

FEDERAL RESERVE BANK OF DALLAS  
DALLAS, TEXAS 75222

Circular No. 72-152  
July 20, 1972

INTERPRETATIONS OF REGULATION Z

(Basis for Finance Charge and Allocation  
of Payments of Open-End Credit Accounts)

To All Banks, Other Creditors and Others  
Concerned in the Eleventh Federal Reserve District:

The Board of Governors has published two interpretations of Regulation Z concerning the determination of the balance that may be used as the basis for a finance charge in open-end credit accounts, and the allocation of payments in such accounts.

The interpretations are printed on the reverse of this circular.

Yours very truly,

P. E. Coldwell,

President

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TRUTH IN LENDING

INTERPRETATIONS OF REGULATION Z

Interpretation Section 226.703 is amended to read as follows:

**SECTION 226.703 FINANCE CHARGE BASED ON AVERAGE DAILY BALANCE IN OPEN END CREDIT ACCOUNTS.**

Section 226.7(b)(8) requires that periodic statements for open end accounts shall disclose, among other things, "The balance on which the finance charge was computed, and a statement of how that balance was determined." In some instances, creditors compute a finance charge on the average daily balance by application of a monthly periodic rate. In such case, this information is adequately disclosed if the statement gives the amount of the average daily balance on which the finance charge was computed, and also states how the balance is determined. In other instances, the finance charge is computed on the balance each day by application of a daily periodic rate and such charges are accumulated and debited to the account in a single amount for the billing cycle. The question arises whether the periodic statement must show for each day of the billing cycle a balance on which a finance charge was computed.

If a daily periodic rate is used, the balance to which it is applicable shall be stated as follows:

- (1) A balance for each day in the billing cycle; or
- (2) A balance for each day in the billing cycle on which the balance in the account changes; or
- (3) The sum of the daily balances during the billing cycle; or
- (4) The average daily balance during the billing cycle in which case the creditor shall state on the face of the periodic statement, its reverse side, or on an enclosed supplement wording to the effect that the average daily balance is or can be multiplied by the number of days in the billing cycle and the periodic rate applied to the product to determine the amount of the finance charge.

**SECTION 226.706 OPEN END CREDIT — ALLOCATION OF PAYMENTS**

Section 226.7(a)(2) provides that before the first transaction is made on any open end credit account, the creditor must disclose "the method of determining the balance upon which a finance charge may be imposed." Section 226.7(b)(8) requires the creditor to disclose on the periodic statement "the balance on which the finance charge was computed, and a statement of how that balance was determined." The question is raised whether these provisions require a creditor to provide a description of the manner in which payments or other credits are applied to various portions of the balance or balances on which finance charges are computed.

In disclosing the method of determining the balance(s) upon which finance charges are computed, it is not necessary to show the method of allocating payments or other credits. For example, explanation of the manner in which payments or credits may be applied to late charges, overdue balances, finance charges, insurance premiums or other portions of balances is not required. Similarly, explanation of the method of allocating such payments between cash advance and purchase portions of the account is not required. Such explanations in many cases involve lengthy and complex descriptions which may unduly complicate disclosures.

Explanation of the allocation method may be made by creditors where it can be done in conformity with § 226.6(c) which authorizes additional information or explanations as long as they are not stated, utilized, or placed so as to mislead or confuse the customer or contradict, obscure, or detract attention from the required disclosures.

6/21/72

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