or 452–3667; for the hearing impaired *only* contact Diane Jenkins, Telecommunications Device for the Deaf at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background

The Truth in Savings Act (TISA) was enacted in December 1991. The Board published a final regulation, Regulation DD, to implement the act on September 21, 1992 (57 FR 43337) (correction notice at 57 FR 46480, October 9, 1992). Compliance with the regulation became mandatory in June 1993. The act and regulation require depository institutions to disclose yields, fees, and other terms concerning deposit accounts to consumers at account opening. The regulation also includes rules about advertising of deposit accounts. Depository institutions are generally subject to civil liability for violations of the act and regulation. Credit unions are not subject to Regulation DD, but are governed by a substantially similar regulation issued by the National Credit Union Administration.

II. Proposals Regarding APY Calculation

In 1993, deposit brokers covered by Regulation DD's advertising rules petitioned the Board to reconsider how the annual percentage yield (APY) is calculated. They expressed concern that for a certificate of deposit that has a maturity greater than one year and that does not compound interest, the APY is less than the contract interest rate under the formula prescribed by Regulation DD. The Board subsequently published several proposals addressing this matter (58 FR 64190, December 6, 1993; 59 FR 24376, May 11, 1994; 59 FR 35271, July 11, 1994; 60 FR 5142, January 26, 1995).

In January 1995, to address immediately one anomaly created by the regulation's formula for APY calculations, the Board adopted an interim rule applicable to time accounts with maturities greater than one year that do not compound but require interest distributions at least annually (60 FR 5128, January 26, 1995).

III. Summary of Final Rule

The interim rule permitted institutions to disclose an APY equal to the contract interest rate for noncompounding CDs with a maturity greater than one year if they require interest distributions at least annually. The Board received more than 250 comments—about 75 comments on the interim rule and the remainder on a proposal published concurrently with the interim rule that would have amended the APY formula. The majority of commenters supported the interim rule and urged the Board to make the interim rule permanent. Many commenters believed that the interim rule adequately addressed the concerns of deposit brokers and depository institutions that require interest distributions at least annually. Commenters noted that the interim rule provided a simple solution that would be understandable to consumers. Some banks that opposed any change to the APY calculations favored the interim rule among the alternatives offered.

Based on the comments received and further analysis, the Board has amended Regulation DD by making the interim rule final. The final rule permits institutions to disclose an APY equal to the contract interest rate for noncompounding CDs with a maturity greater than one year if they require interest distributions at least annually. Institutions may not disclose an APY equal to the contract interest rate for noncompounding multi-year CDs that either prohibit withdrawal of interest or that permit but do not require interest distributions; for these time accounts, institutions will continue to use the current formula for APY calculations. The Board believes that this narrow rule provides a targeted response to questions about the APY disclosures for certain time accounts that otherwise would have to disclose an APY that is lower than the contract interest rate. The amendment retains the interim rule's requirement of a brief narrative disclosure about the effect of interest payments on the APY and earnings from the account to minimize any possible consumer confusion.

IV. Regulatory Revisions: Section-by-Section Analysis

Section 230.4 Account Disclosures

4(b) Content of Account Disclosures

4(b)(6) Features of Time Accounts

4(b)(6)(iii) Withdrawal of Interest Prior to Maturity

Consistent with the interim rule, paragraph 4(b)(6) adds a brief narrative for institutions stating an APY equal to the contract interest rate for noncompounding CDs that have a maturity greater than one year and that require interest payouts at least annually. The Board believes a statement alerting consumers to the fact that interest cannot remain in the account will assist them in comparison shopping between CDs with annual compounding and CDs that do not compound but require interest payouts during the account term. The Board believes the disclosure does not add an undue burden on institutions.

Section 230.8 Advertising

8(c) When Additional Disclosures are Required

8(c)(6) Features of Time Accounts

Consistent with the interim rule, paragraph 8(c)(6) adds a brief disclosure for any advertisement that states an APY equal to the contract interest rate for a noncompounding multi-year CD that requires the automatic payment of interest at least annually. To assist

consumers in comparison shopping, institutions must state that interest payouts are mandatory and that interest cannot remain in the account, parallel to the disclosure required by § 230.4(b)(6)(iii).

Appendix A to Part 230—Annual Percentage Yield Calculation

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

E. Time Accounts With a Stated Maturity Greater Than One Year That Pay Interest at Least Annually

The final rule adds paragraph E to Appendix A to clarify how APYs may be determined for noncompounding time accounts that have a maturity greater than one year and that pay interest at least annually. Two examples are added, including an example calculating the APY for a stepped-rate account covered by the amendments.

The statute provides that the APY shall be calculated under a method prescribed by the Board in regulations. It authorizes the Board to provide for adjustments and exceptions for any class of accounts that, in the Board's judgment, are necessary or proper to carry out the purposes of the act, prevent circumvention of the act's requirements, or facilitate compliance. Based on the comments received and further analysis, the Board finds that a final rule permitting institutions to disclose an APY equal to the contract interest rate, for noncompounding CDs with a maturity greater than one year that require interest distributions at least annually, is necessary to carry out the purposes of the act—enabling consumers to make informed decisions about deposit accounts. The exception is narrowly drawn, and reflects the value of receiving payments at least annually on accounts that do not permit account holders to keep interest on deposit until maturity.

Appendix B to Part 230—Model Clauses and Sample Forms

B–1 Model Clauses for Account Disclosures

(h) Disclosures Relating to Time Accounts

(h)(v) Required Interest Distribution

Under the final rule, the Board has included a model clause to describe the effect of interest payments on earnings.

V. Regulatory Flexibility Analysis

Final Rule on Annual Percentage Yields for Certain Time Accounts

Need and objectives of the rule. The annual percentage yield in Regulation DD is an effective rate of interest, which shows the effect of compounding on the rate of return. Annual percentage yields greater than the rate of simple interest reflect the additional earnings resulting from the conversion of interest to principal during a year.

When interest is not compounded and the term to maturity is greater than a year, the annual percentage yield in the original Regulation DD is less than the rate of simple interest. This result reflects an assumption that interest accumulates idly in the account rather than generating additional returns. Following implementation of the regulation, a national trade association representing deposit brokers questioned the appropriateness of this calculation for multiple-year time deposits that distribute the interest—such as brokered deposits. The association argued that because the distributed interest is available to reinvest, the annual percentage yield understated the potential return on such time deposits. The Truth in Savings requirement that advertisements for brokered deposits contain annual percentage yields made it difficult for the association's members to market brokered deposits, which distribute interest.

In response to a petition of the trade association, Board staff and the Board explored alternatives to the annual percentage yield formula specified in the original regulation in four requests for public comment (December 1993, May 1994, July 1994, and January 1995). The most recent request for public comment included an interim rule permitting institutions to disclose an annual percentage yield equal to the rate of simple interest for multiple-year time accounts that require distributions of interest at least annually. The interim rule is a limited exception to the general formula for the annual percentage yield. It eliminated the marketing problem of members of the petitioning association without fundamentally changing the original regulation. The final rule adopts this interim rule.

Issues raised by public comment to proposed rule. Board staff and the Board considered several alternative approaches to resolve the issue raised by the trade association. These alternative approaches included (1) proposals to change the assumptions underlying the calculation of the annual percentage yield, (2) proposals to change industry practices regarding the compounding and distribution of interest, and (3) proposals to create exceptions from the general rule. Commenters suggested that proposals following the first two approaches would be especially costly to implement and may not improve some consumers' ability to make choices among investment alternatives. They suggested that proposals following the second approach also had the potential to impose opportunity costs by reducing consumer choices. Some commenters questioned the need to make any changes in the original rule, noting that an institution could avoid the problem by simply offering to compound interest at least annually. Many public comments supported retaining the original rule or, if necessary, creating a limited exception.

Number of small entities to which the rule will apply. There were 6,334 small commercial banks at the end of September 1996, where small is defined as having assets of less than $100 million.[1] Almost all small banks offered time deposits with terms to maturity greater than a year, and 15% of small banks did not compound interest on time deposits with terms to maturity greater than a year.[2] In contrast, only about 10% percent of medium-sized and large banks did not compound interest on time deposits with terms to maturity greater than a year.

Thrift institutions (savings banks, savings and loan associations, and credit unions) also offer time deposits, and securities brokers offer brokered deposits. Many of these institutions are small, but data on the terms to maturity on their offerings of time deposits or brokered deposits are not available.

Description of projected compliance requirements. Since the interim rule is already effective, the start-up costs of the final rule are probably negligible. Most institutions that require at least annual withdrawal of interest paid on multiple-year time deposits probably have already implemented the interim rule because the annual percentage yield for such time deposits is higher under the interim rule than under the original Regulation DD. If any institutions waited because of uncertainty about whether the interim rule would be adopted as a final rule and now choose to implement the rule,

[1] Federal Deposit Insurance Corporation [Online], Statistics on Banking, All FDIC-Insured Depository Institutions, Number of Institutions by Asset Size, (September 30, 1996), Available through: http://www.fdic.gov/databank/ [April 29, 1996].

[2] Monthly Survey of Selected Deposits (FR2042), September 1994. More recent data on compounding practices for time deposits by term to maturity are not available.

they would need new disclosures for affected accounts. Software modifications and some employee training would be required to produce the new disclosures.

The ongoing costs of the disclosures under the new rule are likely to be similar to those under the original Regulation DD. Thus, adopting the interim rule as a final rule would not significantly change ongoing compliance costs.

Description of the steps taken to minimize the impact on small entities. No special steps were taken to minimize the impact of the rule on small entities. The cost of implementing a change in the method of calculating annual percentage yields was a major consideration leading to the choice of the interim rule over the other alternative rules, however. During its deliberations, the Board was aware of evidence of the existence of scale economies in start-up compliance costs, which implies that per-unit compliance costs would be higher at small institutions than at large institutions.[3] Although the start-up costs of the interim rule are probably subject to scale economies, the interim rule may have a less disparate effect on small institutions than the other alternatives because it has a relatively small effect on institutions' operations.

VI. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the rule under the authority delegated to the Board, by the Office of Management and Budget, after consideration of comments received during the public comment period. The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The OMB control number is 7100–0271.

The collection of information that is revised by this rulemaking is found in 12 CFR 230 and in Appendices A and B. This information is mandatory (12 U.S.C. 4308) to evidence compliance with the requirements of the Truth in Savings Act and the Board's Regulation DD. This information is used to assist consumers in comparing deposit accounts offered by depository institutions, principally through the disclosure of fees, APY, interest rate, and other account terms whenever a consumer requests the information and before an account is opened. The regulation also requires that fees and other information be provided on any periodic statement the institution sends to the consumer. The recordkeepers are for-profit financial institutions, including small businesses. Records must be retained for twenty-four months.

No comments specifically addressing the burden estimate were received.

The current estimated total annual burden for this information collection is 1,478,395 hours, as shown in the table below. These amounts reflect the burden estimate of the Federal Reserve System for the 996 state member banks under its supervision. This regulation applies to all types of depository institutions (except credit unions), not just to state member banks. Other agencies account for the paperwork burden for the institutions they supervise.

The final rule revises the APY that may be disclosed for noncompounding CDs with maturities greater than one year that require interest payouts at least annually. It also adds a brief narrative for account disclosures and advertisements for accounts that disclose the contract interest rate as the APY. The Board believes that there is no net change in the Board's current estimate of paperwork burden associated with Regulation DD. There is estimated to be no associated capital or start up cost and no annual cost burden over the annual hour burden.

	Number of respondents	Estimated annual frequency	Estimated response time	Estimated annual burden hours
Complete account disclosures (Upon request and new accounts)	996	300	5 minutes	24,900
Subsequent notices:				
Change in terms	996	1,130	1 minute	18,757
Prematurity notices	996	1,095	1 minute	18,177
Periodic statements	996	84,615	1 minute	1,404,609
Advertising	996	12	1 hour	11,952
Total				1,478,395

Because the records would be maintained at state member banks and the notices are not provided to the Federal Reserve, no issue of confidentiality under the Freedom of Information Act arises.

The Federal Reserve has a continuing interest in the public's opinions of our collections of information. At any time, comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0271), Washington, DC 20503.

[3] For a summary of the evidence, see Gregory Elliehausen, *The Cost of Bank Regulation*, Staff Studies (Board of Governors of the Federal Reserve System, forthcoming).

List of Subjects in 12 CFR Part 230

Advertising, Banks, Banking, Consumer protection, Federal Reserve System, Reporting and recordkeeping requirements, Truth in savings.

Accordingly, the interim rule amending 12 CFR part 230 which was published at 60 FR 5128 on January 26, 1995, is adopted as a final rule with the following changes:

PART 230—TRUTH IN SAVINGS (REGULATION DD)

1. The authority citation for part 230 continues to read as follows:

Authority: 12 U.S.C. 4301, *et seq.*

2. Section 230.4 is amended by revising the sentence at the end of paragraph (b)(6)(iii) to read as follows:

§ 230.4 Account disclosures.

* * * * *

(b) * * *

(6) * * *

(iii) * * * For accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, that require interest payouts at least annually, and that disclose an APY determined in

accordance with section E of Appendix A of this part, a statement that interest cannot remain on deposit and that payout of interest is mandatory.

* * * * *

3. Section 230.8 is amended by revising paragraph (c)(6)(iii) to read as follows:

§ 230.8 Advertising.

* * * * *

(c) * * *

(6) * * *

(iii) *Required interest payouts.* For noncompounding time accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, that require interest payouts at least annually, and that disclose an APY determined in accordance with section E of Appendix A of this part, a statement that interest cannot remain on deposit and that payout of interest is mandatory.

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4. In Part 230, Appendix A is amended by revising section E of Part I to read as follows:

Appendix A To Part 230—Annual Percentage Yield Calculation

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E. Time Accounts with a Stated Maturity Greater than One Year that Pay Interest At Least Annually

1. 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 the consumer to withdraw interest at least annually, the annual percentage yield may be disclosed as equal to the interest rate.

Example

(1) If an institution offers a $1,000 two-year certificate of deposit that does not compound and that pays out interest semi-annually by check or transfer at a 6.00% interest rate, the annual percentage yield may be disclosed as 6.00%.

(2) For time accounts covered by this paragraph that are also stepped-rate accounts, the annual percentage yield may be disclosed as equal to the composite interest rate.

Example

(1) If an institution offers a $1,000 three-year certificate of deposit that does not compound and that pays out interest annually by check or transfer at a 5.00% interest rate for the first year, 6.00% interest rate for the second year, and 7.00% interest rate for the third year, the institution may compute the composite interest rate and APY as follows:

(a) Multiply each interest rate by the number of days it will be in effect;

(b) Add these figures together; and

(c) Divide by the total number of days in the term.

(2) Applied to the example, the products of the interest rates and days the rates are in effect are (5.00%×365 days) 1825, (6.00%×365 days) 2190, and (7.00%×365 days) 2555, respectively. The sum of these products, 6570, is divided by 1095, the total number of days in the term. The composite interest rate and APY are both 6.00%.

* * * * *

By order of the Board of Governors of the Federal Reserve System, July 24, 1998.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 98–20268 Filed 7–29–98; 8:45 am]

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