FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 6334]
[May 15, 1969]

Interpretations of Regulation Z

To All State Member Banks, and Others Concerned,
in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System recently announced the approval of seven interpretations of provisions in its Truth in Lending Regulation Z, which goes into effect on July 1. A copy of each interpretation is printed below. They will be published shortly in the *Federal Register* and *Federal Reserve Bulletin.*

Additional copies of this circular will be furnished upon request.

Alfred Hayes, *President.*

§ 226.201 Lay-Away Plans as extensions of credit

(a) Many vendors offer Lay-Away Plans under which they retain the merchandise for a customer until the cash price is paid in full and the customer has no contractual obligation to make payments and may, at his option, revoke a purchase made under the plan and request and receive prompt refund of any amounts paid toward the cash price of the merchandise.

(b) A purchase under such a Lay-Away Plan shall not be considered an extension of credit subject to the provisions of Regulation Z.

§ 226.402 Term of insurance coverage

(a) Under § 226.4(a)(5) and (6) certain disclosures of insurance premium costs, if applicable, are required. The question arises as to whether such amounts of cost disclosed must include the cost of insurance for the full term of the transaction.

(b) Under § 226.4(h) the cost of insurance for the full period of insurance coverage which the creditor will require shall be disclosed if the cost of the insurance premium is required to be included in the finance charge. However, if the cost of insurance is not required to be included in the finance charge, the cost to be disclosed need only be the cost of premiums for the term of the initial policy or policies written in connection with the transaction, accompanied by a statement of the type of insurance and the term thereof.

§ 226.703 Finance charge based on average daily balance in open end credit accounts

(a) 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.

(b) 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) The sum of the daily balances during the billing cycle, or

(3) 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 that the average daily balance is 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.

In each case the annual percentage rate shall be determined and disclosed by multiplying the daily periodic rate by 365.

§ 226.704 Annual percentage rate computation where transaction charges are imposed on open end credit accounts

(a) Section 226.7(b)(6) prescribes the method by which an annual percentage rate is computed where the creditor of the open end credit account imposes finance charges with respect to specific transactions during the billing cycle.

(b) In determining the denominator of the fraction under § 226.7(b)(6), no amount will be used more than once when adding the sum of the balances to which periodic rates apply to the sum of the amounts financed to which specific transaction charges apply. In every case the full amount of transactions to which specific transaction charges apply shall be included in the denominator. Other balances or parts of balances shall be included according to the manner in which a periodic rate is applied, as illustrated in the following examples of accounts on monthly billing cycles:

(OVER)

1. Previous balance—none

   A specific transaction of $100 occurs on first day of the billing cycle.

   The average daily balance is $100.

   A specific transaction charge of 3% is applicable to the specific transactions.

   The periodic rate is $1\frac{1}{2}\%$ applicable to the average daily balance.

   The numerator is the amount of the finance charge, which is $4.50.

   The denominator is the amount of the transaction (which is $100), plus the amount by which the balance to which the periodic rate applies exceeds the amount of specific transactions (such excess in this case is 0), totaling $100.

   The annual percentage rate is the quotient (which is 4.5%) multiplied by 12 (the number of months in a year), i.e. 54%.

2. Previous balance—$100

   A specific transaction of $100 occurs at midpoint of the billing cycle.

   The average daily balance is $150.

   A specific transaction charge of 3% is applicable to the specific transaction.

   The periodic rate is $1\frac{1}{2}\%$ applicable to the average daily balance.

   The numerator is the amount of finance charge, which is $5.25.

   The denominator is the amount of the transaction (which is $100), plus the amount by which the balance to which the periodic rate applies exceeds the amounts of specific transactions (such excess in this case is $50), totaling $150.

   As explained in example 1, the annual percentage rate is $3.5\% \times 12 = 42\%$.

3. If, in example 2, the periodic rate applies only to the previous balance, the numerator is $4.50 and the denominator is $200 (the amount of the transaction, $100, plus the balance to which only the periodic rate is applicable, the $100 previous balance).

   As explained in example 1, the annual percentage rate is $2.25\% \times 12 = 27\%$.

4. If, in example 2, the periodic rate applies only to an adjusted balance (previous balance less payments and credits) and the customer made a payment of $50 at midpoint of billing cycle, the numerator is $3.75 and the denominator is $150 (the amount of the transaction, $100, plus the balance to which only the periodic rate is applicable, the $50 adjusted balance). As explained in example 1, the annual percentage rate is $2.5\% \times 12 = 30\%$.

5. Previous balance—$100

   A specific transaction (check) of $100 occurs at the midpoint of the billing cycle.

   The average daily balance is $150.

   The specific transaction charge is 25 cents per check.

   The periodic rate is $1\frac{1}{2}\%$ applied to the average daily balance.

   The numerator is the amount of the finance charge, which is $2.50, and includes the 25 cents check charge and the $2.25 resulting from the application of the periodic rate. The denominator is the full amount of the specific transaction (which is $100) plus the amount by which the average daily balance exceeds the amount of the specific transaction (which in this case is $50), totaling $150. As explained in example 1, the annual percentage rate would be $1\frac{2}{3}\% \times 12 = 20\%$.

(c) Regardless of such method of computation, the annual percentage rate to be disclosed shall be not less than the periodic rate multiplied by the number of periods in a year or the rate as may otherwise be determined under § 226.5(a).

§ 226.802 Disclosures on mail or telephone orders

(a) Under § 226.8(g), disclosures may be made at any time not later than the date the first payment is due under certain conditions. The question arises as to when disclosures shall be made on mail or telephone orders, where the information outlined in § 226.8(g)(1) and (2) is not available to the customer or prospective customer.

(b) Under the circumstances set forth in the above question, the creditor shall make the disclosures required under Regulation Z as follows:

1. With respect to credit sales, not later than at the time of delivery of the property or first performance of service ordered.
2. With respect to loans, not later than at the time proceeds of the loan are disbursed.
3. Except that if the transaction is subject to the provisions of § 226.9, the disclosures shall be made before the transaction is consummated.

§ 226.803 Disclosures when discounts apply for prompt payment

(a) Under § 226.8(o), disclosures shall be made on the billing statement whereas under § 226.8(a) disclosures shall be made before the transaction is consummated. The question arises as to which provision prevails.

(b) The provisions of § 226.8(o) prevail under the conditions set forth in that paragraph unless the transaction is also subject to the provisions of § 226.9 in which event the disclosures shall be made before the transaction is consummated.

§ 226.804 Series of sales—content of agreement

(a) Under § 226.8(h), if a credit sale is one of a series of transactions made under an agreement providing for the addition of a current sale to an existing outstanding balance and the customer has approved in writing the annual percentage rate or rates and certain other requirements are met, disclosures may be made at any time not later than the date the first payment for that sale is due.

(b) The question arises as to how the annual percentage rate or rates should be shown in an agreement where, for example, an 18% annual percentage rate applies to the first $500 of balance, a 12% annual percentage rate applies to all balances over $500, and the mix of the two rates on transactions over $500 will produce a gradually decreasing annual percentage rate as the amount of balance over $500 increases.

(c) In addition to meeting the other requirements of § 226.8(h), if two or more annual percentage rates apply to ranges of balances, the agreement need only state each annual percentage rate and the range of balances to which it applies. However, the disclosures which must be made not later than the date the first payment is due must include the actual annual percentage rate applicable to that sale.