FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 8365
June 2, 1978

PROPOSED INTERPRETATION OF REGULATION Z

Computation of Annual Percentage Rate on Unequal-Payment Mortgages

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System proposed for comment an amendment to an interpretation of Regulation Z — Truth in Lending — that would facilitate the computation of the annual percentage rate for graduated payment mortgages.

The Board requested comment by June 26.

Graduated payment mortgages, and other real estate mortgages, may involve one payment period that is different (longer or shorter) from others. The proposed amendment would apply to all mortgages with a minor variation in a payment period and that have a maturity of 15 years of more, with monthly payments.

Graduated payment mortgages have been developed by the Federal Housing Administration to assist young people, and others, to buy homes. Under them, mortgage payments increase annually during the first five or ten years of the mortgage. The proposed amendment (to Interpretation 226.503 of Regulation Z) would simplify the use of annual percentage rate computation tables prepared by FHA for use when homes are bought on its graduated payment mortgage plan.

Printed below is the text of the proposal. Comments should be submitted by June 26, and may be sent to our Consumer Affairs Division.

PAUL A. VOLCKER,
President.

[Reg. Z; Docket No. R-0164]

Minor Irregularities — Maximum Irregular Period Limits

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed revised interpretation.

SUMMARY: This proposed revised interpretation would expand the current "minor irregularities" provisions of Regulation Z which permit certain irregular payment amounts and payment periods to be considered regular for purposes of calculating the annual percentage rate on consumer credit transactions. It provides that in most real property transactions with a term of 15 years or more, an irregular first period of up to 62 days may be treated as though it were a regular period. The proposed rule is intended to simplify computation of the annual percentage rate in long-term real property transactions involving unequal payments, including graduated payment mortgages.

DATE: Comments must be received on or before June 26, 1978.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

FOR FURTHER INFORMATION CONTACT: Glenn E. Loney, Section Chief (202-452-3867), of the Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

(OVER)

SUPPLEMENTARY INFORMATION:

(1) In an effort to simplify computation of annual percentage rates in graduated payment mortgages, such as those made under the HUD/FHA Section 245 Experimental Financing Program, the Board is proposing to revise Interpretation § 226.503. That interpretation currently allows first payment periods of up to 50 days to be treated as if they were regular for purposes of the annual percentage rate calculation, only in transactions longer than one year which are otherwise payable in equal monthly instalments. Since graduated payment mortgages, by their very nature, involve unequal instalments, creditors offering them cannot now take advantage of the minor irregularities provision.

The Board believes this requirement that the obligation be otherwise payable in equal instalments may appropriately be relaxed in the case of most long-term real property transactions, even if the instalments are unequal. Moreover, it believes that in such transactions allowing a first period of up to 62 days to be considered regular will have only a minor effect on the annual percentage rate. It therefore proposes to allow such a longer period to be treated as regular.

There are two limitations on the type of real property transaction that qualifies for this special rule regarding irregularities. The transaction must be for a term of at least 15 years, and it must be otherwise payable in monthly instalments. These limitations are included to ensure that use of this provision will not result in major deviations from the true annual percentage rate.

The Board is permitted by § 107 of the Truth in Lending Act (15 U.S.C. § 1606) to allow variances in the annual percentage rate.

The Board would like to receive any comments the public might have on this proposal. In particular, the Board believes comments on the following issues would be helpful.

1. Are the restrictions placed on the use of this amendment appropriate? Are any additional restrictions necessary? Should any of the proposed restrictions be made less severe, more strict, or eliminated? For example, the amendment applies only to real property transactions whose terms are 15 years or more. Could that minimum eligible term be increased, decreased, or eliminated, without seriously distorting the annual percentage rate?

2. To assure less distortion in the rate calculation, would it be advisable or necessary to limit this amendment to apply to those mortgage credit plans that require the customer to pay interest for the irregular portion of the first payment period?

3. Does this adjustment achieve the desired result as stated above?

(2) To aid in the consideration of this matter by the Board, interested persons are invited to submit relevant data, views, comments, or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than June 26, 1978, and should include the docket number R-0164. The material submitted will be made available for inspection and copying upon request, except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information (12 C.F.R. 261.6(a)).

3. Pursuant to the authority granted in 15 U.S.C. § 1064 (1968), the Board proposes to revise Regulation Z, 12 C.F.R. Part 226.503 by adding the following at the end thereof:

SECTION 226.604 — Minor Irregularities —
Maximum Irregular Period Limits

* * *

Notwithstanding the above or the language in § 226.5(d) that limits the minor irregularities provisions to transactions that are "otherwise payable in equal instalments scheduled at equal intervals," the following rule may be applied to real property transactions.

An initial payment period of 62 days or less may be treated as though it were regular if:

1) the term of the obligation (the date from which the finance charge begins to accrue to the date of the final payment) is at least 15 years, and

2) the obligation is otherwise payable in monthly instalments.