FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; Doc. No. R-0689]

Truth in Lending; Intent to Make Determination of Effect on State Law; Wisconsin

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of intent to make preemption determination.

SUMMARY: The Board is publishing for comment a proposed determination as to the consistency with the Truth in Lending Act and Regulation Z of certain provisions in the law of Wisconsin. Those provisions deal with disclosures for home equity plans and the right of a nonapplicant spouse to terminate a plan and a creditor to accelerate the outstanding balance. The Board is proposing to preempt some of the state provisions.

DATES: Comments must be received on or before June 8, 1990.

ADDRESSES: Comments should refer to Docket No. R-0689 and be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. They may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays or delivered to the guard station in the Eccles Building Courtyard on 20th Street, NW. (between Constitution Avenue and C Street, NW.) any time. All comments received at the above address will be available for inspection and copying by any member of the public in the Freedom of Information Office, Room B-1122 of the Eccles Building between 9:00 a.m. and 5:00 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Sharon Bowman, Staff Attorney, Division of Consumer and Community Affairs, at (202) 452-3667. For the hearing impaired *only*, contact Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (TDD), at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: (1) *General.* The Board has received a request for a determination that certain provisions of Wisconsin law are inconsistent with the Truth in Lending Act and Regulation Z and therefore preempted. Section 111(a)(1) of the Truth in Lending Act authorizes the Board to determine whether an inconsistency exists between chapters 1, 2, and 3 of the federal act or the implementing provisions of the regulation and state laws.

Section 226.28(a)(1) of Regulation Z, which implements section 111(a)(1) of the Truth in Lending Act, provides that state requirements are inconsistent with, and therefore preempted by, the federal provisions if the state law requires a creditor to make disclosures or take actions that contradict the requirements of federal law. A state law is contradictory, and therefore preempted, if it significantly impedes the operation of the federal law or interferes with the purposes of the federal law. Under § 226.28(a)(1), a state law is contradictory, for example, if it requires the use of the same term for a different amount or a different meaning than the federal law, or if it requires the use of a different term than the federal law to describe the same item.

The procedure for requesting a determination and the general procedures followed in making a determination are contained in appendix A to 12 CFR part 226. These proposed preemption determinations are issued under authority delegated to the Director of the Division of Consumer and Community Affairs, as set forth in the Board's Rules Regarding Delegation of Authority (12 CFR 265.2(h)(3)).

In previous preemption determinations (48 FVR 4454, February 1, 1983) the Board developed principles to be applied in making preemption determinations. These principles require that preemption should occur only in those transactions in which an actual inconsistency exists between the state and federal laws. In addition, a state law is not inconsistent merely because it requires more information than federal law or requires disclosure in transactions where federal law requires none.

Preemption determinations are generally limited to those provisions of state law identified in the request for a determination. At the Board's discretion, however, other state provisions that may be affected by the federal law also will be addressed.

(2) *Discussion of specific request and proposed determination.* The Board has been asked to determine whether specific provisions of the Wisconsin Statutes regarding disclosures for open-end credit plans and the ability of a nonapplicant spouse to terminate an open-end credit plan are inconsistent with amendments to Regulation Z (12 CFR § 226.5b) that regulate disclosure and substantive provisions of open-end credit plans secured by a consumer's dwelling. The requesting party asks whether provisions of Wisconsin Statutes § 422.308, requiring certain disclosures to be given in a certain manner for open-end credit plans, including home equity plans, are preempted by § 226.5b (a) and (d) of Regulation Z. The requesting party also questions whether Wisconsin Statutes § 766.565(5), part of Wisonsin's Marital Property Act, is preempted by § 226.5b(f)(3) of Regulation Z.

Content and Form of Disclosures Under Wisconsin Statutes Section 422.308 and Section 226.5b (a) and (d) of Regulation Z

The requesting party asks for a determination as to possible inconsistency between the state and federal requirements for early disclosures of home equity plans. Wisconsin Statutes § 422.308(1) requires the following disclosures to be set forth in every application for an open-end credit plan: (1) The annual percentage rate (APR); that the loan contains a variable rate feature, if applicable, and the circumstances under which the rate may increase; any limitations on the increase and the effects of the increase; (2) when the finance charge begins to accrue; (3) the amount of any annual fee charged; and (4) the type and amount of any other fees or charges. Under Wisconsin Statutes § 422.308(2), these disclosures must be given prior to opening an open-end credit plan in cases where an application is not required.

Section 226.5b(d) of Regulation Z requires certain disclosures to be given at the time an application is provided to a consumer. These disclosures include, among other items, the APR for fixed-rate plans and a statement that the rate does not include costs other than interest, fees imposed under the plan, and certain disclosures for variable-rate plans. The variable rate disclosures include the fact that the APR may vary, how the APR is determined, a statement that the APR does not include costs other than interest, how often the APR will change, and any limitations on such changes. There is no required disclosure about when the finance charge begins to accrue.

There appears to be a possible inconsistency between the state and federal disclosure requirements with regard to disclosure of the APR. State law does not define "annual percentage rate," but it does define "finance charge" in Wisconsin Statutes § 421.301(20) to include charges other than interest. There appears to be nothing in Wisconsin law that directly states that creditors must base their APR disclosure, particularly the APR disclosed at application, on this

definition of finance charge. If, however, the APR under state law is analogous to that under federal law and is derived from the finance charge, an assumption can be made that state law could require a creditor to include nonInterest finance charges in the APR disclosed at application. While the definition of "finance charge" under federal law also includes charges other than interest, the APR creditors are required to state in the disclosures given at application for home equity plans clearly does not include costs other than interest. (In fact, § 226.5b(d)(6) and (d)(12)(ii) of Regulation Z requires an explicit statement that the disclosed APR does not include costs other than interest.).

A contradiction between state and federal law may be unlikely since, other than the state law's definition of "finance charge," there is nothing to suggest that the APR disclosed under Wisconsin law at the application stage includes noninterest finance charges. The Board, however, proposes to determine that in cases where the amount of the APR disclosed to consumers under state law differs from the amount that would be disclosed under federal law, the state disclosure is preempted, since in those cases the state law requires the use of the same term as the federal law to represent a different amount than the federal law.

The Board proposes to determine that the remaining state disclosures do not contradict federal law and are not preempted since a creditor can comply with both the state and federal provisions. The additional state disclosure about when the finance charge begins to accrue is not contradictory because the requirement of additional or different information is not by itself inconsistent with federal law.

The requesting party also questioned whether the provision under Wisconsin Statutes § 422.308(1) requiring that disclosures be set forth on the application for open-end credit contradicts § 226.5b(a)(1) of Regulation Z, which permits early disclosures for home equity plans to be provided on the application form or a separate form. Since a creditor can comply with both the state and federal provisions, the Board proposes to determine that this provision of state law is not preempted.

Wisconsin Statutes Section 766.565(5) and Section 226.5b(f) of Regulation Z

The requesting party also asked the Board to determine whether Wisconsin Statutes § 766.565(5) conflicts with, and is therefore preempted by, § 226.5b(f)(3) of Regulation Z. Under the state law, the spouse of a consumer who opens an open-end credit plan may terminate the plan by giving written notice to the creditor. Creditors, in turn, are permitted to include in their open-end credit agreements a provision authorizing them to declare the account balance due and payable upon receiving this notice.

Although the requesting party has asked for a determination as to possible inconsistency between the state law and § 226.5b(f)(3) of the federal law (which restricts changes in terms once a home equity plan is established), the Board believes that the more appropriate question is whether the state law is inconsistent with § 226.5b(f)(2) of Regulation Z. That section limits the circumstances under which a creditor may terminate a home equity plan and accelerate the outstanding balance to cases where the consumer has committed fraud or made a material misrepresentation in connection with the plan, has not met the repayment terms of the plan, or has acted or failed to act such that the creditor's security for the plan has been adversely affected. A creditor also may terminate a home equity plan in response to a request by the consumer. Section 226.2(a)(11) of the federal regulation defines "consumer" as a natural person to whom consumer credit is offered or extended.

A strict application of the federal preemption standards to the state law suggests that the state provision is inconsistent with the federal law. Permitting one who is not the consumer to terminate a home equity plan and a creditor to accelerate the outstanding balance upon notice of such termination is clearly inconsistent with the purpose of the federal law, which is to strictly limit the circumstances under which a creditor may terminate a plan and accelerate the outstanding balance without the consumer's agreement.

It appears, however, in this case, that the state of Wisconsin has declared a strong interest in protecting certain marital property rights by effectively deeming a non-obligor spouse to be a "consumer" specifically for purposes of terminating an open-end credit plan. Therefore, while an inconsistency exists between the state and federal laws, it appears that a valid basis exists for not preempting this aspect of the Wisconsin law since the state itself in effect has elevated the spouse to the status of a "consumer" in such instances. In addition, the person exercising the right to terminate a plan has an ownership interest in the property that secures the plan and the state has recognized that person's right to limit the availability of his or her interest in the property for debts incurred under the home equity plan by the obligor. Moreover, deeming the non-incurring spouse who has an ownership interest in the property that secures the plan to be a "consumer" (and thus able to terminate a plan) already has some basis in Regulation Z. The regulation broadens the definition of "consumer," for purposes of the right of rescission under §§ 226.15 and 226.23, to include a natural person whose ownership interest in property will be subject to a security interest, even if that person is not an obligor on the credit transaction.

A similar basis, however, does not exist for permitting a creditor to interfere with the operation of the federal scheme by accelerating the outstanding balance in such cases. While a strong argument can be made that the non-incurring spouse is a "consumer" for purposes of § 226.5b and thus able to terminate a home equity plan, a creditor still only may accelerate the outstanding balance in the limited circumstances described in § 226.5b(f)(2) of the regulation.

A weighing of these two alternatives suggests that the provision under Wisconsin Statutes § 766.565(5) that permits a non-obligor spouse to terminate a home equity plan should not be preempted. The Board proposes to determine, however, that the provsion permitting a creditor to accelerate the outstanding balance in such cases is inconsistent with the purpose of the federal law and is therefore preempted.

(3) *Comment requested.* The Board requests comment on the inconsistency with the federal law of the provisions in the Wisconsin statutes discussed above. After the close of the comment period and analysis of the comments received, notice of final action on the proposal will be published in the **Federal Register.**

List of Subjects in 12 CFR Part 226

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

Board of Governors of the Federal Reserve System, April 4, 1990.

William W. Wiles,

Secretary of the Board.

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