

C O M M E N T A R Y

RIN 3064-AD92

12 CFR Part 327

**Subj: Federal Deposit Insurance Corporation (FDIC)
Request for Comment - Notice of Proposed Rulemaking:
Assessments, Large Bank Pricing Definition Revisions**

Request for Comments:

1. Deposit Insurance Pricing Definitions:
 - h. Is the definition of refinance appropriate? **No!**

For purposes of brevity and logic, this commentary is to suggest that only one definition of “Re-finance” is necessary for both consumer loans and commercial loans because there should be and is only one definition of refinance. Federal Reserve Board Regulation Z, 12 C.F.R. Section 226.20(a) provides the proper definition of “refinancing”. I see no reason to change, alter or re-invent an otherwise established understanding of an effective existing rule that has passed the test of time both from a legal standpoint as well as a practical basis.

The proposed definition for Consumer Loans: “A refinance for this purpose is an extension of new credit or additional funds on an existing loan or the replacement of an existing loan by a new or modified obligation. A refinance includes the consolidation of multiple existing obligations, disbursement of additional funds to the borrower, an increase or decrease in the interest rate, or rescheduling of principal or interest payments to create or increase a balloon payment or extend the legal maturity date of the loan by more than six months. Additional funds include a material disbursement of additional funds or, with respect to a line of credit, a material increase in the amount of the line of credit, but not a disbursement, draw, or the writing of convenience checks within the original limits of the line of credit.” (What a hodge-podge of confusing statements!)

The proposed definition for Commercial Loans: “A refinance occurs when the original obligation has been replaced by a new or modified obligation or loan agreement. A refinance includes an increase in the master commitment of the line of credit, disbursement of additional money other than amounts already committed to the borrower, extension of the of the legal maturity date, rescheduling of principal or interest payments to create or increase a balloon payment, substantial release of collateral, consolidation of multiple existing obligations, or an increase or decrease in the interest rate. A modification or series of modifications to a commercial loan other than described in this paragraph does not constitute a refinance.”

First, let’s look at the components or basic terms of a loan agreement. They include: (a) an opening or origination date; (b) if a closed end loan, then a maturity date; (c) a loan amount (also known as the original loan amount or the credit limit amount); (d) an interest rate of charge(fixed or variable); and finally, (e) repayment terms. That’s it! Security Agreements and collateral are separate items and not a part of the loan agreement. So now, let’s look at my definitions of refinance, renew, extend or modify.

A **refinancing** occurs when an existing obligation and loan agreement are rewritten to a new loan amount and the existing obligation and loan agreement are terminated. A loan **renewal** is the rewriting of an existing obligation and loan agreement back to the original loan amount, with or without changes in the original rates, terms and conditions. A loan renewal also requires the cancelling of the original loan agreement. A loan **extension** is extending the original maturity date of the existing loan agreement with or without changes in the rates and or repayment terms. A **modification** is a change in the loan agreement rates, terms or conditions made after the origination date and before the maturity date.

Background information: I have a copy of a letter written by a Regional Director of the FDIC in 1983 to an attorney for the former Bankers Systems, Inc. forms company, regarding a loan extension form. The attorney was requesting consideration of a conclusion that a lender is not required to re-disclose for Truth in Lending purposes even if, on a simple interest transaction, the interest rate is increased, provided that the original obligation is not “satisfied” or cancelled”. The FDIC’s interpretation was as follows: “Section 226.20(a) provides that a bank is not required to re-compute the APR and give a “subsequent disclosure” where the terms of a closed-end loan are renegotiated and changed after a loan was made. This is true even if the interest rate is increased through the renegotiation.”

In 1995, I requested an affirmation from the FDIC Regional Office that this interpretation was still in effect. To clarify the request, I defined a loan extension as the continuation of an existing unsatisfied transaction with a new maturity date modified by our current offered interest rate and a restructured repayment schedule. (Refinancing and/or renewals are understood to be as defined in Reg. Z, Section 226.20(a)). The response received indicated that the position of that office regarding the necessity for subsequent disclosure per section 226.20 remains unchanged and consistent with the September 22, 1983, letter.

In 2011, because of numerous lending regulation changes and new concerns about “sub-prime” loans, I again requested clarifications from the FDIC regarding the definition of “refinancing” in Reg. Z, Truth in Lending. This is a paraphrase of the response: “As you are aware, Reg. Z requires new disclosures if the extension/modification meets the definition of “refinancing”. Regulation Z, 12 C.F.R. Section 226.20(a), the regulation providing guidance for the Truth in Lending Act (TILA), defines “refinancing” under the section addressing subsequent disclosures as follows:

- a) *Refinancings*. A refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced by a new obligation by the same consumer. A refinancing is a new transaction requiring new disclosures to the consumer.”

“This definition indicates that a refinancing is a new loan that completely satisfies and replaces an existing loan by the same borrower.” “Whether a refinancing has occurred is determined by reference to whether the original obligation has been satisfied or extinguished and replaced by a new obligation based on the parties’ intent as shown by the terms of the contract and other factors described in applicable law (which by definition means state law).”

The primary factor in determining whether a refinancing has occurred is the parties’ intentions. Barring evidence of those intentions, we look at state law to determine whether an existing obligation has been replaced by a new one. Although the facts of each case must be considered, it is generally held in Missouri that the mere execution of a renewal note evidences the same debt by a new promise and does not constitute a payment or discharge of the original note but operates only as an extension of time for payment. In most instances, a new note or similar document will evidence whether the old obligation has been extinguished and replaced by a new obligation. Generally, a renunciation must be in writing or the instrument must be delivered to the maker. Actions such as stamping a note “paid” indicate an intent to replace the original note. However, stamping the note “renewed” or entering an extension or modification agreement indicate intent not to replace the original note.

For states in our region, where it appears the parties did not intend to satisfy and replace an old obligation and there is no clear evidence to the contrary, an extension or modification is likely not a refinancing, regardless of the change in terms.”

In Staff Commentary to 226.20 (a) Refinancings, in addition to the above information, it adds: “The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer’s behalf, or the rescheduling of payments under an existing obligation. In any form, the new obligation must completely replace the prior one.

- Changes in the terms of an existing obligation, such as the deferral of individual installments, will not constitute a refinancing unless accomplished by the cancellation of that obligation and the substitution of a new obligation.”

In keeping with the intent and definition of “Refinancing” as originally stated in FRB Reg. Z, C.F.R. 226.20(a), I am proposing that the section marked *Definition of Refinance/Timing of Classification as a Higher-Risk Asset*, Section 1. “Refinance” Definition for Consumer Loans be changed as follows:

A refinance for this purpose is an extension of new credit or additional funds when an existing obligation has been satisfied and replaced by a new obligation undertaken by the same consumer(s). A refinance includes the consolidation of multiple existing obligations, disbursement of additional funds to the borrower, and the rescheduling of principal or interest payments to create or increase a balloon payment. Additional funds include a material disbursement of additional funds or, with respect to a line of credit, a material increase in the amount of the line of credit, but not a disbursement, draw, or the writing of convenience checks within the original limits of the line of credit.

The proposed definition for Commercial Loans: “A refinance occurs when the original obligation has been replaced by a new or modified obligation or loan agreement. A refinance includes an increase in the master commitment of the line of credit, disbursement of additional money other than amounts already committed to the borrower and consolidation of multiple existing obligations. A modification or series of modifications to a commercial loan other than described in this paragraph, such as an increase or decrease in the interest rate or rescheduling the maturity date, does not constitute a refinance.”

Instead of adding lots of useless descriptive verbiage, why not just retain the definition and commentary outlined in Regulation Z, Section 226.20? Or, better yet, just define a refinance as the cancellation of an existing obligation and loan agreement with a corresponding new obligation and loan agreement?

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