

RULES and REGULATIONS
FEDERAL RESERVE SYSTEM

12 CFR Part 226

Reg. Z; TIL-1
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Truth in Lending; Update to Official
Staff Commentary

Tuesday, March 7, 1989

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Official staff interpretation.

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 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.

DATES: Effective February 28, 1989, but compliance optional until October 1, 1989.

FOR FURTHER INFORMATION

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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 (TIL-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 seven general updates and one limited update so far. This notice contains the eighth general update. This update reflects material that was published in two proposed updates in 1988--a special update regarding disclosures for adjustable-rate mortgages published at 53 FR 38018 (September 29, 1988) and the proposed general update published at 53 FR 48925 (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(a)(25) "Security Interest". In the original proposal, comment 23(b)-3 would have been revised to clarify that multiple security interests in the same property need not be disclosed on rescission notices. The comment, for example, would have clarified that the disclosure that an interest is retained, as in form H-9, is adequate in a refinancing where a new mortgage is filed and a new advance 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 2(a)(25)-6, instead of in comment 23(b)-3.

Section 226.4--Finance Charge

4(a) Definition

Comment 4(a)-3 is revised to clarify that charges imposed on the consumer by someone other than 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 (8). Comment 4(b) (7) and (8)-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 consummation 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 the 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 renumbered as 17(c)(1)-15 and 17(c)(1)-16, respectively. New comment 17(c)(1)-14 is added to clarify how lenders should 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 end (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 § 226.19(b), as appropriate.

Section 226.18--Content of Disclosures

18(f) Variable Rate

Paragraph 18(f)(2). Comment 18(f)(2)-1 is revised by adding a cross-reference to the commentary to § 226.17(a)(1) regarding the disclosure of additional variable-rate information as directly related information.

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(b) are not required for the construction phase. The comment also makes clear that a creditor may treat 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 § 226.18(f)(2) would be required. As provided in comment 17(a)(1)-5, 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 226.19(b). References to applicable sections and to particular parties are deleted as unnecessary and in order to make the comment more concise.

Paragraph 19(b)(2). Comment 19(b)(b)-1 is revised to omit references to the form of disclosures for ARM programs. New comment 19(b)(2)-3 has been added to describe the manner in which creditors may make the disclosures for each ARM program 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 if 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 in these instances, creditors do not know the loan program terms in advance and therefore cannot prepare program disclosures until after they conclude their negotiations with the consumer. They also expressed concern that "customized" program disclosures might be needed to disclose each individually negotiated program.

Accordingly, an additional sentence has been added to comment 19(b)(2)-1 to make clear that, in such cases, creditors may provide appropriate program disclosures as soon as reasonably possible after the terms have been decided upon, but in no event later than the time a non-refundable fee is paid.

Furthermore, with the flexibility provided in this commentary concerning disclosure of variations in loan maturities, rate caps and frequencies of adjustments, the potential that "customized" disclosures will need to be developed for each private banking customer is significantly limited.

Comment 19(b)(2)-2 has been revised to clarify that the term to maturity of an ARM loan does not constitute a program variation. This revision corresponds to the guidance provided in new comments 19(b)(2)(viii)-5 and 19(b)(2)(x)-2 on the terms to maturity which may be used in calculating and disclosing the historical example and the initial and maximum rates and payments.

Comments 19(b)(2)-3 and -4 have been renumbered as comments 19(b)(2)-4 and -5, respectively. Based upon public comment and to permit greater flexibility for compliance with the requirements, new comment 19(b)(2)-3

has been added to describe the form for disclosures required under § 226.19(b)(2). The Comment incorporates material previously contained in comment 19(b)(2)-1 and includes new material which explains that a creditor may use either a separate disclosure form to describe each ARM program it offers or a disclosure form which describes more than one available ARM program. The comment explains that the multiple program form must disclose if any program features are available only in conjunction with certain other features. Finally, the new comment explains that multiple terms to maturity or multiple payment amortizations may be illustrated in any program disclosure form whether the form describes separate or multiple programs.

Paragraph 19(b)(2)(iii). Comment 19(b)(2)(iii)-1 differs from the proposal in two respects. The use of the term "balloon payment" has been replaced by a more specific reference to the type of transactions subject to the disclosure provisions. The comment is revised to clarify that, in transactions where paying the periodic payments will not fully amortize the loan 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 creditor, however, need not reflect any irregular final payment in the historical example or in the disclosure of the initial and 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.)

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

19(b)(2)(v)-1 is 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 program disclosure.

Paragraph 19(b)(2)(vi). Comment 19(b)(2)(vi)-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.

Paragraph 19(b)(2)(vii). 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 pricing of the loan. The final comment extends the alternative disclosure rule to periodic limitations in addition to overall rate limitations. In such cases, the comment explains that the creditor may disclose the range of the lowest and highest periodic and overall 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)-1 is revised to clarify that, in transactions that end before the last

year in the historical example, the example must illustrate all significant loan program terms such as rate limitations that would have affected the interest rate for the remaining years shown in the example.

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 and further consideration, the proposed comment has been revised. Under the final comment, creditors will be permitted to base the disclosures required under § 226.19(b)(2)(viii) and (x) for ARM loans within certain ranges upon only three maturities--five, fifteen and thirty years. Thus, a creditor who offers ARM loans for any term over one year would be permitted to make the disclosures required under these sections based on five-, fifteen- and thirty-year terms, and need not illustrate every other maturity that is offered. The comment also permits creditors to use five-, fifteen- and thirty-year term assumptions for disclosing payments based on amortizations different than 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)-1 must base the historical example upon the highest rate limitation disclosed under § 226.19(b)(2)(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)(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)(ix). Comment 19(b)(2)(ix)-1 states that a creditor should base the example of how a consumer may calculate their actual payments 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 last payment shown in the historical table.

Paragraph 19(b)(2)(x). Comment 19(b)(2)(x)-2 is added to allow creditors to base their calculations of the initial and maximum rates and payments upon the terms to maturity stated in new comment 19(b)(2)(viii)-5. The comment explains that the term used for making

disclosures under § 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 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)-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 periodic and overall rate limitation disclosed under § 226.19(b)(2)(vii). The creditor would be further required to state the periodic and overall rate limitations used in calculating the maximum rate and payment.

Comment 19(b)(2)(x)-4 also is 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 § 226.19(b)(2)(vi).

Section 226.20--Subsequent Disclosure Requirements

20(b) Assumptions

The proposed amendment to comment 20(b)-6 to add a cross reference to § 226.19(b) 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 creditor should disclose any 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)-8 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 30-8 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 30-8. The disclosure requirements for limitations on rate increases are described elsewhere in the regulation and commentary.

Appendix D--Multiple-Advance Construction Loans

Although not reprinted 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)(1)(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 266--[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. The revisions amend the commentary (TIL-1, 12 CFR Part 226 Supp. I) by adding comment 2(a)(25)-6; adding a sentence and a bullet at the end of comment 4(a)-3; revising the heading and text of comment 4(b) (7) and (8)-2; adding a bullet at the end of comment 17(a)(1)-5; adding two sentences after the first sentence, and revising the second and third sentences and the parenthetical material in comment 17(c)(1)-8; redesignating comments 17(c)(1)-14 and -15 to be comments 17(c)(1)-15 and -16, respectively; adding comment 17(c)(1)-14; adding parenthetical material at the end of comment 18(f)(2)-1; adding three sentences at the end of comment 19(b)-1; revising the first, third and fourth sentences, adding a sentence after the third sentence, and removing the last three sentences 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)(iii)-1; adding a new sentence before the parenthetical material at the end of comment 19(b)(2)(v)-1; adding four sentences and parenthetical material at the end of comment 19(b)(2)(vi)-1; adding five sentences and parenthetical material at the end of comment 19(b)(2)(vii)-1; revising the third sentence in the parenthetical material after the first sentence in comment 19(b)(2)(viii)-1; adding comments 19(b)(2)(viii)-5, -6 and -7; adding a sentence after the second sentence in comment 19(b)(2)(ix)-1; adding comments 19(b)(2)(x)-2, -3 and -4; adding a sentence after the second sentence in comment 20(c)(4)-1; revising comment 20(c)(5)-1; changing the references to "comment 18(f)-8" in the first sentence and in the first bullet of comment 24(b)-5 to be "comment 17(c)(1)-10"; adding comment 25(a)-3; revising the first sentence of comment 30-8; revising the last sentence in comment 30-13; removing the word "most" and changing the reference to "§ 226.18(f)(4)" in comment app. D-2 to be "§ 226.18(f)(1)(iv)" to read as follows:

Supplement 1--[Amended]

Subpart A--General

Section 226.2--Definitions and Rules of Construction

2(a) Definitions.

2(a)(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 when security interests from prior transactions remain of record and a new security interest is taken in connection with the transaction.

Section 226.4--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 loan 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) (7) and (8)

2. Insurance written in connection with a transaction. Insurance sold after consummation in closed-end credit transactions 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 226.17--General Disclosure 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(c) Basis of Disclosures and Use of Estimates. Paragraph 17(c)(1)

8. Basis of disclosures in variable-rate transactions. * * * Creditors should base the disclosures only on the initial rate and should not assume that this rate will increase. For example, in a loan with an initial rate of 10 percent and a 5 percentage points rate cap, creditors should base the disclosures on the initial rate and should not assume that this rate will increase 5 percentage points. However, in a variable-rate transaction with a seller buydown that is reflected in the credit contract, a consumer buydown, 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(c) for a discussion of buydown, discounted, and premium transactions and the commentary to section 226.19(a)(2) for a

discussion of the redisclosure 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 disclosures assume that you will repay the loan at the time our payments to you end. As provided in your agreement, your repayment may be required at a different time."

- If the reverse mortgage has neither a specified period for disbursements nor a specified repayment date and these terms will be determined solely 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). 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 which do not include the consumer's death, the creditor must base the disclosures upon the occurrence of the event estimated to be most likely to occur first.)

- In making the disclosures, the creditor must assume that all disbursements and accrued interest will be paid by the consumer. For example, if the note has a nonrecourse provision providing that the consumer is not obligated for an amount greater than the value of the house, 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 comment 17(c)(1)-11, and the appreciation feature must be disclosed in accordance with § 226.18(f)(1). If the reverse mortgage has a variable interest rate, is written for a term greater than one year, and is secured by the consumer's principal

dwelling, the shared appreciation feature must be described under § 226.19(b)(2)(vii).

Section 226.18--Content of Disclosures

18(f) Variable Rate

Paragraph 18(f)(2)

1. Disclosure required. * * * (See the commentary to § 226.17(a)(1) regarding the disclosure of certain directly related information in addition to the variable-rate disclosures required under § 226.18(f)(2).)

Section 226.19--Certain Residential Mortgage Transactions

19(b) 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, the creditor may treat the construction and the permanent phases as separate transactions with distinct terms to maturity or as a single combined transaction. For purposes of the disclosures required under section 226.18, the creditor may nevertheless treat the two phases either as separate transactions or as a single combined transaction in accordance with section 226.17(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 226.18(f)(2)(ii) or 226.19(b).

Paragraph 19(b)(2)

1. Disclosure for each variable-rate program. A creditor must provide disclosures to the consumer that fully describe each of the creditor'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 non-refundable fee is paid. If a consumer who has received program disclosures subsequently expresses an interest in other available variable-rate programs subject to 226.19(b)(2), or 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 § 226.19(b)(2)(viii) and (x), variable-rate loans that differ as to that feature constitute separate programs under § 226.19(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 program need not repeat information applicable to each program that is described. For example, a form describing multiple programs may disclose the information applicable to all of the programs in one place with the various program features (such as options permitting conversion to a fixed rate) disclosed separately. The form, however, must state if any program feature that is described is available only in conjunction with certain other program features. Both the separate and multiple program disclosures 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 inserted or printed in the Consumer Handbook (or a suitable substitute) as long as they are identified as the creditor's loan program disclosures.

Paragraph 19(b)(2)(iii)

1. Determination of interest rate and payment. * * * 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 creditor must disclose this fact. For example, the disclosure might read, "Your periodic payments will not fully amortize your loan and you will be required to make a single payment of the periodic payment plus the remaining unpaid balance at the end of the loan term." The creditor, however, need not

reflect any irregular final payment in the historical example or in the disclosure of the initial and maximum rates and payments. * * *

Paragraph 19(b)(2)(v)

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 its program disclosures. * * *

Paragraph 19(b)(2)(vi)

1. Frequency. * * * 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 will 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 need not disclose each periodic or overall rate limitation that is currently available. As an alternative, the creditor

may disclose the range of the lowest and highest periodic and 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 at each adjustment will be set at an amount in the following range: Between 1 and 2 percentage points at each adjustment. 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 periodic and overall rate limitations.)

Paragraph 19(b)(2)(viii)

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.)

5. Term of the loan. In calculating the payments and loan balances in the historical example, a 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 amortizations 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 20 years may be based on a 15-year term or amortization; and ARMs with terms or amortizations over 20 years may be based on a 30-year term or amortization. Thus, disclosures for ARMs offered with any term from over 1 year to 40 years may be based solely on terms of 5, 15 and 30 years. Of course, a creditor may always base the disclosures on the actual terms or amortizations offered. If the creditor bases the disclosures on 5-, 15- or 30-year terms or payment amortization as provided above, the term or payment amortization used in making the disclosure must be stated.

6. Rate caps. A creditor using the alternative rule described in comment 19(b)(2)(vii)-1 for disclosure of rate limitations must base the historical example upon the highest periodic and overall rate limitations disclosure under section 226.19(b)(2)(vii). In addition, the creditor must state the limitations 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 now known.)

Paragraph 19(b)(2)(ix)

1. Calculation of payments. * * *
However, in transactions in which the latest payment shown in the historical example is not for the latest year of index values shown (such as in a five-year loan), a creditor may provide additional examples based on the initial and maximum payments disclosed under § 226.19(b)(x).

Paragraph 19(b)(2)(x)

2. Term of the loan. In calculating the initial and maximum payments the creditor need not base the disclosures on each term to maturity or payment amortization 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 or payment amortizations selected for the purpose of making disclosures under § 226.19(b)(2)(viii) must be used. In addition, creditors must state the term or payment amortization used in making the disclosures under this section.

3. Rate caps. A creditor using the alternative rule for disclosure of interest rate limitations described in comment 19(b)(2)(vii)-1 must calculate the maximum interest rate and payment based upon the highest periodic and overall rate limitations disclosed under § 226.19(b)(2)(vii). In addition, the creditor must state the rate limitations 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 payment upon the earliest possible first adjustment disclosed under § 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.)

Section 226.20--Subsequent Disclosure Requirements

20(c) Variable-Rate Adjustments

Paragraph 20(c)(4).

1. Contractual effects of the adjustment. * * * 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 has changed as a result of the rate adjustment.

Paragraph 20(c)(5).

1. Fully-amortizing payment. This paragraph requires a disclosure only when negative amortization occurs as a result of the adjustment. A disclosure is not required simply because a loan calls for non-amortizing or partially amortizing 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 equal 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 § 226.20(c)(4) is not sufficient to prevent negative amortization in the loan. The adjustment notice must state the payment required to prevent negative amortization. (This paragraph does not apply if the payment disclosed in § 226.20(c)(4) is sufficient to prevent negative amortization in the loan but the final payment will be a different amount due to rounding.)

Subpart D--Miscellaneous

Section 226.25--Record Retention

25(a) General Rule

3. Certain variable-rate transactions. In variable-rate transactions that are subject to the disclosure requirements of § 226.19(b), written procedures for compliance with those requirements as well as a sample disclosure form for each loan program represent adequate evidence of compliance. (See comment 25(a)-2 pertaining to permissible methods of retaining the required disclosures.)

Section 226.30--Limitation on Rates

8. 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.

Board of Governors of the Federal Reserve System, February 28, 1989.

William W. Wiles,

Secretary of the Board.