FEDERAL RESERVE BANK
OF NEW YORK

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May 8, 1980]

CONSUMER CREDIT RESTRAINT

Additional Questions and Answers—Ninth Series

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

Printed below is the ninth series of questions and answers, representing the views of the legal staffs of the Federal Reserve Bank of New York and of the Board of Governors of the Federal Reserve System, regarding the Credit Restraint Program. This series of questions and answers relates to the consumer credit restraint program (Subpart A of the Board's regulation on Credit Restraint).

Any questions concerning the Credit Restraint Program may be directed to the persons listed in our Circular No. 8794, dated April 9, 1980.

ANTHONY M. SOLOMON,
President.

Special Deposits on Consumer Credit

Subpart A

A-75. Q: A customer assumes an existing consumer credit obligation from the current customer. The creditor remains the same. Does the assumption affect whether the loan is covered credit?

A: No. If the loan was exempt as to the first customer, it remains exempt. Similarly, covered credit continues to be reported as covered credit after an assumption. However, if the assumption involves the advance of additional funds to the subsequent customer, the creditor must make an independent determination as to whether the new money is covered credit.

A-76. Q: Does covered credit include overdrafts of checking accounts that are not pursuant to a prearranged plan?

A: Yes. When a bank pays an overdraft, even if the drawer and the bank have not entered into an overdraft payment agreement, credit is extended. Unless one of the exceptions applies, the amount must be included in the bank's covered credit.

A-77. Q: What insurance company policy loans are excluded from covered credit?

A: Loans by an insurance company up to the accrued cash value of the policy are excludable to the extent that the company is obligated under the terms of the policy to lend to the policyholder.

A-78. Q: An employee receives a loan from a profit-sharing or pension plan in which the employee participates. Is this covered credit?

A: A loan to a participant by a pension or profit-sharing plan is not covered credit if the plan is obligated by its terms to lend to the participant an amount up to the amount of the participant's vested interest in the plan.

A-79. Q: A customer obtains a loan from creditor B to pay off a land contract with creditor A. Both transactions are secured by the property involved. Is the loan with creditor B covered credit?

A: If the land contract is the equivalent of a "bridge" loan and is intended as short term, interim financing before permanent financing can be arranged, the loan with creditor B is not covered credit.

A-80. Q: Creditor B provides long term permanent financing to replace interim financing from creditor A for the purchase of a home. Both loans are secured by the customer's home. Is the refinancing covered credit?

A: No. The refinancing is regarded as part of a purchase money transaction.

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A-81. Q: For purposes of its base report, a creditor has made an estimate of the proportion of its loans in a given category that are covered credit. When payments are received, how should the creditor allocate them in determining the reduction in the amount of covered credit?

A: A creditor may either maintain records on a loan-by-loan basis or allocate payments in proportion to the share of covered credit in that category as determined on the basis of the preceding month's report.

A-82. Q: Is a loan to an individual for an investment to be considered business credit?

A: A loan for investment would be considered consumer credit unless investing of the type for which the loan was made constitutes the borrower's business. However, if the loan is for the purchase or improvement of rental property, it is considered business credit. (See Question A-55).

A-83. Q: Creditor A purchases covered credit of creditor B with reservation of a right to assert against B any claims for breach of warranty. Does this constitute "recourse" within the meaning of Subpart A.

A: No. Recourse involves the sharing of the credit risk. The reservation of a right to assert claims does not constitute recourse. If creditor A assumes the entire credit risk, the transfer is without recourse, and the credit becomes the covered credit of that creditor, despite reservation of any right to assert claims against B.

A-84. Q: Where creditor A purchases covered credit of creditor B on a less than 100% recourse basis, must the transferred credit be apportioned between the two creditors on the basis of the extent of the recourse.

A: No. If creditor A has any recourse to creditor B on that transfer of credit, the transfer is *with* recourse, and the transferred credit therefore would be considered covered credit of creditor B.

A-85. Q: A guarantor of a loan that constitutes covered credit is required to repay a loan to a creditor when the borrower defaults; as a consequence, the guarantor acquires the loan note from the creditor. Is the loan now covered credit of the guarantor?

A: No. The definition of "covered credit" under Subpart A is not intended to include obligations acquired by guarantors solely by virtue of their having had to repay debts of third parties arising from their guarantee obligations.

A-86. Q: A creditor wishes to change the terms of its existing open-end accounts to allow imposition of a variable annual percentage rate (APR). Must it provide the notice and options required by Section 229.6 each time the rate varies?

A: The creditor need not comply with Section 229.6 on all subsequent rate changes if, in disclosing the variable rate APR initially under Section 229.6, the creditor informs the customer of: (1) the fact that the rate is subject to change; (2) the conditions under which the rate may be changed; and (3) any maximum and minimum rates possible. Later changes in the APR that conform with these disclosures would not require any further notice under Section 229.6.

A-87. Q: Prior to the effective date of Section 229.6, a creditor with open-end credit accounts imposed a variable annual percentage rate and disclosed that fact to consumers under Interpretation Section 226.707 of Regulation Z (Truth in Lending). When the APR on the accounts subsequently changes, in accord with the previously-disclosed variable rate provision, must the creditor comply with the change in terms rule in Section 229.6?

A: No. A variation in the APR resulting from a variable rate provision previously disclosed under Section 226.707 does not trigger a change in terms notice under Section 229.6.

A-88. Q: Sections 226.9(g)(6) and 226.904 of Regulation Z provide certain rules about how a creditor may make changes in open-end consumer credit accounts where debt on those accounts is secured by the type of interest in the consumer's home that gives rise to a right of rescission. How do those sections relate to Section 229.6?

A: If a creditor desires to make the types of changes specified in Section 229.6(a), the provisions of 229.6 should be followed. However, whenever applicable, the right of rescission notice required by sections 226.9(g)(6) and 226.904 of Regulation Z must also be given. The following language or substantially similar language should be added to the notice required by Section 229.6(c):

> Please remember, your open-end credit account is secured with a lien on your (home, lot). This means that your failure to live up to our agreement could result in the loss of your (home, lot).

This language is best added in the portion of the notice immediately following the word "WARNING."

A-89. Q: While acting as a trustee, a bank makes a loan of the type that would be covered credit to a beneficiary of the trust. Is the bank extending covered credit?

A: Yes.