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Handbook Mailing HM-09-5

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 617

RIN 3052-AC45

Borrower Rights; Effective Interest Rates

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA) proposes to amend two sections of its borrower rights regulations governing what initial and subsequent disclosures a qualified lender must make to a borrower when the borrower's interest rate is directly tied to a widely publicized external index. The proposed revisions would require qualified lenders to provide additional disclosure to borrowers at loan closing on how and where to track the external index, and allow qualified lenders, who are required to provide the additional disclosure, to send written notices of subsequent rate changes to borrowers no later than the borrower's first regularly scheduled billing statement after the effective date of the change.

DATES: You may send comments on or before August 18, 2009.

ADDRESSES: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by e-mail or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Select "Public Commenters," then "Public Comments," and follow the directions for "Submitting a Comment."
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail: Gary K. Van Meter, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

You may review copies of comments we receive at our office in McLean, Virginia, or from our Web site at <http://www.fca.gov>. Once you are in the Web site, select "Public Commenters," then "Public

Comments," and follow the directions for "Reading Submitted Public Comments." We will show your comments as submitted but, for technical reasons, we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

Jacqueline R. Melvin, Policy Analyst, Office of Regulatory Policy, Farm Credit Administration, McLean, VA, (703) 883-4414, TTY (703) 883-4434;

or

Robert Taylor, Attorney, Office of General Counsel, Farm Credit Administration, McLean, VA 22102-5090, (703) 883-4020, TTY (703) 883-4020.

SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this proposed rule is to ensure that borrowers with loans directly tied to a widely publicized external index receive appropriate disclosure of interest rate changes in accordance with statutory requirements while minimizing regulatory burden on Farm Credit System (FCS or System) institutions.

II. What Does the Statute Require?

Section 4.13(a)(4) of the Farm Credit Act of 1971, as amended (Act), requires qualified lenders to provide borrowers, for all loans not subject to the Truth in Lending Act (15 U.S.C. 1601 et seq.), "meaningful and timely disclosure" of any change in the interest rate applicable to the borrower's loan within a "reasonable time after the effective date" of a change.¹

III. Why did Congress Establish this Requirement?

At the time of the 1985 adoption of the interest rate notice requirements, almost all FCS loans were administered² rate loans and there were few, if any, FCS loans directly tied to an external index.³ Administered rates require definitive action at the discretion of the lending bank or association to change the interest rate charged. Administered rates are usually based on an institution's internal index or other standard and take into account the lending institution's costs. Administered rates may also reflect management's assessments of whether rate changes are warranted or feasible in view of competitive market conditions; therefore, the actual interest rates charged on administered rate loans may not mirror the movement of market interest rates.⁴

Prior to adopting the interest rate notice requirements (during the farm crisis of the 1980s), Congress and FCA received a number of complaints and inquiries from borrowers about interest rate changes made on administered rate loans without adequate explanation to borrowers. Therefore, it appears that the new notice provisions were necessary to protect borrower rights because of the lack of transparency associated with the System's administered rate loans. While Congress may not have anticipated that the interest rate notice provisions cover widely publicized external index loans, these loans are not excluded from the reach of the Act.

IV. Section-by-Section Analysis

What initial disclosures must a qualified lender make to a borrower? [§ 617.7130]

The proposed revision to § 617.7130(b) would add a paragraph (6), requiring, when the borrower's interest rate is directly tied to a widely publicized external index, that a qualified lender must provide information on how and where the borrower may track changes to the index and when the borrower will receive written notice of changes to the borrower's interest rate.

This additional information would be included in the initial disclosure to ensure that borrowers have adequate knowledge, at loan closing, of how and where they may access information to monitor changes in the interest rate. Further, the borrower would be fully informed as to how billing or other statements would reflect changes in the loan's interest rate.

What subsequent disclosures must a qualified lender make to a borrower? [§ 617.7135]

Section 4.13(a)(4) of the Act requires qualified lenders to provide, no later than loan closing, notice to borrowers that change in the interest rate applicable to the borrower's loan may be made within a reasonable time after the effective date of increase or decrease. Current § 617.7135(a)(2) requires that the qualified lender provide the borrower whose loan is directly tied to a widely publicized external index a notice within 45 days after the effective date of the rate change.

We propose amending the regulation to require the qualified lender to provide written notice to the borrower of a rate change applicable to the borrower's loan no later than the borrower's first regularly scheduled billing statement after the effective date of the change, so long as the qualified lender provided the disclosures required by proposed § 617.7130(b)(6) no later than the time of loan closing.

There have been several trends in the use of external indexes and enhanced information availability that have caused us to now believe that the billing statement option is reasonable and justifiable. For example, between 1999 and 2008, the volume of administered rate loans has declined by 16 percent as more borrowers opt to use their knowledge and understanding of index loans to meet their operating needs.⁵ Further, advances in technology, such as broad band Internet access in rural communities, increased usage of mobile phones and personal computers for accessing the Internet and receiving information via e-mails and text messages, provide borrowers instantaneous information regarding any changes in external index rates. Moreover, most System associations now offer borrowers online access to their loan balances, rate changes, and other information. Therefore, when a qualified lender provides the initial disclosure proposed for § 617.7130(b), we believe that written notice of subsequent rate changes to the borrower, no later than the first regularly scheduled billing statement after the effective date of the change, protects borrower rights in accordance with the statute regarding "meaningful and timely disclosure." Also, institutions do not incur the burden of additional mailing costs, which may be passed on to their borrowers.

The new notice requirements would not apply to rate changes applicable to a borrower's loan closed prior to the effective date of the final rule (the borrowers would not have received the enhanced initial disclosures). Therefore, the current 45-day notice requirement would still apply to interest rate changes on those loans.

V. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the FCA

hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

¹12 U.S.C. 2199(a)(4). "Qualified lenders" include Farm Credit System lenders (except for a bank for cooperatives), and non-System lenders (other financing institutions (OFIs)) for loans that OFIs make with funding from a Farm Credit bank. See 12 U.S.C. 2202a(a)(6).

²"Administered" and "adjustable" rates are synonymous terms that describe the types of variable rates offered by System institutions.

³FCA considers the nationally published commercial bank Prime Rate and the London Interbank Offered Rate (LIBOR) to be the primary examples of widely publicized external indexes. Other rates may also meet the criteria, but the qualified lender must ensure that the rate is published in a source readily available to its borrowers. See 68 FR 5587 (Feb. 4, 2003).

⁴See the Federal Farm Credit Bank Funding Corporation's annual report to investors at www.farmcredit-ffcb.com.

⁵Historical data compiled from 1999 to 2008 in the Federal Farm Credit Banks Funding Corporation annual report to investors available at www.farmcredit-ffcb.com.

List of Subjects in 12 CFR Part 617

Agriculture, Banks, banking, Rural areas.

For the reasons stated in the preamble, part 617 of chapter VI, title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 617--BORROWER RIGHTS

1. The authority citation for part 617 continues to read as follows:

Authority: Secs. 4.13, 4.13A, 4.13B, 4.14, 4.14A, 4.14C, 4.14D, 4.14E, 4.36, 5.9, 5.17 of the Farm Credit Act (12 U.S.C. 2199, 2200, 2201, 2202, 2202a, 2202c, 2202d, 2202e, 2219a, 2243, 2252).

Subpart B--Disclosure of Effective Interest Rates

2. Amend § 617.7130 by revising introductory text of paragraph (b) and adding a new paragraph (b)(6) to read as follows:

§ 617.7130 What initial disclosures must a qualified lender make to a borrower?

* * * * *

(b) *Adjustable rate loans.* A qualified lender must provide the following information for adjustable rate loans in addition to the requirements of paragraph (a) of this section:

* * * * *

(6) If the borrower's interest rate is directly tied to a widely publicized external index, a qualified lender must provide:

- (i) How and where the borrower may track changes to the index; and
- (ii) When the borrower will receive written notice of changes to the borrower's interest rate.

3. Amend § 617.7135 by revising paragraph (a)(2) to read as follows:

§ 617.7135 What subsequent disclosures must a qualified lender make to a borrower?

* * * * *

(a) * * *

(2) If the borrower's interest rate is directly tied to a widely publicized external index, a qualified lender must provide written notice to the borrower of the rate change no later than the borrower's first regularly scheduled billing statement after the effective date of the change, except that a qualified lender must provide written notice to the borrower of the rate change within 45 days after the effective date of the change if the loan closed before the disclosures required under § 617.7130(b)(6).

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Dated: June 16, 2009

**Roland E. Smith,
Secretary,
Farm Credit Administration Board.**