

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 10772]
February 13, 1995]

TRUTH IN SAVINGS

**— Revised Proposed Amendments to Regulation DD
— Interim Rule on Calculating APY on Time Accounts**

Comments on Proposal Due March 20, 1995

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

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

The Federal Reserve Board has decided to reconsider an earlier decision to amend its Truth in Savings regulation and to seek further comment on possible changes in the formula for calculating annual percentage yields on deposit accounts.

On January 4, the Board approved an amendment to its Regulation DD requiring that the annual percentage yield (APY) reflect the frequency of interest payments. Seven banking and two consumer organizations petitioned the Board to reconsider its decision and seek further comment.

In view of these requests and the complexity of the issues, the Board decided unanimously to grant the petitions. Under the action taken today, the Board:

- Granted the petitions for reconsideration, thus nullifying the January 4 decision requiring that the APY reflect the frequency of interest payments. Except as indicated below, this leaves the original regulation in place pending final action.
- Seeks further comment on the January 4 amendment, as well as the interest rate of return formula that was previously proposed but withdrawn last year.
- Adopted as an interim rule a narrowly drawn amendment to Regulation DD to permit institutions to disclose an APY equal to the contract interest rate for time accounts with maturities greater than one year that do not compound but require interest distributions at least annually.

Printed on the following pages is the text of the Board's proposal, followed by the text of the interim rule, as published in the *Federal Register*. The interim rule became effective on January 18. Comments on the proposed amendments should be submitted by March 20, 1995, and may be sent to the Board, as specified in the notice, or to our Compliance Examinations Department.

WILLIAM J. McDONOUGH,
President.

Proposed Rules

Federal Register

Vol. 60, No. 17

Thursday, January 26, 1995

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Part 230

[Regulation DD; Docket No. R-0869]

Truth in Savings

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is publishing for public comment proposed amendments to Regulation DD (Truth in Savings) that would amend the current formula to factor the frequency of interest payments into the calculation of the annual percentage yield (APY), along with the interest rate paid and frequency of compounding. The proposal is intended to correct an anomaly under the current formula, to avoid misranking accounts that pay out interest (without compounding). The Board is also soliciting comment on an alternative approach that would use an internal rate of return formula to calculate the APY. The Board believes an APY that reflects the timing of interest payments would enhance comparison shopping among savings products, and the proposals provide two approaches for reaching that result. Institutions would not be required to change the nature of their accounts under either approach, nor would they be required to compound interest at the same frequency as they credit interest by check or transfer when consumers may receive interest payments or leave interest in the account. Separately published elsewhere in this issue of the *Federal Register*, the Board is adopting an interim rule for certain noncompounding multi-year certificates of deposit that would permit institutions to disclose an APY equal to the contract interest rate while the public is commenting on the proposal and the Board is evaluating those comments.

DATES: Comments must be received on or before March 20, 1995.

ADDRESSES: Comments should refer to Docket No. R-0869, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street NW. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding availability of information.

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

SUPPLEMENTARY INFORMATION:

I. Background

The Truth in Savings Act (12 U.S.C. 4301 *et seq.*) requires depository institutions to provide disclosures to consumers about their deposit accounts, including an annual percentage yield (APY) on interest-bearing accounts calculated under a method prescribed by the Board. The APY is the primary uniform measurement for comparison shopping among deposit accounts. The law also contains rules about advertising, including the advertising of accounts at depository institutions offered to consumers by deposit brokers. The Board's Regulation DD (12 CFR part 230), which was adopted in September 1992 and became effective in June 1993, implements the act. (See 57 FR 43337, September 21, 1992, and 58 FR 15077, March 19, 1993.)

In adopting Regulation DD, the Board considered various approaches for calculating the APY, reflecting several competing interests and concerns. The current APY formula is simple and easy to use. It assumes that interest remains on deposit until maturity. This assumption produces an APY that has

the effect of reflecting the time value of money in cases when interest payments are made at the same frequency as interest is compounded for funds that remain on deposit until maturity. It does not always reflect the time value of money when there are interest payments prior to maturity.

II. Proposals Affecting the APY

As deposit brokers began complying with the APY formula and the regulation's advertising rules, the Securities Industry Association (SIA) asked the Board to reconsider how the APY is calculated. The SIA objected to the fact that, for multi-year certificates of deposit (CDs) that are noncompounding but pay interest at least annually, the formula produces an APY that is less than the account interest rate. Disclosure of an APY lower than the interest rate did not, according to the SIA, always allow for meaningful comparison shopping among deposit accounts. The SIA argued that the APY should at least equal the account interest rate.

In December 1993, the Board published a proposal that factored into the APY calculation the specific time intervals for interest paid on the account—that is, the time value of money—and provided an additional internal rate of return formula (58 FR 64190, December 6, 1993). The proposal also offered an alternative limited change in the APY disclosure for multi-year noncompounding CDs; under this approach, institutions would disclose an APY equal to the account interest rate if the CDs paid interest at least annually. The proposal was withdrawn in May, based on considerations of cost and burden at that time (59 FR 24376, May 11, 1994).

Simultaneously with the withdrawal of the December proposal, in May 1994 the Board published a related proposal that addressed depository institutions' compounding and crediting practices. Under the May proposal, institutions offering accounts that paid interest by check (or transfer) or by posting interest to the account would have to post interest at least as often as they pay out interest by check. That is, for accountholders leaving the interest in the account, interest would compound on at least as frequent a basis as the interest payments made to others. For example, if an institution offered a two-

year CD, and would permit consumers to receive accrued interest in monthly interest checks or to permit interest to remain in the account, the institution would have to credit and compound interest at least monthly.

The May proposal also would treat the distribution of interest from the account as the equivalent of compounding. For example, if an institution sent consumers the interest payments (and did not permit consumers to leave interest in the account), the institution would treat the interest payment frequency as compounding in the APY calculation. Thus, for a two-year CD that requires consumers to receive an annual interest payment, the APY would reflect annual compounding.

In July, the Board extended the time to provide comments on the proposed amendments. At the same time, the Board reopened comment on the limited alternative that had been published in December 1993 and withdrawn in May 1994; that alternative equates the APY and the account interest rate for noncompounding multi-year CDs that pay interest at least annually (59 FR 35271, July 11, 1994).

The Board received about 550 comments on the proposal (including comments on the alternative approach involving noncompounding multi-year CDs). About 95% of the comments were from financial institutions. The remaining 5% were from trade associations, data processors, and others. Approximately 450 comments addressed the proposed amendments affecting the APY formula; about 2% were in favor of the proposal, 98% were opposed, most of them because of the proposed matching of compounding and crediting frequencies. About 100 commenters addressed the alternative that would equate the APY to the interest rate; nearly 60% supported this approach.

On January 4, 1995, the Board adopted one part of the May 1994 proposal. The Board voted to amend the definition of the APY to reflect the frequency of interest payments; it declined to adopt another portion of the May proposal that would have affected institutions' crediting and compounding policies. The Board also declined to adopt the alternative proposal published in July 1994 that equated the APY and the interest rate for multi-year, noncompounding certificates of deposit that make interest payments at least annually. The effective date for the Board's APY rule adopted on January 4 would permit institutions to comply immediately; compliance became mandatory in September 1995.

Subsequently, the Board received petitions for reconsideration from both the major banking industry trade associations and consumer advocates. The trade associations and consumer groups stated several reasons in their letters asking for reconsideration and protesting the Board's action, including that the public should have been given an opportunity to comment directly on the amendment requiring the APY to reflect the frequency of interest payments—as modified from the May proposal—before its adoption by the Board.

On January 17, in order to address the concerns raised by the petitioners regarding public comment and to ensure a full airing of all aspects of proposed amendments to the APY calculation and definition, the Board granted the petitions and decided to publish for further public comment the proposal adopted on January 4 as well as an alternative internal rate of return formula affecting the calculation of the APY. At the same time, the Board adopted an interim rule that would permit institutions to equate the APY and the contract interest rate for noncompounding multi-year accounts that mandate interest payouts at least annually. (See Docket R-0836 elsewhere in today's *Federal Register*.)

III. Factoring the Time Value of Interest Payments Into the APY

Based on the comments received and upon further analysis, the Board is proposing to reflect the frequency of interest payments in the calculation of the APY, along with the interest rate paid and frequency of compounding. This proposed amendment would factor the time value of interest payments into the APY calculation using the current formula. It is a modified version of the May 1994 proposal. The proposal would apply to all account types.

This approach could be more helpful to consumers who comparison shop among deposit accounts and other investment products. For example, it could allow consumers more easily to compare accounts that require the distribution of interest payments with those that permit consumers to receive payments, such as when two institutions offer a two-year CD with a 6.00% interest rate and semi-annual payouts (mandatory with Institution A and optional by Institution B). If the APY reflected the timing of interest payments, both institutions would disclose a 6.09% APY to a consumer who receives payouts. Currently, the APYs disclosed may differ. Both institutions would disclose a 5.83% APY if interest left in the account does

not compound. Institution B, however, would disclose a 6.00% APY if interest left in the account compounds annually even though payments are made on the same basis as Institution A.

The Board is also soliciting comment on an alternative approach to factor the time value of money into the APY. It would require an additional formula to calculate the APY—the internal rate of return formula proposed in December 1993. Both proposals would reflect the time value of money, and, as the table below illustrates, the APY would reflect this value. The example illustrates the effect of receiving interest payments during the term for a noncompounding 2-year CD at a 6% interest rate.

Frequency of interest pay outs	APY under current rule (percent)	APY under proposed rules (percent)
Annual	5.83	6.00
Semi-annual	5.83	6.09
Quarterly	5.83	6.14
Monthly	5.83	6.17

Under this proposal, the amendments to Regulation DD adopted in the interim rule would be replaced, if the final rule adopts either of the proposed amendments using the current APY formula or the alternative APY calculation method using an internal rate of return formula.

May 1994 Proposal Affecting Compounding and Crediting Frequencies

One part of the May 1994 proposal would have required institutions to match crediting and compounding policies for accounts where consumers may receive interest payments or leave interest in the account. It also would have clarified when interest becomes principal and defined "crediting" and "compounding." The Board recognizes that the commenters raised valid concerns about this approach, and because of these concerns the Board is not considering those aspects of the May proposal in this proposed rule. Neither of the proposals under consideration would require institutions to compound interest at the same frequency as the institution credits interest by check or transfer for accounts where consumers may receive interest payments or leave interest in the account.

IV. Proposed Regulatory Revisions: Section-by-Section Analysis

Section 230.2—Definitions

2(c) Annual Percentage Yield

The act and regulation define the APY as the total amount of interest that

would be received based on the interest rate and the frequency of compounding for a 365-day year. The proposed amendment would broaden the definition to treat the distribution of interest from the account (through interest checks or transfer) as the equivalent of compounding. For instance, if an institution pays a 6.00% interest rate on an account, the same APY of 6.17% would result whether an institution compounds monthly or sends out monthly interest payments. The Board is concerned that the current formula misranks certain alternatives, and is seeking comment about whether the proposed changes would better accomplish the Congressional purpose.

The Board solicits comment on whether an exception should be made to the definition of APY to factor in the timing of interest distributions, and whether the purpose of the regulation—enabling consumers to make informed decisions about deposit accounts—is better met if the APY captures the time value of interest received as an interest payment during the term of the account, as well as by compounding.

Section 230.3—General Disclosure Requirements

3(e) Oral Response to Inquiries

The regulation requires institutions to state the annual percentage yield in an oral response to a consumer's inquiry about interest rates payable on its accounts. The proposal would add a brief disclosure about the APY, to assist consumers in understanding the earnings and APY for the account. When responding orally to a consumer's inquiry about interest rates, institutions would be required to state the APY and the corresponding frequency of compounding or interest distribution. For example, if an institution offers a two-year CD with a 6.00% interest rate and compounds interest semi-annually but permits monthly interest checks, the oral response to a consumer who inquires about interest rates for a two-year CD could be "6.17%, based on monthly checks" (or "6.09%, based on semi-annual compounding," or both).

Section 230.4—Account Disclosures

4(b) Content of Account Disclosures

4(b)(1) Rate Information

4(b)(1)(iii) Effect of Interest Payments

The act and regulation require institutions to disclose the APY and interest rate before an account is opened or upon request. A brief disclosure for APYs is proposed, to assist consumer understanding of an APY based on the frequency of interest payments in

addition to compounding. The disclosure requirement would apply to all account types (money market deposit accounts as well as CDs, for example). If the annual percentage yield is based (in whole or in part) on interest distributions, institutions would be required to disclose the interest distribution frequency and include a statement that the annual percentage yield assumes interest payments are immediately reinvested at the account's interest rate. If an institution offers a two-year CD with a 6.00% interest rate and compounds interest semi-annually but permits monthly interest checks, for example, consumers choosing to receive interest by check each month would receive a disclosure such as "You will earn a 6.17% APY, based on monthly checks. The annual percentage yield assumes you immediately reinvest your interest payment at the account interest rate." (Consumers choosing semi-annual compounding would receive disclosures about the compounding frequency under § 230.4(b)(2).) The new disclosure would also apply to accounts where interest compounds prior to the distribution of interest. For example, if an institution offers an account with a 6.00% interest rate, monthly compounding, and quarterly interest checks, the APY would be 6.17%, based on the assumption that the quarterly checks (which reflect monthly compounding) are reinvested at the account interest rate and compounding frequency. Consumers would receive a disclosure such as "You will earn a 6.17% APY, based on monthly compounding. The annual percentage yield assumes you immediately reinvest your interest payment at the account interest rate."

4(b)(6) Features of Time Accounts

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

The regulation currently requires a disclosure for institutions offering time accounts that compound interest and permit a consumer to withdraw accrued interest during the account term. The disclosure states that the APY assumes interest remains on deposit until maturity and that a withdrawal will reduce earnings. The proposal would eliminate the disclosure, since the APY would no longer reflect the assumption that interest remains on deposit until maturity. Further, under the proposal, consumers would receive transaction-specific disclosures reflecting their interest payment choice.

Section 230.5—Subsequent Disclosures

5(a) Change in Terms

5(a)(2) No Notice Required

5(a)(2)(iv) Changes to the Frequency of Interest Payments Initiated by the Consumer

The act and regulation require institutions to give 30-days' advance notice of any change in the account disclosures if the change might reduce the APY or adversely affect the consumer. The proposal would create an exception for changes to the interest-payment intervals that are initiated by the consumer. For example, if a consumer receives monthly interest payments on an account and prior to maturity requests the institution to start making payments semi-annually, no advance notice would be required. However, if an institution that permits interest payments monthly eliminates that payment option during the term of an account, advance notice of the change would be required for consumers who are receiving monthly payments.

Section 269 of the act authorizes the Board to make adjustments and exceptions that are necessary or proper to carry out the purposes of the act. The Board solicits comment on whether the proposed exception to the change-in-terms notice requirements should be made.

Section 230.8—Advertising

8(c) When Additional Disclosures Are Required

8(c)(7) Effect of Compounding or Interest Distributions

The act and regulation provide that when an APY is stated in an advertisement, additional disclosures are required. For the same reasons as discussed for account disclosures requirements, institutions that advertise an APY would be required to indicate whether the APY is based on the frequency of interest checks or compounding. The Board believes it is important that consumers who use advertisements to comparison-shop are alerted to this assumption, to avoid potential confusion or misunderstanding. Similarly, if an APY is based in whole or in part on interest distributions, the advertisement would have to alert consumers that the APY assumes that interest received is reinvested at the account interest rate. For example, if an institution advertises a two-year CD with a 6.00% interest rate, monthly compounding, and quarterly interest checks, the institution must include in the advertisement a

disclosure such as "You will earn a 6.17% APY, based on monthly compounding and quarterly checks. The annual percentage yield assumes you immediately reinvest your interest payment at the account interest rate." The Board also proposes to amend paragraph (e) of this section, which exempts certain types of advertisements from some disclosure requirements.

Appendix A to Part 230—Annual Percentage Yield Calculation

The proposed amendment that would factor the time value of interest payments into the APY calculation using the current formula (the modified version of the May 1994 proposal) is discussed below as "Alternative 1." The alternative approach that would use an internal rate of return formula to calculate the APY (proposed in December 1993) is discussed as "Alternative 2."

Both approaches would incorporate two assumptions to provide greater flexibility and to ease compliance. First, institutions could calculate the APY by assuming an initial deposit amount of \$1,000. Or, institutions could factor in the actual dollar amount of a deposit, although the Board notes that the effects of rounding interest paid on a very small deposit amount such as \$25 can produce a skewed APY.

Second, if interest is paid out monthly, quarterly, or semi-annually, institutions could base the number of days either on the actual number of days for those intervals or on an assumed number of days (30 days for monthly distributions, 91 days for quarterly distributions, and 182 days for semiannual distributions). Appendix A permits institutions to use a similar assumption for determining the number of days in the term of a "three-month" or "six-month" time account, for example. (Of course, if the institution chooses to use 91 days as the number of days for each quarter, it must also use 91 days to compute interest for those quarters. And see § 230.7, which requires institutions to pay interest on the full principal balance in the account each day.) To illustrate, assume the institution sends interest payments at the end of each calendar month to consumers with six-month CDs. If the institution bases its APY calculation on an assumed term of 183 days, the institution could calculate the effect of monthly interest payments by using the actual days in each calendar month or assuming five 30-day intervals and one 33-day interval.

Also, footnote 3 would be deleted as unnecessary, since both alternatives

specifically factor in when interest payments are made on an account.

The following illustrates the differences in the two calculation methods under Alternative 1 and Alternative 2. If an institution offers a noncompounding two-year stepped-rate CD that pays a 5.00% interest rate in the first year and a 10.00% interest rate the second year and sends annual interest checks of \$50 and \$100 on a \$1,000 deposit, the APY would be 7.47% under Alternative 1 (the proposed amendment using the current formula), and 7.41% using the internal rate of return formula (Alternative 2). If a noncompounding two-year stepped-rate CD paid a 10.00% interest rate in the first year and a 5.00% interest rate the second year and the institution sends annual interest checks of \$100 and \$50 on a \$1,000 deposit, the APY would be 7.47% under Alternative 1 and 7.59% under Alternative 2.

Alternative 1: Modifying the Current APY Formula

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

A. General Rules

Under Alternative 1, the Board would amend the definition of "interest" in the APY formula to provide that institutions must factor in the timing of interest payments, if interest payments occur more frequently than any compounding. In effect, the interest payment would be treated as if the interest were compounded. For example, if an institution offers a two-year CD with a 6.00% interest rate and annual compounding and offers interest payments semi-annually to the consumer by check or transfer to another account, the "Interest" figure used in the APY formula would be \$125.51 on a \$1,000 deposit for the consumer who chooses semi-annual interest payments. This is the dollar amount of interest earned for a two-year CD with a 6.00% interest rate that compounds semi-annually. The APY for the account with semi-annual interest payments would be 6.09%. For the consumer who leaves interest in the account for annual compounding, the "interest" figure would be \$123.60 and the APY 6.00%. On the other hand, if the same CD offered daily compounding and monthly interest checks (with daily compounding), the imputed interest figure would be \$127.49, which reflects daily compounding and the assumption that the monthly interest checks are reinvested at the daily compounding rate. The APY would be 6.18% for consumers who leave interest in the

account and for those who receive monthly interest checks. In this case (when interest compounds more frequently than interest is distributed), the APY would be based on the compounding frequency. On the other hand, if the institution offers daily compounding to those consumers who leave interest in the account and does not compound interest if consumers choose to receive monthly interest checks, the APY would be 6.17% for the "monthly check" account. In another example, if an institution compounds monthly but offers consumers the option of receiving interest checks quarterly or semi-annually, the APY would be based on monthly compounding. The APY would be 6.17%. Two examples would be added to illustrate the new rule.

Alternative 2: Adding an Internal Rate of Return Formula

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

A. General Rules

2. Formula for all Accounts

Under Alternative 2, the Board would add a standard internal rate of return formula which produces an APY that reflects the timing of interest payments. The new formula could be used for all accounts. It would have to be used for accounts that pay interest prior to the maturity of the account. For example, institutions would use the formula to calculate the APY for a one-year time account that compounds semi-annually and for which the consumer receives interest payments during the year.

The APY is determined directly from the proposed formula. For an internal rate of return program that is standard for most calculators and software, calculations would consider the amount and days at which payments are made in relation to the amount and day of the deposit. Using standard programs, the calculation will result in a daily yield, which is annualized to produce the APY.¹

3. Formula for Certain Accounts

Institutions could continue to use the APY formulas currently in Appendix A for accounts with a single interest payment made at maturity (whether or not compounding occurs prior to maturity).

¹ Annual percentage yield = $((\text{daily yield} \times 100 + 1)^{365} - 1) \times 100$.

B. Stepped-Rate Accounts (Different Rates Apply in Succeeding Periods)

An additional example is proposed to illustrate the use of the new formula.

C. Variable-Rate Accounts

The proposal modifies the example in this paragraph to illustrate the use of the proposed new formula.

Appendix B to Part 230—Model Clauses and Sample Forms

The proposed amendments to model clauses and sample forms would address disclosure issues raised by factoring the timing of interest payments into the APY, under the proposed amendments using the current APY formula or an internal rate of return formula.

B-1 Model Clauses for Account Disclosures

An additional model clause (a)(v) is proposed to describe the effect of interest payments on the APY.

Clause (b)(i) provides model language that may be used to disclose the frequency of an institution's compounding and crediting practices. The proposal adds a new sentence providing model language to use when interest is credited by check payments or transfer to another account.

In accord with the proposed removal of paragraph 4(b)(6)(iii), the Board also proposes to remove clause (h)(iii), and to redesignate clause (h)(iv) as (h)(iii).

B-7 Sample Form

Given the proposed removal of paragraph 4(b)(6)(iii) and model clause B-1(h)(iii), the proposal would remove the last two sentences in the first paragraph of the sample form.

B-10 Sample Form

The proposed new sample form illustrates a disclosure for a CD that offers consumers the options to compound interest or to receive interest on a more frequent basis. The form discloses which interest payment option was chosen, and an APY reflecting that choice.

V. Interpretive Guidance

APY Disclosures for Accounts Offering Multiple Payment and Compounding Options

In addition to disclosing the APY before an account is opened, institutions must state an APY when responding to consumers' requests for written information about an account or to an oral inquiry about rates. (See 12 CFR 230.4(a) and 12 CFR 230.3(e).) In a consumer account advertisement,

institutions must disclose any rate stated as the APY (see 12 CFR 230.8(b)) and may also state the interest rate.

Also, the regulation requires institutions to provide disclosures, including the APY, prior to maturity of automatically renewing time accounts. (12 CFR 230.5(b)) The Board solicits comment on how institutions offering accounts with multiple payment and compounding options may comply with the regulation's requirements under § 230.4(a) (requests for account disclosures), § 230.3(e) (oral inquiries), § 230.8(b) (advertisements), and § 230.5(b) (disclosures for maturing rollover CDs) in a manner that best serves consumers who are comparison shopping. For example, comment is requested on whether an institution could state, along with any compounding and crediting frequency: (1) any currently available APY, such as, "An annual percentage yield of 6.17% assumes you receive monthly interest payments," (2) the lowest and highest APYs for a given maturity, or (3) all APYs for the account.

VI. Form of Comment Letters

Comment letters should refer to Docket No. R-0869, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text in machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3½ inch or 5¼ inch computer diskettes in any IBM-compatible DOS-based format.

VII. Regulatory Flexibility Analysis and Paperwork Reduction Act

The Board's Office of the Secretary has previously prepared regulatory analyses on proposals to factor the timing of interest payments into the APY. Copies may be obtained from Publication Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3245.

The proposed amendments would require institutions to disclose an APY that reflects the timing of interest payments as well as compounding. Either alternative would likely require one-time software modifications and changes to account disclosures and advertisements. The Board solicits comments on the likely costs for complying with the proposed amendments, and whether the costs to implement Alternative 1 (modifying the current formula) would differ

significantly from those required to implement Alternative 2 (adding an internal rate of return formula).

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

List of Subjects in 12 CFR Part 230

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

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

PART 230—TRUTH IN SAVINGS (REGULATION DD)

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

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

2. Section 230.2 would be amended by revising paragraph (c) to read as follows:

§ 230.2 Definitions.

* * * * *

(c) *Annual percentage yield* means a percentage rate reflecting the total amount of interest earned or imputed on an account, based on the interest rate and the frequency of compounding, or interest distributions from the account, for a 365-day period and calculated according to the provisions in Appendix A of this part.

* * * * *

3. Section 230.3 would be amended by revising the first sentence of paragraph (e) to read as follows:

§ 230.3 General disclosure requirements.

* * * * *

(e) *Oral response to inquiries.* In an oral response to a consumer's inquiry about interest rates payable on its accounts, the depository institution shall state the annual percentage yield, accompanied by the corresponding frequency of compounding or interest distribution.* * *

* * * * *

4. Section 230.4 would be amended as follows:

a. A new paragraph (b)(1)(iii) would be added,

b. Paragraph (b)(6)(iii) would be removed, and

c. Paragraph (b)(6)(iv) would be redesignated as paragraph (b)(6)(iii).

The addition would read as follows:

§ 230.4 Account disclosures.

* * * * *

- (b) * * *
-
- (1) * * *

(iii) *Effect of interest payments.* If the annual percentage yield is based in whole or in part on interest distributions:

(A) The interest distribution frequency.

(B) A statement that the annual percentage yield assumes the consumer immediately reinvests interest payments at the account's interest rate.

* * * * *

5. Section 230.5 would be amended by adding a new paragraph (a)(2)(iv) to read as follows:

§ 230.5 Subsequent disclosures.

- (a) * * *
-
- (2) * * *

(iv) *Changes to the frequency of interest payments initiated by the consumer.* Changes initiated by the consumer to the frequency of interest payments.

* * * * *

6. Section 230.8 would be amended as follows:

a. Paragraph (c)(6)(iii) would be removed;

b. A new paragraph (c)(7) would be added; and

c. Paragraph (e)(1) introductory text would be revised.

The addition and revision would read as follows:

§ 230.8 Advertising.

* * * * *

- (c) * * *

(7) *Effect of compounding or interest distributions.* The frequency of compounding or interest distributions. If the annual percentage yield is based (in whole or in part) on interest distributions, a statement that the annual percentage yield assumes the consumer immediately reinvests interest payments at the account's interest rate.

* * * * *

(e) *Exemption for certain advertisements—(1) Certain media.* If an advertisement is made through one of the following media, it need not contain the information in paragraphs (c)(1), (c)(2), (c)(4), (c)(5), (c)(6)(ii), (c)(7), (d)(4), and (d)(5) of this section:

* * * * *

7. In Part 230, Appendix A would be amended under one of the two following alternatives:

a. Under the first alternative, Appendix A would be amended to read as follows:

i. The introductory text would be revised;

ii. The introductory text to Part I would be revised;

iii. In Part I, A. General Rules the text preceding *Examples* would be revised;

iv. In Part I, A. General Rules, under *Examples*, new paragraphs (3) and (4) would be added; and

v. In Part I, A. section E would be removed.

b. Under the second alternative, Appendix A would be amended as follows:

i. The introductory text to Appendix A would be revised;

ii. The introductory text to Part I would be removed;

iii. In Part I, A. General Rules would be revised;

iv. In Part I, B. Stepped Rate Accounts (Different Rates Apply in Succeeding Periods), the *Examples* would be revised;

v. In Part I, C. Variable-Rate Accounts would be revised; and

vi. In Part I, section E would be removed.

The revisions and additions under the first alternative would read as follows:

Appendix A to Part 230—Annual Percentage Yield Calculation

The annual percentage yield measures the total amount of interest earned or imputed on an account based on the interest rate and the frequency of compounding or interest distributions.¹ The annual percentage yield is expressed as an annualized rate, based on a 365-day year.² Part I of this appendix discusses the annual percentage yield calculations for account disclosures and advertisements, while Part II discusses annual percentage yield earned calculations for periodic statements.

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

In general, the annual percentage yield for account disclosures under §§ 230.4 and 230.5 and for advertising under § 230.8 is an annualized rate that reflects the relationship between the amount of interest that would be earned by the consumer for the term of the account (taking into account the frequency of interest distributions or

¹ The annual percentage yield reflects only interest and does not include the value of any bonus (or other consideration worth \$10 or less) that may be provided to the consumer to open, maintain, increase or renew an account. Interest or other earnings are not to be included in the annual percentage yield if such amounts are determined by circumstances that may or may not occur in the future.

² Institutions may calculate the annual percentage yield based on a 365-day or a 366-day year in a leap year.

compounding) and the amount of principal used to calculate that interest. Special rules apply to accounts with tiered and stepped interest rates.

A. General Rules

1. The annual percentage yield shall be calculated by the formula shown in paragraph 2 of Part I.A. of this appendix. Institutions shall calculate the annual percentage yield based on the actual number of days in the term of the account. For accounts without a stated maturity date (such as a typical savings or transaction account), the calculation shall be based on an assumed term of 365 days. In determining the total interest figure to be used in the formula, institutions shall assume that no withdrawals or deposits of principal occur during the term. For time accounts that are offered in multiples of months, institutions may base the number of days on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. If institutions choose to use the latter rule, they must use the same number of days to calculate the dollar amount of interest earned on the account that is used in the annual percentage yield formula (where "Interest" is divided by "Principal").

2. The annual percentage yield is calculated by use of the following general formula ("APY" is used for convenience in the formulas):

$$APY + 100 \left[\left(1 + \frac{\text{Interest}}{\text{Principal}} \right)^{\left(\frac{365}{\text{Days in term}} \right)} - 1 \right]$$

a. "Principal" is the amount of funds assumed to have been deposited at the beginning of the account.

b. "Interest" is the total dollar amount of interest earned on the Principal for the term of the account in which interest remains in the account. If interest is distributed by check or transfer at the same frequency or more frequently than interest is compounded, "Interest" is imputed to be the amount that would result if it were compounded at the same frequency interest is distributed. If interest is distributed by check or transfer and that interest is based in part on compounding, "Interest" is imputed to be the amount that would result if the distributed interest based on that compounding frequency had remained in the account.

c. "Days in term" is the actual number of days in the term of the account. When the "days in term" is 365 (that is, when the stated maturity is 365 days or when the account does not have a stated maturity), the annual percentage yield can be calculated by use of the following simple formula:

APY=100 (Interest/Principal)

Examples

(3) If an institution offers a \$1,000 two-year certificate of deposit that distributes interest semi-annually by check or transfer, and there is annual compounding at a 6.00% interest rate, using the general formula above, the annual percentage yield is 6.09% for an account with semi-annual checks, and 6.00% for an account where interest is left in the account for compounding.

$$\text{APY}=100[(1+(125.51/1,000))^{(365/730)} - 1]$$

$$\text{APY}=6.09\%$$

$$\text{APY}=100[(1+(123.60/1,000))^{(365/730)} - 1]$$

$$\text{APY}=6.00\%$$

(4) If an institution offers a \$1,000 two-year certificate of deposit that compounds daily and distributes monthly interest checks at a 6.00% interest rate, using the general formula above, the annual percentage yield is 6.18%, for consumers who leave interest in the account and for those who receive monthly checks:

$$\text{APY}=100[(1+(127.49/1,000))^{(365/730)} - 1]$$

$$\text{APY}=6.18\%$$

The revisions and additions under the first alternative would read as follows:

Appendix A to Part 230—Annual Percentage Yield Calculation

The annual percentage yield measures the total amount of interest earned or imputed on an account based on the interest rate and the frequency of compounding or interest distributions.¹ The annual percentage yield is expressed as an annualized rate, based on a 365-day year.² Part I of this appendix discusses the annual percentage yield calculations for account disclosures and advertisements, while Part II discusses annual percentage yield earned calculations for periodic statements.

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

A. General Rules

1. *General.* In general, the annual percentage yield for account disclosures under §§ 230.4 and 230.5 and for

¹ The annual percentage yield reflects only interest and does not include the value of any bonus (or other consideration worth \$10 or less) that may be provided to the consumer to open, maintain, increase or renew an account. Interest or other earnings are not to be included in the annual percentage yield if such amounts are determined by circumstances that may or may not occur in the future.

² Institutions may calculate the annual percentage yield based on a 365-day or a 366-day year in a leap year.

advertising under § 230.8 is an annualized rate that reflects the relationship between the amount of interest that would be earned by the consumer for the term of the account (taking into account the frequency of interest distributions or compounding) and the amount of principal used to calculate that interest. Special rules apply to accounts with tiered and stepped interest rates. The annual percentage yield shall be calculated by the formula shown in paragraph 2. of Part I.A. of this appendix. Institutions shall calculate the annual percentage yield based on the actual number of days in the term of the account. For accounts without a stated maturity date (such as a typical savings or transaction account), the calculation shall be based on an assumed term of 365 days. In determining the total interest figure to be used in the formula, institutions shall assume that no withdrawals or deposits of principal occur during the term. For time accounts that are offered in multiples of months, institutions may base the number of days on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. If institutions choose to use the latter rule, they must use the same number of days to calculate the dollar amount of interest earned on the account that is used in the annual percentage yield formulas. If interest is paid to the account or to the consumer from the account by check or transfer monthly, quarterly or semi-annually, institutions may base the number of days on either the actual number of days for those intervals, or the following assumed intervals: monthly, 30 days; quarterly, 91 days; and semi-annually, 182 days. If institutions choose to use the latter rule, they must use the same number of days to calculate the dollar amount of interest earned on the account that is used to determine when interest was paid to the account or to the consumer from the account. Institutions may base the dollar amount of a deposit on either the actual amount of the deposit or an assumed deposit of \$1,000.

2. *Formula for all accounts.* The following formula may be used for all accounts. It shall be used for all accounts where interest is paid prior to the maturity of the account. This formula reflects the specific frequency of interest payments to the consumer.

$$\text{Deposit} = \text{First payment} / (1 + \text{APY}/100)^{\text{Day of deposit to day of first payment}/365}$$

$$+ \text{Succeeding payment} / (1 + \text{APY}/100)^{\text{Day of deposit to succeeding payment}/365}$$

+ ...

$$+ \text{Final Payment} / (1 + \text{APY}/100)^{\text{Day of deposit to day of final payment}/365}$$

- "APY" is the annual percentage yield paid on the deposit.
- "Deposit" is the initial deposit.
- "First payment" is the amount of the first interest payment made during the term of the account.
- "Succeeding payment" is the amount of each succeeding interest payment, excluding the first and final payments, made during the term of the account.
- "Final payment" is the amount of the final payment including principal made at the end of the account.
- "Day of deposit to day of first payment" is the number of days between the day of the initial deposit and the first payment.
- "Day of deposit to succeeding payment" is the number of days between the day of the initial deposit and each succeeding payment.
- "Day of deposit to day of final payment" is the actual number of days in the term of the account.

Examples

(1) For a \$1,000 two-year CD (with a 6.00% interest rate and a .01644% daily periodic rate, and no compounding but semi-annual interest payments), an institution makes two midyear interest payments of \$29.92 on day 182 of each year (days 182 and 547) and two interest payments of \$30.08 at each year's end (days 365 and 730). Using the formula in paragraph 2. of Part I.A. of this appendix, the annual percentage yield is 6.09%:

$$1,000 = 29.92 / (1 + \text{APY}/100)^{182/365} + 30.08 / (1 + \text{APY}/100)^{365/365} + 29.92 / (1 + \text{APY}/100)^{547/365} + 1030.08 / (1 + \text{APY}/100)^{730/365}$$

$$\text{Daily yield} = .01619\%$$

$$\text{APY} = 6.09\%$$

(2) For a \$1,000 one-year CD (with a 6.00% interest rate and a .01644% daily periodic rate, compounded semi-annually), an institution which allows the consumer to elect quarterly interest payments assumes three quarterly interest payments of \$14.96 at 91-day intervals (days 91, 182 and 273), and a final payment of \$1015.12 on day 365. Using the formula in paragraph 2. of Part I.A. of this appendix, the annual percentage yield for the quarterly payment option is 6.14%:

$$1,000 = 14.96 / (1 + \text{APY}/100)^{91/365} + 14.96 / (1 + \text{APY}/100)^{182/365} + 14.96 / (1 + \text{APY}/100)^{273/365} + 1015.12 / (1 + \text{APY}/100)^{365/365}$$

$$\text{Daily yield} = .01632\%$$

$$\text{APY} = 6.14\%$$

3. *Formula for certain accounts.* The formula under this paragraph may be

used for accounts that make a single interest payment at maturity. When using the formula, institutions shall determine the total interest figure to be used in the formula by assuming that all principal and interest remain on deposit for the entire term and that no other transactions (deposits or withdrawals) occur during the term. The annual percentage yield is calculated by use of the following formula ("APY" is used for convenience in the formulas):

$$APY=100 [(1+(\text{Interest}/\text{Principal}))^{(365/\text{Days in term})} - 1]$$

a. "Principal" is the amount of funds assumed to have been deposited at the beginning of the account.

b. "Interest" is the total dollar amount of interest earned on the Principal for the term of the account.

c. "Days in term" is the actual number of days in the term of the account. When the "days in term" is 365 (that is, where the stated maturity is 365 days or where the account does not have a stated maturity), the annual percentage yield may be calculated by use of the following simple formula:

$$APY=100 (\text{Interest}/\text{Principal})$$

Examples

(1) If an institution pays \$61.83 in interest in a single payment at maturity for a 365-day year on \$1,000 deposited into a one-year CD (with a 6.00% interest rate and daily compounding), using the formula shown in paragraph 3. of Part I.A. of this appendix, the annual percentage yield is 6.18%:

$$APY=100 [(1+(61.83/1,000))^{(365/365)} - 1]$$

$$APY=6.18\%$$

(2) If an institution offers a \$1,000 six-month certificate of deposit (where the six-month period used by the institution contains 182 days, interest is paid at maturity, and there is daily compounding at a 6.00% interest rate), using the formula shown in paragraph 3. of Part I.A. of this appendix, the annual percentage yield is 6.18%:

$$APY=100 [(1+(30.37/1,000))^{(365/182)} - 1]$$

$$APY=6.18\%$$

B. Stepped-Rate Accounts (Different Rates Apply in Succeeding Periods)

* * * * *

Examples

(1) If an institution offers a \$1,000 6-month certificate of deposit on which it pays a 5.00% interest rate, compounded daily, for the first three months (which contain 91 days), and a 5.50% interest rate, compounded daily, for the next three months (which contain 92 days), the total interest paid in a single payment at maturity for six months is \$26.68, and using the formula in

paragraph 3. of Part I.A. of this appendix, the annual percentage yield is 5.39%:

$$APY=100 [(1+(26.68/1,000))^{(365/183)} - 1]$$

$$APY=5.39\%$$

(2) If an institution offers a \$1,000 two-year certificate of deposit on which it pays a 6.00% interest rate, compounded daily, for the first year, and a 6.50% interest rate, compounded daily, for the next year, the total interest paid in a single payment at maturity is \$133.13 and, using the formula in paragraph 3. of Part I.A. of this appendix, the annual percentage yield is 6.45%:

$$APY=100 [(1+133.13/1,000)^{(365/730)} - 1]$$

$$APY=6.45\%$$

(3) For a \$1,000 two-year certificate of deposit (with an interest rate of 6.00% and a daily periodic rate of .01644% the first year, and an interest rate of 6.50% and a daily periodic rate of .01781% the second year, no compounding but semi-annual interest payments), an institution makes two payments during the first year, a midyear interest payment of \$29.92 on day 182 and a year-end interest payment of \$30.08 on day 365, and two payments during the second year, a midyear interest payment of \$32.41 on day 547 and a final payment of \$1032.59 on day 730. Using the formula in paragraph 3. of Part I.A. of this appendix, the annual percentage yield is 6.34%:

$$1,000=29.92/(1+APY/100)^{182/365}+30.08/$$

$$(1+APY/100)^{365/365}$$

$$+32.41/(1+APY/100)^{547/365}+1032.59/$$

$$(1+APY/100)^{730/365}$$

$$\text{Daily yield}=.01684\%$$

$$APY=6.34\%$$

C. Variable-Rate Accounts

1. For variable-rate accounts without an introductory premium or discounted rate, an institution must base the calculation only on the initial interest rate in effect when the account is opened (or advertised), and assume that this rate will not change during the year.

2. Variable-rate accounts with an introductory premium (or discount) rate must be calculated like a stepped-rate account. Thus, an institution shall assume that: (i) The introductory interest rate is in effect for the length of time provided for in the deposit contract; and (ii) the variable interest rate that would have been in effect when the account is opened or advertised (but for the introductory rate) is in effect for the remainder of the year. If the variable rate is tied to an index, the index-based rate in effect at the time of disclosure must be used for the remainder of the year. If the rate is not tied to an index, the rate in effect for

existing consumers holding the same account (who are not receiving the introductory interest rate) must be used for the remainder of the year.

3. For example, assume an institution offers an account on which it pays quarterly interest payments at an introductory 7.00% interest rate and a .01934% daily periodic rate, compounded daily, for the first three months (which, for example, contain 91 days), while the variable interest rate that would have been in effect when the account was opened was 5.00% with a daily periodic rate of .01378%. For a 365-day year on a \$1,000 deposit an institution would make one quarterly interest payment on day 91 of \$17.60 (based on 91 days at 7.00%), followed by two interest payments of \$12.54 on days 182 and 273, and a final payment of \$1012.68 on day 365 (based on 274 days at 5.00%). Using the formula in paragraph 2. of Part I. A. of this appendix, the annual percentage yield is 5.66%:

$$1,000=17.60/(1+APY/100)^{91/365}+12.54/$$

$$(1+APY/100)^{182/365}$$

$$+12.54/(1+APY/100)^{273/365}+1012.68/$$

$$(1+APY/100)^{365/365}$$

$$\text{Daily yield}=.01508\%$$

$$APY=5.66\%$$

* * * * *

8. In Part 230, Appendix B would be amended as follows:

a. Under B-1—Model Clauses For Account Disclosures:

i. A new paragraph (a)(v) would be added following the text under *Tiering Method B*;

ii. Paragraph (b)(i) would be revised;

iii. Paragraphs (h)(iii) and (h)(v) would be removed; and

iv. Paragraph (h)(iv) would be redesignated as paragraph (h)(iii),

b. The last two sentences in the first paragraph of B-7—Sample Form would be removed; and

c. A new B-10—Sample Form would be added.

The additions and revisions would read as follows:

Appendix B to Part 230—Model Clauses and Sample Forms

* * * * *

B-1—Model Clauses For Account Disclosures

(a) * * *

(v) Effect of interest payments

Your annual percentage yield is based on _____(time period) payments/ checks, and assumes you immediately reinvest interest payments at the account interest rate.

* * * * *

(b) Compounding and crediting

(i) Frequency

Interest will be compounded (on a _____ basis/every _____ (time period)).

Interest will be credited to your account (on a _____ basis/every _____ (time period)).

Interest for your account will be paid [by check/to another account] [(time period)].

* * * * *

BILLING CODE 6210-01-P

B-10 -- SAMPLE FORM (CERTIFICATE OF DEPOSIT)**XYZ SAVINGS BANK
1 YEAR CERTIFICATE OF DEPOSIT****Rate information**

The interest rate for your account is 5.00 % with an annual percentage yield of 5.12 %. You will be paid this rate until the maturity date of the certificate. Your certificate will mature on September 30, 1994.

Interest for your account will be:

Compounded and credited to your account ___ two times a year.
___ four times a year.

Paid monthly to you by check ___ to another
___ four times a year account.

Interest begins to accrue on the business day you deposit any noncash item (for example, checks).

Minimum balance requirements

You must deposit \$1,000 to open this account.

You must maintain a minimum balance of \$1,000 in your account every day to obtain the annual percentage yield listed above.

Balance computation method

We use the daily balance method to calculate the interest on your account. This method applies a daily periodic rate to the principal in the account each day.

Transaction limitations

After the account is opened, you may not make deposits into or withdrawals from the account until the maturity date.

Early withdrawal penalty

If you withdraw any principal before the maturity date, a penalty equal to three months' interest will be charged to your account.

Renewal policy

This account will be automatically renewed at maturity. You have a grace period of ten (10) calendar days after the maturity date to withdraw the funds without being charged a penalty.

FEDERAL RESERVE SYSTEM**12 CFR Part 230****[Regulation DD; Docket No. R-0836]****Truth in Savings****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Interim rule.

SUMMARY: The Board has adopted an interim rule amending Regulation DD (Truth in Savings) to permit institutions to disclose an annual percentage yield (APY) equal to the contract interest rate for time accounts with maturities greater than one year that do not compound but require interest distributions at least annually. This interim rule does not apply to or affect institutions that permit but do not require (or that bar) interest distributions before maturity. This amendment resolves questions about the APY disclosure for these accounts during consideration of public comments on a related proposal published elsewhere in today's **Federal Register**.

EFFECTIVE DATE: January 18, 1995.

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

SUPPLEMENTARY INFORMATION:**I. Background**

The Truth in Savings Act (12 U.S.C. 4301 et seq.) requires depository institutions to provide disclosures to

consumers about their deposit accounts, including an annual percentage yield (APY) on interest-bearing accounts calculated under a method prescribed by the Board. The APY is the primary uniform measurement for comparison shopping among deposit accounts. The law also contains rules about advertising, including the advertising of accounts at depository institutions offered to consumers by deposit brokers. The Board's Regulation DD (12 CFR part 230), which was adopted in September 1992 and became effective in June 1993, implements the act. (See 57 FR 43337, September 21, 1992, and 58 FR 15077, March 19, 1993.)

In adopting Regulation DD, the Board considered various approaches for calculating the APY, reflecting several competing interests and concerns. The current APY formula is simple and easy to use. It assumes that interest remains on deposit until maturity. This assumption produces an APY that has the effect of reflecting the time value of money for accounts that remain on deposit until maturity. It does not always reflect the time value of money when there are interest payments prior to maturity.

II. Proposals Affecting the APY

As deposit brokers began complying with the APY formula and Regulation DD's advertising rules, the Securities Industry Association (SIA) asked the Board to reconsider how the APY is calculated. The SIA objected to the fact that, for multi-year certificates of deposit (CDs) that are noncompounding but pay interest at least annually, the formula produces an APY that is less than the contract interest rate. Disclosure of an APY lower than the interest rate did not, according to the SIA, always allow for meaningful comparison shopping among deposit accounts. The SIA believed that the APY should at least equal the contract interest rate.

In December 1993, the Board published a proposal that would have factored into the APY calculation the specific time intervals for interest paid on the account—that is, the time value of money (58 FR 64190, December 6, 1993); an additional internal rate of return formula would have been added to the regulation. The proposal also offered an alternative limited change in the APY disclosure for multi-year noncompounding CDs; under this approach, institutions would disclose an APY equal to the contract interest rate if the CDs paid interest at least annually. The proposal was withdrawn in May 1994, based on considerations of

cost and burden at that time (59 FR 24376, May 11, 1994).

Simultaneously with the withdrawal of the December 1993 proposal, in May 1994 the Board published a related proposal that addressed depository institutions' compounding and crediting practices. Under the May proposal, institutions offering accounts that pay interest by check (or transfer) or by posting interest to the account would have to post interest at least as often as they pay out interest by check. That is, for accountholders leaving the interest in the account, interest would compound on at least as frequent a basis as the interest payments made to others. For example, if an institution offers a two-year CD, permits consumers to receive accrued interest in monthly interest checks, and also permits interest to remain in the account, the institution would have to credit and compound interest at least monthly. If an institution sends consumers the interest payments (and does not permit consumers to leave interest in the account), the institution would treat the interest payment frequency as compounding in the APY calculation. For example, for a two-year CD that requires consumers to receive an annual interest payment, the APY would reflect annual compounding.

In July, the Board extended the time to provide comments on the proposed amendments. At the same time, the Board reopened comment on a limited alternative that had been published in December 1993 and withdrawn in May 1994; that alternative equates the APY and the contract interest rate for noncompounding multi-year CDs that pay interest at least annually. (59 FR 35271, July 11, 1994)

The Board received about 550 comments on the proposal (including comments on the alternative approach involving noncompounding multi-year CDs). About 95% of the comments were from financial institutions. The remaining 5% were from trade associations, data processors and others. Approximately 450 comments addressed the proposed amendments affecting the APY formula; about 2% were in favor of the proposal, 98% were opposed, most of them because of the proposed matching of compounding and crediting frequencies. About 100 commenters addressed the alternative that would equate the APY to the interest rate; nearly 60% supported this approach.

On January 4, 1995, the Board adopted one part of the May 1994 proposal. The Board voted to amend the definition of the APY to reflect the frequency of interest payments; it

declined to adopt another portion of the May proposal that would have affected institutions' crediting and compounding policies. The Board also declined to adopt the alternative proposal published in July 1994 that equated the APY and the interest rate for multi-year, noncompounding certificates of deposit that make interest payments at least annually. Subsequently, the Board received petitions for reconsideration from both the major banking industry trade associations and consumer advocates.

On January 17, the Board granted the petitions and decided to publish for public comment a modified version of the May 1994 proposal, which would factor the time value of interest payments into the APY calculation using the current formula, but would not require institutions to match crediting and compounding policies for accounts where consumers may receive interest payments or leave interest in the account. The Board is also soliciting comment on a second approach that would factor the time value of interest payments into the APY calculation using an additional internal rate of return formula. (See Docket R-0869 elsewhere in today's Federal Register.)

In order to address immediately one anomaly created by the current rule, the Board is adopting as an interim rule an APY disclosure for noncompounding multi-year CDs.

III. Equating the APY and Interest Rate for Multi-Year Noncompounding CDs

The interim rule represents a modified version of the July proposal: Institutions may disclose an APY equal to the contract interest rate for noncompounding multi-year CDs that require interest distributions at least annually. Institutions that prohibit withdrawal of interest or that permit (but do not require) interest distributions are not affected. The Board believes that this narrow rule provides a targeted response to questions about the APY disclosure for the class of accounts that currently must disclose an APY that is lower than the stated interest rate. The Board believes adopting the interim rule is necessary to limit any consumer confusion and to allow more effective comparison shopping by consumers.

The interim rule is based on concerns expressed by commenters in the earlier rulemakings and upon further analysis by the Board. For example, commenters voiced concern that under the July 1994 proposal, which covered noncompounding multi-year CDs that paid—or offered to pay—interest at least annually, the same APY could be

disclosed for compounding and noncompounding CDs (such as a noncompounding two-year CD with annual interest checks and a two-year CD that also offers annual interest checks or annual compounding) and this might discourage compounding. The Board believes the interim rule responds to these concerns. The interim rule does not apply to a multi-year CD that provides optional periodic withdrawals of interest. That account must compound at least annually to quote an APY equal to the contract interest rate. Under the existing rules, for example, if a consumer invests \$1,000 in a two-year CD and Institution A offers a noncompounding two-year CD at a 6% interest rate and *permits* interest withdrawals or requires interest payouts only at maturity, the APY is 5.83%. Under the interim rule, if Institution B offers a noncompounding two-year CD at the same interest rate and *requires* annual interest checks, the APY is 6.00%.

In addition to narrowing the scope of the amendment, the Board is requiring a brief narrative for account disclosures and advertisements if institutions choose to comply with the interim rule and state an APY equal to the contract interest rate. The Board believes this narrative will further minimize possible consumer confusion about the effect of interest payments on the APY and earnings from the account.

The interim rule being adopted by the Board will permit new APY disclosures to be made in certain circumstances pending final resolution of this matter. As the Board moves toward a permanent resolution of this issue, it will consider commenters' views on retaining the interim rule.

IV. Regulatory Revisions: Section-by-Section Analysis

Section 230.4—Account Disclosures

4(b) Content of account disclosures

4(b)(6) Features of time accounts

4(b)(6)(iii) Withdrawal of interest prior to maturity

The regulation requires a disclosure for institutions offering time accounts that compound interest and permit a consumer to withdraw accrued interest during the account term. The disclosure states that the APY assumes interest remains on deposit until maturity and that a withdrawal of interest will reduce earnings. Under the interim rule, the Board is adding a brief narrative for institutions that state an APY equal to the contract interest rate for noncompounding multi-year CDs that require interest payouts at least annually. The Board believes a

statement alerting customers to the fact that interest cannot remain in the account will assist consumers in comparison shopping between multi-year CDs with annual compounding and multi-year CDs that do not compound but require interest payouts during the account term, without adding an undue burden on institutions.

Section 230.8—Advertising

8(c) When additional disclosures are required

8(c)(6) Features of time accounts

The regulation requires institutions advertising APYs to disclose other key features about the account. Under the interim rule, the Board is adding a brief narrative that parallels the disclosure required by § 230.4(b)(6)(iii). If an institution states an APY equal to the contract interest rate in advertising a noncompounding multi-year CD that requires interest payments, the fact that interest payouts are mandatory and that interest cannot remain in the account must be stated. The Board believes that the disclosure will assist consumers in comparison shopping between multi-year CDs that compound annually and multi-year CDs that do not compound but require interest payouts at least annually, without adding undue burden on institutions.

Appendix A to Part 230—Annual Percentage Yield Calculation

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

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

Under the interim rule, the amendments to Appendix A affect institutions offering noncompounding multi-year CDs that require interest payouts at least annually. A new paragraph E is added to clarify how APYs may be determined for such accounts. Two examples are added, including an example calculating the APY for a stepped-rate account covered by the amendments.

The statute provides that the APY shall be calculated under a method prescribed by the Board in regulations, and authorizes the Board to provide for adjustments and exceptions for any class of accounts that, in the Board's judgment, are necessary or proper to carry out the purposes of the act, prevent circumvention of the act's requirements, or facilitate compliance. Based on the comments received and further analysis, the Board finds that an interim rule permitting institutions to disclose an APY equal to the contract

interest rate for noncompounding multi-year CDs that require interest distributions at least annually is necessary to carry out the purposes of the act—enabling consumers to make informed decisions about deposit accounts. The exception is narrowly drawn, and reflects the value of receiving payments at least annually on accounts that do not permit accountholders to keep interest on deposit until maturity.

Appendix B to Part 230—Model Clauses and Sample Forms

B-1 Model Clauses for Account Disclosures

(h) Disclosures relating to time accounts

(h)(v) Required interest distribution

Under the interim rule, the Board is adding a model clause to describe the effect of interest payments on earnings.

V. Regulatory Flexibility Analysis and Paperwork Reduction Act

The Board's Office of the Secretary has prepared a regulatory analysis on the interim rule. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3245.

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

The interim rule revises the APY that may be disclosed for noncompounding CDs greater than one year that require interest payouts at least annually. It also adds a brief narrative for account disclosures and advertisements for accounts that disclose the contract interest rate as the APY. The Board believes the burden associated with the amendment affects a narrow class of accounts and is likely to be minimal. New calculations are permissive, and the Board believes only a small number of institutions will be affected. Based on its analysis of the impact of the amended regulation, the Board believes that there is no net change in the Board's current estimate of paperwork burden associated with Regulation DD. The annual information disclosure burden for state member banks is estimated to be 1.7 million hours.

List of Subjects in 12 CFR Part 230

Advertising, Banks, banking, Consumer protection, Federal Reserve

System, Reporting and recordkeeping requirements, Truth in savings.

For the reasons set forth in the preamble, the Board amends 12 CFR part 230 as set forth below:

PART 230—TRUTH IN SAVINGS (REGULATION DD)

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

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

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

§ 230.4 Account disclosures.

* * * * *

(b) * * *

(6) * * *

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

* * * * *

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

§ 230.8 Advertising.

* * * * *

(c) * * *

(6) * * *

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

* * * * *

4. In Part 230, Appendix A is amended as follows:

a. The second sentence in the introductory text to Part I is revised;

b. The first sentence of the introductory text to Part I, A. General Rules is revised; and

c. A new section E is added to Part I.

The revisions and addition read as follows:

Appendix A to Part 230—Annual Percentage Yield Calculation

* * * * *

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

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

A. General Rules

Except as provided in Part I.E. of this appendix, the annual percentage yield shall be calculated by the formula shown below.* * *

* * * * *

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

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

Example

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

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

Example

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

- (a) Multiply each interest rate by the number of days it will be in effect;
- (b) Add these figures together; and
- (c) Divide by the total number of days in the term.

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

* * * * *

5. In Part 230, Appendix B, under B-1 Model Clauses For Account Disclosures, a new paragraph (h)(v) is added to read as follows:

Appendix B to Part 230—Model Clauses and Sample Forms

* * * * *

B-1—Model Clauses for Account Disclosures

* * * * *

- (h) * * *
- (v) Required interest distribution.

This account requires the distribution of interest and does not allow interest to remain in the account.

* * * * *

By order of the Board of Governors of the Federal Reserve System, January 18, 1995.

William W. Wiles,
Secretary of the Board.

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