FEDERAL RESERVE press release

For immediate release September 28, 1988

The Federal Reserve Board today issued proposed revisions to its official staff commentary to Regulation Z, Truth in Lending, that interprets an amendment, issued December 22, 1987, requiring creditors to provide consumers with more information regarding closed-end adjustable-rate mortgage loans (ARMs) secured by the consumer's principal dwelling.

The Board is publishing proposed interpretations on a limited number of issues affecting ARMs disclosures in advance of its regular update to the Regulation Z commentary. Additional interpretations, addressing the ARM disclosure rule and other provisions of Regulation Z, are expected to be proposed in November.

The Board's notice is attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; Docket No. R-0645]

Proposed Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed official staff interpretation.

SUMMARY: The Board is publishing for comment proposed changes 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 proposed revisions offer additional guidance under the amended adjustable-rate mortgage (ARM) disclosure provisions of Regulation Z with which lenders are required to comply on October 1, 1988. This notice addresses a limited number of issues affecting transactions where certain program features change frequently or have minor variations. The proposed revisions describe the permissible disclosures for such transactions, and will limit the possibility that numerous disclosure forms would be required to reflect the program variations. Additional guidance on other issues arising under the ARM disclosure rule and under other provisions of Regulation Z will be issued in the regular update to the commentary expected to be published in November.

DATES: Comments must be received on or before December 1, 1988.

ADDRESSES: Comments should refer to Docket No. R-0645 and be sent to Mr. William W. Wiles, Secretary, Board of Governors of

the Federal Reserve System, Washington, D.C. 20551. They may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays or delivered to the guard station in the Eccles Building Courtyard on 20th Street, N.W. (between Constitution Avenue and C Street, N.W.) any time. All comments received at the above address will be available for inspection and copying by any member of the public in the Freedom of Information Office, Room B-1122 of the Eccles Building between 9:00 a.m. and 5:00 p.m. weekdays.

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

SUPPLEMENTARY INFORMATION: (1) Background. This proposed official interpretation addresses four significant issues arising under the revised disclosure rules for adjustable-rate mortgages (ARMs) in Regulation Z. The new ARM disclosure rules were adopted in final form effective December 28, 1987 (52 FR 48665, December 24, 1987). Compliance with the new rules is mandatory on October 1, 1988, but has been optional since the effective date. Since the adoption of the new disclosure rules, questions have arisen concerning the impact of compliance with certain provisions of the rules. The narrow application of certain

disclosure provisions -- especially those relating to variations in ARM programs -- may cause difficulties in transactions where program features change frequently or result in numerous forms reflecting minor program variations. This notice addresses certain disclosures involving program variations under the ARM disclosure rule, such as rate limitations, terms to maturity, frequency of adjustments, and multiple options. With the revisions, minor program variations should not result in multiple disclosure forms, and fluctuations in certain program features should not result in frequent changes to those forms. In light of the importance of these issues to certain creditors, the Board is publishing the proposed interpretations in advance of the regular update to the Regulation Z commentary. Additional proposed revisions to the Regulation Z commentary, addressing both the ARM disclosure rule and other provisions, are expected to be published in a subsequent notice in November.

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

SUBPART C -- CLOSED-END CREDIT

SECTION 226.19 Certain Residential Mortgage Transactions

19(b) Certain Variable-Rate Transactions

Paragraph 19(b)(2)

Comment 19(b)(2)-1 would be amended to clarify that the disclosure form for an ARM program in which the only feature that varies is the term to maturity may include the applicable disclosures affected by each term. For example, disclosures for

an ARM program which is offered for terms of both 15 and 30 years may contain the disclosures affected by both the 15- and 30-year terms in a single program disclosure form. Furthermore, the comment would be revised to state that certain options that are program features may be disclosed in a single program disclosure form.

Paragraph 19(b)(2)(vi)

Comment 19(b)(2)(vi)-1 would be 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.

Paragraph 19(b)(2)(vii)

Comment 19(b)(2)(vii)-1 would be revised to address the disclosures for transactions in which the overall limitation on rate increases (and decreases) varies depending on the loan features the consumer chooses, or upon fluctuations in the pricing of the loan. In such cases, the comment explains that the creditor may disclose the range of the lowest and highest rate limitations that may be applicable to the creditor'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 would be added to allow the creditor to base disclosures for ARM transactions upon terms to maturity within certain ranges specified in the new comment. The Board requests comment about whether it should require disclosures to be based upon specified terms within those ranges, or whether it should adopt the proposed comment allowing creditors to base disclosures upon any term offered within the ranges. The comment also explains that the creditor would be required to state the term used in making the disclosures.

Comment 19(b)(2)(viii)-6 would be added to explain that a creditor following the alternative rule for disclosing overall rate limitations described in revised comment 19(b)(2)(vii)-1 must base the historical example upon the highest rate limitation disclosed in section 226.19(b)(2)(vii). In addition, such creditors must state the overall limitation used in the historical example.

Comment 19(b)(2)(viii)-7 also would be 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)(vi)-1. 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 would be added to allow creditors to base their calculations of the initial and maximum rates and

payments upon the ranges for terms to maturity stated in new comment 19(b)(2)(viii)-5. The comment explains that the term the creditor selects for making disclosures under section 226.19(b)(2)(viii) also must be used in disclosing the initial and maximum interest rates and payments.

Comment 19(b)(2)(x)-3 would be added to describe how a creditor following the alternative rule for disclosing overall rate limitations described in revised comment 19(b)(2)(vii)-1 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 overall rate limitation disclosed under section 226.19(b)(2)(vii). The creditor would be further required to state the overall rate limitation used in calculating the maximum rate and payment.

Comment 19(b)(2)(x)-4 also would be 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)(vi)-1. The comment explains that the creditor must assume that the first adjustment occurs at the earliest time disclosed under section 226.19(b)(2)(vi).

List of Subjects in 12 CFR Part 226

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

To highlight the proposed revisions to the commentary, new language is shown inside arrows. Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board proposes to amend the official staff commentary to Regulation Z (12 CFR Part 226 Supp. I) as follows:

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

AUTHORITY: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96-221, 94 Stat. 170 (15 U.S.C. 1604 et seq.); sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552.

(2) Text of revisions. The commentary (12 CFR Part 226 Supp. I) is amended by revising comments 19(b)(2)-1, 19(b)(2)(vi)-1, and 19(b)(2)(vii)-1; and adding comments 19(b)(2)(viii)-5 through -7 and 19(b)(2)(x)-2 through -4.

SUPPLEMENT I -- OFFICIAL STAFF INTERPRETATION

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SUBPART C -- CLOSED-END CREDIT

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SECTION 226.19 Certain Residential Mortgage Transactions

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19(b) Certain Variable-Rate Transactions

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Paragraph 19(b)(2)

1. Disclosure for each variable-rate program. A creditor must provide disclosures to the consumer that fully and separately

describe each of the creditor's variable-rate loan programs in which the consumer expresses an interest. * * * An individual program disclosure may consist of more than one page. For example, a creditor may attach a separate page containing the historical payment example for the particular program. ►A creditor offering an ARM with different terms to maturity (or payments based on different amortizations) may make all of the applicable disclosures affected by the term of the loan in a single ARM program disclosure. (See comments 19(b)(2)(viii)-5 and 19(b)(2)(x)-2 for an explanation of how different maturities should be reflected in the program disclosures.) In addition, the creditor is permitted to include the disclosures for the following options in a single program disclosure if the features are available for the ARM being described: options permitting conversion to a fixed interest rate and options permitting preferred rates for certain consumers. The creditor must state that these options are available and should not reflect them elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rates and payments.◄ * * *

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Paragraph 19(b)(2)(vi)

1. Frequency. The frequency of interest rate and payment adjustments must be disclosed. If interest rate changes will be imposed more frequently or at different intervals than payment

changes, a creditor must disclose the frequency and timing of both types of changes. For example, in a variable-rate transaction where interest rate changes are made monthly, but payment changes occur on an annual basis, this fact must be disclosed. ►In certain ARM transactions, the interval 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 minimum and maximum amount of time from consummation or closing. For example, the creditor might state: "The first adjustment to your interest rate and payment may occur no sooner than 6 months and no later than 18 months after closing. Subsequent adjustments may occur once each year after the first adjustment." (See comments 19(b)(2)(viii)-7 and 19(b)(2)(x)-4 for guidance on other disclosures when this alternative disclosure rule is used.)◄

Paragraph 19(b)(2)(vii)

1. Rate and payment caps. The creditor must disclose limits on changes (increases or decreases) in the interest rate or payment. If an initial discount is not taken into account in applying overall or periodic rate limitations, that fact must be disclosed. If separate overall or periodic limitations apply to interest rate increases resulting from other events, such as the exercise of a fixed-rate conversion option or leaving the creditor's employ, those limitations must also be stated. ►In certain ARM transactions, a creditor may offer a range of overall

limitations on interest rate changes depending upon a variety of factors such as the program features the consumer chooses, the type of residential property involved, or the amount of the loan or the downpayment. In other ARM transactions, the overall limitations on rate changes offered by creditors may vary within a certain range depending upon factors such as fluctuations in initial interest rates and in margins. In such transactions, the creditor need not disclose each overall rate limitation that is currently available. Instead, the creditor may disclose the range of the lowest and highest overall rate limitations that may be applicable to the creditor's ARM transactions. For example, the creditor might state: "The limitation on increases to your interest rate over the term of the loan will be set at an amount in the following range: between 4 and 7 percentage points above the initial interest rate." A creditor using this alternative rule must include a statement in its program disclosures suggesting that the consumer ask about the overall rate limitations currently offered for the creditor's ARM programs. (See comments 19(b)(2)(viii)-6 and 19(b)(2)(x)-3 for an explanation of the additional requirements for a creditor using this alternative rule for disclosure of overall rate limitations.)◄ Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See section 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

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Paragraph 19(b)(2)(viii)

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►5. Term of the loan. In calculating the payments and loan balances disclosed in the historical example, a creditor may assume that an ARM that would have been outstanding during any portion of a year would have been outstanding for the full year. In addition, a creditor need not base the disclosures on each term to maturity that it offers. Instead, disclosures for ARMs with terms to maturity within the following ranges may be based on any single term (in full years) that is offered within the applicable range: over 1 year to 5 years; over 5 years to 10 years; over 10 years to 15 years; over 15 years to 20 years; over 20 years to 25 years; over 25 years to 30 years; over 30 years to 35 years; and over 35 years to 40 years. For example, disclosures for ARMs offered with terms from 15 to 30 years may be based on terms such as 15, 20, 25, and 30 years, or on any other 4 terms within the appropriate ranges stated above. In addition, the creditor must state the term used in making the disclosures.

6. Overall rate caps. In certain transactions, a creditor may use the alternative rule described in comment 19(b)(2)(vii)-1 for disclosure of overall rate limitations. In such cases, the historical example must be based upon the highest overall rate limitation disclosed under section 226.19(b)(2)(vii). In addition, the creditor must state the overall limitation used in

the historical example. (See comment 19(b)(2)(x)-3 for an explanation of the use of the highest rate limitation in other disclosures.)

7. Frequency of adjustments. In certain transactions, creditors may use the alternative rule described in comment 19(b)(2)(vi)-1 for disclosure of the frequency of rate and payment adjustments. In such cases, the creditor may assume for purposes of the historical example that the first adjustment occurred at the end of the first full year in which the adjustment could occur. For example, in an ARM in which the first adjustment may occur between 6 and 18 months after closing and annually thereafter, the creditor may assume that the first adjustment occurred at the end of the first year in the historical example. (See comment 19(b)(2)(x)-4 for an explanation of how to compute the maximum interest rate and payment when the initial adjustment period is not known.)◄

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Paragraph 19(b)(2)(x)

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►2. Term of the loan. In calculating the initial and maximum payments, the creditor need not base the disclosures on each term to maturity offered under the program. Instead, the creditor may follow the rules set out in comment 19(b)(2)(viii)-5. In calculating the initial and maximum payment, the terms to maturity selected for the purpose of making disclosures under section 226.19(b)(2)(viii) must be used. In addition, creditors

must state the term used in making the disclosures under this section.

3. Overall rate caps. In certain transactions, a creditor may use the alternative rule for disclosure of overall interest rate limitations described in comment 19(b)(2)(vii)-1. In such cases, the maximum interest rate and payment must be based upon the highest overall rate limitation disclosed under section 226.19(b)(2)(vii). In addition, the creditor must state the overall rate limitation used in calculating the maximum interest rate and payment. (See comment 19(b)(2)(viii)-6 for an explanation of the use of the highest rate limitation in other disclosures.)

4. Frequency of adjustments. In certain transactions, a creditor may use the alternative rule for disclosure of the frequency of rate and payment adjustments described in comment 19(b)(2)(vi)-1. In such cases, the creditor must base the calculations of the initial and maximum rates and payments upon the earliest possible first adjustment disclosed under section 226.19(b)(2)(vi). (See comment 19(b)(2)(viii)-7 for an explanation of how to disclose the historical example when the initial adjustment period is not known.)◄

By order of the Board of Governors of the Federal Reserve System, September 26, 1988.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board