Federal Reserve Board Announces Changes to Official Staff Commentaries for Regulations B, E, and Z

Summary: The Federal Reserve Board (FRB) has recently issued revisions to the official staff commentary for three of the consumer credit protection regulations for which it has rulewriting responsibilities: Regulation B, Equal Credit Opportunity; Regulation E, Electronic Fund Transfers; and, Regulation Z, Truth in Lending.

Thrift institutions should be aware that the Regulation Z commentary revisions regarding disclosures for adjustable rate mortgages were made in consultation with Federal Home Loan Bank Board and System staff. Since the Bank Board has regulations substantially similar to the Regulation Z requirements regarding adjustable rate loans, consistency and uniformity of interpretative guidance offered to lenders subjected to either requirement is strongly desired by the FRB and the Bank Board. Consequently, the FRB commentary revisions relating to the adjustable rate mortgage provisions of Regulation Z being transmitted with this bulletin are also applicable to the Bank Board’s regulations.

Attached is the Federal Register material containing the FRB’s commentary revisions for all three regulations.

For Further Information Contact:
The FHFLB District in which you are located or the Compliance Programs Division of the Office of Regulatory Activities, Washington, D.C. 20006.

Thrift Bulletin 21

The revisions to the official staff commentary for Regulation B address a recent preemption determination made by the FRB regarding New York law. Basically, and as explained further in the commentary, the state of New York may not prohibit special-purpose credit programs or related inquiries that are permissible under federal law. This preemption determination became effective March 7, 1989.

The revisions to the FRB official staff commentary for Regulation E clarify various situations associated with the initial disclosure requirements applicable when consumers preauthorize direct deposit of Social Security and other federal government benefits. These revisions are effective April 1, 1989.

The revisions to the official staff commentary for Regulation Z address a variety of questions that have arisen in connection with the regulation, and include new material and changes in existing material. The comments address, for example, disclosure questions raised by the emergence of reverse mortgage products, questions concerning the amendments to Regulation Z affecting disclosures for adjustable rate mortgages, and questions concerning when a third party fee may be a finance charge in a credit transaction. These revisions became effective on February 28, 1989, but compliance is optional until October 1, 1989.
The Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) makes it unlawful for creditors to discriminate in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise of any right under the Consumer Credit Protection Act. This statute is implemented by the Board’s Regulation B (12 CFR Part 202).

This Board also publishes an official staff commentary (EC-1, Supp. 1 to 12 CFR Part 202) to interpret the regulation. The commentary provides guidance to creditors in applying the regulation to specific transactions, and is updated periodically to address significant questions that arise. This notice contains the third update, and codifies the reexemption determination that took effect on November 11, 1988 (53 FR 45756).

(2) Revision

The following is a brief description of the revision to the commentary:

Section 202.11—Relation to State Law.

Paragraph 11(a) is added to the commentary in light of the Board’s recent determination that a provision of New York law on credit discrimination is inconsistent with federal law, and that it is preempted by the ECOA and Regulation B to the extent of the inconsistency. Thus, the state of New York may not prohibit special-purpose credit programs or related inquiries that are permissible under federal law.

(3) Text of Revision

Pursuant to authority granted in section 703 of the Equal Credit Opportunity Act (15 U.S.C. 1691b), the Board amends the official staff commentary to Regulation B (12 CFR 202 Supp. I) as follows:

PART 202—AMENDED

1. The authority citation for Part 202 continues to read:


Supplement I—[Amended]

2. The addition amends the commentary (12 CFR Part 202, Supp. I) by adding comment 11(a) to read as follows:

Section 202.11—Relation to State Law.

11(a) Inconsistent state laws.

1. Preemption determination—New York. Effective November 11, 1988, the Board has determined that the following provisions in the state law of New York are preempted by the federal law:

a. Article 15, section 209a(1)(b)—Unlawful discriminatory practice in relation to credit on the basis of race, creed, color, national origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars a creditor from requesting and considering information regarding the particular characteristics (for example, race, creed, color, national origin, or sex) required for eligibility for special-purpose credit programs.

b. Article 15, section 209a(1)(c)—Unlawful discriminatory practice to make any record or inquiry based on race, creed, color, national origin, age, sex, marital status, or disability. This provision is preempted to the extent that it bars a creditor from requesting and considering information regarding the particular characteristics (for example, race, creed, color, national origin, or sex) required for eligibility for special-purpose credit programs.


William W. Wiba,
Secretary of the Board

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12 CFR Part 205

(Reg. E, EFT-2)

Electronic Fund Transfers; Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final official staff interpretation.

SUMMARY: The Board is publishing in final form an update to the official staff commentary to Regulation E (Electronic Fund Transfers). The commentary applies and interprets the requirements of Regulation E and is a substitute for individual staff interpretations of the regulation. The revisions address questions that have arisen about the disclosure requirements of the regulation.

EFFECTIVE DATE: April 1, 1989.

FOR FURTHER INFORMATION CONTACT: Contact Sharon T. Bowman or Thomas J. Noto, Staff Attorneys, Division of Consumer Affairs, at (202) 452-3607. For the hearing impaired only, Earmeme Hall or Dorothese Thompson, Telecommunications Device for the Deaf, at (202) 452-3541. Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) General.

The Electronic Fund Transfer Act (15 U.S.C. 1601 et seq.) governs any transfer of funds that is electronically initiated and that debits or credits a consumer’s account. This statute is implemented by the Board’s Regulation E (12 CFR Part 205).

The Board has published an official staff commentary (Supp. II to 12 CFR Part 205) to interpret the regulation. The commentary is designed to provide guidance to financial institutions and others in applying the regulation to specific situations. The commentary is updated periodically to address significant questions that arise. This notice contains the seventh update.
which was proposed for comment on December 1, 1988. The revisions are effective April 1, 1989.

(2) Description of Revisions

Following is a brief description of the revisions of the commentary:

Section 205.7 Initial Disclosure of Terms and Conditions

Question 7-1. Question 7-1 addresses the situation where a financial institution provides EFT disclosures when a consumer opens an account. The question is revised to clarify that the regulation does not impose a time limit by which a consumer must sign up for an EFT service with a third party in order for the disclosures originally provided by the account holding institution to satisfy the regulation's requirements.

Question 7-2. Question 7-2 is revised to clarify that, in cases where a financial institution does not receive notice that a consumer has signed up for direct deposit of Social Security or other government payments (because there has been no prenotification and because no Form 1109A or other written agreement has been completed by the consumer and the financial institution), the financial institution must provide the necessary disclosures as soon as possible after the first electronic fund transfer has been made. In response to concerns raised by some commenters, the Board has revised its proposed language to read "as soon as reasonably possible."

In cases where the financial institution does receive prior notice of the consumer's enrollment in the direct deposit program, the financial institution must provide disclosures before the first EFT occurs. The institution has the option, of course, of providing disclosures to customers when an account is opened, as described in question 7-1.

List of Subjects in 12 CFR Part 205

Banks, banking, Consumer protection, Electronic fund transfers, Federal Reserve System, Penalties.

(3) Text of Revisions

Pursuant to authority granted in section 904 of the Electronic Fund Transfer Act, 15 U.S.C. 1603b, the Board amends the official staff commentary to Regulation E (12 CFR Part 205, Supp. II) as follows:

PART 205—AMENDED

1. The authority citation for Part 205 continues to read:


2. The official staff commentary to Regulation E, Supp. II to 12 CFR Part 205, is amended by revising questions 7-1 and 7-2 for §205.7 to read as follows:

Supplement II—Official Staff Interpretations

Section 205.7 Initial Disclosure of Terms and Conditions

7-1 Q: Timing of disclosures—early disclosure. An institution is required to give initial disclosure either (1) when the consumer contracts for an EFT service or (2) before the first electronic fund transfer to or from the consumer's account. If an institution provides initial disclosures when a consumer opens a checking account and the consumer does not sign up for an EFT service until a later time, has the institution satisfied the disclosure requirements?

A: Yes, if the EFT contract is between the consumer and a third party for preauthorized electronic transfers to be initiated by the third party to or from the consumer's account. In this case, the financial institution need not repeat disclosures previously given unless the terms and conditions required to be disclosed are different from those that were given.

If, on the other hand, the EFT contract is directly between the consumer and the financial institution—for the issuance of an access device, or for a telephone bill-payment plan, for example—the institution should provide the disclosures at the time of contracting. Disclosures given before the time of contracting will satisfy the regulation only if they occurred in close proximity thereto. [§ 205.7(s)]

7-2 Q: Timing of disclosures—Social Security and other government direct deposits. In the case of direct deposits by a government agency—Social Security payments, for example—how can the financial institution comply with the disclosure requirements absent prenotification, such as in cases where the government agency no longer uses Form 1109A?

A: Before direct deposit of payments such as Social Security takes place, usually the consumer and the institution both must complete a Form 1109A, and the institution can make disclosures at that time. However, if a Form 1109A (or a comparable form providing notice to the institution) is not used and there is no pretelocation, the institution should provide the required disclosures as soon as reasonably possible after the first direct deposit is received, unless the institution has previously given the disclosures (see question 7-1). [§ 205.7(a)]


William W. Wiles, Secretary of the Board.

(7) U.S.C. 1516a and 1516a(b).

12 CFR Part 226

Reg. Z, TL-1

Truth in Lending; Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material. The comments addressed, for example, disclosure questions raised by the emergence of reverse mortgage products, questions concerning the amendments to Regulation Z affecting disclosures for adjustable-rate mortgages, and questions concerning when a third party fee may be a finance charge in a credit transaction.


FOR FURTHER INFORMATION CONTACT: The following attorneys in the Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412: Sharon Bowman, Michael Bylsma, Leonard Chanin, Adrienne Hurt, Thomas Noto, or Linda Vespereny. For the hearing impaired only, Telecommunications Device for the Deaf (TDD), Earnestine Hill or Dorothy Thompson, at (202) 452-3544. Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: (1) General. The Truth in Lending Act (15 U.S.C. 1601 et seq.) governs consumer credit transactions and is implemented by the Board's Regulation Z (12 CFR Part 226). Effective October 13, 1981, an official staff commentary (TL-1, Supp. I to 12 CFR Part 226) was published to interpret the regulation. The commentary is designed to provide...
guidance to creditors in applying the regulation to specific transactions and is updated periodically to address significant questions that arise. There have been several updates and one limited update as of the notice contains the eighth general update. This update reflects material that was published in two proposed updates in 1986—a special update regarding disclosures for adjustable-rate mortgages published at 53 FR 30018 (September 29, 1988) and the proposed general update published at 53 FR 44925 (December 5, 1988). Creditors are free to rely on the revised commentary as of February 28, 1989, although they need not follow the revisions until October 1, 1989.

(2) Revisions. The following is a brief description of the revisions to the commentary:

Subpart A—General

Section 226.2—Definitions and Rules of Construction

2(a) Definitions

2(e)(25) "Security Interest." In the original proposal, comment 23(b)-3 would have been revised to clarify that multiple properties in the same property need not be disclosed on revised notices. The comment, for example, would have clarified that the disclosure that an interest is retained, as in form H-4, is adequate in a refinancing where a new mortgage is filed and a new mortgage is made. Several commenters suggested that the commentary also provide guidance on the specificity required of the security interest disclosure under §§ 226.6, 226.15, and 226.18. In order to clarify that the same principle holds true in other required disclosures of security interests, the substance of the proposed comment has been incorporated in new comment 23(b)-3, instead of in comment 23(b)-4.

Section 226.4—Finance Charge

4(a) Definition

Comment 4(a)-3 is revised to clarify that charges imposed on the consumer by another, even though the creditor are finance charges if the creditor requires the services of the third party. For example, if a consumer cannot obtain the same credit terms from the creditor without using a loan broker, a fee imposed by the broker is a finance charge. The revised comment does not affect existing rules regarding charges which are excluded from the finance charge.

4(b) Examples of Finance Charges

Paragraphs 4(b)(7) and (9). Comment 4(b)(7) and (9)-2 is revised to clarify that insurance "written in connection with a credit transaction" does not include insurance written during an open-end credit plan if the insurance is written because of the consumer's default or because the consumer requests voluntary insurance after the opening of the plan. If insurance written during the term of the open-end plan is required by the creditor not as a result of the consumer's default, however, the insurance is written in connection with the plan. The final comment, which differs from the proposed comment, will provide identical rules for insurance written after consumption of a closed-end transaction and insurance written during the life of an open-end plan.

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1). Comment 17(a)(1)-5 is revised to provide that creditors with variable-rate transactions subject to § 226.18(f)(2) may also provide information set forth in § 226.18(f)(1) as information directly related to the required disclosures.

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(1). Comment 17(c)(1)-8 is revised to clarify the basis of disclosure for variable-rate transactions with no initial discounted or premium rate. The comment explains that creditors should base their disclosures only on the initial rate and not on any potential rate increases. The comment also has been reorganized for clarity, but is not different in substance from the proposal. Comments 17(c)(1)-14 and 17(c)(1)-15 are restated to provide disclosures for reverse mortgages. These mortgages, also known as reverse annuity or home equity conversion mortgages, typically involve the disbursement of monthly or other periodic advances to the consumer for a fixed period or until the occurrence of an event such as the sale of the house by the consumer or the consumer's death. Repayment of the loan may be required at the end of the disbursement period or at a later time: both accrued interest and principal generally are payable in one payment. Some reverse "term" mortgages have a fixed term for the disbursement of funds to the consumer, but provide that the loan does not have to be repaid until a later time, such as when the consumer dies. The comment provides that the creditor should assume repayment will occur at the time disbursements are scheduled to end (or during a period following the date of the final disbursement which is not longer than the regular interval between disbursements). For example, in a transaction with monthly disbursements scheduled for ten years, the creditor may assume that repayment will be made in the 120th or 121st month.

The new comment also provides guidance on how creditors should make disclosures when both the period for disbursements and the date for repayment are determined solely by reference to future events, including the consumer's death. In such cases, the creditor may assume that disbursements will end upon the consumer's death (by using actuarial tables, for example). Alternatively, the creditor may assume that disbursements end upon the occurrence of the event that the creditor estimates will be most likely to occur first. If terms will be determined by reference to future events which do not include the consumer's death, the creditor must base the disclosures on the event estimated to be most likely to occur first. The creditor must assume repayment will occur at the same time the disbursements and (or during a period following the final disbursement which is not longer than the regular interval between disbursements).

The comment also provides that, in making disclosures, creditors would assume that all disbursements and accrued interest must be paid by the consumer. Thus, if a reverse mortgage has a "nonrecourse" provision providing that the consumer is not obligated for an amount greater than the value of the house, the comment explains that the disclosures must assume that the full amount disbursed will be repaid, although the creditor is permitted to explain that the consumer's contract may limit the amount that must be repaid.

Finally, the comment addresses the disclosure of shared-appreciation features associated with reverse mortgages. The commentary provides that the appreciation feature should be disclosed in accordance with either § 226.18(f)(1) or § 226.18(b), as appropriate.
Section 226.19—Certain Residential Mortgage Transactions

19(b) Certain Variable-Rate Transactions

Comment 19(b)-1 is revised to clarify the disclosure of variable-rate construction loans that may be permanently financed. Under the current rules in §226.17(c)(6), a creditor may disclose the construction and permanent financing arrangements, under §226.18, as a single combined transaction or as separate transactions. Under revised comment 19(b)-1, a creditor is permitted to apply a similar analysis in determining the applicability of the variable-rate disclosure requirements of §226.19(b). Thus, the creditor may treat the construction phase as a separate transaction and, if the term is one year or less, disclosures under §226.19 are not required for the construction phase. The comment also makes clear that a creditor may disclose the construction and permanent phases as separate and distinct transactions for purposes of determining coverage under §226.19(b), yet still provide a single §226.18 disclosure in accordance with the rules in §226.17(c)(6). If the construction and permanent phases are treated as a single combined transaction with a term greater than one year, disclosures under §226.19(b)(2) would be required. As provided in comment 19(b)-1, however, the creditor may describe the variable-rate features of the combined transaction pursuant to §226.18(f)(1).

Comment 19(b)-1 also is revised to address the disclosure requirements in assumptions of variable-rate transactions secured by the consumer’s principal dwelling with a term longer than one year. The comment explains that disclosures need not be provided under §226.18(f)(2)(ii) or 19(b)-7. References to applicable sections and to particular parties are deleted as unnecessary and in order to make the comment more concise.

Comment 19(b)-2 also is revised to address the disclosures for ARM programs they offer. Comment 19(b)(2)-1 also is revised to clarify the timing requirements for disclosures provided in response to a subsequent expression of interest by the consumer. Editorial changes have been made to the original proposal. The final comment makes clear that if a consumer expresses an interest in a different program, or it the consumer and creditor decide on a program different than that set forth in the disclosures that were first provided, disclosures for the new program must be provided as soon as reasonably possible.

In addressing the proposed revision to comment 19(b)(2)-1, several commenters also requested clarification of the timing requirements in situations, such as private banking arrangements, where loan terms that are not generally offered to the public are individually negotiated with a consumer. Commenters indicated that these instances, creditors do not know the loan program terms and cannot disclose the construction and permanent phases as separate and distinct transactions where paying the periodic payments will not fully amortize the loans at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the creditor must disclose that such a payment will be required. The comment explains that a creditor, however, need not reflect any irregular final payment in the historical example or in the disclosure of variations in the maximum rates and payments. (The exception for all irregular final payments is an expansion of the proposed comment, and would include final payments that differ in amount due to the effect of rate changes.)

Comment 19(b)(2)-2 has been revised to clarify that consumer buydowns and third-party buydowns reflected in the consumer’s credit obligation should be disclosed in accordance with the rules for discounted variable-rate transactions. The revised comment also makes clear that no additional disclosures relating to the buydown need be provided on the primary disclosure.

Comment 19(b)(2)(vii)-1 is revised to address the disclosures for transactions in which the interval between consummation or closing and the initial adjustment is not known—for example, when ARM loans are grouped together for sale to a secondary mortgage market purchaser. In such cases, the comment explains that lenders may disclose the timing for the first adjustment as a range of the minimum and maximum length of time from consummation or closing until the first adjustment.

Comment 19(b)(2)(vii)-1 is revised to address the disclosures for transactions in which the
overall limitations on rate increases (and decreases) vary—for example, based on the loan features the consumer chooses or upon fluctuations in the cost of money. The final comment extends the alternative disclosure rule to periodic limitations in addition to overall limitations described in 226.19(b)(2)(vii)-7 in such cases. The comment explains that the creditor may disclose the range of the lowest and highest rates that may be applicable to the consumer's ARM transactions, and must include a statement that the consumer ask about the rate limitations that are currently applicable.

Paragraph 19(b)(2)(viii). Comment 19(b)(2)(viii)-5 is added to describe the terms to maturity or payment amortizations which may be used as a basis for the disclosures in ARM transactions. Based upon public comment or upon fluctuations in the cost of money, the proposed comment has been revised. Under the final comment, creditors will be permitted to base the disclosures on the initial or maximum payment adjustments described in 226.19(b)(2)(vii)-7 and (x) for ARM loans within certain ranges upon only three maturities—five, fifteen and thirty years. The proposal later who offers ARM loans for any term over one year would be permitted to make the disclosures on the initial or maximum payments if the three sections based on five-, fifteen- and thirty-year terms, and need not illustrate every other maturity that is offered. The comment is revised to clarify that the five-, fifteen- and thirty-year term assumptions for disclosing payments based on different maturities are based on the actual loan term. (Disclosures based on fifteen- and thirty-year maturities should provide payments that fairly approximate the payments for long-term ARMs. Disclosures based on a five-year maturity should provide payments that fairly approximate the payments for most short-term ARMs. Finally, the comment explains that the creditor would be required to state the term (or amortization) used in making the disclosures when using the three terms specified in the comment.) Comment 19(b)(2)(viii)-6 is added to explain that a creditor following the alternative rule for disclosing periodic and overall rate limitations described in revised comment 19(b)(2)(vii)-7 must base the historical example upon the highest rate limitation disclosed under § 226.18(b)(3)(vii). In addition, such creditors must state the periodic or overall limitation used in the historical example.

Comment 19(b)(2)(viii)-7 also is added to explain the assumptions that can be made by a creditor following the alternative rule for disclosing the frequency of rate and payment adjustments described in revised comment 19(b)(2)(vii)-7. The comment explains that, in disclosing the historical example, the creditor may assume that the first adjustment occurred at the end of the first year in which the adjustment could occur.

Paragraph 19(b)(2)(x). Comment 19(b)(2)(x)-2 states that a creditor should base the example of how a consumer may calculate their actual payment on the latest payment shown in the historical example. The comment is revised to clarify that, in transactions where the latest payment shown in the historical example is not for the latest year of index values shown, a creditor may include additional examples that are based on the initial or maximum payments disclosed under § 226.19(b)(2)(x). This revision differs from the proposal in that it provides that creditors may provide the extra examples in addition to, but not as alternatives for, the example based on the latest payment shown in the historical table.

Paragraph 19(b)(2)(x). Comment 19(b)(2)(x)-3 is added to allow creditors to base their calculations of the initial and maximum rates and payments upon the term so maturity stated in new comment 19(b)(2)(viii)-6. The comment explains that the term used for making disclosures under § 226.18(b)(2)(vii) also may be used in calculating the initial and maximum interest rates and payments.

Comment 19(b)(2)(x)-3 is added to describe how a creditor following the alternative rule for disclosing periodic and overall rate limitations described in revised comment 19(b)(2)(vii)-7 would calculate the maximum interest rate and payment. In such cases, the comment explains that the creditor must base the disclosure of the maximum rate and payment upon the highest periodic and overall rate limitations used in calculating the maximum rate and payment.

Comment 19(b)(2)(x)-4 is also added to explain how to calculate the initial and maximum rates and payments if a creditor follows the alternative rule for disclosing the timing of the first rate and payment adjustment described in revised comment 19(b)(2)(vii)-4. The comment explains that the creditor must state the periodic or overall limitation used at the earliest time disclosed under § 226.19(b)(2)(vii).

Section 226.20—Subsequent Disclosure Requirements

20(b) Assumptions

The proposed amendment to comment 20(b)-8 to add a cross reference to § 226.19(b)(5) is deleted as unnecessary.

20(c) Variable-Rate Adjustments

Paragraph 20(c)(4). Comment 20(c)(4)-1 differs from the proposal in that it replaces the term "balloon payment" with a more specific reference to the type of transactions covered by the disclosure provisions. The comment is revised to clarify that the provisions of this paragraph apply to transactions in which paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance. The comment explains that the new rule shall not cause a change in such a payment that results from an interest rate adjustment.

Paragraph 20(c)(5). Comment 20(c)(5)-1 is revised to clarify that the provisions of this paragraph apply only when negative amortization occurs in a transaction, and not merely because a payment is a non-amortizing or partially amortizing payment.

Section 226.24—Advertising

24(b) Advertisement of Rate of Finance Charge

Although not reprinted in this notice, comment 24(b)-5 is revised to change the references to comment 18(f)-4 to be comment 17(c)(1)-10. No substantive change is intended.

Subpart D—Miscellaneous

Section 226.25—Record Retention

25(a) General Rule

Comment 25(a)-3 is added to address the record retention requirements for variable-rate transactions that are subject to the disclosure requirements of § 226.19(b). The comment explains that maintaining written procedures for compliance with the disclosure provisions as well as retaining a sample disclosure form for each loan program will be adequate evidence of compliance. The comment also states that creditors may rely on the methods for reconstructing the required
disclosures provided for under comment 25(a)-2.

Section 226.30—Limitation on Rates

Comment 30-4 is revised to clarify that this paragraph applies to the manner of stating the maximum interest rate in the credit contract only. This paragraph does not govern how interest rate ceilings should be stated in Truth in Lending disclosures. The disclosures are governed by provisions found elsewhere in the regulation and commentary.

Comment 30-13, concerning footnote 50, is revised to clarify the requirements of the regulation after October 1, 1988. For purposes of 226.30, the rate must be stated in the credit contract as prescribed in comment 30-4. The disclosure requirements for limitations on rate increases are described elsewhere in the regulation and commentary.

Appendix D—Multiple-Advance Construction Loans

Although not revised in this notice, the first sentence of comment app. D-2, is revised to delete the word "most" and to change the reference to § 226.18(f)(4) to be § 226.18(f)(3)(iv). No substantive change is intended by either revision.

List of Subjects in 12 CFR Part 226

Advertising, Banks, Banking, Consumer protection, Credit, Federal Reserve System, Finance, Penalties. Rate Limitations, Truth in Lending.

Text of Revisions

Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended) and section 1204 of the Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552, the Board amends the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

PART 226—AMENDED?

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


2. The revisions amend the commentary (TL-1, 12 CFR Part 226 Supp. I) by adding comment 21(a)-25(6); adding a sentence and a bullet at the end of comment 4(a)-8; revising the heading and text of comment 4(b)(7) and (8)-2; adding a bullet at the end of comment 17(c)(1)-5; adding two sentences at the first sentence, and revising the second and third sentences and the parenthetical material in comment 17(c)(1)-6 redesignating comments 17(c)(1)-14 and -15 to be comments 17(c)(1)-15 and -16; respectively; adding comment 17(c)(1)-16; adding parenthetical material at the end of comment 19(b)(2)-1; adding three sentences at the end of comment 19(b)(2)-1; revising the third sentence and the opening clause of the second and fifth sentences of comment 19(b)(2)-2; redesignating comments 19(b)(2)-3 and -4 to be comments 19(b)(2)-4 and -5, respectively; adding comment 19(b)(2)-3; adding three sentences after the second sentence in comment 19(b)(2)-1; adding a new sentence before the parenthetical material at the end of comment 19(b)(2)-3(v); adding four sentences and parenthetical material at the end of comment 19(b)(2)-5(vii); revising the third sentence in the parenthetical material after the first sentence in comment 19(b)(2)-vii; adding comment 19(b)(2)-vii-2; revising a sentence after the second sentence in comment 19(b)(2)-vii-2; adding comments 19(b)(2)7(vii)-3 and -4; adding a sentence after the second sentence in comment 19(b)(2)-vii-2; changing the reference to "comment 17(c)(1)-4" in the first sentence and in the first bullet of comment 19(b)(2)-4 to be "comment 17(c)(1)-10; adding comment 21(b)-3; revising the first sentence of comment 20(c)-4 and revising the last sentence in comment 20(c)-13; removing the word "most" and changing the reference to § 182.18(1)(iv) in comment app. D-2 to be § 182.18(1)(iv)" to read as follows:

* * * * *

Supplement 1—[Amended]

Subpart A—General

Section 226.8—Definitions and Rules of Construction

2(a) Definitions.

2(c)(25) "Security interest":

6. Specificity of disclosure. A creditor need not separately disclose multiple security interests that it may hold in the same collateral. The creditor need only disclose that the transaction is secured by the collateral, even where security interests based on prior transactions remain of record and a new security interest is taken in connection with the transaction.

* * * * *

Section 226.9—Finance Charge

4(a) Definition.

3. Charges by third parties

In contrast, charges imposed on the consumer by someone other than the creditor are finance charges (unless otherwise excluded) if the creditor requires the services of the third party. For example:

* A fee charged by a home broker if the consumer cannot obtain the same credit terms from the creditor without using a broker.

4(b) Example of Finance Charges

Paragraphs 4(b)(1) and (6)

3. Insurance written in connection with a transaction. Insurance sold after consummation of a closed-end credit transaction or after the opening of a plan in open-end credit transactions is not "written in connection with" the credit transaction if the insurance is written because of the consumer's default (for example, by failing to obtain or maintain required property insurance) or because the consumer requests insurance after consummation or the opening of a plan (although credit sale disclosures may be required for the insurance sold after consummation if it is financed).

Subpart C—Closed End Credit

Section 226.10—General Disclosures Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

5. Directly related

* * * * *

The disclosures set forth under section 226.18(f)(1) for variable-rate transactions subject to section 226.18(f)(2).

17(b) Basis of Disclosures and Use of Estimates. Paragraph 17(b)(1)

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8. Basis of disclosures in variable-rate transactions

* * * * *

A creditor should base the disclosures only on the initial rate and should not assume that the rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, the creditor should base the disclosures on the initial rate and should not assume that the rate will increase 5 percentage points. However, in a variable-rate transaction with a collar plan that is reflected in the credit contract, consumer brokers, or a discounted or premium rate, disclosures should not be based solely on the initial terms. In those transactions, the disclosed annual percentage rate should be a composite rate based on the rate in effect during the initial period and the rate that is the basis of the variable-rate feature for the remainder of the term. (See the commentary to § 226.17(e))
for a discussion of buydown, discounted, and premium transactions and the commentary to section 228.19(b)(2) for a discussion of the disclosure in certain residential mortgage transactions with a variable-rate feature.

14. Reverse mortgages. Reverse mortgages, also known as reverse annuity or home equity conversion mortgages, typically involve the disbursement of monthly advances to the consumer for a fixed period or until the occurrence of an event such as the consumer’s death. Repayment of the loan (generally a single payment of principal and accrued interest) may be required to be made at the end of the disbursements or, for example, upon the death of the consumer. In disclosing these transactions, creditors must apply the following rules, as applicable:

- If the reverse mortgage has a specified period for disbursements but repayment is due only upon the occurrence of a future event such as the death of the consumer, the creditor must assume that disbursements will be made until they are scheduled to end. The creditor must assume repayment will occur when disbursements end (or within a period following the final disbursement which is not longer than the regular interval between disbursements). This assumption should be used even though repayment may occur before or after the disbursements are scheduled to end. In such cases, the creditor may include a statement such as “The disbursements will end upon the consumer’s death (estimated by using actuarial tables, for example), and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements). Alternatively, the creditor may base the disclosures upon another future event it estimates will be most likely to occur first. (If terms will be determined by reference to future events including the consumer’s death, the creditor may assume that the disbursements will end upon the consumer’s death (estimated by using actuarial tables, for example) and that repayment will be required at the same time (or within a period following the date of the final disbursement which is not longer than the regular interval for disbursements)."

- In making the disclosures, the creditor must assume that all disbursements and accrued interest will be paid by the consumer. However, if the note has a nonrecourse provision providing that the consumer is not obligated for an amount greater than the noted advance, the creditor must nonetheless assume that the full amount to be disbursed will be repaid. In this case, however, the creditor may include a statement such as “The disclosures assume full repayment of the amount advanced plus accrued interest, although the amount you may be required to pay is limited by your agreement.”

- Some reverse mortgages provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. Such loans are considered variable-rate mortgages, as described in section 228.17(c)(11), and the appreciation feature must be disclosed in the disclosure as a statement such as “The mortgage has a variable interest rate, as written for a term greater than one year, and is subject to the consumer’s principal dwelling, the shared appreciation feature must be described under § 228.19(b)(2)(vii).”

Section 228.18—Content of Disclosures

18(i) Variable Rate

Paragraph 18(i)(2)

1. Disclosure required. **See** (the commentary to § 228.17(b)(3)) regarding the disclosure of certain related information in addition to the variable-rate disclosures. A creditor must provide disclosures under § 228.18(f)(2). **

Section 228.19—Certain Residential Mortgage Transactions

19(iii) Certain Variable-Rate Transactions

1. Coverage. **In determining whether a construction loan that may be permanently financed by the same creditor is covered under this section § 228.19(b)(2), the creditor may assume that the construction and the permanent phases as separate transactions with distinct terms to the consumer or as a single combined transaction. For purposes of the disclosures required under section 228.18, the creditor may nevertheless treat the two phases either as separate transactions or as a single combined transaction in accordance with section 228.17(c)(6). Finally, in any assumption of a variable-rate transaction secured by the consumer’s principal dwelling with a term greater than one year, disclosures need not be provided under sections 228.10(f)(2)(i)(ii) or 228.19(b).**

Paragraph 18(b)(2)(ii)

1. Disclosure for each variable-rate program to the consumer that fully describes the nature of each of the consumer’s variable-rate loan programs in which the consumer expresses an interest. **Disclosures must be given at the time an application form is provided or before the consumer pays a nonrefundable fee, whichever is earlier. If program disclosures cannot be provided because a consumer expresses an interest in individually negotiating loan terms that are not generally offered, disclosures reflecting those terms may be provided as soon as reasonably possible after the terms have been decided upon, but not later than the time a nonrefundable fee is paid. If a consumer has received program disclosures subsequently expresses an interest in other available variable-rate programs subject to 228.19(b)(2), the creditor and consumer decide on a program for which the consumer has not received disclosures, the creditor must provide appropriate disclosures as soon as reasonably possible.**

2. Variable-rate loan program defined. * * * For example, separate loan programs would exist based on differences in any of the following loan features: **In addition, if a loan feature must be taken into account in preparing the disclosures required by § 228.19(b)(2)(viii) and (x), variable-rate loans that differ as to that feature constitute separate programs under § 228.19(b)(2). * * *

For example, separate programs would not exist based on differences in the following loan features: * * *

3. Form of program disclosures. A creditor may provide separate program disclosure forms for each ARM program it offers or a single disclosure form that describes multiple programs. A disclosure form may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for a particular program. A disclosure form describing more than one periodic payment with remaining balance features may illustrate more than one loan maturity or payment amortization—for example, by including multiple payment and loan balance columns in the historical payment example.

Disclosures may be printed or printed in the Consumer Handbook (or a suitable substitute) as long as they are identified as the creditor’s loan program disclosures.

Paragraph 18(b)(2)(iii)

1. Determination of interest rate and payment. * * * In transactions where paying the periodic payment with remaining balance for the outstanding balance at the end of the loan term and where the final payment will equal the outstanding balance at the end of the loan term, the creditor, however, need not require interest at final payment in the historical example or in the disclosure of the initial and maximum rates and payments. * * *

Paragraph 18(b)(2)(iv)

1. Discounted and premium interest rate. * * * In a transaction with a consumer buydown or with a third-party buydown that will be incorporated in the legal obligation, the creditor should disclose the program as a discounted variable-rate transaction, but need not disclose additional information.
regarding the buydown in the program disclosures."

Paragraph 19(b)(2)(vii)

1. Frequency. * * * In certain ARM transactions, the interest between loan closing and the initial adjustment is not known and may be different from the regular interval for adjustments. In such cases, the creditor may disclose the initial adjustment period as a range of the month and number of payments and interest amount of time from loan closing. For example, the creditor could disclose the interest rate over 6 months and 12 months after closing. The creditor may also disclose the interest rate over an initial period of 18 months after closing and any subsequent adjustments may occur once each year after the first adjustment. * * *

Paragraph 19(b)(2)(viii)

1. Rate and payment caps. * * * The creditor need not disclose each periodic or overall rate limitation that is currently available. As an alternative, the creditor may disclose the range of the lower and highest periodic and overall rate limitations that may be applicable to the creditor's ARM program. For example, the creditor might state: "The limitation on increases to your interest rate at each adjustment will be set at a certain amount in the following ranges: Between 1 and 2 percentage points above the initial rate; and between 2 and 3 percentage points above the initial rate." A creditor using this alternative rule may state in its disclosures that a further disclosure, if available, would be a list of values for the rate and payment caps. The disclosures for ARMs offered with any terms from over 1 year to 40 years may be based on projections of the minimum and maximum amount in the following range: Between 4 and 8 months after closing. Subsequent adjustments may occur once each year after the first adjustment. * * *

Paragraph 19(b)(2)(ix)

1. Index movement. * * * For the remaining ten years, 1982-1991, the creditor need only show the remaining index values, margin and interest rate and must continue to reflect all significant loan program terms such as rate limitations affecting them. * * *

Paragraph 19(b)(2)(vii)

1. Terms of the loan. In calculating the maximum payment on the loan being shown in the historical example, the creditor need not base the disclosures on each term to maturity or payment amortization that it offers. Instead, disclosures for ARMs may be based upon terms to maturity or payment amortization of 5, 15, and 30 years, as follows. ARMs with terms or amortizations from over 1 year to 10 years may be based on a 5-year term or amortization; ARMs with terms or amortizations from over 10 years to 30 years may be based on a 15-year term or amortization; and ARMs with terms or amortizations over 30 years may be based on a 30-year term or amortization. Thus, disclosures for ARMs offered with any terms from over 1 year to 40 years may be based on monthly payments of 1, 15, and 30 years. Of course, a creditor may always base the disclosures on the actual terms or payment amortization that it offers. If the creditor bases the disclosures on a 5-, 15- or 30-year term or payment amortization as provided above, the term or payment amortization need in making the disclosures must be stated. * * *

Paragraph 19(b)(2)(c)

1. Rate and payment caps. A creditor using the alternative rule described in paragraph 19(b)(2)(v) for disclosure of rate and payment caps must base the historical example upon the highest periodic and overall rate limitations disclosure under section 228.19(b)(9)(viii). In such cases, the creditor must base the limitations states in the historical example. * * *

Paragraph 19(b)(2)(d)

1. Frequency of adjustments. In certain transactions, creditors may use the alternative rule described in paragraph 19(b)(2)(c). * * *

Paragraph 19(b)(2)(f)

1. Calculation of payments. * * * In transactions in which the latest payment disclosed in the historical example is not for the latest year of index values shown (such as in a five-year ARM), the creditor may provide additional examples based on the initial and maximum payments disclosed under § 228.19(b)(4). * * *

Paragraph 19(b)(2)(j)

1. Interest rate and payment cap. The limit on increases to your interest rate and payment as a result of the rate and payment caps is now known. * * *

Paragraph 19(b)(2)(n)

1. Calculation of payments. * * * In transactions where paying the periodic payments will not fully amortize the outstanding balance at the end of the loan term and where the final payment will equal the periodic payment plus the remaining unpaid balance, the amount of the adjusted payment must be disclosed if such payment is based on a range of values for the rate and payment cap. * * *

Paragraph 20(a)

1. Fully-amortizing payment. This paragraph requires a disclosure only when negative amortization is a result of the adjustment. A disclosure is not required simply because a loan calls for non-amortization or partially-amortized payments. For example, in a transaction with a five year term and payments based on a longer amortization schedule, and where the final payment will repay the periodic payment plus the remaining unpaid balance, the creditor would not have to disclose the payment necessary to fully amortize the loan in the remainder of the five year term. A disclosure is required, however, if the payment disclosed under § 228.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment limit necessary to prevent negative amortization. (This paragraph does not apply if the payment disclosed in § 228.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.) * * *

Paragraph 20(b)

1. Subpart D—Miscellaneous

Paragraph 23(b)

1. Disclosure requirements. * * *

Paragraph 24(a)

1. Conversion of variable-rate transactions. In variable-rate transactions that are subject to the disclosure requirements of § 228.19(b), creditors must provide disclosures for compliance with these requirements as well as a simple disclosure.
form for each loan program represent adequate evidence of compliance. (See comment 22(e)-2 pertaining to permissible methods of retaining the required disclosures.)

Section 226.39—Limitation on Rates

5. Manner of stating the maximum interest rate. The maximum interest rate must be stated in the credit contract either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the rate ceiling will be over the term of the obligation.

13. Transition rules. * * * On or after that date, creditors must have the maximum rate set forth in their credit contracts and, where applicable, as part of their truth in lending disclosures in the manner prescribed in the applicable sections of the regulation.


William W. Miller, Secretary of the board.

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