

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 73-112

May 14, 1973

INTERPRETATION OF REGULATION Z
PROPOSED AMENDMENT TO REGULATION Z

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

Enclosed is an interpretation of Regulation Z specifying that the method of rebate may be identified on a disclosure statement without including a mathematical formula or narrative description.

The Board of Governors also proposes to amend its Regulation Z, "Truth in Lending," to require a creditor to disclose whether his installment contract provides for a rebate of finance charges in the event of prepayment. Attached are the details of the proposal.

Comments on the proposed amendment should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D. C. 20551, to be received not later than June 15, 1973.

Yours very truly,

P. E. Coldwell,

President

Enclosures

FEDERAL RESERVE SYSTEM

[12 CFR PART 226]

[Reg. Z]

TRUTH IN LENDING

Credit Other Than Open End--Specific Disclosures

1. Pursuant to the authority contained in the Truth in Lending Act (15 U.S.C. § 1601 et seq.), the Board of Governors proposes to amend Part 226 (Regulation Z). The proposed amendment would require creditors to disclose to customers, in advance of their becoming obligated on a credit contract, if the contract does not provide for rebates of finance charges upon prepayment of the obligation. The amendment is proposed in the manner and for the reasons set forth below:

Amend § 226.8(b)(7) to read as follows:

§ 226.8--CREDIT OTHER THAN OPEN END--SPECIFIC DISCLOSURES

* * * * *

(b) Disclosures in sale and nonsale credit. * * *

(7) Identification of the method of computing any unearned portion of the finance charge in the event of prepayment of an obligation which includes precomputed finance charges and a statement of the amount or method of computation of any charge that may be deducted from the amount of any rebate of such unearned finance charge that will be credited to the obligation or refunded to the customer. If the credit contract does not provide for any rebate of finance charges upon prepayment, this fact shall be disclosed.

2. The proposed amendment would add a requirement to § 226.8(b)(7) regarding rebates on contracts with precomputed finance charges to the effect that "if the credit contract does not provide for any rebate of finance charges upon prepayment, this fact shall be disclosed." Presently creditors are required to make a disclosure regarding finance charge rebates only in the event that rebates are made. The proposal would require creditors whose contracts do not call for rebates to disclose this fact to their customers. The provision has been amended to also clarify its application only to obligations which include precomputed finance charges.

3. Should the Board adopt the proposed amendment after considering the comments received on it, an effective date would be set far enough in advance to allow for the orderly change of forms where necessary. This notice is published pursuant to section 553(b) of Title 5 United States Code, and § 262.2(a) of the Rules of Procedure of the Board of Governors of the Federal Reserve System (12 CFR 262.2(a)).

To aid in the consideration of these matters by the Board, interested persons are invited to submit relevant data, views, or arguments. Any such material should be submitted in writing to the Secretary, the Board of Governors of the Federal Reserve System, Washington, D. C. 20551, or to any Federal Reserve Bank for transmittal to the Board, to be received at the Board not later than June 15, 1973. Such material will be made available for inspection and copying upon

request, except as provided in § 261.6(a) of the Board's Rules
Regarding Availability of Information.

By order of the Board of Governors, April 30, 1973.

(Signed) Tynan Smith

Tynan Smith
Secretary of the Board

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TRUTH IN LENDING

INTERPRETATION OF REGULATION Z

SECTION 226.818 REFUND OF UNEARNED
FINANCE CHARGE; PREPAYMENT
PENALTY

(a) Under §226.8(b)(7) a creditor must provide an identification of the method of computing any unearned portion of the finance charge in the event of prepayment of an obligation, as well as a statement of the amount or method of computation of any charge that may be deducted from the amount of any rebate. Section 226.8(b)(6) requires the creditor to provide "a description of any penalty charge that may be imposed by the creditor or his assignee for prepayment of the principal of the obligation . . ." A question arises whether the computation of certain rebates of unearned finance charges on contracts with precomputed finance charges involves a "prepayment penalty." A second question concerns the disclosures required to identify the method of computing any finance charge rebate.

(b) Section 226.8(b)(6) relates only to charges assessed in connection with obligations which do *not* involve precomputed finance charges included in the obligation. It applies to transactions in which the finance charge is computed from time to time by application of a rate to the unpaid principal balance. Prepayment penalties which require disclosure under this section (which principally arise in connection with prepayment of real estate mortgages) occur when the obligor in such a transaction is required to pay separately an additional amount for paying all or part of the obligation before maturity. On the other hand, §226.8(b)(7) is designed to encompass the dis-

closures necessary with regard to the prepayment of an obligation involving precomputed finance charges which are included in the face amount of the obligation. Therefore, although in a pre-computed obligation the finance charge rebate to a customer may be less when calculated according to the "Rule of 78's," "sum of the digits," or other method than if calculated by the actuarial method, such difference does not constitute a penalty charge for prepayment that must be described pursuant to §226.8(b)(6).

(c) Section 226.8(b)(7) requires "identification" of the rebate method used on precomputed contracts. Many State statutes provide for rebates of unearned finance charges under methods known as the "Rule of 78's" or "sum of the digits" or other methods. In view of the fact that such statutory provisions involve complex mathematical descriptions which generally cannot be condensed into simple accurate statements, and which if repeated at length on disclosure forms could detract from other important disclosures, the requirement of rebate "identification" is satisfied simply by reference by name to the "Rule of 78's" or other method, as applicable.

(Interprets and applies 15 U.S.C. 1638 and 15 U.S.C. 1639)

* * * * *

4/30/73