

62 F.R. 23189

PROPOSED RULES

FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Reg. Z; Docket No. R-0969]

Truth in Lending

Tuesday, April 29, 1997

***23189** AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Public hearings and request for comments.

SUMMARY: The Board will hold public hearings on home-equity lending, and invites consumers, consumer advocacy organizations, lenders, and other interested parties to attend and to provide written comments on relevant issues. The hearings are required by the Home Ownership Equity Protection Act of 1994, which amended the Truth in Lending Act to impose additional disclosure requirements and substantive limitations on certain closed-end mortgage loans bearing rates or fees above a certain percentage or amount. The act directs the Board to examine the home-equity loan market and the adequacy of existing Truth in Lending provisions in protecting the interests of consumers. The Board will also use the hearings to examine broader Truth in Lending issues, primarily on how the finance charge could more accurately reflect the cost of consumer credit. In the Truth in Lending Act Amendments of 1995, the Congress directed the Board to study the finance charge issue. The Board submitted a preliminary analysis last year, and the hearings will assist the Board in its further deliberations.

DATES: Hearings. The hearings are scheduled as follows:

1. June 3, 1997, 8:15 a.m. to 4:30 p.m., in Los Angeles, California.
2. June 5, 1997, 8:15 a.m. to 4:30 p.m., in Atlanta, Georgia.
3. June 17, 1997, 8:15 a.m. to 4:30 p.m., in Washington, DC.

Comments. Comments from persons unable to attend the hearings or wishing to submit written views on the issues raised in this notice must be received by Friday, July 18, 1997.

ADDRESSES: Hearings. Hearings will be held at the following locations:

1. Los Angeles--Federal Reserve Bank of San Francisco, Los Angeles Branch, 950 South Grand Avenue.
2. Atlanta--Federal Reserve Bank of Atlanta, 104 Marietta Street.
3. Washington, DC--Terrace Room E of the Federal Reserve Board Martin Building, C Street Northwest, between 20th and 21st Streets.

Comments. Comments on the questions listed in this document should refer to Docket No. R-0969, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, NW. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin

Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: Jane E. Ahrens, Senior Attorney, or Sheilah A. Goodman, Staff Attorney, Division of Consumer and Community Affairs, at (202) 452-3667 or 452-2412; for copies of the Board's reports to the Congress on possible changes to the finance charge and on the adequacy of consumer protections for home-equity credit lines, Publications, at (202) 452-3244, Board of Governors of the Federal Reserve System; users of Telecommunications Device for the Deaf (TDD) only, contact Diane Jenkins at (202) 452-3544. The reports are also available on the Internet at [http:// www.bog.frb.fed.us/boarddocs/RptCongress](http://www.bog.frb.fed.us/boarddocs/RptCongress).

For directions and other matters relating to the meeting facilities in Los Angeles, Public Information, Federal Reserve Bank of San Francisco, Los Angeles Branch, at (213) 683-2901; in Atlanta, Ms. Jess Palazzolo, Public Affairs Department, Federal Reserve Bank of Atlanta, at (404) 521-8747.

SUPPLEMENTARY INFORMATION:

I. Background

The purpose of the Truth in Lending Act (TILA) (15 U.S.C. 1601 et seq.) is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The act requires creditors to disclose the cost of credit as a dollar amount (the "finance charge") and as an annual percentage rate (the "APR"). Uniformity in creditors' disclosures is intended to assist consumers in comparison shopping. The TILA requires additional disclosures for loans secured by a consumer's home and permits consumers to rescind certain transactions that involve their principal dwelling. The act is implemented by the Board's Regulation Z (12 CFR part 226).

II. Public Hearings

The Home Ownership Equity Protection Act of 1994 (HOEPA), contained in the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. 103-325, 108 Stat. 2160, amends the TILA to impose new disclosure requirements and substantive limitations on certain closed-end home-equity mortgage loans. The act also directs the Board to hold hearings on home-equity lending no later than September 1997.

The Board has scheduled three one-day hearings in Los Angeles (Tuesday, June 3), Atlanta (Thursday, June 5), and Washington, DC (Tuesday, June 17). The hearings will focus for much of the day on statements from the public about home-equity lending, as mandated by the HOEPA. The remaining portion of the hearings will elicit views about broader Truth in Lending issues that are currently under Board consideration, primarily how the TILA's finance charge disclosure could more accurately reflect the cost of consumer credit. The Truth in Lending Act Amendments of 1995, Pub. L. 104-29, 109 Stat. 271, direct the Board to study the finance charge issue, including the feasibility of treating as ***23190** finance charges all costs associated with a credit transaction. A preliminary analysis of these matters was submitted to the Congress in April 1996, and additional information gathered at the hearings will assist the Board in its further deliberations.

Home-Equity Lending

The HOEPA is the Congress's response to anecdotal evidence about abusive lending practices involving elderly and often unsophisticated homeowners who used their home as security for loans with high rates or high closing fees and with repayment terms the homeowners could not possibly meet. Changes to the TILA were implemented in section 32 of the Board's Regulation Z (12 CFR 226.32), effective in October 1995. 60 FR 15463, March 24, 1995.

The law does not prohibit creditors from making any home-secured loan, nor does it limit or cap rates that creditors may charge. Instead, the HOEPA amendments layer disclosure and timing requirements onto the requirements already imposed for

consumer credit transactions. Creditors offering HOEPA-covered loans must provide abbreviated disclosures to consumers three days before the loan is closed. The disclosures provide that consumers are not obligated to complete the closing, remind borrowers that they could lose their home if they fail to make payments, and state a few key cost disclosures, including the APR, the regular payment, and, if the loan has a variable rate, a "worst case payment" if rates increase as high and quickly as possible under the loan agreement.

In addition, creditors making "section 32" loans are prohibited from including in their loan agreements, among other provisions: (1) Balloon payments in loans with maturities of less than five years, (2) payment schedules that result in negative amortization, (3) higher default interest rates, and (4) prepayment penalties in most instances. Consumers entering into a HOEPA-covered loan may rescind the transaction for up to three years after closing if creditors fail to provide the early disclosures or if they include a prohibited term in the loan agreement.

Some types of home-secured loans are exempt from the section 32 requirements. For example, home-purchase loans are exempt. Reverse mortgages are exempt from these requirements (but are subject to an alternative detailed disclosure scheme also a part of the HOEPA and implemented in section 33 of Regulation Z).

Open-end lines of credit are also exempt from section 152 of the HOEPA, as congressional hearings preceding enactment did not reveal evidence of abusive practices connected with open-end home-equity lending. Instead of covering open-end credit, the Congress directed the Board to submit a report on whether the existing Truth in Lending rules provide adequate protections for consumers obtaining home-equity lines of credit, and to hold initial hearings within three years of the law's enactment. In November 1996, the Board submitted to the Congress a report finding that there was no evidence at that time to support the belief that excluding open-end home-secured lines of credit from the HOEPA encourages creditors to offer open-end home-equity loans as a way of evading the act's stricter disclosure rules and limitations for closed-end home-equity loans. The report concluded that the current TILA disclosure requirements give consumers important information that they generally find helpful, and generally provide consumers with adequate information and protection.

Section 158 of the HOEPA requires the Board, in consultation with its Consumer Advisory Council, to conduct public hearings that examine home-equity loans in the marketplace and the adequacy of federal laws (including the new rules affecting section 32 mortgages and reverse mortgage transactions) in protecting consumers-- particularly low-income consumers. The statute provides that the Board should solicit participation from consumers, representatives of consumers, lenders, and other interested parties.

To focus the discussion at the hearings, interested parties wishing to present oral statements at the hearings (and persons submitting written comments to the Board) on these matters are asked to address the issues set forth below, as applicable.

General

The HOEPA is a reaction to anecdotal evidence about sometimes dire consequences for homeowners with low or fixed incomes who live in communities lacking access to traditional lending institutions and who entered into home-equity loans with high rates or high fees. The law does not prohibit any type of home-equity lending or regulate the cost of home-equity loans, but seeks to curb possible consumer harm by additional disclosures and substantive contract limitations.

- What effect has the HOEPA had on homeowners seeking home-equity credit and on credit opportunities in the communities that were the focus of the legislation: (1) Has there been a change in the volume of consumers seeking and obtaining home-equity installment loans? (2) Have costs for home-equity installment credit increased, decreased, or stayed about the same? (3) For consumers who have received them, what has been the effect of the HOEPA disclosures? For example, is there evidence that the disclosures or three-day waiting period have dissuaded consumers from

consummating the loan, or caused them to question or renegotiate certain terms? (4) Are the current disclosures adequate? Could they be augmented to provide better protections? If so, describe the additional disclosures and how they would provide better protections.

Exemptions

Section 129(1)(1) of the TILA authorizes the Board to exempt specific mortgage products or categories of mortgages from some or all of the HOEPA's prohibitions if the Board finds that the exemption (1) is in the interest of the borrowing public, and (2) will apply only to products that maintain and strengthen home ownership and equity protection.

- Discuss any suggested exemption for the Board to consider, identifying the specific mortgage product or categories of mortgages, the extent of the exemption believed to be appropriate, and how the exemption would meet the standards required for the Board to provide the exemption.

Prohibitions

Section 129(1)(2) of the TILA authorizes the Board to prohibit acts or practices in connection with (1) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade section 152 of the HOEPA; and (2) refinancings of mortgage loans that the Board finds to be associated with abusive lending practices or that are otherwise not in the interest of the borrower. In 1995 as a part of its study of the TILA's finance charge, the Congress asked the Board to address any abusive refinancing practices that creditors may use to avoid the TILA's three-day right of rescission for certain home-secured loans. In its report to the Congress on those issues, the Board noted certain practices identified by consumer advocates and governmental agencies. Overall, the Board concluded that the problem of creditors engaging in refinancings for the purpose of avoiding a consumer's rescission rights was not widespread, and that existing state and federal laws adequately provide protection against creditors that ***23191** circumvent the TILA or that engage in unfair and deceptive credit practices.

- Discuss any acts or practices that the Board might consider prohibiting, and the reasons why, or disclosure or other remedies the Board might consider to address the acts or practices.

Open-End Credit

Open-end lines of credit are exempt from section 152 of the HOEPA. The Congress directed the Board to submit a report on whether the existing Truth in Lending rules provide adequate protections for consumers obtaining home-equity lines of credit. The Board's report concluded that in general existing rules provide adequate protections and that there was no evidence at that time to support the belief that the exclusion encourages creditors to offer open-end home-equity loans as a way to evade the HOEPA's stricter requirements for closed-end home-equity loans.

- Address the issue of whether the existing exemption for open-end home-equity loans is appropriate, and the reasons why. If additional protections are needed, specify the suggested changes and how those changes address the concerns which trigger the need for the additional requirements.

Reverse Mortgages

Reverse mortgages--which typically contain payment schedules with negative amortization and a balloon payment--are exempt from the requirements of section 152. The Act provides for an alternative detailed disclosure scheme in section 154. Creditors must disclose costs associated with the reverse mortgage, including a total annual loan cost rate, at least three business days before consummation of the transaction (or before the first transaction under an open-end plan).

- (1) Are the current disclosures adequate? Could they be augmented to provide

better protections? If so, describe the additional disclosures and how they would provide better protections. (2) What has been the effect of consumers receiving the new reverse mortgage disclosures at least three days before consumers consummate the loan? (3) Are you aware of any problems with the current regulatory scheme that the Board might consider addressing?

Finance Charge

The TILA and Regulation Z require disclosure of the "finance charge," the cost of consumer credit expressed as a dollar amount. The cost of credit is also expressed as an annual percentage rate. The uniform disclosure of financing costs is intended to assist consumers in shopping for credit products. The finance charge does not include every cost associated with obtaining consumer credit, such as many charges paid in a real estate-secured loan. Despite rules that attempt to define with precision which charges should or should not be considered finance charges, ambiguities--and litigation alleging incorrect categorization of charges--sometimes result.

The Congress responded to creditors' concerns about liability in the Truth in Lending Act Amendments of 1995. The amendments expressly exclude from the finance charge some of the specific fees that have been the subject of litigation. The 1995 Amendments direct the Board to report to the Congress on how the finance charge could be modified to more accurately reflect the cost of consumer credit, including the feasibility of treating as finance charges all costs required by the creditor or paid by the consumer as an incident of the credit. The Board published a notice of the congressional report and sought comment from the public. 60 FR 66179 (December 21, 1995). The Board received about 200 comments relating to possible changes to the finance charge, mostly from creditors or their representatives.

In April 1996 the Board submitted to the Congress a preliminary analysis of possible changes to the finance charge. The Board did not reach definitive conclusions, given the short statutory deadline for the report and the complexity of the issues. The preliminary report will be supplemented by a final report at a later date, allowing the Board to take advantage of additional sources of information, such as evidence that may be presented at the June 1997 hearings.

To focus discussion at the hearings, persons wishing to offer oral statements (or persons submitting written comments) should address the following issues presented in the Board's preliminary report:

Striving for a "Meaningful" Cost Disclosure

The TILA is intended to help consumers compare costs when they shop for credit. To be meaningful, disclosures must be accurate and complete. They should be detailed enough to enable the borrower to understand the effect of different pricing alternatives, but generic enough to permit an easy comparison of the overall cost between products and creditors. To enable consumers to make comparisons, disclosures should be provided before the consumer decides which creditor to use.

Today's credit marketplace is complex. Consumers are offered a myriad of choices for installment and revolving credit products. There are many pricing alternatives and opportunities to obtain ancillary products and services, such as optional credit life insurance. Some credit decisions are gradual, typically for a home-purchase loan. Others can be immediate, increasingly so as consumers shop for credit via the telephone or electronic communications. The TILA attempts in a single set of rules to ensure that consumers receive accurate, complete disclosures whether they are considering simple or complex credit transactions. For the most part, these disclosures are provided before the consumer becomes obligated for the debt but after the consumer has chosen which credit provider to use.

The current regulatory disclosure scheme is admittedly imperfect. Early disclosures are unlikely to be complete, particularly in the case of real estate-secured loans or cases where decisions have not been made about optional products. Many consumers receive their TILA disclosures after the credit choice has been made.

As a shopping tool, the disclosures may miss the mark. Instead, the TILA disclosures provide consumers with a standardized confirmation of the terms of the credit agreement.

- How can the TILA best provide meaningful cost disclosures? Would consumers be better served if fewer cost disclosures, such as the interest rate, closing costs, and payment schedule, were delivered earlier in the shopping process? How should the disclosures address costs for optional products or for required services with transaction-specific pricing? If less precise disclosures are provided earlier, what disclosures, if any, should be provided after costs become known, and when should the more accurate disclosures be provided?

Defining the "Cost" of Credit

The finance charge includes many but not all costs associated with a credit transaction. There is broad agreement that greater consistency for categorizing charges is needed, but not on how to achieve it. One view is that the TILA disclosures should identify "what the consumer pays" in connection with a credit transaction. Thus, finance charges should include all charges paid by the borrower to the creditor or to the creditor and to third parties, such as service providers (even if the service is optional, such as credit life insurance). Only costs that are paid in a comparable ***23192** cash transaction would be excluded from the finance charge.

Another approach to the cost of credit looks at "what the creditor requires" to provide the credit. This perspective raises issues concerning the treatment of fees paid to third parties. Some would include fees for services required (or if not required, if the fee was retained by the creditor). Others would oppose any duty on creditors to include fees imposed by third parties, such as for appraisals, courier fees, and title insurance. Still others believe the price of optional services--whether paid to the creditor or a third party--should never be included as a "cost" of the credit.

- Address how the "cost" of credit is most accurately reflected, including the treatment of fees--whether optional, or required or retained by the creditor.

Charges Included in the APR

The APR translates the dollar amount of the disclosed finance charge into a percentage figure. For open-end credit, the APR for advertisements and account-opening disclosures solely reflects the cost of interest, since the nature of the product typically involves fluctuating balances and account activity. The APR that appears on periodic billing statements is a somewhat broader measure. It reflects interest and certain finance charges that typically recur (a transaction fee for cash advances, for example); one-time fees or those associated with originating or renewing a credit line (such as "points" imposed to open a home-secured line of credit) are not included, to avoid a skewed APR during a single billing cycle.

The APR for closed-end loans includes the interest and certain other charges such as points and required insurance. There is broad support for improving this APR disclosure, but ideas differ widely on how to go about it. Some believe the APR for closed-end credit would be more meaningful if it reflected all costs paid by the consumer, including those currently excluded such as fees associated with real estate-secured loans (for example, fees for appraisals or title insurance) or premiums for credit life insurance purchased at the consumer's option. Others argue that the current APR figure is too broad and is not helpful because consumers are confused about the relationship between the APR and the contract interest rate and thus ignored it as a shopping tool. Others say the APR does not reflect the economic reality of the credit transaction in the case of home-purchase loans and that an APR based on an average time homeowners stay in a home would be more helpful than an APR based on a twenty-year loan term, for example.

Changing the APR calculation for home-secured closed-end transactions would have dramatic implications for creditors and consumers. Creditors would face major and

immediate costs--to reprogram computers, create new forms, and retrain personnel. Consumer education would be needed over an extended period to assist consumers in understanding the significance of new disclosures.

- Address the issue of how the APR disclosure for open-end plans or closed-end credit could be improved. Estimate the costs associated with creditor compliance and consumer education for any alternatives you offer to the present regulatory scheme.

III. Form of Statements and Comments

These hearings are open to the public to attend. Invited speakers will participate in several panel discussions. In addition, about an hour is scheduled for brief statements by interested parties in each segment, starting at 11:45 a.m. for home-equity lending and at 3:45 p.m. for issues concerning the TILA's finance charge. To allow as many persons in these segments to offer their views as possible, oral statements should be brief (about five minutes or less, if possible); written statements of any length may be submitted for the record. Interested parties who wish to participate are asked to contact the Board in advance of the hearing date, to facilitate planning for this portion of the hearings. The order of speakers will be based on their registration at the hearing site on the day of the hearing.

Comment letters should refer to Docket No. R-0969, and, when possible, should use a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text into machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3 1/2 inch or 5 1/4 inch computer diskettes in any IBM-compatible DOS-based format.

By order of the Board of Governors of the Federal Reserve System, April 24, 1997.

Jennifer J. Johnson,

Deputy Secretary of the Board.

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