

51 F.R. 42241

PROPOSED RULES

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; Docket No. R-0545]

Truth in Lending; Variable-Rate Disclosure Under Regulation Z

Monday, November 24, 1986

***42241** AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board is republishing for comment a proposed amendment to Regulation Z (Truth in Lending) that would require creditors to provide more information about the variable-rate feature of adjustable-rate mortgages than is currently required under Regulation Z. The proposed rule would supersede the Board's proposed rule on variable-rate mortgages published for comment on May 15, 1985 [50 FR 20221]. The current proposal would require creditors to distribute to consumers an educational booklet about adjustable-rate mortgages, and to provide a more detailed description of the variable-rate feature, along with an historic example, at the time an application form is given to the consumer or before the consumer pays a non-refundable fee, whichever is earlier. These revisions are intended to address concerns regarding the adequacy of information given to consumers applying for adjustable-rate mortgages and regarding the creditor burden of duplicative federal regulations.

DATE: Comments must be received on or before January 20, 1987.

***42242** ADDRESS: Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to the 20th Street courtyard entrance, 20th Street, between C Street and Constitution Avenue, NW., Washington, DC, between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to Docket No. R-0545. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Michael Bylsma, Senior Attorney, or Sharon Bowman, Staff Attorney, Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412, or 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

Recently the Board has been working with the other federal financial regulatory agencies to develop a uniform set of disclosures for adjustable-rate mortgages (ARMs). This effort arose because of concern about the different disclosure requirements imposed by the various federal agencies. Currently, four federal agencies require that lenders subject to their regulations provide specific disclosures about ARMs to borrowers. Under Regulation Z, the Board requires that a variable-rate feature be described briefly to consumers. In contrast to Regulation Z, the regulations of two other federal financial agencies and the Department of Housing and Urban Development (HUD) call for more extensive, detailed information. The Federal Home Loan Bank Board (FHLBB) requires variable-rate disclosures for federally-chartered savings and loan associations and also for certain other lenders

that wish to market their loans to federally-chartered savings and loans (12 CFR 545.33). The Office of the Comptroller of the Currency (OCC) mandates variable-rate disclosures for national banks and other lenders that seek to market their loans to national banks (12 CFR Part 29). Under the "Alternative Mortgage Transaction Parity Act of 1982" (12 U.S.C. 3802), state-chartered institutions and other mortgage lenders may take advantage of federal authorization of ARMs by following the rules of the FHLBB or the OCC. Finally, HUD prescribes disclosures for lenders wishing to participate in the Federal Housing Administration (FHA) insurance program (24 CFR Parts 203 and 234).

The federal financial agencies believe that this regulatory structure, which requires different disclosures by different lenders delivered at different times, is causing problems for both consumers and mortgage lenders. The ability of consumers to understand and make important decisions about ARMs before entering into these transactions may be hampered by their receipt of different information about ARM programs depending on what type of lender they have approached. This problem is exacerbated by the variety of ARM products now being offered as well as the complexity of some of these programs. At the same time, these regulatory requirements have proven burdensome to the mortgage industry, particularly when mortgage lenders must satisfy more than one regulation in order to take full advantage of the secondary market. Under certain circumstances, lenders who wish to originate mortgages for possible sale to either a federal savings and loan association or to a national bank may have to make disclosures under both agencies' rules. Furthermore, it has been claimed that the variety of regulatory requirements has hampered the development of a thriving secondary market for ARMs.

Based on recommendations by the Federal Financial Institutions Examination Council (FFIEC) and its own analysis, the Board proposed in May 1985 to amend Regulation Z to provide more information to consumers about ARMs and to encourage uniform disclosures among the agencies. The FFIEC had two recommendations for the Board, which grew out of the work of a task force composed of representatives from HUD, the OCC, the FHLBB, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Board. These recommendations were: (1) Consumers should be given information about ARMs before they submit a loan application or pay any fee; and (2) the disclosures should include an explanation of the nature of ARMs, including an example of payment changes that would result in a creditor's ARM program assuming 2 percentage points index rate increases in each of the first three years of a mortgage.

On May 15, 1985, the Board published its proposed amendment to Regulation Z which incorporated the recommendations of the FFIEC and which would have eliminated the provision of Regulation Z (footnote 43) that permits creditors to substitute the disclosures required by other federal regulations for the variable-rate disclosure required by Regulation Z. Specifically, the Board proposed that creditors make available to consumers information explaining ARMs and stated that the Consumer Handbook on Adjustable Rate Mortgages could be used by creditors to fulfill the requirement. The Board further proposed that detailed, transaction-specific disclosures be given to the consumer, including an example of the consumer's payment terms if the index rate increased 2 percentage points in each of the first three years.

The Board reviewed over 500 comments on its May 1985 proposal. All of the commenters addressing the issue supported the goal of uniformity in adjustable-rate mortgage disclosures. About 80% of the 200 commenters who expressed their opinion on the best way to achieve uniformity favored the Board's retaining footnote 43 until the other federal financial agencies agreed upon a uniform disclosure rule. A majority of the commenters on the issue also supported the Board's proposal to require creditors to make available the Consumer Handbook on Adjustable Rate Mortgages, or a comparable brochure.

About one-third of the commenters generally opposed to the proposed rule opposed it because of the payment example required and the possible increase

In August 1985, the FFIEC discussed the negative public comments received on the

Board's proposal, and recommended that the FFIEC Consumer Compliance Task Force develop a different approach to ARM disclosures. In October 1985, the Task Force *42243 recommended to the FFIEC that "generic" loan program disclosures be developed, but asked the FFIEC to decide whether the payment example should be based on assumed 2 percentage points annual increases in index values. The ARM disclosure proposal was discussed at three subsequent meetings of the FFIEC in late 1985 and in 1986. During that period, the Federal financial agencies received letters from members of Congress recommending that the disclosures show the borrower's maximum rate and payment exposure. On August 11, 1986, the FFIEC approved a proposal requiring that creditors provide two types of disclosures: (1) The Consumer Handbook on Adjustable Rate Mortgages, or a suitable substitute, and (2) disclosures that fully describe each of the creditor's ARM programs, with a 15-year historical example of how changes in the index or formula values used to compute interest rates would have affected the interest rates and payments on a \$10,000 loan. In addition, the maximum interest rate and payment that could result under the program for the \$10,000 loan would be disclosed.

(2) Proposed Amendment

Based on recommendations from the FFIEC, the Board is republishing for comment amendments to Regulation Z to provide more information to consumers about adjustable-rate mortgages. Like the original proposal published in May 1985, this proposal provides for a handbook to be distributed to consumers, as well as detailed disclosures about a creditor's ARM loan programs. Some provisions of the new proposal, however, most notably the example of rate adjustments, differ significantly from the earlier proposal.

As proposed earlier, the amendments would apply only to transactions secured by the consumer's principal dwelling. This would include all purchase-money mortgages, in which the consumer is obtaining a mortgage loan for the purpose of purchasing a home, as well as all transactions in which the consumer is using the home as security for a loan. (Home equity lines, in which an open-end line of credit is secured by the consumer's home, would not be subject to the new requirements, which apply only to closed-end mortgages.) All other consumer credit transactions that contain a variable-rate feature would continue to be subject to the current variable-rate disclosure requirements in Regulation Z.

In its earlier proposal, the Board solicited comment on whether the timing for the ARM disclosures should be earlier than proposed (for purchase-money ARMs, three days after a creditor's receipt of a written application). As recommended by the FFIEC, the Board is now proposing that ARM disclosures, including both the ARM brochure and the other detailed ARM information, be provided to prospective borrowers when an application form is furnished or before the payment of a non-refundable fee, whichever is earlier. This rule is consistent with the FHLBB's current timing rule for distribution of the ARM brochure. It would permit creditors to provide the detailed disclosures to consumers as an insert to the handbook when it is given. This change also reflects the views of some of the commenters on the Board's original proposal, who felt that ARM information should be provided to consumers as early as possible--particularly, before payment of an application fee--in order for consumers to use the information for comparison shopping. Disclosure at this point in time is possible under the new proposal because, unlike the original proposal, the new rule would require that disclosures reflect ARM loan program features, but not the terms of individual transactions. A special timing rule applies in cases where an ARM application reaches a creditor by way of an intermediary agent or broker in footnote 45b. In such cases, both the ARM brochure and the other detailed ARM information must be placed in the mail or delivered not later than three business days after the creditor receives the consumer's application.

Under the new timing rule, variable-rate disclosures would be given to consumers earlier than the standard Truth in Lending information required by § 226.18. A sentence would be added to § 226.17(b) to cross-reference the early timing requirement for ARMs. For purchase-money ARMs, the standard Truth in Lending disclosures generally are provided three days after a creditor's receipt of a written application. For other ARMs, the Truth in Lending disclosures are not

given until consummation of the transaction, which is typically at closing. Because of this difference in the timing of disclosures under § 226.19(b), a new paragraph (f)(2) would be added to § 226.18 to require that the later Truth in Lending disclosures make reference to the earlier ARM information received by consumers, as well as state that an adjustable-rate feature exists.

A new paragraph (b)(1) requiring an ARM brochure has been added to § 226.19. The method of providing this disclosure differs from that originally proposed. The May 1985 proposal required that an ARM brochure be made available to consumers so that they would have a chance to pick up a copy and review it before entering into the application process. The new proposal, instead, would require that creditors give each consumer a brochure, rather than simply making the brochures available, when an application form is given to a consumer or before a consumer pays a non-refundable fee, whichever is earlier. This provision mirrors the rule that the FHLBB has had in effect for federally-insured savings associations since August 1985. The rule ensures that every consumer considering applying for an ARM will receive a brochure at an early stage in the application process.

As proposed in May 1985, the Consumer Handbook on Adjustable Rate Mortgages, developed by the Board and the FHLBB, may be used by creditors to fulfill this requirement if they choose. The new proposal would also permit creditors to provide a "suitable substitute" in place of the consumer handbook. Rather than the Board's evaluating whether an individual creditor's ARM brochure is a "suitable substitute," the regulation would require individual creditors to make a good faith determination of whether a brochure is, in fact, a suitable substitute. The Board envisions that substitutes must be, at a minimum, comparable to the consumer handbook in substance and comprehensiveness, recognizing that some lenders' brochures may contain more detailed descriptions of their particular ARM programs than contained in the Consumer Handbook.

The remainder of the proposal contains the revisions that would be made to the variable-rate disclosures currently required by Regulation Z. These revisions have been made in proposed § 226.19(b)(2). Like the original proposal, the new proposal requires that detailed, specific information about all major aspects of a variable-rate feature be clearly disclosed to consumers. To illustrate the proposed requirements, sample form H-14 has been revised, and model clauses have been included in a proposed revision to Appendix H-4.

Many of the disclosures in the new proposal, other than the example of rate and payment changes, are similar to those originally proposed by the Board in May 1985. Creditors would be required to identify the index to which interest rate changes are tied, or provide a brief description of the formula used in calculating changes if no index is used. ***42244** A new requirement, which is currently included in both the OCC's and the FHLBB's disclosure rules, would be the disclosure of a source of information about an index. For example, if index values are listed in the Wall Street Journal, creditors could make such a statement in disclosing a source of information about their index. The proposal also would call for an explanation of how the interest rate will be determined, for example, by a statement that the interest rate will be based on a specified index plus a margin. Furthermore, creditors would be required to include a statement suggesting that consumers ask for the current margin value and interest rate. As proposed in May 1985, creditors would need to alert consumers about a discount feature when the initial rate is discounted. As required now by the Board, the OCC, and the FHLBB, the frequency of rate and payment adjustments also would be disclosed, along with rate and payment caps. If no payment or rate caps exist, the disclosure would indicate conspicuously that there are no limits on potential increases in payments or rates. If the presence of rate or payment caps would result in interest rate carryover or negative amortization, the disclosure statement would need to contain a statement about those features, as now mandated in the OCC's disclosure rule. Two proposed disclosures that were not contained in the Board's original May 1985 proposal are the fact that a loan program contains a demand feature, if applicable, and a statement reflecting what information will be contained in an adjustment notice and when such notice will be provided. Finally, creditors would be required to include a notice to consumers that disclosure forms are available for the creditor's other ARM loan programs.

The most significant change from the May 1985 proposal is the type of example mandated in the variable-rate disclosures. The Board's earlier proposal would have required creditors to show the effects of rate changes on a particular loan. In contrast, the new proposal would provide for an example based on a \$10,000 loan, as does the current OCC rule. As a result, the disclosures could be pre-printed for each loan program and given to consumers with an ARM handbook. Creditors also would be required to include a statement on the disclosure form explaining to consumers how to calculate their actual monthly payment amount for a loan amount other than \$10,000. The example based on \$10,000 reflects the recommendation of the FFIEC, and is premised, in part, on the rationale that figures based on a \$10,000 example provide information that consumers can use with minimal difficulty to calculate their actual monthly payments for a specific transaction. In addition to the effect on monthly payments, the example would need to reflect the effect of index rate changes on the outstanding loan balance as of the end of the year.

The other major change to the example contained in the Board's earlier proposal is the assumed index rate changes on which the example must be based. The May 1985 proposal would have required that two examples be shown: one based on an assumed increase of 2 percentage points in the index rate in each of the first three years and one based on no changes in the index rate during the loan term. In contrast, the new proposal has deleted the example of no changes in index rates and would require that the example shown be based on the history of the specific index or formula to be used in the loan program. The index values

If the values for an index have not been available back to 1977, creditors would need only go back as far as the values have been available in giving the history. The history should reflect the method of choosing values for each program. For instance, if an average of index values is used, averages would be used in the history, but if a single index value as of a certain date is used, that value would be shown. If a creditor uses an index value as of a certain date in making interest and payment adjustments, and this date is changed several times annually, the creditor may assume one date on which to base the history of index values for each loan program. Only one index value per year need be shown, even if the program provides for adjustments to the interest rate or payment more than once in a year. In such cases, the creditor may assume that the index rate remained constant for the full year for the purpose of calculating the interest rate, payment, and loan balance. Updating would be necessary only when done to reflect the most recent index values.

The provision that the example be based on the historical performance of individuals indices reflects the recommendation of the FFIEC. This type of example also was recommended by some of the commenters on the Board's earlier proposal. Some of these commenters felt that the example based on assumed 2 percentage points increases for three years was too negative and, in fact, misleading to consumers when used for ARMs tied to stable indices, such as the cost of funds.; Furthermore, some commenters asserted that consumers would be in a better position to compare ARM programs with an example based on the past performance of different indices, rather than an example based on arbitrary assumed increases.

The payment and outstanding loan balance figures in the example would reflect all significant loan program terms. For example, features such as rate and payment caps, a discounted interest rate, negative amortization, and interest carryover would need to be taken into account by creditors in calculating the payment and outstanding balance figures. Because disclosures would be given early, creditors would need to assume a value for the margin in order to do the calculations for the example. Creditors may select a margin that they have used during the preceding six months and disclose on the form that the margin is one that they have used recently. The margin selected may be used until a creditor updates the disclosure form to reflect the most recent 15 years of index values.

Another significant change from the Board's earlier proposal is the requirement that the maximum interest rate and payment be disclosed. These disclosures would be calculated based on a \$10,000 loan that is originated at the most recent interest

rate shown in the historical example, and would assume that the interest rate then increases as rapidly as possible under the program. Thus, in a loan with interest rate limitations, or "caps," of 2 percentage points per year, and 5 percentage points for the life of the loan, the maximum interest rate would be 5 percentage points higher than the most recent rate shown in the historical example. Furthermore, the loan would not reach the maximum interest rate increased until the third year of the loan because of the 2 percent annual limitations. Consequently, the maximum payment disclosed would reflect the amortization of the loan during that period. Statement of a maximum interest ***42245** rate and payment would not be required if the loan contained no caps, although the disclosure would state conspicuously that there are no limits on potential increases in payment or rates.

As mentioned earlier, the ARM disclosures given before application would state what information will be provided in notices of adjustments and the timing for such notices. A paragraph also has been added as § 226.20(c) to require a subsequent disclosure form. Regulation Z does not presently require this subsequent disclosure although the OCC and the FHLBB regulations require it. The new paragraph, which largely tracks the OCC's rule, would require notice of the adjusted payment amount, interest rate, index rate, and loan balance. The creditor also would be required to disclose the extent to which any increase in the interest rate has not been fully implemented at the adjustment date (for example, if the new index rate plus margin would exceed an interest rate adjustment cap), and the payment that would be required to fully amortize a loan (if different from the payment already disclosed). In transactions providing that payment adjustments may accompany each interest rate adjustment, creditors would be required to send borrowers notice at least 30, but not more than 120, days before the effective date of each scheduled interest rate adjustment. This notice would be required to be given, for example, whenever an interest rate adjustment is accompanied by a payment adjustment, or whenever an interest rate adjustment is made and could have been accompanied by a payment adjustment except for the effect of a payment cap. Notice also would be given whenever interest rate adjustments and accompanying payment adjustments can be made periodically under the loan agreement but are not made because, for example, the index values have not changed or an interest rate cap has prevented any such adjustments. However, creditors would be required to send borrowers notice only each year if interest rate adjustments are made without accompanying payment adjustments. Thus, for example, in transactions where the interest rate may be adjusted more frequently than the payment, the creditor would be required to send at least one notice each year during which there have been interest rate adjustments but no accompanying payment adjustments.

Finally, another significant change from the Board's original proposal is the retention and renumbering of footnote 43 to Regulation Z. The Board had originally proposed deleting footnote 43, which allows creditors to utilize the variable-rate disclosures of other agencies in place of the variable-rate disclosures required under Regulation Z. The board believed that eliminating the footnote would encourage further movement by the agencies toward uniform disclosures. In view of the progress that has been made among the federal financial agencies in agreeing to uniform ARM disclosures, the Board believes that the provision should be retained. This will also benefit lenders originating ARMs insured by the Federal Housing Administration which will continue to have separate disclosure requirements. HUD interprets its statute as requiring creditors to provide a schedule of payments showing how a consumer's actual payments--based on a consumer's actual loan amount--would change if the index increased 1 percentage point in each of the first five years of the loan. HUD has advised that the FFIEC--recommended disclosure requirements do not fully meet the minimum statutory requirements for "transaction-specific" disclosures on FHA-insured ARMs. Although the FFIEC recommendation for disclosures which can be pre-printed and distributed before application differs from HUD's minimum requirements, the impact on consumers and the industry may be minimal. Of all the ARMs outstanding, a total of about 8,000 have been insured by FHA since mid-1984--approximately less than 1 percent of the total ARMs in existence.

(Because the new disclosure requirements appear in § 226.19(b), footnote 43 would be redesignated as footnote 45a. The existing footnote 44 (discussing § 226.18(h)) would be redesignated as footnote 43.) Under footnote 45a creditors

could continue to use other agencies' disclosures without facing the current problem of overlapping and duplicative regulations of the federal financial agencies. Creditors also will be permitted to utilize the subsequent disclosure requirements of other federal agencies in place of the subsequent disclosure requirements of § 226.20(c). (A footnote 45b would be added to the regulation to permit this substitution. Existing footnote 45 a would be redesignated as footnote 45c.)

(3) Economic Impact Statement

The Board's Division of Research and Statistics has prepared an economic impact statement on the proposed 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, Truth in Lending.

PART 226-- [AMENDED]

Certain conventions have been used to highlight the proposed revisions. New language is shown inside arrows, while language that would be removed is set off with brackets. Pursuant to authority granted in section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended), the Board proposes to amend Regulation Z (12 CFR Part 226) as follows:

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

Authority: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96-221, 945 Stat. 170 (15 U.S.C. 1604 et seq.).

2. Text of proposed revision. The Board proposes to amend 12 CFR Part 226 by revising paragraph (b) of § 226.17, by removing footnote 43 from paragraph (f) of § 226.18, by redesignating paragraph (f) of § 226.18 as paragraph (f)(1) and republished, by adding paragraph (f)(2) to § 226.18, by redesignating footnote 44 to be footnote, 43, by redesignating footnote 45 to be footnote 44 and reserving footnote 45, by redesignating paragraphs (a) and (b) of § 226.19 to be paragraphs (a)(1) and (2) and republished, by adding new paragraph (b) to § 226.19, by redesignating footnote 45a to be footnote 45d, by adding footnote 45b and 45c, by adding paragraph (c) to § 226.20, and by redesignating existing H-4 as H-4(A), adding H-4(B) and (C), and revising H-14 of Appendix H to read as follows:

Subpart C--Closed-End Credit

§ 226.17 General disclosure requirements.

* * * * *

(b) Time of disclosures. The creditor shall make disclosures before consummation of the transaction. In certain residential mortgage transactions, special timing requirements are set forth in § 226.19(a). G7; In certain variable-rate mortgage transactions, special timing requirements for variable rate disclosures are set forth in § 226.19(b).G7. In certain transactions involving mail or telephone orders or a series of sales, the timing of the disclosures may be ***42246** delayed in accordance with paragraphs (g) and (h) of this section.

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§ 226.18 Content of disclosures.

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(f) Variable rate. G7;(1)G7. If the annual percentage rate may increase after consummation G7;and the transaction is not secured by the consumer's principal dwellingG7., the following disclosures: [[FN43]]

[43] Information provided in accordance with variable rate regulations of other federal agencies may be substituted for the disclosures required by paragraph (f) of this section.]

- [1] (i) The circumstances under which the rate may increase.
- [2] (ii) Any limitations on the increase.
- [3] (iii) The effect of an increase.
- [4] (iv) An example of the payment terms that would result from an increase.

G7;(2) If the annual percentage rate may increase after consummation and the transaction is secured by the consumer's principal dwelling, the following disclosures:

- (i) The fact that the transaction contains a variable-rate feature.
- (ii) A statement that variable-rate disclosures have been provided earlier.G7.

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§ 226.19 Certain residential and variable-rate mortgage transactions.

- (a) G7;Residential mortgage transactions subject to RESPA.G7.

G7;(1)G7. Time of disclosure. In a residential mortgage transaction subject to the Real Estate Settlement Procedures Act (12 U.S.C. 2601 et seq.) the creditor shall make good faith estimates of the disclosures required by § 226.18 before consummation, or shall deliver or place them in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier.

[b] G7;(2)G7. Redisclosure required. If the annual percentage rate in the consummated transaction varies from the annual percentage rate disclosed under § 226.18(e) by more than 1/8 of 1 percentage point in a regular transaction or more than 1/4 of 1 percentage point in an irregular transaction, as defined in § 226.22, the creditor shall disclose the changed terms no later than consummation or settlement.

G7;(b)G7. Certain variable-rate mortgage disclosure requirements. [FN45a] If the annual percentage rate may increase after consummation and the transaction is secured by the consumer's principal dwelling, the following disclosures must be provided at the time an application form is provided or before the consumer pays a non-refundable fee, which is earlier: [FN45b]

FNG7; [FN45a] Information provided in accordance with variable-rate regulations of other federal agencies may be substituted for the disclosures required by paragraph (b) of this section.G7.

FNG7; 45 b Disclosures must be delivered or placed in the mail not later than three business days following receipt of a consumer's written application when the application reaches the creditor through an intermediary agent or broker.G7.

(1) The booklet titled Consumer Handbook on Adjustable Rate Mortgages published by the Board and the Federal Home Loan Bank Board, or a suitable substitute.

(2) A loan program disclosure for each variable-rate program in which the consumer expresses an interest. The following disclosures, as applicable, shall be provided:

- (i) The fact that the interest rate, payment, or term of the loan can change.

(ii) The index or formula used in making adjustments, and a source of information about the index or formula.

(iii) An explanation of how the interest rate and payment will be determined, including an explanation of how the index is adjusted, such as by the addition of a margin.

(iv) A statement that the consumer should ask about the current margin value and current interest rate.

(v) The fact that the interest rate will be discounted.

(vi) The frequency of interest rate and payment changes.

(vii) Any rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.

(viii) A conspicuous statement that there are no limitations on payment or interest rate increases.

(ix) An historical example, based on a \$10,000 loan amount, illustrating how payments and the loan balance would have been affected by interest rate changes implemented according to the terms of the loan program. The example shall be based upon index values beginning in 1977 and be updated annually until a 15- year history is shown. Thereafter, the example shall reflect the most recent 15 years of index values. The example shall reflect all significant loan program terms, such as negative amortization, interest rate carryover, interest rate discounts, and interest rate and payment limits, that would have been affected by the index movement during the period.

(x) An explanation of how the consumer may calculate the payments for the loan amount to be borrowed based on the most recent payment shown in the historical example.

(xi) In loans subject to overall limitations, a statement of the maximum interest rate and payment for a \$10,000 loan originated at the most recent interest rate shown in the historical example assuming the maximum periodic increase in rates and payments under the program.

(xii) The fact that the loan program contains a demand feature.

(xiii) The type of information that will be provided in notices of adjustments and the timing of such notices.

(xiv) A statement that disclosure forms are available for the creditor's other variable-rate loan programs.

§ 226.20 Subsequent disclosure requirements.

* * * * *

(c) Variable-rate adjustments. [FN45] c A scheduled adjustment to the interest rate with or without a corresponding adjustment to the payment in a variable-rate transaction subject to section 226.19(b) is an event requiring new disclosures to the consumer. At least once each year during which an interest rate adjustment is implemented without an accompanying payment change, or, if the loan documents provide for a payment change accompanying each interest rate adjustment, at least 30, but no more than 120, days before the effective date of each scheduled interest rate adjustment, the following disclosures:

FN45 c Information provided in accordance with variable-rate subsequent disclosure regulations of other federal agencies may be substituted for the disclosures required by paragraph (c) of this section.G7.

- (1) The current and prior interest rates.
- (2) The index values upon which the current and prior interest rates are based.
- (3) The extent to which the creditor has foregone any increase in the interest rate.
- (4) The contractual effects of the adjustment, including the payment due after the adjustment is made and the loan balance.
- (5) The payment, if different from that referred to in paragraph (c)(4), that would be required to fully amortize the loan at the new interest rate over the remainder of the loan term.G7.

***42247 Appendix H--Close-End Model Forms and Clauses**

[H-4-Variable-Rate Model Clauses (§ 226.18(f))]

H-4(A) Variable-Rate Model Clauses (under § 226.18(f)(1))G7.

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H-4(B) Variable-Rate Model Clauses (under § 226.18(f)(2))

Your loan contains a variable-rate feature. Disclosures about the variable-rate feature have been provided to you earlier.G7.

H-4(C) Variable-Rate Model Clauses (under § 226.19(b))

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate is Determined

- Your interest rate will be based on [an index plus a margin] [a formula].
- [The interest rate will be the rate of (identification of index) plus our margin. Ask for our current margin.]
- [The interest rate will be the rate of (identification of formula).]
- [The initial interest rate is not based on the index/formula used to make later adjustments and will be percentage points higher/lower for (time period).]

How Your Interest Rate Can Change

- Your interest rate can change (frequency).
- [Your interest rate cannot increase or decrease more than percentage points at each adjustment.]
- [Your interest rate cannot increase or decrease more than percentage points over the term of the loan.]
- [Change in the index not passed on as changes in the interest rate will be carried over to subsequent interest rate adjustment dates.]
- [THERE ARE NO LIMITS ON INCREASES TO YOUR INTEREST RATE.]

How Your Payment Can Change

- Your (principal and interest) payment can change (frequency) baed on changes in the interest rate.

Year	Index (percent)	Margin (percent)	Interest rate (percent)	Monthly payment (dollars)	Remaining balance (dollars)
1977					
1978					
1979					
1980					
1981					
1982					
1983					
1984					
1985					
1986					
1987					
1988					
1989					

1990
1991

To see what your payments would have been during that period, divide your mortgage amount by \$10,000; then multiply the monthly payment by that amount. (For example, in 1991 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be: $\$60,000/10,000=6$, and $6 \times \$= \$$ per month.)G7.

FN*This is a margin we have used recently; your margin may be different.

H-4(D) Variable-Rate Model Clauses (Under § 226.20(c))

Your new interest rate will be %, which is based on an index value of %.

Your prior interest rate was %, which was based on an index value of %.

Your new loan balance is \$.

[The new interest rate does not reflect percentage point change in the index value which was not added because of .]

[The new payment will be \$.]

[Changes in the index not passed on in this change to the interest rate will be carried over to subsequent interest rate adjustment dates.]

[Your (new) (existing) payment will not be sufficient to cover the interest due and the difference will be added to the loan amount. The payment amount that would be necessary to amortize the loan at the new interest rate is \$.]

[The following interest rate adjustments have been implemented this year without changing your payment: . These interest rates were based on the following index values: .]

H-14 Variable-Rate Mortgage Sample

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate is Determined

- Your interest rate will be based on an index rate plus a margin.
- The interest rate will be the rate of a 1-year Treasury Bill adjusted to a constant maturity, plus our margin. Ask us for our current interest rate and margin.
- You can find information about the index rate in the H-15 (519) series which is published weekly by the Federal Reserve Board.
- Your interest rate will equal the index rate plus our margin unless interest rate "caps" limit the amount of change in the interest rate.

How Your Interest Rate Can Change

- Your interest rate can change yearly.
- Your interest rate cannot increase or decrease more than 2 percentage points per year.
- Your interest rate cannot increase or decrease more than 5 percentage points over the term of the loan.

- Changes in the index not passed on as changes in the interest rate will be carried over to subsequent interest rate adjustment dates.

How Your Monthly Payment Can Change

- Your monthly (principal and interest) payment can change yearly based on changes in the interest rate.

- THERE ARE NO LIMITS ON INCREASES TO YOUR MONTHLY PAYMENTS OTHER THAN LIMITS ON CHANGES IN INTEREST RATES.

- For example, on a \$10,000, 30-year loan with an initial interest rate of 10.73% (which is the interest rate shown in the interest rate column below for the year 1986), the maximum amount that the interest rate could rise under this program is 5 percentage points, to 15.73%, and the monthly payment could rise to a maximum of \$131.59.

- You will be notified in writing 30 days before the annual interest rate and payment adjustment may be made. This notice will contain information about your index and interest rates, payment amount, and loan balance.

*42248 Example

The example below shows how your payments would have changed under this ARM program based on actual index changes that occurred from 1977 to 1986. This does not necessarily indicate how your index will change in the future. The example is based on the following assumptions:

Amount \$10,000
 Term 30 years
 Payment adjustment 1 year
 Interest adjustment 1 year
 Margin 3 percent [FN*]
 Caps 2% annual interest rate
 5% lifetime interest rate
 No payment caps
 Interest rate carryover
 Index 1-year Treasury Bill adjusted to a constant maturity.

Year (as of January)	Index (percent)	Margin (percent)	Interest rate (percent)	Monthly payment (dollars)	Remaining balance (dollars)
1977	5.29	3	8.29	75.41	9,921.14
1978	7.28	3	10.28	89.59	9,863.27
1979	10.41	3	12.28 [FN*] [FN*]	104.34	9,820.02
1980	12.06	3	13.29 [FN*] [FN*]	111.91	9,779.79
1981	14.08	3	13.29 [FN*] [FN*]	111.91	9,733.88
1982	14.32	3	13.29 [FN*] [FN*]	111.91	9,681.45
1983	8.62	3	11.62	99.98	9,602.56
1984	9.90	3	12.90	108.92	9,530.07
1985	9.02	3	12.02	102.86	9,436.19
1986	7.73	3	10.73	94.39	9,309.94

<<triangle>>*This is a margin we have used recently; your margin may be different.
**This interest rate reflects a 2% annual interest rate cap.
***This interest rate reflects a 5% lifetime interest rate cap.<<triangle>>

To see what your payments would have been during that period, divide your mortgage amount by \$10,000; then multiply the monthly payment by that amount. (For example, in 1986 the monthly payment for a mortgage amount of \$60,000 taken out in 1977 would be: $\$60,000 \div \$10,000 = 6$, and $6 \times \$94.39 = \566.34 per month.) G7.

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By order of the Board of Governors of the Federal Reserve System, November 17, 1986.

William W. Wiles,

Secretary of the Board.

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