COMPLYING WITH THE TRUTH IN SAVINGS ACT

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Congress passed the Truth in Savings Act\(^1\) in December 1991 as part of the Federal Deposit Insurance Corporation Improvement Act. The purpose of the Act and its related regulations is to provide bank customers with detailed disclosures on the types of savings accounts and methods of computations.

Congress designed the Act to mirror the Truth in Lending Act. Just as the Truth in Lending Act was designed to provide borrowers with detailed disclosures and to some extent define the nature of the disclosures, the Truth in Savings Act was designed to foster uniform disclosures for depositors. The Act states that:

It is the purpose of this chapter to require the clear and uniform disclosure of:
(1) the rates of interest which are payable on deposit accounts by depository institutions; and
(2) the fees that are assessable against deposit accounts, so that customers can make a meaningful comparison between the competing claims of depository institutions with regard to deposit accounts.\(^2\)

The legislative history and debate over the Truth in Savings Act reveals that some members of Congress wanted to end certain bank practices which they found misleading. The final act as passed by Congress includes mandatory methods of disclosures such as formulas to be used in calculating annual percentage yields and restrictions on certain banking practices. Specifically, banks are now prohibited from offering savings accounts that pay interest only on the "investable" amount.

Some commentators criticize the regulations on the basis that the complexity and burden of Truth in Savings Act compliance requirements may lead institutions to offer fewer deposit products and to decrease the yield on deposits to cover additional compliance costs.\(^3\) Such critics point to 1986 survey by the Federal Reserve Board which found that the vast majority of consumers believe that financial institutions were already providing adequate disclosures regarding the terms and conditions of their posit accounts. Only 4 percent of the consumers responding reported a problem relating to their accounts in the five year period preceding the survey with two thirds indicating that it had been resolved satisfactorily.\(^4\)

Congress passed the Truth in Savings Act as part of the Federal Deposit Insurance Corporation Improvement Act of 1991. The Federal Reserve Board published proposed rules to implement the act on April 13, 1992.\(^5\)
In October 1992, Congress then enacted the Housing and Community Development Act which contains three provisions amending the Truth in Savings Act. In accordance with the Housing and Community Development Act, the Federal Reserve Board issued proposed and final regulations implementing the Truth in Savings Act in Regulation DD. Final regulations were published on September 21, 1992 by the Comptroller of the Currency.

In accordance with Congress's desire to delay implementation, the Federal Reserve Board delayed the mandatory compliance date from March 21, 1993 to June 21, 1993. A second provision dealt with a technical correction such that institutions are required to send existing depositors required disclosure notices by June 21, 1993. Another technical clarification exempted a change in terms relating to the charges for check printing fees. The Federal Reserve Board concluded that even though some banks impose a "mark up" on checks printed by third parties for their customers, such changes in check fees do not trigger disclosure notices to customers nor are the check printing fees considered maintenance of activity fees for purpose of the advertising rules. The rules clarified when disclosures must be made for signs that are meant to be seen only by customers within the building as opposed to signs to that billboards or posted for viewing by people outside the institution. And finally, the rule clarified the formulas used for computing annual percentage rates.

**Complying with Truth in Savings Act**

The Truth in Savings Act provides that financial institutions must provide consumers with written disclosure of key terms and conditions of a deposit account when:

- opening an account
- renewing a certificate of deposit
- publication of certain types of advertisements or signs
- receiving certain types of monthly statements
- whenever there are changes in terms of deposits accounts.

The basic disclosure requirement calls for any advertisement, announcement or solicitation to provide in a "clear and conspicuous manner"

1. The annual percentage yield
2. The period during which such annual percentage yield is in effect,
3. All minimum account balance and time requirements which must be met in order to earn the advertised yield (and, in the case of accounts for which more than 1 yield is stated, each annual percentage yield and the account minimum balance requirement associated with each such yield shall be in close proximity and have equal prominence.).
(4) The minimum amount of the initial deposit which is required to open the account in order to obtain the yield advertised, if such minimum amount is greater than the minimum balance necessary to earn the advertised yield.
(5) A statement that regular fees or other conditions could reduce the yield.
(6) A statement that an interest penalty is required for early withdrawal.9

For "on-premises" displays such as signs or posters that are intended to be seen from within the financial institution's building, the disclosures may be limited to the accompanying annual percentage yield and a statement that the consumer should (emphasis is authors') request further information from an employee...10 A sign that is placed behind a teller but facing customers at a small glass enclosed branch can be seen by a passing person would be an exempt indoor sign. All indoor advertisements such as banners, preprinted posters, chalk boards or peg boards are exempt. Both Congress and the Federal Reserve recognized that radio, television and outdoor billboards and lobby boards in a financial institution do not lend themselves to complex disclosures. These types of advertisements do not have to contain the same extensive disclosures that newspaper ads must have.11 Regulation DD extends the exemptions from detailed disclosures even further. Regulation DD eliminates detailed disclosures from advertisements on electronic display boards. Many banks use electronic display boards in front of their facilities.

The Act states that no advertisement, announcement or solicitation made by any depository institution or deposit broker may refer to or describe an account as free or no-cost if there is any minimum balance required to avoid additional fees or the number of transactions during such period exceed a maximum number, or if there is any regular service or transaction fee. The Truth in Savings Act prevents financial institutions from advertising or promoting accounts as "free" or "no-cost" if depositors are subjected to minimum balances, restrictions on withdrawals or any service fee is imposed. This type of disclosure restriction is clearly intended to prevent institutions from advertising savings accounts as no-cost unless there are truly no restrictions or conditions placed on the depositor's funds.

The Act provides that "No advertisement, announcement, or solicitation made by any depository institution or deposit broker may refer to or describe an account as a free or no-cost account (or words of similar meaning) if - (1) in order to avoid fees or service charges for any period - (A) a minimum balance must be maintained in the account during such period; or (B) the number of transactions during such period may not exceed a maximum number; or (2) any regular service or transaction fee is imposed."12
While the Act is primarily a disclosure law, it does specifically prohibit financial institutions from paying interest on the "investable balance" of a deposit account. Some financial institutions paid interest on the account balance less any portion against which they were required to hold non-interest-bearing reserves in a Federal Reserve Bank. While these institutions might advertise their interest rates as the same as other institutions who did not use this method of computation, depositors were not receiving the same yield. For example, an institution that was using this investable balance method that had a five percent reserve requirement would only pay interest on 95 percent of the balance of a depositor's account in comparison with an account offering the same interest rate might be paying on 100% of the value of the depositor's account. The effective yield between the two accounts would be different even though their advertised rates were different. Consumer groups testified that this practice was deceptive and Congress responded with a ban on that practice.\textsuperscript{13}

**Account Schedule Disclosure**

Institutions are required to provide a schedule of disclosures either upon request, to a potential customer before an account is opened or a service is rendered; or 30 days prior to the maturity of an automatically renewable time deposit.\textsuperscript{14}

The account schedule is a schedule of fees, charges, interest rates, and terms and condition applicable to each class of accounts offered by the depository institution. The account schedule should include the following information:

1. Any annual percentage yield.
2. The period during which any such annual percentage yield will be in effect.
3. Any annual rate of simple interest.
4. The frequency with which interest will be compounded and credited.
5. A clear description of the method used to determine the balance on which interest is paid.\textsuperscript{15}

If the financial institution offers accounts requiring minimum balances to earn the rates or yields advertised, or if they impose minimum time requirements, or any provisions that any interest which has accrued but has not been credited to an account at the time of a withdrawal from the account will not be paid due to a withdrawal, then these conditions must be reflected in the account schedule. The most significant disclosure is the requirement to compute the Annual Percentage Yield or APY. The APY disclosure is required for all accounts including:

* Accounts where the annual rate of interest is guaranteed for less than one year.
* Variable interest rate accounts;
* Accounts which do not guarantee payment of a stated rate.
* Multiple rate accounts
* Accounts where the determination of annual percentage yield is based on an annual rate of interest that is guaranteed for a stated term.\textsuperscript{16}

Most significant is the requirement to disclose the annual percentage yield on interest bearing accounts. Financial institutions offering interest-bearing checking accounts will be required to show the effective annual percentage yield on monthly statements.\textsuperscript{17}

**Computation of APR When Reporting Period is Shorter than the Compounding Period**

Regulation DD prescribes a formula for computing Annual Percentage Yield when the reporting period is shorter than the compounding period. This is a reasonably common occurrence since most banks issues monthly statements but may only compound on a quarterly basis.

For example, let's assume the bank offers an annual compounded rate of five percent but issues monthly statements. To obtain the daily rate of compounding, take the interest rate 5 percent divided by 365. With $1,000 balance you will have earned approximately 13.6 cents per day. If you add 13.6 cents at 365 days, you will have earned $50.00. However banks actually calculate interest earned on compounded daily basis. So that at the end of the month the statement would show $4.11 as opposed the actual earnings which would be 1/12th of fifty dollars or $4.166. Under compounding, at the beginning of the period you are understating the interest earned as opposed to the end of the period in which daily compounding would achieve a higher rate of return.

Regulation DD commentary explains that "institutions that use the daily balance method to accrue interest noted that if a periodic statement is sent more frequently than the period for which interest is compounded, the annual percentage yield earned could be higher than the annual percentage yield provided in advertisements and opening account disclosures."

If an institution pays 5% interest rate and compounds annually, it would disclose an annual percentage yield of 5.00% in its advertisements and initial account disclosures. However, under the general annual percentage yield earned formula, the institution would show $4.11 of interest accrued on $1,000 of principal on a monthly periodic statement reflecting 30 days, and an annual percentage yield earned of 5.12% on that statement.\textsuperscript{18}

Regulation DD prescribes a special formula designed to reflect the actual annual percentage yield. The special formula for APY is used when the reporting period is shorter than the compounding period. The special formula for APY is: the interest
earned divided by the balance which in turn is divided by the days in the period of that statement multiplied times the compounding period expressed in the same manner as the statement period. If you are in days in the statement period, one would use days in the compounding statement. This expression plus one is raised to the power that is the relationship of 365 divided by the number of days in the compounding period. The result is multiplied times 100. This product minus one gives you the annual percentage yield.

Financial institutions are now required to use the special APY formula for any situation where the bank sends an interim statement then the interest is calculated on a period that is less than that which the interest rate is compounded.\textsuperscript{19}

\textbf{Liability for Failure to Comply with Truth in Savings Disclosures}

Financial institutions that fail to comply with the provisions are subject to civil liability including class action damages. An account holder may sue for any actual damage sustained as a result of the failure plus an amount to be determined by the court that is no less than $100 nor greater than $1,000.\textsuperscript{20} In the case of a class action, the class may receive their actual damages plus any amount from zero to $1,000 per account holder with a maximum limitation of the lesser of $500,000 or one percent of the net worth of the depository institution.\textsuperscript{21} The real cost may well be the award of attorney fees for the winning plaintiff. Truth in Savings Act dictates that a court shall consider the following factors in determining the amount of the award in any class action:

(1) the amount of any actual damages awarded
(2) the frequency and persistence of failures of compliance
(3) the resources of the depository institution
(4) the number of persons adversely affected
(5) the extent to which the failure of compliance was intentional.\textsuperscript{22}

\textbf{Analysis of Cost versus Benefit}

The purpose of the Truth in Savings Act is to protect the "consumer" depositor through uniform disclosures provided through detailed Schedule of Fees and posted Annual Percent Yield rates. The immediate cost to financial institutions consists of the cost of modifying existing signs, advertisements, pamphlets or disclosure statements to conform to regulations. Periodic reports to customers may have to be redesigned by institutions who used to offer accounts where interest was only paid on investable amounts. Longer term costs of the regulations and required disclosures may result in dampening the offering of new depository contracts only because each new form of depository arrangement would necessitate a new printing of disclosures. Secondly, the
ban on paying interest on only the investable amounts is a slight shift to uniformity of investment products by depository institutions.

In testimony to Congress, Martha R. Seger, Member of the Board of Governors of the Federal Reserve System stated:

Because of our experience with these recent laws—as well as with numerous other consumer statutes for which we have rule-writing authority—we know firsthand that simple concepts invariably result in complex regulations. For example, the concepts of improved funds availability and uniform consumer deposit disclosures appeared to be simple and straightforward. Yet, as history has shown, to encompass the diversity of business practices and products among financial institutions, the implementing regulations of necessity are intricate and voluminous. Moreover, we have learned that even rules that are not designed to affect the number of diversity of products—such as simple disclosure requirements—may have the practical effect of standardizing products. If fewer options are available, consumer may be deprived of the benefits of variety. ...\(^2\)

Third, the requirement to provide written disclosures on a frequent basis to new customers, etc. will require some additional training of bank personnel. And fourth, the regulations certainly necessitate legal review of changes in time instruments or depository contracts.

One way to measure the benefit of improved disclosures based on Annual Percentage Yield is to simply calculate the difference between the interest earned on an account with semi-annual versus hourly compounding of interest. Since this statute was clearly designed to protect the small investor, we illustrate the benefit by computing the effective yield on $1,000 deposited in an account that is paid annually compared with an account that is compounded hourly. The total interest on $1,000 invested in an account paying 5 percent compounded semi-annually is $50.62. Five percent compounded hourly on a $1,000 is $51.27. The difference on $1,000 compounded hourly and compounded semi-annually is 65 cents. On the national debt, this difference would be significant. However, Congress passed the Act to protect the small depositor, not the institutional bond traders.

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1 12 U.S.C.A. Section 4301...
2 12 U.S.C.A. Section 4301 (b).
4 Ibid.
6 106 Stat.3672.
9 12 U.S.C.A. Section 4302.
10 Ibid.
12 12 U.S.C.A. Section 4302(d).
13 12 U.S.C.A. Section 4301 ...
14 12 U.S.C.A. Section 4305.
15 12 U.S.C.A. Section 4304(c).
16 12 U.S.C.A. Section 4304
18 57 Fed. Reg. 15082 which is Appendix A to Part 230..
19 Ibid.
20 12 U.S.C.A. Section 4310.
21 Ibid.
22 Ibid.