

Banking Law

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BANKING LAW

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CHAPTER 151

Introduction to Consumer Credit

SYNOPSIS

§ 151.01 Summary of This Chapter

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§ 151.03 Coverage and Organization

§ 151.01 Summary of This Chapter

Prior to 1968, the only statutory regulation of consumer credit transactions were the state installment sales acts. These statutes exempted consumer transactions from state usury laws, and required minimal disclosure by merchants. The 1968 enactment of the Consumer Credit Protection Act began the flood of federal legislation aimed at protection of the consumer. See § 151.02 *infra*.

The federal consumer protection statutes are enforced by different federal agencies that have the power to issue regulations, and official and unofficial interpretations, and to enforce these statutes. See § 151.03 *infra*.

§ 151.02 Consumer Credit Legislation

Before 1968, only consumer credit regulation was state installment sales acts that contained usury exemption and required minimal disclosure; 1968 Consumer Credit Protection Act was first of several federal laws to protect consumer

Consumer credit has existed in the marketplace since colonial times. However, it was not until the “buy-now-pay-later” phenomenon following World War I that this type of purchasing arrangement became commonplace. Sales were structured along a time-price doctrine under which a seller charged one price if the purchase was for cash, and a higher price if the purchase was to be paid over a period of time. The price differential was not considered interest, was not subject to usury laws, and was not subject to any type of credit regulation.

A merchant offering time-price sales would frequently sell its buyers’ obligations to a bank or finance company at a discount. The merchant would receive approximately the cash price. The entire transaction was governed by common law principles. No government regulation was involved.

The first laws dealing with retail installment credit were enacted on the state level at the urging of creditors, who were concerned that the burgeoning use of credit would lead to chaotic competition among finance companies. State retail installment sales acts frequently exempted consumer credit transactions from state usury laws, while at the same time requiring disclosure to the consumer of the cash price, the down payment required, the finance charges, the insurance charges, the unpaid balance of the cash price, and the time price.¹ Compliance with these retail installment sales acts was a relatively simple matter, receiving scant attention from the commercial law practitioner, and producing very little litigation.

The credit card movement began to burgeon in the 1950s and 1960s. The movement began with the oil companies, expanded into the travel and entertainment industry, and culminated in the

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¹ See, for example, Ohio Rev. Code Ann. § 1317.

offering of all-purpose credit. Amid this tremendous growth in the availability of credit and its universal use, Senator Paul Douglas proposed the first “Truth in Lending” legislation in 1960.² The objective of the proposal was to require national uniformity in the disclosure of the terms of credit. It was hoped that this measure would alleviate the often conflicting regulations at the state level. Senator Douglas’ proposal required credit disclosure to be made in terms of simple annual interest.

Congressional action culminated in the passage of the Consumer Credit Protection Act in May 1968.³ The cornerstone of the act is Title I, the Truth in Lending Act, which became effective on May 29, 1969. The Truth in Lending Act provides for the disclosure of the cost of consumer credit.⁴ Title II of the Consumer Credit Protection Act makes the extortionate extension of credit a federal crime. Title III places restrictions on garnishments, while Title IV established the now-defunct National Commission on Consumer Finance. Title V set forth the effective dates of the preceeding titles.

The Truth in Lending Act (TIL Act) has been amended several times, first in 1971 to regulate the issuance of credit cards and to provide a limitation on the liability of the holder of a credit card for its unauthorized use.⁵ The Fair Credit Billing Act was passed in 1975 and became part of the TIL Act.⁶ It provides procedures for the correction of billing errors, and restrictions with respect to the handling of credit accounts. In 1977, the TIL Act was again expanded to cover consumer lease transactions and credit advertising.⁷ Most recently, the Truth in Lending Simplification and Reform Act, passed as part of the Depository Institutions Deregulation and Monetary Control Act of 1980, has substantially amended many TIL Act provisions.

² See Hearings on S. 2755 before the Subcomm. on Production and Stabilization of the Senate Committee on Banking and Currency, 86th Cong., 2d Sess. (1960). Senator Douglas introduced similar legislation in succeeding years.

³ Act of May 29, 1968, Pub. L. 90-321, 82 Stat. 146; 15 U.S.C. § 1601 *et seq.*

⁴ See § 152.01 *et seq. infra.*

⁵ Act of Oct. 26, 1970, Pub. L. 91-508, 84 Stat. 1126.

⁶ Act of Oct. 28, 1974, Pub. L. 93-495, 88 Stat. 1512; 15 U.S.C. § 1666 *et seq.*

⁷ Act of Mar. 23, 1976, Pub. L. 94-240, 90 Stat. 257.

Congress has also added four additional titles to the Consumer Credit Protection Act. Title VI, known as the Fair Credit Reporting Act, was added in 1970.⁸ It restricts requests for, and uses of, information relating to a consumer's medical, credit, insurance, and employment history.

Title VII, known as the Equal Credit Opportunity Act, became effective in 1975.⁹ This act prohibits specified lending practices found to be discriminatory, and requires that credit applicants be notified of any adverse actions taken with respect to their applications.

Title VIII, known as the Fair Debt Collection Practices Act, was added in 1978, and places restrictions and prohibitions upon the activities of debt collectors.¹⁰

The last title of the Consumer Credit Protection act is Title IX, known as the Electronic Funds Transfer Act.¹¹ Title IX regulates electronic (paperless) transfers of funds by financial institutions and became effective in substantial part in 1980.

Other federal legislation directed toward consumer protection includes the Real Estate Settlement Procedures Act of 1974,¹² which prescribes disclosures that must be made by specified institutional lenders granting mortgage loans for the purchase of residential real estate. The Home Mortgage Disclosure Act of 1975¹³ requires specified real estate mortgage lenders to report annually the amount, type, and location of real estate held as security for loans. The Community Reinvestment Act of 1977¹⁴ requires

⁸ Act of Oct. 26, 1970, Pub. L. 91-508, 84 Stat. 1127; 15 U.S.C. § 1681 *et seq.* See § 153.01 *et seq. infra*.

⁹ Act of Oct. 28, 1974, Pub. L. 93-495, 88 Stat. 1524; 15 U.S.C. § 1691 *et seq.* See § 154.01 *et seq. infra*.

¹⁰ Act of Sept. 20, 1977, Pub. L. 95-109, 91 Stat. 874; 15 U.S.C. § 1692 *et seq.* See § 155.01 *et seq. infra*.

¹¹ Act of Nov. 10, 1978, Pub. L. 95-630, 92 Stat. 3728; 15 U.S.C. § 1693 *et seq.* See § 164.01 *et seq. infra*.

¹² Act of Dec. 22, 1974, Pub. L. 93-533, 88 Stat. 1724; 12 U.S.C. § 2601 *et seq.* See § 156.01 *et seq. infra*.

¹³ Act of Dec. 31, 1975, Pub. L. 94-200, 89 Stat. 1125; 12 U.S.C. § 2801 *et seq.* See § 157.01 *et seq. infra*.

¹⁴ Act of Oct. 12, 1977, Pub. L. 95-128, 91 Stat. 1147; 12 U.S.C. § 2901 *et seq.* See § 158.01 *et seq. infra*.

specified lenders to develop affirmative lending programs within their market area and requires a demonstration that the credit needs of a community are being served as a condition to supervisory agency approval of any branch application, merger, or acquisition. Another significant piece of federal consumer protection legislation in the Right to Financial Privacy Act, enacted as part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.¹⁵ The Right to Financial Privacy Act restricts the scope of requests for financial information concerning customers of financial institutions, and prescribes procedures that must be followed by United States governmental agencies in seeking access to those financial records.

Three final enactments of importance to consumers are the civil rights and fair housing laws,¹⁶ the Federal Trade Commission's holder in due course rule,¹⁷ and the Flood Disaster Protection Act of 1973.¹⁸

¹⁵ Act of Nov. 10, 1978, Pub. L. 95-630, 92 Stat. 3697; 12 U.S.C. § 3401 *et seq.* See § 162.01 *et seq. infra*.

¹⁶ See § 161.01 *et seq. infra*.

¹⁷ See § 159.01 *et seq. infra*.

¹⁸ See § 160.01 *et seq. infra*.

§ 151.03 Coverage and Organization

Federal consumer protection statutes are enforced by different federal agencies that have power to issue regulations, and official and unofficial interpretations, and to enforce statutes

Each of the statutes mentioned in Section 151.02 *supra* has generated administrative agency implementing regulations, opinions, official and unofficial interpretations, and litigation. It is with this ever-changing and evolving tangle of statutory and regulatory requirements in mind that the materials in these volumes have been organized.

The major legislation and regulations are initially set out and analyzed individually. This type of organization allows a practitioner who has identified the points in the credit and collection process of concern to him to rapidly determine which federal statutes and regulations are applicable, and what their effect is.

Space and time limitations have prevented a meaningful treatment of state consumer credit protection laws. The practitioner must, however, refer to any applicable state law or rule that also govern the transaction at hand.

CHAPTER 152

Truth in Lending Act

SYNOPSIS

- § 152.01 Summary of This Chapter
- § 152.02 Purpose of Act
- § 152.03 Scope of Act
 - [1] Type of Credit
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- § 152.08 Definitions in Act and Regulation Z
- § 152.01 Summary of This Chapter

The Truth in Lending Act was enacted to provide consumers with meaningful information about credit transactions in which they became involved. The act requires uniform disclosure of credit terms, including an annual percentage rate as defined in the act, provides to consumers a right of rescission if the personal

residence of a consumer is used as collateral in a credit transaction, prohibits the mailing of unsolicited credit cards to consumers, and establishes procedures for handling billing disputes arising out of credit transactions. See § 152.02 *infra*.

The Truth in Lending Act applies only to consumer credit transactions. A consumer credit transaction is a transaction in which a creditor, who may be either an organization or a natural person, extends credit to a natural person. The credit must be extended primarily for personal, family, household, or agricultural purposes, and not primarily for business or commercial purposes. The creditor must also either impose a finance charge in connection with the extension of credit, or require repayment of the debt incurred in more than four installments. Only creditors who regularly extend, or arrange for the extension of, credit in the ordinary course of their businesses are subject to the provisions of the Truth in Lending Act. Transactions in which the amount financed exceeds \$25,000 are exempt from the provisions of the act, unless the transactions involve a security interest in real property. See § 152.03 *infra*.

Regulation Z, promulgated by the Board of Governors of the Federal Reserve System, implements the Truth in Lending Act. The requirements of the regulation are deemed to be requirements of the act. Creditors may rely upon official interpretations of the Federal Reserve Board and official interpretations of the staff of the Federal Reserve Board to avoid civil and criminal penalties under the act, but they may not rely upon unofficial staff interpretations to avoid civil and criminal penalties. Only forms developed subsequent to the Truth in Lending Simplification and Reform Act may be relied upon to avoid civil and criminal penalties. See § 152.04 *infra*.

The Truth in Lending Act is implemented by regulations promulgated by the Board of Governors of the Federal Reserve System; the act is enforced by several federal regulatory agencies including the Federal Trade Commission as well as the federal bank regulatory agencies. The agencies enforce the act and its implementing regulation (Regulation Z) against the creditors subject to each agency's usual jurisdiction; the agencies employ their usual cease and desist procedures. Restitution procedures against creditors committing disclosure violations were codified

by the Truth in Lending Simplification and Reform Act. See § 152.05 *infra*.

Creditors are subject to civil penalties for Truth in Lending Act disclosure violations. The damages imposed may equal the actual damages sustained by a consumer plus costs and reasonable attorneys' fees incurred in a court action. An individual consumer can also recover twice the finance charge; this penalty cannot, however, be greater than \$1000 or less than \$100. In a class action, damages may not exceed the lesser of \$500,000 or 1 percent of a creditor's net worth. Creditors have several defenses in civil actions including good faith conformity with requirements of Regulation Z or official interpretations, inadvertent error, and corrective measures already undertaken. A one-year statute of limitations also provides some protection to creditors. See § 152.06 *infra*.

The Truth in Lending Act takes precedence over inconsistent state laws. State disclosure laws are altered, annulled, or affected by the Truth in Lending Act only to the extent that the state laws are inconsistent with the Truth in Lending Act. States may give consumers greater rights than the Truth in Lending Act gives to them, and may apply to the Board of Governors of the Federal Reserve System for an exemption in cases in which the state requirements are substantially similar to federal disclosure requirements. See § 152.07 *infra*.

For purposes of these disclosure rules, the Truth in Lending Act or Regulation Z assign specific meanings to terms and amounts commonly used in consumer lending transactions, including the annual percentage rate, which is defined as the cost of credit expressed as a percentage rate, and calculated in a prescribed manner, and the finance charge, which is defined as the cost of consumer credit expressed as a dollar amount and including all charges incident to the extension of credit. See § 152.08 *infra*.

§ 152.02 Purposes of Act

Truth in Lending Act was enacted to provide consumers meaningful information about their credit transactions; act requires uniform disclosure of credit terms, including annual percentage rate, imposes restrictions on credit advertising, provides right of rescission where personal residence used as collateral, prohibits mailing of unsolicited credit cards, and establishes procedures for handling billing disputes

The Consumer Credit Protection Act (CCPA) was passed on May 22, 1967.¹ The passage of the act culminated almost a decade of intense interest in the consumer lending practices of creditors.² This interest was spurred in no small part by the dramatic expansion of consumer credit.³

The CCPA originally contained five titles.⁴ Title I, entitled

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¹ Act of May 29, 1968, Pub. L. 90-321, 82 Stat. 146, 15 U.S.C. § 1601 *et seq.* Dates of consideration and passage were: Senate—July 11, 1967, May 22, 1968; House—Feb. 1, 1968, May 22, 1968. See [1968] U.S. Code Cong. & Ad. News 1963 *et seq.*

² Senator Paul Douglas first introduced a consumer credit protection bill in 1960. Hearings on S. 2755 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency, 86th Cong., 2d Sess. (1960). He subsequently introduced similar legislation in succeeding years. Hearings on S. 1740 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency, 87th Cong., 1st and 2d Sess. (1961-62); Hearings on S. 750 before the Subcomm. on Production and Stabilization of the Senate Comm. Banking and Currency, 88th Cong., 2d Sess. (1964).

³ See Conf. Rep. No. 1397, 90th Cong., 2d Sess., *reprinted in* [1968] U.S. Code Cong. & Ad. News 2021, 2024 and H.R. Rep. No. 1040, 90th Cong., 2d Sess., *reprinted in* [1968] U.S. Code Cong. & Ad. News 1962, 1963.

⁴ Four additional titles were subsequently added to the CCPA. Title VI, added in 1970, is officially cited as the Fair Credit Reporting Act. The act regulates the purposes for which requests for medical, credit, and insurance information about a consumer may be obtained, and restricts the dissemination of this information. See § 153.01 *et seq. infra*. Title VII, added in 1974, is officially cited as the Equal Credit Opportunity Act. The act prohibits discrimination in credit transactions based upon race, color, religion, national creed, sex, marital status, age, receipt of public assistance, or exercise of rights under the CCAP.

Consumer Credit Cost Disclosure, is officially referred to as the Truth in Lending Act.⁵ Title II is directed at the activities of organized crime, and makes extortionate extensions of credit a federal offense.⁶ Title III restricts garnishments. Title IV established the National Commission on Consumer Finance, whose existence has now expired. Title V specified the effective dates of the preceding titles.⁷

Title I, the Truth in Lending Act (TIL Act), and its implementing regulation, Regulation Z,⁸ generated more controversy and analysis than the other titles of the CCPA.⁹ President Lyndon B. Johnson, in his message on American Consumer Protection,¹⁰ summarized the concerns that motivated Congress to pass the TIL Act.

“We can make an important advance by incorporating the wisdom of past discussions on how the costs of credit can best be expressed. As a result of these discussions, I recommend legislation to assure—

“Full and accurate information to the borrower; and simple and routine calculations for the lender.

“This legislation is urgently needed to—

See § 154.01 *et seq. infra*. Title VIII, added in 1977, is officially cited as the Fair Debt Collection Practices Act. The act prohibits specified activities of debt collectors and restricts other activities. See § 155.01 *et seq. infra*. Title IX, added in 1978, is officially cited as the Electronic Funds Transfer Act. The act prescribes procedures that must be followed in connection with specified transactions that are initiated electronically. See § 164.01 *et seq. infra*.

⁵ Act of May 29, 1968, Pub. L. 90-321, Title I, § 101, 82 Stat. 146, 15 U.S.C. § 1601 *et seq.*

⁶ Conf. Rep. No. 1397, 90th Cong., 2d Sess., *reprinted in* [1968] U.S. Code Cong. & Ad. News, 2021, 2024.

⁷ H. R. Rep. No. 1040, 90th Cong., 2d Sess., *reprinted in* [1968] U.S. Code Cong. & Ad. News, 1962, 1963.

⁸ 12 C.F.R. § 226.1 *et seq.*

⁹ See N. 3 *supra*.

¹⁰ Message from the President of the United States transmitting recommendations for consumer protection in the field of credit investments, health, meat inspection, hazards in the home, electric power availability, and natural gas pipeline safety. H. R. Doc. No. 57, 90th Cong., 1st Sess. 3 (1967).

“Close an important gap in consumer information.

“Protect legitimate lenders against competitors who misrepresent credit costs.

“The Truth-in-Lending Act of 1967 would strengthen the efficiency of our credit markets, without restraining them. It would allow the cost of credit to be fully determined by informed borrowers and responsible lenders. It would permit the volume of consumer credit to be fully responsive to the growing needs, ability to pay, and aspirations of the American consumer.”¹¹

The TIL Act became fully effective on July 1, 1969. It was subsequently amended in October, 1970,¹² and in October, 1974.¹³ The latter amendments were generally of a technical nature.¹⁴ The TIL Act was further amended by the Consumer Leasing Act of 1976¹⁵ and was substantially revised in 1980 by the Truth in Lending Simplification and Reform Act.¹⁶

¹¹ *Ibid.*

¹² Act of Oct. 26, 1970, Pub. L. 91-508, Title VI, 84 Stat. 1127, 15 U.S.C. § 1681 *et seq.*

¹³ Act of Oct. 28, 1974, Pub. L. 93-495, 88 Stat. 1500. See [1974] U.S. Code Cong. & Ad. News 6119.

¹⁴ Conf. Rep. No. 93-1429, 93rd Cong., 2d Sess., *reprinted in* [1974] U.S. Code Cong. & Ad. News 6148, 6152. These 1974 amendments also included substantive provisions that added Chap. 4 to the TIL Act, officially cited as the Fair Credit Billing Act.

For an analysis of the technical amendments, see “Consumer Protection: Amendments to Truth-in-Lending Act,” 28 Okla. L. Rev. 567 (1975).

¹⁵ Act of Mar. 23, 1976, Pub. L. 94-240, 90 Stat. 257 added Chap. 5 to the TIL Act, 15 U.S.C. § 1667 *et seq.*

¹⁶ The Truth in Lending Simplification and Reform Act is part of an extensive piece of legislation, Pub. L. 96-221, enacted on Mar. 31, 1980, popularly known as the Depository Institutions Deregulation and Monetary Control Act of 1980. The legislation covers such diverse subjects as the preemption of state usury laws, deregulation of interest on deposits, and amendments to the National Banking Act.

The effective date for the amendments to the TIL Act is 24 months from March 31, 1980. However, creditors have the option of complying with the amendments any time after the Board of Governors of the Federal Reserve System issues implementing regulations. For purposes of discussing the TIL Act, reference to the last date (March 31, 1982) on which creditors must comply with the amended act will be used. For an analysis of the need to reform the TIL

The stated purpose of the TIL Act is to provide consumers with meaningful information about credit transactions in which they may become involved. The act provides, in pertinent part:

“The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this title 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. . . .”¹⁷

Prior to the TIL Act, the cost of credit was conveyed to consumers in a variety of ways. One creditor might state the rate of interest on an installment loan in “add-on” terms, while another creditor would quote the rate of interest on these loans in “discount” terms.¹⁸ The consumer was left the task of determining which rate of interest represented the more attractive cost of credit.

Congress determined that the varying costs and terms of credit could be effectively compared and analyzed by consumers only if creditors provided uniform disclosure of specified information. It is the purpose of the TIL Act to create a uniform format within which credit transactions are explained to consumers. This disclosure format was designed to “strip away the disguises which frequently hide or distort the true price of credit.”¹⁹

The centerpiece of the disclosure format is the annual percentage rate, which is a concept designed to accurately reflect the true rate of interest imposed for credit extended. In addition, all

Act, see Landers and Rohner, “A Functional Analysis of Truth in Lending,” 26 U.C.L.A. L. Rev. 71 (1979).

¹⁷ Consumer Credit Protection Act of 1968, Pub. L. 90-321, § 102(a), 82 Stat. 146, 15 U.S.C. § 1601(a).

¹⁸ Hearings on S. 750 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency, 88th Cong., 1st Sess., Part 1, at 2 (1963). Despite statements in Congressional hearings that creditors’ varying practices were efforts to disguise the true cost of credit, these practices may have arisen, at least in part, as a result of the varying requirements of state laws. See Curan, *Trends in Consumer Credit Legislation* 2, 6, 9, and 15-45 (1965).

¹⁹ Hearings on S. 750 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency, 88th Cong., 1st Sess., Part 1, at 3 (1963).

(Pub.052)