FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8793
April 7, 1980]

CREDIT RESTRAINT

Amendments to Subpart A

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

The Board of Governors of the Federal Reserve System has announced amendments to Subpart A of its new regulation on "Credit Restraint." Subpart A of the regulation deals with consumer credit. The following is quoted from the Board's announcement:

The Federal Reserve Board made the following amendments to its consumer credit restraint regulations announced March 14:

1. Established a uniform, national rule for creditors to follow if they (1) impose or increase any finance or other charges, (2) change the method of computing the balance upon which the charges are applied, or (3) increase the required minimum periodic payment.

The above changes can be made *only* if:

— Written notice of a change is provided to all affected account holders at least 30 days before the effective date of the change.

— The account holders are given the option to pay off their outstanding debt in accord with the original terms of their contract.

If an account holder continues to use a credit card after the effective date of the specified changes he or she will be subject to the new terms on all outstanding credit.

This change does not affect State consumer credit rate ceiling laws, other Truth in Lending disclosures or rules under the Equal Credit Opportunity Act.

Creditors who have begun mailing notices of changes to their account holders prior to March 14 may implement such changes without regard to the new notice procedures.

2. Provided creditors subject to the Consumer Credit Restraint Program with an alternative base period for calculation of the 15 percent special deposit requirement. This alternative base is designed to prevent an undue burden for creditors that face large seasonal increases in their business in the months ahead.

The choice of base will be either the original base of March 14, 1980, or the following option which gradually reduces year-over-year increases in outstanding credit that are possible without incurring special deposit requirements:

— The base for any given month will equal the outstanding covered credit for the same month a year earlier, scaled up by a gradually diminishing factor based on the expansion of a firm's covered credit from March 1979 to March 1980. The growth factor will be reduced by one-twelfth each month so that by March 1981 any year-over-year increase in covered credit will be subject to the special deposit requirement, which applies to any growth of covered credit over the base level.

For example, if a firm experienced growth in covered credit of 6 percent between March 1979 and March 1980, under the alternative method its April 1980 base would equal the April 1979 level of covered credit, scaled up by $^{11}/_{12}$ of 6 percent. For May, its base would equal the May 1979 level, scaled up by $^{10}/_{12}$ of 6 percent.

(over)

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In a related action, the Board said it will attempt, whenever possible in further rulemaking under the Credit Control Act of 1969, to give notice and opportunity for public comment before making a final decision. However, the Board cannot commit itself to doing so in all cases, since (as in the case of the rules issued March 14), such advance notice would result in frustration of the anti-inflationary objective of restraining credit increases by giving opportunity for credit to increase before new credit-restraining rules become effective.

The Board acted in response to a petition from the Consumer Federation of America.

In making the decision the Board said:

> The Board recognizes the contribution to the decision making process that public participation provides, and has in the past encouraged broad participation in its rulemaking proceedings, particularly in the consumer and equal credit area. . . . The Board will attempt to provide an opportunity for public comment whenever this is possible and would not frustrate its intended actions. Finally, the Board intends that its regulations (under the Credit Control Act) be implemented in as fair and equitable a manner as possible.

The Board indicated that — as it has done in the past with respect to other regulations — where opportunity for prior public comment is not practicable, it will consider public comment on its actions received after its rules are issued, and stands ready to amend the rules if necessary.

Enclosed is the text of the amendment to Subpart A of the "Credit Restraint" regulation that provides for the establishment of a 30-day notice requirement prior to making changes in financing terms; the text of the amendment to Subpart A concerning the establishment of an alternative base for calculating the 15 percent special deposit requirement will be sent to you shortly. Legal questions regarding the amendments may be directed to Donald L. Bittker, Assistant Counsel, Legal Department (Tel. No. 212-791-5036); other questions may be directed to the Consumer Credit Reports Unit (Tel. Nos. 212-791-7721 through 7725).

ANTHONY M. SOLOMON,
President.

Board of Governors of the Federal Reserve System

CREDIT RESTRAINT

SUBPART A—CONSUMER CREDIT

(effective April 2, 1980)

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: On March 14, 1980, the Board adopted a consumer credit restraint program (12 CFR Part 229, Subpart A; 45 FR 17927, March 19, 1980) that requires certain creditors that extend certain types of consumer credit, including open-end credit, to maintain a special deposit with the Federal Reserve Banks. Many creditors believe that to best restrain the growth of open-end consumer credit they will have to modify the terms of existing accounts. Because the rules that govern how and when account terms can be changed vary from state to state, and because consumer accountholders are insufficiently protected in many states, the Board is adding a new section to Subpart A to establish national uniformity. The new section requires 30 days advance notice of certain changes in account terms, and permits consumers to pay off existing account balances in accordance with the old terms. However, if after the effective date of the change, a consumer continues to use the open-end account, the consumer will have agreed to pay the entire account balance in accordance with the new terms.

EFFECTIVE DATE: April 2, 1980.

FOR FURTHER INFORMATION CONTACT: Nathaniel E. Butler, Associate Director, or David A. Myers, Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3000).

SUPPLEMENTARY INFORMATION:

When the Board adopted the consumer credit restraint program, it chose to impose a special deposit requirement on the growth of a creditor's covered consumer credit above the amount outstanding on March 14, 1980. The Board expected creditors to individually decide how to limit subsequent growth in their open-end credit programs.

It has come to the Board's attention, however, that legal requirements governing the change of open-end account terms vary from state to state. In a minority of states, primarily those that have enacted some

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For this Regulation to be complete, retain:

1) Regulation pamphlet entitled "Credit Restraint," adopted effective March 14, 1980.
2) Subpart D, effective March 28, 1980.
3) Amendment to Subparts B, effective March 28, 1980.
4) This slip sheet.

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version of the Uniform Consumer Credit Code, advance notice of certain changes in terms must be given from three to six months before the change is implemented. Some states, again a minority, do not permit a creditor to impose new terms on account balances outstanding on the date of change. Finally, some of these state laws may not apply to all classes of consumer creditors within a single state (for example, retail creditors may be covered, but not banks).

The Board's Truth in Lending regulation (12 CFR § 226.7(f)), which controls in the majority of states, allows creditors to change account terms after giving notice at least 15 days before the start of the billing cycle in which the change is to occur. The federal law is silent about whether changes can be applied to existing balances and thus, in certain states as mentioned above, the local statutory requirements would prevail. In a few other instances, courts have devised a judicial answer based upon public policy considerations. In the majority of states, however, whether changes can be applied to existing account balances depends upon the terms of the contract between the customer and the creditor.

The Board believes that the goals of the Credit Control Act and its implementing regulation may be significantly frustrated by prohibition of certain term changes, or by lengthy advance notice requirements before terms of open-end credit accounts can be changed. Requiring creditors to wait from three to twelve months before they can take action to restrain the growth of credit to existing customers is unreasonable in light of the exigent circumstances that prompted the Board's initial action on March 14. The Board further believes that in these circumstances disparate notice requirements from state to state, or among classes of creditors within a state, are undesirable and would unfairly distort the effect of the Board's March 14 action as to both creditors and consumers.

The Department of Energy (DOE) has a regulation that, among other things, prohibits oil companies from imposing stricter credit terms with respect to their open-end accounts (10 CFR § 210.62(a)). The Board, however, has been informed by DOE that DOE interprets the Board's amendment as superseding DOE's regulation to the extent that they are inconsistent. Consequently, DOE has indicated that changes in the terms of open-end credit accounts made by oil companies pursuant to the amendment are not prohibited by DOE's regulation which otherwise prohibits any more stringent credit term or payment schedule than existed on May 15, 1973.

The amendment set forth below establishes a uniform, national requirement that advance notice of certain changes must be given at least 30 days before the date that the change is implemented. The notice must be sent to each affected consumer accountholder, although only one notice need be sent for each joint account. The amendment preempts contrary law or private contract provisions, and modifies the Truth in Lending requirements. It applies to all increases in charges, changes in balance computation methods, and increases in minimum periodic payments that are effective after March 14, 1980, unless a creditor had started mailing or delivering notice of those changes to affected consumer accountholders before that date. The Board emphasizes that limitations on the maximum permissible rate of interest or finance charge that can be imposed on open-end consumer credit accounts are unaffected by the amendment.

The amendment also establishes rules about whether term changes can be applied to existing account balances. The Board is concerned that in a majority of states this question is answered by private contract. Consumers generally are unable to individually negotiate the contract governing their open-end accounts, and may well be unaware that changes can be imposed in most states on existing, as well as future, balances. Because changes in account terms are a predictable response to the Board's credit restraint program, the Board believes that all consumers should be given reasonable opportunity to reject certain changes. Additionally, it is the Board's intent to restrain growth in consumer credit, and permitting creditors to impose new terms on account balances that generally represent credit extended prior to March 14 is not consonant with this purpose.

Consequently, the amendment requires that consumers be permitted to choose either to pay off outstanding account balances under the existing terms, or to accept the new terms as to both existing and new balances by use of the account after the effective date of the change. The advance notice of change must explain this option clearly. The notice itself must be on a single document, and be readily understandable. It must explain the current term(s) that are being changed, as well as the new term(s), to insure that consumers understand the change. The amendment provides specific guidance on the language of the notice.

The Board believes that establishing uniform, national standards of this type will prevent unfair surprise to consumers, will enable creditors to manage their open-end credit plans in a feasible way, and will contribute to the goal of restraining the growth of consumer credit. The Board also believes that publication of this amendment for comment, or any delay in its effective date, would result in undesirable increases in outstanding consumer credit during the period before the amendment was adopted or became final. The Board, therefore, for good cause finds that the notice, public proceedings, and deferral of effective date provisions of 5 U.S.C. § 553(b) with regard to this action are impracticable and contrary to the public's interest.

Pursuant to its authority under the Credit Control Act (12 U.S.C. §§ 1901-1909) as implemented by Executive Order 12201, the Board hereby amends 12 CFR Part 229, Subpart A, effective April 2, 1980, by adding a new section as follows:

SECTION 229.6 -- CHANGE IN TERMS OF OPEN-END CREDIT ACCOUNTS

(a) Notwithstanding the terms of any open-end credit agreement or the provision of any other law, a covered creditor, with respect to its open-end credit accounts, may (1) impose or increase any finance or other charge, (2) change the method of computing the balance upon which charges are imposed, or (3) increase the required minimum periodic payment, if the following two conditions are met. First, the covered creditor shall mail or deliver a written notice of the change to each affected consumer

accountholder at least 30 days before the effective date of the change. Second, the covered creditor shall permit each affected consumer accountholder to repay, under the existing account terms, any debt incurred prior to the effective date of the change, unless the accountholder incurs additional debt on or after that date or otherwise assents in writing to the changes.

(b)(1) This section does not authorize a covered creditor to impose a rate of interest or finance charge in excess of the maximum permitted by law.

(2) This section does not govern any change in the terms specified in paragraph (a) of this section if the covered creditor began mailing or delivering notice of that change to affected consumer accountholders before March 14, 1980.

(c)(1) The notice required by this section shall clearly set forth the new term(s), the corresponding existing term(s), and the effective date of the change; shall appear on a single document that contains no other information except the changed account agreement or other material directly related to the change; and shall be in plain language.

(2) The notice also shall clearly explain the two options available to the consumer. The options shall be presented more conspicuously than the rest of the notice by, for example, bold-faced type, larger type size, or contrasting color. Language similar to the following, or modified to reflect the creditor's individual credit plan, may be used:

"WARNING: Continued use of your account on or after [effective date of change] will result in stricter terms.

You have TWO OPTIONS:

(1) You may stop making charges on your account before [effective date of change] and pay off under the existing terms described in this notice all or any part of what you owe us on that date. You may continue to use your account on or after that date, but if you do so, the new terms will apply as explained in option (2) below.

OR

(2) You may make charges on your account on or after [effective date of change], in which case the new terms described in this notice will apply to what you then owe us and to future charges."

By order of the Board of Governors of the Federal Reserve System, effective April 2, 1980.

(Signed Griffith L. Garwood)
Griffith L. Garwood
Deputy Secretary of the Board