FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10562**
August 13, 1992]

REGULATION Z — TRUTH IN LENDING

— Retention of Current Rules on Disclosure of Home Equity "Teaser" Rates and Payment Examples

— Final Rule on Home Equity Credit Lines for Lenders' Executive Officers

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

Our Circular No. 10508, dated January 13, 1992, contained a request by the Board of Governors of the Federal Reserve System for public comment on (a) whether to change its rules regarding the disclosure of any discounted initial rate and the payment examples for home equity lines of credit, and (b) whether to adopt a proposed rule regarding home equity credit lines for bank executive officers. Following consideration of the comments received, the Board of Governors has announced its decision to adopt the proposal on home equity credit lines for bank executive officers, but *not* to change the other rules.

Enclosed — for depository institutions and for others who maintain sets of the Board's regulations — is the text of the Board's official notice in this matter, as published in the *Federal Register* of August 6. Note that the effective date of the amendment is July 29, 1992, but that compliance is optional until October 1, 1993. Additional copies of the enclosure may be obtained at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling our Circulars Division (Tel. No. 212-720-5215 or 5216).

Questions may be directed to our Compliance Examinations Department (Tel. No. 212-720-5914).

E. Gerald Corrigan,
President.

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Thursday
August 6, 1992
Vol. 57, No. 152
Pp. 34676-34681

federal register

Amendment to Regulation Z
Docket No. R-0743

Home equity disclosure rules

Effective July 29, 1992

[Enc. Cir. No. 10562]

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FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–0743]

Truth in Lending; Home Equity Disclosure Rules

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending Regulation Z (Truth in Lending) to provide that depository institutions may retain the right to demand payment of a home equity line of credit extended to their own executive officers when required by federal law; and not changing the rules in Regulation Z that set forth the way creditors disclose discounted initial rates and certain payment examples for home equity lines. The rules in question relate to the Home Equity Loan Consumer Protection Act of 1988, which requires creditors to provide consumers with information for open-end credit plans secured by the consumer's dwelling, and places certain substantive limitations on the way in which those lines may be structured. With regard to the amendment, depository institutions that currently include such a provision in their executive officer's contracts will not be affected by this amendment. The approach adopted by the Board for disclosure of the discounted initial rate and certain payment examples has been examined by the U.S. Court of Appeals for the District of Columbia Circuit in recent litigation, and remanded to the Board for further consideration. After such reconsideration and analysis of the comment letters, the Board has decided to retain the existing rules.

EFFECTIVE DATE: July 29, 1992, but compliance optional until October 1, 1993.

FOR FURTHER INFORMATION CONTACT: Leonard Chanin, Senior Attorney, Division of Consumer and Community Affairs, at (202) 452–3667 or (202) 452–2412; for the hearing impaired only, contact Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452–3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) Background

The Home Equity Loan Consumer Protection Act was enacted in November 1988. On January 23, 1989, the Board published for comment a proposed rule to implement the statute (54 FR 3063) and on June 9, 1989, adopted a final rule (54 FR 24670). Compliance with the regulation was mandatory as of November 7, 1989.

On November 1, 1989, Consumers Union filed suit against the Board challenging certain aspects of the regulation.[1] The U.S. District Court for the District of Columbia issued a decision in favor of the Board on several aspects of the lawsuit in May 1990. *Consumers Union* v. *Federal Reserve Board* (736 F. Supp. 337). Consumers Union appealed that decision to the U.S. Court of Appeals for the District of Columbia Circuit. In July 1991, the Court of Appeals issued its opinion, deciding in favor of the Board on four of the issues presented on appeal, and remanding to the Board for further consideration two other issues. *Consumers Union* v. *Federal Reserve Board* (938 F.2d 266). The two issues deal with how creditors disclose a "teaser" or initial discounted rate, and the payment examples that must be provided in the preapplication disclosures. On December 30, 1991, the Board published a proposed rule seeking comment on whether the regulation should be amended (56 FR 67233). The Board also requested comment on a third issue, unrelated to the litigation, concerning the conflict between section 22 of the Federal Reserve Act, which regulates member bank loans to executive officers, and the substantive rules contained in the home equity statute.

The Board received 84 comments on the proposal. Based on a review of the comments and further analysis the Board is revising the regulation relating to credit extended to executive officers, but is leaving unchanged the provisions dealing with discounted rates and the payment examples.

Section 105(d) of the Truth in Lending Act provides that amendments to Regulation Z shall have an effective date of October 1, and must be promulgated at least six months before that date. Thus, in the present case the Board believes an October 1, 1993 effective date is required by the statute.

(2) Amendments to Regulation Z

(i) *Teaser rate provision.* The home equity statute provides that creditors must state any initial "teaser" or discounted rate in the preapplication disclosures. Specifically, the statute states [I]f an initial annual percentage rate is offered which is not based on an index—

(i) A statement of such rate and the period of time such initial rate will be in effect.

In the final regulations implementing the statute, the Board did not require that the exact amount of the discounted rate be stated. Instead, creditors were required to disclose the fact that the initial rate is discounted, state the period of time the rate will be in effect, and alert consumers to "ask about" the current discounted rate. In its briefs to the District Court and the Court of Appeals, the Board stated that the regulation diverged from the statutory language in reliance on the Board's "exception" authority.

The Truth in Lending Act grants the Board broad authority in implementing the statute. Section 105 of the act provides that implementing regulations may contain such classifications, differentiations, or other provisions, and *may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper* to effectuate the purposes of [the Truth in Lending Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith. (Emphasis added.)

The Court of Appeals noted that the issue of the Board's exception authority had been raised for the first time during the course of the litigation, and had not been passed upon in the first instance by the Board itself. The Court thus remanded this portion of the regulation to the Board, to allow it to identify the scope of its exception authority under the Truth in Lending Act, to decide how broad the "class of transactions" can be that is exempted, and to decide whether an exception was necessary or appropriate in the case of the teaser rate provision.

In December 1991, the Board solicited comment on the teaser rate disclosure and whether the regulation should be amended to require disclosure of the exact teaser rate in the early disclosures. The Board also requested comment on whether an exception is necessary or appropriate in the case of the discounted initial rate disclosure.

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[1] Among other issues, Consumer Union challenged the provision in the regulation permitting creditors to suspend advances of credit during any period the rate cap is reached. Consumers Union also challenged the part of the regulation permitting creditors to give disclosures about any "repayment" period—that is, when advances are no longer made and the consumer is paying off the amount borrowed—at the time the repayment period begins, rather than at the time of application. In March 1990 the Board published a proposed rule to amend the regulation relating to the rate cap and delayed timing issues. (55 FR 10465, March 21, 1990) In September 1990 the Board adopted a final rule (55 FR 38310, September 18, 1990) (correction notice at 55 FR 39538, September 27, 1990) on these two issues.

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The Board asked commenters to explain why stating the amount of time any discount is in effect (which is required by the regulation) does not raise the same problems as requiring the amount of the discount to be stated. The Board also solicited comment on whether the use of ranges to state the discount would be desirable

Of the sixty-seven commenters who discussed the discount issue, fifty-seven stated the Board should not change the rules dealing with initial discounted rates. A number of commenters stated that if creditors were required to state the exact amount of the discount in the early disclosures they might discontinue offering such a feature, due to the need to frequently update forms. Several commenters stated that reprinting disclosures every time a discount changed would impose significant costs, substantially increase the potential for errors in printing and distributing new forms, and raise additional liability risks.

Several commenters noted that in a rapidly changing rate environment creditors would have to update the preprinted forms on a frequent basis, imposing significant printing, administrative, and distribution costs that would be passed on to consumers. Commenters stated that these increased costs greatly outweighed any benefits consumers might derive from receiving the specific discount. Commenters also noted practical problems that would arise if the exact amount of the discount had to be stated. Commenters stated that it could take months to prepare the preprinted disclosures and, if the discount had to be preprinted, the institution might want to change the discount by the time the new forms were ready for distribution.

Ten commenters stated that the Board should change its rule, and require creditors to state the exact amount of the discount in the preapplication disclosures. In general, these commenters felt consumers needed to know the precise amount of the discount at this early stage to be able to accurately compare accounts. These commenters stated that without this figure consumers could not determine which of two (or more) plans offers the better deal.

Based on a review of the comment letters and further analysis the Board is retaining the current rule in the regulation dealing with initial discounted rates. The Board believes the current approach provides the information that is most useful to consumers about discounted rates (that is, the fact that the initial rate is discounted, the temporary nature of the discount, and a reminder to ask for current rates). The Board believes this approach fulfills Congress' intent to ensure that applicants know the most important features of home equity lines, and is an appropriate case for making an adjustment to the statutory provision. The Board believes that requiring creditors to state the exact amount of any initial discounted rate in the preapplication disclosures could cause consumers to suffer adverse consequences.

The Board believes if creditors were required to state the exact amount of the discount, many creditors might eliminate this feature from their plans, thus reducing choices (particularly lower-cost alternatives) available to consumers. For those that continued to offer discounted plans, the Board believes the costs incurred in complying (which would ultimately be paid by the consumer) would vastly exceed the benefits consumers derive from the disclosure.

The Board notes that the regulation requires creditors to inform consumers that the rate is temporary and the length of time it is in effect with the early preprinted disclosures. In addition, creditors must disclose to consumers the exact amount of any discounted initial rate with other information given prior to consummation, under § 226.6 of the regulation. Finally, lenders have an incentive to let the consumer know the amount of the discount since the purpose of a discounted rate program is to encourage consumers to open a home equity line.

As mentioned earlier, the Board asked commenters to explain why stating the amount of the discount raised a problem when creditors must state the time a discount is in effect. Several commenters stated that providing the time a discount is in effect was not a problem since programs are typically offered for a standard period of time, such as six months or one year. Commenters distinguished this requirement from stating the exact discount since the latter figure could and often did change frequently.

The Board also solicited comment on whether consumers would benefit by having the discount stated as a range. Commenters stated that providing a range for a discount might be more workable for creditors than stating the exact amount of the discount, but would be of little benefit to the consumer, since the consumer would have to contact the creditor anyway to find out the exact amount of the discount. The Board believes this approach would provide limited value to consumers, and is not adopting it.

(ii) *Payment examples issue.* The statute requires three types of payment examples to be provided for home equity plans: (1) An example showing the minimum periodic payment and amount of time needed to repay the line, based on a $10,000 balance and a recent annual percentage rate (the "minimum payment" example); (2) a statement of the minimum periodic payment based on a $10,000 balance when the maximum annual percentage rate is in effect (the "worst case" example); and (3) an historical table, based on a $10,000 extension of credit, showing how annual percentage rates and payments would have been affected by index value changes over the most recent 15 year period (the "historical example"). The statute provides that the worst case example and the historical example must be stated for "each repayment option" under the plan.

In implementing the statute, the Board chose to allow creditors to provide representative examples of the various payment options offered, rather than requiring separate examples for each payment option. (See comments 5b(d)(5)(iii)–(2), 5b(d)(12)(x)–1, and 5b(d)(12)(xi)–7 of the Official Staff Commentary.) Under this rule, no matter how many payment options were offered, creditors would never have to disclose more than three minimum payment examples, three worst case examples, and three historical examples. In its briefs to the District Court and Court of Appeals the Board noted that requiring a worst case example and historical example for every payment option offered would result in "information overload" and would likely lead lenders to reduce the options offered to consumers. The briefs argued that the Board adopted its rule pursuant to its exception authority. Again, the Court of Appeals remanded this issue to the Board because the issue of the Board's exception authority under the Truth in Lending Act had not been developed in the rulemaking record, but was raised only in litigation.

In its December 1991 proposal, the Board solicited comment on whether the payment example rule should be revised to require an example for each payment option. Sixty-four commenters addressed this issue. Sixty of them stated that Board should *not* amend the regulation to require payment examples for all payment options offered. Four commenters stated that the Board should require such examples and argued that consumers needed such

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information to make informed decisions about home equity plans.

Based on a review of comment letters and further analysis, the Board is retaining the payment example rules as written. The Board believes the approach adopted provides consumers with the information needed to compare accounts. The use of representative examples, when coupled with a complete description of the minimum payment requirements and other disclosures, provides consumers with the most useful information.

The Board believes if creditors were required to provide a 15-year historical example and "worst case" example for every payment option offered, many creditors would eliminate choices of payment plans provided to consumers. A number of commenters stated that they would reduce options available if they had to provide a 15-year historical example, minimum payment example and worst case example for every option, due to the expense, risk of error, and potential liability involved in providing such information. For example, one commenter stated it permits consumers to make payments of interest and a fixed amount of principal—with the consumer deciding how much principal to pay. If this creditor had to provide three payment examples for each option given to the consumer, this could require hundreds of examples.

For those creditors that choose to provide numerous payment choices, the Board believes providing three examples for each option would produce an overwhelming amount of information. Several commenters pointed out this fact. The Board believes in such cases consumers may be overwhelmed with the sheer amount of information, and not read the disclosures, or not read the most important pieces of information, such as the index used to make rate adjustments. Such a result would be antithetical to the Congress' purpose in enacting the law. Therefore, the Board believes this is an appropriate case for the exercise of its authority to make an exception to the statutory requirements.

The Board recognizes that examples, by their nature, cannot capture precisely what a particular consumer's payments under a particular plan will be. The examples are based on an assumed $10,000 extension of credit. Obviously, if a consumer's line of credit is greater than that, the payment examples will not reflect his or her actual payments, regardless of how many examples are provided. Examples are illustrative, and providing a huge number of examples will not necessarily assist consumers in choosing a plan.

The Board also notes that the regulation requires creditors to narratively describe every payment option given to consumers, and this ensures that consumers have a full description of the choices offered. This information describing the payment provisions is given a second time to consumers before they open the plan. (See § 226.6(e)(2).)

(iii) *Use of Exception Authority.* As mentioned earlier, section 105 of the Truth in Lending Act grants the Board broad authority in implementing the statute. The Supreme Court has recognized this broad delegation of authority to the Board. The Court has stated: "[b]ecause of their complexity and variety * * * credit transactions defy exhaustive regulation by a single statute. Congress therefore delegated expansive authority to the Federal Reserve Board to elaborate and expand the legal framework governing commerce in credit."[2]

The Board is using its "exception authority" to address three circumstances: disclosure of information about an initial discounted rate, disclosure of a historical example for payment options, and disclosure of the "worst case" example for payment options. The Board believes these exceptions are necessary and proper to accomplish the purposes of the act and facilitate compliance and fall within the limits on its authority to make exceptions.

The Board believes that, while its authority to make exceptions is broad, the authority does have limits. The Board does not take the view that it is permitted to radically undermine the Congress' purpose in enacting key elements of a statutory scheme, even if the Board strongly disagreed with the wisdom of the Congress' decision. The Board does believe it is authorized to fashion rules that are faithful to the essential purposes of the law and that take account of the needs and capacity of both consumers and creditors.

The home equity statute and implementing regulation require creditors to provide a significant amount of information to consumers about the home equity line offered by the creditor. Depending on the type of features of a specific creditor's plan (such as multiple payment options and variable rate provisions) over 50 facts may be required to be disclosed to consumers (in addition to a 15-year historical example which shows index values, annual percentage rates and payments).

The Board believes that use of its exception authority is warranted in the case of the discount issue for several reasons. First, if the exact discount were required to be disclosed, the Board believes many creditors would stop offering discounted plans. Due to the critical compliance problems—the inability to provide updated rate information with the preprinted disclosures to respond to market and competitive conditions—a result of such a requirement would likely be fewer choices to consumers and, in particular, the loss to consumers of lower rate alternatives. The Board believes some creditors would eliminate this option from their plans due to the increased risk of error and liability. Second, consumers might be misled if they rely on a discounted rate that turned out to be effective for only a short time after the disclosures were provided.[3] If an exact figure were given, a consumer would receive information that is accurate when provided, but the discount could change if the consumer did not apply for the plan soon after receiving the disclosures.[4]

Third, the Board believes the key information the consumer needs is not the initial rate, but the fact that it is only temporary. Placing too much emphasis on the initial rate could diminish the fact that such a rate cannot be relied on for the long term. Finally, costs of complying with such a rule would be significant. Forms might have to be frequently changed at great expense to creditors. For those that continued to offer such plans the Board believes the costs of complying with such rules would greatly exceed any consumer

[2] *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 559–60 (1980). The Court also noted that: "[t]he concept of 'meaningful disclosure' that animates TILA * * * cannot be applied in the abstract. Meaningful disclosure does not mean more disclosure. Rather, it describes a balance between 'competing consideration of complete disclosure * * * and the need to avoid * * * [information overload].' "*Id.* at 568 (emphasis in original).

[3] While disclosures must be accurate when provided, creditors are not required to guarantee any terms for the plan, as is reflected by the disclosure in § 226.5b(d)(2)(i) concerning terms subject to change.

[4] In this case, consumers would likely have to call the institution to ensure that the rate is still available. Alternatively, an institution could be required to guarantee the rate and include a date identifying how long it is available. Since discounted rates are a function of competitive and other factors, however, it might be very difficult for an institution to accurately predict how long a rate will be made available to the public. This could lead institutions to commit to only a short time period, in order to retain the option of offering a less favorable discount in light of competitive or market conditions. Consumers would derive little benefit from having a discounted rate disclosed if they ultimately had to call institutions to verify the current rate anyway.

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benefits.

With regard to the rule dealing with payment examples, the Board is making an adjustment for two categories of payment options.[5] For that class of transactions that permit payment of a fixed percentage or fixed fraction of the outstanding balance, the Board is not requiring a 15-year historical example and worst case example for every possible payment choice within that category, but just one representative example. Similarly, for that class of transactions that permit payment of, for example, a specified dollar amount plus accrued finance charges, the Board is not requiring a 15-year historical example and worst case example for every possible payment choice within that category.

The Board believes use of its exception authority is warranted in the case of the 15-year historical example and worst case example for several reasons. First, the Board believes that if creditors were required to provide these examples for every payment option offered, the result would be that many lenders would reduce the payment choices provided to consumers. Due to the complexity and costs in complying, and the increased risk of error and liability, many creditors would eliminate choices currently offered to consumers. Second, the Board believes providing a multitude of examples would likely obscure important information, such as the index used for the plan, and for those creditors that choose to continue offering multiple payment options, consumers might not read the voluminous disclosures or might miss the most important terms of the plan. The Board believes providing multiple payment examples, beyond those already required by the regulation, would overload the consumer with information.[6] Third, the Board believes the costs of complying with such a rule would be tremendous and greatly exceed any consumer benefits. This is especially true since the examples are not intended to demonstrate the exact payment that will be made by the consumer under the plan, but rather to provide a general sense of the impact of rate changes on the minimum payments.

(iv) *Home equity lines and executive offices.* The home equity statute provides that a creditor may not terminate and demand payment of a line of credit except in three specified circumstances: Fraud, failure of the consumer to make payments, and action by the consumer that impairs the security for the plan. The regulation implementing this provision provides that a creditor may not include in its contract a provision permitting it to terminate and accelerate the balance due except for these situations. (See § 226.5b(f)(2) and the accompanying Official Staff Commentary.)

Section 22(g) of the Federal Reserve Act establishes rules relating to loans to executive officers by member banks. The law provides that a member bank may extend credit to its own executive officers provided "it is on condition that it shall become due and payable on demand of the bank" any time the person is indebted to any other bank in an amount in excess of that prescribed by the appropriate federal banking agency. Shortly after the Board considered the current proposal (but prior to publication in the **Federal Register**), the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 was enacted. Section 306 of FDICIA provides that the provisions in section 22(g) of the Federal Reserve Act apply to savings associations and nonmember insured banks. Thus, member banks, savings associations and nonmember insured banks that extend credit to their executive officers must retain the ability to call the loan in the circumstances set out in section 22(g) of the Federal Reserve Act.[7]

Regulation O (12 CFR part 215), which implements the Federal Reserve Act, provides that a member bank making loans to any of its executive officers shall retain the right to call the loan any time the officer is indebted to any other bank in excess of 2.5% of the member bank's capital and unimpaired surplus or $25,000 (whichever is higher), but in all cases any amount over $100,000.[8] The statute and implementing regulation are intended to limit the risks of insider lending and to implement important safety and soundness policies.

If the home equity statute and section 22(g) of the Federal Reserve Act (and section 306 of FDICIA) were given full effect, they could be read as effectively prohibiting home equity lines by member banks, savings associations and insured nonmember banks to their executive officers. The home equity statute prohibits calling a loan except in the circumstances specifically set forth in the statute. Section 22(g) of the Federal Reserve Act (and section 306 of FDICIA) prohibits member banks, savings associations and insured nonmember banks from making loans to executive officers unless the institutions retain the ability to demand payment of the loan in certain circumstances. The home equity statute does not recognize the condition as a permissible reason to call a line of credit. Thus, if both laws were given full effect, member banks and savings associations could not offer home equity lines to their executive officers.

The Board requested comment on whether the home equity regulation should be amended to permit banks to include a call feature in their contracts for home equity lines for executive officers, and exercise that feature as provided in section 22 of the Federal Reserve Act and implementing Regulation O. Based on a review of the comment letters and further analysis, the Board is modifying the regulation to permit depository institutions to include a demand provision in home equity lines to executive officers, as provided in the Federal Reserve Act and FDICIA. The Board believes that the Congress, in enacting the home equity statute, did not intend to override the provisions in the Federal Reserve Act dealing with demand provisions in loans made to executive officers. This idea is buttressed by the fact that the Congress recently enacted FDICIA which extended the important safety and soundness policies contained in section 22(g) of the Federal Reserve Act to savings associations and insured nonmember banks. There is no suggestion in the legislative history of the home equity statute that the Congress intended to repeal section 22(g) of the Federal Reserve Act and prohibit banks from offering home equity lines to their executive officers. Indeed, enactment of section 306 of the FDICIA supports the idea that the Congress intended for this provision to continue in full force in spite of enactment of the home equity statute.

[5] The Board is not exempting that class of payment plans that permit payment of only accrued finance charges ("interest-only" transactions).

[6] It is worth noting that the information required by Regulation Z is in addition to information a creditor includes in its contract with the consumer, the deed accompanying the transaction, any state law-mandated disclosures, and other federal disclosures.

[7] On March 4, 1992, the Federal Deposit Insurance Corporation amended its rules to provide that, with certain exceptions, the rules in Regulation O apply to insured nonmember banks (57 FR 7647). On April 9, 1992, the Office of Thrift Supervision proposed a rule to implement the provision in FDICIA dealing with loans to executive officers of savings associations (57 FR 12232).

[8] Subsequent to publication of the proposal to amend Regulation Z, the Board proposed to amend Regulation O to implement amendments to FDICIA. On May 28, 1992, the Board published a final rule amending Regulation O. (57 FR 22417.) Among other changes, a technical revision was made to § 215.5(d)(4) to clarify that member banks must "in writing" provide for the ability to call a loan to an executive officer.

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A number of persons commented on whether the home equity provisions should override the policies contained in section 22(g) of the Federal Reserve Act. All commenters but one believed the policies in the Federal Reserve Act, dealing with safety and soundness, should take precedence over the home equity protections. Those commenters stated that they favored a narrow exception to the home equity rules for executive officers, and that an exception was necessary and appropriate to effectuate the policies of the Federal Reserve Act. The one commenter opposing the Board's action stated that this was an inappropriate action to be taken by the Board, and that the Congress itself should make this determination.

The Board is modifying the home equity rules to provide that member banks, savings institutions and insured nonmember banks can include a provisions in their credit contracts with executive officers granting the right to call a home equity line of credit to the extent required by section 22 of the Federal Reserve Act and section 306 of FDICIA. The final regulation permits, as did the proposal, all depository institutions, and not solely member banks, to use the exception regarding a demand feature. While current federal law (in the Federal Reserve Act and FDICIA) is limited to member banks, savings associations and insured nonmember banks, the Board has used the broader category of depository institutions for ease of reference, and in the event any other federal law or regulation is enacted that requires other institutions to retain the ability to call credit extended to executive officers. The home equity rules will ensure that the same rules apply equally to all depository institutions.

The creation of an exception to the home equity rules accommodates the express terms of section 22(g) of the Federal Reserve Act and section 306 of FDICIA. This approach gives effect to the policies contained in the Federal Reserve Act, and at the same time creates a very limited exception to the home equity statute. The Board also believes its exception authority under the Truth in Lending Act is consistent with this modification of the home equity rules to permit depository institutions to include a demand feature in lines of credit made to executive officers. Without this modification, the Board believes some institutions may not make lines available to their executive officers. By clarifying that institutions may make such lines available to their executive officers, the Board believes it is ensuring some consumers access to such credit, which may not have been offered previously to them.

The regulation reflects the fact that institutions that wish to offer home equity lines to their executive officers must include such a provision in their home equity agreements with those officers. The Board has added specific language to the regulation to expressly require this condition in the credit contract.[9] Of course, an institution may only have a demand feature as broad as that required by the Federal Reserve Act, FDICIA and their implementing regulations in its home equity lines with executive officers. A broader demand provision is prohibited under Regulation Z.

The Board solicited comment on whether a specific disclosure should be provided to executive officers if the home equity rules were interpreted to permit inclusion of this demand provision. The Board requested comment on whether a contractual provision setting forth this provision would provide adequate information if the provision is not also specifically disclosed in the preapplication disclosures. After reviewing the comment letters and for the reasons set forth below, the Board is requiring only that this provision be in the home equity contract, rather than requiring it to be separately disclosed with the preapplication disclosures.

The vast majority of commenters opposed requiring a separate disclosure referencing this call provision. Commenters stated that including this provision in the contract with the executive officer was sufficient to notify the person of the right of the institution. Commenters also noted that executive officers are already likely to be aware of the limitations contained in Regulation O. The Board believes inclusion of this provision in the contract will notify executive officers of this condition.

Commenters stated that including such a notice on disclosure forms given to all consumers would be very confusing to consumers, since the provision would be inapplicable to the vast majority of consumers. Many commenters also stated that having a separate disclosure form solely for executive officers, or requiring the use of an insert or attachment highlighting this feature would be unnecessary, and would increase the likelihood of error (in distributing the wrong form).

The Board also will be permissive on whether this condition is separately disclosed under § 226.6(e)(1) of the regulation. (Section 226.6(e) generally requires creditors to provide again to consumers many of the preapplication disclosures at the time the account is opened.) The Board believes that the inclusion of this feature in the home equity agreement provides sufficient notice to executive officers of this feature. In addition, since these later disclosures are generally combined with contractual provisions, the Board believes that requiring a specific disclosure of such a feature, in most cases, would not provide the borrower with any additional information. Furthermore, requiring a disclosure under § 226.6(e), but not requiring a disclosure under § 226.5b(d)(4), would likely create a more complicated rule and could increase compliance problems, with little, if any, additional benefit provided to the executive officer.

Commenters requested that the Board address how this call feature relates to the closed-end disclosure rules. Specifically, commenters asked whether a demand disclosure is required under §§ 226.18(i) and 226.19(b)(2)(xi), if a closed-end loan to an executive officer contains a call provision. The Board believes that when an institution has a narrow demand feature in its closed-end credit agreement to the extend required by section 22(g) of the Federal Reserve Act and 306 of FDICIA, institutions should be permitted to provide or not to provide demand disclosures. For consistency and to minimize compliance burdens, the Board believes it is important to treat these features similarly under the disclosure rules for open-end and closed-end credit. Of course, if an institution has a demand feature in its closed-end agreement that is broader than that required by the Federal Reserve Act and FDICIA, such a feature would have to be disclosed under § 226.18(i) and, in the case of variable-rate mortgages, § 226.19(b).

The Board expects to propose technical conforming amendments to the official staff commentary in the fall, under the normal schedule for commentary revisions, reflecting these positions concerning §§ 226.5b(d)(4), 226.6(e)(1), 226.18(i), and 226.19(b)(2)(xi).

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[9] While Regulation O requires that this provision must be "in writing," in order to implement provisions in the Home Equity Loan Consumer Protection Act that prohibit "unilateral" changes to a home equity plan, the Board believes that institutions must include such a provision in the home equity agreement entered into by the executive officer.

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(3) Economic Impact Statement

The change to the regulation is likely to have an insignificant impact on creditors' costs, including those of small entities.

(4) Text of Revisions

Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board is amending Regulation Z, 12 CFR part 226, by modifying §§ 226.5b(f)(2)(ii) and 226.5b(f)(2)(iii) and by adding § 226.5b(f)(2)(iv).

List of Subjects in 12 CFR Part 226

Advertising, Federal Reserve System, Reporting and recordkeeping requirements, Truth in lending.

For the reasons set out in the preamble, 12 CFR part 226 is amended as follows:

PART 226—[AMENDED]

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

Authority: Truth in Lending Act, 15 U.S.C. 1604 and 1637(c)(5); sec. 1204(c), Competitive Equality Banking Act, 12 U.S.C. 3806.

Subpart B—Open-End Credit

2. 12 CFR 226.5b is amended by revising paragraphs (f)(2)(ii) and (f)(2)(iii), and by adding paragraph (f)(2)(iv) to read as follows:

§ 226.5b Requirements for home equity plans.

* * * * *

(f) * * *

(2) * * *

(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance;

(iii) Any action or inaction by the consumer adversely affects the creditor's security for the plan, or any right of the creditor in such security; or

(iv) Federal law dealing with credit extended by a depository institution to its executive officers specifically requires that as a condition of the plan the credit shall become due and payable on demand, provided that the creditor includes such a provision in the initial agreement.

* * * * *

By order of the Board of Governors of the Federal Reserve System, July 30, 1992.

William W. Wiles,
Secretary of the Board.

[FR Doc. 92-18468 Filed 8-5-92; 8:45 am]
BILLING CODE 6210-01-M

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