FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

American Revolution Bicentennial

Circular No. 76-121
August 27, 1976

PROPOSED INTERPRETATION OF REGULATION Z

Formal Interpretation that Separate Disclosure of a Dealer Participation Is not Required Under the Truth-in-Lending Act or Regulation Z

TO ALL BANKS, OTHER CREDITORS,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

On August 17, 1976, the Board of Governors of the Federal Reserve System proposed an interpretation of its Regulation Z, Truth-in-Lending, which states that where a dealer and a creditor share in the interest payable on a consumer credit contract, such participation need not be separately stated in disclosures given to the consumer. The Board was requested to issue an official position in a recent court action.

A participation is a part of total finance charge paid by a creditor to a seller of automobiles or other major consumer goods, where the creditor either buys the dealer's instalment contract with the consumer or provides direct consumer financing through the dealer. In such cases, the creditor and the seller typically share in the interest received.

In proposing the interpretation, the Board said it does not believe that separate disclosure of a dealer participation is required under the Truth-in-Lending Act or Regulation Z.

The Board stated in issuing the proposal:

> "The present length and complexity of Truth-in-Lending disclosures argue against any additional disclosure which is not clearly mandated by the letter and the spirit of Truth-in-Lending and which may in fact detract from consumer's awareness of important credit terms."

Interested people are invited to submit written comments concerning this proposal to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than September 27, 1976. Comments should include a reference to Docket No. R-0053.

Printed on the attached pages is the text of the proposed interpretation as submitted for publication in the FEDERAL REGISTER. Any questions about the proposed interpretation should be directed to our Regulations Department at (214) 651-6169.

Sincerely yours,
T. W. Plant
First Vice President

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TITLE 12--BANKS AND BANKING

SUBCHAPTER A--BOARD OF GOVERNORS

OF THE FEDERAL RESERVE SYSTEM

(Reg. Z)

PART 226--TRUTH-IN-LENDING

(Docket No. R-0053)

Proposed Interpretation on Disclosure of Amount of Dealer Participation

The Board of Governors of the Federal Reserve System proposes to adopt an interpretation of Regulation Z regarding disclosure of the amount of a dealer participation, commonly found in the financing of purchases of automobiles and other major consumer goods. In order to provide an opportunity for public discussion, the Board is publishing this interpretation for comment prior to any final action on this issue by the Board. The interpretation will not become effective until further notice by the Board.

The interpretation relates to the requirements of §226.8(c)(8)(i) of Regulation Z with respect to identification of allocations by creditors to dealers of a portion of the finance charge on credit used to finance the purchase of automobiles and other consumer goods. The amount of dealer participation typically represents a portion of the interest component of a finance charge which is either allocated by the creditor to the dealer on the sale of its retail instalment contracts to that creditor or paid by the creditor to the dealer for arranging or referring a direct loan from the creditor.

The Board has been requested to determine whether these portions of the finance charge constitute finder's fees or similar charges within the meaning of §226.4(a)(3) of the Regulation and whether they must be itemized as a separate component in disclosure of the finance charge under §226.8(c)(8)(i).

Proponents of a requirement for separate disclosure of this amount take the position that the dealer participation represents a separate charge and that its specific disclosure would be beneficial to consumers. It is argued that disclosure of this amount would place the consumer in a more advantageous bargaining position with the dealer and that it would encourage a consumer to engage in further cost comparisons among various credit sources. Those in favor of this position apparently believe that this disclosure would indicate to the consumer that some portion of the cost of credit is attributable to the dealer's presence in the transaction. This awareness, they argue, would prompt the consumer to shop for better terms through direct financing.

Based on the information presently available, the Board does not believe that separate disclosure of these amounts is either required by the terms of the Regulation or mandated by the purposes of the Act. In the Board's view, a dealer participation differs from the concept of a finder's fee as that term is used in the Regulation. Unlike the dealer

participation, a finder's fee or other charge of the type described in §226.4(a)(3) is considered to be a separate charge imposed in addition to that portion of the finance charge which is attributable to a percentage rate or rates. Such fees are normally earned in full at the time of the transaction and are not subject to later adjustments on the basis of subsequent events.

A dealer participation, to the contrary, serves the purpose of apportioning the risk of loss on the credit transaction between the dealer and the financial institution. Through dealer reserve accounts and various recourse devices, the institution is able to accept a lower yield on dealer-related transactions where it does not bear the entire risk of loss. Because these amounts are frequently subject to later deductions for such occurrences as prepayment or default on the contract, the amount of dealer participation which would be disclosed to the customer may bear no relationship to the amount ultimately received by the dealer.

In the Board's view, the credit-shopping function of Truth-in-Lending is primarily served by disclosure of the total finance charge and annual percentage rate. These two terms, which already reflect any portion of the finance charge received by the dealer, provide the essential information needed for comparing credit sources and would not be enhanced by separate disclosure of the dealer participation. The present length and complexity of Truth-in-Lending disclosures argue against any additional disclosure which is not clearly mandated by the letter and the spirit of Truth-in-Lending and which may in fact detract from consumers' awareness of important credit terms.

For the reasons stated, the Board takes the position, in a proposed interpretation §226.821, that allocations of the finance charge between the dealer and the institution do not constitute finder's fees or similar charges and need not be separately described, when they represent a distribution of a portion of a finance charge which is computed by the application of a percentage rate or rates to the amount financed.

While the Board believes that the proposed interpretation correctly applies the present requirements of the Truth-in-Lending Act and Regulation Z, the Board is aware that this issue has been the subject of some controversy and wishes to provide an opportunity for public discussion before any final action is taken. Therefore, the Board invites written comments on the issue addressed in the interpretation. Comments should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 and must be received by September 27, 1976. Comments should include a reference to Docket No. R-0053.

The text of the proposed interpretation is as follows:

Section 226.821--Disclosure of dealer participation

(a) Section 226.8(c)(8)(i) requires the itemization of each component of a finance charge consisting of more than one type of charge. Section 226.4(a)(3) lists among the types of charges to be included in the finance charge a "finder's fee or similar charge." In certain credit transactions, such as the sale of automobiles and other consumer goods,

where the finance charge is determined by application of a percentage rate or rates to the amount financed, a portion of that charge may be allocated to the dealer by the financial institution as a dealer participation. The question arises whether such allocations must be itemized as a separate component of the total finance charge in the nature of a finder's fee.

(b) The requirement for itemization of a finance charge which includes a finder's fee or other elements in addition to an interest component is intended to assure that the total finance charge disclosed to the customer properly reflects all components which must be included in that amount. Any component of the finance charge which is computed by the application of a percentage rate or rates to the amount financed constitutes a single charge of the type described in §226.4(a)(1). As such, it must be included in the finance charge calculation and disclosure. A portion of such single component of the finance charge which is distributed to a dealer is not considered a "finder's fee or similar charge" and need not be separately identified or disclosed. The concept of a "finder's fee," as that term is used in §226.4(a)(3), is intended to cover certain charges in the nature of brokerage fees which are imposed in addition to that portion of the finance charge attributable to the application of a percentage rate or rates to the amount financed. Any such separate fee must, of course, be separately itemized.

(Interprets and applies 12 C.F.R. 226.8)

By order of the Board of Governors, August 17, 1976.

(Signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

(SEAL)