

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 7224]
[August 29, 1973]

Interpretation of Regulation Z

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

Printed below is the text of an interpretation of Regulation Z, issued August 24 by the Board of Governors of the Federal Reserve System, to clarify the treatment of prepaid finance charges in credit transactions.

Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.

(Reg. Z)

PART 226 – TRUTH IN LENDING

Add-on and discount finance charges as "prepaid finance charges"

This interpretation intends to make clear 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.

§ 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).

(Interprets and applies 15 U.S.C. 1638 and 15 U.S.C. 1639).

By order of the Board of Governors, August 23, 1973.