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Handbook Mailing HM-09-10

[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Part 617

RIN 3052-AC45

Borrower Rights; Effective Interest Rates

AGENCY: Farm Credit Administration.

ACTION: Final rule.

SUMMARY: The Farm Credit Administration (FCA or we) issues a final rule amending the disclosure requirements governing what initial and subsequent disclosures a Farm Credit System (FCS or System) qualified lender must make to a borrower when the borrower's adjustable rate loan's interest rate is directly tied to a widely publicized external index. The final rule requires qualified lenders to include, in the initial disclosure to borrowers (at loan closing), how and where to obtain information on changes to the external index. The final rule also requires qualified lenders to make the disclosures to "existing" borrowers with adjustable rate loans directly tied to a widely publicized external index who had not previously been given the "new" initial disclosures. In addition, the final rule allows qualified lenders to send written notices of subsequent rate changes to borrowers within 45 days after the effective date of the change or as part of the borrower's first regularly scheduled billing statement affected by the rate change.

EFFECTIVE DATE: This regulation will be effective 30 days after publication in the Federal Register during which either or both Houses of Congress are in session. We will publish a notice of the effective date in the Federal Register.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Objective

The objective of this final 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 allowing System institutions to provide the notices in a more efficient manner.

II. Background

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 Under our current rules, where the borrower’s interest rate is directly tied to a widely publicized external index, qualified lenders must provide a written notice to the borrower within 45 days after the effective date of the change; where the borrower’s rate is not directly tied to a widely publicized external index, qualified lenders must send written notice within 10 days.²

On June 19, 2009 (74 FR 29143), the FCA published a proposed rule in the Federal Register that would amend two sections of the disclosure requirements in part 617 of FCA’s regulations. First, we proposed enhancing the initial information a qualified lender gives to borrowers with loans directly tied to a widely publicized external index. Second, we proposed that the subsequent disclosure notifying the borrower of changes in the external index be included in the first regularly scheduled billing statement after the effective date of the change. However, if the borrower’s loan closed before the proposed new initial disclosures became effective, the qualified lender would be required to provide written notice of the rate change within 45 days after the effective date of change.

III. Summary of Comments on the Proposed Rule

The FCA received comments from two Farm Credit banks and one agricultural credit association on the proposed rule. Commenters expressed concern that the new rule would add burden by requiring a “dual” disclosure regime (one disclosure system for new borrowers and one for existing borrowers). Commenters also requested clarification on what information a qualified lender must provide to a borrower with the initial disclosure.

IV. Summary of Changes to the Final Rule

After careful review of comments received, the final rule eliminates the need for a “dual” notice regime by revising § 617.7135 to require that the new § 617.7130(b)(6) disclosures be provided to all borrowers with a loan interest rate directly tied to a widely publicized external index. The final rule gives qualified lenders the option of continuing to give borrowers the 45-day rate change notice required under the current rule or to give notice of the rate change as part of the borrower’s first regularly scheduled billing statement affected by the rate change. In addition, we also added a provision to § 617.7135 that requires qualified lenders to provide a one-time notice to applicable borrowers with adjustable rate loans directly tied to a widely publicized external index who did not previously receive the initial disclosures required by new § 617.7130(b)(6). We also made changes to the language of final § 617.7130(b)(6)(i) and (ii); these clarifications are consistent with the intent of the proposed rule and do not represent substantive changes. The comments and corresponding changes to the final rule are more fully discussed in the section-by-section analysis below.

V. FCA’s Section-by-Section Analysis of Comments with FCA’s Response

A. Initial Disclosure Requirement

Comment: One commenter requested more guidance as to the FCA’s expectations on the level of detail that qualified lenders will be required to provide to borrowers to satisfy the initial disclosures. For example, the commenter wanted to know whether a reference to the Wall Street Journal or a single Web site would satisfy the requirements of the proposed rule.

Response: Section 617.7130(b)(1) through (b)(5) of our regulations provides qualified lenders the level of information that must be given to borrowers at loan closing regarding adjustable rate loans. We proposed revising § 617.7130 by adding paragraph (b)(6) to ensure that borrowers have adequate knowledge, at loan closing, of how and where they may access information on adjustable rate loans that are directly tied to a widely publicized external index. The FCA expects the qualified lender to make an independent assessment of information availability in the community that it serves in determining whether a single financial news source or a single Web site reference is sufficient for borrowers to obtain information on the external index. For example, if the institution publicizes index change information on its Web site and the institution’s borrowers have reasonable access to that Web site, a qualified lender may direct their borrowers to the institution’s Web site.

Comment: A commenter requested clarification of how and where the borrower may “track” changes to the index. For example, the commenter wanted to know whether qualified lenders will only be required to tell the borrowers where they will be able to find changes in the index as the changes occur or will qualified lenders also be expected to tell borrowers where they can find a history of the changes to the index.

Response: To avoid confusion, the FCA is eliminating the term “track” changes. To ensure that the regulation is clear, the final rule will require qualified lenders to provide information on how and where the borrower may “obtain” information on changes to the index. Qualified lenders will be required to tell borrowers where they can get current information on index rates so that borrowers can stay informed about interest rate changes that affect them. Qualified lenders will not be expected to tell borrowers where they can find historical data on index rates.

B. Subsequent Disclosure Requirement

Comment: A commenter stated that, while proposed § 617.7135(a)(2) would create a new disclosure system for loans going forward, qualified lenders would be required to maintain the old disclosure system for existing loans. The commenter also stated that besides the additional expense in maintaining two systems simultaneously, “we are unclear as to whether or not this would be feasible with our current infrastructure.” Furthermore, the commenter stated that a “dual” disclosure system will also be confusing to borrowers with existing loans that thereafter close a second loan under the proposed rule because the borrowers would presumably receive different notices depending on when the loan was booked.

A second commenter similarly stated that the proposed regulations set up two separate classes of loans with different compliance requirements with respect to notices of interest rate changes. The commenter also stated that the additional compliance requirements would be burdensome for qualified lenders to manage. Instead of two separate disclosure systems, the commenter suggested that FCA allow institutions to establish one process for all loans with interest rates directly tied to a widely publicized external index. Another commenter requested the flexibility to have the new notice requirement for subsequent disclosures apply to the existing loans if the qualified lender provided the enhanced disclosures to the existing borrowers, telling them how and where they may track changes to the index.

Response: Upon consideration, we believe the commenters concerns are well-founded and we have changed the final rule as suggested to allow for comparable treatment for all borrowers. The FCA's intention was to make the subsequent disclosure requirements for notifying borrowers of changes in the external index more flexible. This flexibility was intended to satisfy the statutory requirements for disclosure within a "reasonable time after the effective date" of a change. However, after consideration of the comments, we see the challenge that qualified lenders would face in managing two systems instead of one. We therefore agree with the commenters that subsequent notice of the enhanced disclosure information to existing borrowers is appropriate to allow qualified lenders to begin providing the same subsequent interest rate change notice to all borrowers.

The final rule allows an institution to select one of two options for notifying borrowers of changes in the external index. Since either method complies with regulatory requirements, a qualified lender may choose to use either or both methods. However, unlike the proposed rule, the final rule does not require a "dual" notice system and therefore whichever system is selected, the process can be the same for all borrowers regardless of when the loan closed.

The final rule also requires that the initial disclosures be made to applicable borrowers with adjustable rate loans directly tied to a widely publicized external index who were not previously provided with the disclosures in § 617.7130(b)(6). This subsequent disclosure must be made no later than the qualified lender's next regularly scheduled correspondence to those borrowers after April 1, 2010. The April 1, 2010 date will provide a transition period after the effective date of the final rule. Providing the new disclosure, which could be sent with planned mail (or e-mail in accordance with FCA's e-commerce rules) communication, such as a 45-day notice, a billing statement, or some other form of communication directly to the borrower -- but not advertisements or other generic communications sent to all customers -- would eliminate the need for a "dual" notice requirement.

Comment: A commenter noted that the existing § 617.7130(b) requires the qualified lender to "provide" information for adjustable rate loans to borrowers. However, proposed § 617.7130(b)(6)(ii) would require disclosure of when the borrower would "receive" notice of changes in the borrower's interest rate. The commenter stated that since the qualified lender has little control over when the notice of the rate change is actually received by the borrower the qualified lender should not be required to include a statement to this effect.

Response: We agree with the commenter that, as proposed, the term "receive" places responsibility on the qualified lender when there is little control over the outcome. Therefore, the final rule requires that the qualified lender disclose to the borrower when the qualified lender will "provide" written notice of the rate change.

C. **Billing Statements**

Comment: A commenter stated that the proposed regulation provides for the submission of a rate change notice no later than the borrower's first billing statement which, in the case of monthly pay loans where monthly statements are sent 20 days prior to the due date, would reduce the time for notice from 45 days to 10 days. The commenter also stated that the proposed process would be further complicated by the possibility of multiple changes in a given month. In addition, the commenter stated that for annual payment loans, the proposed regulation is unclear as to whether qualified lenders should provide the latest change immediately prior to the annual payment or all of the changes throughout the year in the billing statement. As such, the commenter urged FCA to consider amending the rule to provide System institutions the ability to "opt out" and continue using the existing disclosure methodology for all loans. Another commenter had similarly requested clarification about the billing

statement schedule.

Response: Generally, we expect that a borrower's billing statement would disclose the interest rate being charged in connection with the payment due. Proposed § 617.7135(a)(2) required disclosure as part of the borrower's first regularly scheduled billing statement "after the effective date of the change." To clarify our intent and the qualified lender's responsibility, the language of final § 617.7135 is revised to require disclosure as part of the borrower's first regularly scheduled billing statement "affected by the rate change." Therefore, if the qualified lender elects to provide the subsequent disclosure notifications to the borrower as part of the regularly scheduled billing statement, the qualified lender will include all intermittent rate changes as part of the borrower's billing statement. For example, if the borrower's loan was tied to an external index that adjusts monthly and the borrower's regularly scheduled billing statements are provided annually, then the qualified lender must include in the billing statement all of the changes to the external index that occurred throughout the year that affected the borrower's interest rate and the resulting annual payment due from the borrower.

Additionally, as previously discussed, the final rule gives the qualified lender an option of continuing with the current process of the subsequent disclosure notifications to borrowers within 45 days after the effective date of the change.

VI. 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 final 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.

¹ 12 U.S.C. 2199(a)(4). "Qualified lenders" include 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 12 CFR 617.7135(a). FCA 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).

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 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), paragraphs (b)(4) and (b)(5), 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:

* * * * *

(4) Any limitations on the amount or frequency of adjustments;

(5) The specific factors that the qualified lender may take into account in making adjustments to the interest rate on the loan; and

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

(i) How and where the borrower may obtain information on changes to the index; and

(ii) When the qualified lender will provide written notice of changes to the borrower's interest rate.

3. Amend § 617.7135 by revising paragraph (a)(2), redesignating existing paragraph (b) as new paragraph (c), and adding a new paragraph (b) 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 either:

(i) Within forty-five (45) days after the effective date of the change; or

(ii) As part of the borrower's first regularly scheduled billing statement affected by the rate change.

* * * * *

(b) *Notice to adjustable rate loan borrowers with interest rates directly tied to a widely publicized external index.* A qualified lender must provide the written disclosure required by § 617.7130 (b)(6) to applicable borrowers who were not previously given the disclosure no later than the qualified lender's next regularly scheduled correspondence to those borrowers occurring after April 1, 2010.

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Dated: December 16, 2009

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