

received by the lender in exchange for making the loan should be included in the EIR calculation. Having fewer items included in the EIR more clearly demonstrates the effect of stock and origination charges paid to the qualified lender and reduces artificial inflation of the EIR. We also believe that separate disclosure of charges not included in the EIR calculation, consisting of a list of the actual cost of other items, is more meaningful to borrowers than including them in the EIR calculation.

Section 617.7120—How Should a Qualified Lender Present the Disclosures to a Borrower?

Paragraph (a) requires a qualified lender to disclose the effective interest rate and other required information clearly and conspicuously in writing, in a form that is easy to read and understand and that may be kept by the borrower. Paragraph (b) further provides that the required disclosures cannot be combined with any information not directly related to the information required by proposed §§ 617.7130 and 617.7135. These standards are intended to provide reasonable assurance that qualified lenders provide user-friendly, meaningful disclosures to borrowers. We also propose to eliminate the model forms contained in the Appendix to 12 CFR 614.4367 of the current regulations to permit lenders to tailor their disclosures to a variety of loan types.

Section 617.7125—How Should a Qualified Lender Determine the Effective Interest Rate?

Current FCA regulations provide direction as to the general requirements of EIR disclosures; they do not, however, prescribe a specific formula or methodology for calculation of an effective interest rate. The absence of a definitive methodology for calculating an effective interest rate has led to the use of different approaches—ranging from simplistic to a more complex discounted cash flow method.

Proposed § 617.7125 provides that a qualified lender must calculate the effective interest rate on a loan using a discounted cash flow method showing the effect of the time value of money in determining the EIR. Further, the proposed rule provides that, for all loans, the cash flow stream used for calculating the effective interest rate of a loan must include: (1) Principal and interest; (2) the cost of stock or participation certificates that a borrower is required to purchase in connection with the loan; and (3) loan origination charges described in § 617.7115(a).

The discounted cash flow method required by proposed § 617.7125 is

conceptually similar to the formula prescribed in Regulation Z for determination of the annual percentage rate (APR) on loans subject to TILA. While loan charge components differ between the EIR required by the Act and the APR required by Regulation Z, we believe requiring the disclosure of an EIR determined under a widely used method for analyzing the cost of credit would provide more meaningful information to borrowers.

As discussed earlier, we believe it is not appropriate to graft TILA or Regulation Z requirements onto the Act's EIR disclosure requirements. Consequently, the proposed rule does not impose, on qualified lenders, a formula or specific procedures for calculating the EIR. Instead, we propose that all qualified lenders establish policies and procedures for calculating the EIR and use a standard methodology (the discounted cash flow method) for determining required EIR disclosures to borrowers.

Paragraph (c) requires lenders to establish policies and procedures for disclosing the effect of the cost of borrower stock and loan origination charges on the interest rate of a loan. Qualified lenders will also be required to establish policies and procedures for determining the major assumptions used in calculating the EIR, such as for calculating the EIR for adjustable rate loans, revolving or open-end lines of credit, or other loans where key terms may vary or may not be fixed. Qualified lenders may not, however, assume retirement of stock in calculating the EIR disclosed to borrowers because the Act provides that borrower stock is "at risk" and a qualified lender cannot guarantee stock retirement. Qualified lenders, may, however, provide supplemental disclosures to borrowers to demonstrate the effect of potential stock retirements so long as the additional disclosures are not misleading.

In considering the best way to achieve consistent, accurate, and meaningful EIR disclosures, the FCA considered common practices in the financial services industry for similar disclosures. Regulation Z for consumer credit provides detailed requirements for uniform APR calculations that essentially use a discounted cash flow method. Because the discounted cash flow method for calculating an EIR explicitly and routinely weighs the time value of money, we believe it produces the most accurate reflection of a loan's cost.

Although the discounted cash flow method involves somewhat complex mathematical computations, the FCA

does not believe a requirement to use this method would cause undue burden to lenders. A survey of System-lender disclosures we conducted in the spring of 2002 indicated that a substantial majority (more than 80 percent) of FCS lenders have already incorporated discounted cash flows in their EIR calculations. In addition, a variety of computer-based tools for calculating effective interest rates are readily available in the market place at a reasonable cost.

FCA believes that the complexity of agricultural lending requires a more flexible disclosure approach than provided for under Regulation Z. Therefore, rather than prescribing the exact form and content of disclosure, the proposed rule requires qualified lenders to disclose the EIR and other loan information to borrowers in a form that is easy to read and understand and that the borrower may keep, as long as disclosures are made clearly and conspicuously in writing. However, as discussed above, qualified lenders must establish written policies and procedures regarding disclosure of the EIR and loan information to borrowers and apply the policies and procedures consistently. Each qualified lender must also maintain adequate documentation showing how the lender calculated and disclosed the EIR on each loan.

When a single borrower closes on multiple loans simultaneously and the borrower is required to purchase stock and pay loan origination charges on a per borrower basis, a qualified lender must retain documentation evidencing specific procedures used for assigning costs among the loans in determining the EIR for each particular loan.

To illustrate the determination of an EIR based on discounted cash flows, we have included two examples in Part IV of this preamble.

Section 617.7130—What Initial Disclosures Must a Qualified Lender Make to a Borrower?

(a) *Required disclosures-in general*—To ensure that all essential elements of a loan are disclosed, the information required by existing § 614.4367(a)(1), (3), (4), and (5) are incorporated in proposed § 617.7130(a). Qualified lenders must disclose the following in writing:

- (1) The interest rate on the loan;
- (2) The effective interest rate of the loan;
- (3) The amount of stock or participation certificates that a borrower is required to purchase in connection with the loan and included in the calculation of the effective interest rate of the loan;