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Truth in Lending

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Truth in Lending

Cooperative Extension Service:
South Dakota State University
and U. S. Department of Agriculture

Truth in Lending

FS 471

By Arthur B. Sogn, research and extension economist

The purpose of this fact sheet is to assist those businesses and particularly agri-businesses which extend credit and are subject to Regulation "Z" of the Truth in Lending Law made effective July 1, 1969. It is the intent of the author to include changes in Regulation "Z" since the effective date, and to make certain interpretations not clearly stated in the original regulation.

Regulation "Z" of the Truth in Lending legislation applies to all persons who, in the ordinary course of business, regularly extend, or offer to extend, or offer to arrange for the extension of, consumer credit. All businesses which extend credit, which make a finance charge, or are in other ways subject to the regulations of the Truth in Lending Law, may be consoled by the fact that the law is thought by many to be difficult to understand and with which to comply. This need not be the case if three basic features exist in the credit policy of a business.

1. Have simple credit policy.
2. Do not offer cash discounts in excess of 5 percent. (A business may offer cash discounts not to exceed 5 percent on a single payment transaction, without disclosing the annual percentage rates.) (Bona fide volume discounts are also not subject to Regulation "Z.")
3. Offer only open-end credit. (Open-end credit is defined as the normal revolving charge account including most credit cards, where charges and payments are made with no special terminal date.)

A business may complicate compliance with Regulation "Z" by offering several different finance rates for different commodities, or by offering unit discounts on a series of products (such as a cent a gallon off, etc.) or by offering closed-end, monthly payment credit where the actuarial method of finance charge calculation is used. However, if a business has a simple one rate finance charge, does not offer cash discounts in excess of 5 percent, and offers only open-end credit, then only two things are necessary to comply with truth in lending requirements:

- Make proper disclosure of your credit policy.
- Alter your billing statement to include the required disclosures, using the terminology prescribed in Regulation "Z."

Credit Policy Disclosure

The law requires the following items must be told at least once to the credit customer, if they are a part of the seller's credit policy. Each new customer must be informed of the credit policy in writing before the first transaction.

1. The condition under which a finance charge may be imposed and the period in which a payment can be made without incurring a finance charge.

Example: "All open account balances not paid within 30 days following the billing cycle date (26th of the month) will be assessed a 1 percent per month finance charge."

This tells the customer a finance charge will be assessed after 30 days and if the account is paid before 30 days from the 26th there will be no charge for credit.

2. The method used in determining the balance on which a finance charge is to be made.

Example: "All payments and other credits applied to purchases shall be credited to the oldest purchase first. The balance of the account over 30 days old will be subject to the finance charge."

3. How the actual finance charge in dollars is determined.

Example: "If there are charges other than the 1 percent per month charge on past due accounts, then the charge customer must be informed of these charges. Credit report fees, a charge for cashing checks, credit life insurance or a minimum charge are examples of other charges that may be included in the finance charge."

4. The periodic rates and the range of balances to which each applies.

Example: If your policy is 1½ percent per month charge on balances up to \$500 and 1 percent per month over \$500, this must be so stated.

5. Description of any lien which you may acquire on a customer's property.

6. The minimum payment that must be made on each billing.

Thus, if a creditor has as his credit policy a simple "1 percent per month on accounts over 30 days," he needs to make disclosures of only four disclosure requirements mentioned above (items 1, 2, 3, and 5—and only three if he relinquishes any right to a lien),

Any Store Company, U.S.A.

DISCLOSURE STATEMENT

Statement of Credit Terms and Disclosure of Finance Charges

TERMS

Terms are cost for amount of purchase. Convenience open account credit is available to customers with approved credit.

Convenience open account credit is defined as follows:

Statement of account shall be rendered to all customers at the end of each month and/or billing date. If account is paid within 30 days following the billing date, no finance charge will be assessed.

FINANCE CHARGES

All open accounts not paid within 30 days following the billing date will be assessed a 1% per month FINANCE CHARGE. This FINANCE CHARGE is equivalent to an ANNUAL PERCENTAGE RATE OF 12%. All payments and other credits shall be applied first to payment of the FINANCE CHARGE and then to purchases. All payments and other credits applied to purchases shall be credited against the oldest purchase first. No other finance charges employed.

ELIGIBILITY

Open account credit privileges will be suspended if a charge purchase remains unpaid on an account on the 10th of the month following the second monthly billing statement after the purchase. For example: A purchase of \$100.00 which must be paid by August 10th to avoid FINANCE CHARGE. If payment was not received by August 10th, a FINANCE CHARGE of \$1.00 would be added to the account on August 11th. If no other purchases or payments were made in August, the August 31st statement would have a new balance of \$101.00, which would be payable by September 10th to avoid another FINANCE CHARGE. In addition, if the balance was not paid by September 10th, credit privileges would be suspended until the account is paid.

OTHER THAN OPEN ACCOUNT CREDIT

Intermediate Term Financing may be arranged by contacting the manager. Simple interest of 8% will be charged on the principal amount of the intermediate term financing to the maturity date of the note.

SECURITY INTERESTS

The Federal Regulation commonly referred to as the "Truth in Lending" requires that you be advised of any possible security interest on your property arising out of a credit sale.

The articles and by-laws of your cooperative provide that your cooperative has a secured interest to any individual patron's equities up to the amount of that individual's indebtedness to the cooperative.*

The Any Store Co. may acquire a security interest in property owned by the customer by (1) pursuant to statutes and provisions of the Uniform Commercial Code which grant such an interest whether recorded or not or (2) by written agreement signed by seller—Any Store Co.—and the customer. The Any Store Co. may acquire a mechanic's, materialmen's, artisan's, seed and similar liens, and/or vendor's lien in both real and personal property if it becomes necessary to protect the interests of the Any Store Co.

You will be informed of any changes in the above terms in accordance with the applicable laws.

The above terms shall be effective June 30, 1969. All inconsistent provisions of outstanding agreements are amended accordingly.

The above disclosures are made in order for us to comply with the Federal Truth in Lending Act, Regulation "Z."

Any Store Co., U.S.A.

*Applies to Cooperatives and other corporations having a secured interest in members or stockholders equity.

Figure 1.

as these are the only ones that pertain to his particular credit policy. Disclosure of credit terms to a customer could be made in this manner and fulfill requirements of Regulation "Z."

Under this credit policy, all open accounts not paid within 30 days following purchase (or billing date if

you chose) will be assessed a 1 percent per month **finance charge**. This finance charge is equivalent to an **annual percentage** rate of 12 percent. All payments and other credits applied to purchases shall be credited against the oldest purchase first. No other finance charges will be assessed.

A business may make proper disclosure of its right to secure a lien by the inclusion of a paragraph in the disclosure notice similar to the following:

"The **Any Store Company** may acquire a security interest in property owned by the customer (1) pursuant to statutes and provisions of the Uniform Commercial Code which grants such an interest whether recorded or not or (2) by written agreement signed by seller and customer. **Any Store Company** may acquire a mechanic's, materialmen's, artisan's, seed and similar liens, and/or vendor's lien in both real and personal property if it becomes **necessary to protect the interest of Any Store Company.**"

The Billing Statement

The creditor's statement to a customer must conform to certain uniform requirements of Regulation "Z." Once the statement design is completed, its use becomes routine.

Regulation "Z" lists some guides that must be followed to comply with the law and other suggested guides.

Regulation "Z" states: "Periodic statements **are required** for open-end credit, where a finance charge is assessed—except in the case of an account which the creditor deems uncollectable or with respect to which delinquency procedures have been instituted.

"**The creditor** of any open-end credit account **shall** mail or deliver to the customer (all customers) for each **billing cycle** at the end of which there is an outstanding debt balance in excess of \$1—or where a finance charge is made." This says all customers with an account balance over \$1 must be sent a statement—not just select customers. The statements must be such that the customer may retain the pertinent information listed below.

The Statement Must Include:

1. The outstanding balance at the beginning of the billing cycle using the term—"Previous Balance."
2. The amount and date of each extension of credit, and unless previously furnished, a brief identification of any goods or services purchased or other extension of credit.
 - (a) If a customer is given a sales ticket at the time of purchase he has been previously furnished a description, and reference to ticket number is all that is needed for the statement. The customer need not sign the ticket for proof. The general practice of giving the customer a ticket at a time of sale is sufficient.
 - (b) If copies of the sales ticket are included with the statement, the total amount of purchases in dollars is all that needs to be

entered in the purchases column of the statement.

- (c) Codes can be used to identify purchases as to departments or items, but the codes must be listed on the statement front for identification.
 - (d) Copies of ledger cards containing other than the current billing cycle's business cannot be made to conform to Regulation "Z."
3. The amounts credited to the account during the **billing cycle** for payments using the term "Payments," and the amounts credited to the account for returns, etc., using the term "**Credits.**" Credits and payments may be in the same column of the statement if they are distinguished. Credit for returned merchandise may even be shown in different color ink in the purchase column of the statement, to indicate a reduction in purchases if the customer is aware of the system used.
 4. The amount in dollars of any finance charge using the term "**Finance Charge.**" The regulation states that any finance charge debited to the account must be disclosed, but the interpretation here is rather that any finance charge you **attempt to collect**, whether or not it is actually debited to the account before payment, must be disclosed. Any other charge included in the finance charge must be so identified (such as charge for checks, etc.)
 5. Each periodic rate, using the term "**Periodic Rate**" if this applies to your credit policy, and a description of rates and amounts to which they apply (for example, 1½ percent finance charge per month on balances up to \$500, 1 percent charge per month on balances over \$500).
 6. The annual percentage rate using the term "**Annual Percentage Rate.**" The annual percentage rate for a 1 percent per month finance charge works out as follows:
$$\frac{\$1.00 \text{ Finance Charge}}{\$100 \text{ Account}} = .0100 \times 12 \text{ months} = 12 \text{ percent annual percentage rate}$$
 7. The statement must also show the **balance on which the finance charge** was computed, and make it obvious **how that balance was determined.** (1 percentage charge on the previous balance or 1 percent on all charges over 30 days, etc.) **The closing date of the billing cycle**, and the **new balance**, using the term "New Balance," must also be shown on the statement.

The statement for open-end credit must be such that the customer retains the information listed above. This means if any part of the statement is to be detached and returned with the payment, the above information must be on the part the customer retains.

The sample statement shown below (Figure 2) was prepared by the Federal Trade Commission as an acceptable statement form containing the necessary information.

Any Store U.S.A.
MAIN STREET—ANY CITY, U.S.A.

(Customer's name here)

AMT. PAID. \$

TO INSURE PROPER CREDIT RETURN THIS PORTION WITH YOUR PAYMENT

PREVIOUS BALANCE	FINANCE CHARGE 50 CENT MINIMUM	PAYMENTS	CREDITS	PURCHASES	NEW BALANCE	MINIMUM PAYMENT
<p>FINANCE CHARGE IS COMPUTED BY A "PERIODIC RATE" OF % PER MONTH (OR A MINIMUM CHARGE OF 50 CENTS FOR BALANCES UNDER \$) WHICH IS AN ANNUAL PERCENTAGE RATE OF % APPLIED TO THE PREVIOUS BALANCE WITHOUT DEDUCTING CURRENT PAYMENTS AND/OR CREDITS APPEARING ON THIS STATEMENT.</p> <p>NOTICE PLEASE SEE ACCOMPANYING STATEMENT(S) FOR IMPORTANT INFORMATION.</p> <p>PAYMENTS, CREDITS OR CHARGES, RECEIVED AFTER THE DATE SHOWN ABOVE THE ARROW, WHICH IS THE CLOSING DATE OF THIS BILLING CYCLE, WILL APPEAR ON YOUR NEXT STATEMENT. TO AVOID ADDITIONAL FINANCE CHARGES PAY THE "NEW BALANCE" BEFORE THIS DATE NEXT MONTH.</p>						

ANY STORE, U.S.A. MAIN STREET, ANY CITY, U.S.A.

Figure 2.

Deviations from Figure 2 are possible, if they are deemed necessary, as long as the truth in lending requirements are met. The previous balance, purchases, payments, credits, finance charge, periodic rate, annual percentage rate, and balance on which finance charge was computed, with the explanation of how the balance was determined must be on the face of the statement. The closing date of billing cycle, new balance, and date for payment to avoid additional finance charges, may appear elsewhere.

Suggested Possible Deviations

1. If a column is needed for the date of the transaction, the payments and credits column could be combined leaving one column for the date. The payments could be identified by a code such as PMT and the credits as CR.
2. To make this manual billing statement procedure simpler, in the payments-credits column, as well as in the purchase column, could be the notation "tickets enclosed," thus eliminating the need for itemization of transactions and further listing of dates of the transactions.

Summary

A simple credit policy makes conforming to Regulation "Z" correspondingly simple.

1. Once your present customers are notified of your credit policy in detail, you need only give each "new customer" a written copy of that policy.
2. Once a statement form is adopted that will conform to Regulation "Z," merely fill them out and send them to each customer as before.

The requirements of Regulation "Z" are generally sound business principles that should be followed by any business offering credit and willing to disclose the price of the credit.

Copies of the entire Regulation "Z" and other information may be obtained from the addresses below or from the area office for South Dakota.

- Federal Trade Commission
Washington, D. C. 20580
- Federal Trade Commission
2806 Federal Office Building
911 Walnut Street
Kansas City, Missouri 64106

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