year CD, and would permit consumers to receive accrued interest in monthly interest checks or to permit interest to remain in the account, the institution would have to credit and compound interest at least monthly.

The May proposal also would treat the distribution of interest from the account as the equivalent of compounding. For example, if an institution sent consumers the interest payments (and did not permit consumers to leave interest in the account), the institution would treat the interest payment frequency as compounding in the APY calculation. Thus, for a two-year CD that requires consumers to receive an annual interest payment, the APY would reflect annual compounding.

In July, the Board extended the time to provide comments on the proposed amendments. At the same time, the Board reopened comment on the limited alternative that had been published in December 1993 and withdrawn in May 1994; that alternative equates the APY and the account interest rate for noncompounding multi-year CDs that pay interest at least annually (59 FR

35271, July 11, 1994). The Board received about 550 comments on the proposal (including comments on the alternative approach involving noncompounding multi-year CDs). About 95% of the comments were from financial institutions. The remaining 5% were from trade associations, data processors, and others. Approximately 450 comments addressed the proposed amendments affecting the APY formula; about 2% were in favor of the proposal, 98% were opposed, most of them because of the proposed matching of compounding and crediting frequencies. About 100 commenters addressed the alternative that would equate the APY to the

interest rate; nearly 60% supported this

approach. Òn January 4, 1995, the Board adopted one part of the May 1994 proposal. The Board voted to amend the definition of the APY to reflect the frequency of interest payments; it declined to adopt another portion of the May proposal that would have affected institutions' crediting and compounding policies. The Board also declined to adopt the alternative proposal published in July 1994 that equated the APY and the interest rate for multi-year, noncompounding certificates of deposit that make interest payments at least annually. The effective date for the Board's APY rule adopted on January 4 would permit institutions to comply immediately; compliance became mandatory in September 1995.

Subsequently, the Board received petitions for reconsideration from both the major banking industry trade associations and consumer advocates. The trade associations and consumer groups stated several reasons in their letters asking for reconsideration and protesting the Board's action, including that the public should have been given an opportunity to comment directly on the amendment requiring the APY to reflect the frequency of interest payments—as modified from the May proposal—before its adoption by the Board.

On January 17, in order to address the concerns raised by the petitioners regarding public comment and to ensure a full airing of all aspects of proposed amendments to the APY calculation and definition, the Board granted the petitions and decided to publish for further public comment the proposal adopted on January 4 as well as an alternative internal rate of return formula affecting the calculation of the APY. At the same time, the Board adopted an interim rule that would permit institutions to equate the APY and the contract interest rate for noncompounding multi-year accounts that mandate interest payouts at least annually. (See Docket R-0836 elsewhere in today's Federal Register.)

## III. Factoring the Time Value of Interest Payments Into the APY

Based on the comments received and upon further analysis, the Board is proposing to reflect the frequency of interest payments in the calculation of the APY, along with the interest rate paid and frequency of compounding. This proposed amendment would factor the time value of interest payments into the APY calculation using the current formula. It is a modified version of the May 1994 proposal. The proposal would apply to all account types.

This approach could be more helpful to consumers who comparison shop among deposit accounts and other investment products. For example, it could allow consumers more easily to compare accounts that require the distribution of interest payments with those that permit consumers to receive payments, such as when two institutions offer a two-year CD with a 6.00% interest rate and semi-annual payouts (mandatory with Institution A and optional by Institution B). If the APY reflected the timing of interest payments, both institutions would disclose a 6.09% APY to a consumer who receives payouts. Currently, the APYs disclosed may differ. Both institutions would disclose a 5.83% APY if interest left in the account does

not compound. Institution B, however, would disclose a 6.00% APY if interest left in the account compounds annually, even though payments are made on the same basis as Institution A.

The Board is also soliciting comment on an alternative approach to factor the time value of money into the APY. It would require an additional formula to calculate the APY—the internal rate of return formula proposed in December 1993. Both proposals would reflect the time value of money, and, as the table below illustrates, the APY would reflect this value. The example illustrates the effect of receiving interest payments during the term for a noncompounding 2-year CD at a 6% interest rate.

Frequency of interest pay outs	APY under current rule (percent)	APY under proposed rules (percent)
Annual	5.83 5.83 5.83 5.83	6.00 6.09 6.14 6.17

Under this proposal, the amendments to Regulation DD adopted in the interim rule would be replaced, if the final rule adopts either of the proposed amendments using the current APY formula or the alternative APY calculation method using an internal rate of return formula.

## May 1994 Proposal Affecting Compounding and Crediting Frequencies

One part of the May 1994 proposal would have required institutions to match crediting and compounding policies for accounts where consumers may receive interest payments or leave interest in the account. It also would have clarified when interest becomes principal and defined "crediting" and 'compounding.'' The Board recognizes that the commenters raised valid concerns about this approach, and because of these concerns the Board is not considering those aspects of the May proposal in this proposed rule. Neither of the proposals under consideration would require institutions to compound interest at the same frequency as the institution credits interest by check or transfer for accounts where consumers may receive interest payments or leave interest in the account.

## IV. Proposed Regulatory Revisions: Section-by-Section Analysis

Section 230.2—Definitions 2(c) Annual Percentage Yield

The act and regulation define the APY as the total amount of interest that