STATE OF COLORADO

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Uniform Consumer Credit Code
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ADMINISTRATIVE INTERPRETATION NO. 3.107-8501

A "REQUIRED COMPENSATING BALANCE" DOES NOT INCLUDE (1) AN ESCROW ACCOUNT FOR ITEMS SUCH AS TAXES, INSURANCE OR REPAIRS; (2) A DEPOSIT THAT EARNS NOT LESS THAN 5% PER YEAR; OR (3) PAYMENTS UNDER A MORRIS PLAN. A REQUIRED COMPENSATING BALANCE MUST BE DEDUCTED FROM THE FACE AMOUNT OF THE NET AMOUNT PAID IN COMPUTING THE PRINCIPAL FOR PURPOSES OTHER THAN DELIVERY OF REG. Z DISCLOSURES.

In response to inquiries concerning the proper treatment of required deposit balances under the Colorado Uniform Consumer Credit Code, articles 1-9, title 5, C.R.S., the administrator issues this official interpretation pursuant to section 5-6-104(4), C.R.S. (1973).

Inquiries have focussed on the definition of "required compensating balances" and the treatment of such balances under the Colorado U.C.C.C. and Reg. Z, 12 C.F.R. 226. Some creditors require as a condition of the extension of credit that the consumer make, maintain, or increase a deposit balance. The exact nature and amount of the deposit arrangements varies from plan to plan. Generally, the consumer earns not less than 5% per year on the deposited funds. The general purpose is to provide credit worthiness and security for the consumer loan and perhaps to increase the yield to the creditor due to the differential between deposit and loan rates.

The question presented is whether the "safe harbor" exclusion of certain deposit accounts from the concept of "required deposit balance" in Reg. Z, 12 C.F.R. 226.18(r), fn. 45, applies for U.C.C.C. analysis. It is my opinion that the exclusion applies. The definition of "required compensating balance" under the Colorado U.C.C.C. does not include an escrow account for items such as taxes, insurance or repairs; a deposit that earns not less than 5 percent per year; or payments under a Morris Plan.

The U.C.C.C. unfortunately fails to provide a clear definition of "required compensating balance". The term is used only once in official comment 3 to section 3.107:

> An advance payment of loan finance charge or a required compensating balancing is deducted from the face amount of the 'net amount paid' under paragraph (a) of this subsection.

Of course, this comment is not part of the legislative text. See section 2-5-113(4), C.R.S. (1984 Supp.). However, that comment is informative of the intent of the uniform commissioners and the drafters of the U.C.C.C. Non-statutory material is routinely examined by courts and enforcement personnel. Vandermee v. Dist. Ct., 164 Colo. 117, 433 P.2d 335 (1967); People's Savings & Trust Company v. Munsert, 212 Wis. 449, 249 N.W. 527, (1933), reh. den. 212 Wis. 464, 250 N.W. 385 (1933).

The adoption of the Reg. Z safe harbor exclusion of most required balance plans from that category for purposes of state law is appropriate for several reasons. This interpretation is consistent with the provisions of sections 5-1-102(2)(f), 5-6-104(2) and 5-6-104(3), C.R.S., indicating an intent to conform state regulations to the policies of the Federal Consumer Credit Protection Act. This intent should be read with some caution; these sections do not constitute a wholesale delegation of state legislative and regulatory authority to Congress and the Board of Governors of the Federal Reserve System. Creditors should not automatically conclude that compliance with Reg. Z constitutes compliance with the Colorado U.C.C.C.

There is a careful balance between one, the need for uniformity, particularly in disclosure matters, and, two, the police power of the state to regulate matters not preempted by federal law, particularly non-disclosure matters like rate ceilings. Unless preempted by federal law, state substantive provisions differing from policy treatment under Reg. Z cannot simply be made to conform to Reg. Z by administrative fiat. However, in instances in which the code is silent or ambiguous and there is no overriding contrary policy concern, the code urges use of Reg. Z provisions. The definition of "required compensating balances" is one such area. Note that the exclusions in 12 C.F.R. 226.18(r), fn. 45 were provided in former Reg. Z section 226.8(e)(2). Since the bases of the current exclusions were in existence at the time of adoption of the U.C.C.C., one could ar-

gue that the legislative intent to follow Reg. Z on this point is bolstered.

This interpretation is supported by policy concerns. Many creditors have relied on the Reg. Z safe harbor in structuring compensating balance loan plans. A contrary result would cause unnecessary and undesirable interruption of small loan arrangements. The administrator could conceivably devise a separate definition or safe harbor exclusion for "required compensating balances." Any such effort probably causes more harm than good by the resulting non-uniformity and the complexity of the definition. The Federal Reserve Board, prior to the adoption of revised Reg. Z, struggled with the complexities of required deposit balances and required the balance to be considered in the APR disclosure. See, former Reg. Z, section 226.8(e)(2).

There is no overriding contrary public policy concern. Although enforcement of Colorado maximum rate limitations is a significant matter, deposits earning at least 5% more resemble security interests than a prepaid finance charge. The principal purpose is to obtain security for the loan and not to obtain additional fee income. The bright lines afforded by the safe harbor exclusion simply outweigh the occasional instance in which the deposit arrangement is intended to skirt the maximum rate limitation.

However, comment 3 to section 3.107 is helpful in determining the correct treatment of a required deposit balance once it is identified. The required deposit must be deducted from the face amount of the net amount paid in computing the principal and the maximum loan finance charge. For example, if the consumer borrows $2,000 to be repaid in 24 monthly installments, the maximum permissible loan finance charge for a supervised loan is approximately $638.32. If the consumer must maintain a $500 required compensating balance as a condition of the loan, the amount financed is $1,500, on which the maximum loan finance charge is approximately $514.56. Any excess is an excess charge in violation of the U.C.C.C.

This result is different than that for disclosures under Reg. Z. Even if the deposit is a required deposit balance, Reg. Z only requires a disclosure that the annual percentage rate (APR) disclosure does not reflect the effect of the required deposit. 12 C.F.R. 226.18(r) 1/. This Federal Reg. Z disclosure, which must be given as a matter of federal law, also may be delivered to satisfy the disclosure requirements of part 3, article

3, title 5, C.R.S. See, sections 5-3-301 and 5-1-302, C.R.S. (1973). 2/

In summary, the safe harbor exclusions in 12 C.F.R. 226.18(r), fn. 45 apply for identification of required compensating balances under the Colorado U.C.C.C. However, if the deposit is a required compensating balance, pursuant to section 5-3-107 the balance must be deducted from the face amount of the net amount paid in computing the principal.

1/ Apparently, in connection with an open-end transaction, the creditor need not even disclose that the required deposit is not considered in calculating the APR. Under this interpretation, the safe harbor exclusions in 12 C.F.R. 226.18(r), fn. 45 concerning closed end loans would be applicable to open end transactions. Otherwise, there would be no guidance under state law for "required compensating balances" in open end transactions.

2/ Note that U.C.C.C. disclosures not found in part 3, article 2 or part 3, article 3 are not satisfied simply by delivery of federal disclosures. For example, the notices concerning changes in terms of revolving loans (section 5-3-408, C.R.S. (1973 and 1984 Supp.)) or notice of right to cure default (section 5-5-109, C.R.S. (1984 Supp.)) must be given in addition to Reg. Z disclosures. The U.C.C.C. contains other similar notice and disclosure requirements.

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