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FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-0858]

# Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

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SUMMARY: The Board is publishing for comment proposed amendments to Regulation Z (Truth in Lending). The amendments implement recent changes made to the Truth in Lending Act by the Riegle Community Development and Regulatory Improvement Act of 1994. The law imposes new disclosure requirements and substantive limitations on mortgages bearing high rates or fees. The amendments would provide greater protections to consumers entering into high-rate, high-fee mortgages. The law also imposes new disclosure requirements to assist consumers in comparing the cost of reverse mortgage transactions, which provide periodic payments to primarily elderly homeowners and rely principally on the home's value for repayment.

DATES: Comments must be received on or before January 18, 1995.

ADDRESSES: Comments should refer to Docket No. R-0858, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

FOR FURTHER INFORMATION CONTACT: Jane Ahrens, Senior Attorney, or Kyung Cho-Miller or Sheilah Goodman, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for the hearing impaired only, Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

## I. Background

The purpose of the Truth in Lending Act (15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose credit terms and the cost of credit as an annual percentage rate (APR). The act requires additional disclosures for loans secured by a consumer's home, and permits consumers to cancel certain transactions that involve their principal dwelling. Limitations are imposed on some credit line plans secured by a consumer's principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR part 226).

## II. Proposed Regulatory Provisions

The Home Ownership and Equity Protection Act of 1994 (Equity Protection Act), contained in the Riegle Community Development and Regulatory Improvement Act of 1994 (Community Development Act), Pub. L. 103-325, 108 Stat. 2160, amends the Truth in Lending Act (TILA). Section 152 of the Equity Protection Act adds a new section 129 dealing with high-rate, high-fee mortgages. Section 154 adds a new section 138 dealing with reverse mortgage transactions. The Equity Protection Act was enacted in September 1994, and directs the Board to issue final regulations within 180 days. It provides that the statutory provisions and rules adopted by the Board shall apply on the October 1 following six months after the final regulation is issued.

The Board is proposing regulations for comment, and expects to adopt final implementing regulations in March 1995. Compliance with the law would be mandatory by October 1, 1995. Section 156 of the Equity Protection Act states that the final rule governs all high-rate, high-fee mortgage transactions consummated after the mandatory effective date. The Board believes that the same compliance rule would apply to reverse mortgage transactions consummated after the mandatory effective date.

## III. Section-By-Section Analysis

### Section 226.2--Definitions and Rules of Construction

#### 2(a) Definitions

#### 2(a)(17) Creditor

Section 152(c) of the Equity Protection Act states the number of high-rate, high-fee mortgage transactions a lender may make before becoming a creditor for purposes of the TILA. The proposed regulation parallels the statute. The regulation provides that persons making occasional home-secured loans--less than five during a calendar year--are not subject to the act. The proposed regulation provides that a creditor includes a person originating two or more high-rate, high-fee mortgage loans, or one or more such mortgage loans through a mortgage broker during any 12-month period. Thus, for example, a person originating one high-rate, high-fee mortgage that soon thereafter enters into two home-secured loans, one of which was a high-rate, high-fee loan, would be required to comply with TILA for both transactions.

### Subpart B--Open-End Credit

### Section 226.5b--Requirements for Home Equity Plans

#### 5b(f) Limitations on Home Equity Plans

The TILA allows creditors to terminate open-end plans and demand repayment in narrowly drawn circumstances such as when the consumer fails to make payments or takes actions that affect the creditor's security. Section 154(c) of the Equity Protection Act excludes reverse mortgage transactions from these substantive limitations. The legislative history states that the amendment is intended to codify the Board's interpretation regarding a creditor's ability to accelerate an open-end reverse mortgage loan in accordance with the credit contract. The proposed amendment reflects that intent.

Subpart C--Closed-end Credit

Section 226.23--Right of Rescission

23(a) Consumer's Right to Rescind

Section 152(b) of the Equity Protection Act provides that high-rate, high-fee mortgage disclosures are ``material'' for purposes of the TILA. Proposed amendments to footnote 48 implement the change. The effect is to give consumers the right to rescind a high-rate, high-fee mortgage if a creditor fails to furnish the disclosures set forth in proposed Sec. 226.32(c) or provides for a prohibited credit term set forth in proposed Sec. 226.32(d).

Subpart D--Miscellaneous

Section 226.28--Effect on State Laws

28(b) Equivalent Disclosure Requirements

Section 152(e) of the Equity Protection Act provides that the procedure for substituting substantially similar state law disclosures for federal TILA requirements does not apply to state disclosure requirements for high-rate, high-fee mortgages. The proposed amendments reflect this limitation.

Subpart E--Certain Mortgage Transactions

The amendments to the TILA (section 129 dealing with high-rate, high-fee mortgages and section 138 dealing with reverse mortgage transactions) layer disclosure and timing requirements onto the requirements already imposed for these consumer credit transactions. The Board proposes to implement these provisions by adding a new subpart E to the regulation: proposed Sec. 226.31 addresses general requirements such as timing and format rules; Sec. 226.32 contains rules relating to high-rate, high-fee mortgages; and Sec. 226.32 addresses reverse mortgages.

Section 226.31--General Disclosure Requirements

31(a) Relation to Other Subparts

The proposed regulation explicitly states that the requirements and limitations of Subpart E are in addition to--not in lieu of--those otherwise provided in other subparts of the regulation. For example, creditors offering closed-end, variable-rate loans that are secured by the consumer's principal dwelling and have a term greater that one year must generally provide disclosures at the time of application and prior to consummation, according to the requirements of Subpart C. If these transactions are also high-rate, high-fee mortgage loans, this subpart requires creditors to provide additional disclosures at least three business days prior to the loan's consummation.

31(c) Timing of Disclosures

31(c)(1) High-rate, High-fee Mortgage Disclosures

Section 129 of the TILA and the proposed regulation require a three-day ``cooling off'' period between the time consumers are furnished with special disclosures about a high-rate, high-fee mortgage and the time the consumer becomes obligated under the loan.

The law also authorizes the Board to identify in the regulation circumstances under which a homeowner may modify or waive the right to the three-day waiting period to meet bona fide personal financial emergencies. The legislative history states that the provision is intended to protect consumers from high-pressure sales tactics and to ensure that consumers understand the terms of loans with high interest rates or up-front fees. The Board is not proposing regulations regarding waivers of the cooling-off period at this time. Sections 226.15(e) and 226.23(e) of the regulation discuss waivers of the right to rescind, and the Board solicits comments on whether similar provisions should be incorporated for high-rate, high-fee mortgage loans.

31(c)(2) Reverse Mortgage Disclosures

Besides the other disclosures required by the regulation, section 138 of the TILA requires creditors to furnish additional disclosures to consumers at least three business days prior to consummation of a reverse mortgage transaction. Timing requirements for closed-end credit are often tied to the consummation of the transaction, and the regulation parallels the statute for closed-end reverse mortgage loans.

However, reverse mortgage loans may also be structured as open-end credit plans. In that case, the proposed regulation provides that the disclosures must be given at least three business days prior to the first transaction under the open-end credit plan.

Conforming Paragraphs

Proposed paragraphs (d), (e), and (f) mirror provisions in subparts B and C, and provide consistency among the subparts of the regulation. (See Sec. 226.5 and Sec. 226.17.)

Section 226.32--High-Rate, High-Fee Mortgages

32(a) Coverage

Section 152 of the Equity Protection Act provides that the high-rate, high-fee mortgage rules do not apply to a residential mortgage transaction, a reverse mortgage transaction, and an open-end credit plan. The proposed regulation tracks those exceptions, with two additions for clarification. The Board believes the Congress intended to exempt from coverage only those reverse mortgage transactions which are part of the new disclosure scheme in proposed Sec. 226.33, and the proposed amendment reflects that limitation. Also, the proposed amendment clarifies that the exception for open-end credit plans extends to all plans subject to subpart B of the regulation (Open-end Credit).

32(b) Definitions

32(b)(1) High-Rate, High-Fee Mortgage

Section 103(aa) of the TILA defines the mortgages covered by new section 129 based on the rates charged and fees paid. For ease of compliance, the proposed amendments refer to those mortgages as high-rate, high-fee mortgages.

32(b)(1)(i)

The statute covers mortgages that charge rates above a specified standard. The rate-based test is tied to Treasury securities having comparable terms of the loan's maturity. Rate information for Treasury securities is widely available. For example, the Board's Selected Interest Rates (statistical release H-15) identifies Treasury securities with maturities of 1, 2, 3, 5, 7, 10, 20 and 30 years. The Board anticipates that for loan maturities that do not match those of Treasury securities, creditors will use rounding to determine a comparable maturity. For example, the APR for an eight-year loan would be compared to securities with a seven-year maturity; a nine-year loan would be compared to a ten-year maturity.

The Board is required by section 157 of the Equity Protection Act to conduct a study and make recommendations to the Congress about whether a high-rate mortgage could be defined with a more appropriate interest rate index than Treasury securities of comparable maturities. The study will begin when the proposed regulation is adopted in final form and will end 18 months later. As an adjunct to the study, the Board solicits comments on other interest rate indices that might be more appropriate.

32(b)(1)(ii)

The statute also covers mortgages if the total points and fees payable by the consumer at or before loan closing exceed the greater of $400 or 8 percent of the total loan amount. The $400 dollar amount will be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index, as reported on June 1 of the previous year. The Board contemplates that any adjustment will be published at the same time as proposed periodic updates of Regulation Z's official staff commentary, which are regularly published for public comment in the autumn of each year.

The Board believes the statute requires creditors to use the principal balance--and not additional costs that may be incurred at closing--when determining whether the ratio of fees to the total loan amount exceeds 8 percentage points.

The TILA's timing rules for providing disclosures--including those disclosures proposed below--are generally triggered by the consummation of a closed-end credit transaction. State law determines when consummation occurs, and it often, but not always, coincides with the loan closing. The statute defines a high-fee mortgage by measuring the amount of fees paid at or before closing; the proposed amendment reflects that timing rule.

32(b)(2) Points and Fees

Section 103(aa) of the TILA defines points and fees as all finance charges (except interest or the time-price differential), all compensation paid to mortgage brokers, and all items identified in section 106(e) (other than amounts held for future payment of taxes) unless the charge is reasonable, the creditor receives no direct or indirect compensation from the charge, and the charge is not paid to an affiliate of the creditor. The proposed amendments replicate the statute, except that the proposed definition refers to the regulatory provisions implementing section 106(a) (finance charges) and section 106(e) (closing costs for real estate-related transactions) of the TILA.

The Board believes the Congress intended a very broad application of the term ``compensation,'' including, for example, amounts paid to brokers by creditors (in addition to amounts paid by consumers).

Section 103(aa) also authorizes the Board to identify other charges that would be appropriate to include in the total fee calculation. The proposed regulation does not identify any such additional charges. The legislative history includes credit insurance premiums as an example of fees that could be included, if evidence showed that the premiums were being used to circumvent the statute. The Board solicits comment on charges not captured by the statute that would be appropriate to include in the test to determine whether a transaction is a high-fee mortgage, and if so, why.

32(b)(3) Affiliate

Section 129(k) of the TILA defines ``affiliate'' for purposes of the high-rate, high-fee mortgage rules by a statutory reference to the Bank Holding Company Act of 1956. (12 U.S.C. 1841(k)) That act defines affiliate as any company that controls, is controlled by, or is under the common control with another company. It also defines ``company'' and when one company is considered to ``control'' another. See 12 U.S.C. 1841(a) and (b). The proposed amendment simply defines the term by statutory reference.

32(c) Disclosures

The proposed regulation mirrors the disclosure requirements of section 129(a). The law requires creditors to disclose a monthly payment based on an interest rate cap required for consumer contracts by a provision in the Competitive Equality Banking Act of 1987 (CEBA), which is implemented in Sec. 226.30. The legislative history provides that in calculating the maximum payment based on the interest rate cap, creditors should assume the maximum possible increases in rates in the shortest possible timeframe. To ease compliance, proposed paragraph (c)(4) refers to Sec. 226.30 rather than CEBA.

32(d) Limitations

Section 129 of the TILA prohibits high-rate, high-fee mortgage creditors from including several terms in their credit contracts.

32(d)(5) Rebates

Section 129(d) of the TILA restricts how creditors may calculate refunds of interest when a high-rate, high-fee mortgage loan is accelerated due to a consumer's default. The statute provides that creditors must calculate the refund by a method no less favorable than the actuarial method, as defined under section 933(d) of the Housing and Community Development Act of 1992 (HCDA). That section describes a method of allocating payments so that a payment is first applied to accumulated finance charges. Any remaining amount is applied to the unpaid balance of the amount financed. The effect of the actuarial method is to prohibit calculating refunds by the ``rule of 78s.'' The proposed amendment defines the actuarial method by statutory reference.

32(d)(6) Prepayment Penalties

Section 129(c) of the TILA generally bars creditors from including a prepayment penalty in a high-rate, high-fee mortgage contract. The statute includes as a prepayment penalty, refunds of unearned interest calculated less favorably than the actuarial method in HCDA's section 933(d). The proposed regulation likewise limits rebate calculations by a statutory reference to the HCDA.

The legislative history notes that the ``actuarial method'' has been defined by some states, and that in some jurisdictions the actuarial method provides a refund that is greater than the refund received under the HCDA definition. The legislative history states that in those circumstances, creditors should continue to apply state law to determine if a refund is a prepayment penalty for a high-rate, high-fee mortgage. The legislative history also states that the reference to the HCDA is not intended to be exclusive, and that penalties based on a percentage of the outstanding balance or on the number of months of interest are also prohibited.

32(d)(7) Exception

Section 129(c)(2) of the TILA allows creditors to provide for a penalty when a consumer prepays a high-rate, high-fee mortgage under narrowly drawn circumstances. The proposed amendment follows the statute, except that in discussing permissible refund calculation methods, the proposed amendment incorporates the heading of HCDA's section 933(b)--prohibiting the rule of 78s--rather than referring to the actuarial method.

32(e) Prohibited Acts and Practices

Section 129(l)(2) of the TILA authorizes the Board to prohibit acts or practices in connection with mortgage loans that the Board finds to be unfair, deceptive or designed to evade the high-rate, high-fee mortgage rules. The Board also may prohibit acts or practices related to refinancing mortgage loans that the Board finds are associated with abusive lending practices or that are not in the borrower's interest.

The Board believes a study and hearing required by the Equity Protection Act will assist the Board in its determination of whether certain acts or practices should be prohibited. Section 157 of the Equity Protection Act requires the Board to conduct a study and make recommendations to the Congress regarding, in part, the adequacy of federal laws protecting consumers with open-end credit plans secured by the consumer's principal dwelling. The statutory timeframe for the study is eighteen months, beginning after the amendments are adopted. Section 158 of the Equity Protection Act requires the Board (in consultation with its Consumer Advisory Council) to conduct public hearings that examine home equity loans in the marketplace and the adequacy of federal laws (including the new rules affecting high-rate, high-fee mortgages and reverse mortgage transactions) in protecting consumers--particularly low-income consumers. The statute provides that the first hearing must be held prior to September 1997, and the Board contemplates the initial hearing will occur sometime in 1996, so that the impact of the new rules can be evaluated. Thus, the Board is not proposing to prohibit a particular act or practice at this time.

32(e)(1) Repayment Ability

Section 129(h) of the TILA prohibits creditors extending high-rate, high-fee mortgage loans from engaging in a pattern or practice of extending such credit to consumers based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment. The Board believes that the information provided by the consumer in connection with paragraph (d)(7) can be relied on when considering a consumer's ability to repay the debt.

32(e)(2) Home Improvement Contracts

Section 129(i) of the TILA restricts how creditors may disburse proceeds to contractors under a home improvement contract secured by a high-rate, high-fee mortgage. The proposed regulation reflects the statutory requirement that the creditor must disburse the proceeds by an instrument payable to the consumer or jointly to the consumer and the contractor.

Alternatively, at the election of the consumer, the creditor could disburse the proceeds through an escrow agent in accordance with terms established in a written agreement signed by the consumer, the creditor, and the contractor prior to the disbursement. The Board solicits comment on whether further guidance is needed regarding the use of a third party escrow agent. For example, comment is solicited on whether an affiliate of the creditor could act as a disbursing agent. The Board believes the Congress contemplated that both the consumer and the creditor would make a good-faith effort to agree to a mutually acceptable third party.

The statutory provision on check disbursements is technical and narrowly drawn. Its limitations are imposed only on ``creditors''--the person to whom a note is intially made payable. The consumer protections of this provision would not apply to the disbursement of funds by a lender such as a bank or finance company that purchases a high-rate, high-fee mortgage note made payable to a home improvement contractor, because the lender is not the ``creditor.''

Exemptions

Section 129(l)(1) of the TILA authorizes the Board to create exemptions to the limitations set forth in proposed paragraph (d) and paragraph (e) of this section, upon a finding that the exemption is in the interest of the borrowing public and will apply only to mortgage products or categories of products that maintain and strengthen home ownership and equity protection. The legislative history expresses the Congress' concern that the legislation might inappropriately apply to some government loans or short-term ``bridge'' construction loans. It also states that in granting the exemption authority to the Board, the Congress intended that the Board consider exemptions on a product-by-product basis.

The Board has not proposed any exemptions at this time. Comment is solicited on whether the Board should exercise its exemption authority for a product. And if a product is identified, the Board requests comment on the potential for abusive lending practices to be used for the products, and how the product is used to facilitate homeownership and strengthen the homeowner's equity interest.

Section 226.33--Reverse Mortgages 33(a) Definition

Section 154 of the Equity Protection Act defines a ``reverse mortgage'' as a nonrecourse transaction that is secured by the consumer's principal dwelling and that ties repayment (other than upon default) to the homeowner's death or the permanent move from or transfer of the home. The proposed regulation tracks the statute.

A nonrecourse transaction limits the homeowner's liability to no more than the proceeds of the sale of the home (unless a lesser amount is provided for in the credit obligation such as by an equity reservation or an equity conservation agreement between the consumer and creditor). Neither the statute nor the proposed regulation defines ``nonrecourse transactions.'' Similarly, specific acts of default for purposes of the reverse mortgage rules are not defined. Neither the act nor the legislative history identifies such acts, and the Board believes that the determination of ``default'' is most appropriately left to the legal obligation between the parties and state or other law. However, the Board notes that further guidance could be given if such an approach results in creditors defining default in a way that circumvents the protections for consumers entering into reverse mortgage transactions.

33(b) Content of Disclosures

Section 138 of the TILA establishes a new standard to measure the cost of reverse mortgage credit. The statute requires reverse mortgage creditors to disclose a good faith estimate of the projected total cost of the credit to the consumer, expressed as a table of annual interest rates. The legislative history states that the Congress contemplated a disclosure scheme modeled after the matrix disclosure currently required by section 255 of the National Housing Act and implemented by the Department of Housing and Urban Development's (HUD's) Home Equity Conversion Mortgage (HECM) program. The proposed regulation reflects that approach, except as noted below.

The regulation requires creditors to use the term ``total annual loan cost rate'' rather than ``annual interest rate'' in complying with this section. The statute does not mandate the use of the term ``annual interest rate,'' and the Board believes that using a different term will avoid possible confusion between the disclosure of an ``annual interest rate'' and the ``annual percentage rate,'' which is required by other parts of the regulation. The term ``total annual loan cost rate'' is unlikely to be confused with the more frequently used APR. Furthermore, the Board believes ``total annual loan cost rate'' is a more accurate description of the percentage cost of reverse mortgages than ``annual interest rate.'' For example, the rate may reflect costs other than interest, such as annuity premiums, appraisal fees and a percentage of any appreciation in the consumer's home.

Section 138(a)(1) of the TILA requires creditors to disclose total annual loan cost rates for not less than three projected appreciation rates and not less than three credit transaction periods, as determined by the Board. HUD's HECM matrix similarly discloses nine ``average annual percentage rates'' based on three assumed annual home appreciation rates and three assumed loan terms. The proposed regulation would require the tabular disclosure of nine total annual loan cost rates.

The HECM matrix is accompanied by a listing of the basic factors used in calculating the projected total cost of credit, such as the age of the borrower, the value of the consumer's home, etc., and a brief discussion of some assumptions used in calculating the rates in the matrix. The proposed regulation would require that the matrix be accompanied by a listing of key factors used in calculating the total annual loan cost rates, along with a brief narrative that helps consumers to interpret the rates disclosed in the matrix. (See the supplementary material accompanying proposed Appendix K for further discussion of the model disclosure.)

33(c) Projected Total Cost of Credit

Section 138(a) and 138(b) of the TILA identify factors creditors must consider when calculating the projected total cost of credit and the corresponding total annual loan cost rates. The proposed regulation lists those requirements in paragraph (c) of this section. (The mathematical formulas for determining the total annual loan cost rate is contained in Appendix K.)

33(c)(1) Costs to Consumer

Section 138(b)(2) of the TILA includes in the projected total cost of credit all costs and charges to the consumer, including the costs of any associated annuity that the consumer elects or is required to purchase as part of the reverse mortgage transaction. The proposed regulation parallels the statute, except that the term ``associated'' has been deleted.

The Board believes the Congress intended a very broad application of the terms ``costs and charges.'' For example, the Board believes all costs and charges connected with the reverse mortgage transaction must be included in the projected total cost of credit, whether or not the charge is deemed to be a finance charge under Subpart A of the regulation.

Some creditors require or permit consumers to purchase an annuity as part of the transaction that at some future time supplements or replaces the creditor's payments. The law and regulation require the amount paid by the consumer for the annuity to be included as a cost to the consumer. This is the case whether the purchase is made through the creditor or a third party, or whether the purchase is mandatory or voluntary.

The HECM program does not include disposition costs as a part of the total annual loan cost rate, and the proposed regulation follows that approach. The Board solicits comment on the treatment of disposition costs that may be incurred when the loan is repaid.

33(c)(2) Payments to Consumer

Section 138(b)(3) of the TILA requires creditors to consider in the projected total cost of credit all payments to and for the benefit of the consumer, including annuity payments received by the consumer from an annuity purchased as part of the reverse mortgage transaction. The regulation would generally track the statute, with slight modifications for clarity.

33(c)(3) Additional Creditor Compensation

Section 138(b)(1) of the TILA includes in the total cost of a reverse mortgage loan any shared appreciation or equity that the creditor is entitled to receive pursuant to the credit contract. For example, creditors sometimes offer a reduced interest rate in exchange for a portion of the appreciation or equity that may be realized when the dwelling is sold.

33(c)(4) Limitations on Consumer Liability

Section 138(b)(4) of the TILA requires creditors to consider in the projected total cost of credit any limitation on the consumer's liability under the reverse mortgage loan. This would include, for example, equity conservation agreements. These agreements protect a portion of the equity in the dwelling for the consumer or the consumer's estate.

This paragraph would also apply to the nonrecourse provision that is a part of any credit contract meeting the definition of a reverse mortgage transaction. (See paragraph (a) of this section.) Some reverse mortgage transactions provide that a consumer's liability will not exceed a specific percentage of the projected home value, say 75 percent. Other reverse mortgages set the consumer's maximum liability at the ``net proceeds'' available from the sale of the home. That is, if a consumer sells the home for $100,000 and brokerage commissions and other incidental selling costs were $7,000, the creditor would receive no more than $93,000--the net proceeds of the sale.

The Board believes that the purposes of the reverse mortgage disclosures would be enhanced if the calculations of projected total costs for ``net proceeds'' recourse limitations were based on uniform assumptions about the costs associated with the sale of the home. Thus, if a contract does not otherwise specify a percentage for net proceeds, creditors must assume closing costs of 7 percent, which approximates the amounts paid for typical brokerage fees and other incidental costs. The Board solicits comment on this approach. If another amount is more appropriate, commenters should provide the rationale for the alternative approach.

33(c)(5) Assumed Annual Appreciation Rates

Section 138(a)(1) of the TILA requires each total annual loan cost rate to be based on one of (at least) three projected appreciation rates for the consumer's dwelling. The proposed regulation tracks the appreciation rates used in HUD's HECM program. That is, the total annual loan cost rates are based on assumed annual home appreciation rates of 0 percent, 4 percent and 8 percent. The Board believes these appreciation rates are appropriate estimates for reverse mortgage transactions. For example, HUD's program based the 4 percent annual appreciation rate on its assessment of long-term averages of historical housing appreciation rates. The 0 percent and 8 percent rates help consumers understand the potential costs and benefits of the loan if their dwelling does not appreciate in value at all, or if its value appreciated at a rate double the 4 percent rate. The Board solicits comment on other appreciation rates that might be used in lieu of the proposed rates; and if alternative rates are suggested, commenters should provide the rationale for why those rates would be a more appropriate measure for calculating the total annual loan cost rate.

33(c)(6) Assumed Loan Period

Section 138(a)(1) of the TILA also requires each total annual loan cost rate to be based on one of (at least) three credit transaction periods, as determined by the Board, including a short-term reverse mortgage, a term equaling the actuarial life expectancy of the consumer, and ``such longer term as the Board deems appropriate.'' The proposed regulation tracks the assumed loan periods required under the HECM program: a period of two years, a period equal to the consumer's life expectancy, and a period equal to approximately 1.4 times the consumer's life expectancy (the creditor would use the life expectancy of the youngest consumer in transactions involving multiple borrowers).

The Board believes these proposed loan periods produce total annual loan cost rates that will assist consumers in understanding the costs of the reverse mortgage transaction in the event that, for example, they move permanently from the dwelling either sooner or later than anticipated. (See the supplementary material accompanying proposed Appendix L for further discussion of the life expectancy data used to derive two of the assumed loan periods.)

The statute authorizes the Board to require total annual loan cost rates for more than three assumed loan periods. The Board notes that, depending on the age of the borrower, a significant time interval could exist between the shortest loan period (two years) and the consumer's life expectancy. Accordingly, the Board solicits comment on whether other assumed loan periods, such as an assumed loan period of one-half of the life expectancy figure, should be added to the regulation; and if so, whether calculations based on the additional assumed loan periods should be required (which promotes uniformity), or optional.

Appendix K--Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions

The proposed regulation bases the calculation of total annual loan cost rates on a commonly used computation tool, an internal rate of return formula. The formula uses the estimation or ``iteration'' procedure required to compute APRs under Appendix J of this part. However, Appendix J is written in the context of forward (not reverse) mortgages. The proposed formulas are similar to those in Appendix J; however, to ease compliance and avoid confusion about terminology, definitions and instructions appropriate for reverse mortgages are placed in Appendix K.

(b) Instructions and Equations for the Total Annual Loan Cost Rate

(b)(5) Number of Unit-Periods Between Two Given Dates

The proposed total annual loan cost rates are based on a proposed assumption that the reverse mortgage transaction begins on the first day of the month in which consummation is estimated to occur. The total annual loan cost rates are good faith estimates based on a number of assumptions. The Board believes that using fractional unit-periods required under Appendix J for calculating APRs is unnecessary for these disclosures, and has not incorporated many definitions relating to time intervals.

(b)(8) Solution of General Equation by Iteration Process

Rather than restate the iteration process required to be used in determining total annual loan cost rates under the appendix, the Board has referred lenders to Appendix J of this regulation for the procedures to be followed. The Board solicits comment on whether this is sufficient guidance to reverse mortgage lenders.

(b)(9) Assumption for Discretionary Cash Advances

Some reverse mortgage transactions permit consumers to control when advances are received. The proposed regulation requires creditors to use a special assumption for calculating the total annual loan cost rate in this case. Creditors must assume that 50 percent of the amount of the credit line is advanced when the consumer becomes obligated under the transaction (at the interest rate then in effect) and that no further advances are made during the remaining term. The Board believes this assumption is appropriate for reverse mortgage credit lines, given that the amount and timing of advances (thus, the estimated interest owed) are within the consumer's control. The proposal also is consistent with Appendix D's requirements for an estimated interest figure when the amount and timing of construction loan advances are unknown, as well as with HUD's HECM program.

Creditors would follow this approach for estimating interest on open-end reverse mortgage credit lines. Once the interest figure is determined, creditors would use the general equation in section (b)(8) of this appendix to calculate the total annual loan cost rate.

(b)(10) Assumption for Variable-Rate Reverse Mortgage Transactions

Regulation Z provides that to calculate the APR, creditors offering variable-rate transactions must base disclosures on the initial interest rate and not assume the rate will increase. The Board proposes to adopt the same convention for calculating total annual loan cost rates. The Board notes, however, that HUD's HECM program requires creditors to assume an ``expected average mortgage interest rate'' or ``expected interest rate'' instead of the initial rate. The convention required by HUD reflects an average of long-term U.S. Treasury securities and results in a rate that is generally higher than the initial rate. The Board solicits comments on the benefits to consumers and burdens to creditors if creditors offering variable-rate reverse mortgage transactions were required to use both HUD's and the proposed assumptions to compute total annual loan cost rates.

(b)(11) Assumption for Closing Costs

The proposed regulation requires creditors to assume all closing and other consumer costs are financed by the creditor. These costs are generally financed as a part of the transaction, and the Board believes the proposed assumption provides uniformity.

(c) Examples of Total Annual Loan Cost Rate Computations

Three examples are provided to assist creditors in calculating the total annual loan cost rate. The Board solicits comment on whether other examples should be provided, and if so, what should be illustrated.

(d) Reverse Mortgage Model Form and Sample Form

The proposed regulation requires that the matrix be accompanied by a disclosure substantially similar to the model form in this paragraph. Reverse mortgages are complicated transactions, and the Board believes a uniform disclosure would enhance consumer understanding of the proposed transaction and promote informed comparison shopping.

The proposed model form and sample form are placed in this appendix, because they apply to both open-end and closed-end reverse mortgage transactions. This avoids publishing the forms twice, in Appendix G (Open-end model forms and clauses) and Appendix H (Closed-end model forms and clauses).

Appendix L--Assumed Loan Periods for Calculation of Total Annual Loan Cost Rates

As stated previously, the law requires the total annual loan cost rate disclosures for reverse mortgage transactions to be based on three assumed loan periods, as determined by the Board. The proposed regulation tracks the assumed loan period requirements of HUD's HECM program (two years, a period equal to the youngest consumer's life expectancy, and a period 1.4 times that consumer's life expectancy).

The Board proposes to use the U.S. Decennial Life Tables for the life expectancy figures. These tables are published by the Department of Health and Human Services and are widely available to the public. The figures in the proposed appendix are based on data currently available, that is, on tables for 1979-1981, as rounded to the nearest whole year. The Board contemplates updating the figures as data are published periodically. The Board solicits comment on other sources of life expectancy data that are also widely available and would be appropriate for determining the total annual loan cost rate for reverse mortgage transactions.

The proposed regulation also tracks the HECM program's use of female life expectancy figures for calculating total annual loan cost rates for all borrowers, as women are estimated to comprise the majority of borrowers under existing reverse mortgage programs.

IV. Form of Comment Letters

Comment letters should refer to Docket No. R-0858, and, when possible, should use a standard Courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text in machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3\1/2\ inch or 5\1/4\ inch computer diskettes in any IBM-compatible DOS-based format.

The comment period ends on January 18, 1995, a period slightly less than the 60 days normally called for in the Board's policy statement on rulemaking (44 FR 3957, January 19, 1979). The law provides for a short timeframe to issue implementing amendments in final form, and the Board believes an abbreviated comment period is desirable to ensure that a final rule is in place as soon as possible to provide guidance to creditors affected by the new rules.

V. Regulatory Flexibility Analysis

The Board's Office of the Secretary has prepared an economic impact statement on the proposed amendments to Regulation Z. A copy of the analysis may be obtained from Publications Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, at (202) 452-3245.

## VI. Paperwork Reduction Act

In accordance with section 3507 of the Paperwork Reduction Act of 1980 (44 U.S.C. 35; 5 CFR 1320.13), the proposed revisions will be reviewed by the Board under the authority delegated to the Board by the Office of Management and Budget after consideration of comments received during the public comment period.

The proposal requires creditors offering high-rate, high-fee mortgages and creditors offering reverse mortgage transactions to furnish to consumers at least three days prior to consummation a one-time notice disclosing costs of the loan and reminding consumers that signing an application or receiving disclosures does not require the consumer to complete the transaction. A model form in Appendix K is proposed to ease compliance for creditors furnishing reverse mortgage disclosures.

The Board believes that the types of mortgage products that would trigger these additional disclosures are not typically offered by state member banks; thus, the proposed requirements would have only a negligible impact on the paperwork burden for state member banks. Any estimates of paperwork burden for institutions other than state member banks that would be affected by the proposed amendments would be provided by the federal agency or agencies that supervise these lenders.

## VII. Indexing Terms

The Code of Federal Regulations publishes a list of subjects identifying common research terms that are intended to assist laypersons with the use of the Code of Federal Regulations. The list of subjects under which 12 CFR part 226 is listed would be expanded as listed below.

### List of Subjects in 12 CFR Part 226

Advertising, Banks, banking, Consumer protection, Credit, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Truth in lending.

Certain conventions have been used to highlight the proposed revisions to the regulation. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 226 as follows:

## PART 226--TRUTH IN LENDING (REGULATION Z)

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

Authority: 12 U.S.C. 3806, 15 U.S.C. 1604 and 1637(c)(5).

2. Section 226.1 would be amended as follows:
a. Paragraph (b) would be revised;
b. Paragraph (d)(5) would be redesignated as paragraph (d)(6);
c. A new paragraph (d)(5) would be added; and

d. Redesignated paragraph (d)(6) would be revised.
The revisions and addition would read as follows:

Sec. 226.1 Authority, purpose, coverage, organization, enforcement and liability.

* * * * *

(b) The purpose of this regulation is to promote the informed use of consumer credit be 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 [,]. It also [and] imposes limitations on home equity plans that are subject to the requirements of Sec. 226.5b and high-rate, high-fee mortgages that are subject to the requirements of Sec. 226.32. The regulation does not govern charges for consumer credit.

* * * * *

(d) * * *

(5) [There are several appendices containing information such as the procedures for determinations about state laws, state exemptions and issuance of staff interpretations, special rules for certain kinds of credit plans, a list of enforcement agencies, and the rules for computing annual percentage rates in closed-end credit transactions.] Subpart E relates to high-rate, high-fee mortgage transactions and reverse mortgage transactions. It contains rules on disclosures, fees, and total annual loan cost rates.

(6) There are several appendices containing information such as the procedures for determinations about state laws, state exemptions and issuance of staff interpretations, special rules for certain kinds of credit plans, a list of enforcement agencies, and the rules for computing annual percentage rates in closed-end credit transactions and annual interest rates for reverse mortgage transactions.

* * * * *

3. In Sec. 226.2, footnote 3 in paragraph (a)(17)(i) would be revised to read as follows:

Sec. 226.2 Definitions and rules of construction.

(a) * * *

(17) * * *

(i) * * *<SUP>3 * * *

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\3\A person regularly extends consumer credit only if it extended credit (other than credit subject to the requirements of Sec. 226.32) more than 25 times (or more than 5 times for transactions secured by a dwelling) in the preceding calendar year. If a person did not meet these numerical standards in the preceding calendar year, the numerical standards shall be applied to the current calendar year. A person regularly extends consumer credit if, in any 12-month period, it originated two or more credit extensions that are subject to the requirements of Sec. 226.32 (covering high-rate, high-fee mortgages) or one or more such credit extensions through a mortgage broker.

---------------------------------------------------------------------------

* * * * *
    4. In Sec. 226.5b paragraph (f)(2) introductory text would be revised and a new paragraph (f)(4) would be added to read as follows:

Sec. 226.5b   Requirements for home equity plans.

* * * * *
    (f) * * *
    (2) Terminate a plan and demand repayment of the entire outstanding balance in advance of the original term (except for reverse mortgage transactions that are subject to paragraph (f)(4) of this section) unless
* * * * *
* * * * *
    <r-arrow>(4) For reverse mortgage transactions that are subject to Sec. 226.33, terminate a plan and demand repayment of the entire outstanding balance in advance of the original term except:
    (i) In the case of default;
    (ii) If the consumer transfers title to the property securing the note;
    (iii) If the consumer ceases using the property securing the note as the primary dwelling; or
    (iv) Upon the consumer's death.<l-arrow>
* * * * *
    5. In Sec. 226.23, footnote 48 in paragraph (a)(3) would be revised to read as follows:

Sec. 226.23  Right of rescission.

    (a) * * *
    (3) * * * \48\ * * *
---------------------------------------------------------------------------

    \4\8The term ``material disclosures'' means the required disclosures of the annual percentage rate, the finance charge, the amount financed, the total payments, [and] the payment schedule[.]<r-arrow>, and the disclosures and limitations referred to in Sec. 226.32(c) and (d).<l-arrow>
---------------------------------------------------------------------------

* * * * *
    6. In Sec. 226.28, the first sentence of paragraph (b) would be revised to read as follows:

Sec. 226.28  Effect on State laws.

* * * * *
    (b) Equivalent disclosure requirements. If the Board determines that a disclosure required by state law (other than a requirement relating to the finance charge [or] <r-arrow>,<l-arrow> annual percentage rate,<r-arrow> or the disclosures required under Sec. 226.32<l-arrow>) is substantially the same in meaning as a disclosure required under the act or this regulation, creditors in that state may make the state disclosure in lieu of the federal disclosure.

* * *
* * * * *

7. Part 226 would be amended by adding a new Subpart E to read as follows:

<r-arrow>Subpart E--Certain Mortgage Transactions



Subpart E--Certain Mortgage Transactions

Sec. 226.31 General disclosure requirements.

(a) Relation to other subparts. The requirements and limitations of this subpart are in addition to and not in lieu of those contained in other subparts of this part.

(b) Form of disclosures. The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep.

(c) Timing of disclosures.--(1) High-rate, high-fee mortgage disclosures. The creditor shall furnish the disclosures required by Sec. 226.32 at least three business days prior to consummation of a high-rate, high-fee mortgage transaction.

(i) New disclosures. After complying with paragraph (c)(1) of this section and prior to consummation, if the creditor changes any term that makes the disclosures inaccurate, new disclosures shall be provided in accordance with the requirements of this subpart.

(ii) Telephone disclosures. A creditor may provide new disclosures by telephone if the consumer initiates the change, and if, at consummation--

(A) The creditor provides new written disclosures; and

(B) The consumer and creditor sign a statement that the new disclosures were provided by telephone at least three days prior to consummation.

(2) Reverse mortgage disclosures. The creditor shall furnish the disclosures required by Sec. 226.33 at least three business days prior to:

(i) Consummation of a closed-end credit transaction; or

(ii) The first transaction under an open-end credit plan.

(d) Basis of disclosures and use of estimates. Disclosures shall reflect the terms of the legal obligation between the parties. If any information necessary for accurate disclosure is unknown to the creditor, the creditor shall make the disclosure based on the best information reasonably available and shall state clearly that the disclosure is an estimate.

(e) Multiple creditors; multiple consumers. If a transaction involves more than one creditor, only one set of disclosures shall be given and the creditors shall agree among themselves which creditor must comply with the requirements that this regulation imposes on any or all of them. If there is more than one consumer, the disclosures may be made to any consumer who is primarily liable on the obligation. If the transaction is rescindable under Sec. 226.15 or Sec. 226.23, however, the disclosures shall be made to each consumer who has the right to rescind.

(f) Effect of subsequent events. If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of this regulation, although new disclosures may be required under paragraph (c) of this section, Sec. 226.9(c), Sec. 226.19, or Sec. 226.20.

## Sec. 226.32 High-rate, high-fee mortgages.

(a) Coverage. This section does not apply to the following:

(1) A residential mortgage transaction.

(2) A reverse mortgage transaction subject to Sec. 226.33.

(3) An open-end credit plan subject to subpart B of this part.

(b) Definitions. For purposes of this subpart, the following definitions apply:

(1) High-rate, high fee mortgage means a consumer credit transaction that is secured by the consumer's principal dwelling, and in which either:

(i) The annual percentage rate at consummation will exceed by more than 10 percentage points the yield on Treasury securities having comparable periods of maturity on the fifteenth day of the month immediately preceding the month in which the application for the extension of credit is received by the creditor; or

(ii) The total points and fees payable by the consumer at or before loan closing will exceed the greater of 8 percent of the total loan amount, or $400; the $400 figure shall be adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1.

(2) For purposes of paragraph (b)(1)(ii) of this section, points and fees mean:

(i) All items required to be disclosed under Sec. 226.4(a) and 226.4(b), except interest or the time-price differential;

(ii) All compensation paid to mortgage brokers; and

(iii) All items required to be disclosed under Sec. 226.4(c)(7) (other than amounts held for future payment of taxes) unless the charge is reasonable, the creditor receives no direct or indirect compensation, and the charge is not paid to an affiliate of the creditor.

(3) Affiliate means an entity defined in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) Disclosures. In addition to other disclosures required by this part, for each high-rate, high-fee mortgage transaction, the creditor shall disclose the following:

(1) Notices. The following statement: ``You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan.''

(2) Annual percentage rate. The annual percentage rate.

(3) Monthly payment. The amount of the regular monthly payment.

(4) Variable-rate. For variable-rate transactions, a statement that the interest rate and monthly payment may increase, and the amount of the maximum monthly payment, based on the maximum interest rate required to be disclosed under Sec. 226.30.

(d) Limitations. A high-rate, high-fee mortgage transaction may not

provide for the following terms:
    (1) Balloon payment. A payment schedule with regular periodic payments that do not repay the full amount of interest.
    (2) Negative amortization. A payment schedule with regular periodic payments that when aggregated, do not fully amortize the outstanding principal balance.
    (3) Advance payments. A payment schedule that consolidates more than two periodic payments and pays them in advance from the proceeds.
    (4) Increased interest rate. An increase in the interest rate after default.
    (5) Rebates. A refund calculation by a method less favorable than the actuarial method (as defined under section 933(d) of the Housing and Community Development Act of 1992), for rebates arising from a loan acceleration due to default.
    (6) Prepayment penalties. Except as provided in paragraph (d)(7) of this section, a penalty for paying all or part of the principal before the date on which the principal is due. A prepayment penalty includes computing a refund of unearned interest less favorable to the consumer than the actuarial method, as defined under section 933(d) of the Housing and Community Development Act of 1992.
    (7) Exception. A high-rate, high-fee mortgage transaction may contain a prepayment penalty otherwise permitted by law (including a refund calculated according to the rule of 78s) if:
    (i) The penalty can be exercised only for the first five years following consummation;
    (ii) The source of the prepayment funds is not a refinancing by the creditor or an affiliate of the creditor; and
    (iii) At consummation, the consumer's total monthly debts (including amounts owed under the high-rate, high-fee mortgage) do not exceed 50 percent of the consumer's monthly gross income, as verified by the consumer's signed financial statement, a credit report, and payment records for employment income.
    (e) Prohibited acts and practices. A creditor extending high-rate, high-fee mortgage credit may not:
    (1) Repayment ability. Engage in a pattern or practice of extending such credit to a consumer based on the consumer's collateral if, considering the consumer's current and expected income, current obligations, and employment, the consumer is unable to make the scheduled payments.
    (2) Home improvement contracts. Pay a contractor under a home improvement contract from the proceeds of a high-rate, high-fee mortgage, other than:
    (i) By an instrument payable to the consumer or jointly to the consumer and the contractor; or
    (ii) At the election of the consumer, through a third-party escrow agent in accordance with terms established in a written agreement signed by the consumer, the creditor, and the contractor prior to the disbursement.
    (3) Notice to assignee. Sell or otherwise assign a high-rate, high-fee mortgage without furnishing the following statement to the purchaser or assignee: ``Notice: Purchasers or assignees of this mortgage could be liable for all claims and defenses with respect to the mortgage that the borrower could assert against the creditor.''

Sec. 226.33  Reverse mortgages.

(a) Definition. For purposes of this subpart, reverse mortgage transaction means a nonrecourse consumer credit obligation in which:

(1) A mortgage, deed of trust, or equivalent consensual security interest securing one or more advances is created in the consumer's principal dwelling; and

(2) Any principal, interest, or shared appreciation or equity is due and payable (other than in the case of default) only after:

(i) The consumer dies;

(ii) The dwelling is transferred; or

(iii) The consumer ceases to occupy the dwelling as a principal dwelling.

(b) Content of disclosures. In addition to other disclosures required by this part, for each reverse mortgage transaction, the creditor shall provide the following disclosures in a form substantially similar to the model form found in paragraph (d) of Appendix K of this part:

(1) Notice. A statement that the consumer is not obligated to complete the reverse mortgage transaction merely because the consumer has received the disclosures required by this section or has signed an application for a reverse mortgage loan.

(2) Total annual loan cost rates. A good faith estimate of the projected total cost of the credit, determined in accordance with paragraph (c) of this section, and expressed as a table of ``total annual loan cost rates,'' using that term, determined in accordance with Appendix K of this part.

(3) Itemization of pertinent information. An itemization of loan terms, charges, the age of borrower and the appraised property value.

(4) Explanation of table. An explanation of the table of total annual loan cost rates provided in the model form found in paragraph (d) of Appendix K of this part.

(c) Projected total cost of credit. The projected total cost of credit shall reflect the following factors, as applicable:

(1) Costs to consumer. All costs and charges to the consumer, including the costs of any annuity that the consumer elects or is required to purchase as part of the reverse mortgage transaction.

(2) Payments to consumer. All payments to and for the benefit of the consumer, including annuity payments that the consumer will receive from an annuity that the consumer elects or is required to purchase as part of the reverse mortgage transaction.

(3) Additional creditor compensation. Any shared appreciation or equity in the dwelling that the creditor is entitled by contract to receive.

(4) Limitations on consumer liability. Any limitation on the consumer's liability (such as nonrecourse limits and equity conservation agreements).

(5) Assumed annual appreciation rates. Each of the following assumed annual appreciation rates for the dwelling:

(i) 0 percent.

(ii) 4 percent.

(iii) 8 percent.

(6) Assumed loan period. Each of the following assumed loan periods, as provided in Appendix L of this part:

(i) 2 years.

(ii) The actuarial life expectancy of the youngest consumer to become obligated on the reverse mortgage transaction (as of that consumer's most recent birthday).

(iii) The actuarial life expectancy specified by paragraph (c)(5)(ii) of this section, multiplied by a factor of 1.4 and rounded to the nearest full year.

9. A new Appendix K would be added to read as follows:

## Appendix K to Part 226--Total Annual Loan Cost Rate Computations for Reverse Mortgage Transactions

(a) Introduction. Creditors are required to disclose a series of total annual loan cost rates for each reverse mortgage transaction. This appendix contains the equations creditors must use in computing the total annual loan cost rate for various transactions, as well as instructions, explanations, and examples for various transactions. This appendix is modeled after Appendix J of this part (Annual Percentage Rates Computations for Closed-end Credit Transactions); creditors should consult Appendix J of this part for additional guidance in using the formulas for reverse mortgages.

(b) Instructions and equations for the total annual loan cost rate.

(1) General rule. The total annual loan cost rate shall be the nominal total annual loan cost rate determined by multiplying the unit-period rate by the number of unit-periods in a year.

(2) Term of the transaction. For purposes of total loan cost disclosures, the term of a reverse mortgage transaction is assumed to begin on the first of the month in which consummation is expected to occur. If a loan cost or any portion of a loan cost is initially incurred beginning on a date later than consummation, the term of the transaction is assumed to begin on the first of the month in which that loan cost is incurred. For purposes of total loan cost disclosures, the term ends on each of the assumed loan periods specified in Sec. 226.33(c)(6).

(3) Definitions of time intervals.

(i) A period is the interval of time between advances.

(ii) A common period is any period that occurs more than once in a transaction.

(iii) A standard interval of time is a day, week, semimonth, month, or a multiple of a week or a month up to, but not exceeding, 1 year.

(iv) All months shall be considered equal.

(4) Unit-period.

(i) In all transactions other than a single-advance, single-payment transaction, the unit-period shall be that common period, not to exceed one year, that occurs most frequently in the transaction, except that:

(A) If two or more common periods occur with equal frequency, the smaller of such common periods shall be the unit-period; or

(B) If there is no common period in the transaction, the unit-period shall be that period which is the average of all periods rounded to the nearest whole standard interval of time. If the average is equally near two standard intervals of time, the lower shall be the unit-period.

(ii) In a single-advance, single-payment transaction, the unit-period shall be the term of the transaction, but shall not exceed one year.

(5) Number of unit-periods between two given dates.

(i) The number of days between two dates shall be the number of 24-hour intervals between any point in time on the first date to the same point in time on the second date.

(ii) If the unit-period is a month, the number of full unit-periods between two dates shall be the number of months. If the unit-period is a month, the number of unit-periods per year shall be 12.

(iii) If the unit-period is a semimonth or a multiple of a month not exceeding 11 months, the number of days between two dates shall be 30 times the number of full months. The number of full unit-periods shall be determined by dividing the number of days by 15 in the case of a semimonthly unit-period or by the appropriate multiple of 30 in the case of a multimonthly unit-period. If the unit-period is a semimonth, the number of unit-periods per year shall be 24. If the number of unit-periods is a multiple of a month, the number of unit-periods per year shall be 12 divided by the number of months per unit-period.

(iv) If the unit-period is a day, a week, or a multiple of a week, the number of full unit-periods shall be determined by dividing the number of days between the two given dates by the number of days per unit-period. If the unit-period is a day, the number of unit-periods per year shall be 365. If the unit-period is a week or a multiple of a week, the number of unit-periods per year shall be 52 divided by the number of weeks per unit-period.

(v) If the unit-period is a year, the number of full unit-periods between two dates shall be the number of full years (each equal to 12 months).

(6) Symbols. The symbols used to express the terms of a transaction in the equation set forth in paragraph (b)(8) of this appendix are defined as follows:

A<INF>j = The amount of each periodic or lump-sum advance to the consumer under the reverse mortgage transaction.
i = Percentage rate of the total loan cost per unit-period, expressed as a decimal equivalent.
j = The number of unit-periods until the jth advance.
n = The number of unit-periods between consummation and repayment of the debt.
P<INF>n = Min (Bal<INF>n, Val<INF>n). This is the maximum amount that the creditor can be repaid at the specified loan term.
Bal<INF>n = Loan balance at time of repayment, including all costs and fees incurred by the consumer (including any shared appreciation or shared equity amount) compounded to time n at the creditor's contract rate of interest.
Val<INF>n = Val<INF>0 (1 + <greek-s>)<SUP>y, where Val<INF>0 is the property value at consummation, is the assumed annual rate of appreciation for the dwelling, and y is the number of years in the assumed term. Val<INF>n must be reduced by the amount of any equity reserved for the consumer by agreement between the parties, or by 7 percent (or the amount or percentage specified in the credit agreement), if the amount required to be repaid is limited to the net proceeds of sale.
<greek-S> = The summation operator.

Symbols used in the examples shown in this appendix are defined as follows:

FV<INF>x   i = The future value of 1 per unit-period for x unit periods, first advance due immediately (at time = 0, which is consummation).

<GRAPHIC><TIFF>TP02DE94.013

I = wi x 100 = the nominal total annual loan cost rate.

(7) General equation. The total annual loan cost rate for a reverse mortgage transaction must be determined by first solving the following formula, which sets forth the relationship between the advances to the consumer and the amount owed to the creditor under the terms of the reverse mortgage agreement for the loan cost rate per unit-period (the loan cost rate per unit-period is then multiplied by the number of unit-periods per year to obtain the total annual loan cost rate I; that is I = wi):

<GRAPHIC><TIF1>TP02DE94.014

(8) Solution of general equation by iteration process. (i) The general equation in paragraph (b)(7) of this appendix, when applied to a simple transaction for a reverse mortgage loan of equal monthly advances of $350 each, and with a total amount owed of $14,313.08 at an assumed repayment period of two years, takes the special form:

<GRAPHIC><TIF2>TP02DE94.015

Using the iteration procedures found in steps 1 through 4 of (b)(9)(i) of Appendix J of this part, the total annual loan cost rate, correct to two decimals, is 48.53%.

(ii) In using these iteration procedures, it is expected that calculators or computers will be programmed to carry all available decimals throughout the calculation and that enough iterations will be performed to make virtually certain that the total annual loan cost rate obtained, when rounded to two decimals, is correct. Total annual loan cost rates in the examples below were obtained by using a 10-digit programmable calculator and the iteration procedure described in Appendix J to this part.

(9) Assumption for discretionary cash advances. If the consumer controls the timing of advances made after consummation (such as in a credit line arrangement), creditors must use the general formula in paragraph (b)(7) of this appendix. The total annual loan cost rate shall be based on the assumption that 50 percent of the principal loan amount is advanced at closing, or in the case of an open-end transaction, at the time the consumer becomes obligated under the plan. Creditors shall assume the advances are made at the interest rate then in effect and that no further advances are made to, or repayments made by, the consumer during the term of the transaction or plan.

(10) Assumption for variable-rate reverse mortgage transactions. If the interest rate for a reverse mortgage transaction may increase during the loan term and the amount or timing is not known at consummation, creditors shall base the disclosures on the initial interest rate in effect at the time the disclosures are provided.

(11) Assumption for closing costs. In calculating the total annual loan cost rate, creditors shall assume all closing and other consumer costs are financed by the creditor.

(c) Examples of total annual loan cost rate computations.

(1) Lump-sum advance at consummation.

Lump-sum advance to consumer at consummation: $30,000

Total of consumer's loan costs financed at consummation: $4,500
Estimated time of repayment (based on life expectancy of a consumer of age 78): 10 years
Appraised value of dwelling at consummation: $100,000
Assumed annual dwelling appreciation rate: 4%

P<INF>120 = Min (109,441.32, 148,024.43)

<GRAPHIC><TIF3>TP02DE94.016

i = .010843293
Total annual loan cost rate (100(.010843293 x 12)) = 13.01%

(2) Monthly advance beginning at consummation.

Monthly advance to consumer, beginning at consummation: $481.43
Total of consumer's loan costs financed at consummation: $4,500
Estimated time of repayment (based on life expectancy of a consumer of age 78): 10 years
Appraised value of dwelling at consummation: $100,000
Assumed annual dwelling appreciation rate: 8%

P<INF>120 = Min (107,054.49, 215,892.50)

<GRAPHIC><TIF4>TP02DE94.017

i = .009383333
Total annual loan cost rate (100(.009383333 x 12) = 11.26%

(3) Lump sum advance at consummation and monthly advances thereafter.

Lump sum advance to consumer at consummation: $10,725
Monthly advance to consumer, beginning one month after consummation: $725.00
Total of consumer's loan costs financed at consummation: $4,500
Estimated time of repayment (based on life expectancy of a consumer of age 75): 12 years
Appraised value of dwelling at consummation: $100,000
Assumed annual dwelling appreciation rate: 8%

P<INF>144 = Min (229,382.85, 251,817.01)

<GRAPHIC><TIF5>TP02DE94.018

i = .00806917958
Total annual loan cost rate (100(.00806917958 x 12) = 9.68%

(d) Reverse mortgage model form and sample form.
(1) Model form.

Total Annual Loan Cost Rate

Loan Terms

Age of borrower:
Appraised property value:

Interest rate:
Monthly payment:
Initial draw:
Line of credit:

Initial Loan Charges

Closing costs:
Mortgage insurance premium:
Annuity cost:

Monthly Loan Charges

Mortgage insurance:
Servicing fee:

Other Charges

Shared Appreciation:

Repayment Limits

| Appreciation rate (percent) | 2-year loan term | []-year loan term | []-year loan term |
|---|---|---|---|
| 0 | | | |
| 4 | | | |
| 8 | | | |

The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the cost of the loan is for you.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three loan terms: 2 years, life expectancy for someone your age, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%, 4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not disposition costs--costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

Signing an Application or Receiving These Disclosures Does Not Require You to Complete This Loan

(2) Sample Form.

Total Annual Loan Cost Rate

Loan Terms

Age of borrower: 75
Appraised property value: $100,000
Interest rate: 9%
Monthly payment: $301.80
Initial draw: $1,000
Line of credit: $4,000

Initial Loan Charges

Closing costs: $2,500
Mortgage insurance premium: $2,000
Annuity cost: N/A

Monthly Loan Charges

Mortgage insurance: .05%
Servicng fee: $25.00

Other Charges

Shared Appreciation: N/A

Repayment Limits

Net proceeds estimated at 93% of projected home sale

| Appreciation rate (percent) | 2 year loan term (percent) | 12 year loan term (percent) | 17 year loan term (percent) |
|---|---|---|---|
| 0 | 39.8 | 10.8 | 4.6 |
| 4 | 39.8 | 12.2 | 10.6 |
| 8 | 39.8 | 12.2 | 11.2 |

The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the cost of the loan is for you.

This table shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three loan terms: 2 years, life expectancy for someone your age, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your home appreciates at three different rates: 0%,4% and 8%.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not disposition costs--costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

Signing an Application or Receiving These Disclosures Does Not Require You to Complete This Loan<lf-triang>

10. A new Appendix L would be added to read as follows:

Appendix L to Part 226--Assumed Loan Periods for Computations of Total Annual Loan Cost Rates

(a) Required tables. In calculating the total annual loan cost rates in accordance with Appendix K of this part, creditors shall assume three loan periods, as determined by the following table.

(b) Loan periods.

(1) Loan Period 1 is a two-year loan period.

(2) Loan Period 2 is the life expectancy in years of the youngest borrower to become obligated on the reverse mortgage loan, as shown in the U.S. Decennial Life Tables for 1979-1981 for females, rounded to the nearest whole year.

(3) Loan Period 3 is the life expectancy figure in Loan Period 2, multiplied by 1.4 and rounded to the nearest full year. (.5 has been rounded up to 1).

| Age of youngest borrower | Loan period 1 (in years) | Loan period 2 (life expectancy) (in years) | Loan period 3 (in years) |
|---|---|---|---|
| 62 | 2 | 21 | 30 |
| 63 | 2 | 20 | 28 |
| 64 | 2 | 19 | 27 |
| 65 | 2 | 18 | 25 |
| 66 | 2 | 18 | 25 |
| 67 | 2 | 17 | 24 |
| 68 | 2 | 16 | 22 |
| 69 | 2 | 16 | 22 |
| 70 | 2 | 15 | 21 |
| 71 | 2 | 14 | 20 |
| 72 | 2 | 13 | 18 |
| 73 | 2 | 13 | 18 |
| 74 | 2 | 12 | 17 |
| 75 | 2 | 12 | 17 |
| 76 | 2 | 11 | 15 |
| 77 | 2 | 10 | 15 |
| 78 | 2 | 10 | 14 |
| 79 | 2 | 9 | 13 |
| 80 | 2 | 9 | 13 |
| 81 | 2 | 8 | 11 |
| 82 | 2 | 8 | 11 |
| 83 | 2 | 7 | 10 |
| 84 | 2 | 7 | 10 |
| 85 | 2 | 6 | 8 |
| 86 | 2 | 6 | 8 |
| 87 | 2 | 6 | 8 |
| 88 | 2 | 5 | 7 |

| | | | |
|---|---|---|---|
| 89 | 2 | 5 | 7 |
| 90 | 2 | 5 | 7 |
| 91 | 2 | 4 | 6 |
| 92 | 2 | 4 | 6 |
| 93 | 2 | 4 | 6 |
| 94 | 2 | 4 | 6 |
| 95 and over | 2 | 3 | 4' |

<lf-triang>By order of the Board of Governors of the Federal Reserve System, November 28, 1994.

William W. Wiles,
Secretary of the Board.

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