20(c) Variable-rate adjustments.

1. *Timing of adjustment notices.* This section requires a creditor (or a subsequent holder) to provide certain disclosures in cases where an adjustment to the interest rate is made in a variable-rate transaction subject to § 226.19(b). There are two timing rules, depending on whether payment changes accompany interest rate changes. A creditor is required to provide at least one notice each year during which interest rate adjustments have occurred without accompanying payment adjustments. For payment adjustments, a creditor must deliver or place in the mail notices to borrowers at least 25, but not more than 120, calendar days before a payment at a new level is due. The timing rules also apply to the notice required to be given in connection with the adjustment to the rate and payment that follows conversion of a transaction subject to § 226.19(b) to a fixed-rate transaction. (In cases where an open-end account is converted to a closed-end transaction subject to § 226.19(b), the requirements of this section do not apply until adjustments are made following conversion.)

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

Paragraph 20(c)(1).

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

Paragraph 20(c)(2).

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

Paragraph 20(c)(3).

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

Paragraph 20(c)(4).

1. *Contractual effects of the adjustment.* The contractual effects of an interest rate adjustment must be disclosed including the payment due after the adjustment is made whether or not the payment has been adjusted. A contractual effect of a rate adjustment would include, for example, disclosure of any change in the term or maturity of the loan if the change resulted from the rate adjustment. A statement of the loan balance also is required. The balance required to be disclosed is the balance on which the new adjusted payment is based. If no payment adjustment is disclosed in the notice, the balance disclosed should be the loan balance on which the payment disclosed under § 226.20(c)(5) is based, if applicable, or the balance at the time the disclosure is prepared.

Paragraph 20(c)(5).

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

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Appendix H—Closed-End Model Forms and Clauses

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

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

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

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

* * * * *

18. *Model H–14.* This sample disclosure form illustrates the disclosures under § 226.19(b) for a variable-rate transaction secured by the consumer's principal dwelling with a term greater than one year. The sample form shows a creditor how to adapt the model clauses in Appendix H–4(C) to the creditor's own particular variable-rate program. The sample disclosure form describes the features of a specific variable-rate mortgage program and alerts the consumer to the fact that information on the creditor's other closed-end variable-rate programs is available upon request. It includes information on how the interest rate is determined and how it can change over time, and explains how the monthly payment can change based on a $10,000 loan amount, payable in 360 monthly installments, based on historical changes in the values for the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. Index values are measured as of the first week ending in July for the years 1977 through 1987. This reflects the requirement that the index history be based on values for the same date or period each year beginning with index values for 1977. The sample disclosure also illustrates the requirement under § 226.19(b)(2)(x) that the initial and the maximum interest rates and payments be shown for a $10,000 loan originated at the most recent rate shown in the historical example. In the sample, the loan is assumed to have an initial interest rate of 9.71% (which was the interest rate in 1987 for the example shown) and to have 2 percentage point annual (and 5 percentage point overall) interest rate limitations or caps. Thus, the maximum amount that the interest rate could rise under this program is 5 percentage points higher than the 9.71% initial rate to 14.71%, and the monthly payment could rise from $85.62 to a maximum of $123.31. The loan would not reach the maximum interest rate until its fourth year because of the 2 percentage point annual rate limitations, and the maximum payment disclosed reflects the amortization of the loan during that period. The sample form also illustrates how to provide consumers with a method for calculating their actual monthly payment for a loan amount other than $10,000.

* * * * *

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

William W. Wiles,

Secretary of the Board.

[FR Doc. 88–7347 Filed 4–4–88; 8:45 am]

BILLING CODE 6210-01-M

12 CFR Part 226

[Reg. Z; TIL–1]

Truth in Lending; Update to Official Staff Commentary

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official staff interpretation.

SUMMARY: The Board is publishing revisions to the official staff commentary to Regulation Z (Truth in Lending). The commentary applies and interprets the requirements of Regulation Z and is a substitute for individual staff interpretations of the regulation. The revisions address a variety of questions that have arisen about the regulation, and include new material and changes in existing material. The changes address, for example, disclosure questions raised by the emergence of conversion features in adjustable-rate mortgages, as well as the imposition of fees that are considered finance charges at the time an open-end credit account is renewed or continued. Commentary also is included which interprets the Board's recent rule implementing the requirement of the Competitive Equality Banking Act that adjustable-rate mortgages contain a maximum interest rate. (The Board is also publishing in this issue of the **Federal Register** official staff interpretations on the recent amendments to Regulation Z requiring special disclosures for adjustable-rate mortgages secured by a consumer's principal dwelling and having a term greater than one year.)

DATES: Effective April 1, 1988, but compliance optional until October 1, 1988.

FOR FURTHER INFORMATION CONTACT: The following attorneys in the Division of Consumer and Community Affairs, at (202) 452-3667 or (202) 452-2412:

Subparts A and B—Kathleen S. Brueger, Gerald P. Hurst, John C. Wood

Subpart C—Michael S. Bylsma, Leonard N. Chanin, Thomas J. Noto

Subpart D—Adrienne D. Hurt, Sharon T. Bowman

For the hearing impaired *only*, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson, at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

(1) General

The Truth in Lending Act (15 U.S.C. 1601 *et seq.*) governs consumer credit transactions and is implemented by the Board's Regulation Z (12 CFR Part 226). Effective October 13, 1981, an official staff commentary (TIL-1, Supp. I to 12 CFR Part 226) was published to interpret the regulation. The commentary is designed to provide guidance to creditors in applying the regulation to specific transactions and is updated periodically to address significant questions that arise. There have been six general updates: the first in September 1982 (47 FR 41338), the second in April 1983 (48 FR 14882), the third in April 1984 (49 FR13482), the fourth in April 1985 (50 FR 13181), the fifth in April 1986 (51 FR 11422), and the sixth in April 1987 (52 FR 10875). There was also a limited update concerning fees for the use of automated teller machines, which was adopted in October 1984 (49 FR 40560). This notice contains the seventh general update. Creditors are free to rely on the revised provisions as of April 1, 1988, although they need not follow the revisions until October 1, 1988.

(2) Revisions

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

Subpart A—General

Section 226.4—Finance Charge

4(c) Charges Excluded from the Finance Charge; Paragraph 4(c)(4). A cross-reference is added to comment 4(c)(4)-2 addressing participation fees. The cross-reference is to the commentary to § 226.14(c), concerning computation of the annual percentage rate on periodic statements. Comment 14(c)-7, which currently discusses the exclusion of fees related to the opening of the account from the computation of the annual percentage rate for periodic statements, is being revised to also exclude certain account renewal fees from the computation of the annual percentage rate on periodic statements.

Subpart B—Open End Credit

Section 226.6—Initial Disclosure Statement

6(a) Finance Charge; Paragraph 6(a)(2). Comment 6(a)(2)-7 is revised to include a reference to § 226.30 and the commentary to that section. Section 226.30 requires creditors to include a provision setting a maximum interest rate in their dwelling-secured credit contracts that provide for changes in the interest rate.

Section 226.7—Periodic Statement

7(h) Other Charges. Comment 7(h)-1 is revised to clarify the treatment of taxes and filing or notary fees that are excluded from the finance charge under § 226.14(e). Even though the § 226.4(e) items are not required to be disclosed as "other charges" under § 226.6(b), creditors may include such charges in a disclosure of "other charges" on the initial disclosures. Similarly, these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the closing or settlement costs on the initial disclosure statement.

Section 226.14—Determination of Annual Percentage Rate

14(c) Annual Percentage Rate for Periodic Statements. Comment 14(c)-7 discusses the exclusion of finance charges related to opening an account from inclusion in the annual percentage rate computation. This comment is revised to also exclude fees that are imposed for renewal of an account or continued participation in an open-end credit plan, provided the fees are not imposed as a result of specific transactions or specific account activity. For example, charges that are imposed only on consumers that do not charge a certain amount on their credit card annually, or annual fees that are a percentage of the consumer's credit limit, need not be included in the computation of the annual percentage rate. This change recognizes that such charges, when they are not related to specific transactions or specific activity, result in the same problems already identified in this comment with respect to fees related to the opening of an account. Including such fees in the computation of the annual percentage rate would result, in many cases, in significant distortions of the annual percentage rate and the delivery of potentially misleading information to consumers.

Subpart C—Closed-End Credit

Section 226.17—General Disclosure Requirements

17(a) Form of Disclosures; Paragraph 17(a)(1). Comment 17(a)(1)-5 is revised to explain that in variable-rate transactions subject to § 226.18(f)(1) with more than one variable-rate feature, more than one hypothetical example is information that is directly related to the disclosure required under § 226.18(f)(1)(iv).

Section 226.18—Content of Disclosures

18(b) Amount Financed; Paragraph 18(b)(3). Comment 18(b)(3)-1, addressing the treatment of prepaid finance charges in calculations of the amount financed, is deleted and a new comment 18(b)(3)-1 substituted in its place. The new comment clarifies and more fully explains the treatment of prepaid finance charges, which has been the source of considerable confusion. Several changes have been made to the version originally proposed. First, additional examples have been added to illustrate a transaction where the creditor withholds the amount of a finance charge from the amount

advanced to the consumer but does not increase the amount of the note by the amount of the charge. The additional examples clarify that the same rules are applicable in both situations. Second, additional material has been included to clarify that while a finance charge need not, in some circumstances, be subtracted as a prepaid finance charge, the charge nevertheless remains a finance charge.

The new comment is not intended to change the existing rules under § 226.18(b), but merely to clarify when creditors have an option to treat certain fees as prepaid finance charges and what the implications of that choice are under § 226.18(b).

18(c) Itemization of Amount Financed; Paragraph 18(c)(1)(iv). Comment 18(c)(1)(iv)–1, addressing the itemization of prepaid finance charges, is supplemented by a new sentence at the beginning which clarifies that only those finance charges deducted from the principal loan amount under section 226.18(b)(3) should be itemized as prepaid finance charges under section 226.18(c)(1)(iv). The revision is made in conjunction with the clarification to comment 18(b)(3)–1 and is not intended to change the substance of existing rules.

18(f) Variable Rate; Paragraph 18(f)(1). Comment 18(f)(1)–2 is added to discuss the disclosure requirements under this section for variable-rate transactions containing an option permitting consumers to convert to a fixed rate. The conversion option is a variable-rate feature that must be disclosed. The comment explains how the disclosures should be given. It explains that only those limitations on, and effects of, an increase that differ from other variable-rate features need to be stated. Consistent with the revision being made to comment 18(f)(1)(iv)–1, described below, it also clarifies that only one hypothetical example need be disclosed, such as an example of payment terms resulting from changes in the index. The comment applies only to variable-rate transactions that are not secured by a consumer's dwelling, or that are secured by a principal dwelling but have a term of one year or less. The comment number reflects the redesignation of the regulatory section applicable to such variable-rate transactions from § 226.18(f) to § 226.18(f)(1). All other closed-end variable-rate transactions are subject to §§ 226.18(f)(2) and 226.19(b), rather than § 226.18(f)(1).

Paragraph 18(f)(1)(ii). Comment 18(f)(1)(ii)–1 is revised by adding a cross-reference to the requirement in new § 226.30 that a maximum interest rate limitation be included in certain variable-rate transactions.

Paragraph 18(f)(1)(iv). Comment 18(f)(1)(iv)–1 is revised to clarify that § 226.18(f)(1)(iv) requires only one example of the effects of a rate increase on payment terms. The comment states that in transactions with more than one variable-rate feature, only one hypothetical example need be included in the disclosures. It also adds a cross-reference to the commentary to § 226.17(a)(1), which permits inclusion of more than one example as "directly related" information.

Subpart D—Miscellaneous

Section 226.28—Effect on State Laws

28(a) Inconsistent Disclosure Requirements. Comments 28(a)–13 and –14 are added to reflect the Board's 1985 and 1988 determinations of the effect of the Truth in Lending Act on provisions on the consumer credit laws of Arizona and Indiana, respectively. The comment on Arizona law has been revised to indicate that the preempted provision has since been repealed.

Section 226.30—Limitations on Rates

On November 9, 1987, the Board published a final rule amending Regulation Z to incorporate the substance of section 1204 of the Competitive Equality Banking Act (CEBA) into the regulation (52 FR 43178; technical corrections to original notice at 52 FR 45611 (1987)). The rule requires creditors who offer dwelling-secured loans with an adjustable interest rate to include a maximum rate in their credit obligations entered into on or after December 9, 1987. The following comments are included in the commentary to § 226.30.

Comments 30–1 through 30–5 explain the scope of the rule's coverage, including examples of what types of obligations are covered and not covered. Generally stated, the rule is that any post-effective date credit obligation is subject to the interest rate ceiling requirement if it: (1) Is secured by a dwelling, (2) contractually allows for interest rate increases, and (3) requires initial Truth in Lending Act (TILA) disclosures. A credit obligation subject to the TILA may also become subject to § 226.30 in two other instances: (1) If a security interest in a dwelling is added to an obligation that allows for interest rate increases, or (2) a variable rate feature is added to a dwelling-secured credit obligation.

The scope of the substantive requirement of section 1204 of CEBA is limited to obligations subject to the TILA and Regulation Z. Comment 30–6 generally explains that the other provisions of the regulation relating to TILA disclosures and their corresponding commentaries apply to § 226.30 where appropriate (such as definitions and exemptions), unless otherwise specified in the commentary to § 226.30. For example, for purposes of *coverage*, the refinancing and assumption rules of § 226.20 (a) and (b) apply. On the other hand, for purposes of *increasing a maximum interest rate* originally imposed under § 226.30 only the refinancing and assumption rules in comments 11 and 12 to this section apply.

Comments 30–7 through 30–9 explain the requirements to specify the maximum interest rate in credit contracts, including how the rate may be stated and that multiple rates may be set.

Comment 30–10 explains that a maximum rate must be applicable to increases after default. This comment applies only in situations in which a post-default agreement is considered part of the original obligation subject to Regulation Z.

Comments 30–11 and 30–12 explain when the maximum rate originally set on an obligation may be increased. Comment 30–13 further explains the relief provided in footnote 50 to § 226.30.

The final commentary provisions differ from the proposal in that editorial revisions have been made to eliminate unnecessary language and to provide further clarification. For example, a cross reference to the definition of a dwelling has been added to the first sentence in comment 30–1, while other cross references have been deleted as unnecessary. In that comment's second example of transactions not subject to § 226.30, the word "contractual" before the words "legal obligation" has been deleted. There is no intent to modify the term "legal obligation," as discussed in the commentary to § 226.17(c)(1), or § 226.5(c), when used in § 226.30. A fixed rate, closed-end multiple advance transaction secured by a dwelling, in which each advance is disclosed as a separate transaction, has been added to that comment as a third example of transactions not covered by § 226.30. This example was contained in the supplemental information to the final rule, § 226.30, published in November 1987; some commenters asked that it be included in the commentary.

A substantive revision from the proposal has been made to comment 30–7. The requirement that the maximum rate set forth in the credit contract meet the Regulation Z "clear and

conspicuous" standard has been eliminated as unnecessary.

List of Subjects in 12 CFR Part 226

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

Text of revisions. Pursuant to authority granted to section 105 of the Truth in Lending Act (15 U.S.C. 1604 as amended) and section 1204 of the Competitive Equality Banking Act, Pub. L. 100–86, 101 Stat. 552, the Board amends the official staff commentary on Regulation Z (12 CFR Part 226 Supp. I) as follows:

PART 226—[AMENDED]

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

Authority: Sec. 105, Truth in Lending Act, as amended by sec. 605, Pub. L. 96–221, 94 Stat. 170 (15 U.S.C. 1604 *et seq.*); sec. 1204(c), Competitive Equality Banking Act, Pub. L. 100–86, 101 Stat. 552.

2. The revisions amend the commentary (12 CFR Part 226 Supp. I) by revising the parenthetical at the end of comment 4(c) (4)–2; republishing the first two sentences of comment 6(a) (2)–7 and adding a parenthetical after them; revising comments 7(h)–1 and 14(c)–7; adding a new bulleted paragraph at the end of comment 17(a)(1)–5; revising comment 18 (b)(3)–1; adding a sentence at the beginning of comment 18(c)(1)(iv)–1; adding comment 18 (f)(1)–2; revising comments 18(f)(1)(ii)–1 and 18(f)(1) (iv)–1; and adding comments 28(a)–13, 28(a)–14, and 30–1 through 30–13 to read as follows:

Subpart A—General

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Section 226.4—Finance Charge.

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4(c) Charges Excluded from the Finance Charge

* * * * *

Paragraph 4(c)(4)

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2. *Participation fees—exclusions.** * *(See the commentary to § 226.4(b)(2). Also, see comment 14(c)–7 for treatment of certain types of fees excluded in determining the annual percentage rate for the periodic statement.)

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Subpart B—Open-End Credit

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Section 226.6—Initial Disclosure Statement

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6(a) Finance Charge

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Paragraph 6(a)(2)

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7. *Variable-rate plan—limitations on increase.* In disclosing any limitations on rate increases, limitations such as the maximum increase per year or the maximum increase over the duration of the plan must be disclosed. When there are no limitations, the creditor may, but need not, disclose that fact. (A maximum interest rate must be included in dwelling-secured open-end credit plans under which the interest rate may be changed. See § 226.30 and the commentary to that section.) * * *

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Section 226.7—Periodic Statement.

* * * * *

7(h) Other Charges

1. *Identification.* In identifying any "other charges" actually imposed during the billing cycle, the type is adequately described as "late charge" or "membership fee," for example. Similarly, "closing costs" or "settlement costs," for example, may be used to describe charges imposed in connection with real estate transactions that are excluded from the finance charge under § 226.4(c)(7), if the same term (such as "closing costs") was used in the initial disclosures and if the creditor chose to itemize and individually disclose the costs included in that term. Even though the taxes and filing or notary fees excluded from the finance charge under § 226.4(e) are not required to be disclosed as "other charges" under § 226.6(b), these charges may be included in the amount shown as "closing costs" or "settlement costs" on the periodic statement, if the charges were itemized and disclosed as part of the "closing costs" or "settlement costs" on the initial disclosure statement. (See comment 6(b)–1 for examples of "other charges.")

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Section 226.14—Determination of Annual Percentage Rate.

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14(c) Annual Percentage Rate for Periodic Statements

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7. *Charges related to opening, renewing, or continuing an account.* Footnote 33 is applicable to § 226.14 (c)(2) and (c)(3). The charges involved here do not relate to a specific transaction or to specific activity on the account, but relate solely to the opening, renewing, or continuing of the account. For example, an annual fee to renew an open-end credit account that is a percentage of the credit limit on the account, or that is charged only to consumers that have not used their credit card for a certain dollar amount in transactions during the preceding year, would not be included in the calculation of the annual percentage rate, even though the fee may not be excluded from the finance charge under § 226.4(c)(4). (See comment 4(c)(4)–2.) Inclusion of these charges in the annual percentage rate calculation results in significant distortions of the annual percentage rate and delivery of a possibly misleading disclosure to consumers. The rule in footnote 33 applies even if the loan fee, points, or similar charges are billed on a subsequent periodic statement or withheld from the proceeds of the first advance on the account.

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Subpart C—Closed-End Credit.

Section 226.17—General Disclosure Requirements

17(a) Form of Disclosures

Paragraph 17(a)(1)

5. *Directly related.* * * *

• More than one hypothetical example under § 226.18(f)(1)(iv) in transactions with more than one variable-rate feature. For example, in a variable-rate transaction with an option permitting consumers to convert to a fixed-rate transaction, the disclosures may include an example illustrating the effects on the payment terms of an increase resulting from conversion in addition to the example illustrating an increase resulting from changes in the index.

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Section 226.18—Content of Disclosures.

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18(b) Amount Financed

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Paragraph 18(b)(3)

1. *Prepaid finance charges.* Prepaid finance charges that are paid separately in cash or by check should be deducted under § 226.18(b)(3) in calculating the amount financed. To illustrate:

• A consumer applies for a loan of $2,500 with a $40 loan fee. The face amount of the note is $2,500 and the consumer pays the loan fee separately by cash or check at closing. The principal loan amount for purposes of § 226.18(b)(1) is $2,500 and $40 should be deducted under § 226.18(b(3), thereby yielding an amount financed of $2,460.

In some instances, as when loan fees are financed by the creditor, finance charges are incorporated in the face amount of the note. Creditors have the option, when the charges are not add-on or discount charges, of determining a principal loan amount under § 226.18(b)(1) that either includes or does not include the amount of the finance charges. (Thus the principal loan amount may, but need not, be determined to equal the face amount of the note.) When the finance charges are included in the principal loan amount, they should be deducted as prepaid finance charges under § 226.18(b)(3). When the finance charges are not included in the principal loan amount, they should not be deducted under § 226.18(b)(3). The following examples illustrate the application of § 226.18(b) to this type of transaction. Each example assumes a loan request of $2,500 with a loan fee of $40; the creditor assesses the loan fee by increasing the face amount of the note to $2,540:

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,540, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3),

thereby obtaining an amount financed of $2,500.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,500. The same rules apply when the creditor does not increase the face amount of the note by the amount of the charge but collects the charge by withholding it from the amount advanced to the consumer. To illustrate, the following examples assume a loan request of $2,500 with a loan fee of $40; the creditor prepares a note for $2,500 and advances $2,460 to the consumer.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,500, it has included the loan fee in the principal loan amount and should deduct $40 as a prepaid finance charge under § 226.18(b)(3), thereby obtaining an amount financed of $2,460.

• If the creditor determines the principal loan amount under § 226.18(b)(1) to be $2,460, it has not included the loan fee in the principal loan amount and should not deduct any amount under § 226.18(b)(3), thereby obtaining an amount financed of $2,460. Thus in the examples where the creditor derives the net amount of credit by determining a principal loan amount that does not include the amount of the finance charge, no subtraction is appropriate. Creditors should note, however, that although the charges are not subtracted as *prepaid* finance charges in those examples, they are nonetheless finance charges and must be treated as such.

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18(c) Itemization of Amount Financed

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Paragraph 18(c)(1)(iv)

1. *Prepaid finance charge.* Prepaid finance charges that are deducted under § 226.18(b)(3) must be disclosed under this section. * * *

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18(f) Variable Rate

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Paragraph 18(f)(1)

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2. *Conversion feature.* In variable-rate transactions with an option permitting consumers to convert to a fixed-rate transaction, the conversion option is a variable-rate feature that must be disclosed. In making disclosures under § 226.18(f)(1), creditors should disclose the fact that the rate may increase upon conversion; identify the index or formula used to set the fixed rate; and state any limitations on and effects of an increase resulting from conversion that differ from other variable-rate features. Because § 226.18(f)(1)(iv) requires only one hypothetical example (such as an example of the effect on payments resulting from changes in the index), a second hypothetical example need not be given.

* * * * *

Paragraph 18(f)(1)(ii)

1. *Limitations.* This includes any maximum imposed on the amount of an increase in the rate at any time, as well as any maximum on the total increase over the life of the transaction. When there are no limitations, the creditor may, but need not, disclose that fact. Limitations do not include legal limits in the nature of usury or rate ceilings under state or federal statutes or regulations. (See § 226.30 for the rule requiring that a maximum interest rate be included in certain variable-rate transactions.)

* * * * *

Paragraph 18(f)(1)(iv)

1. *Hypothetical example.* The example may, at the creditor's option appear apart from the other disclosures. The creditor may provide either a standard example that illustrates the terms and conditions of that type of credit offered by that creditor or an example that directly reflects the terms and conditions of the particular transaction. In transactions with more than one variable-rate feature, only one hypothetical example need be provided. (See the commentary to section 226.17(a)(1) regarding disclosure of more than one hypothetical example as directly related information.)

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Subpart D—Miscellaneous

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Section 226.28—Effect on State Laws

28(a) Inconsistent Disclosure Requirements

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13. *Preemption determination—Arizona.* Effective October 1, 1986, the Board has determined that the following provision in the State law of Arizona is preempted by the Federal law:

• Section 6-621A.2—Use of the term "the total sum of $_____" in certain notices provided to borrowers. This term describes the same item that is disclosed under Federal law as the "total of payments." Since the State law requires the use of a different term than Federal law to describe the same item, the State-required term is preempted. The notice itself is not preempted.

(**NOTE:** The State disclosure notice that incorporated the above preempted term was amended on May 4, 1987, to provide that disclosures must now be made pursuant to the Federal disclosure provisions.)

14. *Preemption determination—Indiana.* Effective October 1, 1988, the Board has determined that the following provision in the State law of Indiana is preempted by the Federal law:

• Section 23-2-5-8—Inclusion of the loan broker's fees and charges in the calculation of, among other items, the finance charge and annual percentage rate disclosed to potential borrowers. This disclosure is inconsistent with sections 106(a) and § 226.4(a) of the Federal statute and regulation, respectively, and is preempted in those instances where the use of the same term would disclose a different amount than that required to be disclosed under Federal law.

* * * * *

Section 226.30—Limitation on Rates

1. *Scope of coverage.* The requirement of this section applies to consumer credit obligations secured by a dwelling (as dwelling is defined in § 226.2(a)(19)) in which the annual percentage rate may increase after consummation (or during the term of the plan, in the case of open-end credit) as a result of an increase in the interest rate component of the finance charge—whether those increases are tied to an index or formula or are within a creditor's discretion. The section applies to credit sales as well as loans. Examples of credit obligations subject to this section include:

• Dwelling-secured credit obligations that require variable-rate disclosures under the regulation because the interest rate may increase during the term of the obligation.

• Dwelling-secured open-end credit plans that are not considered variable-rate obligations for purposes of disclosure under the regulation but where the creditor reserves the contractual right to increase the interest rate—periodic rate and corresponding annual percentage rate—during the term of the plan.

In contrast, credit obligations in which there is no contractual right to increase the interest rate during the term of the obligation are not subject to this section. Examples include:

• "Shared-equity" or "shared-appreciation" mortgage loans that have a fixed rate of interest and a shared-appreciation feature based on the consumer's equity in the mortgaged property. (The appreciation share is payable in a lump sum at a specified time.)

• Dwelling-secured fixed rate closed-end balloon payment mortgage loans and dwelling-secured fixed rate open-end plans with a stated term that the creditor may, but does not have a legal obligation to, renew at maturity. (Contrast with the renegotiable rate mortgage instrument described in comment 17(c)(1)-11.)

• Dwelling-secured fixed rate closed-end multiple advance transactions in which each advance is disclosed as a separate transaction.

The requirement of this section does not apply to credit obligations entered into prior to December 9, 1987. Consequently, new advances under open-end credit plans existing prior to December 9, 1987, are not subject to this section.

2. *Refinanced obligations.* On or after December 9, 1987, when a credit obligation is refinanced, as defined in § 226.20(a), the new obligation is subject to this section if it is dwelling-secured and allows for increases in the interest rate.

3. *Assumptions.* On or after December 9, 1987, when a credit obligation is assumed, as defined in § 226.20(b), the obligation becomes subject to this section if it is dwelling-secured and allows for increases in the interest rate.

4. *Modifications of obligations.* The modification of an obligation, regardless of when the obligation was entered into, is generally not covered by this section. For example, increasingly the credit limit on a dwelling-secured, open-end plan with a variable interest rate entered into before the effective date of the rule does not make the

obligation subject to this section. If, however, a security interest in a dwelling is added on or after December 9, 1987, to a credit obligation that allows for interest rate increases, the obligation becomes subject to this section. Similarly, if a variable interest rate feature is added to a dwelling-secured credit obligation, the obligation becomes subject to this section.

5. *Land trusts.* In some states, a land trust is used in residential real estate transactions. (See discussion in comment 3(a)–8).) If a consumer-purpose loan that allows for interest rate increases is secured by an assignment of a beneficial interest in a land trust that holds title to a consumer's dwelling, that loan is subject to this section.

6. *Relationship to other sections.* Unless otherwise provided for in the commentary to this section, other provisions of the regulation such as definitions, exemptions, rules and interpretations also apply to this section where appropriate. To illustrate:

- An adjustable interest rate business-purpose loan is not subject to this section even if the loan is secured by a dwelling because such credit extensions are not subject to the regulation. (See generally § 226.3(a).)
- Creditors subject to this section are only those that fall within the definition of a creditor in § 226.2(a)(17).

7. *Consumer credit contract.* Creditors are required to specify a lifetime maximum interest rate in their credit contracts—the instrument that creates personal liability and generally contains the terms and conditions of the agreement (for example, a promissory note or home-equity line of credit agreement). In some states, the signing of a commitment letter may create a binding obligation, for example, constituting "consummation" as defined in § 226.2(a)(13). The maximum interest rate must be included in the credit contract, but a creditor may include the rate ceiling in the commitment instrument as well.

8. *Manner of stating the maximum interest rate.* The maximum interest rate must be stated either as a specific amount or in any other manner that would allow the consumer to easily ascertain, at the time of entering into the obligation, what the rate ceiling will be over the term of the obligation. For example, the following statements would be sufficiently specific:

- The maximum interest rate will not exceed X%.
- The interest rate will never be higher than X percentage points above the initial rate of Y%.
- The interest rate will not exceed X%, or X percentage points about [a rate to be determined at some future point in time], whichever is less.
- The maximum interest rate will not exceed X%, or the state usury ceiling, whichever is less.

The following statements would not comply with this section:

- The interest rate will never be higher than X percentage points over the prevailing market rate.
- The interest rate will never be higher than X percentage points above [a rate to be determined at some future point in time].
- The interest rate will not exceed the state usury ceiling which is currently X%.

A creditor may state the maximum rate in terms of a maximum annual percentage rate that may be imposed. Under an open-end credit plan, this normally would be the corresponding annual percentage rate. (See generally § 226.6(a)(2).)

9. *Multiple interest rate ceilings.* Creditors are not prohibited from setting multiple interest rate ceilings. For example, on loans with multiple variable-rate features, creditors may establish a maximum interest rate for each feature. To illustrate, in a variable-rate loan that has an option to convert to a fixed rate, a creditor may set one maximum interest rate for the initially imposed index-based variable-rate feature and another for the conversion option. Of course, a creditor may establish one maximum interest rate applicable to all features.

10. *Interest rate charged after default.* State law may allow an interest rate after default higher than the contract rate in effect at the time of default; however, the interest rate after default is subject to a maximum interest rate set forth in a credit obligation that is otherwise subject to this section. This rule applies only in situations in which a post-default agreement is still considered part of the original obligation.

11. *Increasing the maximum interest rate—general rule.* Generally, a creditor may not increase the maximum interest rate originally set on a credit obligation subject to this section unless the consumer and the creditor enter into a new obligation. Therefore, under an open-end plan, a creditor may not increase the rate ceiling imposed merely because there is an increase in the credit limit. If an open-end plan is closed and another opened, a new rate ceiling may be imposed. Furthermore, where an open-end plan has a fixed maturity and a creditor renews the plan at maturity, or converts the plan to closed-end credit, without having a legal obligation to renew or convert, a new maximum interest rate may be set at that time. If, under the initial agreement, the creditor is obligated to renew or convert the plan, the maximum interest rate originally imposed cannot be increased upon renewal or conversion (unless, of course, a new obligation is entered into). For a closed-end credit transaction, a new maximum interest rate may be set only if the transaction is satisfied and replaced by a new obligation. (The exceptions in § 226.20(a)(1)–(5) which limit what transactions are considered refinancings for purposes of disclosure do not apply with respect to increasing a rate ceiling that has been imposed; if a transaction is satisfied and replaced, the rate ceiling may be increased.)

12. *Increasing the maximum interest rate—assumption of an obligation.* If an obligation subject to this section is assumed by a new obligor and the original obligor is released from liability, the maximum interest rate set on the obligation may be increased as part of the assumption agreement. (This rule applies whether or not the transaction constitutes an assumption as defined in § 226.20(b).)

13. *Transition rules.* Under footnote 50, if creditors properly include the maximum rate in their credit contracts, creditors need not revise their Truth in Lending disclosure statement forms to add the disclosures about limitations on rate increases as part of the variable-rate disclosures, until October 1, 1988. On or after that date, creditors must have the maximum rate set forth in their credit contracts and, where applicable, as part of their Truth in Lending disclosures.

References

Statute: Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552

Other sections: Sections 226.6, 226.18, and 226.19

Previous regulation: None

1987 changes: This section implements section 1204 of the Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552 which provides that, effective December 9, 1987, adjustable-rate mortgages must include a limitation on the interest rate that may apply during the term of the mortgage loan. An adjustable-rate mortgage loan is defined in section 1204 as "any loan secured by a lien on a one-to-four family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time, adjust the rate of interest." The rule in this section incorporates section 1204 into Regulation Z and limits the scope of section 1204 to dwelling-secured consumer credit subject to the Truth in Lending Act, in which a creditor has the contractual right to increase the interest rate during the term of the credit obligation.

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

William W. Wiles,

Secretary of the Board.

[FR Doc. 88–7350 Filed 4–4–88; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 87–ANM–23]

Control Zone; Hayden, CO

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: This amends the Hayden, Colorado Control Zone. The action provides additional controlled airspace to encompass a new instrument approach procedure. It would ensure segregation of aircraft operating in instrument flight rules conditions and other aircraft operating in visual flight rules conditions.

EFFECTIVE DATE: 0901 UTC, May 5, 1988.

FOR FURTHER INFORMATION CONTACT: Ted Melland, ANM–536, Federal Aviation Administration, Docket No. 87–ANM–23, 17900 Pacific Highway South,