WHAT IS VARIABLE RATE CREDIT?

A credit transaction that has a variable rate starts out with an interest rate based on an index or an index plus a percent called a "margin." **The rate is subject to change.** The rate could change as the index changes or at periods of time such as every month or annually, etc.

Disclosures:

A credit transaction which has a variable rate must disclose the following at the time credit is extended:

- ✓ The circumstances under which the rate may increase.
- ✓ Any limitations on the increase.
- ✓ An example of the payment terms that would result from an increase.

If the credit transaction is to be secured by the consumer's principal dwelling, variable rate disclosures must be given at the time application is made.

VARIABLE RATE BASIC FEATURES

The Index . . . .

Most lenders base interest rate changes to changes in an "index rate." These indexes usually go up and down with the general movement of interest rates.

Loans secured by the consumer's principal residence, in most cases, must use an outside index over which the institution has no control. Other credit can be tied to a financial institution's internal index.

You should ask what index will be used and how often it changes. Also ask how the index has behaved in the past and if it is published.

The Adjustment Period . . . .

The rate can change as the index changes or changes can be monthly, annually, every three years, etc. The period between one rate change and the next is called the adjustment period.

The Margin . . . .

To determine the interest rate on a variable transaction, some lenders add to the index rate a few percentage points called the "margin." The amount of the margin can differ from one lender to another, but the margin is usually constant over the life of the loan.

Index rate + margin = interest rate
Index at 8% + 2% margin = 10% interest rate

Interest Rate Caps . . . .

An interest rate cap places a limit on the amount your interest rate can increase. They can be periodic caps, which limit the interest rate increase from one adjustment period to the next; or overall caps, which limit the interest rate increase over the life of the loan.

Some contracts also limit the amount a rate can decrease during an adjustment period. For instance the contract calls for a 2% periodic interest cap and 2% reduction limit; the rate cannot go up or down more than 2% during an adjustment period.

By law adjustable rate mortgage loans must have an overall cap. This means the interest rate could never exceed the overall cap rate. The overall cap rate could be based on a rate of increase or on a specific rate. For instance, the contract states there is a 5% overall cap and the beginning contracted rate is 8%; the most the rate could increase to during the life of the loan would be 13%. The cap could also be stated as a rate; for instance, the contract stated the rate could not exceed 13%.

Payment Caps . . . .

Some contracts include payment caps, which limit your monthly payment increase at the adjustment periods. The payment caps are usually a percentage of the previous payment. For instance, with a 7 1/2% payment cap, a payment of $100.00 could increase to no more than $107.50 in an adjustment period, and to no more than $115.56 in the next adjustment period.

Payments . . . .

Payments can change as the rate changes as stated above or they may not change. If they do not change, you may owe more or less at maturity. Variable mortgages or adjustable loans usually change payments as the rates change; however, many other types of variable rate credit transactions do not contract for changes in the payments. The last payment or payments may be more or less due to changes in the rate.

If you have a variable rate transaction that does not change the payments, be sure to find out if you have to pay more payments or the balance in full at maturity if the rate were to increase. For instance, you purchased an auto on a variable rate contract; the payments did not change and the rate continued to increase during the term; your final payment could be hundreds of dollars more or you could owe more payments.

Negative Amortization . . . .

If your variable rate contract contains a payment cap or no payment change, you may have a negative amortization. Negative amortization means the principal balance is increasing and it is increasing because the payments do not cover the interest that is due. This means that the interest shortage in your payment is automatically added to your debt and in some instances interest may be charged on that amount.

ASK QUESTIONS ABOUT VARIABLE RATES

When you are entering into a credit transaction be sure to ask if the rate is a "fixed" or a "variable rate." If you do not want credit with a variable rate, be sure you know that there are no references to a variable rate or rate change in the contractual agreement or disclosures.

Read the disclosures and contractual provisions very carefully. You will know from the disclosures and contract provisions if the rate is variable.

MAKE SURE YOU UNDERSTAND ALL OF THE VARIABLE RATE PROVISIONS.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Look Before you Lease
- Mortgage Loans
- Older Consumers
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

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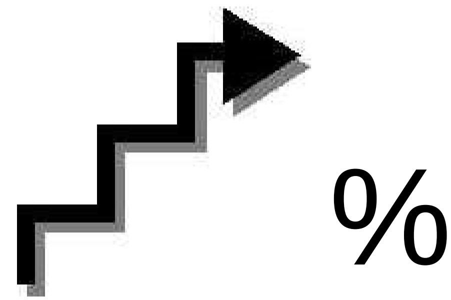
VARIABLE RATE CREDIT



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