Office of Thrift Supervision **July 20, 1998**
Department of the Treasury

Transmittal
TR–198

Federal Register, Vol. 63, No.137, pp. 38461-38463 **Number: TR–198**

The Office of Thrift Supervision (OTS) has finalized a rule giving thrifts two options when disclosing potential interest payments to borrowers taking out an adjustable rate mortgage (ARM) loan.

In changing the final rule from the interim version issued Jan. 8, 1998, which essentially repeated the Federal Reserve Board's ARM disclosure provisions of Regulation Z, OTS decided instead to simply cross reference the Federal Reserve's rule and require thrifts to follow it.

Regulation Z, which was amended Dec. 1, 1997, requires thrifts either to: (1) provide a borrower with a 15-year historical example showing how interest rate changes would have affected ARM payments and loan balances on a $10,000 loan, or (2) disclose the maximum interest rate and payment possible for a $10,000 loan. If a thrift chooses the second option, it must also disclose the initial interest rate and payment amount and provide a statement that the periodic payment may increase or decrease substantially during the life of the loan. Under either option, the thrift must explain how the consumer may calculate interest payments on the actual loan amount. The rules apply to ARMs that have a term exceeding one year and are secured by the consumer's principal dwelling.

The final rule was published in the July 17, 1998, edition of the Federal Register, Vol. 63, No. 137, pp. 38461-38463. The OTS final regulation is effective immediately, although compliance is optional until Oct. 1, 1998, the mandatory compliance date of amendments to Regulation Z.

For further information contact:
Susan Miles 202/906-6798
Attorney, Regulations and Legislation Division, Chief Counsel's Office

— Ellen Seidman
Director
Office of Thrift Supervision

Rules and Regulations

Federal Register
Vol. 63, No. 137
Friday, July 17, 1998

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 560

[No. 98–70]

RIN 1550–AB12

Disclosures for Adjustable-Rate Mortgage Loans

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Office of Thrift Supervision (OTS) is issuing a final rule revising adjustable-rate mortgage loan (ARM) disclosure requirements for savings associations. In the interim final rule, the OTS conformed its ARM disclosure rule text to recent changes to related disclosure provisions in Regulation Z, which was issued by the Federal Reserve Board (FRB) under the Truth in Lending Act (TILA). In today's final rule, the OTS replaces its existing rule with a simple cross-reference to the Regulation Z disclosure provisions. The rule also makes minor technical changes. This substitution does not affect the rule's function of promoting safe and sound lending by savings associations nor OTS's enforcement of its provisions.

EFFECTIVE DATE: Effective date: July 17, 1998. *Compliance date:* Compliance is optional until October 1, 1998.

FOR FURTHER INFORMATION CONTACT: Susan Miles, Attorney, (202) 906–6798, Regulations and Legislation Division, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

To assist borrowers in making informed decisions on the cost of credit, the OTS and FRB have issued regulations imposing disclosure requirements on creditors issuing ARMs. The FRB disclosure rules at 12 CFR Part 226 implement TILA [1] and are commonly referred to as Regulation Z. Regulation Z applies to all lenders subject to TILA, including savings associations. Regulation Z, however, specifically states that information provided in accordance with the variable rate regulations of other federal agencies, such as the OTS, may be substituted for the disclosures required by Regulation Z.[2] To this extent, Regulation Z incorporates the OTS ARM disclosure rule at 12 CFR 560.210, and the OTS rule serves as an implementing regulation of TILA.

Section 560.210 applies to ARMs with a term of more than one year that are secured by property occupied by or to be occupied by the borrower. This rule was first issued by the OTS's predecessor agency, the Federal Home Loan Bank Board (FHLBB) under the agency's authority under the Home Owners' Loan Act (HOLA) [3] to ensure that savings associations operate in a safe and sound manner. The FHLBB believed the regulation was necessary because "[s]afe and sound lending using ARMs requires that the borrower have a full understanding of the type of obligation being incurred in order to make a reasonable and meaningful decision concerning ability to repay." [4] The OTS continues to consider promoting safe and sound lending an important function of this regulation.

Although the original FHLBB regulation was more detailed than Regulation Z, the disclosures required under OTS regulations have been identical to those required under Regulation Z since 1988. Under Regulation Z, if a variable rate transaction exceeds a term of one year and is secured by the consumer's principal dwelling, the creditor must provide various initial disclosures for each variable rate program in which the consumer is interested.[5] Until recently amended, Regulation Z required an institution to provide: (1) A fifteen-year 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; and (2) 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 increases in rates and payments under the loan, and the initial interest rate and payment for that loan.

Section 2105 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) [6] amended section 128(a) of TILA to permit a creditor to elect to provide a statement that periodic rates may substantially increase or decrease (together with the maximum interest rate and payment amount based on a $10,000 loan amount), in lieu of the historical example. On December 1, 1997, the FRB published a final rule implementing section 2105 of EGRPRA.

On January 8, 1998, the OTS published an interim final rule making identical amendments to § 560.210.[7] Under the OTS interim final rule, a savings association may provide either the historical example or the maximum interest rate and payment. If the savings association chooses the maximum interest rate and payment option, however, it must also provide the initial rate and payment amount and a statement that the periodic rate may increase or decrease substantially.

Consistent with the FRB final rule, the OTS interim rule also modified how the interest rate is calculated under the maximum interest rate and payment option. Before the interim final rule, a savings association calculated the maximum interest rate using "the most recent interest rate shown in the historical example." Since a savings association is not required to provide the historical example when it elects the maximum interest rate and payment option, the interim final rule provided for the disclosure of "the initial interest rate (index value plus margin, adjusted by the amount of any discount or premium) in effect as of an identified month and year for the particular loan program."

Similarly, before the interim final rule, the OTS required a savings association to explain how a customer could calculate payments for the loan

[1] 15 U.S.C. 1601 *et seq.*
[2] 12 CFR 226.19(b) n. 45a and 226.20(c) n. 45c.
[3] 12 U.S.C. 1463(a) and 1464(a).
[4] 50 FR 32005 (Aug. 8, 1985).
[5] 12 CFR 226.19(b)(2) (1997).
[6] Pub. L. 104–208, 110 Stat. 3009 (September 30, 1996).
[7] 63 FR 1051.

amount based on the most recent payment shown in the historical example. To allow customers to understand the relationship between their transactions and the disclosures made under the maximum interest rate and payment option, the interim final rule permits a savings association to provide a customer with a similar explanation using the initial interest rate. The FRB made a similar change to Regulation Z.

II. Discussion of Comments

The OTS received comments from three commenters: one state-chartered savings institution, one federal savings bank, and one law firm. All three commenters supported the substantive changes in the interim final rule. Accordingly, today's final rule incorporates the substantive changes to the ARM disclosure requirements.

The OTS specifically solicited comment on whether it should delete the text of the disclosure requirements in § 560.210 and rely on the disclosure requirements in Regulation Z. All three commenters urged the OTS to adopt this approach.

The OTS has deleted the text of the disclosure requirements from the final rule and has substituted appropriate cross-references to Regulation Z. This approach will permit OTS-regulated institutions to immediately comply with all future changes to the Regulation Z disclosures in this area without waiting for the OTS to conform its rule through the rulemaking process.[8] Thus, the rule will ensure that all competing lenders are subject to similar regulatory requirements for ARM loans. This approach is consistent with section 303 of the Community Development Regulatory Improvement Act of 1994 (CDRIA), which instructs each banking agency to review their regulations and remove duplicate requirements and encourages common interagency supervisory policies. Finally, this change more closely conforms OTS rules to those issued by the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation. These agencies' rules do not prescribe any ARM disclosures and, instead, rely entirely on Regulation Z.

Rather than delete all references to ARM disclosure requirements from the regulations, the OTS has decided to retain appropriate cross-references to the disclosure provisions in Regulation Z. This approach, which two commenters supported, preserves the OTS's authority to utilize the full panoply of enforcement actions available under the HOLA and section 8 of the Federal Deposit Insurance Act (FDIA)[9] when an institution has improperly adjusted ARM interest rates. As noted above, § 560.210 implements both HOLA and TILA. Although TILA authorizes the OTS to utilize the standard enforcement remedies under section 8 of the FDIA, it limits when an agency may require an institution to "make dollar adjustments" for errors. Under TILA, the agency is authorized to direct an institution to make dollar adjustments only where an annual percentage rate or finance charge was inaccurately disclosed.[10]

By contrast, the OTS may seek any remedy authorized under the HOLA or section 8 of the FDIA for violations of regulations adopted pursuant to its authority under the HOLA.[11] As previously discussed, a long-standing purpose of the disclosure requirements of § 560.210 and its predecessor regulations has been promoting safe and sound lending by savings associations through ensuring that borrowers have a full understanding of their obligations and can therefore make reasonable and meaningful decisions about their ability to repay their loans. Thus, when enforcing § 560.210 as a safety and soundness regulation, the agency has a wider array of enforcement tools than would be available if it were solely enforcing violations of TILA. Section 8 of the FDIA, for example, permits the OTS to issue cease and desist orders requiring affirmative corrective actions, which may include account adjustments. FDIA also authorizes the OTS to require an institution to make restitution if the institution was unjustly enriched, or acted with reckless disregard.

Changing the format of the regulation to incorporate some provisions of Regulation Z by cross-referencing does not affect this authority. As with other OTS regulations that incorporate regulations of other agencies by cross referencing (e.g., 12 CFR 560.93, 563.43), OTS has the responsibility of enforcing the incorporated regulations as they apply to savings associations. The OTS will continue to enforce violations of § 560.210 using the enforcement remedies provided under the HOLA and FDIA.[12]

In the preamble to the interim rule, the OTS observed that § 560.210, on its face, applies to loans secured by a borrower's principal dwelling or by a second home. By contrast, the applicable Regulation Z disclosure requirements at 12 CFR 226.19(b) and 226.20(c) apply only when the secured property serves as the borrower's primary dwelling.[13] Two commenters urged the OTS to eliminate coverage for loans secured by second homes.

In recent years, the OTS has revised the scope of its ARM disclosure rule to more closely conform to Regulation Z requirements. For example, in the recent Lending and Investment rulemaking, OTS eliminated coverage of ARM loans that are primarily for a business, commercial, or agricultural purpose. The OTS made this revision to minimize the differences between its ARM regulation and Regulation Z and to ensure parity in coverage for all lenders.[14] To ensure that the scope of the OTS rule is, and continues to be, coextensive with Regulation Z, the cross-reference in the final rule refers to variable rate transactions as described under 12 CFR 226.19(b) and 226.20(c). These transactions are limited to those involving principal residences.

In addition to the changes discussed above, the OTS has made minor technical changes to current § 560.210. For example, the new cross-references to variable rate mortgage transactions under Regulation Z, permit the deletion of the existing definitions of "adjustable-rate mortgage loan," "applicant," and "home."

The OTS has also deleted current § 560.210(e). This paragraph states that a savings association making a closed- or open-end ARM loan must comply with Regulation Z (12 CFR 226.30) by specifying in their credit contracts the maximum interest rate that may be imposed during the term of the obligation. This section simply reiterates already applicable requirements under Regulation Z, and may be deleted as unnecessary.

[8] We note that the recent FRB final rule was effective on November 21, 1997. The OTS's related interim final rule was effective on January 8, 1998.

[9] 12 U.S.C. 1818.

[10] 15 U.S.C. 1607(b) & (e)(5).

[11] 12 U.S.C. 1464(d).

[12] One commenter noted that borrowers have additional enforcement remedies under state law and under RESPA's mortgage loan servicing provisions. *See* 12 U.S.C. 2605(e)(1)(B). The OTS does not wish to rely on the efforts of the individual plaintiffs to ensure that thrift institutions use safe and sound banking practices and comply with applicable laws and regulation. Rather, the OTS has retained and will exercise the broadest possible enforcement authority permitted under the existing statutes.

[13] *See e.g.*, 12 CFR Part 226, Supp. I. Official Staff Interpretation, Section 226.19, Paragraph 19(b), Comment 1.

[14] 61 FR 50951, 50962–63 (Sept. 30, 1996). Moreover, we note that the FHLBB's initial ARM disclosure regulation originally specifically excluded the coverage of second homes. 50 FR 32010 (August 8, 1985). In 1987, however, the relevant language was deleted without any discussion. 52 FR 3668 (February 5, 1987).

III. Effective Date

The OTS has determined that there is good cause to dispense with a 30-day delayed effective date under 5 U.S.C. 553(d)(3). The revised disclosure requirements reduce regulatory confusion by conforming the OTS disclosure rules under the HOLA more closely to those of the FRB under TILA. The changes do not have an adverse impact on savings associations because they reduce regulatory burden. Moreover, the substantive changes to disclosure requirements were immediately effective upon publication of the interim rule in January, 1998 and many institutions have already adopted the changes. Accordingly, OTS-regulated institutions will not require additional time to adjust their policies or practices to comply with the rule.

The OTS has also determined, for the reasons stated in the preceding paragraph, that good cause exists to adopt an effective date that is before date that would otherwise be required by section 302 of CDRIA (i.e., the first day of the calendar quarter after the date of publication).

Accordingly, the final rule is effective immediately. However, like the FRB rule, compliance with the OTS rule is optional until October 1, 1998.

IV. Paperwork Reduction Act of 1995

The collections of information contained in this final rule were submitted to and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under OMB Control Number 1550–0078.

Comments on all aspects of this information collection above should be sent to the Office of Management and Budget, Paperwork Reduction Project (1550–0078), Washington, DC 20503, with copies to the Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number assigned to the collection of information in this final rule is displayed at 12 CFR 506.1(b).

The collection of information requirements in this final rule are found at 12 CFR 560.210. The OTS needs the disclosures requirements to ensure that savings associations comply with a statutory TILA requirement and to otherwise supervise safe and sound lending by savings associations. The likely respondents/recordkeepers are OTS-regulated savings associations.

V. Executive Order 12866

The Director of the OTS has determined that this final rule does not constitute a "significant regulatory action" for the purposes of Executive Order 12866.

VI. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act, the OTS certifies that this final rule will not have a significant economic impact on a substantial number of small entities. The final rule will not impose any additional burdens or requirements. Rather, it reduces the disclosures required for ARMs and eases the compliance burden on all savings associations, including small savings associations. Accordingly, a regulatory flexibility analysis is not required.

VII. Unfunded Mandates Act of 1995

The OTS has determined that the requirements of this final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of more than $100 million in any one year. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995, as codified at 2 U.S.C. 1571(a).

List of Subjects in 12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations.

Accordingly, the Office of Thrift Supervision amends title 12, chapter V, of the Code of Federal Regulations as set forth below:

PART 560—LENDING AND INVESTMENT

1. The authority citation for part 560 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j–3, 1828, 3803, 3806; 42 U.S.C. 4106.

2. Section 560.210 is revised to read as follows:

§ 560.210 Disclosures for variable rate transactions.

A savings association must provide the initial disclosures described at 12 CFR 226.19(b) and the adjustment notices described at 12 CFR 226.20(c) for variable rate transactions, as described in those regulations. The OTS administers and enforces those provisions for savings associations.

Dated: July 14, 1998.

By the Office of Thrift Supervision.

Ellen Seidman,

Director.

[FR Doc. 98–19143 Filed 7–16–98; 8:45 am]

BILLING CODE 6720–01–P