RULES and REGULATIONS

FEDERAL RESERVE SYSTEM

12 CFR Part 226

Reg. Z; Docket No. R-0545A
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Update to Official Staff Commentary

Tuesday, April 5, 1988

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

SUMMARY: The Board is publishing in final form changes to the official staff commentary to Regulation Z (Truth in Lending). The commentary provides guidance to creditors in complying with an amendment to Regulation Z that was adopted by the Board in December of 1987 (52 FR 48665). The regulatory amendment requires creditors to provide more information to consumers about certain closed-end variable-rate loans than was previously required under Regulation Z. The commentary revisions include new material and technical changes in existing material. The Board is also publishing changes to the official staff commentary on other provisions of Regulation Z elsewhere in this issue of the Federal Register.

EFFECTIVE DATE: April 1, 1988, but compliance optional until October 1, 1988.

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

SUPPLEMENTARY INFORMATION:

(1) Background

This official staff interpretation applies and interprets a final amendment to Regulation Z that is designed to provide more information to consumers about closed-end variable-rate transactions secured by a consumer's principal dwelling with a term greater than one year. The amendment to the regulation was published on December 24, 1987 (52 FR 48665) with a mandatory compliance date of October 1, 1988. Proposed revisions to the commentary were first published for public comment on November 24, 1986 (51 FR 42248). Upon adoption of the regulatory amendment, the Board published the commentary for additional comment on December 24, 1987 (52 FR 48707). The Board is now adopting the commentary revisions in final form with compliance optional until October 1, 1988. The major revisions to the commentary begin with comment 18(f)(2)-1. Portions of existing commentary that have undergone only minor changes have been reprinted to clarify the revisions. With the exception of the provisions interpreting the new disclosure rules, many of the changes reflect either renumbering of existing paragraphs or shifting of existing general commentary regarding variable-rate disclosures from the commentary to § 226.18(f) to the commentary to section 226.17(c).

(2) Explanation of Revisions

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

Subpart C--Closed-end Credit

Section 226.17--General disclosure requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

Comment 17(a)(1)-2 is amended to clarify that the general segregation requirement in § 226.17(a)(1) does not apply to the disclosures required under new §§ 226.19(b) and 226.20(c). The information contained in the fifth bulleted paragraph under comment 17(a)(1)-5, which discusses disclosure of a variable-rate feature on other documents, has been deleted since similar information will be required under new paragraph (f)(2) of § 226.18. In addition, the ninth bulleted paragraph under comment 17(a)(1)-5, discussing negative amortization, has been revised to change the reference from § 226.18(f)(3) to new § 226.18(f)(1)(iii).

17(b) Time of Disclosures

Comment 17(b)-1 has been expanded by adding a reference to the timing requirements in new § 226.19(b) for variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year. Comment 17(b)-2 has been amended by adding a reference to the timing rules for additional disclosures required upon the conversion of open-end transactions to certain closed-end variable-rate transactions.

17(c) Basis of Disclosures and Use of Estimates

Paragraph 17(c)(1)

The first bulleted paragraph in comment 17(c)(1)-2 has been revised to clarify that preferred-rate loans are variable-rate transactions (while retaining the employee's loan as an example) and to change the reference from § 226.18(f) to § 226.19(b).
Material generally relating to the basis of disclosures for variable-rate transactions currently in the commentary to § 226.18(f) has been moved to the commentary to § 226.17(c)(1) and the material currently in the commentary to § 226.17(c)(1) has been reordered to accommodate this change. Comments 17(c)(1) -8, -9 and -10, discussing graduated payment mortgages, Morris Plans and number of transactions have been redesignated, respectively, as comments 17(c)(1)-12-14 and -15. Material currently contained in comments 18(f)-2 and -3, discussing the basis of disclosures and use of estimates for variable-rate transactions, has been added as comments 17(c)(1)-8 and -9. Comment 17(c)(1)-10 incorporates material on discounted variable-rate transactions currently contained in comment 18(f)-8, and the heading of the comment has been changed to clarify that it applies to transactions in which the initial rate is either lower or higher than the fully indexed rate. In addition, an error in the figures in the example of a transaction with a 7 1/2 percent payment cap has been corrected.

Most of the material currently in comment 18(f)-6 relating to the basis of disclosure for certain variable-rate transactions has been incorporated in comment 17(c)(1)-11. Revisions have been made to clarify that preferred-rate transactions can include transactions other than employee preferred-rate loans. For example, variable-rate rules apply where a preferential rate is offered so long as the consumer permits loan payments to be debited from a deposit account. Two parts of existing comment 18(f)-6 that do not relate to the basis of disclosure, namely the reference in the second bullet to the conditions for imposition of a shared-appreciation feature and the reference to the hypothetical example in the third bullet, have been deleted in the new comment 17(c)(1)-11.

The material currently in comment 18(f)-7, discussing growth-equity mortgages, has been incorporated in new comment 17(c)(1)-13, although detailed discussion of the option of disclosing by analogy to variable-rate disclosures has been deleted in favor of a more general reference in the new comment 17(c)(1)-13.

17(d) Multiple Creditors; Multiple Consumers

Comment 17(d)-2 has been amended to clarify that the disclosures required under § 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program, and not to every consumer who may be entitled to rescind the transaction.

17(f) Early Disclosures

As a result of the revisions to § 226.19 of the regulation, the reference in comment 17(f)-3 to § 226.19(b) has been revised to reference § 226.19(a)(2).

Section 226.18--Content of disclosures.

18(f) Variable Rate

Comment 18(f)-1 has been expanded to explain whether paragraph (f)(1) or (f)(2) of § 226.18 applies to a particular variable-rate transaction. Comment 18(f)-1 indicates that variable-rate loans that are for a term greater than one year and are secured by the consumer's principal dwelling are subject to the special early disclosure requirements of new § 226.19(b). The comment states that "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 226.18(f)(1) regardless of the general coverage of §§ 226.18(f)(1) and 226.19(b). The comment also explains that, under new footnote 43, creditors may substitute the new disclosures under §§ 226.19(b) and 226.18(f)(2) for any closed-end variable-rate transaction. With minor changes, material relating to the basis of disclosures for variable-rate transactions has been moved to the commentary to § 226.17(c)(1). Consequently, comments 18f()-2 and -3 and comments 18(f)-5 through -8 have been deleted. Present comment 18(f)-4 has been redesignated as comment 18(f)(1)- 1. The material currently in comments 18(f)-2 and -3 has been incorporated, respectively, in comments 17(c)(1)-8 and -9, and the material currently in comments 18(f)-6 and -7 has been incorporated in comments 17(c)(1)-11 and -13. The material currently in comment 18(f)-8, discussing discounted transactions, has been incorporated in comment 17(c)(1)-10 and the heading has been changed to clarify that the

comment also applies to transactions where the initial rate is higher than the fully indexed rate. The material currently in comment 18(f)-5 has been incorporated in the commentary to new § 226.19(b). Some of the material currently in comment 18(f)-6 has been incorporated in new comment 19(b)-4 to clarify that the designated transactions are subject to the general disclosure requirements of new § 226.19(b). The material currently in comment 18(f)-6 relating to the basis for disclosures has not been transferred to new comment 19(b)-4, since such information has been incorporated in comment 17(c)(1)-11. The current headings referring to paragraphs 18(f) (1) through (4) have been changed to reference paragraphs 18(f)(1) (i) through (iv) to reflect the fact that current § 226.18(f) of the regulation has become § 226.18(f)(1).
Comment 18(f)(2)-1 has been added to clarify that where a variable-rate transaction is secured by the consumer's principal dwelling and has a term greater than one year, the later disclosures required under § 226.18 must state that the variable-rate feature exists and refer to the variable-rate disclosures provided earlier to the consumer under new § 226.19(b).

Section 226.19 Certain residential mortgage transactions.

The title of this section of the commentary has been revised to read "Certain Residential Mortgage and Variable-Rate Transactions" to reflect the fact that § 226.19 of the regulation now incorporates disclosure provisions for variable-rate loans secured by the consumer's principal dwelling that have a term greater than one year.

19(a) Time of Disclosure

The current heading referring to 19(a) has been redesignated as 19(a)(1). Existing comments 19(a)-1 through 19(a)-5 therefore have become comments 19(a)(1)-1 through -5.

19(b) Redisclosure Required

The current heading referring to 19(b) has been redesignated as 19(a)(2). Existing comments 19(b)-1 through 19(b)-4 have therefore become comments 19(a)(2)-1 through -4.
Comment 19(b)-1 has been added to clarify that the new requirements of § 226.19(b) apply to variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year. The comment states that "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 226.18(f)(1) regardless of the general coverage of §§ 226.18(f)(1) and 226.19(b). The comment also explains that the term of a demand loan is to be determined in accordance with the rules set forth in the commentary to § 226.17(c)(5).
Comment 19(b)-2 explains the special timing rules under § 226.19(b) for cases where applications are received through an agent or broker or by telephone. The comment also explains that where open-end accounts convert, pursuant to a written agreement, to transactions subject to § 226.19(b), the required disclosures may be given at the time of conversion.
Comment 19(b)-3 incorporates material previously contained in comment 18(f)-5 to clarify that creditors may substitute information provided in accordance with the variable-rate regulations of other federal agencies for the disclosures

required by § 226.29(b). The references to footnote 43 and § 226.18(f) in old comment 18(f)-5 have been revised to reference footnote 45a and § 226.29(b), respectively, in the new comment 19(b)-3.

Comment 19(b)-4 incorporates, with changes, some of the material previously contained in comment 18(f)-6 to clarify that the designated transactions are subject to certain or all of the general disclosure requirements of § 226.19(b). The last sentence in the first bullet under old comment 18(f)-6 referring to the disclosures that must be given for renegotiable rate mortgages has been deleted in the new comment 19(b)-4. The language in the third bullet under old comment 18(f)-6 has been revised in the new comment 19(b)-4 to clarify that preferred-rate loans where the rate can increase upon some occurrence are variable-rate transactions even where the initial underlying rate is fixed, and the reference to the hypothetical example in the last sentence has been deleted.

Paragraph 19(b)(1)

Comment 19(b)(1)-1 clarifies what constitutes a suitable substitute for the Consumer Handbook on Adjustable Rate Mortgages. New comment 19(b)(1)-2 explains that the Consumer Handbook requirement is not applicable to loan programs where the underlying interest rate is fixed. Thus the Consumer Handbook need not be provided, for example, in certain preferred-rate transactions or when variable-rate mortgage insurance or required credit life insurance is offered in connection with an otherwise fixed-rate transaction.

Paragraph 19(b)(2)

Comment 19(b)(2)-1 explains that a creditor must provide disclosures for each of its variable-rate programs in which the consumer expresses an interest. The final comment has been expanded from the proposal to also indicate that a creditor need only provide disclosures for programs that are available to the consumer. Thus if an application is denied within the three-day period following receipt through a broker, disclosures need not be provided under footnote 45b of the regulation. In addition, if a program is made available only to certain customers of an institution, the creditor need not provide disclosures for that program to other consumers who express a general interest in the creditor's ARM programs. The final comment also indicates that a creditor should provide additional loan program disclosures in response to subsequent expressions of interest by the consumer. Finally, material has been included to clarify that program disclosures may consist of more than one page.

Comment 19(b)(2)-2 has been added to clarify what constitutes a separate loan program that would require separate program disclosures. The final comment also clarifies that loans with a different term constitute distinct programs.

Comment 19(b)(2)-3 has been added to clarify that the disclosures required under § 226.19(b)(2) need only be made as applicable. The final comment has been expanded to clarify that disclosures relating to payments are only applicable to payments based on the interest rate, loan balance and loan term.

Comment 19(b)(2)-4 has been added to explain the circumstances under which a creditor must revise its loan program disclosures.

Comments to new § 226.19(b)(2) (i)

through (xiii) have been added to clarify the requirements imposed by these paragraphs and to illustrate how a creditor may comply with the new provisions. Additional commentary has been added to explain, for example, how to select index values to be used in the historical index table and how to illustrate discounted and premium rates.

Section 226.20 Subsequent disclosure requirements.

20(a) Refinancings

Comment 20(a)-3 has been amended to clarify that the addition of a variable-rate feature to an obligation or an increase in the rate based on a previously undisclosed variable-rate feature are events requiring disclosures under new § 226.19(b) if the variable-rate transaction is secured by the consumer's principal dwelling and has a term greater than one year. The comment explains that, in such cases, disclosures must be given at the time of the addition or increase.

20(b) Assumptions

Comment 20(b)-6 has been amended to provide that assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year may be disclosed solely in accordance with § 226.18(f)(1) and that disclosures under §§ 226.18(f)(2)(ii) and 226.19(b) need not be provided.

20(c) Variable-Rate Adjustments

Comment 20(c)-1 has been added to explain what subsequent disclosures are required to be made by a creditor or a subsequent holder in cases where an interest rate adjustment is made in a variable-rate transaction subject to new § 226.19(b). Comment 20(c)-2 has been added to clarify that shared-equity or shared-appreciation mortgages are exempt from the subsequent disclosure requirements of § 226.20(c). Comment 20(c)(1)-1 and comment 20(c)(2)-1 have been added to clarify the requirements that current and prior interest rates and index values be disclosed on adjustment notices. Comment 20(c)(3)-1 has been added to clarify that § 226.20(c)(3) is applicable only when interest rate carryover occurs at an adjustment. Comment 20(c)(4)-1 has been added to clarify the disclosure of contractual effects of an adjustment, and comment 20(c)(5)-1 has been added to clarify when the disclosure of fully amortizing payments is required.

Appendix H--Closed-End Model Forms and Clauses

Comment app. H-4 has been revised to clarify that the model clauses set forth in Appendix H-4(A) of the regulation apply to transaction subject to § 226.18(f)(1). In addition, commentary has been provided to interpret the new model clauses H-4(B) through H-4(D) in Appendix H. These additions are numbered as comments app. H-5 through -7. Commentary describing new Sample H-14 has been added as comment app. H-18. Consequently, existing comments app. H-5 through -14 have been renumbered as comments app. H-8 through -17 and existing comments app. H-16 through -20 have been renumbered as comments app. H-19 through -23.

List of Subjects in 12 CFR Part 226

Advertising, Banks, Banking, Consumer

protection, Credit, Federal Reserve System, Finance, Penalties, Rate limitations, Truth in lending.
Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), 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:

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 comment 17(a)(1)-2; removing the information contained in the fifth bullet under comment 17(a)(1)-5 and changing the reference in the ninth bullet under this comment from § 226.18(f)(3) to § 226.18(f)(1)(iii); revising comments 17(b)-1 and 17(b)-2; revising the information contained in the first bullet under comment 17(c)(1)-2; redesignating comment 17(c)(1)-8 as comment 17(c)(1)-12; redesignating comments 17(c)(1)-9 and 17(c)(1)-10 as comments 17(c)(1)-14 and 17(c)(1)-15, respectively; adding comments 17(c)(1)-8 through 17(c)(1)-11 and 17(c)(1)-13; revising comment 17(d)-2; changing the reference in comment 17(f)-3 from § 226.19(b) to § 226.19(a)(2); revising comment 18(f)-1; removing comments 18-(f)-2 and 18-(f)-3; removing comments 18(f)-5 through 18(f)-8; adding a heading "Paragraph 18 (f)(1)(i)" under the heading "Paragraph 18(f)(1)" and redesignating comment 18(f)(1)-1 as comment 18(f)(1)(i)-1; redesignating comment 18(f)-4 as comment 18(f)(1)-1; revising the heading "Paragraph 18(f)(2)" to read "Paragraph 18 (f)(1)(ii)" and redesignating comment 18(f)(2)-1 as comment 18(f)(1)(ii)-1; revising the heading "Paragraph 18(f)(3)" to read "Paragraph 18(f)(1)(iii)" and redesignating comment 18(f)(3)-1 as comment 18(f)(1)(iii)-1; revising the heading "Paragraph 18(f)(4)" to read "Paragraph 18(f)(1)(iv)" and redesignating comments 18(f)(4)-1 and 18(f)(4)-2 as comments 18(f)(1)(iv)-1 and 18(f)(1)(iv)- 2, respectively; adding a heading to read "Paragraph 18(f)(2)"; adding comment 18(f)(2)-1; revising the title to the commentary to § 226.19; revising the heading "19(a) Time of Disclosure" to read "19(a)(1) Time of Disclosure" and redesignating comments 19(a)-1 through 19(a)-5 as comments 19(a)(1)-1 through 19(a)(1)-5, respectively; revising the heading "19(b) Redisclosure Required" to read "19(a)(2) Redisclosure Required" and redesignating comments 19(b)-1 through 19(b)-4 as comments 19(a)(2)-1 through 19(a)(2)-4, respectively; adding a heading "19(b) Certain Variable-Rate Transactions"; adding comments 19(b)-1 through 19(b)(2) (xiii)-1; revising comment 20(a)-3; revising comment 20(b)-6; adding a heading to read "20(c) Variable-Rate Adjustments" and adding comments 20(c)-1, 20(c)-2, 20(c)(1)-1, 20(c)(2)-1, 20(c)(3)-1, 20(c)(4)-1 and 20(c)(5)-1; revising the heading and the first sentence of comment app. H-4; redesignating comments app. H-5 through app. H-20 as comments app. H-8 through app. H-23, respectively; adding comments app. H-5 through app.

H-7; and revising newly redesignated comment app. H-18 as follows:

Supplement I--Official Staff Interpretations

Section 226.17--General Disclosure Requirements.

17(a) Form of disclosures.

Paragraph 17(a)(1).

2. Segregation of disclosures. The disclosures may be grouped together and segregated from other information in a variety of ways. For example, the disclosures may appear on a separate sheet of paper or may be set off from other information on the contract or other documents:
- By outlining them in a box
- By bold print dividing lines
- By a different color background
- By a different type style

(The general segregation requirement described in this subparagraph does not apply to the disclosures required under §§ 226.19(b) and 226.20(c) although the disclosures must be clear and conspicuous.)

17(b) Time of disclosures.

1. Consummation. As a general rule, disclosures must be made before "consummation" of the transaction. The disclosures need not be given by any particular time before consummation, except in certain mortgage transactions and variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year under § 226.19. (See the commentary to § 226.2(a)(13) regarding the definition of consummation.)

2. Converting open-end to closed-end credit. If an open-end credit account is converted to a closed-end transaction under a written agreement with the consumer, the creditor must provide a set of closed-end credit disclosures before consummation of the closed-end transaction. (See the commentary to § 226.19(b) for the timing rules for additional disclosures required upon the conversion to a variable-rate transaction secured by a consumer's principal dwelling with a term greater than one year.) If consummation of the closed-end transaction occurs at the same time as the consumer enters into the open-end agreement, the closed-end credit disclosures may be given at the time of conversion. If disclosures are delayed until conversion and the closed-end transaction has a variable-rate feature, disclosures should be based on the rate in effect at the time of conversion. (See the commentary to § 226.5 regarding conversion of closed-end to open-end credit.)

17(c) Basis of disclosures and use of estimates.

Paragraph 17(c)(1).

2. Modification of obligation.
- If the creditor offers a preferential rate, such as an employee preferred rate, the disclosures should reflect the terms of the legal obligation. (See the commentary to § 226.19(b) for an example of a preferred-rate transaction that is a variable-rate transaction.)

8. Basis of disclosures in variable-rate transactions. The disclosures for a variable-rate transaction must be given for the full term of the transaction and must be based on the terms in effect at

the time of consummation. However, in a variable-rate transaction with either a seller buydown that is reflected in the credit contract or a consumer buydown, 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 lower rate for the buydown 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(c) for a discussion of buydown transactions and the commentary to § 226.19(a)(2) for a discussion of the redisclosure in certain residential mortgage transactions with a variable-rate feature).

9. Use of estimates in variable-rate transactions. The variable-rate feature does not, by itself, make the disclosures estimates.

10. Discounted and premium variable-rate transactions. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. In a discounted transaction, for example, a creditor may calculate interest rates according to a formula using the six-month Treasury bill rate plus a 2 percent margin. If the Treasury bill rate at consummation is 10 percent, the creditor may forgo the 2 percent spread and charge only 10 percent for a limited time, instead of setting an initial rate of 12 percent.

- When creditors use an initial interest rate that is not calculated using the index or formula for later rate adjustments, the disclosures should reflect a composite annual percentage rate based on the initial rate for as long as it is charged and, for the remainder of the term, the rate that would have been applied using the index or formula at the time of consummation. The rate at consummation need not be used if a contract provides for a delay in the implementation of changes in an index value. For example, if the contract specifies that rate changes are based on the index value in effect 45 days before the change date, creditors may use the index value in effect not more than 45 days before consummation in calculating a composite annual percentage rate.
- The effect of the multiple rates must also be reflected in the calculation and disclosure of the finance charge, total of payments, and payment schedule.
- If a loan contains a rate or payment cap that would prevent the initial rate or payment, at the time of the first adjustment, from changing to the rate determined by the index or formula at consummation, the effect of that rate or payment cap should be reflected in the disclosures.
- Because these transactions involve irregular payment amounts, an annual percentage rate tolerance of 1/4 of 1 percent applies, in accordance with § 226.22(a)(3) of the regulation.
- Examples of discounted variable-rate transactions include--

--A 30-year loan for $100,000 with no prepaid finance charges and rates determined by the Treasury bill rate plus 2 percent. Rate and payment adjustments are made annually. Although the Treasury bill rate at the time of consummation is 10 percent, the creditor sets the interest rate for one year at 9 percent, instead of 12 percent according to the formula. The disclosures should reflect a composite annual percentage rate of 11.63 percent based on 9 percent for one year and 12 percent for 29 years. Reflecting those two rate levels, the payment schedule should show 12 payments of $804.62 and 348 payments of $1,025.31. The finance charge should be $266,463.32 and the total of payments $366,463.32.

--Same loan as above, except with a 2 percent rate cap on periodic adjustments. The disclosures should reflect a composite annual percentage rate of 11.53 percent based on 9 percent for the first year, 11 percent for the second year, and 12 percent for the remaining 28 years. Reflecting those three rate levels, the payment schedule should show 12 payments of $804.62, 12 payments of $950.09, and 336 payments of $1,024.34. The finance charge should be $265,234.76, and the total of payments $365,234.76.

--Same loan as above, except with a 7 1/2 percent cap on payment adjustments. The disclosures should reflect a composite annual percentage rate of 11.64 percent, based on 9 percent for one year and 12 percent for 29 years. Because of the payment cap, five levels of payments should be reflected. The payment schedule should show 12 payments of $804.62, 12 payments of $864.97, 12 payments of $929.84, 12 payments of $999.58, and 312 payments of $1,070.04. The finance charge should be $277,040.60, and the total of payments $377,040.60.

This paragraph does not apply to variable-rate loans in which the initial interest rate is set according to the index or formula used for later adjustments but is not set at the value of the index or formula at consummation. For example, if a creditor commits to an initial rate based on the formula on a date prior to consummation, but the index has moved during the period between that time and consummation, a creditor should base its disclosures on the initial rate.

11. Other variable-rate transactions. Examples of variable-rate transactions include:

- Renegotiable rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, where the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate. Disclosures must be given for the longer term of the obligation, with all disclosures calculated on the basis of the rate in effect at the time of consummation of the transaction.
- "Shared-equity" or "shared-appreciation" mortgages that have a fixed rate of interest and an appreciation share based on the consumer's equity in the mortgaged property. The appreciation share is payable in a lump sum at the specified time. Disclosures must be based on the fixed interest rate. (As discussed in the commentary to section 226.2, other types of shared-equity arrangements are not considered "credit" and are not subject to Regulation Z.)
- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures are to be based on the preferred rate.

Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

13. Growth-equity mortgages. Also referred to as payment-escalated mortgages, these mortgage plans involve scheduled payment increases to prematurely amortize the loan. The initial payment amount is determined as for a long-term loan with a fixed interest rate. Payment increases are scheduled periodically, based on changes in an index. The larger payments result in accelerated amortization of the loan. In disclosing these mortgage plans, creditors may either:

- Estimate the amount of payment increases, based on the best information reasonably available; or
- Disclose by analogy to the variable-rate disclosures in 226.18(f)(1).

(This discussion does not apply to growth-equity mortgages in which the amount of payment increases can be accurately determined at the time of disclosure. For these mortgages, as for graduated-payment mortgages, disclosures should reflect the scheduled increases in payments.)

17(d) Multiple creditors; multiple consumers.

2. Multiple consumers. When two consumers are joint obligors with primary liability on an obligation, the disclosures may be given to either one of them. If one consumer is merely a surety or guarantor, the disclosures must be given to the principal debtor. In rescindable transactions, however, separate disclosures must be given to each consumer who has the right to rescind under § 226.23, although the disclosures required under § 226.19(b) need only be provided to the consumer who expresses an interest in a variable-rate loan program.

Section 226.18--Content of Disclosures.

18(f) Variable rate.

1. Coverage. The requirements of § 226.18(f) apply to all transactions in which the terms of the legal obligation allow the creditor to increase the rate originally disclosed to the consumer. It includes not only increases in the interest rate but also increases in other components, such as the rate of required credit life insurance. The provisions, however, do not apply to increases resulting from delinquency (including late payment), default, assumption, acceleration or transfer of the collateral. Section 226.18(f)(1) applies to variable-rate transactions that are not secured by the consumer's principal dwelling and to those that are secured by the principal dwelling but have a term of one year or less. Section 226.18(f)(2) applies to variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. Moreover, transactions subject to § 226.18(f)(2) are subject to the special early disclosure requirements of § 226.19(b). (However, "shared-equity" or "shared-appreciation" mortgages are subject to the disclosure requirements of § 226.(f)(1) and not to the requirements of §§ 226.18(f)(2) and 226.19(b) regardless of the general coverage of those sections.) Creditors are permitted under footnote 43 to substitute in any variable-rate transaction the disclosures required under § 226.19(b) for those disclosures ordinarily required under 226.18(f)(1). Creditors who provide variable-rate disclosures under § 226.19(b) must comply with all of the requirements of that section, including the timing of disclosures, and must also

provide the disclosures required under § 226.18(f)(2). Creditors utilizing footnote 43 may, but need not, also provide disclosures pursuant to § 226.20(c). (Substitution of disclosures under § 226.18(f)(1) in transactions subject to §226.19(b) is not permitted under the footnote.)

Paragraph 18(f)(2).

1. Disclosure required. In variable-rate transactions that have a term greater than one year and are secured by the consumer's principal dwelling, the creditor must give special early disclosures under § 226.19(b) in addition to the later disclosures required under § 226.18(f)(2). The disclosures under § 226.18(f)(2) must state that the transaction has a variable-rate feature and that variable-rate disclosures have been provided earlier.

Section 226.19--Certain Residential Mortgage and Variable-Rate Transactions.

19(B) Certain variable-rate transactions.

1. Coverage. Section 226.19(b) applies to all closed-end variable-rate transactions that are secured by the consumer's principal dwelling and have a term greater than one year. The requirements of this section apply not only to transactions financing the initial acquisition of the consumer's principal dewlling, but also to any other closed-end variable-rate transaction secured by the principal dwelling. Closed-end variable-rate transactions that are not secured by the principal dwelling, or are secured by the principal dwelling but have a term of one year or less, are subject to the disclosure requirements of § 226.18(f)(1) rather than those of § 226.19(b). (Furthermore, "SHARED-EQUITY" OR "SHARED-APPRECIATIOn" mortgages are subject to the disclosure requirements of § 226.18(f)(1) rather than those of § 226.19(b) regardless of the general coverage of those sections.) For purposes of this section, the term of a variable-rate demand loan is determined in accordance with the commentary to § 226.17(c)(5).

2. Timing. A creditor must give the disclosures required under this section at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier. In cases where a creditor receives a written application through an intermediary agent or broker, however, footnote 45b provides a substitute timing rule requiring the creditor to deliver the disclosures or place them in the mail not later than three business days after the creditor receives the consumer's written application. This three-day rule also applies where the creditor takes an application over the telephone. If, however, the consumer merely requests an application over the telephone, the creditor must include the early disclosures required under this section with the application that is sent to the consumer. In cases where the creditor solicits applications through the mail, the creditor must also send the disclosures required under this section if an application form is included with the solicitation. In cases where an open-end credit account will convert to a closed-end transaction subject to this section under a written agreement with the consumer, disclosures under this section may be given at the time of conversion. (See the commentary to § 226.20(a) for information on the timing requirements

for § 226.19(b)(2) disclosures when a variable-rate feature is later added to a transaction.)

3. Other variable-rate regulations. Transactions in which the creditor is required to comply with and has complied with the disclosure requirements of the variable-rate regulations of other Federal agencies are exempt from the requirements of § 226.19(b), by virtue of footnote 45a, and are exempt from the requirements of § 226.20(c), by virtue of footnote 45c. Those variable-rate regulations include the regulations issued by the Federal Home Loan Bank Board and those issued by the Department of Housing and Urban Development. The exception in footnotes 45a and 45c is also available to creditors that are required by state law to comply with the federal variable-rate regulations noted above and to creditors that are authorized by title VIII of the Depository Institutions Act of 1982 (12 U.S.C. 3801 et seq.) to make loans in accordance with those regulations. Creditors using this exception should comply with the timing requirements of those regulations rather than the timing requirements of Regulation Z in making the variable-rate disclosures.

4. Examples of variable-rate transactions. The following transactions, if they have a term greater than one year and are secured by the consumer's principal dwelling, constitute variable-rate transactions subject to the disclosure requirements of § 226.19(b).

- Renegotiable rate mortgage instruments that involve a series of short-term loans secured by a long-term obligation, when the lender is obligated to renew the short-term loans at the consumer's option. At the time of renewal, the lender has the option of increasing the interest rate.
- Preferred-rate loans where the terms of the legal obligation provide that the initial underlying rate is fixed but will increase upon the occurrence of some event, such as an employee leaving the employ of the creditor, and the note reflects the preferred rate. The disclosures under §§ 226.19(b)(1) and 226.19(b)(2)(v), (viii), (ix), (x) and (xiii) are not applicable to such loans.

Graduated-payment mortgages and step-rate transactions without a variable-rate feature are not considered variable-rate transactions.

Paragraph 19(b)(1).

1. Substitutes. Creditors who wish to use publications other than the Consumer Handbook on Adjustable Rate Mortgages must make a good faith determination that their brochures are suitable substitutes to the Consumer Handbook. A substitute is suitable if it is, at a minimum, comparable to the Consumer Handbook in substance and comprehensiveness. Creditors are permitted to provide more detailed information than is contained in the Consumer Handbook.

2. Applicability. The Consumer Handbook need not be given for variable-rate transactions subject to this section in which the underlying interest rate is fixed. (See comment 19(b)-4 for an example of a variable-rate transaction where the underlying interest rate is fixed.)

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. If a program is made available only to certain customers of an institution, a creditor need not provide disclosures for that program to other consumers who express a general interest in a creditor's ARM programs. These disclosures must be given at the time an application form is provided or before the consumer pays a non-refundable fee, whichever is earlier. If the consumer subsequently expresses an interest in other available variable-rate loan programs subject to § 226.19(b)(2), the creditor must provide disclosures for such additional programs. The creditor, of course, is permitted to give the consumer information about additional programs subject to § 226.19(b) initially. 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. In addition, these disclosures may be inserted or printed in the Consumer Handbook (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

2. Variable-rate loan program defined. If the identification, the presence or absence, or the exact value of a loan feature must be disclosed under this section, variable-rate loans that differ as to such features constitute separate loan programs.

For example, separate loan program disclosures would be required based on differences in any of the following loan features:

- The index or other formula used to calculate interest rate adjustments.
- The rules relating to changes in the index value, interest rate, payments, and loan balance.
- The presence or absence of, and the amount of, rate or payment caps.
- The presence of a demand feature.
- The possibility of negative amortization.
- The possibility of interest rate carryover.
- The frequency of interest rate and payment adjustments.
- The presence of a discount feature.

In addition, if a loan feature such as the term of the loan must be taken into account in preparing the disclosures required by § 226.19(b)(2) (viii) and (x), variable-rate loans that differ as to that feature constitute separate programs and require separate loan program disclosures under § 226.19(b)(2). If, however, a representative value may be given for a loan feature or the feature need not be disclosed under § 226.19(b)(2), variable-rate loans that differ as to such features do not constitute separate loan programs. For example, separate program disclosures would not be required based on differences in the following loan features:

- The amount of a discount.
- The amount of a margin.

3. As applicable. The disclosures required by this section need only be made as applicable. Any disclosure not relevant to a particular transaction may be eliminated. For example, if the transaction does not contain a demand feature, the disclosure required under §226.19(b)(2)(xi) need not be given. As used in this section, "payment" refers only to a payment based on the interest rate, loan balance and loan term, and does not refer to payment of other elements such as mortgage insurance premiums.

4. Revisions. A creditor must revise the disclosures required under this section

once a year as soon as reasonably possible after the new index value becomes available. Revisions to the disclosures also are required when the loan program changes.

Paragraph 19(b)(2)(i).

1. Change in interest rate, payment, or term. A creditor must disclose the fact that the terms of the legal obligation permit the creditor, after consummation of the transaction, to increase (or decrease) the interest rate, payment, or term of the loan initially disclosed to the consumer. For example, the disclosures for a variable-rate program in which the interest rate and payment (but not loan term) can change might read, "Your interest rate and payment can change yearly." In transactions where the term of the loan may change due to rate fluctuations, the creditor must state that fact.

Paragraph 19(b)(2)(ii).

1. Indentification of index or formula. If a creditor ties interest rate changes to a particular index, this fact must be disclosed, along with a source of information about the index. For example, if a creditor uses the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity as its index, the disclosure might read, "Your index is the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year published weekly in the Wall Street Journal." If no particular index is used, the creditor must briefly describe the formula used to calculate interest rate changes.
2. Changes at creditor's discretion. If interest rate changes are at the creditor's discretion, this fact must be disclosed. If an index is internally defined, such as by a creditor's prime rate, the creditor should either briefly describe that index or state that interest rate changes are at the creditor's discretion.

Paragraph 19(b)(2)(iii).

1. Determination of interest rate and payment. This provision requires an explanation of how the creditor will determine the consumer's interest rate and payment. In cases where a creditor bases its interest rate on a specific index and adjusts the index through the addition of a margin, for example, the disclosure might read, "Your interest rate is based on the index plus a margin, and your payment will be based on the interest rate, loan balance, and remaining loan term." If applicable, the creditor should also disclose that the rate and payment will be rounded.

Paragraph 19(b)(2)(iv).

1. Current margin value and interest rate. Because the disclosures can be prepared in advance, the interest rate and margin may be several months old when the disclosures are delivered. A statement, therefore, is required alerting consumers to the fact that they should inquire about the current margin value applied to the index and the current interest rate. For example, the disclosure might state, "Ask us for our current interest rate and margin."

Paragraph 19(b)(2)(v).

1. Discounted and premium interest rate. In some variable-rate transactions, creditors may set an initial interest rate that is not determined by the index or formula used to make later interest rate

adjustments. Typically, this initial rate charged to consumers is lower than the rate would be if it were calculated using the index or formula. However, in some cases the initial rate may be higher. If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact. For example, if a creditor discounted a consumer's initial rate, the disclosure might state, "Your initial interest rate is not based on the index used to make later adjustments." (See the commentary to § 226.17(c)(1) for a further discussion of discounted and premium variable-rate transactions.) In addition, the disclosure must suggest that consumers inquire about the amount that the program is currently discounted. For example, the disclosure might state, "Ask us for the amount our adjustable rate mortgages are currently discounted." (See the commentary to § 226.19(b)(2)(viii) for a discussion of how to reflect the discount or premium in the historical example.)

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.

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. Limitations do not include legal limits in the nature of usury or rate ceilings under state of Federal statutes or regulations. (See § 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

2. Negative amortization and interest rate carryover. A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, "If any of your payments are not sufficient to cover the interest due, the difference will be added to your loan amount." In addition, the creditor must disclose the existence of any interest rate carryover provisions. Interest rate carryover exists when a change in the index rate that is not imposed at the time of an adjustment because, for example, it exceeds an adjustment limitation, is carried over and incorporated into the calculation of future rate adjustments. For example, if the index rises 3 percentage points during the year and the loan contains a 2 percentage point cap on annual changes (increases or decreases) in the interest rate, interest rate carryover exists if the creditor may impose the additional percentage point the following year as an addition to the rate derived by using the index or formula. In such cases, the creditor must disclose the fact that changes in the index will be carried over to subsequent interest rate adjustment dates. The disclosure might state,

"Changes in the index not passed on as changes in the interest rate will be carried over and applied to subsequent interest rate adjustments."

3. Conversion option. If a loan program permits consumers to convert their variable-rate loans to fixed-rate loans, the creditor must disclose that the interest rate may increase if the consumer converts the loan to a fixed-rate loan. The creditor must also disclose the rules relating to the conversion feature, such as the period during which the loan may be converted, that fees may be charged at conversion, and how the fixed rate will be determined. The creditor should identify any index or other measure or formula used to determine the fixed rate and state any margin to be added. In disclosing the period during which the loan may be converted and the margin, the creditor may use information applicable to the conversion feature during the six months preceding preparation of the disclosures and state that the information is representative of conversion features recently offered by the creditor. The information may be used until the program disclosures are otherwise revised. Although the rules relating to the conversion option must be disclosed, the effect of exercising the option should not be reflected elsewhere in the disclosures, such as in the historical example or in the calculation of the initial and maximum interest rate and payments.

4. Preferred-rate loans. Section 226.19(b) applied to preferred-rate loans, where the rate will increase upon the occurrence of some event, such as an employee leaving the creditor's employ, whether or not the underlying rate is fixed or variable. In these transactions, the creditor must disclose the event that would allow the creditor to increase the rate such as that the rate may increase if the employee leaves the creditor's employ. The creditor must also disclose the rules relating to termination of the preferred rate, such as that fees may be charged when the rate is changed and how the new rate will be determined.

Paragraph 19(b)(2)(viii).

1. Index movement. This section requires a creditor to provide an historical example, based on a $10,000 loan amount originating in 1977, showing how interest rate changes implemented according to the terms of the loan program would have affected payments and the loan balance at the end of each year during a 15-year period. (In all cases, the creditor need only calculate the payments and loan balance for the term of the loan. For example, in a five-year loan, a creditor would show the payments and loan balance for the five-year term, from 1977 to 1981, with a zero loan balance reflected for 1981. For the remaining ten years, 1982-1991, the creditor need only show the remaining index values, margin and interest rate.) Pursuant to this section, the creditor must provide a history of index values for the preceding 15 years. Initially, the disclosures would give the index values from 1977 to the present. Each year thereafter, the revised program disclosures should include an additional year's index value until 15 years of values are shown. If the values for an index have not been available for 15 years, a creditor need only go back as far as the values are available in giving a history and payment example. In all cases, only one index value per year need be shown. Thus, in transactions where interest rate adjustments are

implemented more frequently than once per year, a creditor may assume that the interest rate and payment resulting from the index value chosen will stay in effect for the entire year for purposes of calculating the loan balance as of the end of the year and for reflecting other loan program terms. In cases where interest rate changes are at the creditor's discretion (see the commentary to § 226.19(b)(2)(ii)), the creditor must provide a history of the rates imposed for the preceding 15 years, beginning with the rates in 1977. In giving this history, the creditor need only go back as far as the creditor's rates can reasonably be determined.

2. Selection of index values. The historical example must reflect the method by which index values are determined under the program. If a creditor uses an average of index values or any other index formula, the history given should reflect those values. The creditor should select one date or, when an average of single values is used as an index, one period and should base the example on index values measured as of that same date or period for each year shown in the history. A date or period at any time during the year may be selected, but the same date or period must be used for each year in the historical example. For example, a creditor could use values for the first business day in July or for the first week ending in July for each of the 15 years shown in the example.

3. Selection of margin. For purposes of the disclosure required under § 226.19(b)(2)(viii), a creditor may select a representative margin that has been used during the six months preceding preparation of the disclosures, and should disclose that the margin is one that the creditor has used recently. The margin selected may be used until a creditor revises the disclosure form.

4. Amount of discount or premium. For purposes of the disclosure required under § 226.19(b)(2)(viii), a creditor may select a discount or premium (amount and term) that has been used during the six months preceding preparation of the disclosures, and should disclose that the discount or premium is one that the creditor has used recently. The discount or premium should be reflected in the historical example for as long as the discount or premium is in effect. A creditor may assume that a discount that would have been in effect for any part of a year was in effect for the full year for purposes of reflecting it in the historical example. For example, a 3-month discount may be treated as being in effect for the entire first year of the example; a 15-month discount may be treated as being in effect for the first two years of the example. In illustrating the effect of the discount or premium, creditors should adjust the value of the interest rate in the historical example, and should not adjust the margin or index values. For example, if during the six months preceding preparation of the disclosures the fully indexed rate would have been 10% but the first year's rate under the program was 8%, the creditor would discount the first interest rate in the historical example by 2 percentage points.

Paragraph 19(b)(2)(ix).

1. Calculation of payments. A creditor is required to include a statement on the disclosure form that explains how a consumer may calculate his or her actual monthly payments for a loan amount other than $10,000. The example should be based upon the most recent payment

shown in the historical example. The creditor, however, is not required to calculate the consumer's payment. (See the model clauses in Appendix H-4(C).)
Paragraph 19(b)(2)(x).
1. Initial and maximum interest rate and payment. The disclosure form must state the initial and maximum interest rates and payments for a $10,000 loan at the most recent interest rate (index value plus margin) shown in the historical example. In calculating the maximum payments under this paragraph, a creditor should assume that the interest rate increases as rapidly as possible under the loan program, and the maximum payment disclosed should reflect the amortization of the loan during this period. Thus, in a loan with 2 percentage point annual (and 5 percentage point overall) interest rate limitations or "caps," the maximum interest rate would be 5 percentage points higher than the most recent rate shown in the historical example. Moreover, the loan would not reach the maximum interest rate until limitations, and the maximum payment disclosed would reflect the amortization of the loan during this period. If the loan program includes a discounted or premium initial interest rate, adjusted by the amount of the discount or premium reflected elsewhere in the disclosure for purposes of the requirements of this paragraph. Furthermore, this disclosure should state the amount by which the most recent rate has been adjusted. (See the commentary to § 226.19(b)(2)(viii) regarding disclosure of the amount of a discount or premium.) The creditor may use an interest rate applicable to the program that is more recent than the latest rate shown in the historical example.
Paragraph 19(b)(2)(xi).
1. Demand feature. If a variable-rate loan subject to § 226.19(b) requirements contains a demand feature, this fact must be disclosed. (Pursuant to § 226.18(i), creditors would also disclose the demand feature in the standard disclosures given later.)
Paragraph 19(b)(2)(xii).
1. Adjustment notices. A creditor must disclose to the consumer the type of information that will be contained in subsequent notices of adjustments and when such notices will be provided. (See the commentary to § 226.20(c) regarding notices of adjustments.) For example, the disclosure might state, "You will be notified at least 25, but no more than 120, days before the due date of a payment at a new level. This notice will contain information about the index and interest rates, payment amount, and loan balance." In transactions where there may be interest rate adjustments without accompanying payment adjustments in a year, the disclosure might read, "You will be notified once each year during which interest rate adjustments, but no payment adjustments, have been made to your loan. This notice will contain information about the index and interest rates, payment amount, and loan balance."
Paragraph 19(b)(2)(xiii).
1. Multiple loan programs. A creditor that offers multiple variable-rate loan programs is required to have disclosures for each variable-rate loan program subject to § 226.19(b)(2). Unless disclosures for all of its variable-rate programs are provided initially, the creditor must inform the consumer that other closed-end variable-rate programs exists, and that disclosure forms are available for these additional loan programs. For example, the disclosure form might state, "Information on other

adjustable rate mortgage programs is available upon request."

Section 226.20--Subsequent Disclosure Requirements.

20(a) Refinancings.

3. Variable-rate. If a variable-rate feature was properly disclosed under the regulation, a rate change in accord with those disclosures is not a refinancing. For example, a renegotiable rate mortgage that was disclosed as a variable-rate transaction is not subject to new disclosure requirements when the variable-rate feature is invoked. However, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one, a new transaction subject to new disclosure results if the creditor either:
- Increases the rate based on a variable-rate feature that was not previously disclosed, or
- Adds a variable-rate feature to the obligation.

If either of these two events occurs in a transaction secured by a principal dwelling with a term longer than one year, the disclosures required under § 226.19(b) also must be given at that time.

20(b) Assumptions.

6. Disclosures. For transactions that are assumptions within this provision, the creditor must make disclosures based on the "remaining obligation." For example:
- The amount financed is the remaining principal balance plus any arrearages or other accrued charges from the original transaction.
- If the finance charge is computed from time to time by application of a percentage rate to an unpaid balance, in determining the amount of the finance charge and the annual percentage rate to be disclosed, the creditor should disregard any prepaid finance charges paid by the original obligor, but must include in the finance charge any prepaid finance charge imposed in connection with the assumption.
- If the creditor requires the assuming consumer to pay any charges as a condition of the assumption, those sums are prepaid finance charges as to that consumer, unless exempt from the finance charge under § 226.4.

If a transaction involves add-on or discount finance charges, the creditor may make abbreviated disclosures, as outlined in § 226.20(b) (1) through (5). Creditors providing disclosures pursuant to this section for assumptions of variable-rate transactions secured by the consumer's principal dwelling with a term longer than one year need not provide new disclosures under § 226.18(f)(2)(ii) or § 226.19(b). In such transactions, a creditor may disclose the variable-rate feature solely in accordance with § 226.18(f)(1).

20(c) Variable-rate adjustments.

1. Timing of adjustment notices. This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to § 226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must

deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to § 226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to § 226.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

2. Exceptions. Section 226.20(c) does not apply to "shared-equity" or "shared-appreciation" mortgages.

Paragraph 20(c)(1).

1. Current and prior interest rates. The requirements under this paragraph are satisfied by disclosing the interest rate used to compute the new adjusted payment amount ("current rate") and the adjusted interest rate that was disclosed in the last adjustment notice, as well as all other interest rates applied to the transaction in the period since the last notice ("prior rates"). (If there has been no prior adjustment notice, the prior rates are the interest rate applicable to the transaction at consummation, as well as all other interest rates applied to the transaction in the period since consummation.) If no payment adjustment has been made in a year, the current rate is the new adjusted interest rate for the transaction, and the prior rates are the adjusted interest rate applicable to the loan at the time of the last adjustment notice, and all other rates applied to the transaction in the period between the current and last adjustment notices. In disclosing all other rates applied to the transaction during the period between notices, a creditor may disclose a range of the highest and lowest rates applied during that period.

Paragraph 20(c)(2).

1. Current and prior index values. This section requires disclosure of the index or formula values used to compute the current and prior interest rates disclosed in § 226.20(c)(1). The creditor need not disclose the margin used in computing the rates. If the prior interest rate was not based on an index or formula value, the creditor also need not disclose the value of the index that would otherwise have been used to compute the prior interest rate.

Paragraph 20(c)(3).

1. Unapplied index increases. The requirement that the consumer receive information about the extent to which the creditor has foregone any increase in the interest rate is applicable only to those transactions permitting interest rate carryover. The amount of increase that is foregone at an adjustment is the amount that, subject to rate caps, can be applied to future adjustments independently to increase, or offset decreases in, the rate that is determined according to the index or formula.

Paragraph 20(c)(4).

1. Contractual effects of the adjustment. The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be

the loan balance on which the payment disclosed under § 226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

Paragraph 20(c)(5).

1. Fully-amortizing payment. A disclosure is required if the payment disclosed in § 226.20(c)(4) is not sufficient to pay off the loan balance (including capitalized interest) in the remaining term of the loan at the adjusted interest rate. In such cases, the adjustment notice must state the payment required to fully amortize the loan over the remainder of the term. (This paragraph does not apply if the new payment disclosed in § 226.20(c)(4) is fully amortizing but the final payment will be a different amount due to rounding.)

Appendix H--Closed-End Model Forms and Clauses

4. Model H-4(A). This model contains the variable rate model clauses applicable to transactions subject to § 226.18(f)(1) and is intended to give creditors considerable flexibility in structuring variable rate disclosures to fit individual plans.

5. Model H-4(B). This model clause illustrates the variable-rate disclosure required under § 226.18(f)(2), which would alert consumers to the fact that the transaction contains a variable-rate feature and that disclosures were provided earlier.

6. Model H-4(C). This model clause illustrates the early disclosures required generally under § 226.19(b). It includes information on how the consumer's interest rate is determined and how it can change over the term of the loan, and explains changes that may occur in the borrower's monthly payment. The model clause also contains an example of how to disclose historical changes in the index or formula values used to compute interest rates for the preceding 15 years. In addition, the model clause illustrates the disclosure of the initial and maximum interest rates and payments for a loan originated at the most recent rate shown in the historical example.

7. Model H-4(D). This model clause illustrates the adjustment notice required under § 226.20(c), and provides examples of payment change notices and annual notices of interest rate changes.

18. Model H-14. This sample disclosure form illustrates the disclosures under § 226.19(b) for a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year. The sample form shows a creditor how to adapt the model clauses in Appendix H-4(C) to the creditor's own particular variable-rate program. The sample disclosure form describes the features of a specific variable-rate mortgage program and alerts the consumer to the fact that information on the creditor's other closed-end variable-rate programs is available upon request. It includes information on how the interest rate is determined and how it can change over time, and explains how the monthly payment can change based on a $10,000 loan amount, payable in 360 monthly installments, based on historical changes in the values for the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. Index values are measured as of the first week ending in July for the years 1977 through 1987. This reflects the requirement that the index history be based on values for the same date or period each year beginning with index values for 1977. The sample disclosure

also illustrates the requirement under § 226.19(b)(2)(x) that the initial and the maximum interest rates and payments be shown for a $10,000 loan originated at the most recent rate shown in the historical example. In the sample, the loan is assumed to have an initial interest rate of 9.71% (which was the interest rate in 1987 for the example shown) and to have 2 percentage point annual (and 5 percentage point overall) interest rate limitations or caps. Thus, the maximum amount that the interest rate could rise under this program is 5 percentage points higher than the 9.71% initial rate to 14.71%, and the monthly payment could rise from $85.62 to a maximum of $123.31. The loan would not reach the maximum interest rate until its fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

Board of Governors of the Federal Reserve System, March 30, 1988.

William W. Wiles,

Secretary of the Board.