RULES and REGULATIONS

FEDERAL RESERVE SYSTEM

12 CFR Part 226

Reg. Z; Docket No. R-0655
FR Doc. 89-13507
Filed 6-8-89

RIN 7100-AA91

Truth in Lending; Home Equity Disclosure and Substantive Rules

Friday, June 9, 1989

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is revising Regulation Z (Truth in Lending) to implement the Home Equity Loan Consumer Protection Act of 1988. The law requires creditors to provide consumers with extensive information for open-end credit plans secured by the consumer's dwelling, and imposes substantive limitations on these plans. Creditors will have to provide information at the time an application is provided to the consumer, including information about the payment terms, fees imposed under the plan, and, for variable-rate plans, information about the index and a fifteen-year history of changes in the index values. Creditors will be required to provide consumers with a brochure prepared by the Board (or a suitable substitute) describing home equity plans. The regulation also imposes duties on third parties who provide applications to consumers and modifies the rules relating to advertisements for home equity plans.

In addition to these disclosure requirements, the regulation limits a creditor's right to terminate a plan and accelerate any outstanding balance, or to change the terms of a plan after it has been opened, and limits the type of index that can be used for variable-rate plans.

EFFECTIVE DATE: June 7, 1989, but compliance is optional until November 7, 1989.

FOR FURTHER INFORMATION CONTACT: Sharon Bowman, Leonard Chanin or Thomas Noto, Staff Attorneys, or Michael Bylsma, Senior Attorney, Division of Consumer and Community Affairs, at (202) 452-3667 or 452-2412; for the hearing impaired only, contact Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) Background

In December 1987 the Board proposed amendments to Regulation Z to change the existing disclosure requirements for home equity lines of credit secured by the consumer's principal dwelling (52 FR 48702). Subsequently, the Home Equity Loan Consumer Protection Act was enacted on November 23, 1988 (Pub. L. 100- 709). The law superseded the Board's proposal.

The statute and amendments to the regulation leave in place existing disclosure requirements for open-end plans. They add, however, two requirements to this framework. First, as is the case for certain closed-end adjustable-rate mortgages (see § 226.19(b) of Regulation Z), creditors generally will be required to provide detailed disclosures about their home equity plans when an application is provided to the consumer. Second, creditors will be required to provide additional information, along with the current disclosures, prior to the first transaction under the plan. In addition to these disclosures the statute and regulation place certain substantive limitations on home equity plans.

On January 23, 1989, the Board published a proposed rule to amend Regulation Z to implement the statute. (54 FR 3063). The Board received approximately 150 comments on the proposal. A number of commenters expressed concern about the new law, and in particular about the substantive requirements. They felt, however, that the Board had provided a workable framework to provide guidance to creditors. Many commenters recognized that the statute provided the Board with little flexibility in implementing the act, but requested further guidance on various issues.

Based on a review of the comments and further analysis, the Board is adopting a final rule implementing the act. The statute provides that creditors must comply with the law five months after enactment of final regulations by the Board. Therefore, compliance is mandatory as of November 7, 1989. Creditors are free to comply with the new requirements prior to that date.

(2) Amendments To Regulation Z

The Home Equity Loan Consumer Protection Act is quite detailed and, for the most part, the regulatory amendments mirror the statutory requirements. The amendments to Regulation Z incorporate the disclosure provisions into a new § 226.5b of the regulation and into existing § 226.6. (A new § 226.5a was added to Regulation Z by the Board on April 6, 1989, to implement the Fair Credit and Charge Card Disclosure Act. See 54 FR 13855. The changes now being made amend the regulation as it has been modified by the amendments implemented under the Fair Credit and Charge Card Disclosure Act.)

Modifications are made to the form and timing rules in § 226.5, the change in terms rules in § 226.9, the rescission provisions in section 226.15, and the advertising rules contained in § 226.16. Technical amendments also are made to §§ 226.1, 226.5a, and 226.14.

This notice contains a detailed section-by-section discussion of the new rules and provides guidance on a large number of technical questions raised by the commenters. In general, the amendments apply to open-end credit lines secured by the consumer's dwelling (not limited to the principal dwelling).

The new rules require that creditors provide disclosures and a brochure at the time an application for such a line of credit is given to the consumer, although extra time is permitted in certain cases, such as where applications are made on the telephone or through intermediaries. The disclosures generally have to be grouped together and separated from any unrelated information. Among other things, creditors must describe the payment terms of the plan, including how the minimum payment is determined. The disclosures cover both the draw period and any repayment period, although some information about the repayment period may be delayed until repayment begins. Creditors must itemize and provide the amount of any fees they impose to open or use the plan, and an estimate of fees imposed by third parties to open the plan.

Detailed information about any variable-rate feature will be provided by creditors. This includes the index used to determine the rate adjustments, the frequency of changes in the annual percentage rate (APR), and a fifteen-year historical table showing how the APRs and payments would have been affected by index value changes over that time.

In addition to these early disclosures, the regulation requires that certain information (such as payment information) be given a second time along with the disclosures currently required when open-end credit accounts are opened. The regulation specifies which disclosures must be given a second time.

Though the regulation principally deals with creditors, third parties have a limited duty to provide information if they provide applications to consumers.

The advertising rules also are modified. For example, if an advertisement states any payment information it must include other cost information.

In addition to disclosures, the regulation contains substantive limitations on the way home equity plans may be structured. The regulation limits the ability of a creditor to terminate a plan and accelerate any outstanding balance, or to change the terms of a plan after it has been opened. The regulation also limits the type of index a creditor can use for variable-rate plans.

Renewals and "conversions" of home equity lines raise a number of issues. Guidance on how these should be handled appears later in this notice, as well as how the effective date of the new rules will affect applications and new plans being offered on that date. Much of the information in this notice will be incorporated into the annual update to the Official Staff Commentary on Regulation Z that will be proposed for comment in the fall. Furthermore, a number of cross-references and modifications will be added to existing commentary provisions when the Official Staff Commentary is proposed. For example, comment 6(a)(2)-2 (dealing with the ability of a creditor to increase a rate without reference to an index) and comment 17(b)-2 (dealing with conversion of open-end credit to closed-end credit) will be modified to reflect the new home equity rules.

Section 226.1--Authority, Purpose, Coverage, Organization, Enforcement and Liability

The amendments to § 226.1 are largely unchanged from the proposal, except that they add a reference to the credit and charge card rules adopted by the Board in April 1989. The amendments to § 226.1(b) reference the fact that variable-rate contracts secured by the consumer's dwelling must state a maximum interest rate. (This requirement was added to § 226.30 of the regulation in November 1987.) This section also references the limitations imposed on home equity plans. The addition of § 226.1(c) reflects the fact that certain requirements of the home equity rules apply to persons other than creditors who provide applications to consumers. The amendments to § 226.1(d) add a reference to the new home equity rules, and amendments made to implement the Fair Credit and Charge Card Disclosure Act (added to the regulation in April 1989).

Section 226.5--General Disclosure Requirements

Footnote 8 accompanying § 226.5(a) is amended to reflect the fact that the disclosures required at the time of application need not be in a form that the consumer can keep. The existing rule in § 226.5(a)(2) also applies to the early disclosure statement. Thus, when the term "annual percentage rate" is disclosed with a number, it must be more conspicuous than other required disclosures. A new paragraph (4) is added to § 226.5(a) to reflect the fact that § 226.5b disclosures have their own form rules. A new paragraph (4) is added to § 226.5(b) to reflect the fact that § 226.5b disclosures have their own timing rules.

Section 226.5a--Credit and Charge Card Applications and Solicitations

Section 226.5a(a)(3) is modified to substitute the new regulatory citation of the home equity rules for the statutory citation in § 226.5a. (Section 226.5a--dealing with credit and charge card applications and solicitations--does not apply to home equity plans accessible by a credit or charge card.)

Section 226.5b--Requirements for Home Equity Plans

Section 226.5b provides that the amendments to Regulation Z apply to all open-end credit plans secured by the consumer's dwelling. Several commenters asked whether the home equity rules apply only where the consumer's principal dwelling is involved. While the statute uses the term "principal dwelling," it is specifically defined to include any vacation or second home of the consumer. The Board is using the term "dwelling" since it has an established meaning under Regulation Z. The final rules apply to all dwellings, a term defined in § 226.2(a)(19) of the regulation to include residential structures containing one to four units. Thus, the new rules are not limited to plans secured by the consumer's primary dwelling. The regulation does not set out special owner-occupancy rules. However, the existing commentary to § 226.3(a) (which discusses whether transactions are consumer or business purpose credit in part based on owner-occupancy criteria) provides guidance on whether a home equity plan is subject to Regulation Z at all.

The fact that coverage of these rules is broader than just principal dwelling does not affect the scope of any other provisions of the regulation. Thus, for example, the right of rescission applies only in cases where the consumer's principal dwelling secures the credit.

The APR referred to throughout new § 226.5b is the APR corresponding to the periodic rate, as determined by § 226.14(b). Since a number of commenters were concerned that the statement to that effect in footnote 10c in the proposal was ambiguous, the provision now appears in the introduction to the section.

Conversion Rules

A number of commenters requested guidance on what disclosures are required if the initial agreement calls for the draw phase of a plan to "convert" to a repayment phase, which has many aspects of closed-end credit. Some home equity plans provide in the initial agreement for a period during which repayment of the amount borrowed is made, but no further draws may be taken. In such cases, the disclosures must include information about both phases of the plan. All of the disclosures in § 226.5b, as applicable, must be given for the repayment phase. Thus, for example, creditors must provide payment information about the repayment phase as well as about the draw period, as required by § 226.5b(d)(5). The information set out in § 226.5b(d)(7), § 226.5b(d)(9) and, if the rate during repayment will be variable, in § 226.5b(d)(12) also must be given for the repayment phase. If the rate that will apply during the repayment phase is fixed at a known amount, the creditor must provide an APR under § 226.5b(d)(6) with regard to that phase. If, however, a creditor uses an index to determine the rate that will apply at the time of conversion--even if the rate during the repayment phase will be fixed--creditors must provide the information in § 226.5b(d)(12), as applicable.

Although full disclosure of the terms about the repayment phase is required, creditors have a choice with regard to when it must be given. Creditors may provide all of this information at the time the other early disclosures are given to the consumer, in accordance with § 226.5b. As an alternative, creditors need disclose only the basic payment terms information under § 226.5b(d)(5)(i) and (ii) with the early disclosures, and defer all the other required disclosures about the repayment phase until conversion. If provided at conversion, disclosures must be based on information available at that later time. For example, the historical table as discussed under § 226.5b(d)(12)(xi) must reflect the index for the most recent fifteen years. Sample form G-14C has been added to the appendix to the regulation to illustrate how this later disclosure might look. Creditors using either of these alternative disclosure rules are required to provide information about the repayment phase as set forth in § 226.6 (See the discussion of this requirement under that section.)

Creditors providing these disclosures, whether early or at conversion, are not required to provide any additional disclosures under the rules in Subpart C of the regulation for closed-end credit. The existing rules (such as those in comments 17(b)-2 and 19(b)-2 of the Official Staff Commentary, which discuss converting an open-end account to a closed-end one) do not apply to home equity plans in which a repayment phase is provided for in the original agreement. The Congress, in the act, requires disclosures about the closed-end aspects of a home equity line to be given as part of the home equity "plan." The Board believes the Congress intended to provide special treatment for this product. Consistent with this approach of treating both phases as a single open-end credit plan, during the repayment phase creditors are required to continue providing periodic statements under § 226.7 and to comply with other open-end credit rules set forth in Subpart B of the regulation, as well as the substantive rules set forth in § 226.5b(f). For example, if the original agreement provides for a repayment phase with a variable-rate feature, rate changes must be tied to an index not within the control of the creditor, as discussed in § 226.5b(f)(1).

If the original home equity line agreement does not call for a repayment phase to follow the draw period, and the creditor and consumer later enter into a closed-end credit agreement to repay the outstanding balance, the creditor must give closed-end credit disclosures (including those under § 226.19(b) and 226.20(c), if applicable) since this would be deemed a new transaction. In such cases, the substantive rules in § 226.5b(f) do not apply to the closed-end credit transaction.

Section 226.5b(a)--Form of Disclosures

Unlike existing Truth in Lending requirements for closed-end and open-end credit, the disclosures provided at the time of application need not be in a form the consumer can keep. Thus, although the disclosures must be in writing, creditors are permitted to place the first set of disclosures on the application form the consumer returns to the creditor to apply for the plan. Although several commenters questioned this rule, the act and legislative history make it clear that creditors are not required to provide this information in a form the consumer can keep. (The disclosures provided under § 226.6(e) of the regulation, however, must be in a form the consumer can keep. See also the discussion under § 226.6(e) for special rules when the early disclosures are given in a retainable form.)

Section 226.5b(a) requires most of the disclosures to be grouped together and "segregated" from unrelated information provided to the consumer in connection with the application. The brochure and the variable rate information described in § 226.5b(d)(12) may be provided either separately from or with the other disclosures. Creditors choosing to provide a description of the items referred to in § 226.5b(d)(4)(iii)--for example, the conditions under which the creditor may prohibit additional extensions of credit--may give this information separately from or with the other disclosures. Similarly, creditors choosing to provide a good faith itemization of fees imposed by third parties--as set forth under § 226.5b(d)(8)--also may give those disclosures separately from or with the other disclosures. (The disclosures required under these sections are set forth in greater detail under the specific sections.)

Under the regulation, greater flexibility is permitted in complying with the segregation standard than currently exists for closed-end credit. Disclosures for home equity plans tend to be less concise and more narrative in form than those for closed-end credit. Therefore, the regulation applies a more liberal standard that permits inclusion of information that explains or expands on the required disclosures. Information on other aspects of the plan that is not related to the required disclosures, such as underwriting criteria, however, is not permitted to be interspersed with the disclosures. Such information, of course, could be provided as long as it is separate from the required disclosures. The segregation requirement does not apply to the second set of disclosures, which are provided under § 226.6 prior to the first transaction.

In the first set of disclosures, that is, those given at application, § 226.5b(a)(2) of the regulation provides that certain items will be further highlighted by requiring them to precede the other disclosures. Consumers will be notified, for example, that: (1) They should keep a copy of the disclosures; (2) they have a right to obtain a refund of fees if terms change and they decide not to enter into the contract as a result;

(3) they risk the loss of the dwelling in the event of default; and (4) a creditor may terminate a plan or suspend future advances under certain circumstances. With regard to the last item, if a creditor describes these conditions, the precedence rule does not apply to that descriptive disclosure. The precedence rule does not apply to the second set of disclosures at all.

If creditors give a single disclosure form covering all of their home equity offerings, all aspects of their plans must be described in the first set of disclosures. For example, if a creditor offers several payment options, all options have to be set forth. Furthermore, if any aspects of a plan are linked together--for example, if the consumer can obtain certain payment options only in conjunction with other plan features, such as a particular variable-rate feature--the creditor must clearly disclose the relation among those plan features. Creditors need not, however, reflect all payment options in providing the minimum payment example under § 226.5b(d)(5)(iii), the "worst case" example under § 226.5b(d)(12)(x), and the historical table under § 226.5b(d)(12)(xi). (See the comments accompanying these sections for the specific disclosure requirements.)

As an alternative to the combined disclosure method, creditors may prepare separate disclosure forms where multiple options exist. For example, creditors offering more than one payment option during the draw phase or during any repayment phase of a plan may choose to create separate disclosure forms for such variations. Thus, creditors who offer consumers a choice during the draw period, for example, of (1) minimum payments equal to any accrued unpaid finance charge or (2) minimum payments equal to two percent of the outstanding balance, could choose to create separate disclosure forms for the two payment options. Creditors who follow this alternative of preparing separate disclosures must include a statement on each form that the consumer should ask about the creditor's other home equity programs. (This disclosure would be required only with respect to other programs available to the public and not, for example, employee preferred-rate plans.)

Creditors would have to provide disclosures about their other programs as soon as reasonably possible in response to any request for the disclosures.

Section 226.5b(b)--Time of Disclosures

Section 226.5b(b) requires the disclosures and brochure to be given at the time an application is provided to the consumer. In the case of applications contained in publications such as magazines or received by the creditor through third parties, footnote 10a allows the creditor to mail or deliver the disclosures and brochure to the consumer within three business days of its receipt of the application. Several commenters suggested this three-day period begin upon receipt of a "completed application", recommending that the Board use the term as used in Regulation B (which implements the Equal Credit Opportunity Act). This has not been adopted in the final regulation. Regulation B uses the term "completed application" to begin the time period in which creditors must notify an applicant of action taken on an application. This is appropriate since a creditor may not be able to make a credit decision until all relevant information has been received. The purpose of the home equity early disclosure rules is quite different. They are meant to assist consumers in shopping for credit; thus it is important to provide information early in the shopping process.

The three-day delay applies where the creditor takes an application over the telephone. If, however, the consumer simply requests over the telephone that an application be mailed, the creditor must provide the disclosures and a brochure with the application sent to the consumer. (Creditors should consult the rules in § 226.5b(h) regarding the imposition of a nonrefundable fee before receipt of the disclosures.)

Some creditors use a general purpose application for their home equity plans as well as their other credit products. The home equity disclosures and brochure must accompany this type of application if the application or materials accompanying it indicate that it can be used to apply for a home equity line of credit. In addition, if a general purpose application is provided to a consumer as a result of an injury about a creditor's home equity plan, the disclosures and brochure must accompany the application, even if the application or accompanying materials do not specify that it can be used to apply for a home equity plan.

Commenters also asked how the disclosure rules relate to mail solicitations and so-called "take-ones." In cases where the creditor sends applications through the mail, the creditor must send the disclosures and a brochure along with the application. Applications made available to the public without need for a request, such as "take-ones," also have to be accompanied by (or combined with) the disclosures and a brochure.

Several commenters raised the issue of whether disclosures had to be provided with "response cards." Some creditors provide a response card instead of an application in solicitation materials sent to consumers. Consumers are requested to return the card to the creditor to indicate their interest in the home equity product. Creditors need not provide the home equity disclosures and brochure with the response card if the only action taken by the creditor upon receiving the card is to send an application form to the consumer (which would then be accompanied by the disclosures and a brochure), or to telephone the consumer regarding an application.

In any situation in which footnote 10a applies, thus permitting a delay in disclosures, the creditor may determine within the three-day period that the application will not be approved. In such a case, the creditor need not provide the disclosures or the brochure. The same would be true if the consumer withdraws the application within that time period.

If an application contained in a magazine or other publication is mailed to an intermediary or broker or if such a person takes an application over the telephone, footnote 10a permits that person to mail the disclosures and a brochure within three business days of receipt. (See the discussion below of when such third parties have a duty to provide disclosures.)

Section 226.5b(c)--Duties of third parties

In addition to requiring creditors to provide disclosures and a brochure to consumers at an earlier time, § 226.5b(c) of the regulation imposes a limited duty on third parties who provide applications to consumers.

Under § 226.5b(c), a third party is

required to provide disclosures only if that party has the disclosures for a creditor's particular home equity plan in its possession. Third parties do not have an affirmative duty to obtain such disclosures about a creditor's program, or to create a set of disclosures based on what the third party knows about a creditor's program. The Board believes that requiring both a third party and a creditor to provide the consumer with identical information about the same plan would result in unnecessary duplication. If, however, a creditor supplies disclosures to a third party along with its application form, the third party must give the consumer the disclosures when the application form is given out. In all cases, consumers will be provided disclosures by the creditor within three days after the creditor receives the application. Furthermore, a nonrefundable fee cannot be collected from the consumer by the creditor or a third party until after the consumer receives the disclosures. (See § 226.5b(h).)

Although the duty of third parties to provide the disclosures may arise infrequently, the regulation requires third parties, in all cases, to give the home equity brochure at the time an application is given to the consumer. Because providing the brochure is not linked to the availability of information from a creditor about its specific plan, the Board believes third parties will have access to the brochure, and thus be able to provide it with the application.

This provision imposes duties on third parties and not on creditors. Therefore creditors are not responsible for ensuring that the third parties comply with the requirements of this section.

Section 226.5b(d)--Content of disclosures

Section 226.5b(d) of the regulation lists the information to be given to consumers when they receive an application for home equity plans. As is the case with existing Truth in Lending disclosure rules, the information would be provided only to the extent applicable; thus, for example, if negative amortization cannot occur in a program, no mention of it need be made.

Section 226.5b(d)(1)--Retention of information

Because the disclosures need not be in a form the consumer can keep, the consumer will be advised to make and retain a copy of the disclosures. Creditors need not include this statement if the disclosures are in a form the consumer can keep, for example, if the disclosures are not part of the form that must be returned to the creditor to apply for a plan.

Section 226.5b(d)(2)--Conditions for disclosed terms

Creditors will include a statement of any time by which an application must be submitted to obtain specific terms disclosed. A number of commenters misunderstood this provision in the proposal. Creditors are free to not guarantee any terms, in which case they must indicate that all of the terms are subject to change. In that case, they need not include a date or time period. The legislative history makes clear that a creditor also may choose to guarantee some of the terms of the plan and not others. If creditors choose to guarantee only some of the terms, they must indicate which terms may change prior to opening the plan. Creditors can provide a specific date or use a time period as long as the consumer can determine from the disclosure the specific date by which an application must be submitted to obtain any guaranteed terms.

Creditors also must notify the consumer of the right to a refund of all fees paid in connection with the application if any disclosed term changes before opening the plan and as a result the consumer chooses not to enter into the plan. The final regulation has been amended to clarify that this provision does not apply to changes resulting from fluctuations in the index value in a variable-rate plan; this includes changes in the APR and changes in the maximum rate or "cap" if it is expressed as an amount over the initial interest rate. (See the discussion of this provision at § 226.5b(g).)

Section 226.5b(d)(3)--Security interest and risk to home

Creditors will have to disclose the fact that a security interest is being taken in the consumer's dwelling and that the consumer may lose the home in the event of default.

Section 226.5b(d)(4)--Possible actions by creditor

Under § 226.5b(d)(4), a statement must be provided that, under certain circumstances, a creditor may terminate the plan and accelerate any outstanding balance, prohibit additional advances or reduce the credit limit, and, if applicable, implement certain modifications to the original terms, as set forth in the initial agreement. The regulation, in conformity with the legislative history accompanying the act, also requires a statement that fees may be imposed if the account is terminated by the lender. This disclosure regarding fees is required, for example, if a penalty or prepayment fee may be imposed upon termination by the lender in such circumstances. The disclosure would not be required if the fees are the same ones that would be imposed when the plan expires in accordance with the agreement. The actual amount of such fees need not be provided. In response to commenters, the Board is clarifying that this disclosure is not required if the only fees that may be imposed upon termination are fees such as attorney fees or court costs involved with the collection of the debt. Additionally, an increase in the APR--such as a higher rate of interest if the consumer fails to make payments--does not trigger this disclosure.

Section 226.5b(d)(4)(ii) provides that consumers will be notified that they can receive, upon request, a description of the conditions that permit the creditor to terminate the plan, prohibit additional advances or reduce the credit limit, and implement modifications during the term of the plan. Upon receiving a request from a consumer for such information prior to the consumer opening the plan, the creditor must provide this information as soon as reasonably possible. This requirement had previously been incorporated in § 226.5b(g) of the proposal.

As an alternative to disclosing that the consumer has the right to receive a statement of the conditions under which the creditor may take the indicated actions, § 226.5b(d)(4)(iii) provides that the creditor may simply disclose what those conditions are. One way to make this disclosure is to provide a highlighted copy of the contract, security agreement or other document which contains such information. The relevant items must be distinguished in some fashion from the other information contained in the document, for example, by use of a cover sheet that specifically points out which contract provisions contain this information, or by marking the relevant items. If a creditor does not choose to provide a document of this sort, it may simply describe the conditions using the language in §§ 226.5b(f)(2) and 226.5b(f)(3)(vi). If specified changes may be implemented during the plan as described in § 226.5b(f)(3)(i), a statement such as the following could be made: "The initial agreement permits us to make certain changes to the terms of the line at specified times or upon the occurrence of specified events." Whichever method is used to provide the list of conditions, it may appear with the segregated disclosures or apart from those disclosures. If it is with the segregated disclosures, it need not appear before other disclosures.

Section 226.5b(d)(5)--Payment terms

Under § 226.5b(d)(5), creditors are required to describe the payment terms of the plan, including the length of the draw period and any repayment period. (The combined length of the draw period and any repayment period does not have to be stated.) If the length is indefinite, creditors would state that fact.

Several commenters requested guidance on how renewal provisions should be handled in making these disclosures. If, under the credit agreement, a creditor retains the right to review a line at the end of the specified draw period and determine whether to "renew" or extend the original draw period of the plan, such provisions should be ignored for purposes of the disclosures. Thus if an agreement provides that the draw period is for five years and that the creditor may renew the draw period for an additional five years, the possibility of renewal should be ignored and the draw period should be considered five years. A creditor may discuss a renewal feature with the other disclosures without violating the segregation rules.

Where a creditor provides a combined disclosure form for all of its home equity offerings, all payment options must be stated, including any different payment terms that may exist during the draw period and during any repayment period, as well as any differences that may apply within either period. As mentioned in the discussion of conversion rules under § 226.5b, creditors may give some of the disclosures about the repayment phase at the time of conversion, rather than with the early disclosures. Whether those disclosures are delayed or not, creditors must provide the basic payment terms information under § 226.5b(d)(5)(i) and (ii) with the early disclosures about both the draw and repayment phases.

If the plan permits the consumer to convert any of the loan balance to a fixed repayment term, this feature must be disclosed under § 226.5b(d)(5)(ii). Such a provision would be ignored for purposes of other disclosures, however, including the historical table under § 226.5b(d)(12)(xi).

The disclosures must set forth how the minimum periodic payment is determined, the frequency of payments, and whether making only the minimum payments may not repay any or all of the principal balance by the end of the plan. The regulation also calls for a disclosure of the possibility of any balloon payment. Under some programs, a balloon payment may occur under

certain circumstances, but is not certain or even likely. In such cases the disclosure would indicate that a balloon payment may occur. In other cases, such as programs where payments include interest only, a balloon payment will occur as a matter of course and the disclosures should reflect that fact. If repayment of the entire outstanding balance would be required only in the case of termination and acceleration, the balloon disclosure would not apply.
Section 226.5b(d)(5)(ii) does not require the amount of any balloon to be provided. (See the requirement under § 226.5b(d)(5)(iii), however.) The term "balloon payment" need not be used.
Several commenters asked whether a final payment that is only slightly larger than any other payment (for example, because of rounding) must be considered a balloon payment. Creditors need not disclose there is a balloon payment if the final payment is not more than twice the amount of other minimum payments under the plan. An explanation of the balance computation method is not required by this section.
Section 226.5b(d)(5)(iii) requires creditors to disclose an example, based on an assumed $10,000 outstanding balance and a recent APR, showing the amount of the minimum periodic payment and of any balloon payment, and the time it would take to pay off the balance if the consumer made only those payments. If it is relevant to calculating its payments, a creditor may assume the credit limit as well as the outstanding balance is $10,000. The issue was raised of whether a creditor that only offers lines of credit for less than $10,000 would have to use this amount in the example. If a creditor only offers lines of credit under $10,000, the creditor may use an alternative assumed outstanding balance of $5,000 rather than $10,000. Footnote 10c provides that, for fixed-rate plans, a recent APR is one that has been in effect under the plan within the twelve months prior to the date the disclosures are provided to the consumer. The footnote also provides that, for variable-rate plans, a recent APR is the most recent index value and margin provided in the historical table (see § 226.5b(d)(12)(xi)), or a more recent rate.
As an alternative to providing examples for each payment option--in plans that have multiple payment options within the draw period or within any repayment period--creditors may provide representative examples. For purposes of this disclosure, as well as for the variable rate disclosures under § 226.5b(d)(12)(x) and (xi) the Board is establishing three categories of payment options. The first category consists of plans that permit minimum payment of only accrued finance charges ("interest only" plans). The second category includes plans in which a fixed percentage or a fixed fraction of the outstanding balance or credit limit (for example, 2% of the balance or 1/180th of the balance) is used to determine the minimum payment. The third category includes all other types of minimum payment options, such as a specified dollar amount plus any accrued finance charges. Creditors may classify their minimum payment arrangements within one of these three categories, even if other features exist, such as varying lengths of a draw or repayment period, required payment of any past due amounts, minimum dollar amounts, and the payment of late charges.
The creditor may use a single example within each category to represent the payment options in that category. For instance, if a creditor permits minimum

payments of 1%, 2%, 3% or 4% of the outstanding balance, it may pick one of these four options and provide the § 226.5b(d)(5)(iii) example for that option alone. The example used to represent a category must be an option commonly chosen by consumers, or a typical or representative example. Creditors choosing to use a representative example within each category must use the same examples for purposes of the disclosures under § 226.5b(d)(5)(iii), 226.5b(d)(12)(x), and 226.5b(d)(12)(xi). Separate examples must be given for the draw and repayment periods unless the payments are determined the same way during both periods.

This approach of allowing a single example to represent a category of payment options does not apply to the requirements under any other provisions. Creditors must fully describe all payment options under § 226.5b(d)(5) (i) and (ii). Similarly, the payment information provided in accordance with § 226.6(e)(2) must reflect the actual payment option chosen by the consumer (or all of the options available if the consumer retains several options during the plan).

Certain "reverse mortgages" (sometimes called "reverse annuity mortgages" or "RAMs") involve an open-end line of credit and require repayment in full only when certain events occur, such as the consumer's death. These RAMs are subject to the new rules if the line is secured by the consumer's dwelling. The payment disclosures will reflect that a single payment is due when one of the specified events happens. The single payment may be considered the "minimum periodic payment" and consequently would not be treated as a balloon payment. The example of the minimum payment under § 226.5b(d)(5)(iii) should assume a single, $10,000 advance to the consumer when the plan is opened and should assume repayment will occur upon the consumer's death, if that is one of the events requiring repayment. In such cases, the disclosures may be based on a representative life expectancy, that is, one that is an average of, or is typical of, life expectancies recently used in developing the creditor's RAM. In making the disclosures, the creditor must assume that the $10,000 advance and any accrued interest will be paid in full by the consumer and must disregard any non-recourse provision (which provides that the consumer is not obligated for an amount greater than the value of the dwelling). Some RAMs provide that some or all of the appreciation in the value of the property will be shared between the consumer and the creditor. As part of the disclosure of the payment terms, the creditor also must describe the shared appreciation feature. (See the discussion of this feature under § 226.5b(f)(3)(i).) (See also the discussion of RAMs under § 226.5b(d)(12) (x) and (xi).)

Section 226.5b(d)(6)--Annual percentage rate

Section 226.5b(d)(6) provides that, for fixed-rate plans, a recent APR will be provided. Consumers also must be told that the APR does not include costs other than interest. Some commenters argued that the proposal's reference to "the APR" was too broad since the "historical APR" on periodic statements does in fact include finance charges other than interest. The introduction to § 226.5b makes clear that APR as used throughout § 226.5b refers to the APR that corresponds to the periodic rate, as determined under § 226.14(b).

Section 226.5b(d)(7)--Fees imposed by the creditor

Under § 226.5b(d)(7), creditors will provide a description and the amount of charges they impose to open, use and maintain the account, and a statement of when the consumer must pay the charges. These fees include items such as application fees, points, annual fees, transaction fees, and fees imposed when the plan converts to a repayment phase (if the conversion is provided for in the original agreement). Fees imposed by third parties, that are initially paid by the consumer to the creditor, may be included in this disclosure or in the disclosures under § 226.5b(d)(8). As discussed in § 226.5b(f)(3)(i), a creditor may provide a step fee schedule in which a fee will increase a specified amount at a specified date. The amount of any fees and when the fee is payable must be disclosed under this section. Charges may be stated as an estimated dollar amount for each fee, or as a percentage of a typical or representative amount of credit or house value. Several commenters asked whether fees imposed for late payment, stop payment, exceeding the credit limit, or closing out an account would have to be disclosed under this section; they do not. Creditors need not use the term "finance charge" or "other charge" in describing the fees imposed by the creditor under this section or those fees imposed by third parties under § 226.5b(d)(8).

Some creditors provide that they will rebate closing costs, for example, to the extent any interest is paid during the first year of the plan. Regardless of such a provision, if closing costs are imposed--even if possibly "rebated" later--creditors must disclose such costs. (The existence of the rebate feature may be included in the disclosures.)

Section 226.5b(d)(8)--Fees imposed by third parties to open a plan

Under § 226.5b(d)(8), an estimate of the total fees imposed by third parties to open the account (such as appraisal, credit report, government agency and attorney fees) stated as a single dollar amount or a range will be provided. Fees imposed by third parties, even if initially paid to the creditor, may be included in this disclosure. Even if such fees may be "rebated" (as discussed in § 226.5b(d)(7)), they must be disclosed. In response to comments, the Board has modified the regulation to clarify that this section covers only those fees imposed by third parties to open the plan. Thus, for example, this section does not require disclosure of a fee imposed by a third party, such as a government agency, at the end of a plan to release a security interest.

Creditors also must provide a statement that the consumer may request more specific cost information about such fees from the creditor. Upon receiving a consumer's request for such an itemization prior to the consumer opening the plan, the creditor must respond as soon as reasonably possible. As an alternative to including this statement, creditors may provide an itemization of such fees (by type and amount) with the early disclosures. Where impractical to provide the dollar amount, fees may be expressed on a unit cost basis, for example, $.50 per $100 of the credit line. If provided, this itemization may appear together with or separate from the other disclosures.

Section 226.5b(d)(9)--Negative amortization

Under § 226.5b(d)(9), a statement if the plan has negative amortization--which will increase the principal balance and reduce the consumer's equity in the dwelling--must be provided.

Section 226.5b(d)(10)--Transaction requirements

Section 226.5b(d)(10) requires creditors to state any limitations on the number of extensions or amount of credit that can be obtained during any time period, and any minimum draw or minimum outstanding balance requirement stated as a dollar amount or as a percentage. A limitation on ATM usage is not covered by this provision, unless that is the only means by which the consumer can obtain funds. This provision does not require a disclosure of the maximum credit limit offered by the creditor.

Section 226.5b(d)(11)--Tax implications

Section 226.5(d)(11) requires that consumers be told to consult a tax advisor if further information regarding the deductibility of interest and charges under the plan is desired.

Section 226.5b(d)(12)--Disclosures for variable-rate plans

Section 226.5b(d)(12) requires creditors to provide information about any variable-rate feature contained in a plan. Many of these disclosures closely parallel the disclosures currently required for closed-end variable-rate transactions secured by a consumer's principal dwelling. (See § 226.19(b) of the regulation.) As discussed above in the general comments on § 226.5b, under this section information must be provided as to variable-rate features of both the draw period and any period in which repayment occurs with no further ability to obtain advances. There is, however, some flexibility regarding the timing of the disclosures about the repayment period. These disclosures, like others, need be provided only as applicable. (See § 226.5b(f)(3)(i) for features that are not considered variable rate and thus do not require disclosure under this section.)

Subsection (i)--APR may change. Creditors are required to state that the APR may change and that the payment or term may change due to the fact that the APR is variable.

Subsection (ii)--APR includes only interest. A statement that the APR does not include costs other than interest must be provided. (See the discussion at § 226.5b(d)(6) about the fact that this refers to the APR that corresponds to the periodic rate.)

Subsection (iii)--Index information. Creditors have to identify the index used to determine rate adjustments and a source of information about the index. (See the comments accompanying § 226.5b(f)(1) for further discussion of what constitutes a source of information.)

Subsection (iv)--How the APR is determined. Creditors have to describe how the APR will be determined (for example, by stating that a margin is added to the index value). This provision does not require disclosure of the specific amount of the margin.

Subsection (v)--"Ask about" current rate information. Because the disclosure forms can be preprinted and rate information may not be current, consumers will be told to "ask about" the current index value, margin, discount or premium (if applicable), and APR.

Subsection (vi)--Discounted or premium rate. If the initial rate is discounted or is a premium, a disclosure of that fact as well as the period the discounted or premium rate will be in effect must be provided.

Subsection (vii)--Frequency of changes in the APR. The frequency of changes in the APR must be stated, for example, monthly or quarterly.

Subsection (viii)--Rules relating to index value, APR and related changes. Rules relating to changes in the index value and the APR and resulting changes in the payment amount must be set forth. This provision requires an explanation of preferred-rate provisions in variable-rate plans, where the rate will increase not only when the index increases but also upon the occurrence of some event, such as the borrower-employee leaving the creditor's employ, or the consumer closing an existing account with the creditor. Similarly, an explanation must be given if the plan permits the consumer to switch from a variable rate to a fixed rate, including disclosure of whether a fee may be imposed for such a change. Any payment limitations and the possibility of rate carryover also must be provided.

Subsection (ix)--Rate limitations. The proposal required a statement of any annual limitations on rate increases. Several commenters raised concerns about how to comply if their rate caps were not expressed as annual limits (for example, if there were only monthly caps). In response to this concern, the regulation provides that an annual cap must be stated if there is one, and that a rate cap for a shorter period can be stated instead if there is no annual cap. Caps for shorter periods must be stated in terms of a specific amount of time (for example, six-month limitations). A limit based on twelve monthly billing cycles should be treated as an annual cap. If there are no annual (or shorter) limits on rate increases, the fact that there is no annual limit must be stated.

The maximum rate that may be imposed under each payment option over the life of the plan also must be provided. The life of the plan includes the draw period and any repayment period that is provided for in the original agreement. This rate may be stated as a specific rate (for example, 18%) or as a stated amount above an initial rate (for example, 5 percentage points above the initial interest rate). In either circumstance, creditors may use a range of the lowest and highest rate limitations that may be applicable in disclosing both the periodic limitations and the maximum overall rate in the early disclosures given at application. Creditors that disclose the caps as ranges and creditors that disclose the maximum rate as a stated amount above an initial rate must include a statement that the consumer should ask about the rate limitations that are currently applicable. This statement may be included with the other features consumers are told to ask about under § 226.5b(d)(12)(v).

Subsection (x)--Maximum payment example. Creditors must show the minimum periodic payment required when the maximum rate for each payment option is in effect, based on a $10,000 outstanding balance. (See the discussion in § 226.5b(d)(5) for circumstances in which creditors may use a lower outstanding balance.) If a range is used to disclose the maximum cap under § 226.5b(d)(12)(ix), the highest rate in the range must be used for this disclosure. The disclosure also must state the earliest time the maximum rate could be imposed; this would reflect, for example, the effect of periodic rate caps. As an alternative to making disclosures based on each payment option, creditors may choose a representative example within the three categories of payment options upon which to base this disclosure. (See the discussion at § 226.5b(d)(5).) However, separate examples must be provided for the draw period and for any repayment period unless the payment is determined the same way in both periods.

In a single payment open-end reverse mortgage, creditors should assume that the APR reaches the maximum as quickly as permitted under the plan and that the maximum rate stays in effect until repayment is called for. (See the discussion at § 226.5b(d)(5) concerning the other assumptions that the creditor should make in disclosing RAMs.)

Subsection (xi)--Historical example. A 15-year historical table, based on an assumed $10,000 initial extension of credit and showing how the APRs and payments would have been affected by the index value changes under the plan, must be provided. (See the discussion in § 226.5b(d)(5) for circumstances in which a creditor may use a lower outstanding balance.) Index values and APRs must be shown for the entire 15 years and must be based on the most recent 15 years. If the length of the plan is less than 15 years, however, payments need only be shown for as long as the plan lasts. If the values for an index have not been available for 15 years, creditors need only go back as far as the values have been available in giving the history and may start the example at the year for which values are first available. In providing this information, creditors should assume that the $10,000 balance is an advance taken at the beginning of the first billing cycle and is reduced according to the terms of the plan. Creditors should assume that the consumer takes no subsequent draws. (If relevant, the creditor may assume the $10,000 is both the advance and the credit limit.)

The history must reflect the method of choosing values for the plan. For instance, if an average of index values is used in the plan, averages would be used in the history, but if an index value as of a particular date is used a single index value would be shown. The creditor is required to assume one date within a year (or one period, if an average is used) on which to base the history of index values for each loan plan. The creditor may choose to use index values as of any date or period as long as the index value as of this date or period is used for each year in the index history. Only one index value per year need be shown, even if the plan provides for adjustments to the APR or payment more than once in a year. In such cases, the creditor can assume that the index rate remained constant for the full year for the purpose of calculating the APR and payment. Updating will be necessary only once each year to reflect the most recent year's index value. To assist creditors in constructing histories of certain common indices, the Board is publishing in this notice tables of index values for commonly used indices.

The payment figures in the example must reflect all significant program terms. For example, features such as rate and payment caps, a discounted APR, negative amortization, and rate carryover must be taken into account in calculating the payment figures if these would have been applicable. Both periodic and overall rate limitations must be reflected

in the example. If ranges of rate limitations are provided under § 226.5b(d)(12)(ix), the highest annual and overall rates must be used in the example. Rate limitations that may apply more often than annually should be treated as if they were annual limitations. For example, if a creditor imposes a 1% cap every six months, this should be reflected in the example as if it were a 2% annual cap.
Creditors need show only one payment per year in the table, even though payments may vary during a year. (The calculations, however, should be based on the actual payment computation formula.) Creditors may assume that payments are made on the last day of the billing cycle, the billing date or the payment due date. Creditors must be consistent in the manner of selecting the month that is used to illustrate payment information.
A few commenters asked whether annual balance information or balloon payments could be added to the table. Information about the remaining balance and any balloon payment may, but need not, be reflected in the table.
Creditors need not provide the required historical disclosure for all of their various payment options, but may select a representative payment option within each of the three categories of payments upon which to base their disclosure. (See the discussion at § 226.5b(d)(5).)
An historical example is required for single payment plans such as RAMs. Although 15 years of index values and APRs would be shown, the payment column would be blank until the year that the single payment would be required, assuming that payment is estimated to occur within 15 years. (See the discussion at § 226.5b(d)(5) for additional guidance in making RAM disclosures, including the assumptions to be made about the term for repayment.)
A value for the margin must be assumed in order to prepare the example. Creditors must select a margin that they have used during the six months preceding preparation of the disclosures and state that the margin is one that they have used recently. The margin selected may be used until the creditor annually updates the disclosure form to reflect the most recent 15 years of index values.
Similarly, if the home equity plan has a discounted or premium initial rate, creditors will be permitted to select a discount or premium 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 example for as long as it is in effect. A creditor may assume that a discount or premium that will be in effect for part of a year is in effect for the entire year for purposes of reflecting it in the example.
In setting forth the historical example under this section, creditors that choose to provide disclosures about the repayment phase as part of the early disclosures (see the general discussion about conversion under § 226.5b) must reflect all features of the repayment phase in the table, including the appropriate index values, margin, length of the phase, and payments. For example, if different indices are used during the draw and repayment phases, the index values for that portion of the 15 years that reflects the repayment phase must be the values for the appropriate index.
Creditors who choose to provide information about the repayment phase at the time the plan converts to the

repayment phase, rather than with the early disclosures, need not reflect the repayment phase in the table (just as they may omit information about the repayment phase for purposes of all the disclosures under § 226.5b(d)(12)). In such cases, the index values and APRs relating to the draw period would be shown for the entire 15 years (even if the draw period is less than 15 years).

Section 226.5b(e)--Brochure

Section 226.5b(e) requires both creditors and third parties providing applications to furnish consumers with a brochure prepared by the Board describing home equity plans, or a suitable substitute. The Board's brochure (which is expected to be published by the end of June 1989) describes home equity plans, including the potential advantages and disadvantages. The brochure also provides guidance on how to compare home equity plans with closed-end credit. The Board envisions that any substitutes must be comparable in substance and comprehensiveness, recognizing that some lenders' brochures may contain more detailed descriptions of their particular home equity programs than contained in the Board's brochure. The regulation requires third parties to provide consumers with the brochure if an application is given to the consumer by the third party. The Board believes, however, that requiring a second brochure to be given by the creditor in such circumstances is unnecessary. Therefore, the creditor's duty to provide the brochure will be met if the third party provides the brochure to the consumer. This will avoid duplication. A number of commenters misunderstood this provision in the proposal, thinking that the Board was attempting to make creditors directly liable for a duty that the act places on the third party. In fact, this provision does not affect the duty of the third party but merely relieves creditors of the need to give a second brochure to the consumer on condition that the creditor ensures that the brochure was actually given. If a creditor does not wish to rely on the actions of the third party, it of course may provide a copy of the brochure.

Section 226.5b(f)--Limitations on home equity plans

The substantive limitations in § 226.5b(f) apply to both actions creditors may take and the provisions that they include in contracts. These limitations apply to assignees and holders as well as the original creditor. The substantive rules apply to both the draw period and to any repayment period that is provided for by the initial agreement. (If the agreement does not call for a repayment period, and the parties subsequently enter into a closed-end transaction to pay off the outstanding balance, the later agreement is not subject to the substantive limitations.)

Section 226.5b(f)(1)--Changing the APR

Under § 226.5b(f)(1), a creditor may change the APR after the plan is opened only if the change is based on an index outside the creditor's control and the index value is available to the public. This provision prohibits a creditor from using its own prime rate or its own "cost of funds" or simply retaining the right to change rates at its discretion. A creditor is permitted, however, to use the prime rate published in a publication or a newspaper, such as the Wall Street Journal, for example, even if the bank's

own prime rate is one of several rates used to establish that rate. A creditor also may use any other index not within the creditor's control. A publicly available index need not always be published in a newspaper, but the creditor must make certain that a consumer could independently verify any rate information.
This provision does not prohibit specific rate changes if set forth in the initial contract, such as in preferred rate and step rate plans, as provided under § 226.5b(f)(3)(i).

Section 226.5b(f)(2)--Termination and acceleration

Under § 226.5b(f)(2), creditors are prohibited from terminating an account and accelerating payment of the outstanding balance prior to the scheduled expiration of the plan. If a creditor offers an "evergreen" account, that is, one that has a potentially indefinite draw period, a creditor may not terminate the plan or accelerate payment of the balance.
There are three exceptions to the rule against termination and acceleration. First, a creditor may terminate the plan if there has been fraud or material misrepresentation by the consumer in connection with the plan. This exception includes fraud or misrepresentation at any time, either during the application process or during the draw period and any repayment period. What constitutes fraud or misrepresentation is determined by State law and the agreement between the parties and may include acts of omission, as well as overt acts, as long as any necessary intent on the part of the consumer exists.
Second, a creditor may terminate the plan and accelerate the balance if the consumer has failed to meet the repayment terms of the agreement. This provision permits termination if the consumer actually fails to make payments. A creditor may not terminate a plan if, for example, the consumer, in error, sends a payment to the wrong location, such as a branch rather than the main office of the creditor. Filing for bankruptcy may permit termination, if the consumer fails to make payments under the plan.
Finally, a creditor is permitted to terminate and accelerate if the consumer acts or fails to act in a way that adversely affects the creditor's security for the plan, or any right of the creditor in such security. In response to commenters, the Board has revised the regulation to more closely parallel the language used in the statute with regard to the creditor's rights in the security. The regulation limits the exception to action or inaction by the consumer (and not third parties) as provided in the statute.
This provision permits termination, for example, if the consumer transfers title to the property or sells the property without the permission of the creditor, or if the consumer fails to maintain required insurance on the dwelling. This exception also may be invoked if the consumer commits waste or otherwise destructively uses or fails to maintain the property such that it adversely affects the security.
Failure to pay taxes on the property or some other action by the consumer resulting in the filing of a lien senior to that held by the creditor also might impair the creditor's security. Death of the consumer and taking of property through eminent domain both permit termination since the title to the property transfers as a result. Commenters asked

whether events such as the filing of a judgment against the consumer or illegal use of the property would permit termination. The Board believes that whether the creditor can terminate an account depends on the circumstances. For example, the filing of a judgment against the consumer would permit the creditor to terminate the plan if the amount of the judgment and collateral subject to the judgment is such that the creditor's security is adversely affected. Foreclosure by a prior lienholder would permit termination of the line if the creditor's security interest is adversely affected.

If an event occurs which allows termination and acceleration, a creditor may take action short of terminating an account and accelerating payment of the outstanding balance. Commenters raised a number of questions about the permissible extent of such action. Under the final regulation, if one of the exceptions would apply, a creditor is permitted to temporarily or permanently prohibit additional extensions of creditor or reduce the credit limit without demanding payment in full. In addition, a creditor may take other action; for example, the creditor may change the payment terms or may require the consumer to pay a fee if the consumer fails to maintain required property insurance and the creditor subsequently purchases the insurance. A creditor may provide in its agreement that a higher rate or higher fees apply, for example, if the consumer fails to meet the repayment terms or otherwise acts so that the creditor is permitted to terminate the plan and accelerate the balance. Furthermore, a creditor that does not immediately and permanently terminate an account and accelerate payment or take another permitted action may take such action at a later time, if the condition constituting an exception under § 226.5b(f)(2) still exists at that time (or if another of the exceptions applies).

Creditors are not permitted to specify in their contracts any other events that allow terminating an account or accelerating payment of the outstanding balance beyond those listed in the regulation. Thus, for example, the contract may not contain a demand provision that may be exercised before the end of the stated term nor may it provide that the account will be terminated and the balance accelerated if the rate cap is reached.

Section 226.5b(f)(3)--Change of terms

Section 226.5b(f)(3) provides that a creditor in general may not change the terms under the plan after the account has been opened. Generally, a creditor may not increase any fee or impose a new fee once the plan has been opened. There are several exceptions to the rule prohibiting the creditor from changing the terms of the plan after it has been opened.

Subsection (i)--Events provided for in the contract. This provision permits a creditor to implement specific changes set forth in the contract that are contemplated on the occurrence of a specific event. Both the triggering event and the resulting modification must be stated with specificity. For example, in an employee loan program, the contract could provide that a specified higher rate--or specified higher margin in a variable-rate plan--will apply if the borrower's employment with the creditor ends. A creditor also could have a step rate or step fee schedule in which specified changes in the rate or the fees are set to occur on certain dates or at specified time periods. A creditor also may provide in the initial agreement that it will be entitled to a share of the appreciation in the value of the property as long as the specific percentage of the appreciation and the specific circumstances in which it must be paid are set forth. A contract also may permit a consumer to switch among minimum payment options during the plan. This option could be provided in the initial agreement (as long as the specific features are described) or could be offered after the plan is opened since it would constitute a "beneficial change" as discussed in § 226.5b(f)(3)(iv). Because this provision applies only to specific changes that are contemplated on the occurrence of specific events, the regulation does not permit a creditor to include a general provision in its contract permitting changes to any or all of the terms of the plan. For example, creditors may not include "boilerplate" language in the agreement stating that they reserve the right to change the fees imposed under the plan.

The regulation also does not permit a creditor to include in the initial agreement any "triggering events" or permissible responses that the regulation expressly addresses. Based on public comment, the proposal may not have been clear on whether the prohibition was intended to cover the inclusion of triggering events, or responses, or both. The Board intends that both be covered. For example, an agreement may not provide that the margin in a variable-rate plan will increase if there is a material change in the consumer's financial circumstances, since the triggering event (a material change in the consumer's financial circumstances) is set forth in the regulation and the permissible response (freezing the line or lowering the credit limit) is spelled out. Similarly a contract cannot contain a provision allowing the creditor to freeze a line due to an insignificant decrease in property value since the regulation allows that response only for a significant decrease. A creditor may not freeze the line, reduce the credit limit, terminate the plan, or accelerate the balance except in those circumstances specified in the regulation, since such consequences are set forth in the regulation.

The Board solicited comment in the proposal on whether creditors should be permitted to specify a second index (for variable-rate plans) in the initial agreement, which would be used should the original index become unavailable. Based on further analysis, the Board believes the statute does not permit such an action since it expressly provides the conditions that must be met to substitute an index when the original index becomes unavailable. The Board has modified the requirement for this second index, however, as set forth under § 226.5b(f)(3)(ii), to provide greater flexibility to lenders if the original index becomes unavailable.

Subsection (ii)--Substitution of index. This provision provides that the creditor may change the index and margin used under the plan if the original index becomes unavailable, as long as historical fluctuations in the two indices were substantially similar, and as long as the new index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. If the new index is newly established and therefore does not have any historical rate history, creditors may nevertheless use it as long as the new index and margin produce an interest rate substantially similar to the rate in effect when the original index became unavailable.

Subsection (iii)--Changes made by written agreement. The regulation prohibits unilateral changes; it permits creditors to change the terms after a plan is opened provided the consumer expressly agrees in writing to the change at that time. Thus, for example, under this subsection a consumer and a creditor could agree in writing to change the repayment terms from interest-only payments to payments that reduce the principal balance.

Any subsequent agreement must be consistent with the rules set out in § 226.5b(f). For example, a creditor and consumer could not enter into an agreement to base changes in the APR on the movement of an index controlled by the creditor, because § 226.5b(f)(1) provides that any index used as a basis for APR changes must be one not under the creditor's control. Similarly, an agreement could not specify events that will permit termination and acceleration beyond those set forth in the regulation. In addition, creditors are not permitted to assume consent because the consumer uses an account, even if use of an account constitutes acceptance under state law. The Board believes this restriction will carry out the Congressional intent to limit changes after a plan is opened, yet accommodate the need for adjustments explicitly agreed to by the consumer.

Subsection (iv)--Beneficial changes. This provision permits creditors to make changes, after the plan has been entered into, that "unequivocally benefit" the consumer as long as the change is beneficial for the entire term of the agreement. In response to suggestions by commenters, the Board is providing additional examples of beneficial changes. A creditor may make changes that offer more options to consumers, as long as existing options remain. For example, a creditor could offer the consumer the option of making lower monthly payments or could increase the credit limit (although the right of rescission under § 226.15 may apply if the credit limit is increased). Similarly, a creditor could extend the length of the plan, as long as it was extended or renewed on the same terms. Creditors are permitted to temporarily reduce the rate or fees charged under a plan. The rate or fees, however, may not later be increased to a level higher than that initially disclosed. (If fees are later increased up to the original level, creditors may need to comply with the requirements in § 226.9(c) concerning notification of changes in terms.)

Creditors also may add additional means to access the line even if fees are associated with using the device, provided that the consumer retains the ability to use prior access devices on the original terms.

Subsection (v)--Insignificant changes. This subsection provides an exception to the general prohibition against changing terms after the plan has been entered into for changes to "insignificant terms." This is intended to address operational and similar problems, such as changing the address of the creditor for purposes of sending payments. In response to commenters, the Board is providing additional examples of items that would constitute insignificant changes. The provision permits minor changes to features such as the billing cycle date, the payment due date (as long as the consumer does not have a diminished grace period if one is provided), and the day of the month on which index values are used to determine changes to the rate for variable-rate plans. A creditor also may change its rounding rules, in accordance with the tolerance rules set forth in § 226.14. For example, a creditor may change its rules to state an exact APR of 14.3333 percent as 14.3 percent, even if it previously stated the APR as 14.33 percent. A creditor may change the balance computation method it uses only if the change produces an insignificant difference in the finance charge paid by the consumer. For example, a creditor may switch from using the daily balance method (including new purchases) to the average daily balance method (including new purchases). This exception would not permit a creditor to unilaterally change a term such as a fee charged for late payments.

Subsection (vi)--Temporary suspensions of credit and reduction of credit limit. This subsection provides that a creditor may temporarily prohibit additional extensions of credit or reduce the credit limit in seven circumstances. First, a creditor may take such action if the value of the dwelling that secures the plan declines significantly below the property's appraised value for purposes of the plan. A number of commenters asked the Board to provide guidance on what constitutes a "significant" decline in the property. The Board believes what constitutes a significant decline will vary according to individual circumstances. In any event, however, if the value of the dwelling declines such that the initial difference between the credit limit and the available equity (based on the property's appraised value for purposes of the plan) is reduced by fifty percent, that will be deemed a significant decline in the value of the dwelling for purposes of the regulation. For example, assume that a house with a first mortgage of $50,000 is appraised at $100,000 and the credit limit is $30,000. The difference between the credit limit and the available equity is $20,000. Therefore, the creditor could prohibit further advances if the value of the property declines from $100,000 to $90,000.

Second, a creditor may prohibit additional extensions of credit or reduce the credit line if the creditor reasonably believes the consumer will be unable to fulfill the repayment obligations under the plandue to a material change in the consumer's financial circumstances. Two conditions must be met for a creditor to use this exception. First, there must be a "material change" in the consumer's financial circumstances. For example, a significant decrease in the consumer's income could meet this part of the requirement. Second, as a result of this change, the creditor must have a reasonable belief that the consumer will be unable to fulfill the payment obligations of the plan. This second condition has been modified from the proposal. A creditor does not have to rely on specific "evidence" (such as the failure to pay other debts) to meet this test. This provision does require, however, that the creditor have some basis for believing that the consumer will be unable to make payments under the plan.

The third exception permits a creditor to prohibit additional extensions of credit or reduce the credit line if the consumer is in default of any material obligations under the agreement. The regulation does not define what qualifies as a default of a material obligation. Some commenters requested that the regulation provide examples of what is a material default. A number of other commenters, however, expressly asked that the regulation not define or provide examples of this provision. They stated that any definition or use of examples might limit the conditions considered a default of a material obligation.

The fourth exception permits a creditor to prohibit additional advances or reduce the credit line if action by a governmental body precludes the creditor from imposing the agreed-upon APR. This exception will generally apply where, for example, a state usury law is enacted which prohibits a creditor from imposing the APR being used at the time of the action.

The fifth exception permits a creditor to prohibit additional advances or reduce the credit line if action by a governmental body adversely affects the priority of the creditor's security interest to the extent that the value of the security interest is less than 120 percent of the amount of the credit line (for example, through imposition of a tax lien).

The sixth exception enables creditors to suspend further advances or reduce the credit limit during any period in which the APR corresponding to the periodic rate reaches the maximum rate allowed under the plan. This provision permits a creditor to suspend credit advances even if a contract contains a "usury savings clause." For example, if a state enacts a rate ceiling lower than the maximum rate specified in the contract, a usury savings clause deems the new state ceiling to be the maximum rate permitted under the plan. Thus, the creditor may freeze the line during any period the APR reaches that maximum rate.

If the APR subsequently declines below the maximum APR, the creditor would have to reinstate credit privileges. This provision was contained in § 226.5b(f)(3)(i) of the proposal. It has been expanded to allow reduction in the credit limit as well as freezing of advances and therefore is part of § 226.5b(f)(3)(vi) which governs temporary suspensions.

Finally, a seventh exception has been added which permits a creditor to prohibit additional advances or reduce the credit line due to certain governmental actions. Several commenters expressed the concern that, because of the restriction on termination and change in terms, they might be required to continue to extend credit even when a federal or state regulatory agency had provided a notice that future extensions could constitute an unsafe and unsound banking practice. To avoid this problem the Board is adding a provision allowing a creditor to temporarily suspend further advances or reduce the credit limit when a regulatory agency with responsibility for supervising the creditor provides notification that continuing to advance funds may constitute an unsafe and unsound practice. The Board believes this limited exception is analogous to the statutory provisions which provide that a creditor may prohibit additional advances as a result of specified government actions.

Under the regulation, creditors are permitted to prohibit additional extensions of credit or reduce the credit limit only as long as any of these seven circumstances exist. Thus, for example, if the creditor cuts off further advances due to a significant decline in the value of the dwelling and during the length of the draw period the value of the dwelling subsequently increases, the creditor would have to reinstate drawing privileges. If a second event occurs that would permit continuing the freeze, of course, the line need not be reinstated as long as that circumstance exists. The creditor's right to reduce the credit limit does not permit reducing the limit below the amount of the outstanding balance if this would require the consumer to make a higher payment. (Section 226.9(c)(3) provides that a creditor must notify the consumer of the decision to freeze the line or reduce the credit limit.)

Several commenters asked whether the creditor is required to automatically reinstate credit privileges when the circumstances allowing suspension cease to exist; they pointed out that some state laws provide that future advances "relate back" to the mortgage only if the creditor is obligated to make advances. The concern was expressed that any advances made after the suspension may not have priority over intervening liens. If there are intervening liens in such a case, the exception provided in section 226.5b(f)(2)(iii) for consumer action that adversely affects the creditor's security interest would apply. Therefore, the creditor could refuse to make further advances due to the intervening lien resulting from consumer action.

A number of commenters asked the Board to provide guidance as to when credit privileges have to be reinstated. They were most concerned about having to constantly monitor accounts, particularly in cases where the consumer is in the best position to know if the circumstances triggering the freeze have changed.

Because the statute states that freezing the line can be only temporary, creditors have the responsibility of ensuring that the freeze is temporary. The creditor must monitor on a regular basis and reinstate credit privileges as soon as reasonably possible if the condition that permitted the creditor to take such action ceases to exist.

As an alternative to this ongoing duty. the Board is providing that the creditor may shift the initial duty to the consumer to request reinstatement of credit privileges. In this circumstance, when the creditor notifies the consumer of action taken, as discussed in § 226.9(c)(3), the creditor also must inform the consumer at the same time that reinstatement of credit privileges must be requested by the consumer. Once the consumer has made such a request, the creditor must investigate and determine whether the condition allowing the freeze has changed.

This section does not prohibit a lender from refusing to permit advances on a line if specifically requested to do so by a consumer. Thus, for example, if two consumers are obligated under a plan and each has the ability to take advances, the agreement may permit either of the two persons to direct the creditor not to make further advances; this section permits the creditor to honor such a request. This may be done only at the express request of one of the parties obligated under the plan. If that person subsequently requests reinstatement of draw privileges, the creditor must honor such a request, unless an event set forth in § 226.5b(f)(2) or § 226.5b(f)(3) permits a continued freeze or other action.

Section 226.5b(g)--Refund of Fees

Section 226.5b(g) imposes a duty on a creditor to refund all fees paid by the consumer in connection with an application if any term disclosed changes (other than one resulting from a variable rate index change) between the time the early disclosures are provided to the consumer and the time the plan is opened, and if, as a result of the change, the consumer decides to not enter into the plan. If a refund is required, it applies to all fees paid in connection with the plan, such as credit report fees, appraisal fees, and insurance premiums, whether such fees are paid directly to the creditor or to third parties. This requirement applies whether or not terms are guaranteed by the creditor under § 226.5b(d)(2)(i).

If a disclosure, such as the maximum rate cap, is stated as a range in the early disclosures, and the rate cap ultimately applicable to a plan falls within that range, a change will not be deemed to occur for purposes of this section. If, however, no range is used and the cap is changed, for example, from 5 to 6 percentage points over the initial rate, this change would permit the consumer to obtain a refund of fees. (See the discussion in § 226.5b(d)(2) dealing with changes in the maximum rate if tied to an initial variable rate.)

The fact that a term is stated in the early disclosures as an estimate does not render this section inapplicable if the term ultimately differs from that disclosed. For example, in the case of fees imposed by the creditor described in § 226.5b(d)(7), an increase in those fees--even if they were stated as estimates in the early disclosures--would entitle the consumer to a refund if the consumer decides not to enter into the plan because of that increase. In the case of the estimated disclosure of fees imposed by third parties under § 226.5b(d)(8), however, a change will not be deemed to occur even if the fees increase later. As in all cases, however, creditors must use the best information available in providing disclosures about such fees.

The refund of fees must be made as soon as reasonably possible after the creditor is notified that the consumer is not entering into the plan because of the changed term, or that the consumer wants a refund of fees. Some commenters questioned the relationship between this provision and the requirement that application fees be charged to all applicants in order to be excluded from the finance charge (pursuant to comment 4(c)(1)-1 of the Official Staff Commentary to Regulation Z). Refunding fees under this section does not affect that test.

The right to a refund of fees under this provision is distinct from the existing right of rescission under § 226.15, which applies only when a plan secured by the consumer's principal dwelling is opened.

Section 226.5b(h)--Imposition of nonrefundable fees

Under § 226.5b(h) neither the creditor nor any other party may impose a nonrefundable fee in connection with an application until three business days after the disclosures and brochure have been provided to the consumer. If disclosures are mailed to the consumer, footnote 10d of the regulation provides that a nonrefundable fee may not be imposed until six business days after the mailing. Several creditors asked whether a refundable fee can become nonrefundable. A refundable fee may become nonrefundable after the three-day period expires. If a fee is collected before the consumer receives the disclosures, the fee must be refunded if, within three days of receiving the disclosures, the consumer decides not to enter into the agreement.

The interaction of this provision with existing rules as well as other parts of the new rules is complex. Comment 5(b)(1)-1 provides that the creditor cannot collect a fee--except an application fee or a refundable membership fee--prior to the time the creditor provides the disclosures under § 226.6. Since membership fees may be collected prior to providing the § 226.6 disclosures only if they remain refundable (and since other fees such as appraisal and credit report fees may not be collected prior to providing the § 226.6 disclosures) the practical effect of § 226.5b(h) as to the fees collected by the creditor is limited to application fees, which may be collected at any time--provided they remain refundable until three business days after the consumer receives the § 226.5b disclosures. After the three-day period expires, an application fee may become nonrefundable except that, under § 226.5b(g), it must be refunded if the consumer elects not to enter into the plan because of a change in terms. (In addition, of course, all fees, including application fees, must be refunded if the consumer later rescinds under § 226.15.)

Section 226.6--Initial Disclosure Statement

Section 226.6(e)--Home equity plan information

In addition to the early disclosures given with an application, the amendments require certain additional disclosures at the time of opening a plan. Section 226.6(e) requires creditors to provide a few of the disclosures set forth in § 226.5b(d) along with the disclosures currently required under § 226.6. Creditors also must disclose a list of the conditions that permit the creditor to terminate the plan, freeze or reduce the credit limit, and implement specified modifications to the original terms. This requirement can be met by providing a separate list or by identifying the provisions in the contract which contain such conditions. (See the discussion under § 226.5b(d)(4) regarding the form of this information.) The disclosures must be provided prior to the first transaction under the plan, in accordance with the existing rule in § 226.5(b). Whereas the proposal stated that § 226.5b disclosures that duplicate existing § 226.6 disclosures need not be given, the final rule states specifically which disclosures must be given at the later time. Creditors have to provide, as applicable: (1) A statement of the conditions under which the creditor may terminate the plan or change the terms as described in § 226.5b(d)(4)(i); (2) the information in §§ 226.5b(d)(5) (i) and (ii) relating to the payment terms of the plan (including both the draw period and any repayment period); (3) the information in § 226.5b(d)(9) relating to negative amortization; (4) the information in § 226.5b(d)(10) relating to transaction requirements; (5) the information in § 226.5b(d)(11) relating to tax implications; and (6) a statement that the APR corresponding to the periodic rate imposed under the plan does not include costs other than interest.

Creditors also have to provide the payment example disclosure under § 226.5b(d)(5)(iii) and the variable-rate information under §§ 226.5b(d)(12) (viii), (x), (xi), and (xii) unless the following conditions are met: (1) The early disclosures were provided in a form a consumer could keep; and (2) the early disclosures of the payment example under § 226.5b(d)(5)(iii), the "worst case" example under § 226.5b(d)(12)(x) and the historical table under § 226.5b(d)(12)(xi) included a representative payment example for the category of payment options the consumer has chosen. For example, if a creditor offers three payment options (one in each of the categories described in § 226.5b(d)(5)) and describes all three options in its early disclosures and provides the disclosures in a retainable form, that creditor need not provide the § 226.5b(d)(5)(iii) or 226.5b(d)(12) disclosures again when the account is opened. If the creditor showed only one of the three options in the early disclosures (which would be the case if it chose to give a separate disclosure form rather than a combined form, as discussed under § 226.5b(a)), the § 226.5b(d)(5)(iii) information and §§ 226.5b(d)(12) (viii), (x), (xi) and (xii) disclosures must be given to any consumer who chose one of the other two options. If the § 226.5b(d)(5)(iii) and § 226.5b(d)(12) disclosures are provided with the second set of disclosures, they need not be transaction-specific, but may be based on a representative example of the category of payment option chosen.

In cases where the creditor has included complete information about both the draw and repayment phases in the § 226.5(b) disclosures given at application, the creditor should similarly make disclosures about both phases when giving the second set. In particular, such a creditor must include the disclosures in § 226.6(e) and the information required in footnote 12 (dealing with any variable-rate feature) for the repayment phase.

On the other hand, if the creditor defers providing the bulk of the § 226.5b disclosures for the repayment phase until conversion, the creditor does not have to provide any information about the repayment period under § 226.6 other than the basic payment items listed in § 226.6(e)(2). Thus, for example, if the disclosures are delayed, the creditor would not have to give the variable-rate information set out in footnote 12 for the repayment phase.

The segregation standard set forth in § 226.5b(a) does not apply to the second set of disclosures provided by the creditor prior to the first transaction under the plan. Rather, they are governed by § 226.5(a)(1), which does not require segregation from other information. These disclosures may be integrated into the contract. In addition, the disclosure of conditions for certain actions described in § 226.5b(d)(4)(i) does not have to precede the other disclosures. Like the existing § 226.6 disclosures, the additional disclosures must be in a form the consumer can keep.

Section 226.9--Subsequent Disclosure Requirements

Section 226.9(c)--Change in terms

The Board is adding a new paragraph (3) to § 226.9(c) to require creditors to provide a notice to consumers if the creditor, under § 226.5b(f)(3)(vi), prohibits additional advances of credit or reduces the credit limit. Under § 226.9(c)(3), creditors have to mail or deliver a written notice of the action to each consumer who is affected. The notice may be provided within three business days after the time the action is taken, rather than in advance of the action. The creditor must notify the consumer of the action taken, and the reason such action has been taken (for example, due to reaching the rate cap under the plan). If the creditor requires the consumer to request reinstatement of the line, the notice shall also include a statement to that effect. (See the discussion under § 226.5b(f)(3)(vi) covering the creditor's duty with regard to reinstatement.)

Section 226.14--Determination of Annual Percentage Rate

Section 226.14(b)--Annual percentage rate for §§ 226.5a and 226.5b disclosures, for initial disclosures and for advertising purposes

Section 226.14(b) is modified by adding a reference to new § 226.5b. The introduction to § 226.5b provides that, throughout § 226.5b, the term annual percentage rate is the APR as determined under § 226.14(b). Section 226.14(b) is modified to reflect this provision. Section 226.14(b) also is modified to refer generally to §§ 226.6 and 226.16, rather than specifically to §§ 226.6(a)(2) and 226.16(b)(2). These provisions are modified because the APR described in the new home equity rules (added to §§ 226.6(e) and 226.16(d)) also is calculated in accordance with the rules in § 226.14(b).

Section 226.15--Right of Rescission

Section 226.15(a)--Consumer's right to rescind

Section 226.15(a)(3) of the regulation states that the consumer may exercise the right of rescission until midnight of the third business day following the opening of the plan, delivery of the notice of the right to rescind, or delivery of all "material disclosures," whichever occurs last. Footnote 36 to this section contains the definition of material disclosures. In the proposal, the Board requested comment on whether to add to the definition certain payment information provided under § 226.6(e). The Board is amending footnote 36 to provide that the payment terms required under § 226.6(e)(2) be treated as a "material disclosure" for purposes of the right of rescission. Including such payment terms in the definition of "material disclosures" is consistent with what constitutes material disclosures in the closed-end credit rescission provisions, and the statutory definition of material disclosures. In addition the Board believes that payment information is important for a consumer to know in order to decide whether to exercise the right of rescission. Neither the payment terms nor any other information given with the first set of disclosures at the time of application is a material disclosure for purposes of rescission.

Section 226.16--Advertising

Section 226.16(d)--Additional advertising requirements for home equity plans

Under § 226.16(d)(1), any reference to a payment term in a home equity advertisement for the draw period or any repayment period (including the length of the plan and any reference to how the minimum payments are determined and the timing of such payments) will "trigger" further disclosures, including loan fees, estimates of other fees that may be imposed, and, for variable-rate plans, the maximum rate that may be imposed under the plan. Furthermore, if any of the "triggers" set forth in § 226.6 (a) or (b) or any payment information is stated affirmatively or negatively, further disclosures must be given. For example, if a creditor states "no annual fee" or "no points" in an advertisement, additional

information must be provided.
Section 226.16(d)(2) provides that if an advertisement states a "discounted" APR or a "premium" APR it must state in equal prominence the APR derived by use of the fully-indexed value. Section 226.16(d)(3) provides that, if an advertisement contains a reference to any payment amount, it must state, if applicable, that the plan contains a balloon payment. (See footnote 10b accompanying § 226.5b(d)(5) for a discussion of when a balloon payment results.)
Under § 226.16(d)(4) of the regulation, if an advertisement states that any interest under the plan may be tax deductible, the advertisement must not be misleading about such deductibility. For example, an advertisement referring to deductibility would not be misleading if it includes a statement that the consumer should consult a tax advisor regarding the deductibility of interest.
Creditors are prohibited by § 226.16(d)(5) from referring to home equity plans as "free money," or from using other misleading terms. For example, an advertisement could not state "no closing costs" if consumers may be required to pay any closing costs, such as recordation fees.
Several commenters asked how this new section relates to the other advertising rules. Advertisements for home equity plans must comply with all provisions in § 226.16, including § 226.16(b), not solely the new § 226.16(d).
Several commenters asked whether an advertisement for a home equity plan would be required to provide information about any "closed-end" (repayment) phase in the ad. Even if an open-end home equity agreement provides for "conversion" to a repayment phase (during which further advances are not permitted), advertisements for such plans are governed exclusively by the requirements of § 226.16, and are not covered by the closed-end advertising rules under § 226.24. Thus, if a creditor states in an advertisement payment information about the repayment phase, this will trigger the duty to provide additional information under § 226.16, but not under § 226.24.

(3) Effective Date

The statute provides that the act and regulations apply to: (1) Any agreement to open a plan which is entered into five months after the regulations become final; and (2) any application to open a plan which is distributed by or received by a creditor five months after regulations become final. Thus, if an application is given to a consumer on or after November 7, 1989, the effective date of the new rules, the § 226.5b disclosures and the brochure must be given to the consumer according to the normal rules. If an application given to the consumer before the effective date is received by the creditor on or after that date, the § 226.5b disclosures and the brochure must be given to the consumer but they may be provided within three business days of receipt of the application. If an application is received by the creditor prior to the effective date, none of the disclosures in § 226.5b or § 226.6(e) or the brochure need to be given to the consumer.
The substantive rules apply to all plans opened on or after the effective date, no matter when the application was provided to the consumer or received by the creditor.

Transition Rules

If a home equity plan is entered into prior to November 7, 1989, § 226.5b does not apply to that plan. Thus neither the substantive limitations nor the disclosure requirements apply to the plan. Furthermore, if an agreement is entered into prior to the effective date, and is renewed by the same consumer (with or without changes in terms) on or after the effective date, the renewed plan also is not subject to the new requirements. (Of course, creditors may have to provide a change in terms notice under § 226.9(c), if applicable.) However, if a line of credit not secured by a consumer's dwelling is entered into prior to the effective date and a security interest in a consumer's dwelling is added to the line on or after the effective date, the substantive provisions in § 226.5b(f)--but not the new disclosure rules--will apply to the plan from that point on.

(4) Disclosure Samples and Model Clauses

The Board is revising Appendix G of the regulation to incorporate disclosure samples and model clauses to assist creditors in preparing disclosures.
(A) Sample forms. Form G-14A illustrates a variable-rate plan with a 10-year draw period followed by a 5-year repayment period. The payments are based on a constant fraction of the outstanding balance so that, independent of rate changes, payments will vary each month. Accordingly, payments are stated as a range in the minimum payment example. In addition, one payment is shown each year in the historical example and the fact that payments would have varied each year is stated. The monthly payment in the historical example is the first payment that would have been due each year, based on the rate in effect for that year. (This assumption also has been used in calculating the payments in Forms G-14B and G-14C.) The calculations for the disclosures, however, are done using the actual payment computation formula.
Form G-14B illustrates a significantly more complicated plan. Three payment options are available to the consumer during the draw period. Two of these are "interest-only" options and one involves the payment of interest and a fixed portion of the balance. In accord with the rules set forth in the discussion of payment terms under § 226.5b(d)(5), the form uses a representative example of the payment options within the "interest-only" category. Thus the minimum payment example, the "worst case" example and the historical example are based on the monthly interest-only payment option. This option, as well as the fixed portion of the balance option, are both illustrated in the same historical example.
In addition, form G-14B illustrates a plan with an initially discounted rate. Accordingly, the first rate in the historical example is discounted by a representative amount and the initial payments reflect the discount. Also, a different index is used during the repayment period from that used during the draw period, and the last five years of the historical example are based on the second index.
Finally, form G-14B illustrates the optional rule, described in the discussion of § 226.5b(d)(4), regarding the disclosure of possible creditor actions. Rather than just mentioning the possibility of termination, suspension of advances and reduction of the credit limit and indicating that more

information is available, the form summarizes the provisions of §§ 226.5b(f)(2) and 226.5b(f)(3)(vi).

Form G-14C illustrates the disclosures that would be provided by a creditor who elected to provide disclosures illustrating the repayment phase of a line at the inception of the repayment phase rather than including them in the original § 226.5b disclosures given when the plan was opened.

(B) Model clauses. The Board has included a number of model clauses in Appendix G-15. In these clauses, language that may or may not be applicable is enclosed in brackets. Alternative phrases are enclosed in brackets and separated by slashes. Alternative clauses are separated by the italicized word "or."

(5) Tables of Certain Index Values

To assist creditors in constructing histories of various indices used in their home equity plans, the Board has prepared tables of values for commonly used indices for the years 1974 through 1989. The indices chosen represent those most frequently requested by commenters. January values are shown from 1975 through 1989, while July values are shown for 1974 through 1988 (since July values are not yet available for 1989). Earlier years in which index values are not available are marked "n.a."

Table 1 provides the values for United States Treasury securities adjusted to constant maturities of 1, 2, 3, and 5 years. Weekly average values are provided as of the first week ending in January and in July. Table 2 provides the January and July monthly average values for the Cost of Funds Ratio to 11th Federal Home Loan Bank District Institutions. Table 3 provides the values as of the last business day in January and July for the prime rate as published in the Wall Street Journal's Money Rates table. A single rate is shown except in cases where multiple rates were published. (Where a range of values are provided, creditors may base their disclosures on the high or low value, or an average depending on their method of figuring the rate.) Creditors need not use these tables in constructing their index histories. Moreover, the dates used in these tables were selected merely to provide index values at specific points within each year. Creditors may choose to use the applicable index values in these tables even if index values as of another date are used in their home equity plans.

Table 1--Constant Maturity Yield on United States Treasury Securities

Year	1 Year	2 Year	3 Year	5 Year
Average for first week ending in January (percent)				
1975	7.29	n.a.	7.33	7.35
1976	6.18	n.a.	7.12	7.50
1977	5.02	5.53	5.83	6.24
1978	7.03	7.26	7.40	7.59
1979	10.51	9.93	9.58	9.30
1980	12.02	11.39	10.75	10.52
1981	13.86	13.00	12.81	12.54
1982	13.68	13.88	14.09	14.04
1983	8.62	9.35	9.65	10.04
1984	10.02	10.77	11.04	11.50
1985	9.19	10.05	10.58	11.16

1986	7.63	8.01	8.25	8.50
1987	5.97	6.36	6.54	6.79
1988	7.15	7.82	8.08	8.38
1989	9.17	9.28	9.30	9.28

Average for first week ending in July (percent)

1974	9.04	n.a.	8.46	8.42
1975	6.92	n.a.	7.58	7.87
1976	6.46	7.01	7.27	7.58
1977	5.72	6.07	6.32	6.68
1978	8.34	8.45	8.51	8.50
1979	9.44	8.97	8.78	8.73
1980	8.51	8.94	9.15	9.47
1981	14.94	14.74	14.58	14.28
1982	14.41	14.75	14.81	14.73
1983	9.78	10.29	10.47	10.80
1984	12.17	13.12	13.38	13.67
1985	7.66	8.59	8.98	9.53
1986	6.36	6.78	6.99	7.21
1987	6.71	7.45	7.72	7.96
1988	7.52	8.04	8.21	8.46

Table 2--Average Cost of Funds Ratio to 11th FHLB District Institutions

Year	January (percent)	July (percent)
1974	n.a.	n.a.
1975	n.a.	n.a.
1976	n.a	n.a.
1977	n.a.	n.a.
1978	n.a.	n.a.
1979	n.a.	n.a.
1980	8.76	9.67
1981	10.45	11.85
1982	11.95	12.23
1983	10.46	9.68
1984	10.03	10.71
1985	10.22	9.37
1986	8.77	8.20
1987	7.40	7.28
1988	7.62	7.59
1989	8.13	----

Table 3-- Prime Rate as Published in the Wall Street Journal

Year	January (percent)	July (percent)
1974	10.75	
1975	9-9.5	7.5
1976	6.75	7-7.25
1977	6.25	6.5-6.75
1978	8	9
1979	11.5-11.75	11.75
1980	15.25	10.75-11
1981	19.5-20	20.5
1982	15.75	15.5
1983	11	10.5
1984	11	13
1985	10.5	9.5

1986	9.5	8
1987	7.5	8.25
1988	8.75	9.5
1989	10.5	---

(6) Economic Impact Statement

The Board's Division of Research and Statistics has prepared an economic impact statement on the revisions to Regulation Z. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, DC, 20551, at (202) 452-3245.

List of Subjects in 12 CFR Part 226

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

(7) Text of Revisions

Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board is amending Regulation Z (12 CFR Part 226) as follows:

PART 226--[AMENDED]

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

Authority: Truth in Lending Act, 15 U.S.C. 1604 and sec. 2. Pub. L. No. 100-583, 102 Stat. 2960; sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100-86, 101 Stat. 552.

Subpart A--General

2. Section 226.1 is amended by revising paragraphs (b) and (d)(2) and adding paragraph (c)(3) to read as follows:

(b) Purpose. The purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. * * * In addition, the regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling, and imposes limitations on home equity plans that are subject to the requirements of § 226.5b. The regulation does not govern charges for consumer credit.

(c) Coverage.

(3) In addition, certain requirements of § 226.5b apply to persons who are not creditors but who provide applications for home equity plans to consumers.

(d) Organization.

(2) Subpart B contains the rules for open-end credit. It requires that initial disclosures and periodic statements be provided, as well as additional disclosures for credit and charge card applications and solicitations and for home equity plans subject to the requirements of §§ 226.5a and 226.5b, respectively.

Subpart B--Open-End Credit

3. Section 226.5 is amended by revising footnote 8 to read as follows:

8 The disclosures required under § 226.5a for credit and charge card applications and solicitations, the home equity disclosures required under § 226.5b(d), the alternative summary billing rights statement provided for in § 226.9(a)(2), the credit and charge card

renewal disclosures required under § 226.9(e), and the disclosures made under § 226.10(b) about payment requirements need not be in a form that the consumer can keep.

3a. Section 226.5 is further amended by adding paragraphs (a)(4) and (b)(4) to read as follows:

§526.5 General disclosure requirements.

(a) Form of disclosures.

(4) For rules governing the form of disclosures for home equity plans, see § 226.5b(a).

(b) Time of disclosures.

(4) Home equity plans. Disclosures for home equity plans shall be made in accordance with the timing requirements of § 226.5b(b).

4. Section 226.5a is amended by revising paragraph (a)(3) to read as follows:

§ 226.5a Credit and charge card applications and solicitations.

(a)

(3) Exceptions. This section does not apply to home equity plans accessible by a credit or charge card that are subject to the requirements of § 226.5b;

5. A new § 226.5b is added to read as follows:

§ 226.5b Requirements for home equity plans.

The requirements of this section apply to open-end credit plans secured by the consumer's dwelling. For purposes of this section, an annual percentage rate is the annual percentage rate corresponding to the periodic rate as determined under § 226.14(b).

(a) Form of disclosures--(1) General. The disclosures required by paragraph (d) of this section shall be made clearly and conspicuously and shall be grouped together and segregated from all unrelated information. The disclosures may be provided on the application form or on a separate form. The disclosure described in paragraph (d)(4)(iii), the itemization of third-party fees described in paragraph (d)(8), and the variable-rate information described in paragraph (d)(12) of this section may be provided separately from the other required disclosures.

(2) Precedence of certain disclosures. The disclosures described in paragraph (d)(1) through (4)(ii) of this section shall precede the other required disclosures.

(b) Time of disclosures. The disclosures and brochure required by paragraphs (d) and (e) of this section shall be provided at the time an application is provided to the consumer.[10a]

(c) Duties of third parties. Persons other than the creditor who provide applications to consumers for home equity plans must provide the brochure required under paragraph (e) of this section at the time an application is provided. If such persons have the disclosures required under paragraph (d) of this section for a creditor's home equity plan, they also shall provide the disclosures at such time. 10a

(d) Content of disclosures. The creditor shall provide the following disclosures, as applicable:

(1) Retention of information. A

[10a] The disclosures and the brochure may be delivered or placed in the mail not later than three business days following receipt of a consumer's application in the case of applications contained in magazines or other publications, or when the application is received by telephone or through an intermediary agent or broker.

statement that the consumer should make or otherwise retain a copy of the disclosures.

(2) Conditions for disclosed terms. (i) A statement of the time by which the consumer must submit an application to obtain specific terms disclosed and an identification of any disclosed term that is subject to change prior to opening the plan.

(ii) A statement that, if a disclosed term changes (other than a change due to fluctuations in the index in a variable-rate plan) prior to opening the plan and the consumer therefore elects not to open the plan, the consumer may receive a refund of all fees paid in connection with the application.

(3) Security interest and risk to home. A statement that the creditor will acquire a security interest in the consumer's dwelling and that loss of the dwelling may occur in the event of default.

(4) Possible actions by creditor. (i) A statement that, under certain conditions, the creditor may terminate the plan and require payment of the outstanding balance in full in a single payment and impose fees upon termination; prohibit additional extensions of credit or reduce the credit limit; and, as specified in the initial agreement, implement certain changes in the plan.

(ii) A statement that the consumer may receive, upon request, information about the conditions under which such actions may occur.

(iii) In lieu of the disclosure required under paragraph (d)(4)(ii) of this section, a statement of such conditions.

(5) Payment terms. The payment terms of the plan, including:

(i) The length of the draw period and any repayment period.

(ii) An explanation of how the minimum periodic payment will be determined and the timing of the payments. If paying only the minimum periodic payments may not repay any of the principal or may repay less than the outstanding balance, a statement of this fact, as well as a statement that a balloon payment may result.[10b]

(iii) An example, based on a $10,000 outstanding balance and a recent annual percentage rate,[10c] showing the minimum periodic payment, any balloon payment, and the time it would take to repay the $10,000 outstanding balance if the consumer made only those payments and obtained no additional extensions of credit.

If different payment terms may apply to the draw and any repayment period, or if different payment terms may apply within either period, the disclosures shall reflect the different payment terms.

(6) Annual percentage rate. For fixed-rate plans, a recent annual percentage rate 10c imposed under the plan and a statement that the rate does not include costs other than interest.

(7) Fees imposed by creditor. An itemization of any fees imposed by the creditor to open, use, or maintain the plan, stated as a dollar amount or percentage, and when such fees are payable.

[10b] A balloon payment results if paying the minimum periodic payments does not fully amortize the outstanding balance by a specified date or time, and the consumer must repay the entire outstanding balance at such time.

[10c] For fixed-rate plans, a recent annual percentage rate is a rate that has been in effect under the plan within the twelve months preceding the date the disclosures are provided to the consumer. For variable-rate plans, a recent annual percentage rate is the most recent rate provided in the historical example described in paragraph (d)(12)(xi) of this section or a rate that has been in effect under the plan since the date of the most recent rate in the table.

(8) Fees imposed by third parties to open a plan. A good faith estimate, stated as a single dollar amount or range, of any fees that may be imposed by persons other than the creditor to open the plan, as well as a statement that the consumer may receive, upon request, a good faith itemization of such fees. In lieu of the statement, the itemization of such fees may be provided.
(9) Negative amortization. A statement that negative amortization may occur and that negative amortization increases the principal balance and reduces the consumer's equity in the dwelling.
(10) Transaction requirements. Any limitations on the number of extensions of credit and the amount of credit that may be obtained during any time period, as well as any minimum outstanding balance and minimum draw requirements, stated as dollar amounts or percentages.
(11) Tax implications. A statement that the consumer should consult a tax advisor regarding the deductibility of interest and charges under the plan.
(12) Disclosures for variable-rate plans. For a plan in which the annual percentage rate is variable, the following disclosures, as applicable:
(i) The fact that the annual percentage rate, payment, or term may change due to the variable-rate feature.
(ii) A statement that the annual percentage rate does not include costs other than interest.
(iii) The index used in making rate adjustments and a source of information about the index.
(iv) An explanation of how the annual percentage rate will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.
(v) A statement that the consumer should ask about the current index value, margin, discount or premium, and annual percentage rate.
(vi) A statement that the initial annual percentage rate is not based on the index and margin used to make later rate adjustments, and the period of time such initial rate will be in effect.
(vii) The frequency of changes in the annual percentage rate.
(viii) Any rules relating to changes in the index value and the annual percentage rate and resulting changes in the payment amount, including, for example, an explanation of payment limitations and rate carryover.
(ix) A statement of any annual or more frequent periodic limitations on changes in the annual percentage rate (or a statement that no annual limitation exists), as well as a statement of the maximum annual percentage rate that may be imposed under each payment option.
(x) The minimum periodic payment required when the maximum annual percentage rate for each payment option is in effect for a $10,000 outstanding balance, and a statement of the earliest date or time the maximum rate may be imposed.
(xi) An historical example, based on a $10,000 extension of credit, illustrating how annual percentage rates and payments would have been affected by index value changes implemented according to the terms of the plan. The historical example shall be based on the most recent 15 years of index values (selected for the same time period each year) and shall reflect all significant plan terms, such as negative amortization, rate carryover, rate discounts, and rate and payment limitations, that would have been affected by the index movement during the period.

(xii) A statement that rate information will be provided on or with each periodic statement.
(e) Brochure. The home equity brochure published by the Board or a suitable substitute shall be provided.
(f) Limitations on home equity plans. No creditor may, by contract or otherwise:
(1) Change the annual percentage rate unless:
(i) Such change is based on an index that is not under the creditor's control; and
(ii) Such index is available to the general public.
(2) Terminate a plan and demand repayment of the entire outstanding balance in advance of the original term unless:
(i) There is fraud or material misrepresentation by the consumer in connection with the plan;
(ii) The consumer fails to meet the repayment terms of the agreement for any outstanding balance; or
(iii) Any action or inaction by the consumer adversely affects the creditor's security for the plan, or any right of the creditor in such security.
(3) Change any term, except that a creditor may:
(i) Provide in the initial agreement that specified changes will occur if a specific event takes place (for example, that the annual percentage rate will increase a specified amount if the consumer leaves the creditor's employment).
(ii) Change the index and margin used under the plan if the original index is no longer available, the new index has an historical movement substantially similar to that of the original index, and the new index and margin would have resulted in an annual percentage rate substantially similar to the rate in effect at the time the original index became unavailable.
(iii) Make a specified change if the consumer specifically agrees to it in writing at that time.
(iv) Make a change that will unequivocally benefit the consumer throughout the remainder of the plan.
(v) Make an insignificant change to terms.
(vi) Prohibit additional extensions of credit or reduce the credit limit applicable to an agreement during any period in which:
(A) The value of the dwelling that secures the plan declines significantly below the dwelling's appraised value for purposes of the plan;
(B) The creditor reasonably believes that the consumer will be unable to fulfill the repayment obligations under the plan because of a material change in the consumer's financial circumstances;
(C) The consumer is in default of any material obligation under the agreement;
(D) The creditor is precluded by government action from imposing the annual percentage rate provided for in the agreement;
(E) The priority of the creditor's security interest is adversely affected by government action to the extent that the value of the security interest is less than 120 percent of the credit line;
(F) The creditor is notified by its regulatory agency that continued advances constitute an unsafe and unsound practice; or
(G) The maximum annual percentage rate is reached.
(g) Refund of fees. A creditor shall refund all fees paid by the consumer to anyone in connection with an application if any term required to be disclosed under paragraph (d) of this section changes (other than a change due to fluctuations in the index in a variable-rate plan) before the plan is opened and,

as a result, the consumer elects not to open the plan.
(h) Imposition of nonrefundable fees. Neither a creditor nor any other person may impose a nonrefundable fee in connection with an application until three business days after the consumer receives the disclosures and brochure required under this section.[10d]

6. Section 226.6 is amended by adding paragraph (e) to read as follows:

§ 226.6 Initial disclosure statement.

(e) Home equity plan information. The following disclosures described in § 226.5b(d), as applicable:
(1) A statement of the conditions under which the creditor may take certain action, as described in § 226.5b(d)(4)(i), such as terminating the plan or changing the terms.
(2) The payment information described in § 226.5b(d)(5) (i) and (ii) for both the draw period and any repayment period.
(3) A statement that negative amortization may occur as described in § 226.5b(d)(9).
(4) A statement of any transaction requirements as described in § 226.5b(d)(10).
(5) A statement regarding the tax implications as described in § 226.5b(d)(11).
(6) A statement that the annual percentage rate imposed under the plan does not include costs other than interest as described in §§ 226.5b(d)(6) and 226.5b(d)(12)(ii).
(7) The variable-rate disclosures described in § 226.5b(d)(12) (viii), (x), (xi), and (xii), as well as the disclosure described in § 226.5b(d)(5)(iii), unless the disclosures provided with the application were in a form the consumer could keep and included a representative payment example for the category of payment option chosen by the consumer.

7. Section 226.9 is amended by adding paragraph (c)(3) to read as follows:

§ 226.9 Subsequent disclosure requirements.

(c) Change in terms.

(3) Notice for home equity plans. If a creditor prohibits additional extensions of credit or reduces the credit limit applicable to a home equity plan pursuant to § 226.5b(f)(3)(vi), the creditor shall mail or deliver written notice of the action to each consumer who will be affected. The notice must be provided not later than three business days after the action is taken and shall contain specific reasons for the action. If the creditor requires the consumer to request reinstatement of credit privileges, the notice also shall state that fact.

8. Section 226.14 is amended by revising paragraph (b) to read as follows:

§ 226.14 Determination of annual percentage rate.

(b) Annual percentage rate for sections 226.5a and 226.5b disclosures, for initial disclosures and for advertising purposes. Where one or more periodic rates may be used to compute the finance charge, the annual percentage rate(s) to be disclosed for purposes of §§ 226.5a,

[10d] If the disclosures and brochure are mailed to the consumer, the consumer is considered to have received them three business days after they are mailed.

226.5b, 226.6, and 226.16 shall be computed by multiplying each periodic rate by the number of periods in a year.

9. Section 226.15 is amended by revising footnote 36 to read as follows:

§ 226.15 Right of rescission.

(a) * * *
(3) * * * [36]

10. Section 226.16 is amended by adding paragraph (d) to read as follows:

§ 226.16 Advertising.

(d) Additional requirements for home equity plans--(1) Advertisement of terms that require additional disclosures. If any of the terms required to be disclosed under § 226.6(a) or (b) or the payment terms of the plan are set forth, affirmatively or negatively, in an advertisement for a home equity plan subject to the requirements of § 226.5b, the advertisement also shall clearly and conspicuously set forth the following:
(i) Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range.
(ii) Any periodic rate used to compute the finance charge, expressed as an annual percentage rate as determined under section § 226.14(b).
(iii) The maximum annual percentage rate that may be imposed in a variable-rate plan.
(2) Discounted and premium rates. If an advertisement states an initial annual percentage rate that is not based on the index and margin used to make later rate adjustments in a variable-rate plan, the advertisement also shall state the period of time such rate will be in effect, and, with equal prominence to the initial rate, a reasonably current annual percentage rate that would have been in effect using the index and margin.
(3) Balloon payment. If an advertisement contains a statement about any minimum periodic payment, the advertisement also shall state, if applicable, that a balloon payment may result. 10b
(4) Tax implications. An advertisement that states that any interest expense incurred under the home equity plan is or may be tax deductible may not be misleading in this regard.
(5) Misleading terms. An advertisement may not refer to a home equity plan as "free money" or contain a similarly misleading term.

11. Appendix G is amended by adding model forms and clauses G-14A, G-14B, G-14C, and G-15 to read as follows:

APPENDIX G--Open-End Model Forms and Clauses

G-14A Home Equity Sample
G-14B Home Equity Sample
G-14C Home Equity Sample
(Repayment phase disclosed later)
G-15 Home Equity Model Clauses

By order of the Board of Governors of the Federal Reserve System, June 1,

[36] The term "material disclosures" means the information that must be provided to satisfy the requirements in section 226.6 with regard to the method of determining the finance charge and the balance upon which a finance charge will be imposed, the annual percentage rate, the amount or method of determining the amount of any membership or participation fee that may be imposed as part of the plan, and the payment information described in §226.5b(d)(5)(i) and (ii) that is required under § 226.6(e)(2).

1989.

William W. Wiles,

Secretary of the Board.