

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 3755]
September 7, 1951]

CONSUMER CREDIT

Interpretation of Regulation W

To all Persons Concerned with Regulation W
in the Second Federal Reserve District:

The Board of Governors has today issued a statement for publication September 10, 1951, concerning the provisions of the Defense Production Act amendments and of Regulation W, Consumer Credit, which permit trade-ins to be counted for all or part of the minimum down payment required under the regulation. The statement, which is in the form of an interpretation of the regulation, emphasizes that the new provisions of the statute and the regulation do not repeal the requirement that a down payment must be obtained. It stresses, also, that a trade-in allowance cannot be counted against the down payment required under the regulation except to the extent it reflects a *bona fide* trade-in or exchange of property having a value that bears a reasonable relationship to the amount credited.

The text of the statement follows:

CONSUMER CREDIT

Interpretation of Regulation W

ISSUED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Since the amendment to Regulation W which was made following the amendment of the Defense Production Act, and which became effective July 31, 1951, questions have been received concerning trade-ins in connection with the instalment sale of listed articles, particularly articles listed in Groups B, C, and D of the Supplement to the regulation.

It should be noted that the new provisions of the statute and the regulation do not repeal the requirement that a down payment must be obtained. Two provisions of the regulation are of special importance here. One is section 6(c)(3) which requires that a trade-in be described in the Registrant's records and that the Registrant set out "the monetary value assigned thereto in good faith." The other is section 8(j)(7) which requires that "any rebate or sales discount" be deducted in calculating the "cash price" of the listed article, and that the required down payment be determined on the basis of the "cash price . . . net of any rebate or sales discount."

The provisions of the statute and regulation, especially those quoted above, prohibit certain practices which would attempt to use fictitious trade-in allowances to evade the down payment requirements. This is true even though the regulation does not necessarily require that trade-in allowances counted against down payments be limited to the actual market value of the trade-in or to the amount for which the Registrant expects to be able to sell it. Some of the more important principles forbidding fictitious trade-in allowances are indicated below.

1. It is evident that a transaction would involve a rebate or sales discount rather than a trade-in where the Registrant in fact did not receive delivery and possession of the property for which a

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so-called trade-in allowance was granted. In such a case an actual trade-in has not occurred, and labeling the transaction as a "trade-in" will not change its essential characteristic as a mere rebate or discount. The Registrant has received nothing in part payment by virtue of the so-called trade-in and has merely reduced the price of the article sold. Accordingly, the required down payment would have to be obtained on the basis of the "cash price" of the article net of such reduction.

2. A transaction would similarly conflict with the requirements of the regulation where there was applied against the required down payment a so-called trade-in allowance in substantial amount for property having a value that was nominal or negligible, or that bore no reasonable relationship to the so-called allowance. Among transactions that would thus conflict would be many made on the basis of a substantial uniform allowance for all so-called trade-ins irrespective of their make, model, or condition.

3. A trade-in could not be counted as a down payment to the extent that there had been any offsetting increase in the price of the article being sold. The price to be used as a standard here would be the actual value at which the Registrant at the time is selling the same or like articles with an all-cash down payment or on a comparable basis; that price might, of course, be lower than the "list" price.

4. From the foregoing it may be noted that a trade-in allowance cannot be counted against the down payment required under the regulation except to the extent that it reflects a *bona fide* trade-in or exchange of property. The regulation does not prevent a Registrant from giving rebates or discounts, or from calling them anything he may like; but no matter what he may choose to call them for his own purposes, they obviously cannot take the place of the down payment required by the regulation and cannot excuse the Registrant from the requirement that he actually obtain the required down payment. In other words, a Registrant is entirely free to give any trade-in allowances, rebates, or discounts that he desires; but such allowances, rebates, or discounts cannot be used as a cloak to conceal evasions of the down payment requirements of the regulation contrary to the principles here set out.

5. Under section 8(a) of the regulation the Registrant is required in any given case to keep such records as are relevant to establishing that his treatment of an allowance as a trade-in or exchange in payment or part payment of the required down payment is in conformity with the foregoing and with the requirements of the regulation.

Additional copies of this circular will be furnished upon request.

ALLAN SPROUL,
President.