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COMMENT

Consumer Credit Legislation and the Banking Industry

American banking history is checkered with various panics and recessions as well as the near-fatal Great Depression. Banks have traditionally been heavily regulated, partly as a result of the historical propensity for banks to lead serious downturns in the economy and partly because of the banking industry's sacred duty as principal guardian of society's monetary assets. Historically, bank regulation has not focused primarily on the bank-customer relationship; instead, it has focused on the financial stability and viability of the bank itself.1

The pattern of major federal noninvolvement in the bank-customer relationship came to an abrupt halt in the late 1960s with the passage of the Consumer Credit Protection Act which included, among other things, the Truth in Lending Act (TILA).2 The stated purpose of the TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit."3 The Act signified an underlying shift in philosophy from "let the borrower beware" to "let the [lender] disclose."4 The net result to the banking industry was that banks could for the first time face substantial liability because of the way they handled their lending transactions.

The legislation was undoubtedly enacted in response to the problems and complexities associated with the rapid growth of consumer credit and consumer credit instruments.5 However, the Act created its own problems and

1. Banks were not really regulated for safety and soundness by the federal government until the passage of the Federal Reserve Act in 1913, which, among other things, gave both the Comptroller of the Currency and the Federal Reserve System authority to supervise and examine member banks. After more than half of the banks in the nation failed during the Great Depression of the 1930s, Congress enacted legislation that: (1) created the Federal Deposit Insurance Corporation (FDIC) to insure deposits; (2) allowed the FDIC to examine all insured banks; (3) prohibited the payment of interest on demand deposits; (4) limited interest payable on time deposits; (5) prohibited banks from engaging in most investment banking activities; (6) established chartering requirements; and (7) allowed the Federal Reserve Board to set reserve requirements. K. SPONG, BANKING REGULATION: ITS PURPOSES, IMPLEMENTATION, AND EFFECTS 16-21 (2d ed. 1985). However, some regulation of the bank-customer relationship is long-standing. See, e.g., 12 U.S.C. § 85 (1982).

5. K. SPONG, supra note 1, at 127.
complexities.\textsuperscript{6} By 1980, there had been some 14,000 lawsuits filed under the TILA.\textsuperscript{7}

Besides the TILA, the Consumer Credit Protection Act has been amended several times in the past few years to add additional consumer credit legislation. The Fair Credit Reporting Act (FCRA) was added in 1970.\textsuperscript{8} Then, the Equal Credit Opportunity Act (ECOA)\textsuperscript{9} and the Fair Credit Billing Act (FCBA)\textsuperscript{10} were added in 1974. Finally, the Debt Collection Practices Act (DCPA) was enacted in 1977.\textsuperscript{11} Enforcement power under these acts is given generally to the Federal Trade Commission while the Federal Reserve Board is generally responsible for the promulgation of regulations.\textsuperscript{12}

In 1974, Congress enacted the Real Estate Settlement Procedures Act (RESPA), which was another consumer disclosure statute.\textsuperscript{13} This statute, however, deals with the disclosure of real estate settlement costs.\textsuperscript{14} RESPA was enacted to “insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices.”\textsuperscript{15}

As if the statutes alone did not produce enough complexity for bankers, Congress also empowered the promulgation of regulations under the various


\textsuperscript{7} F. Miller \& B. Clark, \textit{Cases and Materials on Consumer Protection} 199 (1980).


\textsuperscript{9} Id. §§ 1691-1691f.

\textsuperscript{10} Id. §§ 1665-1666j.

\textsuperscript{11} Id. §§ 1692-1692o. The Consumer Credit Protection Act also contains two other consumer statutes—the Consumer Leasing Act, id. §§ 1667-1677, and the Electronic Fund Transfers Act, id. §§ 1693-1693r. Although these acts can certainly apply to banks, they will not be discussed because they do not normally directly impact on a bank’s consumer lending practices.

\textsuperscript{12} Id. §§ 1604, 1607, 1681s, 1691b, 1691c, 1692i. See also Halverson, \textit{Consumer Credit Regulation and the Federal Trade Commission}, 90 BANKING L.J. 479 (1973).


\textsuperscript{14} A somewhat related statute that deals with interstate land sales and imposes certain disclosure requirements and contains certain prohibitions is the Interstate Land Sales Full Disclosure Act of 1968. 15 U.S.C. §§ 1701-1720 (1982).

Two other federal statutes that deal with mortgage lending are the Home Mortgage Disclosure Act (HMDA), 12 U.S.C. §§ 2801-2809 (1982), and the Community Reinvestment Act (CRA), id. §§ 2901-2905. The HMDA requires mortgage lenders (both purchasers and originators) to compile data with respect to the number and total dollar amount of mortgage loans originated and purchased by the institution during each fiscal year. Id. § 2903(a). The CRA provides that federal financial supervisory agencies (i.e., the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board) shall assess the financial institution’s record for meeting the entire community’s credit needs consistent with the safe and sound operation of the institution. Id. § 2903(1). This record is then required to be taken into account in evaluation of an application by the facility for a national charter; initial deposit insurance; permission to establish a branch; permission to relocate; and permission to merge, acquire assets, or assume the liabilities of another financial institution under 12 U.S.C. § 1828(c) or section 408(e) of the National Housing Act [12 U.S.C. § 1730a(e)]. Id. § 2903(2).

consumer credit statutes. The result has been that banks have been bombarded by various regulations such as Regulation Z for the TILA, Regulation B for the ECOA, and Regulation X for RESPA. Some of these regulations, such as Regulations Z and B, even have official staff commentaries on the regulation. With all of the various statutes and levels of regulations, it is not surprising that banks are confused and often inadvertently violate the rules.

The federal government has not been alone in its regulation of consumer credit transactions. Several states have adopted the Uniform Consumer Credit Code (UCCC), which contains many of the same disclosure requirements as the TILA and regulates various other aspects of consumer credit transactions. Many other states have provisions requiring that lenders make certain disclosures. Additionally, almost every state has some sort of usury law that establishes maximum permissible interest rates for various types of lending transactions.

The purpose of this comment is to provide a guide for banks and their attorneys as they attempt to navigate this jungle of consumer credit legislation and engage in the increasingly hazardous business of consumer lending. The comment outlines the major federal consumer credit statutes and attempts to point out potential liability areas. Several important state statutes that also impact on consumer lending are discussed. The comment concludes by suggesting that banks increasingly need to have counsel involved in their loan committees and policy-making decisions to help avoid substantial liability under the various consumer protection statutes.

Truth in Lending Act (TILA) Coverage

Coverage

Regulation Z was issued by the Board of Governors of the Federal Reserve System to implement the TILA and the FCBA. The regulation applies to individuals or businesses extending credit who can meet four conditions. First, the credit must be offered or extended to consumers. "Consumer" is defined to generally mean "a cardholder or a natural person to whom consumer credit is offered or extended." Thus, an offering or extension of credit to a corporation or other business entity would not be included within the definition of consumer.

16. For example, the Board of Governors of the Federal Reserve System is given this authority under 15 U.S.C. § 1604 (1982) of the Truth in Lending Act.
18. Id. § 202.
20. See, e.g., OKLA. CONST. art. XIV, § 2 (Oklahoma's constitution imposes the basic usury provision and then allows the legislature to set different rates).
22. Id. § 226.1(e).
23. Id. § 226.2(a)(11).
The second precondition to the application of Regulation Z is that the offering or extension of credit must be done regularly.24 "Regularly" is defined as extending credit more than twenty-five times (or more than five times for transactions secured by a dwelling) in the previous year.25 Hence, a normal bank will always meet this requirement.

The third precondition to applicability of Regulation Z, with an exception for travel and entertainment card issuers and other limited exceptions, is that the credit must be subject to a finance charge or be payable by a written agreement in more than four installments.26 Obviously, a bank will meet this requirement in the course of its normal lending activities. One potential risk that this section does impose, however, is that a bank selling repossessed collateral may, as an inducement, "regularly" allow buyers to pay in more than four installments. This could trigger the requirement of disclosure. If proper disclosure was not given, the bank would be in violation of Regulation Z in a transaction that it probably did not contemplate was a credit transaction, much less a Regulation Z transaction.

The final precondition to the applicability of Regulation Z is that the credit must be "primarily for personal, family, or household purpose."27 This requirement is the most important from the bank's standpoint because it is the factor that generally determines whether the TILA and Regulation Z are applicable to a particular credit transaction. As mentioned previously, the second and third requirements will always be met in the normal situation; and the first requirement by definition depends on the existence of this final requirement.28 Therefore, the applicability of Regulation Z to a particular bank credit transaction will usually depend on whether the loan is primarily for personal, family, or household purposes.

The courts and the Federal Reserve staff have struggled with the exact meaning of this requirement and the appropriate test to employ to determine whether it has been met. The Federal Reserve recognizes that there is no precise test for what constitutes credit offered or extended primarily for family, personal, or household purposes.29 However, the Official Staff Commentary on Regulation Z indicates that the following factors should be considered in determining whether the credit is primarily for business purposes.

1. The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.

24. Id. § 226.1(c).
25. Id. § 226.2 n.3.
26. Id. § 226.1(c).
27. Id.
28. "Consumer" is defined as a person to whom "consumer credit" is offered or extended. Id. § 226.2(a)(11). "Consumer credit" is then defined as "credit offered or extended to a consumer primarily for personal, family, or household purposes." Id. § 226.2(a)(12).

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2. The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.

3. The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.

4. The size of the transaction. The larger the transaction, the more likely it is to be business purpose.

5. The borrower’s statement of purpose for the loan.\textsuperscript{30}

Obviously, these guidelines are not very useful in the borderline cases. One such case is \textit{Tower v. Moss}.\textsuperscript{31} In \textit{Tower} the plaintiff/debtor was living in an apartment at the time she approached the defendant for a loan. The proceeds of the loan were for repairs and improvements on a home in which the defendant had resided for a number of years and in which she intended to reside upon her retirement. The home was currently being leased to a tenant who was staying in the home largely in a custodial role and paying nominal rent. The court held the purpose of the credit transaction was primarily for personal, family, or household purposes and disclosure was thus required.\textsuperscript{32}

\textit{Dougherty v. Hoolihan, Neils, & Boland, Ltd.} is another interesting case.\textsuperscript{33} In this case plaintiff gave an attorney a note secured by a mortgage on the plaintiff’s farm as consideration for services provided by the attorney in determining whether a bank had misapplied funds in connection with the foreclosure sale of personal property from the plaintiff’s farm. The court held the transaction was primarily for personal, family, or household use and the \textit{TILA} applied because the legal services were rendered with respect to personal property of the plaintiff.\textsuperscript{34}

These cases clearly demonstrate the difficulty that can be encountered in determining whether a particular transaction is a consumer credit transaction. Another problem that can arise is that a personal loan to a business customer, which may be made by the commercial loan department of the bank, can be classified as a \textit{consumer} loan for purposes of Regulation \textit{Z}. In light of the difficulty of classifying loans as consumer or business and the potential

\textsuperscript{30} Id. \textsection 226.3(a)(2). Additionally, if the property is nonowner-occupied rental property (i.e., owner expects to occupy for fourteen days or less during the coming year), the credit is deemed to be for a business purpose. If the property is owner-occupied rental property (i.e., owner expects to occupy for more than fourteen days during the coming year), the credit is deemed to be for business purposes if: (1) credit is extended to acquire the rental property and it contains more than two housing units; or (2) credit is extended to maintain or improve the rental property and the property contains more than four housing units. \textit{Id.} \textsection 226.3(a)(3), (4).

\textsuperscript{31} 625 F.2d 1161 (5th Cir. 1980).

\textsuperscript{32} \textit{Id.} at 1166-67. This holding should be compared to the Official Federal Reserve Staff Commentary, which states: “Credit extended to acquire, improve, or maintain rental property that is not owner-occupied is deemed to be for business purposes.” \textit{Official Staff Commentary on Regulation Z, supra note 29, \textsection 226.3(a)(3)}.

\textsuperscript{33} 531 F. Supp. 717 (D. Minn. 1982).

\textsuperscript{34} \textit{Id.} at 721.
liability of noncompliance,\textsuperscript{35} a bank would be wise to get legal counsel prior to offering or extending credit, instead of after something goes wrong, as is usually the case. With the aid of informed counsel, the bank can dramatically increase its chances of making a correct decision on the classification of individual credit transactions.

Once the credit transaction has been classified, it must be examined to determine whether it falls within one of Regulation \textit{Z}'s exempt transactions. The regulation specifically excludes (1) business, commercial, agricultural, and organizational credit; (2) credit above \$25,000 not secured by real property or a dwelling; (3) public utility credit; (4) securities or commodities accounts; and (5) student loan programs.\textsuperscript{36} The Official Staff Commentary indicates that a loan commitment for credit in excess of \$25,000 will be exempt even if the amounts actually drawn never reach \$25,000.\textsuperscript{37} However, where an original loan for more than \$25,000 is rewritten for less than \$25,000 or a security interest in real property is added to an extension of credit for more than \$25,000, the transaction is consumer credit requiring disclosure if the existing obligation is satisfied and replaced by a new obligation made for consumer purposes.\textsuperscript{38} Thus, bankers cannot be certain that a loan originally exempted from Regulation \textit{Z} will remain so upon refinancing.

Also, a loan that appears to be clearly for consumer purposes may be characterized as being for business purposes because of what the borrower states he intends to do with the proceeds. Hence, the court in \textit{Conrad v. Smith} held that there was no question of fact as to whether the loan was for consumer purposes where the borrower pledged his house as collateral and declared in his application that the loan was for business purposes.\textsuperscript{39} Once again, the need for caution is apparent.

\textit{Disclosure Requirements}

Once the bank determines that a particular transaction does fall within the scope of Regulation \textit{Z}, it must make certain disclosures. For purposes of making disclosures, Regulation \textit{Z} divides credit into two types—open-end and closed-end. "Open-end credit" is defined as consumer credit extended under a plan in which: (1) the creditor contemplates repeated transactions; (2) the creditor may impose periodic finance charges on the unpaid balance; and (3) the amount of credit that may be extended during the term is generally made available to the extent that any outstanding balance is repaid.\textsuperscript{40} "Closed-end credit," on the other hand, is simply defined as "credit other than 'open-end credit'."\textsuperscript{41} Regulation \textit{Z} imposes different disclosure requirements for each type of credit.

\textsuperscript{35} See infra discussion in text accompanying note 86.
\textsuperscript{36} 12 C.F.R. \$ 226.3 (1987).
\textsuperscript{37} \textit{Official Staff Commentary on Regulation Z}, supra note 29, \$ 226.3(b)(1).
\textsuperscript{38} \textit{Id.} \$ 226.3(b)(3).
\textsuperscript{39} 42 Wash. App. 559, 712 P.2d 866, 867-68 (Ct. App. 1986).
\textsuperscript{40} 12 C.F.R. \$ 226.2(a)(20) (1987).
\textsuperscript{41} \textit{Id.} \$ 226.2(a)(10).
Regardless of the type of credit, Regulation Z requires disclosure of the finance charge.42 "Finance charge" is defined as the cost of consumer credit stated as a dollar amount and includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit."43 Although Regulation Z lists various charges that are or are not included in the finance charge,44 difficulty can still arise in determining exactly what should be included in the finance charge for a particular loan.

For example, in Laubach v. Fidelity Consumer Discount Co., the court held that the lender violated the TILA and Regulation Z by failing to include in the finance charge accrued real estate taxes that the lender required the buyer to pay.45 In Steele v. Ford Motor Credit, the court held that Ford Motor Credit violated the TILA when it refinanced the debtor's prior debt and failed to include sixteen days of unearned interest on the prior loan in the finance charge for the subsequent loan.46 These cases, the results of which may be questionable, nonetheless clearly illustrate some of the risks an unwary banker faces in making routine consumer loans and determining what exactly to include in calculating the finance charge.

Once the banker determines what the finance charge is, he must determine what else he needs to disclose and how he needs to do it. With open-end

42. Id. §§ 226.6(a), 226.18(d). For open-end credit, section 226.6(a) requires disclosure of the circumstances under which a finance charge will be imposed and an explanation of how it will be determined. For closed-end credit, section 226.18(d) requires disclosure of the amount of the finance charge.
43. Id. § 226.4(a).
44. The following are some common charges that Regulation Z includes in the finance charge:
   (1) interest, time price differential, and any amount payable under an add-on or discount system of additional charges;
   (2) service, transaction, and carrying charges;
   (3) points, loan fees, assumption fees, etc.;
   (4) appraisal, investigation, and credit report fees;
   (5) premiums or fees on insurance protecting against consumer's default;
   (6) premiums for credit life, accident, health, or loss of income insurance written in connection with a credit transaction (if such insurance is required by creditor); and
   (7) premiums for property insurance written in connection with the credit transaction in which consumer is not allowed to obtain the insurance from a person of the consumer's choice.

The following are some common charges that Regulation Z excludes from the finance charge:
   (1) application fees;
   (2) charges for late payment, exceeding credit limit, or default;
   (3) fees charged for participation in credit plan;
   (4) seller's points; and
   (5) bona fide and reasonable fees for title examination, abstract of title, title insurance, property survey, deed preparation, mortgage preparation, settlement, notary, appraisal, and credit reports, if the transaction is secured by real property or by the consumer's dwelling and if the proceeds were used to acquire or construct such dwelling. Id. § 226.4(b), (c).
46. 783 F.2d 1016 (11th Cir. 1986). Payments on the first loan were due on the 26th of each month. The lender received four payments on the initial loan, but the debtor refinanced after three months and 14 days. Under state law, the lender was entitled to the full four months' interest. Id. at 1017-18.
credit (i.e., revolving loans, lines of credit, and credit cards) the creditor initially must disclose the following:

1) The method of determining the finance charge, and when it begins to accrue;
2) Each periodic rate that may be used to calculate the finance charge, and the range of balances to which these rates apply;
3) The corresponding annual percentage rate [APR];
4) The method used to determine the balance on which the finance charge will be computed;
5) Other charges;
6) Security interests; and
7) Billing rights.

If the loan is subject to a variable rate of interest, the creditor must also disclose the circumstances under which the rate may increase, any limitations on the increase, and the effects of an increase.

The disclosure statement must be provided before the first transaction is made under the plan. These disclosures must be made "clearly and conspicuously in writing," and the terms "finance charge" and "annual percentage rate" must be more conspicuous than any other disclosure.

Although model disclosure forms are appended to Regulation Z, creditors sometimes run into trouble with the conspicuity requirement. For example, in Herrera v. First National Savings & Loan Association, the court held that the creditor's disclosure statement violated Regulation Z because the term "annual percentage rate" was in boldface capital letters along with more than thirty other terms and phrases in the disclosure statement. Thus, bankers should carefully examine their disclosure forms to ensure that they meet Regulation Z's conspicuity requirement as well as provide all of the required disclosures.

In addition to initial disclosures, the open-end credit lender must furnish the consumer with periodic statements. These statements must list the previous balance, if any; the credit transactions during the period; the credits to the account; the periodic rates; balances to which they apply and the corresponding APR; the amount of the balance on which the finance charge is computed and how it was determined; the amount of the finance charge; the annual percentage rate; other charges; the closing date of the billing cycle; the

47. The "corresponding annual percentage rate" is "a measure of the cost of credit, expressed as a yearly rate" and is computed by multiplying each periodic rate by the number of periods in a year. 12 C.F.R. § 226.14 (1987).
48. Id. § 226.6.
49. Id. § 226.6 n.12.
50. Id. § 226.5(b).
51. Id. § 226.5.
52. 805 F.2d 896 (10th Cir. 1986). See also Dixey v. Idaho First Nat'l Bank, 677 F.2d 749 (9th Cir. 1982) (TILA violated where terms "finance charge" and "annual percentage rate" were in bold-face type but no bolder than several other headings and disclosures on the same page).
new balance; any time period in which any portion of the balance can be paid to avoid additional finance charges; and the address to be used for notice of billing errors.\textsuperscript{34} Also, the creditor must provide periodic statements of billing rights and notice of certain changes in the terms of the account.\textsuperscript{55}

On the other hand, when the credit is closed-end, the creditor must disclose the following:

1) The identity of the creditor;
2) The amount financed;\textsuperscript{56}
3) An itemization of the amount financed, unless the creditor provides a statement to the consumer that he has the right to receive a written itemization with a space for the consumer to indicate whether it is desired, and the consumer does not request the statement;
4) The finance charge;
5) The annual percentage rate;
6) The number, amount, and timing of scheduled payments;
7) The total of all payments to be made;
8) Whether the obligation has a demand feature;
9) The consumer's prepayment rights or right to refund;
10) The amount of any late charges;
11) Any security interests taken;
12) The assumption policy on a residential mortgage transaction;\textsuperscript{57}
13) And certain other specified items.\textsuperscript{58}

If the loan is variable rate, the same disclosures must be given as with an open-end variable rate account, but the creditor must also provide an example of the payment terms that would result from an increase in the rate.\textsuperscript{59}

As with open-end credit, the closed-end credit disclosures are subject to requirements of conspicuity.\textsuperscript{60} Additionally, the disclosures must be grouped together and segregated from everything else.\textsuperscript{61} Also, the terms "finance charge" and "annual percentage rate" must be more conspicuous than any other disclosure except the creditor's identity.\textsuperscript{62} Finally, the required disclosures must be made before "consummation" of the transaction.\textsuperscript{63}

\textsuperscript{54} Id.
\textsuperscript{55} Id. § 226.9.
\textsuperscript{56} The amount financed is calculated by determining the principal loan amount, adding any other amounts that are financed by the creditor, which are not a part of the finance charge, and subtracting any prepaid finance charge. Id. § 226.18(b).
\textsuperscript{57} A "residential mortgage transaction" is defined as a transaction where a consensual security interest is created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling. Id. § 226.2(a)(24).
\textsuperscript{58} Id. § 226.18.
\textsuperscript{59} Id. § 226.18(f).
\textsuperscript{60} Id. § 226.17.
\textsuperscript{61} Id. § 226.17(a)(1).
\textsuperscript{62} Id. § 116.17(a)(2).
\textsuperscript{63} Id. § 226.17(b). "Consummation" is defined as the time that a consumer becomes contractually obligated on a credit transaction. Id. § 226.2(a)(13). The Staff Commentary to Regula-
Not only is disclosure required before consummation, it is also required upon refinancing or an assumption. Regulation Z defines a refinancing as occurring when an existing obligation subject to the TILA is satisfied and replaced by a new obligation undertaken by the same consumer. Thus, a simple refinancing or assumption can also trigger Regulation Z's disclosure requirements.

The result of these complex disclosure requirements is that it is extremely easy for banks and other creditors to innocently violate Regulation Z. For instance, in Whitley v. Southern Discount Co., the court held that the disclosure of the late payment charge was ambiguous and violated the TILA because it failed to indicate how partial payments would be handled. Even if this case is incorrect, it shows how complex the issues are.

Another fertile ground for litigation is the disclosure of security interests. In Kadlec Motors v. Knudson, the underlying sales contract did not state the purpose of the security interest. The court held that the creditor's failure to disclose a consensual security interest violated the TILA.

Besides governing consumer credit in general, Regulation Z also has provisions dealing specifically with limited liability on credit cards and credit advertising. The credit card provision stipulates that credit cards may only be issued upon request by the consumer, or as renewals of previously issued cards. The liability of cardholders for unauthorized use is limited to a maximum of $50. Regulation Z also prohibits offset of the cardholder's debt against any funds that are on deposit with the card issuer. Additionally, Regulation Z's advertising provisions require that certain disclosures be made in consumer credit advertising.

The Right of Rescission

Regulation Z also provides for a right of rescission under both open-end and closed-end credit transactions. The right of rescission is essentially the same under both types of credit. Whenever a security interest is acquired in

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64. 12 C.F.R. § 226.20(a), (b) (1987).
65. Id.
66. 772 F.2d 815 (11th Cir. 1985), See also Watts v. Key Dodge Sales, Inc., 707 F.2d 847, 852 (5th Cir. 1983) (a reasonable debtor could not determine whether the creditor was entitled to impose a delinquency charge of 5% of the full amount of the installment, or merely 5% of the unpaid balance).
68. 12 C.F.R. § 226.12(a), (b) (1987).
69. Id. § 226.12(d). Section 226.12 also has certain other provisions affecting credit cards, but a discussion of those provisions is beyond the scope of this comment.
70. Id. §§ 226.16, 226.24. For example, in closed-end credit, if the advertisement contains the amount or percentage of the down payment, the number of payments or period of repayment, the amount of any payment, or the amount of any finance charge, the following must be disclosed: (1) the amount or percentage of the down payment; (2) the terms of repayment; and (3) the annual percentage rate and any ability to increase it. Id. § 226.24(c).
the consumer's principal dwelling as part of the transaction, Regulation Z
provides that each consumer whose ownership interest is or will be subject
to the security interest has the right to rescind the transaction.71 This right
normally expires at midnight of the third business day following consumma-
tion of the transaction.72 The creditor is required to provide the consumer
with notice of this right.73 Failure to give the notice or make material
disclosures74 extends the right to a maximum of three years.75

When a consumer exercises his right to rescind, the effect is that the security
interest is canceled and the consumer is not liable for any amount, in-
cluding any finance charge.76 Also, the creditor is required to return any money
that the consumer has paid, and the consumer is required to tender back any
money or property that the creditor has delivered.77 Thus, the effect of rescis-
sion is as if the transaction had never occurred, and the parties are returned
to their original positions.

However, certain transactions are exempted from the right of rescission.
The main such exemption applies to the residential mortgage transaction.78
Regulation Z defines this special statutory term as a transaction in which a
consensual security interest is created or retained in the consumer's principal
dwelling to finance the acquisition or initial construction of that dwelling.79
Therefore, the right of rescission will not apply to a purchase money mort-
gage or a construction loan on a consumer's principal dwelling. Another trans-
action that is exempted (for closed-end credit only) is a refinancing or con-

71. Id. §§ 226.15(a), 226.23(a).
72. Id. Under section 226.15(a), the open-end credit consumer has the right to rescind (1)
each credit extension made under the plan, unless the extension is within an established credit
limit; (2) the plan when it is opened; (3) a security interest when added or increased to secure
an existing plan; and (4) the increase when the credit limit on the plan is increased.
73. Id. §§ 226.15(b), 226.23(b).
74. A "material disclosure" is defined by TILA as a required disclosure of the annual percentage
rate; the method of determining the finance charge and the balance upon which finance charge
will be imposed; the amount of the finance charge; the amount to be financed; the total of
the payments; the number and amount of the payments; and the due dates of the payments.
75. 12 C.F.R. §§ 226.15(a)(3) (1987). Actually the right to rescind expires upon the earlier
of three years after consummation, or upon transfer of the consumer's interest in the property
or sale of the property. Id.
76. Id. §§ 226.15(d)(1), 226.23(d)(1).
77. Id. §§ 226.15(d), 226.23(d). The creditor is given twenty days to return any money or
property received and to take any action necessary to reflect the termination of the security
interest. The creditor's performance then triggers the consumer's obligation to tender back any
money or property he has received. The court, however, is given the power to modify these
procedures. Id.
78. Id. §§ 226.15(f)(1), 226.23(f)(1).
79. Id. § 226.2(a)(24).
solidation by the same creditor of an extension of credit already secured by the consumer’s principal dwelling, if no new money is advanced. 80

One of the most prolific areas of litigation under Regulation Z and the TILA is the right of rescission. This can probably be attributed to the fact that a violation of the right of rescission provisions not only allows damages to be collected but also allows the consumer to get out of the loan obligation. In today’s economy, a debtor who cannot pay his obligations is quick to look for a way to legally get out of having to pay. The right of rescission is one easy way.

One case that dramatically indicates the risk banks face from failing to adequately give notice of the right to rescind is Semar v. Platte Valley Federal Savings & Loan Association. 81 In Semar the court allowed the consumers to rescind the mortgage on their home 2½ years after consummation of the loan. The court found the notice of the right to rescind to be inadequate because the lender’s notice stated that the right would expire three business days from July 16, instead of expressly stating that such right would expire on July 21. 82

Another problem is presented by a third party having an ownership interest in the property the consumer has encumbered. The Federal Reserve staff and most commentators agree that the third party also has to be given notice of the right to rescind and can independently exercise the right. 83 However, the situation becomes even more complicated when the consumer has someone else, such as a son, give a security interest in the son’s dwelling as collateral for a loan to the consumer. In State Bank of Wiley v. State, the court was confronted with this situation and held that the consumer had no right to rescind. 84 Seemingly, though, under the official Staff Commentary to Regulation Z, the creditor would still have to give the party who pledged his principal dwelling as security (i.e., the son) a three-day right to rescind. 85 These situations certainly represent examples of some of the traps that exist in the TILA and Regulation Z for the unwary banker, and the cost of falling into these traps can be great.

Liability

The most important question in the banker’s mind is probably: What will happen to me if I violate Truth in Lending or Regulation Z? The right of rescission represents one such adverse consequence. However, the TILA also provides for other civil penalties that can be substantial when considered in their entirety. The TILA provides that a creditor who violates any provision of the statute is liable to the consumer for any actual damages sustained.

80. Id. § 226.23(f)(2).
81. 791 F.2d 659 (9th Cir. 1986).
82. Id. at 703-05.
83. See OFFICIAL STAFF COMMENTARY ON REGULATION Z, supra note 29, 226.23(a)(1)(2); Griffith, supra note 6, at 35.
85. OFFICIAL STAFF COMMENTARY ON REGULATION Z, supra note 29, § 226.23(a)(1)(2).
For the violation of many provisions, the consumer may also recover statutory damages in an amount equal to twice the finance charge, but not less than $100 or greater than $1,000; and a prevailing consumer may recover his costs together with a reasonable attorney's fee.86

Lenders have argued in the past that a threshold question to liability should be whether the disclosure and credit terms actually misled or confused the consumer.87 However, the courts have rejected this argument and, instead, employ an objective standard to determine TILA violations and hold that the credit agreement, rather than the consumer’s understanding of the terms, forms the basis for TILA violations.88

Another issue under the Act is the liability of assignees for TILA and Regulation Z violations by their assignors. The TILA provides that an assignee is liable only if the violation “is apparent on the face of the disclosure statement.”89 However, any consumer who has the right to rescind may exercise his right to rescind against an assignee.90 Also, an assignee may escape liability under the TILA because a particular violation is not apparent on the face of the document, but, according to at least one questionable case, may be held liable under other law for the same violation if a “claims and defenses” clause is present in the underlying installment sales contract.91 Thus, assignees also face potential liability under the TILA.

On the surface, the penalties that the TILA imposes may not appear to be much to the banker. However, closer examination reveals that the total result can be substantial liability for a TILA violation. As one commentator stated:

The actual money recovery awarded under the Act [TILA] to a successful consumer litigant tends to be modest. The recovery of actual damages is virtually unheard of in Truth in Lending actions . . . .

In contrast to these amounts are the substantial sums which the consumer’s attorney may be awarded as a reasonable fee. . . . Creditors do not appear to analyze sufficiently this potential exposure, particularly in their initial evaluation of their cases, and all too often are surprised to learn, usually during the fee hearing or even later, the source of their most significant liability.92

88. See, e.g., Zamarippa v. Cy’s Car Sales, Inc., 674 F.2d 877, 879 (11th Cir. 1982) (court rejected argument that consumer not injured because could not read or understand English).
89. 15 U.S.C. § 1641(a) (1982). Section 1641(a) provides that a violation apparent on the face of the disclosure that can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned and a disclosure that does not use the required terms.
90. Id. § 1641(c).
Hence, the possibility of the award of substantial attorney fees makes potential liability under the Act significant. Substantial liability can also result from the imposition of actual and statutory damages in a class action where actual damages are unlimited and statutory damages of up to the lesser of $500,000 or 1 percent of the lender's net worth can be awarded. 93

Some of the recent TILA litigation has focused on the issue of attorney fees. In James v. Home Construction Co. of Mobile, the Eleventh Circuit allowed an attorney whose fee was omitted from the settlement of a TILA claim to bring a direct action for his fee. 94 The court believed this right was implied in the statutory framework. However, in Freeman v. B & B Associates, the District of Columbia Circuit held that the waiver of attorney fees in a settlement agreement between a borrower and a lender who had violated the TILA barred the borrower's attorneys from an independent action to recover attorney fees. 95 Thus, there is some uncertainty as to the extent of an attorney's right to maintain an independent action for attorney fees.

There has also been some dispute over whether an attorney's fee should be awarded to the consumer for defending a creditor's counterclaim for payment of the debt. 96 In Lacy v. General Finance Corp., the court denied the consumer's request for attorney fees for defending against the creditor's counterclaim because it believed this was not enforcing liability under the Act. 97 In a somewhat related case, however, the court held that the failure of the consumer to prevail on every claim for fraud and securities violations did not require a reduction in the award for attorney fees under the TILA. 98 Seemingly, this case is contrary to the rationale in Lacy because part of the award of attorney fees included time spent on the non-TILA claims. Therefore, this area must also be considered as being somewhat unsettled.

Finally, even if the creditor does prevail on his claim on the underlying obligation, he is not entitled to offset the consumer's attorney fees against this amount. 99 As one court stated, "the attorney is entitled to the fee that is awarded him regardless of any controversy regarding the underlying debt." 100

Defenses

Fortunately for the banker, the TILA provides for several defenses to liability. First, there is no liability for failing to comply with the TILA if within sixty days of discovering a violation, and prior to the institution of an action by the consumer, the creditor notifies the consumer of the error and makes any adjustments necessary to assure that the debtor will not be required to pay

94. 689 F.2d 1357, 1359 (11th Cir. 1982).
95. 790 F.2d 145 (D.C. Cir. 1986).
96. See Griffith, supra note 6, at 50-51.
97. 651 F.2d 1026, 1029 (5th Cir. 1981).
100. Id. at 1365.
an amount in excess of the lower of the charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed.\(^\text{101}\) In essence, these required adjustments severely limit the scope and applicability of this defense. Second, the creditor will not be held liable if the violation was not intentional and resulted from a bona fide error, notwithstanding the maintenance of procedures to avoid any such error.\(^\text{102}\) Third, the creditor will not be held liable for any act done in good faith and in conformity with any Federal Reserve Board rule or interpretation.\(^\text{103}\) Finally, except with regard to the separate three-year limitation period on the right to rescind, the consumer must bring an action for violation within one year from the date of the occurrence of the violation.\(^\text{104}\)

The bona fide error defense may appear at first glance to be a large exception to liability under the TILA. However, the statute lists clerical, calculation, computer malfunction and programming, and printing errors as examples of bona fide errors; an error of legal judgment with respect to the lender’s obligation under the TILA is specifically excepted from this defense.\(^\text{105}\) This seems to indicate that Congress intended that the bona fide error defense apply in very few situations. Also, some substantial burdens for establishing this defense have been imposed by the courts.\(^\text{106}\)

Similarly, the one-year statute of limitations is not the safe harbor that it appears. The TILA specifically provides that the one-year limitation period may not apply to bar an assertion of a TILA violation as a set-off or recoupment defense in an action to collect the debt.\(^\text{107}\) Also, equitable tolling doctrines have been applied by some courts. Thus, in King v. California, the court held that even though the one-year statute of limitations starts to run when disclosure is due, it could be tolled until the consumer learns of the improper disclosure where the consumer did not know of the violation at the time of the credit transaction and could not possibly know of it.\(^\text{108}\) Additionally, repeated violations may each give rise to a new cause of action and, thus, a new one-year statute of limitations.\(^\text{109}\) Again, the banker must

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102. Id. § 1640(c).
103. Id. § 1640(f).
104. Id. § 1640(e).
105. Id. § 1640(c). See also Mirabal v. General Motors Acceptance Corp., 537 F.2d 871, 879 (7th Cir. 1976) (bona fide error defense limited to errors of a clerical nature), overruled on other grounds, Brown v. Marquette, 686 F.2d 608 (7th Cir. 1982).
106. Mirabal, 537 F.2d at 876-79 (creditor must establish both the existence of procedures designed to avoid bona fide errors and the continued maintenance of such procedures).
108. 784 F.2d 910 (9th Cir. 1986).
109. Schmidt v. Citibank South Dakota, 645 F. Supp. 214 (D. Conn. 1986) (where credit card user sends multiple billing statements, each of which have an error in the required disclosure, each statement is a new breach of the law that gives the consumer a new and different cause of action for purposes of determining when the one-year statute of limitations runs).

However, a debtor cannot sue on each of these repeated violations and recover damages for each. Section 1640(g) provides that multiple failures to disclose entitle the debtor to only a single recovery. Thus, the multiple violations would not give rise to multiple recoveries. 15 U.S.C. § 1640(g) (1982).
take every available precaution because one cannot be sure as to how these issues will finally be resolved.

**Equal Credit Opportunity Act (ECOA)**

**Requirements:**

After the TILA, probably the next most important legislation affecting consumer credit is the ECOA. The ECOA is even broader than the TILA; it applies to all types of lending. However, consumer lending seems to be the area where an ECOA violation is most likely to occur because Regulation B provides business creditors with specialized status and exempts them from many of Regulation B’s provisions. It is apparent that many banks, savings and loans, and credit unions fail to comply with the ECOA’s requirements.

The ECOA prohibits discrimination by a creditor against an applicant with respect to any aspect of the credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, an applicant’s derivation of all or part of income from a public assistance program, or an applicant’s exercise of a right under the Consumer Credit Protection Act. A creditor is allowed to inquire into marital status if the inquiry is for the purpose of ascertaining the creditor’s rights and remedies applicable to a particular extension of credit. However, the creditor may not take this information into account in evaluating the creditworthiness of the applicant and thereby use it as a basis for discrimination.

Also, a creditor may inquire into the applicant’s age or whether the applicant’s income derives from a public assistance program if such inquiry is only for the purpose of determining the amount and probable continuance of income levels, credit history, or other pertinent elements of creditworthiness; again, the creditor may not use this information to discriminate against the applicant. Additionally, a creditor is allowed to inquire as to the age of an applicant and use it as a factor in considering the application if the information is used in favor of the applicant; however, the creditor cannot use the applicant’s age as a basis for discriminating against the applicant.

111. 15 U.S.C. §§ 1691 & 1691a(b), (f) (1982) make the Act in general applicable to business credit. However, Regulation B exempts business credit from many of the Regulation B requirements. 12 C.F.R. § 202.3(a), (d) (1987).
112. Miller, Recent Developments—Equal Credit Opportunity, in CONSUMER CREDIT GOING INTO THE 80’s, 245, 249 (1981). Professor Miller reports that the 1980 annual report to Congress by the Federal Reserve Board on equal credit opportunity discloses that 25 percent to more than 50 percent of all examined banks, savings and loans, and credit unions were not in compliance with the ECOA. See also Matheson, The Equal Credit Opportunity Act: A Functional Failure, 21 HARV. J. ON LEGIS. 371, 377-78 (1984) (Federal Reserve Board discovered more than 17,000 violations of the Act during routine bank examinations over one eighteen-month period).
114. Id. § 1691(b)(1); 12 C.F.R. § 202.6(b) (1987).
The ECOA also imposes some procedural requirements. The Act states that each applicant against whom adverse action is taken is entitled to a statement of reasons for such action from the creditor.\textsuperscript{117} The creditor must then, within thirty days of receipt of a completed application, either provide a written statement of the specific reasons for the adverse action taken or give the applicant written notice of his right to a statement of reasons.\textsuperscript{118} "Adverse action" is defined as a denial or revocation of credit; a change in terms of an existing credit arrangement, not agreed to by the applicant, that does not affect a substantial portion of a classification of a creditor's accounts; or a refusal to grant credit in the amount or on substantially the terms requested unless the offered terms are actually accepted.\textsuperscript{119}

Regulation B imposes many additional or more specific requirements on the creditor. Section 202.5 prohibits the creditor from making oral or written statements in advertisements or otherwise that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.\textsuperscript{120} Also, a creditor cannot prohibit a married applicant from opening or maintaining an account in her maiden name; and a creditor is prohibited from requiring the signature of an applicant's spouse if the applicant would qualify individually for the credit under the creditor's standards of creditworthiness.\textsuperscript{121} However, if the applicant is relying in part on property to establish creditworthiness or is pledging property as collateral, the creditor may require the signature of the applicant's spouse or any other person reasonably believed to be necessary under state law to make the property relied upon available to satisfy the debt in case of default.\textsuperscript{122} Also, a creditor may request a cosigner or guarantor if, under the lender's credit standards, the personal liability of another person is necessary; but the lender may not require that the spouse be the additional party.\textsuperscript{123}

Except for cases where intent to discriminate is obvious or a specific rule in Regulation B is violated, a consumer has two ways to show a violation of the law: disparate treatment and disparate impact.\textsuperscript{124} One commentator described disparate treatment that violates the general rule against discrimination of Regulation B, section 202.4 as follows:

\begin{itemize}
  \item \textsuperscript{117} 15 U.S.C. § 1691(d)(2).
  \item \textsuperscript{118} Id. § 1691(d).
  \item \textsuperscript{119} Id. § 1691(d)(6); 12 C.F.R. § 202.2(c). Congress thoughtfully decided to exempt a creditor's refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or in default from the definition of an "adverse action." 15 U.S.C. § 1691(d)(6).
  \item \textsuperscript{120} 12 C.F.R. § 202.5(a).
  \item \textsuperscript{121} Id. § 202.7(b), (d)(1).
  \item \textsuperscript{122} Id. § 202.7(d)(2), (4).
  \item \textsuperscript{123} Id. § 202.7(d)(5).
  \item \textsuperscript{124} Matheson, supra note 112, at 382-85. See also Miller v. American Express Co., 688 F.2d 1235, 1239-40 (9th Cir. 1982) (specific intent to discriminate not required; credit discrimination can be proved by tests delineated under Title VII); Sayer v. General Motors Acceptance Corp., 522 F. Supp. 835, 839-40 (W.D. Mo. 1981); Cragin v. First Fed. Sav. & Loan Ass'n, 498 F. Supp. 379, 384 (D. Nev. 1980); K. Redden & J. McClellan, Federal Regulation of Consumer Creditor Relations § 7.6(D) (1982).
\end{itemize}
Disparate treatment occurs when some people are treated less favorably than others because of an identifiable characteristic such as race, sex or national origin. Discriminatory intent is proved by evidence that the creditor’s stated reason for refusing credit to the plaintiff was not applied by the creditor to others situated similarly to the plaintiff. In essence, proof of disparate treatment is an attempt to show discriminatory intent by means of circumstantial evidence.\(^\text{125}\)

Disparate impact, on the other hand, allows the consumer to prove discrimination by showing that the apparently neutral application of the lender’s credit criteria results in the systematic exclusion of one of the classes protected by the Act, resulting in a disparate impact on that group. In addition, the consumer must show that there is not sufficient justification for this result.\(^\text{126}\) With disparate impact consumers need not show that the creditor intentionally discriminated against them.\(^\text{127}\) Once a consumer shows disparate impact, the burden shifts to the creditor to show that the practice relates to creditworthiness; if that is established, the issue then becomes whether another, less discriminatory practice would serve as well.\(^\text{128}\)

The courts have generally construed the ECOA strictly and have been quick to find violations. For example, in Miller v. American Express Co., the court held that American Express’ policy of automatically cancelling a supplementary cardholder’s account upon the death of the basic cardholder violated the ECOA because it did not provide for a separate inquiry into the creditworthiness of the supplementary cardholder.\(^\text{129}\) Miller involved a suit by a widow who had a separate card number with a separate fee imposed and had signed a separate agreement providing that she would be liable for all charges on the account. The court’s holding in this case is probably justifiable because the facts suggest that for all practical purposes the widow had an account separate from her husband. In a stranger case, Markham v. Colonial Mortgage Service Co., the court held that the lender discriminated on the basis of marital status where it refused to aggregate the incomes of an unmarried couple as it would a married couple when both would be liable on the debt.\(^\text{130}\)

Additionally, courts often apply the ECOA in situations the ordinary banker would not expect. For instance, in Owens & Maddock v. Macgee Finance

\(^{125}\) Matheson, supra note 112, at 383. The author stated as an illustration that a rejected applicant might prove disparate treatment by showing (1) membership in a protected class; (2) that the applicant applied for credit and was financially able and willing to repay; (3) that the applicant was nevertheless refused credit; and (4) that the creditor continues to seek to extend credit to other applicants with similar willingness and ability to repay. Id.

\(^{126}\) Id. at 384.

\(^{127}\) Id.

\(^{128}\) Id. at 385. This test originated in employment discrimination cases and had been applied to ECOA cases by analogy. See Cherry v. Amoco Oil Co., 490 F. Supp. 1026, 1030-32 (N.D. Ga. 1980) (effects test applied in ECOA case).

\(^{129}\) 688 F.2d 1235 (9th Cir. 1982).

\(^{130}\) 605 F.2d 566 (D.C. Cir. 1979).
Service, the court found that a creditor violated the ECOA by refusing to make a second loan to a person unless she first released a TILA claim she had against the creditor in connection with the first loan. In another case, Anderson v. United Finance Co., the court held that requiring a spouse's signature on loan documents, when an applicant is individually qualified for the loan, is discriminatory and violates the ECOA even where the credit was not denied. Thus, ECOA violations can appear in situations where a layman might logically think there was no discrimination.

**Liability and Defenses**

The liability for ECOA violations can be substantial. A creditor who fails to comply with the provisions of the ECOA is liable to the applicant for any actual damages sustained, punitive damages in an amount not to exceed $10,000, costs, and a reasonable attorney's fee. Actual damages may include damages for embarrassment, humiliation, mental distress, and injury to reputation and creditworthiness. Although punitive damages are not limited by the ECOA or Regulation B, ECOA section 706(b) (15 U.S.C. § 1691e(b)) provides that the court, in awarding punitive damages, should consider the amount of actual damages, the frequency and persistence of violations by the creditor, the resources of the creditor, the number of persons adversely affected, and the extent to which the creditor's failure of compliance was intentional. Courts construing section 706(b) have held that punitive damages may only be awarded if (1) the creditor wantonly, maliciously, or oppressively discriminates against an applicant, or (2) the creditor acts in a reckless disregard of the law even though there was no specific intent to discriminate on unlawful grounds. However, there is no requirement that there be any showing of actual damages to entitle the applicant to punitive damages. Thus, a banker who violates the ECOA can face significant actual damages, potential punitive damages, and substantial attorney fees.

Fortunately, the ECOA provides the creditor with some defenses. The statute of limitations for bringing an action for a violation is two years. As with the TILA, though, a violation can continue to be raised as a defense after the two-year statute of limitations has expired. Another defense provided by the ECOA is that a creditor is not liable for any action taken in good faith conformity with any rule, regulation, or interpretation of the Federal Reserve Board. Also, Regulation B provides that a failure to give notice

131. 476 F. Supp. 758 (E.D. La. 1979). The prohibited basis for denying the credit was the applicant's good faith exercise of her rights under the Consumer Credit Protection Act.

132. 666 F.2d 1274 (9th Cir. 1982).


136. Anderson, 666 F.2d at 1278.


under section 202.9 of reasons for adverse action will not constitute a violation when caused by an inadvertent error, provided that, upon discovery, the creditor corrects the error and commences compliance. Hence, the creditor is provided with a few routes to escape liability, but the surest solution appears to be continuing compliance.

**Fair Credit Reporting Act (FCRA)**

The FCRA deals mainly with consumer reporting agencies and consumer reports. Banks, then, will not usually meet the definition of either of these special statutory terms. However, section 615 of the FCRA establishes certain requirements for users of consumer reports, and banks certainly fall within this category. Therefore, a banker needs to be aware of these requirements to avoid liability under the Act.

Section 615 provides that whenever credit for personal, family, or household purposes is denied or the charge for such credit is increased because of information contained in a consumer report from a consumer reporting agency, the creditor must supply the consumer with the name and address of the consumer reporting agency making the report. Whenever such information is supplied by someone other than a consumer reporting agency, the creditor must disclose to the consumer his right to request a statement of the nature of the information. Thus, the FCRA imposes disclosure requirements on the users of consumer reports. These requirements are in addition to the statement of reasons required under the ECOA.

The penalties for violation of the disclosure requirements can be substantial. If the user of the information willfully fails to comply, he is liable to the consumer for any actual damages sustained, such punitive damages as the court may award, and costs of the action together with a reasonable attorney’s fee. If the user’s noncompliance is due to negligence, the consumer is not entitled to punitive damages. Once again, the prudent banker should

142. 15 U.S.C. §§ 1681b-1681l deals with users of consumer reports and consumer reporting agencies. A “consumer report” is defined, in part, as any communication by a consumer reporting agency bearing on a consumer’s creditworthiness, character, etc., which is used as a factor in determining eligibility for credit to be used primarily for personal, household, or family purposes. 15 U.S.C. § 1681a(d). The term does not include any report containing information solely as to transactions or experiences between the consumer and the person making the report, which is the usual type of report a bank would generate. Id. A “consumer reporting agency” is defined as any person who for fees or on a nonprofit cooperative basis regularly engages in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties. Id. § 1682a(l). Banks, of course, do not generally generate credit data for the purpose of furnishing it to third parties. However, cooperative exchanges of information among banks could bring them under the Act. See Guidelines for Financial Institutions in Complying with FCRA, 5 Consumer Cred. Guide (CCH) ¶ 11,203 (June 18, 1971).
144. Id. § 1681m(b).
145. Id. § 1681n.
146. Id. § 1681o.
consider the possibility of substantial attorney fees being awarded, even though
the remainder of the recovery is likely to be small.\textsuperscript{147}

The FCRA does provide a banker or other user of consumer reports one
large defense to liability. The statute provides that no user shall be liable for
failure to give notice to the consumer if he maintained reasonable procedures
to assure compliance with the notice provisions.\textsuperscript{148} Thus, all the banker need
do to insulate himself from liability is make sure that he establishes and main-
tains procedures for giving the necessary notice. Another defense provided
by the statute is that any action for a violation must be brought within two
years from the date on which the liability arises.\textsuperscript{149}

The FTC, in its reviews of creditor compliance with the FCRA notice re-
quirements, has found many violations.\textsuperscript{150} These include failure to provide
disclosures when: (1) the applicant is denied credit because of insufficient credit
history or the total absence of a file at the credit bureau; (2) the credit report
contains negative information, even though the report is only one of several
factors considered by the creditor; (3) a credit scoring system is used, and
the credit report is given a low point total; and (4) the creditor relies on infor-
mation from parties other than credit bureaus.\textsuperscript{151} Also, creditors were found
to fail to give both FCRA and ECOA adverse action disclosures when both
were required.\textsuperscript{152} Hence, this area appears to be ripe for future litigation.

\textit{Fair Credit Billing Act (FCBA)}

The FCBA applies to banks and other creditors' billing practices under open-
end credit extensions, i.e., credit card plans or revolving loan accounts.\textsuperscript{153}
It does not apply to closed-end transactions.\textsuperscript{154} A violation of the FCBA falls
under the same section of the Consumer Credit Protection Act as does a viola-
tion of the TILA.\textsuperscript{155} Thus, the same potential liabilities apply. Also, the statute
has some other significant provisions which affect consumer credit transac-
tions.
The FCBA provides a procedure for the resolution of billing error disputes.\textsuperscript{156}
It also prohibits the creditor from making an adverse report to any third party
during the billing error dispute resolution process and requires that after this

\textsuperscript{147} See \textit{generally} Rubin, supra note 92.
\textsuperscript{148} 15 U.S.C. \textsection{} 1681m(c) (1982).
\textsuperscript{149} Id. \textsection{} 1681p.
\textsuperscript{150} Fortney, \textit{Consumer Credit Compliance and the Federal Trade Commission: Continuing
\textsuperscript{151} Id.
\textsuperscript{152} Id.
\textsuperscript{155} 15 U.S.C. \textsection{} 1640(a) (1982). See supra notes 86-109 and accompanying text for a discussion
of potential lender liability.
\textsuperscript{156} 15 U.S.C. \textsection{} 1666 (1982). If within sixty days of sending the consumer a billing statement,
the consumer gives the creditor written notice of a billing error, the creditor must: (1) send a
written acknowledgement of the consumer's statement within thirty days of receipt, and (2) within
two billing cycles of receipt (but not to exceed ninety days), either make the appropriate corrections
to the consumer's account or, after investigation, send the consumer a statement of why the
creditor believes the account to be correct, along with any requested documentary evidence. Id.
period, if the debt is still disputed, the creditor must so indicate to any third party to which it reports the credit information.\textsuperscript{157} An additional penalty for failure to comply with these provisions is that the creditor forfeits the amount in dispute up to a maximum of $50.\textsuperscript{158}

The FCBA also restricts the card issuer from prohibiting sellers from offering discounts to the cardholder as an inducement to pay by cash rather than using the credit card.\textsuperscript{159} Also, the card issuer may not require a seller, as a condition of participating in the credit card plan, to open an account with or procure any service from the issuer.\textsuperscript{160}

In what is probably the most significant provision of the Act, the card issuer is held subject to all claims (other than tort claims) and defenses arising out of a credit card transaction if: (1) the consumer has made a good faith attempt to resolve the dispute with the person honoring the credit card; (2) the amount of the transaction exceeds $50; and (3) the transaction occurred within the same state as the cardholder’s last mailing address or was within 100 miles of such address.\textsuperscript{161} Fortunately, the issuer’s liability is limited to the amount of credit outstanding with respect to the transaction.\textsuperscript{162}

The FCBA also provides that if an open-end consumer credit plan allows the consumer to pay a portion of the credit extended and avoid an additional finance charge, the creditor may not impose an additional finance charge unless the consumer is mailed a statement that includes the amount upon which the finance charge will be based at least fourteen days prior to the date specified in the statement for payment.\textsuperscript{163}

In sum, the FCBA has some important provisions the banker should consider. In addition to the substantial liability the FCBA can impose, certain aspects, such as the provision making the credit card issuer subject to any claims and defenses arising from the underlying transaction, should be considered by a banker in deciding whether to engage in credit card activities. Thus, the FCBA serves as an example of a situation where a banker should consult counsel before offering a new product or service. By consulting counsel, the banker can be sure that he fully understands all of the potential costs of the new venture.

\textit{Debt Collection Practices Act (DCPA)}

Another consumer credit protection statute is the DCPA.\textsuperscript{164} It strives to “eliminate abusive debt collection practices by debt collectors.”\textsuperscript{165} It ac-

\begin{itemize}
\item \textsuperscript{157} \textit{Id.} \S 1666a.
\item \textsuperscript{158} \textit{Id.} \S 1666(e).
\item \textsuperscript{159} \textit{Id.} \S 1666f.
\item \textsuperscript{160} \textit{Id.} \S 1666g.
\item \textsuperscript{161} \textit{Id.} \S 1666(a). The last two limitations do not apply if the merchant is the card issuer or in some other related cases.
\item \textsuperscript{162} \textit{Id.} \S 1666(b).
\item \textsuperscript{163} \textit{Id.} \S 1666(b(a).
\item \textsuperscript{164} \textit{Id.} \S\S 1692-16920.
\item \textsuperscript{165} \textit{Id.} \S 1692(e).
\end{itemize}
complishes this goal by strictly regulating the way in which debt collectors must conduct their business. A failure to comply with the Act's requirements can result in the debt collector being liable to the consumer for actual damages, punitive damages up to $1,000, and costs, including a reasonable attorney's fee.\textsuperscript{166} The defenses to liability provided by the Act are: (1) unintentional violation resulting from bona fide error, notwithstanding the maintenance of procedures to avoid such an error; (2) a one-year statute of limitations for bringing an action under the Act; and (3) actions taken in good faith in conformity with a FTC advisory opinion.\textsuperscript{167}

It is a relatively simple matter for a bank to avoid liability under the DCPA. The Act only applies to "debt collectors." A "debt collector" is defined as a person who regularly collects or attempts to collect debts owed to another; however, an officer or employee of the creditor acting in the name of the creditor is specifically excluded from the definition.\textsuperscript{168} On the other hand, an attorney acting in his professional capacity on behalf of the creditor is not excluded.\textsuperscript{169} The only way a creditor collecting his own debts is considered a debt collector is if the creditor uses any name other than his own name, which would indicate that a third person is collecting or attempting to collect the debt.\textsuperscript{170} Therefore, a bank can avoid falling within the Act's requirements simply by conducting its collection activities in its own name.

\textit{Real Estate Settlement Procedures Act (RESPA)}

The other major federal statute that directly impacts on the extension of consumer credit is RESPA.\textsuperscript{171} One of the main purposes of RESPA is "to insure that consumers throughout the nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessary high settlement charges caused by certain abusive practices that have developed in some areas of the country."\textsuperscript{172} RESPA accomplishes its purpose by regulating the settlement process for "federally related mortgage loans." Mortgage lending by banks falls within this category because "federally regulated mortgage loans" are defined to include, among other things, first acquisition loans on residential property that are made by a lender whose deposits are insured by any agency of the federal

\textsuperscript{166} Id. \S 1692k(a).
\textsuperscript{167} Id. \S 1692k(c), (d), (e).
\textsuperscript{168} Id. \S 1692a(6). See Woocher, \textit{An Introduction to Debt Collection Law}, 29 PRAC. LAW. 31, 33-34 (Oct. 1983).
\textsuperscript{169} 100 Stat. 768 (1986) amended 15 U.S.C. \S 1692a(6)(f) to eliminate attorneys from the list of those excluded from the definition of "debt collectors." However, in Providence Washington Ins., 89 F.T.C. 345 (1977), the FTC found that the creditor's use of collection letters sent by one of the creditor's officers who was also an attorney, on a letterhead that said "Attorney at Law" with an address and phone number different from the company's, was a misrepresentation under section 5 of the Federal Trade Commission Act, 15 U.S.C. \S 45 (1982).
\textsuperscript{170} 15 U.S.C. \S 1692a(6).
\textsuperscript{171} 12 U.S.C. \S\S 2601-2617 (1982).
\textsuperscript{172} Id. \S 2601(a).
government (i.e., the FDIC). Thus, RESPA will apply to banks when they make acquisition first mortgage loans on residential real estate.

The Act requires that lenders provide all applicants for residential acquisition loans with a HUD booklet on settlement costs and a good faith estimate of those costs. Then, a uniform HUD settlement statement itemizing all charges imposed on the buyer and seller must generally be provided at or before closing. Also, the Act prohibits kickbacks and unearned fees for referring business incident to a real estate settlement. Additionally, RESPA limits the amount of advance deposits that may be required for escrow accounts. The escrow deposit to pay taxes, insurance, and other charges related to settlement is limited to an amount sufficient to pay such charges from the last date on which the charges would normally be paid to the date of the first payment on the mortgage, plus one-sixth of the total estimated charges to be paid during the ensuing twelve-month period. The monthly escrow deposits beginning with the first payment are then limited to one-twelfth of the amount of insurance, taxes, and other charges reasonably estimated to be paid during the ensuing twelve months, plus one-sixth of the amount estimated to be paid during the ensuing twelve-month period.

In sum, RESPA imposes certain requirements with respect to residential acquisition lending. However, the Act provides for no private right of action in most cases. Even if a lender fails to meet all of the Act’s requirements, it does not impose liability for anything other than kickbacks and referral fees.

State Consumer Credit Legislation

The primary focus of this comment is on the impact of federal consumer credit legislation on the banking industry. However, the discussion of the potential liabilities a banker faces in consumer lending would not be complete without at least a brief discussion of some of the pertinent state consumer credit legislation, the most common of which are the Uniform Consumer Credit Code (UCCC or Code), or statutes that cover the same subjects, and usury statutes (the UCCC contains its own usury provisions). Although there are various other state statutes that may deal with consumer credit, this discus-

173. Id. § 2602(1).
174. Id. § 2604(c), (d).
175. Id. § 2603.
176. Id. § 2607. A violation of this provision can result in a fine of up to $10,000 and up to a year in prison. Also, the violators are liable for an amount equal to three times the fee, along with costs and reasonable attorney’s fees. Id. A one-year statute of limitations applies to an action for damages under this section. Id. § 2614.
177. Id. § 2609.
178. Id.
179. For example, Oklahoma has its own equal credit opportunity law (14A OKLA. STAT. § 1-109 (1981)); but it is phrased only in general terms without any specific mechanical detail. Also, there is no private right to enforcement under Oklahoma’s law. See Miller, supra note 112, at 245, 247. But see Note, The Equal Credit Opportunity Act: Guarantors As Applicants—Did the Cost of a Violation Go Up?, 40 OKLA. L. REV. 413 (1987), which suggests that the Oklahoma law may be raised as a defense to liability in an action on the underlying obligation. States also have debt collection rules that apply to creditors.
sion will be limited to the UCCC and usury statutes because these types of statutes are more prevalent.180

Uniform Consumer Credit Code (UCCC)

According to one commentator, the drafters of the UCCC "sought to pro-
tect less knowledgeable and less sophisticated credit recipients by restricting
certain credit practices and abuses, putting ceilings on the price of credit,
enhancing debtor rights and remedies, and providing administrative enforce-
ment tools as well as judicial remedies for redress of Code violations."181

The Code applies to consumer credit transactions, including, among other
things, consumer loans. A "consumer loan" is defined as a loan by a creditor
regularly engaged in the business of making loans in which: (1) the debtor
is a person other than an organization; (2) the debt is incurred primarily for
a personal, family, household, or agricultural purpose; (3) the debt is payable
in installments or a finance charge is made; and (4) the amount financed does
not exceed $25,000 or the debt (other than one for an agricultural purpose)
is secured by an interest in land.182 A consumer loan does not include a loan
secured by an interest in land in which the finance charge does not exceed
12 percent.183 These are essentially the same requirements as those for the
TILA, except for the 12 percent rule and the exclusion of agriculture loans.
Thus, the typical bank's consumer lending will fall within the scope of the
UCCC.

The UCCC has disclosure and rescission provisions similar to those under
the TILA.184 Also, the UCCC has provisions setting the maximum permissible
finance charge for consumer and other loans.185 Although there are also
provisions limiting the imposition of late charges on precomputed consumer
credit transactions, this limitation has diminished importance today because
banks seldom make precomputed loans.186 However, the most significant pro-
visions of the UCCC are those regulating agreements and practices.

In addition to TILA-type disclosures, the UCCC also provides that a
cosigner, comaker, or guarantor is not liable unless he receives a separate
notification of his obligation with respect to the debt.187 Also, a creditor is

180. States that have not adopted the UCCC have at least four, and as many as eight or
ten, different consumer credit laws of varying kinds; but they often cover the same subjects:
disclosure, usury, practices, and remedies. Murane, The Impact of the Uniform Consumer Credit
181. Id. at 269.
183. Id.
184. Id. §§ 3.201, 5.203. See also Murane, supra note 180, at 270.
185. U.C.C.C. §§ 2.201, 2.202, 2.401, 2.601. The various rates and levels at which they apply
are many and beyond the scope of this comment. Some of these rules and other state usury
provisions may not apply to banks under 12 U.S.C. § 85 and DIDA, §§ 501 & 521. See Gelb,
186. U.C.C.C. § 2.502. A "precomputed consumer credit transaction" is a transaction in which
the debt is comprised of the amount financed and the amount of the finance charge computed
in advance. Id. § 1.301(33).
187. Id. § 3.208.
prohibited from taking an irrevocable assignment of earnings of the consumer as payment on a debt or as security for payment.\textsuperscript{188} Likewise, a consumer may not authorize any person to confess judgment on a claim arising out of a consumer credit transaction.\textsuperscript{189} Additionally, depending on the version of the UCCC a state adopts, the UCCC either restricts or limits a creditor from including a provision in the credit agreement requiring the consumer to pay the creditor’s attorney fees.\textsuperscript{190} If any of these provisions are present, they are unenforceable.\textsuperscript{191} Finally, if the loan provides for a balloon payment, defined as a payment more than twice as large as the average of earlier payments, the consumer has the right to refinance the balloon without penalty under terms equally favorable to those in the original loan.\textsuperscript{192}

One of the most significant provisions of the UCCC is section 3.404. This section makes an assignee subject to all of the consumer’s claims and defenses against the seller or lessor that arise out of the sale or lease of property or services, notwithstanding that the assignee is a holder in due course of a negotiable instrument. Thus, the UCCC eliminates the holder in due course doctrine for consumer credit sales and leases.\textsuperscript{193} Similarly, section 3.405 provides that a lender who makes a consumer loan to enable the consumer to buy or lease particular property or services is subject to the consumer’s claims and defenses arising from the sale or lease if one of several conditions are present that indicates lender participation in the underlying transaction. Hence, the UCCC imposes liability on banks as assignees for the acts of certain third parties.

With respect to the creditor’s remedies, the UCCC imposes a duty on the creditor to give the consumer a written notice of his right to cure as a precondition to taking action on the obligation.\textsuperscript{194} The consumer has twenty days after the notice is given to cure.\textsuperscript{195} Cure will then restore the consumer to his rights under the agreement as though no default had occurred.\textsuperscript{196} Also, the creditor may not use self-help repossession to enforce his security interest in certain cases, and judicial process may not even be available.\textsuperscript{197} The con-

\textsuperscript{188} \textit{Id.} \textsection{3.305.}
\textsuperscript{189} \textit{Id.} \textsection{3.306.} The Federal Reserve Board Credit Practices Rules also cover much of this same ground.
\textsuperscript{190} \textit{Id.} \textsection{2.507 (Alternative A or B).} \textit{See also} Murane, \textit{supra} note 180, at 276.
\textsuperscript{191} U.C.C.C. \textsection{3.305, 3.306.}
\textsuperscript{192} \textit{Id.} \textsection{3.308.}
\textsuperscript{193} Federal Trade Commission Trade Regulation Rule on Preservation of Consumer’s Claims and Defenses, 16 C.F.R. \textsection{433 (1987), has much the same effect, requiring a contractual provision giving the consent of the holder to the assertion of claims or defenses by the consumer.}
\textsuperscript{194} U.C.C.C. \textsection{5.110.}
\textsuperscript{195} \textit{Id.} \textsection{5.111.}
\textsuperscript{196} \textit{Id.}
\textsuperscript{197} \textit{Id.} \textsection{5.116.} The lender may not, without a court order, repossess goods in which it has a nonpurchase money security interest where goods are possessed by the consumer, being used by the consumer or a member of his family, are or may be exempt from execution, and are collateral for a “supervised loan” (as defined by \textsection{1.301(43))}. The court may not order process if it finds that the consumer lacks the means to pay all or part of the debt secured and the
consumer's remedies and creditor's defenses for failure to comply or to make TILA-type disclosures are similar to those under the TILA.  

In sum, the UCCC imposes some additional burdens on the banker with respect to his consumer lending transactions. Possibly the most significant change made by the UCCC is its elimination of the holder in due course doctrine in section 3.404. This provision will force banks to look more closely into the business practices of firms from which they buy consumer paper. Also, it will force banks to take steps such as establishing higher reserves for merchants from which they buy paper and buying more paper on a recourse basis in order to protect themselves.  

Usury

Usury statutes in non-UCCC states are often separate from other consumer credit legislation and usually set a maximum permissible rate of interest that can be charged on loan contracts. These statutes were enacted to protect consumers and others from what state legislatures believed were unreasonably high interest rates on loans. Violations of usury provisions can result in fines, forfeiture of interest, and unenforceability of the entire contract. The advent of the maximum interest rate provisions of the UCCC and federal preemption through the DIDA have severely limited the possibility of usury violations under current market conditions. However, if interest rates go up dramatically in the future, usury may again become something that bankers must consider.

Conclusion

This comment has discussed the major federal and state consumer credit legislation. These provisions are obviously complex and contain many nuances. Violations of these statutes can result in substantial liability to a bank or other financial institution. In light of the complexity inherent in these statutes and the potential liability involved, bankers should get the advice of informed counsel early in the loan process and not wait until something goes wrong, as is usually the case. By getting the advice of counsel on potential credit extensions and proposed programs and products, the bank can avoid potential liability arising from its consumer lending practices and avoid having to scramble for defenses once a claim arises. The optimal way for a bank to accomplish this goal is to have its counsel attend its board meetings, its policy committee meetings, and its loan committee meetings. Increasingly, consumers who are unable to pay their debts are looking to the consumer credit statutes

continued use and possession of the item is necessary to avoid undue hardship for the consumer or a member of his family.  

Id. §§ 5.202, 5.203.

Id. §§ 5.202, 5.203.

199. Murane, supra note 180, at 275.


for a way out—either as a bargaining chip or as an offset against liability. It is time for banks to take positive action to decrease their exposure to these tactics. One such step is increased involvement by the bank’s attorney in its consumer lending practice.

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