

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 73-221

August 31, 1973

INTERPRETATION OF REGULATION Z  
(Add-on and Discount Finance Charges as  
Prepaid Finance Charges)

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

The Board of Governors of the Federal Reserve System issued on August 23, 1973, the attached interpretation of its Truth in Lending Regulation Z, clarifying the treatment of prepaid finance charges in credit transactions. The interpretation states that the typical "add-on" or "discount" charge or other precomputed finance charge on an instalment contract or other obligation need not be labeled a "prepaid" finance charge.

Yours very truly,

P. E. Coldwell,

President

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TRUTH IN LENDING

INTERPRETATION OF REGULATION Z

SECTION 226.819 — PREPAID  
FINANCE CHARGES; ADD-ONS  
AND DISCOUNTS

(a) Sections 226.8(c)(6), 226.8(d)(2) and 226.8(e)(1) require that certain finance charges be disclosed as “prepaid finance charges.” They also require that such prepaid finance charges be excluded or deducted from the credit extended in arriving at the “amount financed.” The question arises whether add-on, discount or other precomputed finance charges which are reflected in the face amount of the debt instrument as part of the customer’s obligation, but which are excluded from the “amount financed,” must be labeled as “prepaid” finance charges.

(b) The concept of prepaid finance charges was adopted to insure that the “amount financed” reflected only that credit of which the customer had the actual use. Precomputed finance charges

which are included in the face amount of the obligation are not the type contemplated by the “prepaid” finance charge disclosure concept. Although such precomputed finance charges are not to be included in the “amount financed,” they need not be regarded as finance charges “paid separately” or “withheld by the creditor from the proceeds of the credit extended” within the meaning of § 226.8(e) to require labeling “prepaid” under §§ 226.8(c)(6) and 226.8(d)(2). They are “finance charges”, of course, to be disclosed under §§ 226.8(c)(8) and 226.8(d)(3).

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8/23/73