

We do not propose to materially alter the required content of the notice. Current and proposed rules require notice of the new interest rate and the effective date of the new rate. In the only change, we eliminated the reference to "standard adjustments factors" and now propose that lenders directly disclose "the factors used to adjust the interest rate on the loan," *e.g.*, spread, index averages, etc., in the notice.

(b) *Notice of increase in stock purchase requirement*—Current § 614.4367(c) requires that each qualified lender "that takes any action which changes the amount of stock or participation certificates which borrowers are required to own and that modifies the effective interest rate" send a notice to borrowers at least 10 days before the effective date of the action. The FCC recommends that the 10-day prior notice be changed to a 30-day post-notice, stating that when there is a stock reduction, the requirement is burdensome to the lender (requiring two mailings, one notice and one forwarding the stock retirement proceeds) and does not materially benefit the borrower (who would not normally decide to refinance because of a stock and effective interest rate reduction).

We agree with FCC that prior notice of a decrease in required stock ownership does not provide any meaningful benefit to borrowers. We also believe that the Act does not require a notice for a decrease in stock ownership requirement. Therefore, the proposed rule does not require any notice for a decrease in stock ownership.

However, we believe that the Act requires a lender to make a new EIR disclosure if it increases a borrower's stock purchase requirement because of the need to show the effect of any "purchases" of stock on the EIR. Ten-day (10-day) prior notice of such a change is necessary to give a borrower the opportunity to refinance using a meaningful comparison of interest rates. Therefore, the proposed rule retains the 10-day prior notice requirement for any required increase in stock ownership and includes the same basic information requirements as the current regulation. This obligation should not create a burden on System lenders since a stock increase is typically applicable to borrowers of new loans rather than applied retroactively to existing borrowers.

Subpart C—Disclosure of Differential Interest Rates

Section 617.7200—What Disclosures Must a Qualified Lender Make to a Borrower on Loans Offered With More Than One Rate of Interest?

Under the Act, qualified lenders that offer loans with differential interest rates must disclose additional information to borrowers at the request of a borrower of a loan. This requirement was implemented by existing § 614.4368, which requires a lender to inform borrowers of their rights when the lender offers more than one rate of interest to borrowers. We rearranged the existing regulation and moved it to the proposed § 617.7200 without changes in substance.

IV. Calculation of the Effective Interest Rate Using a Discounted Cash Flow Method

To illustrate how discounted cash flows can be used in determining a loan's effective interest rate, we developed the following examples using computer spreadsheet software based on a given set of assumptions to determine the cash flow stream in the calculation.

We assumed that the borrower's stock is not retired either as the loan is paid down or at maturity. We also assumed the future cash flow stream consists of a series of annual equal payments for calculation of the effective interest rate.

The amount of a lender's loan disbursement to the borrower is the loan amount reduced by the borrower's payments for borrower stock and loan origination charges, regardless of the form of the payments. However, depending on how the borrower stock and loan origination charges are paid by the borrower in a loan transaction, the amount of the promissory note to be used for calculation of the EIR may be different.

The following examples demonstrate a loan transaction with two different loan disbursement scenarios: Consider a 10-year, \$100,000 loan with a stated interest rate of 9 percent and equal annual payments until maturity. The loan has a \$1,000 stock purchase requirement (the lesser of \$1,000 or 2 percent of the loan amount) and a \$200 loan origination charge. In Example A, we have assumed that the borrower has paid for the stock and fees at the time the loan is disbursed. As a result, the borrower takes a \$100,000 loan but only receives loan proceeds of \$98,800 (\$100,000 loan minus \$1,200 stock and loan origination fee). In example B, we have assumed the borrower has rolled the cost of the stock and loan origination fee into the promissory note.

In order to receive loan proceeds of \$100,000, the borrower needs to take \$101,200 loan.

EXAMPLE A.—LOAN PROCEEDS OF \$98,800 TO BORROWER WITH A PROMISSORY NOTE OF \$100,000

Loan proceeds to borrower	\$98,800
Stock purchase	\$1,000
Origination fee	\$200
Promissory note	\$100,000
Interest rate	9.00%
Term of loan	10 years
Annual payment	\$15,582
Effective interest rate	9.2752%

The initial cash flow we used in determining the EIR includes: (1) The principal of the loan; (2) the amount of stock a borrower is required to purchase; and (3) the amount of loan origination charges a borrower is required to pay.

In computing the effective interest rate, the first step is to determine the cash flow stream for the loan to maturity. The first in the series of cash flows is the loan disbursement or the loan proceeds to the borrower. In Example A, the amount of loan disbursement to the borrower is determined by taking the gross loan amount of \$100,000 minus the stock purchase of \$1,000 and the loan origination fee of \$200 for a total of \$98,800. Thus, the borrower's legal obligation is \$100,000, but the borrower only has the use of \$98,800—this is the present value from which the effective interest rate on the loan is derived.

The remainder of the cash flow stream consists of the annual payments on the loan to maturity. Microsoft Excel's ⁶ Payment (PMT) function was used to calculate the constant payment based on the amount of loan to be repaid (*i.e.*, \$100,000), the interest rate (9 percent), and the number of payments in the loan term (10). The amount of annual level payments derived from these given factors is \$15,582.

Once the cash flow stream has been determined, Excel's Internal Rate of Return (IRR) function is used to calculate the loan's effective interest rate. The effective interest rate for the loan derived from the IRR function is 9.2752 percent ⁷ (based on the initial cash outflow of \$98,800 and a future cash inflow stream consisting of 10 level

⁶ We used Microsoft Excel application software to develop these examples. However, the same results can be achieved using other commercially available software.

⁷ For illustration purposes, the EIR is expressed in four decimal points in our examples. However, the EIR may be expressed with two or more decimal points based on the size, term, and common industry practice for similar loans.