

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 10221
January 12, 1988]

TRUTH IN LENDING

Amendment to Regulation Z Regarding Adjustable Rate Mortgages

*To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:*

On January 8, we sent you a circular (Cir. No. 10220) requesting comment on proposed changes in the Official Staff Commentary on Regulation Z of the Board of Governors of the Federal Reserve System that would offer guidance to creditors in complying with the provisions of an amendment to Regulation Z (Truth in Lending). Enclosed is a copy of the text of the amendment to Regulation Z, effective December 28, 1987, which has been reprinted from the *Federal Register*. In submitting the amendment for publication in the *Federal Register*, the Board of Governors issued the following statement:

The Federal Reserve Board has adopted an amendment to its Regulation Z, Truth in Lending, that will require creditors to provide consumers with more extensive information about the variable-rate feature of closed-end adjustable rate mortgages (ARMs), with longer than a one-year maturity, which are secured by the consumer's principal dwelling. The Board's final rule becomes effective October 1, 1988 but creditors may comply immediately.

The Board's amendment requires creditors to provide consumers with a more detailed description of the variable-rate feature. An historical example that shows the effect that actual changes in index values would have had on payments on a \$10,000 loan must be given to the consumer. And, creditors must provide a statement of the initial and maximum interest rates and payments for a \$10,000 loan originated at the most recent interest rate shown in the historical example.

The amendment to the regulation also requires that prospective borrowers be given an educational brochure about ARMs, either *The Consumer Handbook on Adjustable Rate Mortgages* published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

All of this information must be given to the consumer at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier.

Single copies of *The Consumer Handbook on Adjustable Rate Mortgages*, referred to in the above statement, will be sent to depository institutions in this District as soon as they are made available to us by the Board of Governors. Additional copies of the *Handbook* may be obtained from the Board for a small fee; for information regarding those charges you should call the Board's Publications Section (Tel. No. 202-452-3244).

Questions regarding this matter may be directed to our Compliance Examinations Department (Tel. No. 212-720-8136). Additional copies of this enclosure, or of the earlier proposal, will be furnished upon request directed to the Circulars Division of this Bank (Tel. No. 212-720-5215 or 5216).

E. GERALD CORRIGAN,
President.

TRUTH IN LENDING

AMENDMENT TO REGULATION Z

(effective December 28, 1987)

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z: Docket No. R-0545]

Truth in Lending; Variable-Rate Disclosure Under Regulation Z

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is publishing a final rule amending Regulation Z (Truth in Lending) to require creditors to provide more information about the variable-rate feature of closed-end adjustable-rate mortgages than is currently required under Regulation Z. The amendments require creditors to distribute to consumers an educational booklet about adjustable-rate mortgages, and to provide a more detailed description of the variable-rate feature, along with an historical example. The information must be provided at the time an application form is given to the consumer or before the consumer pays a non-refundable fee, whichever is earlier. These revisions are intended to address concerns regarding the adequacy of information given to consumers applying for adjustable-rate mortgages and regarding the creditor

burden of duplicative federal regulations.

EFFECTIVE DATE: December 28, 1987, but optional compliance until October 1, 1988.

FOR FURTHER INFORMATION:

Contact Michael S. Bylsma, Senior Attorney, or Sharon T. Bowman or Thomas J. Noto, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC, 20551, (202) 452-3667 or (202) 452-2412. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson, at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

Background

For some time the Board has been working with the other federal financial regulatory agencies to develop a uniform set of disclosures for adjustable-rate mortgages (ARMs). This effort arose because of concern about the different disclosure requirements imposed by the various federal agencies. Currently, four federal agencies require that lenders subject to their regulations provide specific disclosures about ARMs to borrowers. Under Regulation Z, the Board requires that a variable-rate feature be described briefly to consumers. In contrast to Regulation Z,

the regulations of two other federal financial agencies and the Department of Housing and Urban Development (HUD) call for more extensive, detailed information. The Federal Home Loan Bank Board (FHLBB) requires variable-rate disclosures for federally-chartered savings and loan associations and also for certain other lenders that wish to market their loans to federally-chartered savings and loans (12 CFR 545.33). The Office of the Comptroller of the Currency (OCC) mandates variable-rate disclosures for national banks and other lenders that seek to market their loans to national banks (12 CFR Part 29). Under the "Alternative Mortgage Transaction Parity Act of 1982" (12 U.S.C. 3802), state-chartered institutions and other mortgage lenders may take advantage of federal authorization of ARMs by following the rules of the FHLBB or the OCC. Finally, HUD prescribes disclosures for lenders wishing to participate in the Federal Housing Administration (FHA) insurance program (24 CFR Parts 203 and 234).

The federal financial agencies believe that this regulatory structure, which requires different disclosures by different lenders delivered at different times, is causing problems for both consumers and mortgage lenders. The ability of consumers to understand and make important decisions about ARMs

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For this Regulation to be complete, retain:

- 1) Regulation Z pamphlet, revised effective April 1, 1981.
 - 2) Amendments effective December 3, 1981, April 1, 1982, October 1, 1982, December 31, 1984, April 4, 1985, and December 16, 1986 (printed in slip sheet dated April 1987; also includes amendments to the *Truth in Lending Act*).
 - 3) Amendment effective December 9, 1987.
 - 4) This slip sheet.
- Furnished on request —
- 5) Official Staff Commentary, effective October 16, 1984.
 - 6) Amendments to the Official Staff Commentary (slip sheet dated April 1987).

before entering into these transactions may be hampered by their receipt of different information about ARM programs depending on what type of lender they have approached. This problem is exacerbated by the variety of ARM products now being offered as well as the complexity of some of these programs. At the same time, these regulatory requirements have proven burdensome to the mortgage industry, particularly when mortgage lenders must satisfy more than one regulation in order to take full advantage of the secondary market. Under certain circumstances, lenders who wish to originate mortgages for possible sale to either a federal savings and loan association or to a national bank may have to make disclosures under two agencies' rules.

Revisions to federal ARM disclosure requirements were initially requested by members of Congress in a letter to the Board in August 1984. The request called for uniform federal requirements for disclosures that include a "worst-case" statement of the highest interest rate and payment that might apply to an ARM. The Board asked the Federal Financial Institutions Examination Council (FFIEC) to assist in developing a recommendation for uniform requirements for the federal agencies with ARM disclosure regulations. After extensive deliberations by an FFIEC task force, the FFIEC made an initial recommendation to the Board in November 1984. As outlined by the FFIEC, the required disclosures would be specific to each consumer's transaction and include a "worst-case" payment example based on hypothetical index rate increases of two percentage points per year for three years. Based on these recommendations, the Board proposed amendments to Regulation Z on May 15, 1985 (50 FR 20221). Many of the Board's 500 public comments on the 1985 proposal objected to both the potential burden on creditors of requiring transaction-specific disclosures and to the assumptions about index rate movement.

For more than a year following the Board's proposal of the initial disclosure scheme, the FFIEC considered alternative plans for uniform ARM disclosures. In August 1986, the FFIEC approved a proposal requiring that creditors provide two types of disclosures to consumers seeking information about ARMs: (1) The *Consumer Handbook on Adjustable Rate Mortgages*, or a suitable substitute, and (2) disclosures that fully describe each of the creditor's ARM programs, with a 15-year historical example of how

changes in the index or formula values used to compute interest rates would have affected interest rates and payments on a \$10,000 loan. In addition, the maximum interest rate and payment that could result under the program for the \$10,000 loan would be disclosed.

Based on the recommendations by the FFIEC and its own analysis, the Board on November 24, 1986, again proposed to amend Regulation Z (51 FR 42241). On February 5, 1987, the FHLBB proposed amendments to its ARM disclosure regulations which would require disclosures identical to what the Board proposed (52 FR 3665). The FHLBB regulation, as proposed, would cover all loans secured by borrower-occupied property (including open-end equity lines of credit.) Finally, on October 2, 1987, the OCC proposed to delete its ARM disclosure regulation and to defer to revised Regulation Z disclosure requirements (52 FR 36953).

A total of 135 comments were received during the 60-day period for public comments on the Board's proposal. Generally, commenters supported the concept of uniformity in federal ARM disclosure regulations. Most commenters also endorsed the proposal to require disclosures based on the features of the loan program but not specific to an individual consumer's actual loan amount. On the other hand, about one-fifth of the commenters expressed general opposition to the proposal. These commenters questioned the need for expanded disclosure requirements under Regulation Z and stated that the disclosures would be more costly to prepare and to distribute than the existing disclosures. Many commenters also maintained that the coverage of the proposal was too broad. For example, it was asserted that compliance with the proposed advance notice of interest rate adjustments would be difficult with certain short-term loans such as bridge loans. It was also argued that the 15-year index history would not be meaningful to consumers considering short-term loans, and that the disclosures would be difficult to prepare for loans that are custom-tailored to an individual consumer's needs. Many commenters suggested limiting coverage of the amendments to purchase-money and refinancing transactions which are variable-rate and secured by the consumer's principal dwelling. On the other hand, several commenters supported the coverage of the proposal. Some commenters argued that the proposed disclosures should also be required for open-end home equity lines. These commenters noted that home

equity plans have become more prevalent since the Tax Reform Act of 1986 and impose great risks to consumers whose homes are burdened with such indebtedness. Other commenters requested that creditors be allowed to substitute the expanded disclosures for the existing Regulation Z ARM disclosures for all variable-rate transactions, whether or not secured by the consumer's principal dwelling.

Many commenters favored the requirement of an example showing how the payments and loan balance of a \$10,000 loan would have been affected by historical changes in the index for a 15-year period. Other commenters questioned the usefulness of the historical information and argued that the recent interest rate fluctuations would not be repeated in the future. Commenters also maintained that the historical example would be burdensome to prepare. Some commenters recommended a shorter example or even one based on hypothetical index rate increases over a short period. Some commenters, particularly members of the thrift industry, reversed their previously stated opposition to an example based on hypothetical rate increases and recommended that form of example as a substitute for the historical example.

Many commenters supported the requirement that the maximum interest rate and payment be stated. These commenters argued that the statement would be a useful supplement to the historical example which might not reflect a potential worst-case for the loan in the future. HUD recommended that the maximum payment be stated as a schedule of payment increases showing the initial and maximum payments to correspond to its statutory disclosure requirements. Other commenters stated that the information might portray ARMs in a highly negative light. A few of these commenters requested that the disclosure show the lowest rate and payment possible under the program.

Finally, several commenters addressed the proposed requirement for advance notice of interest rate and payment adjustments. The primary criticism was that the advance notice was required at least 30 days before the effective date of an interest rate adjustment and not before a payment at the new level is due, as is currently required by the OCC. The commenters stated that this proposed requirement would cause problems for lenders offering short-term ARMs that closely track changes in the index values. Some commenters recommended reducing the

number of days before an adjustment that notice is required and clarifying that notice should be given before a payment at a new level is due.

After considering all of the comments, the Board has made changes in the final amendments designed to alleviate the burden of compliance without compromising the amount or detail of information recommended by the FFIEC to be disclosed to consumers. For example, in response to the comments, the Board has made a minor change to the coverage of the amendments, a modification of the requirement for a statement of the maximum interest rate and payment, and a change to the timing of the adjustment notice requirements, as explained below. Generally, the Board has not adopted the other changes suggested by commenters which would substantially alter the uniform disclosure provisions developed by the FFIEC.

Amendments to Regulation Z

Based on recommendations from the FIEC, the Board is adopting amendments to Regulation Z to provide more information to consumers about adjustable-rate mortgages. These amendments will require a handbook to be distributed to consumers, as well as detailed disclosures about a creditor's ARM loan programs. The new ARM disclosure requirements have been added to the regulation at § 226.19(b) and § 226.18(f)(2) while new subsequent disclosure requirements for ARMs have been added at § 226.20(c).

The amendments apply to closed-end credit transactions secured by the consumer's principal dwelling. This coverage includes purchase-money mortgages, in which the consumer is obtaining a mortgage loan for the purpose of purchasing a home, as well as transactions in which the consumer is using the home as security for a loan. In response to comments received about potential compliance problems for short-term loans, an exemption from the new disclosure requirements has been provided for transactions secured by the consumer's principal dwelling with a term of one year or less. These loans will continue to be covered by the existing disclosure requirements of § 226.18(f)(1) of Regulation Z.

Footnote 43 will allow creditors to substitute the new disclosures for any loan subject to the existing requirements of § 226.18(f)(1) of the regulation. This will allow creditors to treat all variable-rate transactions the same without having to provide different disclosures depending on whether the loan is secured by a consumer's principal

dwelling. Creditors who substitute the disclosures under § 226.19(b) for the disclosures ordinarily required under § 226.18(f)(1) also must comply with the requirements under § 226.18(f)(2), although they need not comply with the requirements under § 226.20(c). The footnote does not permit substitution of disclosures required under § 226.18(f)(1) in transactions subject to § 226.19(b). (Home equity lines, in which an open-end line of credit is secured by the consumer's home, are not subject to the new requirements, which apply only to closed-end mortgages.) All other consumer credit transactions that contain a variable-rate feature would continue to be subject to the existing variable-rate disclosure requirements in Regulation Z.

As recommended by the FFIEC, the amendments will require that ARM disclosures, including both the ARM brochure and the other detailed ARM information, be provided to prospective borrowers when an application form is furnished or before the payment of a non-refundable fee, whichever is earlier. This rule will permit creditors to provide the detailed disclosures to consumers as an insert to the ARM brochure when it is given. Disclosure at this point in time is possible under the amendments because the new rule would require that disclosures reflect ARM loan program features, but not the terms of individual transactions. Footnote 45b provides a special timing rule (replacing the general timing rule) for cases where an ARM application reaches a creditor by telephone, or by way of an intermediary agent or broker. In both such cases, both the ARM brochure and the other detailed ARM information must be placed in the mail or delivered not later than three business days after the creditor receives the consumer's application. The proposed special timing rule for intermediary agents or brokers has been expanded to cover telephone applications in response to comments discussing potential compliance problems with the requirement of pre-application disclosures for transactions in which the application is made by telephone.

Under the new timing rule, the new variable-rate disclosures will be given to consumers earlier than the standard Truth in Lending information required by § 226.18. A sentence has been added to § 226.17(b) to cross-reference the early timing requirements for ARMs. In addition, a new paragraph (f)(2) has been added to § 226.18 to require that the later Truth in Lending disclosures be revised to include a statement that an adjustable-rate feature exists and that

the variable-rate disclosures have been provided to the consumer.

A new paragraph (b)(1) requiring a descriptive ARM brochure has been added to § 226.19. The paragraph requires that creditors give each consumer a brochure when an application form is given to a consumer or before a consumer pays a non-refundable fee, whichever is earlier. The rule ensure that every consumer considering applying for an ARM will receive a brochure at an early stage in the application process. The *Consumer Handbook on Adjustable Rate Mortgages*, developed by the Board and the FHLBB, may be used by creditors to fulfill this requirement if they choose. The amendments would also permit creditors to provide a "suitable substitute" in place of the *Consumer Handbook*. Rather than the Board's evaluating whether an individual creditor's ARM brochure is a "suitable substitute," individual creditors should make a good faith determination of whether a brochure is, in fact, a suitable substitute. The Board envisions that substitutes must be, at a minimum, comparable to the *Consumer Handbook* in substance and comprehensiveness, recognizing that some lenders' brochures may contain more detailed descriptions of their particular ARM programs than contained in the *Consumer Handbook*.

The *Consumer Handbook* has been reprinted for resale by private publications companies, and by various trade organizations such as the American Bankers Association, the Mortgage Bankers Association, the National Council of Savings Institutions and the U.S. League of Savings Institutions.

Amendments also have been made in § 226.19(b)(2). They required that detailed, specific information about major aspects of a variable-rate loan program be clearly disclosed to consumers. To illustrate the requirements, sample form H-14 in Appendix H of the regulation has been revised, and model clauses have been included in a revision to Appendix H-4.

Under the amendments, creditors will be required to identify the index to which interest rate changes are tied, or provide a brief description of the formula used in calculating changes if no index is used. If the interest rate changes are purely discretionary or are made by an internally defined index, the creditor will still need to describe the method of rate changes or state that they are discretionary. A source of information about an index also must be disclosed. For example, if index values

are listed in the *Wall Street Journal*, creditors could make such a statement in disclosing a source of information about their index. The amendments call for an explanation of how the interest rate and payment will be determined, for example, by a statement that the interest rate will be based on a specified index plus a margin and that the payment will be based on the interest rate, the loan balance, and the remaining loan term. Furthermore, creditors will be required to include a statement suggesting that consumers ask for the current margin value and interest rate. The disclosures also will alert consumers about a discount feature when the initial rate is discounted and will contain a statement suggesting that consumers ask for the amount of the applicable interest rate discount. In addition, the frequency of rate and payment adjustments will be disclosed, along with rate and payment caps.

If the presence of rate or payment caps would result in interest rate carryover or negative amortization, the disclosure statement would need to contain a statement about those features. Two other disclosures must be made: the fact that a loan program contains a demand feature, if applicable, and a statement describing the type of information that will be contained in an adjustment notice and when each notice will be provided. Finally, creditors will be required to include a notice to consumers that disclosure forms are available for the creditor's other ARM loan programs if the creditor has other closed-end ARM programs subject to the amendments.

One significant feature of the amendments is the requirement of an example, based on a \$10,000 loan, illustrating how payments and the loan balance would have been affected by historical changes in the index to be used. Because the example will not be based on the actual amount to be borrowed, creditors will be able to pre-print the disclosures for each loan program and give them to consumers with an ARM handbook. The provision that the example be based on the historical performance of individual indices, rather than on assumed rate increases, reflects the revised recommendation of the FFIEC. Creditors also will be required to include a statement on the disclosure form explaining to consumers how to calculate their actual monthly payment amount for a loan amount other than \$10,000. The example based on \$10,000 also reflects the recommendation of the FFIEC, and is premised, in part, on the rationale that figures based on a \$10,000

example provide information that consumers can use with minimal difficulty to calculate their actual monthly payments for a specific transaction. The amendments require that the example shown be based on the history of the specific index or formula to be used in the loan program. The index values used in the example will begin with the value for 1977 and be updated annually to add the values for additional years until a 15-year history is shown. For example, the disclosures for an ARM made in 1988 would include index values for each year from 1977 through 1987. In each subsequent year until 1991, a creditor's disclosures will include the index value for one more year. From that time forward, lenders will show a "rolling" history of index values, updated annually, for the preceding 15 years.

If the values for an index have not been available back to 1977, creditors need only go back as far as the values have been available in giving the history and may start the example at the year in which values are available. The history should reflect the method of choosing values for each program. For instance, if an average of index values is used, averages would be used in the history, but if a single index value is used, a single index value would be shown. The creditor should assume one date within a year (or one period, if an average is used) on which to base the history of index values for each loan program. The creditor may choose to use index values as of any date or period as long as the index value as of this date or period is used for each year in the index history. Only one index value per year need be shown, even if the program provides for adjustments to the interest rate or payment more than once in a year. In such cases, the creditor may assume that the index rate remained constant for the full year for the purpose of calculating the interest rate, payment, and loan balance. Updating will be necessary only once each year to reflect the most recent year's index value. New disclosures would be required when an ARM program changes. (To assist creditors in constructing histories of certain common indices, the Board has included tables of index values in section 3 below.)

The payment and outstanding loan balance figures in the example must reflect all significant loan program terms. For example, features such as rate and payment caps, a discounted interest rate, negative amortization, and interest carryover need to be taken into account by creditors in calculating the payment and outstanding balance

figures. Because disclosures will be given early, creditors will need to assume a value for the margin in order to do the calculations for the example. Creditors may select a margin that they have used during the preceding six months and disclose on the form that the margin is one that they have used recently. The margin selected may be used until a creditor updates the disclosure form to reflect the most recent 15 years of index values. Similarly, to the extent that the ARM program has a discounted initial rate, creditors also will be permitted to assume an amount by which the initial rate will be discounted—which is representative of the amount of discounts by the creditor during the preceding six months—and disclose on the form that the initial rate has been discounted to the extent of other discounts offered by the creditor recently. The provision for a representative discount was added to respond to the concerns expressed by creditors about the need for individual program disclosure forms to reflect the amount of every discount offered by the creditor—amounts which could fluctuate daily depending upon market conditions.

The amendments also require disclosure of the maximum interest rate and payment. These disclosures would be calculated based on a \$10,000 loan that is originated at the most recent interest rate shown in the historical example, and would assume that the interest rate then increases as rapidly as possible under the program. Thus, in a loan with interest rate limitations, or "caps," of 2 percentage points per year, and 5 percentage points for the life of the loan, the maximum interest rate would be 5 percentage points higher than the most recent rate shown in the historical example. Furthermore, the loan would not reach the maximum interest rate increase until the fourth year of the loan because of the 2 percentage points annual limitation. Consequently, the maximum payment disclosed would reflect the amortization of the loan during that period. Finally, to enable FHA lenders to follow the new requirements, this provision has been modified also to require a statement of the initial interest rate and payment for that loan. The Board believes that this requirement will also benefit consumers by providing a point of reference for evaluating the stated maximum levels for an ARM.

The final amendments do not contain the proposed requirement that ARMs without limitations on the maximum increases in the interest and payment contain a "conspicuous" statement to

that effect. That provision is no longer necessary in light of section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, section 1204, and the recent amendment to Regulation Z, which require that all dwelling-secured ARM loans contain the maximum interest rate that may apply during the loan term.

As mentioned earlier, the ARM disclosures given before application will describe the type of information that will be provided in notices of adjustments and the timing for such notices. A paragraph also has been added as § 226.20(c) to require a subsequent disclosure form. The new section will apply, except as provided in footnote 43, to all ARMs that have been disclosed in accordance with the new § 226.19(b) requirements. Regulation Z does not currently require a subsequent disclosure of rate and payment changes, although the existing OCC, FHLBB, and HUD regulations already require it. The new paragraph requires notice of the adjusted payment amount, interest rate, index rate, and loan balance. The creditor also will be required to disclose the extent to which any increase in the interest rate has not been fully implemented at the adjustment date (for example, if the new index plus margin would exceed an interest rate adjustment cap), and the payment that would be required to fully amortize a loan (if different from the payment already disclosed). In transactions providing that payment adjustments may accompany interest rate adjustments, creditors would be

required to send borrowers notice at least 25, but not more than 120, days before the due date of a payment at the new level. The final amendment differs from the proposal which called for a notice at least 30 days before the effective date of each scheduled interest rate adjustment. The minimum advance notice was revised to 25 days to track the existing notice requirements of the OCC and to provide creditors more flexibility in giving adjustment notices for the variety of loans that will be subject to the new subsequent disclosure requirements. At the same time, the Board believes that the timing of the disclosures still will provide consumers with adequate advance notice of adjusted payment amounts. The timing requirement was clarified to refer to calendar days and a requirement that the disclosures must be delivered or placed in the mail within the specified period was added for consistency with the requirements for delivery of other disclosures, such as when an application is made by telephone or through an intermediary agent or broker. Finally, the timing provision was tied to the due date of the payment at a new level rather than to the effective date of the interest rate adjustment. Notice is required to be given whenever interest rate adjustments and corresponding payment adjustments can be made periodically under the loan agreement but are not made because, for example, the index values have not changed or an interest rate cap has prevented any such adjustments. However, creditors are

required to send borrowers notice only once each year if interest rate adjustments are made without a corresponding payment adjustment. Thus, for example, in transactions where the interest rate may be adjusted more frequently than the payment, the creditor would be required to send at least one notice each year during which there have been interest rate adjustments but no corresponding payment adjustments.

Finally, footnote 43 to Regulation Z has been retained and renumbered footnote 45a. Retention of the footnote will permit creditors who are required to comply with variable-rate disclosure regulations of other federal agencies to substitute those disclosures for the disclosures required under these amendments. Because the FHLBB likely will adopt disclosure requirements identical in substance to the final amendments to Regulation Z, certain creditors will be permitted to give the uniform ARM disclosures under FHLBB rules without being required to make identical disclosures under Regulation Z. (As proposed, the FHLBB regulations would also require certain other disclosures applicable to the ARM relating to due-on-sale clauses, rate changes and prepayment penalties, escrow payments, call provisions, and conditions of default. Because the FHLBB proposal would permit FHLBB-regulated institutions to purchase from other unaffiliated lenders ARMs for which only the uniform disclosures have been made, the secondary market should not be affected by the FHLBB's

TABLE 1.—CONSTANT MATURITY YIELD ON UNITED STATES TREASURY SECURITIES

Year	Average for first week ending in January (percent)			Average for first week ending in July (percent)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
1977	5.02	5.83	6.24	5.72	6.32	6.68
1978	7.03	7.40	7.59	8.34	8.51	8.50
1979	10.51	9.58	9.30	9.44	8.78	8.73
1980	12.02	10.75	10.52	8.51	9.15	9.47
1981	13.86	12.81	12.54	14.94	14.58	14.28
1982	13.86	14.09	14.04	14.41	14.81	14.73
1983	8.62	9.65	10.04	9.78	10.47	10.80
1984	10.02	11.04	11.50	12.17	13.38	13.67
1985	9.19	10.58	11.16	7.66	8.98	9.53
1986	7.63	8.25	8.50	6.36	6.99	7.21
1987	5.97	6.54	6.79	6.71	7.72	7.98

TABLE 2.—MISCELLANEOUS ARM INDICES

Year	January (percent)	July (percent)
A. Average Cost of Funds Ratio to 11th FHLB District Institutions		
1977	n.a.	n.a.
1978	n.a.	n.a.
1979	n.a.	n.a.
1980	8.76	9.67
1981	10.45	11.85
1982	11.95	12.23

TABLE 2.—MISCELLANEOUS ARM INDICES—Continued

Year	January (percent)	July (percent)
1983	10.46	9.68
1984	10.03	10.71
1985	10.22	9.37
1986	8.77	8.20
1987	7.40	7.28

TABLE 2.—MISCELLANEOUS ARM INDICES—Continued

Year	January (percent)	July (percent)
B. National Average Contract Interest Rate For Major Lenders on the Purchase of Previously Occupied Homes		
1977	8.84	8.83
1978	8.95	9.41
1979	10.08	10.67
1980	11.78	12.23
1981	13.24	14.77

TABLE 2.—MISCELLANEOUS ARM INDICES—
Continued

Year	January (per- cent)	July (per- cent)
1982.....	15.37	14.96
1983.....	13.04	12.18
1984.....	11.70	12.03
1985.....	12.09	11.02
1986.....	10.40	9.88
1987.....	9.19	9.05

TABLE 2.—MISCELLANEOUS ARM INDICES—
Continued

Year	January (per- cent)	July (per- cent)
C. National Monthly Median Cost of Funds Ratio to FSLIC-insured Institutions		
1977.....	n.a.	n.a.
1978.....	n.a.	n.a.
1979.....	n.a.	7.44
1980.....	8.09	9.18

TABLE 2.—MISCELLANEOUS ARM INDICES—
Continued

Year	January (per- cent)	July (per- cent)
1981.....	9.50	10.92
1982.....	11.44	11.54
1983.....	10.14	9.65
1984.....	9.89	9.90
1985.....	9.75	8.87
1986.....	8.50	7.94
1987.....	7.22	6.96

Year	Quarterly Period				Semiannual Period	
	January— March	April— June	July— September	October— December	January— June	July— December
D. National Average Cost of Funds Ratio to FSLIC-insured institutions (percent)						
1977.....	n.a.	n.a.	n.a.	n.a.	6.39	6.48
1978.....	n.a.	n.a.	n.a.	n.a.	6.54	6.79
1979.....	n.a.	n.a.	n.a.	n.a.	7.23	7.71
1980.....	n.a.	n.a.	n.a.	n.a.	8.77	9.11
1981.....	n.a.	n.a.	n.a.	n.a.	10.31	11.53
1982.....	n.a.	n.a.	n.a.	n.a.	11.49	11.27
1983.....	n.a.	n.a.	n.a.	n.a.	9.81	9.84
1984.....	9.74	9.80	10.27	10.31	9.77	10.29
1985.....	9.58	9.35	9.04	8.79	9.47	8.92
1986.....	8.49	8.21	7.99	7.53	8.35	7.76
1987.....	7.11	7.06			7.09	

retention of these additional disclosures.) The footnote will also benefit lenders originating ARMs insured by the Federal Housing Administration, which has not yet adopted the uniform requirements. Furthermore, FHA lenders may continue to take advantage of the footnote at the time HUD amends its ARM disclosure requirements to adopt the uniform requirements.

Creditors also will be permitted to utilize the subsequent disclosure requirements of other federal agencies in place of the subsequent disclosure requirements of § 226.20(c). The FHLBB likely will adopt subsequent disclosure requirements identical to those required under § 226.20(c). A new footnote 45c has been added to permit this substitution. Changes have also been made to Appendix H by redesignating model clause H-4 as H-4(A); adding model clauses H-4(B), H-4(C) and H-4(D), and substituting sample form H-14 with a new form. (The official staff commentary interpreting these regulatory changes is being published for comment in this issue of the Federal Register.)

Tables of Certain Index Values

To assist creditors in constructing histories of various indices used in their ARM programs, the Board has prepared tables of values for common indices for the years 1977-1987. Table 1 provides the values for United States Treasury securities adjusted to constant

maturities of 1, 3, and 5 years. Weekly average values are provided as of the first week ending in January and in July. Table 2 provides the January and July monthly average values for three other indices—the Cost of Funds Ratio to 11th Federal Home Loan Bank District Institutions, the National Average Contract Interest Rate for Major Lenders on the Purchase of Previously Occupied Homes, and the National Monthly Median Cost of Funds Ratio to FSLIC-Insured Institutions. It also includes the semiannual and quarterly average values for the National Average Cost of Funds Ratio to FSLIC-Insured Institutions. Years in which index values were not available are marked "n.a." (Creditors need not use these tables in constructing their index histories. Furthermore, the dates used in these tables were selected merely to provide index values at two or more points within each year. Creditors may choose to use the applicable index values in these tables even if index values as of another date are used in their ARM program.)

Economic Impact Statement

The Board's Division of Research and Statistics has prepared an economic impact statement on the proposed revisions to Regulation Z. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, DC. 20551, at (202) 452-3245.

List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties, Rate limitations, Truth in lending.

For reasons set out in this notice, and pursuant to the Board's authority under section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board amends Part 226 as follows:

PART 226—TRUTH IN LENDING

1. The authority citation for Part 226 continues to read as follows:

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. Section 226.17 is amended by revising paragraph (b) to read as follows:

§ 226.17 General disclosure requirements.

(b) *Time of disclosures.* The creditor shall make disclosures before consummation of the transaction. In certain residential mortgage transactions, special timing requirements are set forth in § 226.19(a). In certain variable-rate transactions, special timing requirements for variable-rate disclosures are set forth in § 226.19(b) and § 226.20(c). In certain transactions involving mail or telephone orders or a series of sales, the timing of

disclosures may be delayed in accordance with paragraphs (g) and (h) of this section.

3. Section 226.18 is amended by revising footnote 43 and paragraph (f) to read as follows:

§ 226.18 Content of disclosures.

(f) *Variable rate.* (1) If the annual percentage rate may increase after consummation in a transaction not secured by the consumer's principal dwelling or in a transaction secured by the consumer's principal dwelling with a term of one year or less, the following disclosures:⁴³

(i) The circumstances under which the rate may increase.

(ii) Any limitations on the increase

(iii) The effect of an increase.

(iv) An example of the payment terms that would result from an increase.

(2) If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures:

(i) The fact that the transaction contains a variable-rate feature.

(ii) A statement that variable-rate disclosures have been provided earlier.

§ 226.22 [Amended]

4. Section 226.22 is amended by redesignating footnote 45a as 45d.

5. Section 226.19 is revised to read as follows:

§ 226.19 Certain residential mortgage and variable-rate transactions.

(a) *Residential mortgage transactions subject to RESPA.*—(1) *Time of disclosures.* In a residential mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) the creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier.

(2) *Redisclosure required.* If the annual percentage rate in the consummated transaction varies from the annual percentage rate disclosed under § 226.18(e) by more than $\frac{1}{8}$ of 1 percentage point in a regular transaction or more than $\frac{1}{4}$ of 1 percentage point in

an irregular transaction, as defined in § 226.22, the creditor shall disclose the changed terms no later than consummation or settlement.

(b) *Certain variable-rate transactions.*^{45a} If the annual percentage rate may increase after consummation in a transaction secured by the consumer's principal dwelling with a term greater than one year, the following disclosures must be provided at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier:^{45b}

(1) The booklet titled *Consumer Handbook on Adjustable Rate Mortgages* published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

(2) A loan program disclosure for each variable-rate program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:

(i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted, and a statement that the consumer should ask about the amount of the interest rate discount.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) An historical example, based on a \$10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. The example shall be based upon index values beginning in 1977 and be updated annually until a 15-year history is shown. Thereafter, the example shall

^{45a} Information provided in accordance with variable-rate regulations of other federal agencies may be substituted for the disclosures required by paragraph (b) of this section.

^{45b} Disclosures may be delivered or placed in the mail not later than three business days following receipt of a consumer's application when the application reaches the creditor by telephone, or through an intermediary agent or broker.

reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate payment limitations, that would have been affected by the index movement during the period.

(ix) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.

(x) The maximum interest rate and payment for a \$10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increases in rates and payments under the program; and the initial interest rate and payment for that loan.

(xi) The fact that the loan program contains a demand feature.

(xii) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xiii) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

6. Section 226.20 is amended by adding paragraph (c) to read as follows:

§ 226.20 Subsequent disclosure requirements.

(c) *Variable-rate adjustments.*^{45c} An adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable-rate transaction subject to § 226.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, and at least 25, but no more than 120, calendar days before a payment at a new level is due, the following disclosures, as applicable, must be delivered or placed in the mail:

(1) The current and prior interest rates.

(2) The index values upon which the current and prior interest rates are based.

(3) The extent to which the creditor has foregone any increase in the interest rate.

(4) The contractual effects of the adjustment, including the payment due after the adjustment is made, and a statement of the loan balance.

(5) The payment, if different from that referred to in paragraph (c)(4) of this

^{45c} Information provided in accordance with variable-rate subsequent disclosure regulations of other federal agencies may be substituted for the disclosure required by paragraph (c) of this section.

⁴³ Information provided in accordance with §§ 226.18(f)(2) and 226.19(b) may be substituted for the disclosures required by paragraph (f)(1) of this section.

section, that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.

Appendix H—[Amended]

7. Appendix H is amended by redesignating H-4 as H-4(A) and revising the heading in the table of Contents, by adding H-4(B), H-4(C), and H-4(D), and by revising H-14 and the heading in the table of contents to read as follows:

Appendix H—Closed-end Model Forms and Clauses

- * * * * *
- H-4(A) Variable-Rate Model Clauses (§ 226.18(f)(1))
- H-4(B) Variable-Rate Model Clauses (§ 226.18(f)(2))
- H-4(C) Variable-Rate Model Clauses (§ 226.19(b))
- H-4(D) Variable-Rate Model Clauses (§ 226.20(c))
- * * * * *
- H-14 Variable-Rate Mortgage Sample (§ 226.19(b))
- * * * * *
- H-4(A) Variable-Rate Model Clauses
- * * * * *

H-4(B) Variable-Rate Model Clauses

Your loan contains a variable-rate feature. Disclosures about the variable-rate feature have been provided to you earlier.

H-4(C) Variable-Rate Model Clauses

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate and Payment are Determined

- Your interest rate will be based on [an index plus a margin] [a formula].
- Your payment will be based on the interest rate, loan balance, and loan term.

—[The interest rate will be based on (identification of index) plus our margin. Ask for our current interest rate and margin.]

—[The interest rate will be based on (identification of formula). Ask us for our current interest rate.]

—[Information about the index [formula for rate adjustments] is published [can be found] _____.]

—[The initial interest rate is not based on the (index) (formula) used to make later adjustments. Ask us for the amount of current interest rate discounts.]

How Your Interest Rate Can Change

- Your interest rate can change (frequency).
- [Your interest rate cannot increase or decrease more than _____ percentage points at each adjustment.]
- Your interest rate cannot increase [or decrease] more than _____ percentage points over the term of the loan.

How Your Payment Can Change

- Your payment can change (frequency) based on changes in the interest rate.
- [Your payment cannot increase more than (amount or percentage) at each adjustment.]
- You will be notified in writing _____ days before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount, and loan balance.
- [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 your interest rates, payment amount, and loan balance.]

- For example, on a \$10,000 [term] loan with an initial interest rate of _____ (the rate shown in the interest rate column below for the year 19____), the maximum amount that the interest rate can rise under this program is _____ percentage points, to _____ %, and the monthly payment can rise from a first-year payment of \$_____ to a maximum of \$_____ in the _____ year.

Example

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1977 to 1991. This does not necessarily indicate how your index will change in the future.

The example is based on the following assumptions:

- Amount of loan..... \$10,000
- Term..... _____
- Change date _____
- Payment adjustment.... (frequency)
- Interest adjustment..... (frequency)
- [Margin] *..... _____
- Caps _____ [periodic interest rate cap] _____ lifetime interest rate cap _____ [payment cap]
- [Interest rate carryover]—
- [Negative amortization]
- [Interest rate discount] **
- Index (identification of index or formula)

* This is a margin we have used recently; your margin may be different.
 ** This is the amount of a discount we have provided recently; your loan may be discounted by a different amount.

Year	Index (%)	Margin (percentage points)	Interest rate (%)	Monthly payment (\$)	Remaining balance (\$)
1977					
1978					
1979					
1980					
1981					
1982					
1983					
1984					
1985					
1986					
1987					
1988					
1989					
1990					
1991					

To see what your payments would have been during that period, divide your mortgage amount by \$10,000; then multiply the monthly payments by that amount (For example, in 1991 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be: \$60,000 ÷ \$10,000 = 6; 6x_____ = \$_____ per month.)

H-4(D) Variable-Rate Model Clauses

Your new interest rate will be _____%.

which is based on an index value of _____%.

Your previous interest rate was _____%, which was based on an index value of _____%.

[The new interest rate does not reflect a change of _____ percentage points in the index value which was not added because of _____.]

[The new payment will be \$_____.]

[Your new loan balance is \$_____.]

[Your (new) (existing) payment will not be sufficient to cover the interest due and the difference will be added to the loan amount. The payment amount needed to pay your loan in full by the end of the term at the new interest rate is \$_____.]

[The following interest rate adjustments have been implemented this year without changing your payment: _____. These interest rates were based on the following index values: _____.]

* * * * *

H-14 Variable-Rate Mortgage Sample

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate and Payment are Determined

- Your interest rate will be based on an index rate plus a margin.
- Your payment will be based on the interest rate, loan balance, and loan term.
- The interest rate will be based on the weekly average yield on United States Treasury securities adjusted to a constant maturity of 1 year (your index), plus our margin. Ask us for our current interest rate and margin.
- Information about the index rate is published weekly in the *Wall Street Journal*.
- Your interest rate will equal the index rate plus our margin unless your interest rate "caps" limit the amount of change in the

interest rate.

How Your Interest Rate Can Change

- Your interest rate can change yearly.
- Your interest rate cannot increase or decrease more than 2 percentage points per year.
- Your interest rate cannot increase or decrease more than 5 percentage points over the term of the loan.

How Your Monthly Payment Can Change

- Your monthly payment can change yearly based on changes in the interest rate.
- For example, on a \$10,000, 30-year loan with an initial interest rate of 9.71% (the rate shown in the interest rate column below for the year 1987), the maximum amount that the interest rate can rise under this program is 5 percentage points, to 14.71%, and the monthly payment can rise from a first-year payment of \$85.62 to a maximum of \$123.31 in the fourth year.
- You will be notified in writing 25 days before the annual payment adjustment may be made. This notice will contain information

about your interest rates, payment amount, and loan balance.

Example

The example below shows how your payments would have changed under this ARM program based on actual changes in the index from 1977 to 1987. This does not necessarily indicate how your index will change in the future. The example is based on the following assumptions:

- Amount..... \$10,000
- Term..... 30 years.
- Payment adjustment..... 1 year.
- Interest adjustment..... 1 year.
- Margin 3 percentage points.
- Caps 2 percentage points annual interest rate.
- 5 percentage points lifetime interest rate.
- Index..... Weekly average yield on U.S. Treasury securities adjusted to a constant maturity of one year.

Year (as of 1st week ending in July)	Index (percent)	Margin (percentage points)	Interest rate (percent)	Monthly payment (dollars)	Remaining balance (dollars)
1977	5.72	3	8.72	78.46	9,927.64
1978	8.34	3	10.72**	92.89	9,874.67
1979	9.44	3	12.44	105.67	9,832.70
1980	8.51	3	11.51	98.79	9,776.04
1981	14.94	3	13.51**	113.51	9,731.98
1982	14.41	3	13.72***	115.07	9,683.39
1983	9.78	3	12.78	108.25	9,618.21
1984	12.17	3	13.72***	114.96	9,554.39
1985	7.66	3	11.72**	101.08	9,456.03
1986	6.36	3	9.72**	88.13	9,311.25
1987	6.71	3	9.71	88.07	9,151.55

*This is a margin we have used recently; your margin may be different.
 **This interest rate reflects a 2 percentage points annual interest rate cap.
 ***This interest rate reflects a 5 percentage points lifetime interest rate cap.

To see what your payments would have been during that period, divide your mortgage amount by \$10,000; then multiply the monthly payment by that amount. (For example, in 1987 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be: \$60,000 ÷ \$10,000 = 6; 6 × \$88.07 = \$528.42.)

By order of the Board of Governors of the Federal Reserve System, dated December 21, 1987.

William W. Wiles,
 Secretary of the Board.

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