(iii) The horses have not been bred by or bred to any horses from an affected premises; and

(iv) The horses have had no other contact with horses that have been found to be affected with CEM or with horses that were imported from countries affected with CEM.

(b) If a horse is presented for importation from a country where it has been for less than 60 days, the horse must be accompanied by a certificate that meets the requirements of paragraph (a) of this section that has been issued by a salaried veterinary officer of the national government of each country in which the horse has been during the 60 days immediately preceding its shipment to the United States. The dates during which the horse was in each country during the 60 days immediately preceding its exportation to the United States shall be included as a part of the certification.

(c) Following the port-of-entry inspection required by § 92.306 of this part, and before a horse offered for importation from any part of the world is released from the port of entry, an inspector may require the horse and its accompanying equipment to be disinfected as a precautionary measure against the introduction of foot-and-mouth disease or any other disease dangerous to the livestock of the United States.

9. Preceding § 92.315, in the undesignated center heading ''CANADA[18]'', footnote 18 and its reference are redesignated as footnote 16.

10. Preceding § 92.319, in the undesignated center heading ''COUNTRIES OF CENTRAL AMERICA AND WEST INDIES[19]'', footnote 19 and its reference are redesignated as footnote 17.

11. Preceding § 92.321, in the undesignated center heading ''MEXICO[20]'', footnote 20 and its reference are redesignated as footnote 18.

§ 92.324 [Amended]

12. In § 92.324, in the third sentence, footnote 21 and its reference in the text are redesignated as footnote 19.

Done in Washington, DC, this 2nd day of October 1996.

A. Strating,

Acting Administrator, Animal and Plant Health Inspection Service.

[FR Doc. 96–25639 Filed 10–04–96; 8:45 am]

BILLING CODE 3410–34–P

FEDERAL RESERVE SYSTEM

12 CFR Part 213

[Regulation M; Docket No. R–0892]

Consumer Leasing

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is publishing a final rule to amend Regulation M, which implements the Consumer Leasing Act. The Act requires lessors to provide uniform cost and other disclosures about consumer lease transactions. The Board has reviewed Regulation M, pursuant to its policy of periodically reviewing its regulations, and has revised the regulation to carry out more effectively the purposes of the Act. The final rule adds disclosures, primarily in connection with motor vehicle leasing, including, for example, disclosures about early termination charges and how scheduled payments are derived (which requires disclosure of such items as the gross capitalized cost of a lease, the vehicle's residual value, the rent charge, and depreciation). General changes in the format of the disclosures require that certain leasing disclosures be segregated from other information. Revisions to the advertising provisions implement a statutory amendment, allowing a toll-free number to substitute for certain disclosures in radio and television advertisements, and make other changes to the advertising rules. A lessor is not required to disclose the cost of a lease expressed as a percentage rate; however, if a rate is disclosed or advertised, a special notice must accompany the rate. Further, a rate in an advertisement cannot be more prominent than any other Regulation M disclosure.

DATES: Effective date. October 31, 1996. *Compliance date.* Compliance is optional until October 1, 1997.

FOR FURTHER INFORMATION CONTACT: Kyung H. Cho-Miller, Obrea O. Poindexter, or W. Kurt Schumacher, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452–2412 or 452–3667. For matters concerning the Regulatory Flexibility Analysis, in appendix I, contact Thomas A. Durkin, Office of the Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452–2326. Users of Telecommunications Device for the Deaf *only* may contact Dorothea Thompson, at (202) 452–3544.

SUPPLEMENTARY INFORMATION:

I. Background on the Consumer Leasing Act and Regulation M

The Consumer Leasing Act (CLA), 15 U.S.C. 1667–1667e, was enacted into law in 1976 as an amendment to the Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.* The Board was given rulewriting authority, and its Regulation M (12 CFR Part 213) implements the CLA. An official staff commentary interprets the regulation. (Supplement I to 12 CFR 213).

The CLA generally applies to consumer leases of personal property in which the contractual obligation does not exceed $25,000 and has a term of more than four months. An automobile lease is the most common type of consumer lease covered by the act. Leases accounted for about one-third of all passenger car deliveries to consumers in 1995. Leasing in the luxury-car market is estimated to account for more than 70 percent for some models. Used cars are also now being leased, although to date they account for a relatively small segment of the market.

Under the statute, prior to entering into a lease agreement, lessors must give consumers 15 to 20 disclosures, including the amount of initial, end-of-lease, and other charges to be paid by the consumer (such as security deposits, insurance premiums, disposition fees, and taxes); an identification of the leased property; a payment schedule; the responsibilities for maintaining the leased property; and the liability for terminating a lease early. Special provisions apply to open-end leases. These provisions regulate balloon payments by limiting liability at the end of a lease term to no more than three times the monthly payment, and also require several disclosures unique to open-end leases (in §§ 213.4 (k) and (m)).

Open-end leases are a very small segment of the consumer leasing market. In open-end leases, the consumer's liability at the end of the lease term is based on the difference between the residual value of the leased property and its realized value. The consumer—not the lessor—assumes the risk that the realized value may be less than what was initially estimated. Closed-end leases are the most common type of lease covered under the CLA and Regulation M. These leases are sometimes referred to as ''walk-away'' leases because the consumer is not liable for the difference between the residual and the realized values at the end of the lease term.

II. The Review of Regulation M

The Board's Regulatory Planning and Review Program calls for the periodic review of a regulation with four goals in mind: to clarify and simplify regulatory language; to determine whether regulatory amendments are needed to address technological and other developments; to reduce undue regulatory burden on the industry; and to delete obsolete provisions.

Advance Notice of Proposed Rulemaking. The Board began its review of Regulation M—the first substantial review of the regulation since it was issued in 1976—by publishing an advance notice of proposed rulemaking on November 19, 1993 (58 FR 61035). Although comment was solicited generally on all provisions of the regulation, the Board specifically sought comment on three issues: disclosure of early termination charges, broadcast media advertising of leases, and segregation of leasing disclosures from other information. Most of the 70 comment letters that were received commented only on the three issues addressed in the advance notice. The comment letters were received mostly from automobile lessors or their representatives, but also from federal and state government agencies and from consumer representatives. Most of the commenters supported revisions to the disclosures about early termination charges either to better alert consumers about such charges or to address concerns about lender liability associated with providing extremely complex disclosures about these charges. Some commenters supported more flexibility in the advertising rules, while others expressed concern about the manner in which leases are advertised. Many supported segregation of leasing disclosures from other information. In addition, many commenters urged the Board to mandate the disclosure of the ''capitalized cost'' of a lease, meaning the value of the leased vehicle and other items that are capitalized by agreement between the lessor and lessee.

The Proposed Rule to Revise Regulation M. The Board published a proposed rule to substantially revise Regulation M on September 20, 1995 (60 FR 48752) and an extension of comment period notice was published on December 6, 1995 (60 FR 62349). The proposal offered a new disclosure format for model forms and some substantive changes to the regulation. New disclosures were proposed pursuant to the Board's authority under § 105(a) of the TILA. Section 105(a) of the TILA provides that the Board's regulations ''may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the CLA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith.''

The proposal contained the following proposed amendments to Regulation M:

Segregation of certain leasing disclosures. (Leasing disclosures were dispersed throughout a leasing contract.) Additionally, a statement would remind consumers to read their contracts for other important consumer leasing disclosures not included in the segregated disclosures.

Revision of the disclosure of upfront fees to make it easier for a consumer to understand the amounts to be paid and how they are allocated, including the amount of any trade-in allowance.

Disclosure of the ''gross cost'' (the agreed upon acquisition value of leased property) and the ''residual value'' (the estimated value at the end of the lease term).

Disclosure of an ''estimated lease charge,'' a figure similar in purpose to the finance charge in a credit transaction.

Disclosures about early termination charges—including a transaction-specific example of such a charge at an assumed termination point after one year—and about charges for excessive wear of leased property.

Changes to the advertising rules to implement a statutory amendment, simplify disclosure requirements, and deter misleading advertising.

About 150 comment letters were received on the Board's proposed rule, from consumer representatives involved in leasing issues and a large segment of the consumer leasing industry. A majority of the commenters generally supported the requirement that certain disclosures be segregated from the remaining disclosures and other information. Major industry representatives expressed concern, however, about the overall disclosure format and offered an alternative that presented some disclosures in a mathematical progression. Commenters generally supported additional disclosures but many of them suggested modifications to the Board's proposed definition of the estimated lease charge and the gross cost. While many commenters favored an early termination warning about charges for terminating a lease early, a large majority of them opposed the requirement of a transaction-specific numerical example for early termination.

To get direct feedback from individual consumers, in January 1996 the Board conducted four focus groups, two in the Washington, D.C. area and two in Los Angeles, California. Participants gave their opinions on various disclosure formats, including the Board's proposed model form, an alternative form showing a mathematical progression of how periodic payments are derived, and a format in which a few disclosures would be highlighted in boxes. There were a total of 32 participants (evenly representing men and women), about a quarter of whom had previously leased automobiles.

While focus group participants had some concerns about the layout and language in the disclosure statements presented, they responded more favorably to the mathematical progression format than to the Board's proposal. Some participants liked the payment calculation disclosure because it ''walked you through the process.'' Many of them were generally familiar with the highlighting of certain disclosures in credit transactions. For lease transactions, they expressed an interest in seeing the value of the car, the total due at lease signing, and the monthly payments highlighted.

The Final Rule Amending Regulation M. The final rule includes most of the disclosures to supplement the act that were contained in the proposed rule. The major changes primarily affect motor vehicle leasing. They include a mathematical progression on how the periodic payment is derived (using figures such as the gross capitalized cost, residual value, amount of depreciation and amortized amounts) and a warning statement about charges for terminating a lease early. Certain leasing disclosures must be segregated from other information.

The final rule contains revisions to the advertising provisions, including the implementation of a statutory amendment. The statute allows a toll-free number or a print advertisement to substitute for certain lease disclosures in radio commercials, and the final rule expands the application of this provision to television.

The Board had expressly solicited comment in the proposal about whether the regulation should require the disclosure of a lease rate. Under the final rule, a lessor is not required to disclose the cost of a lease expressed as a percentage rate. If a rate is disclosed or advertised, a notice must accompany the rate stating that the percentage may not measure the overall cost of financing the lease transaction. Also, in the case

of advertising, a rate cannot be more prominent than any other Regulation M disclosure.

Other changes have been made to clarify and update the regulation. Obsolete provisions have been deleted, and generally footnotes have been moved to the regulatory text or to the Official Staff Commentary to Regulation M.

The final rule contains the following major amendments to Regulation M:

A revised disclosure format.

A total of payments disclosure.

An itemization that shows the mathematical progression used to derive the periodic payment.

A strong narrative warning about the possibility of substantial charges for early termination.

A notice to accompany any percentage rate (to indicate the limitations of rate information).

Implementation of a statutory amendment for certain broadcast advertisements and other changes to the advertising rules.

Official Staff Commentary. When the Board published the proposed revisions to Regulation M for public comment, it also published proposed revisions to the Official Staff Commentary on September 20, 1995 (60 FR 48769). The Board will publish an updated proposal to the commentary in mid-November 1996. The proposal will include material that was published for comment in September 1995, incorporate guidance contained in the section-by-section discussion that accompanies this final rule, and address other questions that may be brought to the Board's attention following the public's review of the final rule.

III. Recommendations for Legislative Changes

In addition to seeking comment on the proposed regulatory changes, the Board's September 1995 notice solicited views on whether specific legislative revisions to the CLA may also be warranted. A few commenters suggested that CLA coverage be expanded to cover leases that exceed the current $25,000 cap, given the higher cost of automobiles.

IV. Effective Date

This final rule is effective October 31, 1996, but compliance is optional until October 1, 1997. The mandatory effective date is designated by section 105(d) of the act, which states that any regulation promulgated by the Board is effective October 1 of a given year, provided the rule was published at least six months in advance.

V. Section-by-Section Discussion of the Final Rule

The following discussion covers the revisions section-by-section. Changes that are self-evident, and text that has been simplified or clarified without substantive change, are generally not discussed. Captions have been added to each paragraph, to conform with current Board style; the addition or wording of captions alone is not meant as a substantive change in the meaning of the paragraph itself.

Section 213.1 Authority, Scope, Purpose, and Enforcement

Former paragraph 1(d) on the issuance of staff interpretations has been moved to appendix C.

1(b) Scope and Purpose

An introductory sentence has been added to state the scope of the law. This paragraph has been revised to more closely parallel the purpose clauses in § 102 of the TILA.

Section 213.2 Definitions

Certain definitions are redesignated or added as indicated below. Former section 213.2(b)—the rules of construction—has been deleted except that former paragraph 2(b)(1) has been moved to paragraph 2(e)(1) of this section. Former § 213.3—exempt transactions—has been moved to paragraph 2(e)(3) of this section.

Definition	Final rule
"Act" in former 213.2(a)(1).	213.2(a).
"Advertisement" in former 213.2(a)(2).	213.2(b); examples moved to commentary.
"Agricultural purpose" in former 213.2(a)(3).	Moved to commentary.
"Arrange for lease of personal property". in former 213.2(a)(4).	Moved to commentary.
"Board" in former 213.2(a)(5).	213.2(c).
"Closed-end lease" ...	213.2(d) new.
"Consumer lease" in former 213.2(a)(6).	213.2(e).
"Gross capitalized cost".	213.2(f) new.
"Lessee" in former 213.2(a)(7).	213.2(g).
"Lessor" in former 213.2(a)(8).	213.2(h).
"Open-end lease"	213.2(i) new.
"Organization" in former 213.2(a)(9).	213.2(j).
"Period" in former 213.2(a)(10).	Deleted as unnecessary.
"Person" in former 213.2(a)(11).	213.2(k).
"Personal property" in former 213.2(a)(12).	213.2(l).
"Real property" in former 213.2(a)(13).	Deleted as unnecessary.
"Realized value" in former 213.2(a)(14).	213.2(m).
"Residual value"	213.2(n) new.
"Security interest" in former 213.2(a)(15).	213.2(o); examples of security interests moved to the commentary.
"State" in former 213.2(a)(16).	213.2(p).
"Total lease obligation" in former 213.2(a)(17).	Deleted as unnecessary; open-end and closed-end terminology conformed.
"Value at consummation" in former 213.2(a)(18).	Deleted as unnecessary; open-end and closed-end terminology conformed.

2(b) Advertisement.

The definition of advertisement is simplified and the examples have been moved to the commentary. The definition of advertisement is broad, covering commercial messages in any medium, including electronic media such as the Internet, that directly or indirectly promote a lease transaction.

2(d) Closed-end lease.

A definition of a closed-end lease has been added, modeled after the definition of closed-end credit in Regulation Z (12 CFR § 226.2(a)(10)). The term covers any lease that does not fall within the definition of an open-end lease. Commenters generally favored having definitions of open- and closed-end leases.

2(e) Consumer lease.

The paragraph has been reorganized. The rule of construction in former § 213.2(b)(1) has been moved to paragraph (e)(1). Transactions not included in the definition of consumer lease are now in paragraph (e)(2). Former section § 213.3 on exempt transactions is now paragraph (e)(3). The term contractual obligation excludes refundable and ''pass-through'' amounts a lessee is obligated to pay. For example, the total contractual obligation does not include license and registration fees and taxes. It also does not include the residual value.

2(f) Gross capitalized cost.

A definition of gross capitalized cost has been added to this section. Only items capitalized or amortized by the lessor are included in this figure. The Board's proposal had contained a broader definition using the term gross cost. Commenters favored a narrower definition. Definitions of the related terms capitalized cost reduction and

adjusted capitalized cost have also been added to this section. The supplementary information to § 213.4(f)(1) provides a discussion of these terms and further discussion about the gross capitalized cost, including the disclosure of the agreed upon value.

2(h) Lessor.

The definition of lessor incorporates a numerical test similar to the test in Regulation Z for defining a creditor (see footnote 3 to 12 CFR 226.2(a)(17)). Commenters generally supported the revision. The phrase ''in the ordinary course of business'' has been omitted as unnecessary.

2(i) Open-end lease.

A definition of an open-end lease has been added. Disclosures in §§ 213.4(k) and (m) and § 213.7(d)(2)(vi) are only relevant to open-end leases.

2(n) Residual value.

A definition of residual value has been added. Many commenters urged the Board to clarify that the residual value is the lessor's assigned value of the vehicle used to calculate the lessee's monthly payments, and not necessarily a projection of the value of the car. Several lessors noted that often a value is assigned to accommodate promotional campaigns of a manufacturer. The final rule has a revised definition in accordance with these comments.

Section 213.3 General disclosure requirements.

The following sections are redesignated or added as indicated below:

Former	Final rule
213.4(a)(1)	213.3(a)(1).
213.4(a)(2)	213.3(a)(1); 3(a)(3). 213.3(a)(2) new.
213.4(a)(3)	213.3(a)(1).
213.4(a)(4)	213.3(a)(4).
213.4(b)	213.3(b).
213.4(c)	213.3(c).
213.4(d)	213.3(d).
213.4(e)	213.3(e).
213.4(f)	213.3(f).

Paragraph 3(a) contains general rules about the disclosures required under § 213.4, including the form, content, and timing of disclosures. Paragraph 3(f) on minor variations includes former comment 4(a)–2. The major revision to this section, discussed under paragraph 3(a)(2), is the requirement to segregate certain disclosures from other information. Clear and conspicuous lease disclosures must be given prior to consummation of a lease on a dated written statement that identifies the lessor and lessee.

3(a) *General requirements.*

Based on comments and to provide a standard consistent with that of other consumer regulations, the Board has added language requiring that disclosures be given in a form the consumer may keep.

3(a)(1) *Form of disclosures.*

Former §§ 213.4(a)(1) and 4(a)(2) required that all disclosures be made together on a separate statement or in the lease contract ''above the place for the lessee's signature.'' The Board has deleted this requirement along with the meaningful sequence, same-page, and type-size disclosure requirements, replacing them with the requirement that disclosures be segregated. Most commenters generally supported the proposed segregation requirement, although some commenters opposed the deletion of the other requirements. They believed that the signature requirement ensured that lessors would give disclosures before the consumer becomes obligated on the lease and discouraged lessors from putting important information on the back of a lease document. The Board believes that a segregation requirement and the clear and conspicuous standard provide the same level of protection as the previous rules.

The segregated disclosures and other CLA disclosures must be given to a consumer at the same time. Lessors must continue to ensure that the disclosures are given to lessees before the lessee becomes obligated on the lease transaction. For example, by placing disclosures that are included in the lease documents above the lessee's signature, or by including instructions alerting a lessee to read the disclosures prior to signing the lease.

Nonsegregated disclosures need not all be on the same page, but should be presented in a way that does not obscure the relationship of the terms to each other.

3(a)(2) *Segregation of certain disclosures.*

Most commenters—representing both the industry and consumer groups—generally supported some form of segregation of leasing disclosures. Many commenters believed that consumers would be more likely to read and understand the disclosures if key items were segregated from other disclosures and contract terms. Pursuant to its authority under section 105(a) of the TILA, the Board has adopted the requirement that certain consumer leasing disclosures be segregated from other required disclosures and from general contract terms to assure clear, conspicuous, and meaningful disclosure of lease terms.

Some commenters, including trade groups that represent a large portion of the motor vehicle leasing industry, suggested that the more important disclosures be further highlighted in a manner similar to the Board's Regulation Z. The Board believes that the segregation requirement and the requirement that disclosures be in a form substantially similar to the applicable model form in appendix A adequately focuses the consumer's attention on key information.

Lessors may provide the segregated disclosures on a separate document or may include them in their lease contracts, apart from other information. The general content, format, and headings for these disclosures should be substantially similar to those contained in the model forms in appendix A. Lessors may continue to provide the remaining disclosures required by Regulation M and the CLA in a nonsegregated format.

The model forms in Appendix A for open-end leases, closed-end leases, and furniture leases have been revised.

3(a)(4) *Language of disclosures.*

Under former § 213.4(a)(4), lease disclosures had to be provided in English, except in the Commonwealth of Puerto Rico, where they could be given in Spanish. The final rule revises this position. Lessors are permitted to give disclosures in another language as long as disclosures in English are given upon request. The Board believes that a more permissive rule promotes a more meaningful delivery of disclosures to consumers.

3(b) *Additional information; nonsegregated disclosures.*

Former § 213.4(b) permitted additional information to be included with any disclosures required by the regulation. The Board proposed to permit additional information only with the nonsegregated disclosures. Some commenters believed that the Board should permit the inclusion of state-required disclosures among the federally-required segregated disclosures. The Board believes that the purpose of segregating disclosures could be diluted if additional information is permitted among them. The final rule permits additional information only with the nonsegregated CLA leasing disclosures.

Former §§ 213.4(b)(1) and 4(b)(2) on inconsistent disclosures have been

deleted. Pursuant to § 186(a) of the CLA, § 213.9 addresses the preemption of state law if information required by state law is inconsistent with the requirements of the act or regulation.

3(c) *Multiple lessors or lessees.*

Paragraph 3(c) provides that when a transaction involves multiple lessors, one lessor may make the disclosures on behalf of all of them. The phrase ''and the one that discloses shall be the one chosen by the lessors'' has been deleted as unnecessary. No substantive change is intended.

3(d) *Use of estimates.*

Former § 213.4(d) on the use of estimated disclosures has been redesignated and simplified as paragraph 3(d). The last sentence of the former paragraph has been deleted as unnecessary.

3(e) *Effect of subsequent occurrence.*

The rule in paragraph 3(e), previously stated in former § 213.4(e), has been revised to add a reference to consummation, to clarify that this rule is limited to events occurring after consummation of a lease. Footnote 1 of the former regulation, containing a specific example of a subsequent occurrence, has been moved to the commentary except for the second sentence, which has been deleted as unnecessary.

3(f) *Minor variations.*

Paragraph 3(f) incorporates into the regulation the rules on minor variations that may be disregarded in making disclosures, including provisions formerly contained in comment 4(a)-2 of the staff commentary.

Section 213.4 Content of disclosures.

Although the regulation applies to leases of all types of personal property such as furniture, much of the focus of the Board's review under the Regulatory Planning and Review Program has been on motor vehicle leasing. Because the regulatory issues have arisen in this context, the final rule limits some of the new disclosure, formatting, and advertising requirements to leases for motor vehicles. This section has been reorganized essentially to follow the progression of disclosures in the model forms as follows:

Former	Final rule
213.4(g)(1)	213.4(a).
213.4(g)(2)	213.4(b).
213.4(g)(3)	213.4(c).
213.4(g)(4)	213.4(n).
213.4(g)(5)	213.4(d).
213.4(g)(6)	213.4(o).
213.4(g)(7)	213.4(p).
213.4(g)(8)	213.4(h); 4(h)(3) new.
213.4(g)(9)	213.4(r).
213.4(g)(10)	213.4(q).
213.4(g)(11)	213.4(i).
213.4(g)(12)	213.4(g); 4(g)(2) new.
213.4(g)(13)	213.4(k).
213.4(g)(14)	213.4(l).
213.4(g)(15)	213.4(m).
	213.4(e) new.
	213.4(f) new.
	213.4(j) new.
	213.4(s) new.

4(b) *Amount due at lease signing.*

Paragraph 4(b) requires lessors to disclose to consumers the total amount of any payment due at lease signing (consummation of the lease). The Board has adopted several revisions to this paragraph. The revised language provides that the total amount of payments due at lease signing must be itemized by amount as well as by type and included among the segregated disclosures under the heading ''amount due at lease signing.'' Previously, the lessor was required to itemize these charges by type but not by amount. Also, to enhance consumer understanding of the transaction, the lessor is required to itemize by type and amount ''how the amount due at lease signing will be paid,'' which typically includes any net trade-in allowance, rebate, noncash credits, and payments in cash. (See the model forms in appendix A for format.) The Board believes that the standardization of terminology and the full itemization of the amounts due and means of payment provide consumer benefit without imposing substantial compliance costs on lessors.

Commenters supported the proposal in substance. Most of the commenters supporting the proposal believed that the proposed side-by-side format would discourage unscrupulous lessors from failing to credit a lessee's downpayment or trade-in. Some industry representatives offered an alternative format using only one column to present the disclosure, in place of the ''balance sheet'' approach. Upon further analysis, the Board believes that the balance sheet approach, in which the two columns equal one another, is appropriate to ensure that the amounts of trade-ins, rebates, and cash payments are used to reduce the total amount due at lease signing.

Some commenters asked whether a rebate that is subtracted from the value of the vehicle in arriving at the gross capitalized cost needs to be disclosed and itemized under this paragraph. They also inquired about ''negative trade-ins.'' A rebate would be included in the itemization under this section only when it is applied against the amount due at lease signing. Also, where the amount owed on a prior loan or lease exceeds an agreed-upon trade-in value, the difference is reflected in the gross capitalized cost, and no trade in allowance would be reflected under the column ''how the amount due at lease signing is paid.''

4(d) *Other Charges*

In addition to the periodic payment, the regulation requires disclosure of a total of other charges and an itemization by type and amount, payable during and at the end of the lease term. The model forms include examples of such fees—for example, an annual tax and a disposition fee at the end of the lease term.

4(e) *Total of payments*

The Board adopted this disclosure to serve as a tool for comparing leases that involve the same or similar types of leased properties for the same lease duration. As the disclosure includes all payments the consumer is obligated to make under the lease, it is not meant to reflect the cost of financing the lease transaction.

This disclosure, accompanied by the statement ''the amount you will have paid by the end of the lease,'' is the net sum of the amount due at lease signing (excluding refundable amounts such as the security deposit), the total of periodic payments (excluding the first periodic payment, if paid at lease signing), and other charges are not part of the periodic payments (such as a disposition fee). An additional disclosure is required for open-end leases because, with some limitations, consumers are liable for the difference between the residual and realized values of the leased property.

4(f) *Payment calculation*

Many commenters on the Board's proposed rule expressed concern that the revised format of the Board's model disclosure form did not present information in a manner that would allow consumers to understand the relationship of lease terms such as the ''gross cost'' and the ''residual value'' of a lease. Representatives of major automobile leasing companies offered an alternative format, one that shows how the periodic payments are derived. They said that such a disclosure scheme would result in better consumer understanding of a lease transaction and would enable consumers to verify their periodic payment. These commenters

also noted that the disclosure would impose little additional compliance burden as lessors make this calculation in setting up a lease transaction.

The Board believes that a mathematical progression itemizing the components of the periodic payment is valuable to consumers. It enables consumers to see several of the newly required disclosures in the context of the calculation, thereby enhancing the consumer's understanding of the particular disclosures. Also, it allows consumers to verify their periodic payment amount.

The CLA does not call for a payment calculation, but based on the comments and on further analysis, the Board is exercising its rulemaking authority under § 105(a) of the TILA to require the disclosure of the amounts comprising the periodic payment, in motor vehicle leases, in a manner substantially similar to the model leasing forms in appendix A. The payment calculation utilizes several disclosures from the proposal; it requires the modification of others that were proposed, and adds new ones, as discussed below.

4(f)(1) *Gross capitalized cost*

In the past, federal law has not required disclosure of information on the base price of the leased property in closed-end leases. Because this figure has not typically been given, consumers often have assumed that the lease is based on the manufacturer's suggested retail price (MSRP), or on a sales price negotiated by the consumer (who might have initially contemplated financing or paying cash for the vehicle). If the lessor uses a different starting price in the lease payment computation, one that is higher than either the MSRP or the negotiated figure, the consumer would be unaware of that fact, and thus would not be aware that perhaps the periodic payment could be lower.

The Board's proposal would have required disclosure of the ''gross cost'' among the segregated disclosures. This disclosure would have been applicable only to closed-end leases, given that the regulation already required the disclosure of a comparable term—the ''value at consummation (the initial value)''—in open-end leases. Under the proposal, the Board would have defined the gross cost as ''the total dollar amount of all items included in the value of a lease at consummation.''

A large majority of the commenters supported the disclosure of the base price of the leased property in closed-end leases, in one form or another. However, many of the industry commenters strongly objected to using the term ''gross cost'' and objected also to the items that would be included in the definition. Most of these commenters recommended that the term be changed from ''gross cost'' to either ''gross capitalized cost'' or ''capitalized cost'' to conform with state law (as several states now require the disclosure of this figure) and also to conform with industry practice. Trade associations that represent a large segment of the industry have encouraged their members to voluntarily disclose the ''capitalized cost,'' and some lessors have been doing so. Industry commenters suggested that the term ''capitalized cost'' has gained a certain amount of acceptance from consumers. Finally, both leasing representatives and consumer interest groups believed that the disclosed figure should reflect only the amounts that are *capitalized* by the lessor (such as the price of the leased property on which the lease is based); and, in particular, believed that it should not include amounts that are paid at lease signing by the consumer.

In response to the comments and upon further analysis, the Board has modified the final rule to require the disclosure of the ''gross capitalized cost,'' using that term, in both closed-end and open-end motor vehicle leases. Only items capitalized or amortized by the lessor are to be included. The gross capitalized cost is readily available to lessors from worksheets they use in setting the terms and conditions of the lease, and hence the Board believes that this disclosure requirement will not be unduly burdensome for lessors.

Some commenters representing consumer interests asked that the capitalized cost figure be itemized to give the consumer a clear picture of the base price of the leased automobile and other amounts being financed, such as an outstanding balance from a prior loan or lease. They suggested that without a breakdown, consumers could easily misunderstand what is included or excluded from the capitalized cost disclosure. A few industry commenters believed that disclosing an itemization would be burdensome for lessors; they also believed an itemization would have to be quite detailed to provide adequate guidance to lessees concerning the treatment of specific costs.

The final rule requires a disclosure of the gross capitalized cost with a description such as ''the agreed upon value of the vehicle [state the amount] and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance).'' The ''agreed upon value'' of the motor vehicle means the amount for the vehicle agreed upon by the lessor and the lessee for purposes of the lease. This would include capitalized items such as the following: charges for vehicle accessories and options, delivery or destination charges, and rustproofing. The lessor could also include taxes and fees for license, title, and registration. The ''value'' would not include charges for service or maintenance contracts, insurance products, gap waivers, or an outstanding balance on a prior lease or loan.

Based on comments and upon further analysis, the Board believes that disclosure of the gross capitalized cost (including the agreed upon value) may aid consumers in better understanding lease pricing. The final rule also allows the consumer to obtain an itemization of the gross capitalized cost upon request. (See the model form in appendix A.) As in the case of Regulation Z, the itemization must be given separately, not within the segregated disclosures.

The Board solicited comment on whether the gross cost—the first item on the proposed model form—should be de-emphasized or removed from the required disclosures to avoid potential manipulation of the figure by lessors to mislead consumers. The few commenters that addressed the issue thought that the potential risk is negligible.

4(f)(2) *Capitalized cost reduction.*

The Board's proposed rule required the disclosure of any ''capitalized cost reduction'' in the disclosure of the total amount due at lease signing. Like a downpayment in the case of a credit transaction, the capitalized cost reduction reduces the capitalized cost and thus the periodic payments. In response to comments, the final rule requires that any capitalized cost reduction be reflected both in the disclosure of the amount due at lease signing and in the mathematical progression of the periodic payment amount.

4(f)(3) *Adjusted capitalized cost.*

In response to the comments, the final rule requires the disclosure of the ''adjusted capitalized cost,'' which equals the gross capitalized cost less any capitalized cost reduction. This net figure is the starting point for determining the periodic payment of the lease.

4(f)(4) *Residual value.*

The Board proposed to make the residual value of the leased property a required disclosure in closed-end leases. (A disclosure called the ''estimated value of the vehicle at the end of the lease'' was already required by Regulation M in an open-end lease.)

Many commenters, including both industry and consumer representatives, favored the disclosure of this term. The residual value is the amount estimated or assigned at consummation as the value of the lease property at the end of the lease term. In motor vehicle leases, this figure is frequently but not always obtained by reference to accepted guides used by lessors, such as the ''ALG Residual Percentage Guide.'' In the payment calculation, the residual value is accompanied by the statement: ''the value of the vehicle at the end of the lease used in calculating your base [periodic] payment.''

4(f)(5) *Depreciation and any amortized amounts.*

The disclosure of the ''depreciation and any amortized amounts'' was not included in the Board's proposed rule but is a necessary part of the payment calculation. The depreciation represents the difference between the adjusted capitalized cost and the residual value. This is the amount that the lessee pays for the vehicle's decline in value attributable to normal use and for other items paid over the lease term.

4(f)(6) *Rent charge.*

This figure, added in the final rule in response to comments, represents the lessor's ''rent'' or ''interest.'' The rent charge is an essential component in the payment calculation.

4(f) (7)–(10) *Total of base periodic payments, lease term, base periodic payment, itemization of other charges, and total periodic payment.*

Several other items are used in the payment calculation. The ''lease term'' and the ''total periodic payment'' are already required disclosures under the CLA, and appear both in the payment calculation and in the payment schedule disclosures. The ''total of base periodic payments'' is not required by the CLA, but was used in open-end lease disclosures and is necessary in the payment calculation. Itemization of the periodic payment (the base monthly payment and other charges that are part of the periodic payment) is also not currently required, although over the years many lessors have routinely provided an itemization. The periodic payment typically consists of an amount for depreciation and a rent charge; there may also be state tax and other fees.

4(g) *Early termination.*

The CLA requires lessors to disclose the conditions under which the lessee or lessor may terminate the lease before the end of the lease term and the amount or method of determining a penalty or other charge for early termination. Lessors typically disclose the method of determining an early termination charge, a disclosure which is often complex.

The proposed rule noted that a U.S. Court of Appeals case, *Lundquist* v. *Security Pacific Automotive Financial Services Corp.*, 993 F.2d 11 (2d Cir.), *cert. denied,* 510 U.S. 959 (1993), caused lessors concern in determining the requirements for disclosing their early termination provisions. In that case, the court held a lessor liable for violating the ''reasonably understandable'' standard for disclosure under Regulation M; the lessor had an early termination formula that the court found to be overly complex and beyond the understanding of the average consumer. Many lessors believe that, given the complexity of modern automobile lease transactions, it is difficult to describe every part of an early termination formula in terms clearly understandable to consumers. In particular, lessors believe that the various methods used to determine the ''unamortized capitalized cost'' portion of their early termination formulas are inherently complex and cannot be reduced to a disclosure that is easily understandable.

In response to the Board's proposal, many commenters (mostly those representing the leasing industry) favored allowing a reference to the name of the method employed to determine the unamortized capitalized cost portion of the early termination formula instead of requiring a detailed description of that method. Opponents believed that merely providing the name of the method would not be useful and would make it difficult or impossible for consumers to compute the amount of an early termination charge. Some consumer advocates believed that in using complex methods and highly complicated descriptions for determining early termination charges, lessors preclude consumers from determining whether the charges themselves are reasonable. (The CLA specifies that charges for early termination must be ''reasonable.'') Other commenters, including some lessors and many consumer representatives, favored a full description of all aspects of a lessor's early termination method, along with an example of how that method would work.

Based on the comments and upon further analysis, the Board continues to believe that the CLA mandates full disclosure of a lessor's method of determining an early termination charge, even if it is complex. Therefore, a full description of the complete early termination method must be disclosed. Given the complexity of the methods involved, however, a lessor is permitted—in giving the full description of its early termination method—to refer by name to a generally accepted method of computing the adjusted lease balance (also known as the unamortized capitalized cost) for purposes of the early termination charge. For example, a lessor may state that the ''constant yield'' method will be utilized in determining the unamortized portion of the gross capitalized cost, but the lessor would have to specify how that figure—and any other term or figure—is used in computing the total early termination charge that would be imposed upon the consumer. Additionally, if a lessor refers to a named method in this manner, the lessor will have to provide a written explanation of that method if requested by the consumer. Lessors should provide clear and understandable explanations of their early termination provisions to consumers. Explanations that are full, accurate, and not intended to be misleading are in compliance with CLA and Regulation M disclosure requirements even if such explanations are complex.

The Board proposed new disclosure requirements in addition to requiring this basic statutory information about charges for terminating a lease early. The proposed rule added a statement alerting consumers about charges for terminating a lease early, and also would have required an example of an early termination charge based on an assumed termination of the lease at the end of the first year. In general, most commenters supported the Board's requiring a general statement warning the consumer of the possibility of substantial charges for early termination.

Many of the commenters representing the leasing industry objected to the Board's proposed requirement of an early termination example. They believed that a transaction-specific example would substantially increase compliance burdens. They said the figure would be difficult to calculate because published residual values at the end of one year are not available; the tables typically start at 24 months. Also, the figure would be imprecise, since charges for early termination are typically determined based on the realized, not the residual, value of the leased property at the time of early termination. The realized value, these commenters pointed out, can vary widely from the residual value based on factors such as the demand for a

particular model and the condition of the vehicle at the time of early termination. Moreover, the example would not be representative of an actual charge because few leases terminate at the end of the first year. It is more typical for termination to occur nearer to the end of the lease.

Industry commenters expressed concern about the compliance burden attached to a transaction-specific mathematical calculation, as well as concern about possible consumer misunderstanding of a numerical example that might be out of line with the amount a consumer would have to pay if, in fact, the lease is terminated early. Some commenters suggested, as an alternative, an enhanced general warning to the effect that charges for early termination could be substantial and ''may be several thousand dollars.'' They also suggested adding a statement that the actual charge will depend on when the lease is terminated, and the earlier the consumer ends the lease, the greater this amount is likely to be.

Commenters representing consumer interests believed that an example is needed to give consumers a concrete idea of just how substantial an early termination charge could be. Some of these commenters suggested that the early termination example could be rephrased to make clear that the early termination charge shown in any example is contingent upon the realized value of the property at the time of termination. They suggested using language such as ''if you terminate this lease at the end of the first year, you may owe the lessor the difference between your adjusted lease balance of [stated amount] and the realized value at that time.''

While there have been very few consumer complaints about consumer leasing at the federal level, one of the more frequent issues raised involves early termination charges. At the state level, authorities report that early terminations are a major source of consumer complaints about leasing. Lessees often are surprised that an early termination charge can be several thousand dollars. Many consumers apparently think that as long as they are current in their monthly payments, upon early termination they can merely return the car owing nothing more or at most a nominal termination fee. The transaction-specific example proposed by the Board was intended to show just how substantial a charge could be. Based on the comments and further analysis, the Board has dropped the requirement of an example and has instead strengthened the warning to consumers. The final rule requires the following revised statement among the segregated disclosures:

Early Termination. You may have to pay a substantial charge if you end this lease early. *The charge may be up to several thousand dollars.* The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

The Board believes that a strong narrative statement, even without the proposed example, will serve to apprise consumers that charges for early termination may indeed be quite substantial.

4(h) *Maintenance responsibilities.*

To heighten a consumer's awareness about maintenance responsibilities without imposing substantial compliance costs on lessors, the Board proposed to add a disclosure requirement, among the segregated disclosures, that ''you may be charged for excessive wear and use based on the lessor's standard for normal use.'' Any applicable charge for excessive mileage must also be included. In the final rule, this requirement is limited to motor vehicle leases.

Several commenters requested guidance on disclosing the notice in paragraph 4(h)(3) when a specific figure for excess mileage is not available. They suggested that a description of the method for assessing charges for excess mileage should be allowed in place of a specific amount. The final rule allows a lessor to disclose a description of the method used for calculating excess mileage charges in place of a specific amount, when disclosing an amount is not feasible.

4(i) *Purchase option.*

An association representing automobile lessors sought clarification on whether reference to the fair market value based on an automobile publication such as N.A.D.A. (published by the National Automobile Dealers Association) could be disclosed in place of a sum certain, as the purchase-option price. The Board clarifies that lessors may commit to a sum certain as the purchase-option price at a future date by reference to an independent source. The reference should provide sufficient information so that the lessee will be able to determine the actual price at the time the option becomes available. Statements of a lease end price such as ''negotiated price'' or ''fair market value'' do not comply with the requirement of this paragraph. For a purchase option during the lease term, the Board recognizes that the price may vary depending on when the lessee exercises this option, and therefore under the final rule, lessors are allowed to describe a method for determining the price as an alternative to providing the price.

4(j) *Statement referencing nonsegregated disclosures.*

To alert consumers to the nonsegregated CLA disclosures, the final rule requires a statement among the segregated disclosures to direct consumers to other CLA-required disclosures in the lease documents. The nonsegregated disclosures include information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest.

4(k) *Liability between residual and realized values.*

This provision is substantially unchanged from the provision found under former § 213.5(g)(13); minor edits have been made.

4(l) *Right of appraisal.*

Paragraph 4(l) requires disclosure of the right to an appraisal of leased property. This language has been adopted as proposed, with a few changes for clarity and accuracy; for example, the term ''realized value'' replaces ''estimated value.'' No substantive change is intended. This provision is applicable both to open-end and to closed-end leases.

4(m) *Liability at end of lease term based on residual value.*

Except as discussed below, editorial changes have been made to this section without substantive change.

4(m)(1) *Rent and other charges.*

Former §§ 213.2(a)(17) and 2(a)(18) defined the terms ''total lease obligation'' and ''value at consummation,'' that were applicable to open-end leases. The Congressional intent regarding these definitions, as set forth in a committee report, was that the lessee would have a readily understandable method for comparing the cost of one lease with another or with the cost of buying the same property for cash or on credit (Senate Committee on Banking, Housing and Urban Affairs, Consumer Leasing Act of 1976, S. Rep. No. 94–590 (1976)). The report stated, in pertinent part:

> Under subsection 182[(10)][of the CLA], in addition the lessor must calculate and disclose the difference between the total lease obligation and the market value of the goods at the inception of the lease. These figures then will provide an easy comparison

between the cost of the lease and the cost of an outright cash purchase, and the differential figure provides a rough comparison to the amount of finance charge which would be involved in a credit purchase. The consumer lessee therefore will have at hand the essential data to compare leases, and to evaluate alternatives to leasing.

Commenters noted that the value at consummation, defined as ''the cost to the lessor of the leased property including, if applicable, any increase or markup by the lessor prior to consummation,'' is essentially the same as the capitalized cost.

The Board believes that the purpose of the disclosure of the total lease obligation, the value at consummation, and the differential between these two figures is served by requiring lessors in open-end leases to disclose the ''rent and other charges'' described as ''the total amount of rent and other charges imposed in connection with your lease [state the amount].'' Because of the new comprehensive disclosure scheme, including a required disclosure of the gross capitalized cost (including the agreed upon value) of leased property, the ''total lease obligation'' disclosure (as defined in former § 213.2(a)(17)), and the ''value at consummation'' disclosure (as defined in former § 213.2(a)(18)) have been deleted as unnecessary. The final rule has been revised accordingly.

4(o) *Insurance.*

Along with the amount paid to the lessor, this disclosure provides information on the type and amount of coverage of insurance, whether voluntary or required, as well as the cost. Several commenters pointed out that unlike collision and comprehensive liability policies, the lessor could not furnish the amount of coverage for mechanical breakdown protection contracts (in states where these contracts are treated as insurance). For mechanical breakdown protection insurance contracts not capped by a dollar amount, lessors may describe coverage by referring to a limitation by mileage or time period. For example, the mechanical breakdown contract insures parts of the automobile for up to 100,000 miles.

4(p) *Warranties or guarantees.*

The Board was asked to clarify whether warranties were limited to maintenance warranties, or included UCC warranties such as warranty of title, and whether disclosure is required if certain warranties do not apply to the lessee. Whether warranties under the UCC should be treated as warranties under this section is to be determined by state or other applicable law. If a lessor provides a comprehensive list of warranties to a consumer, the lessor must indicate which warranties apply or, alternatively, which do not apply.

4(q) Penalties and other charges for delinquency

As proposed, the final rule adds that any penalty or charge shall be reasonable, to reflect the requirement found in § 183(b) of the CLA. No substantive change is intended.

4(r) Security interest

This section has been adopted as proposed without substantive change. The phrase ''in connection with the lease'' has been deleted as unnecessary.

4(s) Limitation on rate information

Until recently, lessors did not disclose rate information to consumers, although they have commonly used an implicit interest rate for internal purposes. Now some automobile lessors disclose rate information in contracts, or advertise lease rates, or orally provide rate information to consumers who lease or express an interest in leasing. Typically these rates are based on the lessor's ''money factor''—representing only the ''rent'' or the ''interest'' charge—and are sometimes labelled as an ''annual percentage rate.''

In the proposed rule, the Board solicited comment on whether Regulation M should require a rate disclosure, and whether (and how) the rate should be made comparable to the annual percentage rate (APR) in a credit transaction. Many commenters addressed this issue. For the most part, commenters representing consumer constituencies advocated the disclosure of a uniformly calculated lease rate. Those representing industry interests generally opposed a lease rate disclosure, although some supported further consideration of the issue.

Those commenters who supported a rate disclosure believed that a federally-mandated annual lease rate is needed to assure uniform disclosure of lease-cost information. They expressed particular concern that rates currently disclosed by some lessors in advertisements and in contracts may mislead consumers about lease costs, given the lack of any calculation standards. Commenters also argued that if the capitalized cost, the residual value of leased property, and other lease terms are disclosed to a consumer, the lease rate is the only missing component necessary to fully demonstrate the cost of the lease. They generally believed that a rate disclosure would be an effective tool for comparison shopping.

Those commenters opposed to a rate disclosure requirement believed that such a disclosure would be meaningless and perhaps even misleading to consumers. They argued that there is no effective way to calculate a lease rate that will be meaningful to consumers, absent rules constraining lease terms. Many expressed concern that consumers would inappropriately compare credit and lease transactions by comparing the APR with the lease rate. A few commenters, mostly representing independent lessors, suggested that the Board would be exceeding its rulemaking authority under the CLA if it were to mandate a rate disclosure, given that the statute does not impose this requirement. Commenters also suggested that a rate disclosure presents the opportunity for unscrupulous lessors to purposely manipulate the lease rate (to make it look more attractive) by adjusting the residual value. These commenters suggested that, to quote a low lease rate, such lessors might use a residual value lower than the figure the lessor actually expects to realize from the sale of the vehicle at the scheduled termination of the lease. Reducing the residual value increases the portion of the periodic payment attributable to depreciation, thus lowering the amount imputed to the rent charge in each payment. Indeed, for lease transactions in which the adjusted capitalized cost, lease term, and periodic payments remain constant, adjustments in the residual value can produce significantly different lease rates.

Consideration of alternative approaches. The Board considered several approaches to address the lease rate issue: it considered requiring, permitting, or prohibiting a disclosure. In principle, the disclosure of a lease cost expressed as an annual rate, rather than solely as a dollar amount, could have value to consumers in negotiating lease terms and in comparing one lease to another. In practice, however, there are problems associated both with the computation of the lease rate and with what the figure represents.

The major problem with a rate computation is that it is subject to variations in the residual value, whether the variation is narrow or wide and whether it results from unscrupulous manipulation or from legitimate, good-faith differences about estimates of value. As to some of the comparisons that consumers might attempt to make, it is arguable that comparing the costs incurred in leasing and in financing based primarily on rate information may never be totally appropriate because the comparison overlooks legal and

economic distinctions between the two transactions—in a lease the consumer accumulates no equity in the property. Given these limitations, and the fact that the legislative history provides little support for requiring a lease rate disclosure, the Board decided not to mandate a lease rate disclosure.

The Board considered prescribing a method for calculating a rate so that consumers could be assured of uniformity in any rate disclosures they received. The calculation could use an ''actuarial method'' formula similar to that used for the APR under the Board's Regulation Z. This formula would analyze the present value of all advances made to the lessee or on the lessee's behalf against the present value of all payments received by the lessor.

To address rate manipulation, the Board considered placing certain general constraints on the use of the residual value, such as requiring that the residual value used to calculate the rate be the same one on which the periodic payments are based, and requiring also that the residual value be a reasonable approximation of the value of the leased property at the end of the lease term. While this approach would promote more uniformity in rate disclosure than currently exists, it would not make the rates quoted to a consumer completely reliable given the legitimate range of residual values. Alternatively, the Board considered requiring that lessors use the purchase-option price instead of the residual value in calculating a rate when the option price is higher. However, basing a lease rate on a purchase-option price assumes, often incorrectly, that the consumer will purchase the leased property at the end of the lease term. Moreover, because only about 60 percent of leases have an option price, this restraint on possible manipulation would not be available in all instances.

Given the limitations under any of these approaches, the Board believes that in specifying a rate calculation method, it would be endorsing the use of an imperfect tool—one whose accurate use for comparison shopping is questionable in many cases.

As an alternative, the Board considered whether to prohibit the disclosure of lease rates. However, a regulatory prohibition would essentially require a determination by the Board that a rate disclosure is inherently deceptive or misleading to consumers. In light of the wide support for a uniform lease rate disclosure among consumer advocates and others, the Board believes it would be difficult to support such a determination in all cases.

Still, the Board believes that the concerns about variations in lease rates cannot be ignored. These concerns exist whether variations result from a lessor's manipulation of the residual value to show a lower lease rate, or occur despite a lessor's use of different good-faith estimates of the residual value. Accordingly, the final rule imposes constraints on the disclosure of rate information to deter—as much as possible—inappropriate comparisons of leases by consumers based on rate information offered by different lessors, and mistaken comparisons between the distinct transactions of financing and leasing. The final rule requires that where rate information is provided in an advertisement or in lease documents, a notice must accompany the rate disclosure stating that ''this percentage may not measure the overall cost of financing this lease.''

Under the final rule, a lessor advertising or disclosing a lease rate is also precluded from calling the rate an ''annual percentage rate'' or any equivalent term to avoid the inference that the rate is directly comparable to the APR. Moreover, the rate may not be placed among Regulation M's segregated disclosures. The final rule in § 213.7(b)(2) also provides that the disclosure of a lease rate in an advertisement cannot be more prominent than disclosures in the advertisement required by Regulation M, except for the disclosure that must accompany the rate.

The estimated lease charge. In its proposed rule, the Board solicited comment on a new disclosure, called the estimated lease charge, to show the total ''financing'' costs that would be charged to the consumer over the lease term, including ''rent'' or ''interest.'' In name, the proposed figure was similar to the finance charge disclosed in credit transactions subject to the TILA. In concept, however, it was quite different in that it included fees that the consumer would pay in a comparable cash transaction and fees paid to third parties (such as automobile registration fees, insurance premiums, and state taxes). These are items that in the credit context would be excluded from the finance charge in most cases.

Commenters representing consumer interests, who generally supported the proposed ''all-inclusive'' definition of the estimated lease charge, believed that such a disclosure meets the goal of the CLA to provide meaningful and full disclosure to consumers of the ''true'' cost of leasing. They thought it could facilitate shopping among comparable lease transactions, and would not be burdensome for lessors to disclose. A majority of commenters—all representing the leasing industry—either opposed the estimated lease charge disclosure in general or as it was defined in the proposal. They believed that any lease charge should ideally reflect only that portion of each lease payment representing the ''rent'' or ''interest'' charged by the lessor. Also, they believed an all-inclusive lease charge disclosure could mislead consumers to view leasing as more expensive in comparison with financing, when that may not be the case. Most of these commenters believed that if a lease charge were to be disclosed, the rules should at least be more comparable to Regulation Z regarding the type of fees included, based on their concern that consumers might attempt to compare a lease charge to the finance charge in a credit transaction.

Although virtually all costs associated with a lease transaction are itemized and disclosed under the final rule, there could be some value in bringing together in one figure the various interest and noninterest charges that may be split among those due at lease signing, in the periodic payments, and at lease end. The Board considered that a lease charge, redefined to more closely parallel the finance charge disclosed in a credit transaction, could have utility in some instances. For example, it might assist a consumer in comparing the cost of leasing a vehicle offered by different lessors, such as when shopping to lease a particular make and model with the same lease duration. It would not be very useful in comparing the leasing of cars with different values or different lease durations, or in comparing a lease transaction to a credit transaction. For purposes of Regulation M, a lease charge disclosure is related primarily to the calculation of a lease rate (as lessors would need to know what fees to include in the calculation) and to verify compliance with the prescribed formula. Given that there is no federally-mandated lease rate disclosure, there is little need for a lease charge disclosure (in a closed-end lease). Based on the comments and upon further analysis, the final rule does not require the disclosure of a lease charge.

Section 213.5 Renegotiations, extensions, and assumptions.

Section 213.5 is adopted as proposed with some editorial changes. No substantive change is intended. This section contains all the redisclosure rules governing leases that are renegotiated, extended, or assumed, which were generally contained in

former § 213.4(h). Paragraphs have been rearranged and revised for clarity. Rules on assumptions have been moved from the commentary. Section 213.5(d) retains the substance of the exceptions found in the former regulation as well as the exceptions previously located in the commentary for renegotiations, court proceedings, and deferrals under former comments 4(h)-3, 7, and 8, respectively.

Section 213.6 [Reserved]

Section 213.7 Advertising.

Former § 213.5 is redesignated as indicated below:

Former	Final rule
213.5(a)	213.7(a).
	213.7(b) new, incorporating standard in one place.
	213.7(b)(1) new.
	213.7(b)(2) new.
213.5(b)	213.7(c).
213.5(c)	213.7(d).
213.5(d)	213.7(e).
	213.7(f) new.

The final rule contains several substantive additions to the advertising rules as discussed below. Some of the language of existing provisions has been revised for simplicity.

7(b) Clear and conspicuous standard.

In response to commenters' request for guidance on the clear and conspicuous standard for advertisements, the Board clarifies that an advertisement must be understandable and readable. For example, very fine print in a television advertisement or detailed and rapidly stated information in a radio advertisement does not meet the clear and conspicuous requirement if consumers cannot see and read or comprehend all of the information required to be disclosed. Further, in the official commentary, the Board proposed to require that lease disclosures appear on a television screen at a minimum of five seconds to meet the clear and conspicuous standard. Upon further analysis, the Board believes that this ''five second'' rule, which was referred to in a case by the Federal Trade Commission, is inadequate as a test for the clear and conspicuous standard. Therefore, the Board is withdrawing the ''five second'' rule as a standard to be used for television advertisements.

7(b)(1) Amount due at lease signing.

The proposal sought to address misleading advertisements primarily in which a lessor refers to a low or no capitalized cost reduction (downpayment) and, in small print lists other upfront charges such as an acquisition fee, a security deposit, the first monthly lease payment. The Board proposed that a reference in an advertisement to any component of the total amount due at lease signing may not be more prominently displayed than the required disclosure of the total amount of payments due at lease signing.

The majority of commenters supported the proposed requirement, stating that it would minimize deceptive practices and that it provided clarity to the clear and conspicuous standard. However, a number of commenters opposed the adoption of an equal prominence rule. They believed the proposed rule was overbroad, and suggested that the final rule should ensure that the prominence rule is not triggered when the only payment due at lease inception is the first scheduled periodic payment. Several commenters sought further clarification on the clear and conspicuous standard.

The final rule provides an exception to the prominence test for the periodic payment. Stating the amount of any periodic payment will not trigger the prominence rule. The rule is triggered by oral or written references (which includes electronic media such as the Internet) to any other component of the total amount due at lease signing. The Board believes the final rule addresses some of the concerns about lease advertisements without adding significant burden on lessors or interfering with the effective marketing of their products. The final rule does not specify what terms are to be advertised, but only that components of the total amount due at lease signing cannot be emphasized without giving equal prominence to the disclosure of the total amount due itself. Lessors can advertise lease transactions without including any CLA disclosures. Disclosures are only required when certain ''trigger'' terms are included in the advertisement. The CLA requires only disclosure of the total due, not an itemization of its component parts, in advertisements. Such an itemization is provided in the transaction-specific disclosures.

7(b)(2) Advertisement of a lease rate.

As discussed in the supplementary information to § 213.4(s), if a percentage rate is stated in an advertisement, a notice must accompany the rate. The notice must be placed next to the rate without any other intervening language or symbols. For example, a lessor may not state a rate with an asterisk and make the disclosure in a different location in the advertisement or lease document. The notice states that this percentage may not measure the overall cost of financing the lease. In addition, with the exception of the notice required by § 213.4(s), the rate cannot be more prominent than the disclosures in the advertisement required by § 213.4.

7(c) Catalogs and multi-page advertisements.

Section 7(c) is adopted as substantially proposed, with no substantive change from the former rule.

7(d) Advertisement of terms that require additional disclosure.

In paragraph 7(d)(2)(iii), the word ''such'' prior to ''payments under the lease,'' inadvertently omitted in the proposal, is inserted back in the paragraph.

In complying with paragraph 7(d)(2)(iv), lessors are required to provide a sum certain if the purchase option is available at the end of the term. Referring to a source for determining a sum certain in the future complies with this requirement. Statements of a lease-end price such as ''negotiated price'' or ''fair market value'' do not comply with the requirement of this paragraph.

7(e) Alternative disclosures—merchandise tags.

The substance of this section is unchanged from the former provision in § 213.5(d); editorial changes have been made.

7(f) Alternative disclosures—telephone or radio advertisements.

Section 336 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103–325, 108 Stat. 2160) amends § 184 of the CLA to provide an alternative disclosure scheme for radio lease advertisements. In radio advertisements, lessors are permitted to substitute a reference to a toll-free telephone number or to a print advertisement for the disclosures about the purchase option and the end-of-term liability. When calling an advertised toll-free number, if a consumer obtains a recording that provides several dialing options—such as providing directions to the lessor's place of business—the option allowing the consumer to request lease disclosures should be provided early in the phone message to ensure that disclosure information is not obscured by other information.

In keeping with the purpose of the statutory amendment, the final rule requires language to accompany the telephone number indicating that all required disclosures are available by

calling the toll-free number. Without language such as, ''call 1–800–000–0000 for details about costs and terms,'' consumers are not put on notice that disclosures may be obtained by calling the toll-free number. A specific reference to disclosures in print advertisements is also required.

The Board proposed to extend the alternate disclosure provision to television advertisements. The majority of commenters supported this proposal. They agreed that television has the same time and space constraints as radio and that the alternate disclosure provision allows consumers the opportunity to obtain lease information in a format that can be retained and studied at a convenient time.

The Board also solicited comment on whether constraints similar to those for television and radio advertisements exist for print advertisements. Although some commenters encouraged imposing the same standard for both broadcast and print media, the majority of commenters did not support the application of the alternative disclosure rules to print media. Much of the oral and written disclosure information in a broadcast is difficult for lessors to provide and for consumers to comprehend or retain. The Board believes that lessors have the ability to more efficiently provide the required disclosures in print format. And generally, print advertisements are easier to retain for use by consumers who are shopping for a lease. Therefore, the Board has extended the alternate disclosure provision to television but not to print media.

Appendices

To simplify the regulation, the written information contained in former appendices A and B about the procedures and criteria for preemption and exemption determinations have been removed. Such information is available from the Board upon request. The model forms are in appendix A. The list of federal agencies that enforce the CLA for particular classes of businesses is moved from former appendix D to appendix B. Appendix C incorporates former § 213.1(d).

Appendix A—Model Forms

The model forms illustrate the new segregated disclosure scheme required by § 213.3(a)(2). Instructions have been deleted as unnecessary.

A–1—Model Open-End or Finance Vehicle Lease Disclosures

A–2—Model Closed-End or Net Vehicle Lease Disclosures

A–3—Model Furniture Lease Disclosures

VI. Regulatory Flexibility Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C 603), the Board's Office of the Secretary has reviewed the amendments to Regulation M. The text of a detailed analysis appears at the end of this document as appendix I. The changes to Regulation M will require a substantial revision to the disclosure format currently required of lessors. In issuing the final rule, the Board has attempted to minimize the burden of changing to the new disclosure format by requiring, wherever possible, disclosures that can be preprinted. Further, the Board has provided model disclosure forms to facilitate compliance. Section 105 of the Truth in Lending Act provides that a lessor that uses the appropriate model forms published by the Board ''shall be deemed to be in compliance with the disclosure provisions of this title with respect to other than numerical disclosures....'' Thus, using the model forms properly provides lessors with a safe harbor from civil liability. Required disclosures will be the same for large and small lessors, but the Board does not expect that the changes to Regulation M will have a substantial adverse economic impact on a large number of small entities. The automobile leasing industry, at which most of the changes are directed, is highly concentrated in a small number of large firms. Actual preparation of lease documents will typically take place in the offices of numerous automobile dealers, many of which are small entities. However, preparation will take place through computer terminals and computer programs provided by the lessors. Because the new forms are provided through the lessors' computer systems, they will be clearer and easier for dealer personnel to understand. Explanations and necessary training of personnel should actually be enhanced and made easier for dealers.

VII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget.

The respondents are individuals or businesses that regularly lease, offer to lease, or arrange for the lease of personal property under a consumer lease. The purpose of the disclosures associated with Regulation M is to ensure that lessees of personal property receive meaningful information that enables them to compare lease terms with other leases and, where appropriate, with credit transactions. Records, required in order to evidence compliance with the regulation, must be retained for twenty-four months. The revisions to the disclosure requirements in this regulation are found in §§ 213.3, 213.4, and 213.7.

Regulation M applies to all types of financial institutions, not just state member banks. Under the Paperwork Reduction Act, however, the Federal Reserve accounts for the paperwork burden associated with Regulation M only for state member banks. Any estimate of paperwork burden for institutions other than state member banks affected by the amendments is provided by the federal agency or agencies that supervise those lessors. The Federal Reserve has found that few state member banks engage in consumer leasing and that while the prevalence of leasing has increased in recent years, it has not increased substantially among state member banks. It also has found that among state member banks that engage in consumer leasing, only a very few advertise consumer leases.

The estimated burden per response for the disclosures is eighteen minutes, three minutes more than the estimate of the burden for the disclosures under the former rule. Under the Board's September 1995 proposal, the estimate was seventeen minutes. The final rule adds two particular items: an itemized mathematical progression of the periodic payment and, if an annual lease rate is included, a statement that the rate may not measure the overall cost of financing the lease. The estimated burden for advertisement disclosures, twenty-five minutes (a decrease of five minutes from the former rule), is unchanged since the proposal. It is estimated that there will be 310 respondents and an average frequency of 120 responses per respondent each year. The combined amount of annual burden is estimated to increase from 9,322 hours to 11,179 hours. In addition, start-up costs are estimated to be $12,000 per respondent, amounting to a total of $3,720,000 for state member banks.

The Board received no comments that specifically addressed the burden estimate.

The disclosures made by lessors to consumers under Regulation M are mandatory (15 USC 1667 et seq.). Because the Federal Reserve does not collect any information, no issue of confidentiality under the Freedom of Information Act arises. Consumer lease information in advertisements is available to the public. Disclosures of the costs, liabilities, and terms of

consumer lease transactions relating to specific leases are not publicly available.

An agency may not conduct or sponsor, and an organization or individual is not required to respond to, an information collection unless it displays a currently valid OMB control number. The OMB control number for Regulation M is 7100–0202.

Comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0202), Washington, DC 20503.

List of Subjects in 12 CFR Part 213

Advertising, Federal Reserve System, Reporting and recordkeeping requirements, Truth in Lending.

For the reasons set forth in the preamble, the Board amends 12 CFR Part 213 as follows:

PART 213—CONSUMER LEASING (REGULATION M)

1. The authority citation for part 213 continues to read as follows:

Authority: 15 U.S.C. 1604.

2. The table of contents to part 213 is revised to read as follows:

Sec.
213.1 Authority, scope, purpose, and enforcement.
213.2 Definitions.
213.3 General disclosure requirements.
213.4 Content of disclosures.
213.5 Renegotiations, extensions, and assumptions.
213.6 [Reserved]
213.7 Advertising.
213.8 Record retention.
213.9 Relation to state laws.
Appendix A to Part 213—Model Forms
Appendix B to Part 213—Federal Enforcement Agencies
Appendix C to Part 213—Issuance of Staff Interpretations
Supplement I to Part 213—Official Staff Commentary to Regulation M

3. Part 213 is amended as follows:

a. Sections 213.1 through 213.5 are revised;

b. Section 213.6 is removed and reserved;

c. Sections 213.7 and 213.8 are revised;

d. Section 213.9 is added;

e. Appendices A through C are revised; and

f. Appendix D is removed.

The revisions and additions read as follows:

§ 213.1 Authority, scope, purpose, and enforcement.

(a) *Authority.* The regulation in this part, known as Regulation M, is issued by the Board of Governors of the Federal Reserve System to implement the consumer leasing provisions of the Truth in Lending Act, which is Title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 et seq.).

(b) *Scope and purpose.* This part applies to all persons that are lessors of personal property under consumer leases as those terms are defined in § 213.2(e)(1) and (h). The purpose of this part is:

(1) To ensure that lessees of personal property receive meaningful disclosures that enable them to compare lease terms with other leases and, where appropriate, with credit transactions;

(2) To limit the amount of balloon payments in consumer lease transactions; and

(3) To provide for the accurate disclosure of lease terms in advertising.

(c) *Enforcement and liability.* Section 108 of the act contains the administrative enforcement provisions. Sections 112, 130, 131, and 185 of the act contain the liability provisions for failing to comply with the requirements of the act and this part.

§ 213.2 Definitions.

For the purposes of this part the following definitions apply:

(a) *Act* means the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Consumer Leasing Act is chapter 5 of the Truth in Lending Act.

(b) *Advertisement* means a commercial message in any medium that directly or indirectly promotes a consumer lease transaction.

(c) *Board* refers to the Board of Governors of the Federal Reserve System.

(d) *Closed-end lease* means a consumer lease other than an open-end lease as defined in this section.

(e)(1) *Consumer lease* means a contract in the form of a bailment or lease for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months and for a total contractual obligation not exceeding $25,000, whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease. Unless the context indicates otherwise, in this part ''lease'' means ''consumer lease.''

(2) The term does not include a lease that meets the definition of a credit sale in Regulation Z (12 CFR 226.2(a)). It also does not include a lease for agricultural, business, or commercial purposes or a lease made to an organization.

(3) This part does not apply to a lease transaction of personal property which is incident to the lease of real property and which provides that:

(i) The lessee has no liability for the value of the personal property at the end of the lease term except for abnormal wear and tear; and

(ii) The lessee has no option to purchase the leased property.

(f) *Gross capitalized cost* means the amount agreed upon by the lessor and the lessee as the value of the leased property and any items that are capitalized or amortized during the lease term, including but not limited to taxes, insurance, service agreements, and any outstanding balance from a prior loan or lease. *Capitalized cost reduction* means the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost. The *adjusted capitalized cost* equals the gross capitalized cost less the capitalized cost reduction, and is the amount used by the lessor in calculating the base periodic payment.

(g) *Lessee* means a natural person who enters into or is offered a consumer lease.

(h) *Lessor* means a person who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who has leased, offered, or arranged to lease personal property more than five times in the preceding calendar year or more than five times in the current calendar year is subject to the act and this part.

(i) *Open-end lease* means a consumer lease in which the lessee's liability at the end of the lease term is based on the difference between the residual value of the leased property and its realized value.

(j) *Organization* means a corporation, trust, estate, partnership, cooperative, association, or government entity or instrumentality.

(k) *Person* means a natural person or an organization.

(l) *Personal property* means any property that is not real property under the law of the state where the property is located at the time it is offered or made available for lease.

(m) *Realized value* means:

(1) The price received by the lessor for the leased property at disposition;

(2) The highest offer for disposition of the leased property; or

(3) The fair market value of the leased property at the end of the lease term.

(n) *Residual value* means the value of the leased property at the end of the

lease term, as estimated or assigned at consummation by the lessor, used in calculating the base periodic payment.

(o) *Security interest* and *security* mean any interest in property that secures the payment or performance of an obligation.

(p) *State* means any state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

§ 213.3 General disclosure requirements.

(a) *General requirements.* A lessor shall make the disclosures required by § 213.4, as applicable. The disclosures shall be made clearly and conspicuously in writing in a form the consumer may keep, in accordance with this section.

(1) *Form of disclosures.* The disclosures required by § 213.4 shall be given to the lessee together in a dated statement that identifies the lessor and the lessee; the disclosures may be made either in a separate statement that identifies the consumer lease transaction or in the contract or other document evidencing the lease. Alternatively, the disclosures required to be segregated from other information under paragraph (a)(2) of this section may be provided in a separate dated statement that identifies the lease, and the other required disclosures may be provided in the lease contract or other document evidencing the lease. In a lease of multiple items, the property description required by § 213.4(a) may be given in a separate statement that is incorporated by reference in the disclosure statement required by this paragraph.

(2) *Segregation of certain disclosures.* The following disclosures shall be segregated from other information and shall contain only directly related information: §§ 213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1). The headings, content, and format for the disclosures referred to in this paragraph (a)(2) shall be provided in a manner substantially similar to the applicable model form in appendix A of this part.

(3) *Timing of disclosures.* A lessor shall provide the disclosures to the lessee prior to the consummation of a consumer lease.

(4) *Language of disclosures.* The disclosures required by § 213.4 may be made in a language other than English provided that they are made available in English upon the lessee's request.

(b) *Additional information; nonsegregated disclosures.* Additional information may be provided with any disclosure not listed in paragraph (a)(2) of this section, but it shall not be stated, used, or placed so as to mislead or confuse the lessee or contradict, obscure, or detract attention from any disclosure required by this part.

(c) *Multiple lessors or lessees.* When a transaction involves more than one lessor, the disclosures required by this part may be made by one lessor on behalf of all the lessors. When a lease involves more than one lessee, the lessor may provide the disclosures to any lessee who is primarily liable on the lease.

(d) *Use of estimates.* If an amount or other item needed to comply with a required disclosure is unknown or unavailable after reasonable efforts have been made to ascertain the information, the lessor may use a reasonable estimate that is based on the best information available to the lessor, is clearly identified as an estimate, and is not used to circumvent or evade any disclosures required by this part.

(e) *Effect of subsequent occurrence.* If a required disclosure becomes inaccurate because of an event occurring after consummation, the inaccuracy is not a violation of this part.

(f) *Minor variations.* A lessor may disregard the effects of the following in making disclosures:

(1) That payments must be collected in whole cents;

(2) That dates of scheduled payments may be different because a scheduled date is not a business day;

(3) That months have different numbers of days; and

(4) That February 29 occurs in a leap year.

§ 213.4 Content of disclosures.

For any consumer lease subject to this part, the lessor shall disclose the following information, as applicable:

(a) *Description of property.* A brief description of the leased property sufficient to identify the property to the lessee and lessor.

(b) *Amount due at lease signing.* The total amount to be paid prior to or at consummation, using the term ''amount due at lease signing.'' The lessor shall itemize each component by type and amount, including any refundable security deposit, advance monthly or other periodic payment, and capitalized cost reduction; and in motor-vehicle leases, shall itemize how the amount due will be paid, by type and amount, including any net trade-in allowance, rebates, noncash credits, and cash payments in a format substantially similar to the model forms in appendix A of this part.

(c) *Payment schedule and total amount of periodic payments.* The number, amount, and due dates or periods of payments scheduled under the lease, and the total amount of the periodic payments.

(d) *Other charges.* The total amount of other charges payable to the lessor, itemized by type and amount, that are not included in the periodic payments. Such charges include the amount of any liability the lease imposes upon the lessee at the end of the lease term; the potential difference between the residual and realized values referred to in paragraph (k) of this section is excluded.

(e) *Total of payments.* The total of payments, with a description such as ''the amount you will have paid by the end of the lease.'' This amount is the sum of the amount due at lease signing (less any refundable amounts), the total amount of periodic payments (less any portion of the periodic payment paid at lease signing), and other charges under paragraphs (b), (c), and (d) of this section. In an open-end lease, a description such as ''you will owe an additional amount if the actual value of the vehicle is less than the residual value'' shall accompany the disclosure.

(f) *Payment calculation.* In a motor-vehicle lease, a mathematical progression of how the scheduled periodic payment is derived, in a format substantially similar to the applicable model form in appendix A of this part, which shall contain the following:

(1) *Gross capitalized cost.* The gross capitalized cost, including a disclosure of the agreed upon value of the vehicle, a description such as ''the agreed upon value of the vehicle [state the amount] and any items you pay for over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance),'' and a statement of the lessee's option to receive a separate written itemization of the gross capitalized cost. If requested by the lessee, the itemization shall be provided before consummation.

(2) *Capitalized cost reduction.* The capitalized cost reduction, with a description such as ''the amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost.''

(3) *Adjusted capitalized cost.* The adjusted capitalized cost, with a description such as ''the amount used in calculating your base [periodic] payment.''

(4) *Residual value.* The residual value, with a description such as ''the value of the vehicle at the end of the lease used in calculating your base [periodic] payment.''

(5) *Depreciation and any amortized amounts.* The depreciation and any amortized amounts, which is the difference between the adjusted

capitalized cost and the residual value, with a description such as ''the amount charged for the vehicle's decline in value through normal use and for any other items paid over the lease term.''

(6) *Rent charge.* The rent charge, with a description such as ''the amount charged in addition to the depreciation and any amortized amounts.'' This amount is the difference between the total of the base periodic payments over the lease term minus the depreciation and any amortized amounts.

(7) *Total of base periodic payments.* The total of base periodic payments with a description such as ''depreciation and any amortized amounts plus the rent charge.''

(8) *Lease term.* The lease term with a description such as ''the number of [periods of repayment] in your lease.''

(9) *Base periodic payment.* The total of the base periodic payments divided by the number of payment periods in the lease.

(10) *Itemization of other charges.* An itemization of any other charges that are part of the periodic payment.

(11) *Total periodic payment.* The sum of the base periodic payment and any other charges that are part of the periodic payment.

(g) *Early termination*—(1) *Conditions and disclosure of charges.* A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term; and the amount or a description of the method for determining the amount of any penalty or other charge for early termination, which must be reasonable.

(2) *Early-termination notice.* In a motor-vehicle lease, a notice substantially similar to the following: ''Early Termination. You may have to pay a substantial charge if you end this lease early. *The charge may be up to several thousand dollars.* The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.''

(h) *Maintenance responsibilities.* The following provisions are required:

(1) *Statement of responsibilities.* A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility;

(2) *Wear and use standard.* A statement of the lessor's standards for wear and use (if any), which must be reasonable; and

(3) *Notice of wear and use standard.* In a motor-vehicle lease, a notice regarding wear and use substantially similar to the following: ''Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use.'' The notice shall also specify the amount or method for determining any charge for excess mileage.

(i) *Purchase option.* A statement of whether or not the lessee has the option to purchase the leased property, and:

(1) *End of lease term.* If at the end of the lease term, the purchase price; and

(2) *During lease term.* If prior to the end of the lease term, the purchase price or the method for determining the price and when the lessee may exercise this option.

(j) *Statement referencing nonsegregated disclosures.* A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interests, if applicable.

(k) *Liability between residual and realized values.* A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value.

(l) *Right of appraisal.* If the lessee's liability at early termination or at the end of the lease term is based on the realized value of the leased property, a statement that the lessee may obtain, at the lessee's expense, a professional appraisal by an independent third party (agreed to by the lessee and the lessor) of the value that could be realized at sale of the leased property. The appraisal shall be final and binding on the parties.

(m) *Liability at end of lease term based on residual value.* If the lessee is liable at the end of the lease term for the difference between the residual value of the leased property and its realized value:

(1) *Rent and other charges.* The rent and other charges, paid by the lessee and required by the lessor as an incident to the lease transaction, with a description such as ''the total amount of rent and other charges imposed in connection with your lease [state the amount].''

(2) *Excess liability.* A statement about a rebuttable presumption that, at the end of the lease term, the residual value of the leased property is unreasonable and not in good faith to the extent that the residual value exceeds the realized value by more than three times the base monthly payment (or more than three times the average payment allocable to a monthly period, if the lease calls for periodic payments other than monthly); and that the lessor cannot collect the excess amount unless the lessor brings a successful court action and pays the lessee's reasonable attorney's fees, or unless the excess of the residual value over the realized value is due to unreasonable or excessive wear or use of the leased property (in which case the rebuttable presumption does not apply).

(3) *Mutually agreeable final adjustment.* A statement that the lessee and lessor are permitted, after termination of the lease, to make any mutually agreeable final adjustment regarding excess liability.

(n) *Fees and taxes.* The total dollar amount for all official and license fees, registration, title, or taxes required to be paid to the lessor in connection with the lease.

(o) *Insurance.* A brief identification of insurance in connection with the lease including:

(1) *Voluntary insurance.* If the insurance is provided by or paid through the lessor, the types and amounts of coverage and the cost to the lessee; or

(2) *Required insurance.* If the lessee must obtain the insurance, the types and amounts of coverage required of the lessee.

(p) *Warranties or guarantees.* A statement identifying all express warranties and guarantees from the manufacturer or lessor with respect to the leased property that apply to the lessee.

(q) *Penalties and other charges for delinquency.* The amount or the method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable.

(r) *Security interest.* A description of any security interest, other than a security deposit disclosed under paragraph (b) of this section, held or to be retained by the lessor; and a clear identification of the property to which the security interest relates.

(s) *Limitations on rate information.* If a lessor provides a percentage rate in an advertisement or in documents evidencing the lease transaction, a notice stating that ''this percentage may not measure the overall cost of financing this lease'' shall accompany the rate disclosure. The lessor shall not use the term ''annual percentage rate,'' ''annual lease rate,'' or any equivalent term.

§ 213.5 Renegotiations, extensions, and assumptions.

(a) *Renegotiation.* A renegotiation occurs when a consumer lease subject to this part is satisfied and replaced by a new lease undertaken by the same consumer. A renegotiation requires new

disclosures, except as provided in paragraph (d) of this section.

(b) *Extension.* An extension is a continuation, agreed to by the lessor and the lessee, of an existing consumer lease beyond the originally scheduled end of the lease term, except when the continuation is the result of a renegotiation. An extension that exceeds six months requires new disclosures, except as provided in paragraph (d) of this section.

(c) *Assumption.* New disclosures are not required when a consumer lease is assumed by another person, whether or not the lessor charges an assumption fee.

(d) *Exceptions.* New disclosures are not required for the following, even if they meet the definition of a renegotiation or an extension:

(1) A reduction in the lease charge;

(2) The deferment of one or more payments, whether or not a fee is charged;

(3) The extension of a lease for not more than six months on a month-to-month basis or otherwise;

(4) A substitution of leased property with property that has a substantially equivalent or greater economic value, provided no other lease terms are changed;

(5) The addition, deletion, or substitution of leased property in a multiple-item lease, provided the average periodic payment does not change by more than 25 percent; or

(6) An agreement resulting from a court proceeding.

§ 213.6 [Reserved]

§ 213.7 Advertising.

(a) *General rule.* An advertisement for a consumer lease may state that a specific lease of property at specific amounts or terms is available only if the lessor usually and customarily leases or will lease the property at those amounts or terms.

(b) *Clear and conspicuous standard.* Disclosures required by this section shall be made clearly and conspicuously.

(1) *Amount due at lease signing.* Except for the statement of a periodic payment, any affirmative or negative reference to a charge that is a part of the total amount due at lease signing under paragraph (d)(2)(ii) of this section, such as the amount of any capitalized cost reduction (or no capitalized cost reduction is required), shall not be more prominent than the disclosure of the total amount due at lease signing.

(2) *Advertisement of a lease rate.* If a lessor provides a percentage rate in an advertisement, the rate shall not be more prominent than any of the disclosures in § 213.4, with the exception of the notice in § 213.4(s) required to accompany the rate; and the lessor shall not use the term ''annual percentage rate,'' ''annual lease rate,'' or equivalent term.

(c) *Catalogs and multipage advertisements.* A catalog or other multipage advertisement that provides a table or schedule of the required disclosures shall be considered a single advertisement if, for lease terms that appear without all the required disclosures, the advertisement refers to the page or pages on which the table or schedule appears.

(d) *Advertisement of terms that require additional disclosure.*—(1) *Triggering terms.* An advertisement that states any of the following items shall contain the disclosures required by paragraph (d)(2) of this section, except as provided in paragraphs (e) and (f) of this section:

(i) The amount of any payment;

(ii) The number of required payments; or

(iii) A statement of any capitalized cost reduction or other payment required prior to or at consummation, or that no payment is required.

(2) *Additional terms.* An advertisement stating any item listed in paragraph (d)(1) of this section shall also state the following items:

(i) That the transaction advertised is a lease;

(ii) The total amount due at lease signing, or that no payment is required;

(iii) The number, amounts, due dates or periods of scheduled payments, and total of such payments under the lease;

(iv) A statement of whether or not the lessee has the option to purchase the leased property, and where the lessee has the option to purchase at the end of the lease term, the purchase-option price. The method of determining the purchase-option price may be substituted in disclosing the lessee's option to purchase the leased property prior to the end of the lease term;

(v) A statement of the amount, or the method for determining the amount, of the lessee's liability (if any) at the end of the lease term; and

(vi) A statement of the lessee's liability (if any) for the difference between the residual value of the leased property and its realized value at the end of the lease term.

(e) *Alternative disclosures—merchandise tags.* A merchandise tag stating any item listed in paragraph (d)(1) of this section may comply with paragraph (d)(2) of this section by referring to a sign or display prominently posted in the lessor's place of business that contains a table or schedule of the required disclosures.

(f) *Alternative disclosures—television or radio advertisements.*—(1) *Toll-free number or print advertisement.* An advertisement made through television or radio stating any item listed in paragraph (d)(1) of this section complies with paragraph (d)(2) of this section if the advertisement states the items listed in paragraphs (d)(2)(i) through (iii) of this section, and:

(i) Lists a toll-free telephone number along with a reference that such number may be used by consumers to obtain the information required by paragraph (d)(2) of this section; or

(ii) Directs the consumer to a written advertisement in a publication of general circulation in the community served by the media station, including the name and the date of the publication, with a statement that information required by paragraph (d)(2) of this section is included in the advertisement. The written advertisement shall be published beginning at least three days before and ending at least ten days after the broadcast.

(2) *Establishment of toll-free number.* (i) The toll-free telephone number shall be available for no fewer than ten days, beginning on the date of the broadcast.

(ii) The lessor shall provide the information required by paragraph (d)(2) of this section orally, or in writing upon request.

§ 213.8 Record retention.

A lessor shall retain evidence of compliance with the requirements imposed by this part, other than the advertising requirements under § 213.7, for a period of not less than two years after the date the disclosures are required to be made or an action is required to be taken.

§ 213.9 Relation to state laws.

(a) *Inconsistent state law.* A state law that is inconsistent with the requirements of the act and this part is preempted to the extent of the inconsistency. If a lessor cannot comply with a state law without violating a provision of this part, the state law is inconsistent within the meaning of section 186(a) of the act and is preempted, unless the state law gives greater protection and benefit to the consumer. A state, through an official having primary enforcement or interpretative responsibilities for the state consumer leasing law, may apply to the Board for a preemption determination.

(b) *Exemptions.*—(1) *Application.* A state may apply to the Board for an

exemption from the requirements of the act and this part for any class of lease transactions within the state. The Board will grant such an exemption if the Board determines that:

(i) The class of leasing transactions is subject to state law requirements substantially similar to the act and this part or that lessees are afforded greater protection under state law; and

(ii) There is adequate provision for state enforcement.

(2) *Enforcement and liability.* After an exemption has been granted, the requirements of the applicable state law (except for additional requirements not imposed by federal law) will constitute the requirements of the act and this part. No exemption will extend to the civil liability provisions of sections 130, 131, and 185 of the act.

Appendix A to Part 213—Model Forms

A–1 Model Open-End or Finance Vehicle Lease Disclosures

A–2 Model Closed-End or Net Vehicle Lease Disclosures

A–3 Model Furniture Lease Disclosures

BILLING CODE 6210–01–P

Appendix A-1 Model Open-End or Finance Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Amount Due at Lease Signing	**Monthly Payments**	**Other Charges** (not part of your monthly payment)	**Total of Payments** (The amount you will have paid by the end of the lease)
(Itemized below)* $ _____	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Disposition fee (if you do not purchase the vehicle) $ _____ [Annual tax] _____ _____ _____ Total $ _____	$ _____ You will owe an additional amount if the actual value of the vehicle is less than the residual value.

*** Itemization of Amount Due at Lease Signing**

Amount Due At Lease Signing:

Capitalized cost reduction	$ _____
First monthly payment	_____
Refundable security deposit	_____
Title fees	_____
Registration fees	_____
_____	_____
Total	$ _____

How the Amount Due at Lease Signing will be paid:

Net trade-in allowance	$ _____
Rebates and noncash credits	_____
Amount to be paid in cash	_____
Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($ _____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... − _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... − _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease term. The number of months in your lease ..... ÷ _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Rent and other charges. The total amount of rent and other charges imposed in connection with your lease $ _____ .

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $_____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $_____.

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

End of Term Liability. (a) The residual value ($ _____) of the vehicle is based on a reasonable, good faith estimate of the value of the vehicle at the end of the lease term. If the actual value of the vehicle at that time is greater than the residual value, you will have no further liability under this lease, except for other charges already incurred [and are entitled to a credit or refund of any surplus.] If the actual value of the vehicle is less than the residual value, you will be liable for any difference up to $ _____ (3 times the monthly payment). For any difference in excess of that amount, you will be liable only if:
1. Excessive use or damage [as described in paragraph ____] [representing more than normal wear and use] resulted in an unusually low value at the end of the term.
2. The matter is not otherwise resolved and we win a lawsuit against you seeking a higher payment.
3. You voluntarily agree with us after the end of the lease term to make a higher payment.
Should we bring a lawsuit against you, we must prove that our original estimate of the value of the leased property at the end of the lease term was reasonable and was made in good faith. For example, we might prove that the actual was less than the original estimated value, although the original estimate was reasonable, because of an unanticipated decline in value for that type of vehicle. We must also pay your attorney's fees.
(b) If you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____ .

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____ .

Late Payments. The charge for late payments is: _____ .

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

Appendix A-2 Model Closed-End or Net Vehicle Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Amount Due at Lease Signing	**Monthly Payments**	**Other Charges** (not part of your monthly payment)	**Total of Payments** (The amount you will have paid by the end of the lease)
(Itemized below)* $ _____	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Disposition fee (if you do not purchase the vehicle) $_____ [Annual tax] _____ _____ _____ Total $_____	$ _____

*** Itemization of Amount Due at Lease Signing**

Amount Due At Lease Signing:

Capitalized cost reduction	$ _____
First monthly payment	_____
Refundable security deposit	_____
Title fees	_____
Registration fees	_____
_____	_____
Total	$ _____

How the Amount Due at Lease Signing will be paid:

Net trade-in allowance	$ _____
Rebates and noncash credits	_____
Amount to be paid in cash	_____
Total	$ _____

Your monthly payment is determined as shown below:

Gross capitalized cost. The agreed upon value of the vehicle ($_____) and any items you pay over the lease term (such as service contracts, insurance, and any outstanding prior loan or lease balance) ..... $ _____

If you want an itemization of this amount, please check this box. ☐

Capitalized cost reduction. The amount of any net trade-in allowance, rebate, noncash credit, or cash you pay that reduces the gross capitalized cost ..... − _____

Adjusted capitalized cost. The amount used in calculating your base monthly payment ..... = _____

Residual value. The value of the vehicle at the end of the lease used in calculating your base monthly payment ..... − _____

Depreciation and any amortized amounts. The amount charged for the vehicle's decline in value through normal use and for other items paid over the lease term ..... = _____

Rent charge. The amount charged in addition to the depreciation and any amortized amounts ..... + _____

Total of base monthly payments. The depreciation and any amortized amounts plus the rent charge ..... = _____

Lease term. The number of months in your lease ..... ÷ _____

Base monthly payment ..... = _____

Monthly sales/use tax ..... + _____

_____ ..... + _____

Total monthly payment ..... =$ _____

Early Termination. You may have to pay a substantial charge if you end this lease early. The charge may be up to several thousand dollars. The actual charge will depend on when the lease is terminated. The earlier you end the lease, the greater this charge is likely to be.

Excessive Wear and Use. You may be charged for excessive wear based on our standards for normal use [and for mileage in excess of _____ miles per year at the rate of _____ per mile].

Purchase Option at End of Lease Term. [You have an option to purchase the vehicle at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the vehicle at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official and license fees, registration, title, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $_____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease:

_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $_____.

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased vehicle:

_____ .

Maintenance.
[You are responsible for the following maintenance and servicing of the leased vehicle:

_____].

[We are responsible for the following maintenance and servicing of the leased vehicle:

_____].

Warranties. The leased vehicle is subject to the following express warranties:

_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:

_____ .

The charge for such early termination is:

_____ .

(b) We may terminate this lease before the end of the lease term under the following conditions:

_____ .

Upon such termination we shall be entitled to the following charge(s) for:

_____ .

(c) To the extent these charges take into account the value of the vehicle at termination, if you disagree with the value we assign to the vehicle, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the leased vehicle which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease:

_____ .

Late Payments. The charge for late payments is: _____ .

Option to Purchase Leased Property Prior to the End of the Lease. [You have an option to purchase the leased vehicle prior to the end of the term. The price will be [$ _____ /[the method of determining the price].] [You do not have an option to purchase the leased vehicle.]

Appendix A-3 Model Furniture Lease Disclosures

Federal Consumer Leasing Act Disclosures

Date _____

Lessor(s) _____ **Lessee(s)** _____

Description of Leased Property				
Item	Color	Stock #	Mfg.	Quantity

Amount Due at Lease Signing	**Monthly Payments**	**Other Charges** (not part of your monthly payment)	**Total of Payments** (The amount you will have paid by the end of the lease)
First monthly payment $ _____ Refundable security deposit $ _____ Delivery/Installation fee $ _____ _____ $ _____ Total $ _____	Your first monthly payment of $ _____ is due on _____, followed by _____ payments of $ _____ due on the _____ of each month. The total of your monthly payments is $ _____.	Pick-up fee $ _____ _____ $ _____ Total $ _____	$ _____

Purchase Option at End of Lease Term. [You have an option to purchase the leased property at the end of the lease term for $ _____ [and a purchase option fee of $ _____].] [You do not have an option to purchase the leased property at the end of the lease term.]

Other Important Terms. See your lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interest, if applicable.

[The following provisions are the nonsegregated disclosures required under Regulation M.]

Official Fees and Taxes. The total amount you will pay for official fees, and taxes over the term of your lease, whether included with your monthly payments or assessed otherwise: $ _____ .

Insurance. The following types and amounts of insurance will be acquired in connection with this lease: _____
_____ .

_____ We (lessor) will provide the insurance coverage quoted above for a total premium cost of $ _____ .

_____ You (lessee) agree to provide insurance coverage in the amount and types indicated above.

Standards for Wear and Use. The following standards are applicable for determining unreasonable or excess wear and use of the leased property:
_____

Maintenance.

[You are responsible for the following maintenance and servicing of the leased property:
_____.]

[We are responsible for the following maintenance and servicing of the leased property:
_____.]

Warranties. The leased property is subject to the following express warranties:
_____ .

Early Termination and Default. (a) You may terminate this lease before the end of the lease term under the following conditions:
_____ .

The charge for such early termination is: _____ .

(b) We may terminate this lease before the end of the lease term under the following conditions: _____ .

Upon such termination we shall be entitled to the following charge(s) for: _____ .

Early Termination and Default. (continued)

(c) To the extent these charges take into account the value of the leased property at termination, if you disagree with the value we assign to the property, you may obtain, at your own expense, from an independent third party agreeable to both of us, a professional appraisal of the _____ value of the property which could be realized at sale. The appraised value shall then be used as the actual value.

Security Interest. We reserve a security interest of the following type in the property listed below to secure performance of your obligations under this lease: _____.

Late Payments. The charge for late payments is: _____.

Purchase Option Prior to the End of the Lease Term.

[You have an option to purchase the leased property prior to the end of the term. The price will be [$ _____]/the method of determining the price].]

[You do not have an option to purchase the leased property.]

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Appendix B to Part 213—Federal Enforcement Agencies

The following list indicates which federal agency enforces Regulation M (12 CFR Part 213) for particular classes of business. Any questions concerning compliance by a particular business should be directed to the appropriate enforcement agency. Terms that are not defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in the International Banking Act of 1978 (12 U.S.C. 3101).

1. *National banks and federal branches and federal agencies of foreign banks*
   District office of the Office of the Comptroller of the Currency for the district in which the institution is located.
2. *State member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act*
   Federal Reserve Bank serving the District in which the institution is located.
3. *Nonmember insured banks and insured state branches of foreign banks*
   Federal Deposit Insurance Corporation Regional Director for the region in which the institution is located.
4. *Savings institutions insured under the Savings Association Insurance Fund of the FDIC and federally chartered savings banks insured under the Bank Insurance Fund of the FDIC (but not including state-chartered savings banks insured under the Bank Insurance Fund)*
   Office of Thrift Supervision regional director for the region in which the institution is located.
5. *Federal credit unions*
   Regional office of the National Credit Union Administration serving the area in which the federal credit union is located.
6. *Air carriers*
   Assistant General Counsel for Aviation Enforcement and Proceedings, Department of Transportation, 400 Seventh Street, S.W., Washington, DC 20590
7. *Those subject to Packers and Stockyards Act*
   Nearest Packers and Stockyards Administration area supervisor.
8. *Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, and Production Credit Associations*
   Farm Credit Administration, 490 L'Enfant Plaza, S.W., Washington, DC 20578
9. *All other lessors (lessors operating on a local or regional basis should use the address of the FTC regional office in which they operate)*
   Division of Credit Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, DC 20580

Appendix C to Part 213—Issuance of Staff Interpretations

Officials in the Board's Division of Consumer and Community Affairs are authorized to issue official staff interpretations of this Regulation M (12 CFR Part 213). These interpretations provide the formal protection afforded under section 130(f) of the act. Except in unusual circumstances, interpretations will not be issued separately but will be incorporated in an official commentary to Regulation M (Supplement I of this part), which will be amended periodically. No staff interpretations will be issued approving lessor's forms, statements, or calculation tools or methods.

Supplement I to Part 213—[Amended]

4. The Supplement to part 213 is amended by revising the heading to read as follows:

Supplement I to Part 213—Official Staff Commentary to Regulation M

Note: Appendix I will not appear in the Code of Federal Regulations.

Appendix I to the Preamble—Regulatory Flexibility Analysis

I. Introduction

Acquiring and financing a substantial asset through purchase credit or a lease contract ranks among the most complicated financial transactions a typical consumer undertakes. In fundamental economic terms, however, a consumer's decision whether to lease rather than use more traditional forms of credit is relatively straightforward. Stating the problem in its simplest form, a consumer should lease an asset rather than purchase it on credit if the discounted present cost of all the lease payments and outflows (including down payments and any deferred payment for a residual value where relevant) is less than the present cost of all outflows for the credit purchase over a comparable period of leasing or ownership.

Unfortunately, difficulties arise that make this criterion less than straightforward for many consumers. One problem is properly accounting for the streams of outflows—including acquisition charges, down payments, periodic payments, disposal charges, taxes, insurance premiums, and other outflows—that can differ in both timing and amounts under the two financing alternatives. A more basic concern is that consumers do not typically think in terms of present values, discount rates, and other elements of financial economics that are second nature to the financial analyst, even though present value is the index that brings asset acquisitions under different financing schemes into the same framework.

To help satisfy concerns that individuals did not have the necessary information available to make lease versus purchase decisions wisely, Congress in 1976 mandated consumer disclosures for leases by passing the Consumer Leasing Act. Structurally, the Consumer Leasing Act is an amendment to the Truth-in-Lending Act, which Congress established as a basic consumer protection in 1968. A recurring question since then is whether the Truth-in-Lending Act generally, including the Consumer Leasing Act component (which is unchanged since passage), meets the needs of consumers in today's marketplace.[1]

This paper examines current and proposed disclosure requirements for vehicle leasing, the largest segment of the leasing industry subject to consumer disclosure requirements, in light of consumers' information needs—including what is necessary to calculate present values, the method of comparison that places all financing methods on the same footing. First, Section II looks briefly at types of automobile leases commonly available in today's marketplace and notes some important characteristics. Section III then reviews the cash flows that arise under the most common form of consumer automobile-leasing arrangement, the closed-end operating lease, and specifies a present value equation that consumers might use to analyze their leasing decisions. Finally, Section IV examines staff proposals to revise the disclosure requirements in Regulation M, the regulation that implements the Consumer Leasing Act, in view of consumers' information needs and the regulatory burdens that the proposed changes would entail.

II. Kinds of Leases

As the leasing market has evolved over the years, the closed-end operating lease has become typical in consumer transactions, at least in the big market for automobiles and light trucks. An ''operating lease'' covers a period of time shorter than the whole economic life of an asset. There is an expectation that an asset will still have an economic value (usually called its ''residual value'') at the end of an operating lease. With an operating lease, an asset user (lessee) agrees to pay for the expected depreciation of an asset during the lease period, plus a financing or lease charge to compensate the owner (lessor) for the use of the lessor's capital, including a

[1] Congress itself is reviewing this question in the 1995–6 session as members in each house have introduced bills to amend both Truth in Lending and the Consumer Leasing Act.

profit. Common car rentals or apartment leases are examples of short-term operating leases.

Also increasingly familiar today are longer-term operating leases (possibly up to 4–5 years) that auto dealers offer consumers through leasing companies and banks. These operating leases have become important substitutes for purchase financing for consumers and are widely advertised by both automobile manufacturers and dealers. Like a car renter or apartment lessee, a vehicle lessee under these plans uses the asset for a term but must return it to the lessor at the end of the lease period (unless the parties make some other arrangement for disposition). An operating lease always assumes the asset will have some remaining economic life and value at lease end. Consequently, transfer of ownership at lease end (to the lessee or another party) requires additional payment for the residual value.[2]

Among operating leases for consumers, the ''closed-end'' operating lease, sometimes referred to as a ''walk-away'' lease, has become the most common form of automobile lease agreement. On a closed-end operating lease the lessee has no obligation concerning the market value of the lessor's asset at lease end. The agreement merely requires the consumer to return the asset at lease end and to pay then for any excess damage above normal expected wear and tear.[3] Common, long-term, closed-end lease agreements for automobiles and trucks typically contain an option for consumers to purchase their vehicles at lease end at a price agreed upon at the outset, but there is no obligation to purchase.

The closed-end operating lease contrasts with the less common ''open-end'' operating lease where the lessee still does not have a requirement to purchase but where there is an obligation at lease end to make up to the lessor any shortfall in the actual market value of the asset from expectations. In effect, the open-end lessee guarantees the residual value of the lessor's asset. Under typical open-end automobile lease contracts, consumer lessees also may purchase their vehicles at lease end for a purchase price guaranteed at the outset, but open-end lessees cannot walk away. Rather, if they return their vehicles, they are liable for any differences between assumed residual values and actual, realized market values at lease end.[4]

From this description it is easy to see that the embedded fixed-price purchase options in common, closed-end operating leases for vehicles present consumers with different risk characteristics on their transaction than purchase financing. Closed-end lessees do not bear any risk of decline in the residual value of used assets below expectations over the lease period, but open-end lessees and purchasers do. If at lease end the value of the asset is below the deferred purchase price set at the outset, the closed-end lessee may return the asset and walk away. If, in contrast, the market value at lease end is greater than expected, the lessee may keep the asset by paying the deferred purchase price agreed upon at the signing of the lease and can retain it or sell it. For the closed-end lessee this amounts to a ''heads I win, tails you lose'' proposition, at least with respect to the residual value of the asset. It seems reasonable to suppose that lessors will charge closed-end lessees for the purchase option feature that transfers the residual-value risk to the lessor. Purchasers and open-end lessees bear this risk themselves. Ultimately, it is this difference in risk bearing, together with differences in the size and timing of cash flows (discussed in the next section), that characterizes the distinction for consumers between leasing and purchase financing.

III. Cash Flows

Before examining proposals for disclosures on consumer vehicle leases, there is some usefulness in examining the cash flows that arise from lease and purchase-financing contracts. Ultimately, it is comparison of the present values of the outflows that arise under the different financing schemes that resolves the question of best choice.

In the long run in a competitive, perfect capital market with full information and without transaction costs or taxes, the type of financing arrangement for retail purchase of automobiles by consumers would be a matter of indifference to both consumers and creditors/lessors: both costs to consumers and yields to creditors and lessors would be the same under the two financing alternatives. Clearly, capital markets are not perfect, however. First of all, there are transaction costs that may differ between leasing and debt financing. Also, taxes may differ between consumers and lessors, as well as between financing schemes, and there may be risk differences among consumers and among types of transactions. On occasion there also may be marketing promotions that encourage one transaction form over the other. Consequently, at different times leasing may be more or less advantageous than purchase financing to either consumers or creditors/lessors, and both consumers and creditors/lessors have an interest in evaluating the alternatives.

Fundamentally, consumers should choose a closed-end operating lease instead of debt financing only if the present value of all the costs (outflows) arising from the lease (including any down payment) is less than the present value of outflows resulting from the credit purchase over a comparable period of leasing or ownership.[5] The present value of the purchase option embedded in a closed-end operating lease, which the consumer also pays for as part of the lease payments, must be subtracted from the present value of the lease payments in order to maintain comparability between the packages of transportation-related services purchased. This presents the following decision criterion:

If Sum PV (LP) − PV (Option) < Sum PV (FP), then lease, where PV ( ) = Present Value (of quantity in brackets),

LP = all payments on a lease,
FP = all payments on a financed purchase, and
Option = Value to lessee of purchase option.

That is, if Sum PV (FP) + PV (Option) − Sum PV (LP) > 0, then lease. (1)

To analyze the decision, a consumer should discount the leasing flows at the annual percentage rate available on the credit purchase or loan. If the discounted present value of the credit flows (which equals the purchase price) plus the present value of the option is greater than the discounted present

[2] The alternative to an operating lease is a ''full-payout'' or ''financial'' lease, which finances the whole economic life of an asset by fully paying for (amortizing) the asset's capitalized cost, plus financing charges. Financial leases are not common in consumer leasing; they are more common in commercial leases and sale-leaseback transactions involving industrial buildings and equipment.

[3] There may be a refundable security deposit to guarantee payment for damages. For automobiles there may also be a small ''disposition'' or ''drop off'' charge specified in the contract. The typical automobile lease contract also specifies a yearly average mileage limit to avoid having charges for excess usage collected at lease end.

[4] The Consumer Leasing Act limits a consumer's liability for the difference between expected and actual market value on an open-end vehicle lease to no more than three times the amount of the monthly payment. This provision likely has encouraged the use of closed-end leases by making open-end leases less useful to lessors as a way of shifting risks to their customers.

[5] Although the discussion here concerns comparing a lease with a purchase, comparing two leases or two purchases would proceed in fundamentally the same way.

value of the leasing flows, then leasing is the better choice and vice versa.[6]

Leaving aside the question whether consumers understand present values and the discounting process, the difficult matter in analyzing the decision is to specify the flows properly for the two kinds of arrangements. Typically, they will differ in form, timing, and amount. Also, valuing the purchase option available on a closed-end lease might become an important aspect of the decision.[7]

Table 1 provides a listing of the four possible patterns of cash outflows arising from (1) a closed-end lease and (2) a purchase agreement for an automobile. For the lessee there are two possibilities at lease end: the lessee may return the vehicle to the dealer or may exercise the purchase option and buy it. For the credit purchaser there are also two possibilities at the end of the payment period: the owner can keep the vehicle or sell it. The table adopts the convention that outflows are positive and inflows negative; thus, the table expresses net costs of the transactions.

Initial Flows. Under this convention, the consumer receives from a lease or a financed purchase an inflow (negative cost) of transportation and other services from the vehicle during the period covered by the agreement.[8] Over comparable time periods the transportation services are assumed to be independent of the financing method (line 1 of Table 1).[9]

Some of the initial outflows arising from the two alternative financing methods will also be the same between the alternatives, but some will differ. For both types of financing the consumer agrees to a series of outflows to satisfy the payment obligation. Frequently, the first of these is a trade-in of a vehicle already owned by the consumer (line 2 in the table). With the assumption that the consumer trades in the same vehicle under both financing schemes, the trade-in is the same under the two alternatives; this is denoted in the table by equal signs between columns.

Often the trade in is accompanied by a cash down payment (line 3). (On a lease the down payment and the trade in are often called the ''capitalized cost reduction.'' In Table 1 this term applies to the cash component.) A lessee typically must also provide a security deposit, which often approximates one monthly payment on the lease obligation (line 4). Upon satisfaction of the lease agreement this security deposit is refunded at lease end (line 5).

Periodic Flows. In addition to these initial outflows, the consumer is also obligated for a series of further cash payments over the agreement period, usually monthly (line 6). On a lease the first payment typically is due at signing, while a credit-purchase agreement normally defers the first payment for a month. In many jurisdictions vehicle owners are also subject to personal property taxes on their vehicles owned or ''garaged'' within tax districts such as counties or states (line 7). On a lease in some jurisdictions the lessor may be responsible for these taxes, which it recoups by upping the necessary periodic payments. Consequently, for lessees the flows for personal property taxes may not appear as a separate, explicit outflow on a lease in many tax jurisdictions, even if personal property taxes are explicit for financed purchases. For comparability with a credit purchase, therefore, either the taxes in these jurisdictions must be subtracted from the lease payments or added to the finance payments.[10]

End-of-Term Flows. End-of-term outflows also differ between purchasing and leasing. In the credit purchase case the consumer owns the vehicle at the end of the financing period and holds the right to continued transportation services over the additional expected life of the vehicle; with a lease the consumer does not have this right. To compare a lease with purchase financing, it is necessary to account for the remaining transportation services at lease end.

One possibility, of course, is that the consumer purchases the leased vehicle at the end of the lease period, thereby obtaining the remaining transportation services. On a typical closed-end lease the consumer obtains the vehicle and its remaining services by purchasing it at the optional purchase price disclosed in the original lease agreement, or at some other price negotiated between the parties. This price becomes another outflow (line 8), this one deferred until the end of the lease period.[11]

Because the lessee does not have to make the decision whether or not to retain the vehicle until the end of the lease period, at the outset the deferred decision amounts to a call option for the lessee, and, as noted previously, this option has value because it transfers risks of residual price fluctuations to the lessor. In effect, when lessees contract for the services of vehicles, they obtain options to call the residual values of their vehicles at the end of the leases by paying at lease end a deferred optional purchase price agreed at the outset. This differentiates the lessee from the credit purchaser who owns the vehicle and bears all of the residual price risk. To maintain comparability with a purchase, the present value of this option must be subtracted from the present value of the lease costs or added to the present value of the purchase-finance costs (see equation 1, above).

The other possibility is that the consumer returns the vehicle to the lessor at lease end, thereby giving up any claim to transportation services

[6] Because discounting the flows from a financed purchase at the annual percentage rate paid for the credit equals the price of the asset, substituting the price of the asset for the discounted present value of the finance flows produces a standard net advantage of leasing (NAL) equation (see Myers, Dill, and Bautista [1976]). Substituting into equation 1 produces the decision criterion:

If NAL = Purchase Price (FP) + PV (Option) − Sum PV (LP) > 0, then lease.

[7] As a practical matter, the value of this option may not be very great to the extent that lessors are reasonably competent in predicting values of used assets in the future and set residual values and optional purchase prices at lease end accordingly.

[8] Services provided by the vehicle may also include psychological services such as pride of ownership or opportunity to drive a new or stylish automobile or truck, and in the past these psychological services may have varied depending on whether the transaction was a purchase with financing or was a lease. For example, it is possible that at least some drivers felt better thinking they ''owned'' a vehicle rather than they merely leased its services. Leasing has recently become such a common financing alternative, however, that it seems reasonable to assume that these psychological services are similar for purchase financing and leasing today and that they are of comparable value. Differences that may have existed formerly may be ignored today.

[9] Transportation services may differ between the leasing and the purchase financing cases if the amount of yearly mileage permitted under a lease without an additional mileage charge (typically 12,000 or 15,000 miles per year, but with variations) constrains the potential purchaser. For illustrative purposes this limitation is assumed not to be binding so that transportation services provided by the leased and financed vehicles are the same for this example. If the constraint were binding because the potential lessee intends to drive more than the yearly maximum, then another term for the present value of the expected deferred excess mileage charge due at lease end would be added to column 2 of the table.

[10] Identifiable personal property taxes may be deductible from adjusted gross income for federal and state income tax purposes for some consumers, which also should be properly taken into account by those eligible for the deduction. There also may be sales taxes associated with both the credit purchase and the lease. For comparing a purchase to a lease, both must be accounted for properly to avoid erroneous conclusions. For example, on a purchase sales taxes may be financed as part of the gross purchase price and paid for through the down payment and periodic payment flows. On a lease they may be collected monthly as part of the monthly payment, either explicitly or not. Each of these possibilities requires an adjustment in the table to account properly for the facts of individual situations.

[11] This purchase price may also be financed, in which case the price becomes another stream of outflows. The lessor and lessee may also agree to another lease or to a continuation of the old lease agreement. The examples in the table do not reflect these possibilities.

remaining in the vehicle. In this case the lessee returns the vehicle and pays any drop-off or disposition charge in the contract (line 9), but not any optional purchase price (line 8 is zero in this case).[12]

Purchasers who sell their vehicles receive a wholesale selling price upon sale (line 10 in the table). Those who sell them privately and not to a dealer may receive an amount closer to the retail price (if the cars are in good condition), less, of course, their costs of selling, including advertising expenses and the costs of personal time spent on the sale process (and subjective personal costs of any accompanying aggravations).

Contingencies. Two contingencies might lead to additional outflows. First, there is a chance that a vehicle may be worth more or less at the time of eventual disposition than the consumer expects at the outset, which may be important to the consumer in some cases. If the consumer expects to purchase the vehicle at lease end or plans to retain the vehicle at the end of the purchase finance period, however, planned disposition likely will take place long enough into the future that the consumer may well not have at the outset any expectation about the value many years hence. If so, this contingency probably need not enter into the present value calculations at the outset of the transaction (or into columns 1 or 3 of Table 1).[13]

In the other situation, that is, if the consumer does not intend to retain the vehicle at lease end or plans to sell the purchased auto, the time before expected disposition is shorter and unexpected loss may become a factor in decision making. For the closed-end lessee the lessor bears this risk; the value to the consumer of avoiding the loss is subsumed into the value of the call option on the vehicle's residual value. Thus, of the four cases only the purchaser who plans to sell the vehicle upon completion of the payments is subject to this potential risk (column 4 on line 11 in the table).[14]

A second contingency is the chance of a loss upon an early termination of the lease or upon a sale of the vehicle before the end of the credit-purchase agreement period. A loss on early termination might occur following theft or an accident not fully covered by insurance, or because the consumer desires to change vehicles before the end of the lease or purchase financing agreement. For both lessees and purchasers this risk is independent of plans to retain the vehicle or not at the end of the payment period and can be assumed equal for all lessors or all purchasers (indicated by equal signs on line 12 of Table 1). Since a loss (outflow) is more likely than an unexpected gain under these circumstances, however, the expected value is probably positive. To minimize the size of such losses for lessees in the cases of accident or theft (and the financial and legal difficulties that might arise) ''gap insurance'' often is available from lessors, typically included as part of the leasing transaction and charge. For most consumers, though, either the prior probability of unexpected early termination (and, consequently, the expected value of any associated loss) is probably small enough in the consumer's mind at the outset of the transaction, or the expectation of a difference in loss size in this area between leasing and purchase financing is probably small enough, that expectation of a loss on early termination is probably not much of a factor in the choice between leasing and financing.[15]

Now, the quantities in Table 1 can be substituted into equation 1 to derive the net advantage of leasing, first, for the case where the consumer keeps the vehicle at lease end (equation 2); and, second, for the situation where the consumer does not retain the vehicle (equation 3).

To ease solution, a few simplifications of the equations are possible. First, because Transportation Services (line 1 of Table 1) are assumed to be the same for comparable periods of ownership and lease holding, they may be ignored and omitted from the equations. Likewise, since the trade in is the same (line 2), it may also be dismissed. Third, if the expected value of the loss from an early termination (line 12) either is not very large or does not differ much between a financed purchase and a lease, it also can drop from the equation, since it is the difference between these quantities for a financed purchase and a lease which would enter the equation anyway. Thus, with these assumptions and recalling that leases but not purchases commonly require one monthly payment in advance, this leaves the following specifications for equations 2 and 3 for finance and lease periods of N months:

(2), (3): See Equations (2) and (3) at the End of the Analysis

These equations exhibit some features that should receive special mention. First, as discount rates move higher but other things are equal, leasing becomes relatively more attractive. Specifically, in the case where the vehicle is retained (equation 2), higher discount rates make leasing more attractive because higher discount rates relatively reduce the discounted future purchase price of the leased vehicle. This decreases the second (subtracted) term in equation 2 (the term in square brackets), tending the equation toward a positive value favoring leasing. In contrast, where the vehicle is not retained at contract end (equation 3), higher discount rates favor leasing for a different reason. In this case as the discount rate rises, it relatively decreases the present value of the sale price of the vehicle in the future. Since this is a subtracted item in the first part of the equation, higher discount rates again increase the likelihood that the equation will be positive, again tending to favor leasing relatively.

Second, the non-retention case (equation 3) requires a term, the future sale price of the vehicle, that is not known at the outset of the transaction. Even if an expected used car price some time in the future is available from some guidebook, there is no certainty concerning this price, and there is no certainty about advertising, sales and aggravation costs that properly should reduce the final sales price. Consequently, equation 3 requires some estimating and cannot serve as a definitive guide.

Third, both equations 2 and 3 contain a term for the discounted value of the purchase option available on a closed-end operating lease. Estimating the value of this option is not a simple matter, although its value may not be very great to the extent that experienced automobile dealers are reasonably proficient at estimating the values of used vehicles some time into the future.

In sum, a consumer's informed choice whether to lease or purchase an asset like a vehicle depends on the amount and pattern of the stream of outflows

[12] The lessee still acquires the purchase option, even if the ultimate decision is to return the vehicle at lease end, and so the present value of the option remains a term in equation 1, above.

[13] Even if there is a recognized prior probability of deferred gain or loss, there is no reason to expect a difference if original acquisition is through a lease or purchase contract. If loss expectations are equal at the outset, they can be ignored in the calculations (and the table) when making comparisons.

[14] For such a purchaser who plans to sell there is the real possibility of an unexpected loss upon disposition of the vehicle, but there may also be an unexpected gain. If the likelihood of the loss or gain is unknown at the outset of the lease arrangement, it might be argued that the expected value of the distribution of possibilities may well be zero, arguing for its dismissal from the calculations and the table. Because the risk of loss exists, however, an expected value of loss upon disposition is a potential outflow for a purchaser (column 4, line 11).

[15] This is not an argument against required disclosure of the existence of such a risk, however.

and on the discount rate that converts the stream of outflows to present values. Unfortunately, presence in a closed-end lease of a purchase option with unknown value and consumer uncertainty about future used-car prices mean that the single-equation optimal decision criterion will always contain multiple unknowns and be insoluble mathematically, even if the discount rate is known. Consequently, the search is not for the perfect set of disclosures, but rather for the set that enables most consumers to make good decisions most of the time.

IV. Required Disclosures

Staff proposals to revise Regulation M would make substantial changes to the format and content of required disclosures on consumer leases. In analyzing this (or any) disclosure regime, a few general principles seem useful:

(1) The goal of a disclosure scheme should be to make available sufficient information that consumers can make good decisions, not to require every disclosure that might possibly be useful to someone, sometime, for some purpose. No disclosure scheme, it seems, will ever be able to insure that all consumers understand everything or that they never have to read contracts or make any calculations for themselves. Required disclosures can be used to compare features of transactions, but cannot reasonably be specific to individuals whose situations will differ.

(2) Whenever possible, disclosures should discourage obvious opportunities for abuses.

(3) Regulatory requirements (and changes in requirements) should maintain a reasonable balance between costs and benefits.

(4) Transaction-specific disclosures are the most costly and should demonstrate clear benefits.

Avoiding the issue whether the Consumer Leasing Act itself satisfies these requirements, it appears that the proposed redrafted Regulation M does so, within the constraints of the law. The redrafted regulation mandates that lessors make substantial changes in the format and content of required disclosures, but it seems that the new approach will improve the quality and accessibility of useful information to consumers. Furthermore, much of the leasing industry supports the bulk of the proposed changes.

It does not seem, however, that any leasing-disclosure scheme can provide all of the information required for consumers to solve equations 2 or 3 for the theoretically correct choice between a lease and a financed purchase. First of all, leasing disclosures cannot reasonably be expected to provide information about the purchase-financing alternative to a lease, which is necessary to solve either equation. Consumers would have to obtain this information themselves by shopping, even if this merely means obtaining the necessary information from the same dealer. Second, some information like personal property taxes and an individual's personal tax situation are idiosyncratic to each shopper and must be factored into the purchase or lease decision by that person. Third, as already mentioned, both equations 2 and 3 require some information, such as future prices of used vehicles and the present value of the purchase option, that is not readily available to either party to the transaction except by crude estimation.

For these reasons, it does not seem reasonable to expect that any disclosure scheme will provide all the information that a consumer might find useful; it simply is not possible. Nonetheless, most of the information that consumers might need to characterize a lease is available from the required disclosures. Moreover, the new disclosure scheme should make this information easier for consumers to comprehend and use.

The proposed regulation redraft does require disclosures of some transaction-specific numerical quantities beyond those mandated by the statute, which is quite detailed. In those cases where the proposed redraft extends the law it appears, for the most part, to respond to consensus of both industry and consumerist comments that such requirements would be useful. Except for the quantity called the ''total of payments,'' all of the new numeric disclosures are amounts that lessors already calculate and have readily available. For this reason disclosing most of these additional quantities, even though not required by statute, may not by itself cause substantial marginal cost as part of a complete revamping of the disclosure regime. Proposed major changes to the regulation include the following:

(1) *Formatting Changes.* The new disclosure plan will require substantial changes in disclosure format for all lessors. Especially notable are first, the requirements for segregation of a group of key disclosures in a highlighted ''federal box''; and second, disclosure of elements that comprise the monthly payment in a mathematical progression. Although a segregated ''federal box'' of disclosures and a mathematical progression are not required by the statute, they follow the general approach for credit disclosures that became part of Regulation Z under the Truth-in-Lending Act amendments of 1980. Third, staff also proposes requiring a new format for itemization of the amount due from the consumer at inception of the lease, disclosures already required. Under the proposed format in this area, itemization of amounts due at signing would be in two columns, one listing amounts due at signing and the other designating means of paying the itemized costs.

It appears that the proposed new requirements for formatting in all three areas could help consumers become aware of important terms without searching through the contract, as is sometimes necessary today. At present, Regulation M contains no placement requirement for the key disclosures except that they be clear, conspicuous, in meaningful sequence, and that they be on the same page and above the lessee's signature. Otherwise, lessors may spread the disclosures through the contract document. For disclosing monthly payments, the current requirement is disclosure of the total amount required plus identification of the components; the regulation does not currently require disclosure of the amounts of the individual components, although some lessors have disclosed amounts of components and there has been some confusion concerning exactly what is required. Presentation of a mathematical progression should help interested consumers understand the intricacies of their transactions. The new requirement for placement of disclosures of amounts due at lease signing should help clarify questions consumers may have about any of these quantities.

Even though the proposed format of the segregated key disclosures, the mathematical progression, and the amounts due at lease signing are not required by the Consumer Leasing Act, comments from the automobile leasing industry largely support such requirements. The automobile leasing industry originally proposed both the segregated key disclosures and the mathematical progression to the monthly payment, and industry comment letters have strongly favored them since. The new requirement for a two-column disclosure of amounts due at lease signing merely calls for a reorganization of current disclosures.

In all three areas the new disclosure placement requirements would replace the current mandates concerning type size, sequencing, and placement on the same page as the lessee's signature. In the past these requirements have, on occasion, caused lessors some difficulties in form design anyway.

Sufficient lead time before a mandatory compliance date could minimize any disruptions caused by the necessity of redesigning and reprinting disclosure forms and of reprogramming computer systems to print the new forms. In addition, staff has proposed new model disclosure forms with segregated disclosures and mathematical progression. Use of these model forms ensures compliance and provides a safe harbor from liability if the form is used properly.

(2) *New Disclosures Associated with the Mathematical Progression Leading to the Monthly Payment.* As indicated above, the revised regulation also requires some new disclosures. They include disclosure of gross capitalized cost, adjusted capitalized cost, residual value, rent charge, and total of payments. Except for total of payments, these new disclosures arise as components of a mathematical progression leading to the monthly payment. There are also requirements for calculating and disclosing certain subtotals. Gross capitalized cost is analogous to gross purchase price including lease acquisition charges, carried-over balances on any previous transactions, initial taxes owed, registration fees, delivery charges, and any after-market products such as extended warranties. Adjusted capitalized cost is gross capitalized cost less ''capitalized cost reductions'' including trade-in allowances, cash down payments, rebates, and any other reductions. The residual value of the lease is the estimated value of the asset at lease end. The rent charge is the lessor's added-on charge to cover transaction costs and the charge for capital use, including any profit from financing.

Lessors determine periodic payments by subtracting the capitalized cost reductions and lease residual from the gross capitalized cost and adding the rent charge. They then divide the resulting quantity by the number of periods to determine the size of the base periodic payments, excluding any added amounts for taxes and insurance. Thus, each of these new disclosures (gross capitalized cost, adjusted capitalized cost, rent charge, and lease residual) are amounts that lessors must have readily available to make their calculations, although there has previously been no requirement for their disclosure. Likewise, newly required subtotals like total capitalized cost reduction (including cash component, trade in, and rebate or other noncash component) and amount to be depreciated and amortized (adjusted capitalized cost less lease residual) are directly derived from amounts already calculated and do not represent departures into a new disclosure scheme.

As noted above, the automobile leasing industry has supported requiring these additional disclosures as part of the development of a mathematical progression leading to the monthly payment. Apparently, some of the industry commentary favoring these disclosures arises from a concern reported from time to time in the press that some dealers may, on occasion, take advantage of potential lessees by raising the capitalized cost of a vehicle and then not disclosing the amount. Because both monthly lease payments and early termination penalties are based on this term, the concern has been that nondisclosure has the potential to permit abuses. Although all of these disclosures are transaction-specific, they are already calculated by the lessor for each transaction and are, therefore, readily available.

One additional new disclosure, the total of payments, is not part of the progression leading to the monthly payment, but it is merely another calculation based on quantities already disclosed or readily available, Thus, it should not be especially costly for lessors to produce as part of a revised disclosure scheme. It consists of the sum of the amounts due at lease signing plus the total of the periodic payments (payment amount times number of payments) plus other charges (likely to consist largely of disposition fees and taxes).

Although disclosure of the total of payments may be useful to consumers on some occasions, it may not be especially useful for shopping purposes on others because the total will vary directly with the value of the vehicle and maturity of the lease, other things equal. Consequently, even if it is useful in some cases for comparing amounts on competing leases with similar terms, it will be less useful for comparing leases on different vehicles or on the same vehicle for different lease maturities. Also, it is not a present value, and the present value of any particular amount can vary substantially with different timing patterns of outflows.

Even if these new disclosures have the potential to improve consumer protection and most appear to be favored by at least most of the automobile leasing industry, they will undoubtedly entail some additional cost. They may also be somewhat controversial among dealers, as opposed to lessors, because the new disclosures may limit their flexibility and will cause them to have to learn about new disclosures and forms. If the effective date of any final rule in this area is sufficiently deferred, however, it will minimize the difficulties of transition. Also, the cost of reprinting forms and reprogramming systems will largely be borne by lessors, who appear to be favorably inclined to the proposal, rather than by dealers.[16]

(3) *Other New Disclosures.* Staff also proposes some additional new disclosures that would appear below the monthly payment calculation on the model form. These include a warning to consumers that they may be liable for excess wear and use (including the amount of any excessive mileage charge), disclosures concerning any purchase option at lease end, and a direction that consumers refer to the rest of the disclosure statement or the contract for a list of other Consumer Leasing Act disclosures. Since all but the purchase-option price, if any, these are not transaction-specific disclosures and lessors can pre-print them on disclosure documents, these changes to the regulation should not be especially costly either, since lessors will be reprinting forms anyway as part of the change to the new disclosure scheme. The purchase-option information can be preprinted (except for the price itself, which may even be hand written).

Another preprinted disclosure requires special mention. The Consumer Leasing Act and Regulation M require lessors to disclose the ''amount or method'' of determining any charge for early termination of a lease and that the amount be ''reasonable.'' Most lessors have disclosed the method of determining the charge, but this approach has generated litigation and a finding by a United States Court of Appeals that a common disclosure violates the Regulation M standard ''that disclosures be in a reasonably understandable form.''[17]

Lessors contend that calculation of prepayment penalties is inherently complicated and, therefore, difficult to describe because of requirements of the accounting principles involved. Consequently, they have requested a determination that disclosure of the name of the method of determining the charge be sufficient, possibly with

[16] Interestingly, although these new disclosures might help prevent abuses and are, consequently, consistent with general principles outlined above for reasonable disclosure requirements, they are not needed for calculating the present value of a stream of outflows arising from a lease, since they are not cash outflows. (Therefore, they do not appear in Table 1.)

[17] Official Staff Commentary on Regulation M, Paragraph 4(a)(1)(1). See *Lundquist vs. Security Pacific Automotive Financial Services Corp.*, 993 F.2d 11, 14–15 (2nd Circuit, 1993).

approved model descriptive clauses as part of the regulation. Instead, staff has recommended requiring in the segregated disclosures a printed warning of the potential for a substantial charge for early termination, plus a full description in the disclosures outside of the segregated grouping of the method of calculating the penalty. This description would comply with the Consumer Leasing Act and Regulation M even if complex, as long as it is full, accurate, not intended to be misleading, and (as the statute requires) it is reasonable.

These generic disclosures, including the printed warning and full description of the methodology for calculating an early termination penalty, should not entail much additional cost because they could be preprinted on disclosure and contract forms. The alternative, proposed last year, of requiring a numerical example of the penalty for early termination likely would entail more substantial cost because it is specific to each individual transaction and could not be preprinted. Unlike gross capitalized cost and most of the other newly required disclosures, this amount is not currently calculated for each transaction by current calculating systems and would, therefore, require substantial system alterations. It entails estimating the market value of used assets at a second point in time for each transaction, one year into the lease as well as at lease end. Furthermore, relatively few actual prepayments would closely fit the timing of the example, since most accounts do not prepay precisely at that time. Thus, there could exist the possibility of good-faith mistakes to which civil liability would apply with only limited correspondence to actual transactions. The current proposal minimizes this possibility.

(4) *Advertising Disclosures.* Under the current regulation, advertised lease transactions that state certain terms trigger the requirement that there be other disclosures as well. Staff believes that there has been some ambiguity concerning disclosures of amounts due at the outset of leasing agreements and that the proposal would clarify the requirements. The proposal would not require itemization of amounts due at the outset, but it would require disclosure of the total with no component being more prominent in the advertisement than the total. Although the proposal will require all advertisers to become aware of the changed regulation and may be costly to some who must change their procedures, it should also make advertisements more readily comparable for consumers.

The ''trigger-term'' feature of the Consumer Leasing Act appears to have reduced the number of radio advertisements, since time often is very limited and advertisers desire to use the time for their preferred messages. In television advertisements it has produced the widely-discussed phenomenon of minute and/or scrolling type, which appears briefly at the bottom of the advertisement. A variety of observers, including attorneys general of some states, has questioned whether the use of such small type complies with the regulation or provides any useful consumer information.

As discussed in the staff memorandum, legislation in 1994 amended the Consumer Leasing Act to resolve some of these concerns for radio advertising. The statutory amendments reduce the number of disclosures that advertisements with trigger terms must contain, and they permit reference to a toll-free telephone number or to print advertisements for the full listing. Relying on the legislative history of this statutory change, staff has proposed extending this approach to television advertising as well as to radio. For radio advertisements this amendment to the regulation should somewhat reduce regulatory burden arising from the advertising provisions of the current regulation by permitting advertisers to shorten the time requirements of their broadcast advertisements. Those consumers subjected to either radio or television advertisements and who are actually interested in learning more about the product can obtain additional information without visiting either sellers or financing sources. This sort of regulatory change may become increasingly important in the future as advertisers begin to use technological innovations in advertising, such as electronic ''interactive'' advertising prepared specifically for selected audiences through new media.

(5) *The Lease Charge.* In the draft final rule staff did not include the new transaction-specific disclosure called the ''Lease Charge'' that was part of the proposal for public comment last year. This potential new disclosure was an attempt to calculate and supply consumers with a measure of the cost of lease financing analogous to the finance charge on a credit purchase. A version of this disclosure considered by the staff would have derived this measure essentially by adding to the amount of the lease rental charge 1) amounts like administrative fees that would qualify as prepaid finance charges, 2) any fees associated either with including a purchase option in the contract or associated with disposition expenses at lease end, and 3) the amount by which any optional purchase price exceeded the lease residual. The assumption behind this last addition is that if the offered optional purchase price exceeds the lease residual, then the difference must be a cost of financing. (The reasonableness of this assumption is examined further below in the following subsection, which discusses the lease rate, another disclosure considered by the staff but not included in the draft final proposal.)

The requirement for disclosure of a lease charge likely would have caused more administrative difficulties and regulatory burden than the other newly required transaction-specific disclosures. Experience with Regulation Z shows that the issue of proper inclusions and exclusions from the finance charge (and the amount financed) on credit transactions has been subject to extensive litigation in the past. Requiring a similar disclosure for leases may have led to increased litigation in the leasing area as well. Also, some questions about how to include in the lease charge fees for exercising a purchase option or for return of the asset to the lessor at end of the contract, which would never both occur on the same contract and would always occur long after contract signing and delivery of the disclosures, would have to have been answered in the Official Staff Commentary or elsewhere before the regulatory change became effective.

Apart from the likely burden of this disclosure and the potential for litigation, the lease charge in dollars would have only limited utility as a shopping tool for consumers anyway. While there may be some usefulness to disclosing the dollar cost of leasing in order to view the absolute magnitude of the agreed amount, this amount is dependent on the size of the transaction and it varies directly with maturity. Consequently, the lease charge is not especially useful for shopping among leases on different vehicles or of different maturities. Furthermore, it is merely a totalling of charges paid and payable regardless of timing; it is not a present value of these amounts. Disclosure of the method of calculating monthly payment through a mathematical progression likely will be of greater usefulness in educating consumers about the intricacies of the leasing transaction.

(6) *The Annual Percentage Lease Rate (ALR).* Many commentators discussed the usefulness of requiring disclosure of lease charges in the form of an Annual Percentage Lease Rate (ALR) analogous to the Annual Percentage Rate (APR)

required by Truth in Lending for a credit transaction. The staff memorandum discusses this issue, although the memorandum does not recommend requiring this disclosure in Regulation M. Ultimately, the difficulties with calculating and disclosing an annual lease rate arise from the necessity of assuming for a lease the value of one or more unknowns to permit solution of the discounting equation.

The mathematical formula for calculating a percentage rate from a series of cash flows is well known and straightforward: the internal rate of return formula commonly used to discount cash flows. For consumer credit, Appendix J to Regulation Z extensively describes the internal rate of return formula for ''unit period'' lengths of time, with many examples. Even an area as long established as calculating annual percentage rates on closed-end credit under Regulation Z can be subject to controversy and litigation, however, although it seems that turmoil rarely, if ever, arises from the mathematical formulas themselves. Instead, litigation comes from questions over items included or not in the formulas.[18]

If anything, leasing is more complicated on this basis than closed-end installment credit. The difficulties associated with leasing disclosures come about because on a lease a consumer does not contract for ownership of the whole economic life of the asset, but rather for only a portion of it. This fact raises questions about how to account properly for economic depreciation in the various parts of the asset's life, offers more opportunities for differing interpretations and conclusions, and even presents opportunities for manipulation.

Calculating an internal rate of return from a series of cash flows requires knowing the amount of the credit and the pattern of the cash flows (see Appendix J of Regulation Z). For installment credit like automobile financing, if assumptions are made that the contract runs to maturity and that all payments arrive as scheduled, then all of these figures are known at the outset of the transaction. On a lease they are not.

On a lease the lessee contracts only to purchase a portion of the economic depreciation of the asset and merely holds an option on the rest. For this reason, it is not possible at the outset to know the complete pattern of the flows. Some lessees will either pay or finance a balloon payment at the end of the lease term, as they acquire the vehicle by exercising their purchase option and paying the agreed-upon amount or refinancing it. Others will not purchase the vehicle and may have no intention at any time of exercising this option, and so the size of the balloon payment is irrelevant to them. Still other consumers will negotiate a continuation of the lease. To calculate a percentage rate at the outset of the lease, some assumption about the events at lease end is necessary.

Although no assumption properly describes the lease-end event for all cases, probably the most reasonable and defensible approach is to assume that the percentage rate calculation for a lease depends only on events of the lease term. This means that the calculation should not consider purchase of the vehicle or negotiated continuation of the lease. Rather, the most reasonable assumption probably is that the consumer returns the vehicle to the dealer at lease end under the terms of the lease contract. In this case the cash flows used in the calculation include only those for which the consumer is contractually liable. Other, hypothetical, possibilities do not become part of the calculation.

Under this assumption, specifying the stream of outflows during the period of the lease is relatively simple, except for the issue of valuing the purchase option. As is the case in calculating the net advantage of leasing over purchase financing (Equations 1–3, above), the present value of the purchase option embedded in a typical closed-end operating lease that permits a lessee to call the residual value of the asset at a prearranged strike price must be subtracted from the present value of the rest of the cash flows to compare the internal rate of return on a lease with purchase financing. The rest of the cash flows are straightforward. They were described in column 2 of Table 1 (see Section III, above).

Equation 4 employs these flows and using the methodology of Appendix J to Regulation Z calculates an annualized internal rate of return for a lease with these cash flows by solving for i.[19]

(4): See Equation (4) at the End of the Analysis

This is not the end of the story, though. There is still the question of lease amount, the top line of equation 4, which is necessary to solve for the ALR. On a credit transaction the amount financed is known at the outset. What is the corresponding amount of the lease?

As mentioned, a lease finances the economic depreciation of the asset during the lease period. In present value terms this is the difference between the asset price after all initial payments (called in the staff draft the ''adjusted capitalized cost'') and the present value of the residual value. Using economic depreciation as the lease amount in Equation 4 and adding the present value of the residual value to both sides of the equation produces Equation 5. Solving Equation 5 for i calculates the ALR:

(5): See Equation (5) at the End of the Analysis

Conceptually, a lessor knows all of the variables in Equation 5 at the outset of the transaction, except the value of the purchase option. Consequently, some commentators have argued, in effect, that the option be valued at zero, which is not a correct assumption, and that lessors solve equation 5 for i and disclose the result, calling it an ALR. But equation 5 has a difficulty of its own, even disregarding the inappropriateness of valuing the purchase option at zero. The remaining important problem is that the residual value used by the lessor for the purposes of making the calculations can never be better than an estimate. No one really knows what the value of the asset will be at the end of the lease, and different lessors may in good faith estimate depreciation over the lease period (and corresponding lease residual) differently. This means that in good faith they can estimate different ALR's for otherwise identical transactions. Beyond good faith differences, there is also the possibility that some market participants may want to manipulate the lease residual to alter a disclosed lease rate.

Table 2 provides an example of an automobile leasing transaction, using a disclosure format that, like the staff proposal, follows a mathematical progression illustrating the components of the calculation. Column 1 describes a hypothetical simplified example of a 24 month lease.

Assume a consumer leases a vehicle with a gross capitalized cost after all negotiations and extras of $20,000 (line 1). This consumer receives a trade-in allowance of $1000 and provides $1000 down payment in cash for a total capitalized cost reduction of $2000 (line 2). This produces an adjusted

[18] This has recently been evident in the controversy surrounding the 1994 ''Rodash'' decision, *Rodash* v. *AIB Mortgage Co.*, 16 F. 3d 1142 (11th Cir. 1994). This case was controversial enough that it prompted Congress to make some changes in the Truth-in-Lending Act itself to settle disputes over what properly is included in the components of the calculation.

[19] The term for the present value of the expected loss from early termination, which appears in Table 1, does not appear in equation 4 because it is a contingency and not predictable. Therefore, it cannot be a part of the calculation for a disclosed percentage rate.

capitalized cost of $18,000 (line 3). Subtracting a residual value for the car after 24 months of $12,000 (line 4) means depreciation of $6000 (line 5). Adding a rent charge of $1500 (line 6) results in a total of periodic payments of $7500 (line 7). A term of 24 months (line 8) means that the monthly payment amount is $312.50 (line 9). The cash flows over the course of the lease consist of the stream of 24 monthly payments of $312.50 in column 1 of the table totaling to $7500.[20]

Column 2 of Table 2 illustrates the problem of different estimates of depreciation (and corresponding lease residuals). Suppose in the example in Table 2 that another dealer/lessor estimates a higher rate of depreciation and, therefore, a lower residual value for the same vehicle. But, also suppose this dealer offers the same monthly payment by charging a lower rental fee. From a consumer's standpoint the transaction illustrated in column 2 is exactly the same as the one in column 1: the vehicle leased in the column 2 transaction is the same, the trade in allowance and cash down payment are the same (each $1000), and the pattern and total of the payments are exactly the same (24 monthly payments of $312.50 for a total of $7500). The calculated percentage rates are different, however, with column 2 leading to a lower ALR. This illustrates how different assumptions about depreciation and residuals can change the annual lease rate for the same payment stream, even apart from any issue of manipulation by dealer/lessors. If a dealer/lessor subject to a disclosure regime decides to minimize the disclosed percentage rate by lowering the expected residual for this reason, it would compound the problem.

Table 3 illustrates the difficulty of requiring disclosure of a percentage rate as the dealer/lessor engages in different marketing strategies. The three columns illustrate common marketing strategies that dealer/lessors often employ, each leading to price reductions for the consumer. The examples are constructed so that in the absence of a requirement for an ALR disclosure the dealer/lessor is financially indifferent among the strategies. Also the example is constructed so that the timing and amount of outlays is the same for consumers. Which strategy lessors choose would seem to depend on their perceptions of which strategies consumers are most likely to notice and respond to. This may vary among dealer clienteles and for any dealer over time.

Column 1 of Table 3 illustrates the common marketing strategy of raising the anticipated residual on the vehicle, thereby lowering depreciation and the size of the monthly payments, a common marketing strategy known as ''subventing'' the residual. Column 2 shows the impact of offering a ''subvented rebate'' on the lease. This has the effect of lowering the adjusted capitalized cost and the recaptured depreciation. The third choice, column 3, contains the example of a ''subvented'' rental charge. In the example this lowers the monthly payments by the same amount as the other strategies, although this time not by lowering the accounted-for depreciation but instead by lowering the rental charge component of the monthly payment. The consumer pays the same amount at the same pace in each case. Thus, from the consumer's standpoint apart from the ALR disclosure these transactions are exactly the same, but their ALR's are much different, 4.79 percent, 5.31 percent, and 0.0 percent, respectively.

To try to minimize the possibility of manipulation of residuals by lessors as a way of lowering ALR's, one alternative considered by the staff would have required that lessors not use the lease residual in their calculation of the lease charge or the Annual Lease Rate if the residual diverges from the optional purchase price. If there is a divergence, then the lessor would use the optional purchase price in the calculation under the argument that the optional purchase price represents a better estimate of the true residual value of the asset, since it is the price at which the lessor really would be wiling to sell the asset. While this approach might appear to help to minimize absolute manipulations of the residual value by lessees, it has a number of problems of its own.

One problem is that many lease contracts do not state an optional purchase price for the asset. It is possible, of course, even if perhaps not likely, that the proportion of leases without an optional purchase price could change as a result of the new disclosure regulation. Regardless of the frequency, because such leases do not contain an optional purchase price, only the residual could be used for calculations and disclosures on these leases. This would negate any purported advantage from requiring that the optional purchase price be used in place of the residual value, at least for these leases. More importantly, it would introduce a source of inconsistency into the methodology of calculations and disclosures: some disclosures would be based on lease residuals while disclosures on other leases would be dependent on optional purchase prices. It is not clear that this would solve the problem of potential for manipulation.

A second problem is that use of the optional purchase price in place of the lease residual introduces into the calculations and disclosures a quantity for which the consumer is not contractually liable. Many consumers do not purchase their leased car at lease end. Substituting the optional purchase price for the lease residual for purposes of calculating the ALR while retaining the residual for calculating the monthly payment, in effect, adds the algebraic difference between the optional purchase price and the residual to the lease charge. But, the closed-end lessee is never contractually liable for this difference at the time the dealer makes disclosures. At the outset of the lease consumers do not agree to subsequent purchase of the vehicle or, consequently, for paying the optional purchase price or the difference between it and the lease residual. In many cases lessees do not purchase their vehicles or ever pay these amounts. Thus, disclosures of a lease charge or an ALR based on optional purchase price are never right for these consumers. Even for consumers who purchase their vehicles at lease end, the price may be negotiated at that time anyway, and may well diverge from the optional purchase price originally disclosed.

A third difficulty is that the exercise price of a purchase option is not simply another estimate of the residual value of an asset. The exercise price of the purchase option may depend on the lessor's business strategy. Even if lessors have the same expectations about depreciation, they may quote different exercise prices because one may want to keep the asset and the other may prefer that the lessee buy the asset at lease end. Lessors may hedge against the possibility that certain high-demand assets may not actually depreciate very much in value over time by quoting a high, but negotiable, optional price. As a result, a lease charge or lease rate calculation that requires use of this optional purchase price, may not even approximate the lease charge or lease rate that a consumer actually pays, especially if the lessee declines to purchase the asset.

V. Impact on Small Entities

The above analysis contains a description of the implications of requiring new methods of disclosures on consumers' automobile leases. The

[20] For illustrative simplicity Table 2 ignores the complicating factors of the security deposit, refund of the deposit, disposition charge, and value of the purchase option. All except the option value could easily be added to the table.

changes will require a substantial revision to the disclosure format currently required of lessors. In issuing the new rule the Board has attempted to minimize the burden of changing to the new disclosure format by requiring, wherever possible, disclosures that can be preprinted. Furthermore, the Board took the opportunity to provide model forms to guide lessors. Section 105 of the Truth-in-Lending Act provides that a creditor or lessor that uses the appropriate model forms published by the Board ''shall be deemed to be in compliance with the disclosure provisions of this title with respect to other than numerical disclosures * * *.'' Thus, using the model forms provides a safe harbor from civil liability if the numbers are filled in accurately.

Required disclosures will be the same for large and small lessors, but the Board does not expect that the changes to Regulation M will have a substantial adverse economic impact on a large number of small entities. The automobile leasing industry, at which the bulk of the changes are directed, is highly concentrated in a small number of large firms. Actual preparation of lease documents will typically take place in the offices of numerous automobile dealers, many of which are small entities. Preparation will take place through computer terminals and computer programs provided by the lessors, however. Because the new forms are provided through the lessors' computer systems will be clearer and easier for dealer personnel to understand, explanations and necessary training of personnel should actually be enhanced and made easier for dealers.

Reference

Myers, Stewart C., David A. Dill, and Alberto J. Bautista, ''Valuation of Financial Lease Contracts,'' Journal of Finance, June 1976.

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Equations (2) Through (5)

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When vehicle is retained, if

$$\begin{aligned}
&\textit{Down Pay}_0 && \text{(Initial)}\\
&+ \sum_{t=1}^{N} (FP_t + PPT_t)(1 + \frac{i}{12})^{-t} && \text{(Periodic)}\\
&- [(CCR_0 + \textit{Secur Dep}_0 + LP_0) && \text{(Initial)}\\
&+ \sum_{t=1}^{N-1} (LP_t)(1 + \frac{i}{12})^{-t} && \text{(Periodic)}\\
&+ (\textit{Pur Price} - \textit{Dep Ref})(1 + i)^{-N} && \text{(End of Term)}\\
&- (\textit{Pur Opt})(1 + i)^{-N}\ ] > 0, \textit{Then Lease.} && (2)
\end{aligned}$$

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When vehicle is not retained, if

$$Down\ Pay_0 \qquad \text{(Initial)}$$

$$+ \sum_{t=1}^{N} (FP_t + PPT_t)(1 + \frac{i}{12})^{-t} \qquad \text{(Periodic)}$$

$$- (Sale - EL/S)(1 + i)^{-N} \qquad \text{(End of Term)}$$

$$[(CCR_0 + Secur\ Dep_0 + LP_0) \qquad \text{(Initial)}$$

$$+ \sum_{t=1}^{N-1} (LP_t)(1 + \frac{i}{12})^{-t} \qquad \text{(Periodic)}$$

$$+ (Disp\ Charge - Dep\ Ref)(1 + i)^{-N} \qquad \text{(End of Term)}$$

$$- (Pur\ Opt)(1 + i)^{-N}\ ] > 0, \textit{Then Lease..} \qquad \textbf{(3)}$$

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$$Lease\ Amount =$$

$$Secur\ Dep_0 + LP_0$$

$$+ \sum_{t=1}^{N-1} (LP_t)(1 + \frac{i}{12})^{-t}$$

$$+ (Disp\ Charge - Dep\ Ref)(1 + i)^{-N}$$

$$- (Pur\ Opt)(1 + i)^{-N} \qquad \textbf{(4)}$$

$$
\begin{aligned}
\textit{Adjusted Capitalized Cost} = \\
& \textit{Secur Dep}_0 + LP_0 \\
& + \sum_{t=1}^{N-1} (LP_t)(1 + \frac{i}{12})^{-t} \\
& + (\textit{Disp Charge} - \textit{Dep Ref})(1 + i)^{-N} \\
& + (\textit{ResidualValue}_N)(1 + i)^{-N} \\
& - (\textit{Pur Opt})(1 + i)^{-N}
\end{aligned}
\tag{5}
$$

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TABLE 1.—CASH OUTFLOWS ASSOCIATED WITH OBTAINING USE OF ASSETS THROUGH CLOSED-END OPERATING LEASES AND CREDIT PURCHASES

	Lease			Credit purchase		
	Retain auto at lease end		Turn in auto at least end	Retain auto when paid		Sell auto when paid
(1)	−Trans Serv		−Trans Serv	−Trans Serv		−Trans Serv
(2)	+Trade-In	=	+Trade-In	+Trade-In	=	+Trade-In
(3)	+CCR		+CCR	+Down Pay		+Down Pay
(4)	+Secur Dep		+Secur Dep			
(5)	−PV (Dep Ref)		−PV (Dep Ref)			
(6)	+Sum PV (LP)		+Sum PV (LP)	+Sum PV (FP)		+Sum PV(FP)
(7)				+Sum PV (PPT)		+SumPV (PPT)
(8)	+PV (Pur Price)					
(9)			+PV (Disp Chrge)			
(10)						−PV (Sale)
(11)						+PV (EL/S)
(12)	+PV (EL/ET)	=	+PV (EL/ET)	+PV (EL/ET)	=	+PV (EL/ET)

Abbreviations Used:
PV ( )—Present Value (of Quantity in Brackets).
Trans Serv—Transportation Services Provided.
CCR—(Cash) Capitalized Cost Reduction.
Down Pay—(Cash) Down Payment.
Secur Dep—Security Deposit.
Dep Ref—Security Deposit Refund.
LP—Lease Payments.
FP—Finance Payments.
PPT—Personal Property Taxes.
Pur Price—Purchase Price.
Disp Chrge—Disposition or Drop-Off Charge.
Sale—Sale Price.
EL/S—Expected Loss on Sale of the Vehicle.
EL/ET—Expected Loss Upon Early Termination of Lease.

TABLE 2—PATTERNS OF DISCLOSURES

	1	2
	Base case	Lower residual
(1) Gross Cap. Cost	20,000	20,000

TABLE 2—PATTERNS OF DISCLOSURES—Continued

	1	2
	Base case	Lower residual
(2) Cap. Cost Reduction	−2000	−2000
(3) Adjusted Cap. Cost	=18,000	=18,000
(4) Residual Value	−12,000	−10,500
(5) Depreciation	=6000	=7500
(6) Rent Charge	+1500	+0
(7) Amount of Periodic Payments	=7500	=7500
(8) Lease Term	24	24
(9) Base Monthly Payment	312.50	312.50
Additional Information about Transaction		
(10) Sale Price of Vehicle	12,000	12,000
(11) Gain on Sale	0	1500
(12) Recovery of Adjusted Cap. Cost	19,500	19,500

TABLE 3.—PATTERNS OF DISCLOSURES

	1	2	3
	Subvent residual	Subvent rebate	Subvent lease charge
(1) Gross Cap. Cost	20,000	20,000	20,000
(2) Cap. Cost Reduction	−2000	−3500	−2000
(3) Adjusted Cap. Cost	=18,000	=16,500	=18,000
(4) Residual Value	−13,500	−12,000	−12,000
(5) Depreciation	=4500	=4500	=6000
(6) Rent Charge	+1500	+1500	+0
(7) Amount of Periodic Payments	=6000	=6000	=6000
(8) Lease Term	24	24	24
(9) Base Monthly Payment	250	250	250
Additional Information about Transaction			
(10) Sale Price of Vehicle	12,000	12,000	12,000
(11) Gain on Sale	(1500)	0	0
(12) Recovery of Adjusted Cap. Cost	18,000	18,000	18,000

By order of the Board of Governors of the Federal Reserve System, September 27, 1996.

William W. Wiles,

Secretary of the Board.

[FR Doc. 96–25273 Filed 10–4–96; 8:45 am]

BILLING CODE 6210–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 96–AWP–19]

Revocation of Class D Airspace; Alameda, CA

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final Rule.

SUMMARY: This action revokes the Class D airspace area at Alameda, CA. The base closure of Alameda Naval Air Station (NAS) has made this action necessary. The intended effect of this action is to revoke controlled airspace since the purpose and requirements for the surface area no longer exist at Alameda NAS (Nimitz Field), CA.

EFFECTIVE DATE: 0901 UTC December 5, 1996.

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