FEDERAL RESERVE BANK OF NEW YORK

[Circular No. **10837**
March 4, 1996]

REGULATION Z — TRUTH IN LENDING

— Adequacy of Protection for Consumers Seeking Home-Equity Lines of Credit

Comments Requested by April 1

— Annual Adjustment of Dollar Amount that Triggers Certain Requirements of Regulation Z

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

Home-Equity Lines of Credit

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

> The Federal Reserve Board is requesting public comment on whether the rules under Truth in Lending provide adequate protection for consumers seeking home-equity lines of credit.
>
> Comment should be received by April 1.
>
> The comments received will be used by the Board in preparing a report to Congress on this issue as required by the Riegle Community Development and Regulatory Improvement Act of 1994.

Printed on the following pages is the text of the Board's official notice in this matter, as published in the *Federal Register* of January 30, 1996. Comments thereon should be submitted by April 1, 1996 and may be sent to the Board, as specified in the notice, or to our Compliance Examinations Department.

Annual Adjustment

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

> The Federal Reserve Board has published an adjustment of the dollar amount that triggers additional disclosure requirements under Truth in Lending for mortgage loans that bear fees above a certain amount.
>
> The Home Ownership and Equity Protection Act of 1994 bars credit terms such as balloon payments and requires additional disclosures when total points and fees payable by the consumer exceed $400 or 8 percent of the total loan amount, whichever is larger. The Board must adjust this amount each year based on the percentage change in the Consumer Price Index as of June 1.
>
> The Board has adjusted the dollar amount from $400 to $412.

Printed on the last page of this circular is the text of the Board's official notice in this matter, as published in the January 31 *Federal Register*. Questions thereon may be directed to our Compliance Examination Department (Tel. No. 212-720-5914).

WILLIAM J. MCDONOUGH,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-0913]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comments.

SUMMARY: The Board is soliciting comment on whether the Truth in Lending Act cost disclosure and other rules for open-end home-secured lines of credit provide adequate consumer protections. The Riegle Community Development and Regulatory Improvement Act of 1994 directs the Board to submit a report to the Congress regarding this matter. Under present law, creditors offering open-end home-equity lending programs have to provide detailed disclosures at the time a consumer applies for a line of credit. The law also imposes specific substantive limitations on how these programs may be structured; however they are not subject to the type of disclosure and restrictions imposed by the Home Ownership and Equity Act of 1994 for closed-end credit.

DATES: Comments must be received on or before April 1, 1996.

ADDRESSES: Comments should refer to Docket No. R–0913, 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 the availability of information.

FOR FURTHER INFORMATION CONTACT: Obrea Poindexter, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452–3667 or 452–2412. For users of Telecommunications Device for the Deaf (TDD), please contact Dorothea Thompson at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background

The Home Ownership and Equity Protection Act (HOEPA) amendments to the Truth in Lending Act, contained in the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) require special disclosures and impose substantive limitations on certain closed-end home-equity loans with rates or fees above a certain percentage or amount. The requirements and prohibitions contained in the HOEPA, which became effective in October 1995, do not apply to open-end home-secured lines of credit. The legislative history notes that congressional hearings on home-equity lending practices revealed little evidence of abusive practices in the open-end home-equity credit market. The legislative history also states that, if the market changes or if the Board finds that open-end credit plans are being used to circumvent the HOEPA, the Board has the authority to address abuses under section 152(d) of the HOEPA.

In addition, the RCDRIA directs the Board to conduct a study and submit a report to the Congress, including recommendations for legislation, on whether existing rules for open-end home-equity lending programs provide consumers obtaining home-equity lines of credit with adequate protections.

II. Current Rules for Home-Equity Lines of Credit

The Home Equity Loan Consumer Protection Act amendments to the Truth in Lending Act, enacted in November 1988, require creditors to give consumers extensive disclosures and an educational brochure for home-equity plans at the time an application is provided. For example, creditors must provide information about payment terms, fees imposed under the plans, and, for variable-rate plans, information about the index used to determine the rate and a fifteen-year history of changes in the index values. In addition, the law imposes certain substantive limitations on home-equity plans, such as limiting the right of creditors to terminate a plan and accelerate an outstanding balance or to change the terms of a plan after it has been opened.

The Board's Regulation Z (12 CFR part 226) implements the Truth in Lending Act. Regulation Z requirements for home-equity lines of credit closely mirror the statutory requirements. As the statute sets forth specific requirements that are restrictive in many cases, the rules implementing the statute are similarly restrictive.

Specific rules on home-equity lines of credit are contained in Regulation Z, §§ 226.5b, 226.6(e), 226.9(c)(3), and 226.16(d) and its accompanying commentary. Requirements for home-equity lines of credit apply to all open-end credit plans secured by a consumer's dwelling. The rules require creditors offering home-equity plans (and third-parties in some instances) to give specific disclosures about costs and terms and limits how creditors may structure programs.

Format and Timing of Disclosures

In most cases, at the time a consumer is provided with an application for a home-secured line of credit, disclosures must be given. These disclosures must be in writing, grouped together, and segregated from all unrelated information. Each consumer must also be given an educational pamphlet prepared by the Board entitled "When Your Home is On the Line: What You Should Know About Home Equity Lines of Credit," or a similar substitute. Program-specific initial disclosures must be given in writing before the first transaction is made under the plan.

Content of Disclosures

Creditors offering home-equity plans must provide information to consumers that is required under section 226.5b of the regulation. This includes, but is not limited to, the following:

(1) The payment terms, including the length of the draw and any repayment period, an explanation of how the minimum periodic payment will be determined and the timing of payments, and an example based on a $10,000

outstanding balance and a recent annual percentage rate (APR): [1]

(2) The APR;

(3) Fees imposed by the creditor and third parties;

(4) A statement that negative amortization may occur and that as a result a consumer's equity in a home may decrease; and

(5) Several statements, including a statement that loss of the home could occur in the event of default.

Subsequent Disclosures

Subject to certain limitations on changes in terms, creditors are generally required to send the consumer a fifteen-day advance notice if a term on the plan is changed. In addition, a notice must also be sent if additional extensions of credit are prohibited or if the credit limit is reduced; this notice must be sent no later than three business days after the action is taken. 12 CFR 226.9(c)

Limitations on Home-equity Plans

Regulation Z prescribes substantive limitations on the changes that a creditor can make in the annual percentage rate, termination of a plan, and any other change in the credit terms that were initially disclosed. For example, a creditor cannot terminate a plan and demand repayment of the entire outstanding balance unless the consumer has engaged in fraud or misrepresentation, failed to meet the repayment terms, or adversely affected the creditor's security by action or inaction. A creditor generally cannot change a term unless the change was provided for in the initial agreement, the consumer agrees to the change in writing, or the change is insignificant or "unequivocally beneficial" to the consumer throughout the remainder of the plan; and cannot apply a new index and margin unless the original index becomes unavailable. 12 CFR 226.5b(f)

Advertising

Creditors generally trigger additional disclosures, in advertisements, if they advertise account-opening disclosures relating to finance charges and other significant charges or repayment terms for a plan. If a home-equity plan advertisement contains a trigger term, creditors must also state the following:

(1) The periodic rate used to compute the finance charge (expressed as an APR);

(2) Loan fees that are a percentage of the credit limit, along with an estimate of other plan fees; and

(3) The maximum APR that could be imposed in a variable-rate plan.

If a minimum payment for the home-equity plan is stated, the advertisement must also state if a balloon payment will result. For a variable-rate plan, if the advertisement states a rate other than one based on the contract's index and margin, the advertisement must also state how long the introductory rate will be in effect. The introductory rate and the fully-indexed rate must be disclosed with equal prominence. In addition, creditors cannot advertise home-equity plans as "free money" (or using a similar term) and cannot discuss the tax consequences of interest deductions in a misleading way. 12 CFR 226.16(d)

III. Request for Comments

The Board requests comment on whether the existing home-equity lending rules provide adequate protections for consumers and whether any statutory or regulatory changes are warranted to ensure adequate disclosure and other consumer protections in connection with open-end home-equity lines of credit.

The Board will submit its report to the Congress in early fall 1996, based on the comments of interested parties and its own analysis.

By order of the Board of Governors of the Federal Reserve System, January 24, 1996.

William W. Wiles,

Secretary of the Board.

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[1] The example must show the minimum periodic payment and the time it would take to repay the $10,000 balance if the consumer made only those payments and obtained no additional credit extensions.

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R–0915]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of adjustment of dollar amount.

SUMMARY: The Board is publishing an adjustment to the dollar amount that triggers certain requirements of Regulation Z (Truth in Lending) for mortgages bearing fees above a certain amount. The Home Ownership and Equity Protection Act of 1994 sets forth rules for creditors offering home-secured loans with total points and fees payable by the consumer at or before loan consummation that exceed the greater of $400 or 8 percent of the total loan amount. The Board is required to annually adjust the $400 amount based on the annual percentage change in the Consumer Price Index as reported on June 1. The Board has adjusted the dollar amount from $400 to $412.

EFFECTIVE DATE: January 1, 1996.

FOR FURTHER INFORMATION CONTACT: Michael Hentrel, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452–3667. For the users of Telecommunications Device for the Deaf only, please contact Dorothea Thompson at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

Background

The Truth in Lending Act (TILA; 15 U.S.C. 1601—1666j) requires creditors to disclose credit terms and the cost of consumer credit as an annual percentage rate. The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling. The TILA is implemented by the Board's Regulation Z (12 CFR part 226).

On March 24, 1995, the Board published amendments to Regulation Z implementing the Home Ownership and Equity Protection Act of 1994 (HOEPA), contained in the Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103–325, 108 Stat. 2160 (60 FR 15463). These amendments, which became effective on October 1, 1995, are contained in § 226.32 of the regulation and impose new disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. Creditors are required to comply with the rules in § 226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $400 or 8 percent of the total loan amount. The TILA and § 226.32(a)(1)(ii) of Regulation Z provide that the $400 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index (CPI) that was reported on the preceding June 1. See 15 U.S.C. 1602(aa).

The Bureau of Labor Statistics publishes consumer-based indices monthly, but does not "report" a CPI change on June 1; adjustments are reported in the middle of each month. The CPI–U is based on all urban consumers and represents approximately 80 percent of the U.S. population; the CPI–W is based on urban wage earners and clerical workers and represents about 30 percent of the population. The Board believes the index representing the broader population of U. S. consumers—the CPI–U—is the appropriate index to use in any adjustment to the $400 dollar figure.

The adjustment to the $400 dollar figure reflects the adjustment reported on May 15 (the rate "in effect" on June 1) which states the percentage increase from April 1994 to April 1995. During that period the CPI–U increased by 3.1 percent which would cause an adjustment of the $400 to $412.40. The Board is rounding that number to whole dollars for ease of compliance.

Adjustment

Effective January 1, 1996, under § 226.32(a), a home mortgage loan is covered by § 226.32 if the total points and fees payable by the consumer at or before loan consummation exceed the greater of $412 or 8 percent of the total loan amount. The adjustment will be codified in the official staff commentary to Regulation Z.

By order of the Board of Governors of the Federal Reserve System, January 25, 1995.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96–1859 Filed 1–30–96; 8:45 am]

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