Robert A. Burgess
SUPERINTENDENT

Harry W. Giddinge
Deputy Superintendent

DEPARTMENT OF BUSINESS, OCCUPATIONAL AND PROFESSIONAL REGULATION
BUREAU OF CONSUMER CREDIT PROTECTION
(207)289-3731

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Interaction of variable rate consumer credit transactions and rules on refinancing, §2-504.

A creditor has posed three questions regarding the relationship between 9-A M.R.S.A. §2-504 on refinancing and various variable rate consumer credit instruments.

The first question addresses whether or not §2-504 is violated if the maturity date of a consumer credit transaction with a variable rate feature is extended, when the interest rate at the time of the extension exceeds the original interest rate by more than 1%. The second question asks if §2-504 is violated when a fixed rate consumer credit transaction is refinanced with a variable rate transaction in which the interest rate, through adjustment, can exceed the rate on the original transaction by more than 1%. The final question involves the rate that may be imposed when a variable rate transaction is refinanced with a fixed instrument.

1. Extension of repayment period

The answer to the first question is "No" because there is no refinancing. The mere deferral of due dates or the extension of the amortization period to reduce payments, without any substitution of the original agreement by a new one, is not a refinancing under either existing case law or regulation. (See AR #76, Part 1, AR #45, and cases cited therein; Regulation Z-2, §226.20(a)(4).) Thus, §2-504 is not even in the picture, and concerns about its rate limitations are misplaced.

2. Conversion of fixed rate to variable at refinancing

The situation is different in the second question, where the creditor seeks to introduce a variable rate feature into a relationship that had previously been based on a fixed rate.

The answer to the second question depends on the terms of the new, refinanced agreement. Section 2-504 prohibits a creditor from "contract[ing] or receiv[ing]" a finance charge that is greater than 1% above the "rate charged in the original agreement and stated to the consumer pursuant to the provisions on disclosure." The rationale behind §2-504 is to "prevent undue exploitation by the creditor of the debtor's necessity." Moore v. Canal National Bank, 409 A. 2d 679, 687 (Me. 1979). This purpose is frustrated if the creditor refinances an agreement with an instrument which has the capacity to exceed the 1% increase limit set forth in §2-504, even if the rate at the time of refinancing is within that limit.

Relief from this conclusion is not found in the fact that §3-310(2) declares that an increase in rates pursuant to a properly disclosed variable rate transaction is not a refinancing under §2-504. this provision relates to subsequent changes in rate in a properly disclosed variable rate instrument, and not to the question of whether use of such an instrument <u>in a refinancing</u> comports with §2-504. The mere fact that the consumer is fully informed of rate volatility when refinancing with an variable rate instrument does not overcome the inherent problem that the rate in such an instrument could exceed the §2-504 limit. A consumer in need of the relief a refinancing can provide is less likely to bargain effectively for favorable terms or limits on upward adjustments in rates. This is the whole reason behind §2-504's protections.

In conclusion to question 2, the refinancing of a fixed rate instrument with any other type of instrument cannot result in a rate in excess of 1% above the rate applicable to the original transaction. A variable rate instrument can be used in a refinancing provided that the rate movement is capped so as not to exceed 1% above the rate charged in the original transaction.

3. <u>Conversion of variable rate to fixed rate at refinancing</u>

If a variable rate transaction is refinanced with a fixed rate instrument, the rate that may be imposed at time of refinancing is the annual percentage rate of the variable instrument prevailing at the time of refinancing, increased by 1%. This assumes, of course, state usury limits would not be exceeded by such an increase.

It is conceivable that a refinancing could be necessitated by a change in rate in a properly disclosed variable rate instrument that ultimately made it unaffordable to the consumer. In such a case, allowing a further increase of 1% in the rate upon refinancing may seem contrary to the public policy of not exploiting the debtor's necessity. Be that as it may, such an increase is legal. The policy questions raised by the application of §2-504 to variable rate instruments are something the Legislature will have to address.

<u>/s/ Robert A. Burgess</u>
Robert A. Burgess
Superintendent

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