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Banking in the Consumer Protection Age: Part III

Parts I and II of this series reviewed the development of consumer protection legislation in the United States, with particular reference to the Truth in Lending Act and the range of criminal and civil sanctions that may be imposed for failure to comply with it. Among the subjects discussed in this final part are the following: (1) elements of an internal Truth in Lending compliance program for banks; (2) principal features of the Fair Credit Reporting Act; (3) important recent and pending legislation involving bank credit cards; and (4) the work of the National Commission on Consumer Finance.

An important protective clause of the Truth in Lending Act provides that a creditor may not be held liable for civil penalties "in any action" if it can clearly show that its violation was not intentional and resulted from a bona fide error even though it maintained procedures designed to avoid any such error.[1] Obviously, the same evidence would preclude any possibility of criminal prosecution. Banks can take advantage of this protective clause by following a number of comparatively inexpensive steps, thereby placing themselves in a favorable position when disputes with consumers or regulatory authorities arise because of errors in disclosure statements.

Elements of a Truth in Lending Compliance Program An effective program begins with designation of a particular officer to be responsible for establishing and maintaining compliance procedures on a regular basis within the organization. The first task of this officer is to equip himself with a file of essential published materials. At minimum, this should include a copy of the Truth in Lending Act and a copy of Regulation Z of the Board of Governors, including amendments and formal interpretations by the Board relating to it. Copies of these materials may be obtained free of charge from any Federal Reserve Bank or from the Publications Section, Board of Governors of the Federal Reserve System, Washington, D. C. 20551. Although the coverage of these materials is comprehensive, supplemental information applicable to particular lending or credit sales transactions will be useful in many situations. The most helpful supplemental source is the large number of informal opinions that have been written by members of the Board of Governors and its staff. Well over 500 opinion letters had been written through December 1971, all in response to inquiries from creditors or the public presenting basic compliance issues in the context of stated factual situations.[2] These informal opinions do not have the same legal status as the formal interpretations of Regulation Z published by the Board of Governors; nevertheless, they do represent the considered judgment of the staff or of individual members of the Board on a subject committed to the Board for administrative decision by Congress. Presumably, therefore, the courts will give weight to these informal opinions in the event of litigation, even though they do not have the same legal status as the Board's official interpretations.

The practical problem a bank or any other creditor faces is how to prove in court that it does in fact maintain procedures designed to prevent unintentional violations from occurring. One important document to help accomplish this is a written compliance policy that has been distributed to all personnel in the organization responsible for the extension of consumer credit. By now, all banks should have forms that meet the disclosure requirements of Truth in Lending. The next logical step for a bank, therefore, is to be able to show that all personnel with responsibilities for completing the forms and transmitting them to customers have been trained to complete them properly. One way to accomplish this is to furnish credit personnel with sample forms properly filled out as they would be in actual or hypothetical transactions, accompanied by written explanations where needed.

As a supplement to direct written instructions to credit personnel, banks should also consider issuing a written directive to their Auditing Departments to make periodic spot checks of compliance. Auditing representatives should examine copies of completed disclosure forms that have been given to customers and make additional investigations as may seem necessary under the circumstances at any particular time. There is yet another advantage to this pro-

[1] 82 Stat. 157 (1968). Section 130(c) of the Act.

[2] One commercial publisher of these opinions is Commerce Clearing House, Inc., 4025 W. Peterson Avenue, Chicago, Illinois 60646, in 4 CCH *Consumer Credit Guide*. Another useful source for many of them, and for many other useful Truth in Lending materials as well, is the *Truth in Lending Manual* by Ralph C. Clontz, Jr., published by Warren, Gorham & Lamont, Inc., 89 Beach Street, Boston, Massachusetts 02111.

cedure. It increases the likelihood that the bank might be able to take advantage of the second creditor defense written into the Truth in Lending Act. Section 130(b) provides that a creditor has no liability for civil penalties if, within 15 days after discovering an error and prior to the institution of a legal action by the consumer or the receipt of written notice of the error from the consumer, the creditor notifies the consumer of the error and makes whatever adjustments are necessary to insure that the consumer will not be required to pay a finance charge in excess of the amount or percentage rate actually disclosed.[3] A program of regular surveillance increases the chances of detecting and correcting errors prior to notification from the consumer. If spot checks suggest that particular lending officers are prone to error in completing disclosure statements, more thorough review of their disclosure statements may be in order. For larger transactions, such as real estate loans, it might be feasible to have a single individual complete all disclosure statements, thus reducing further the chances of error.

The Truth in Lending compliance officer or department can also play a particularly useful role in monitoring the adequacy of disclosure by retail dealers for whom the bank discounts installment paper on a regular basis. Here again, as discussed in Part II, if Truth in Lending violations occur, banks may well be equally as liable for civil penalties as retail dealers themselves. Among the measures that can reasonably be taken by banks to reduce exposure to loss are (1) advance examination and approval of disclosure forms used by dealers; (2) spot checks of disclosure forms completed by dealers for accuracy; (3) insistence that dealers obtain written acknowledgments by consumers that they have received required disclosures; and (4) insistence that dealers forward copies of disclosure statements and acknowledgment of receipt of disclosures by consumers to the bank along with installment contracts that are assigned. While the last step will be of no help if the disclosures have not in fact been received *and* if the credit transactions involve security interests in real property, such acknowledgments are conclusive evidence of compliance by assignee banks in all other situations, *provided* the violations are not apparent on the face of the disclosure statements and the assignee did not know of the violation when the assignment was made.

For insured banks, good faith compliance with the Truth in Lending Act and Regulation Z is essential not only because of the threat of legal proceedings for money damages by consumers but also because examiners are likely to become increasingly alert to the requirements of Truth in Lending and other new consumer protection laws. Already, examiners of the Federal supervisory agencies carry checklists of important Truth in Lending points to aid in their examinations of insured banks.

An excellent recent article by Mr. Griffith L. Garwood, Chief of the Truth in Lending staff of the Board of Governors of the Federal Reserve System, reviews developments with the Truth in Lending Act since 1968. It is published in *The Banking Law Journal,* 89, No. 1 (January 1972).

The Fair Credit Reporting Act With the growth of consumer credit, a necessary satellite industry dedicated to the accumulation and sale of information relating to individuals and their credit standing came into being. This industry is composed, for the most part, of credit bureaus, investigative reporting companies and other organizations whose business it is to gather and report information about consumers. Among the principal users of consumer reports are banks, retail merchants, lenders, insurance companies, and other companies who regularly decide whether individuals who are the subjects of these reports are to receive credit, be granted insurance, or be employed—and, if so, upon what terms.

Erroneous information in a person's file can cause serious injury if it leads or contributes to the denial of credit, insurance, or employment. Prior to enactment of the Fair Credit Reporting Act on October 26, 1970,[4] many people were apparently damaged by inaccurate information, yet there was little they could do about it.[5] Only one state had legislation designed to protect consumers against false and inaccurate reports affecting their financial standing, eligibility for insurance, or employment opportunities. Furthermore, common law rights of consumers have been almost completely ineffective.[6] The individuals themselves had no way of knowing what information was contained in credit files maintained on them. The typical credit investigation required only 30 minutes, and much of the information obtained was not verified. Frequently, victims of erroneous and harmful information were not even aware that a credit report had been used against

[3] 82 Stat. 157 (1968).

[4] Public Law 91-508, 84 Stat. 1127 (1970). The Fair Credit Reporting Act was added as Title VI of the Consumer Credit Protection Act of 1968.

[5] Hearings before the Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess., on S. 823 (1969), especially pp. 427-30.

[6] *Ibid.*, pp. 437-42; *see also*, "Credit Investigations and the Right to Privacy: Quest for a Remedy," *Georgetown Law Journal* (February 1969).

them. In addition, because many people have the same or similar names (John Smith, for example), adverse information about a particular Smith mistakenly found its way into the files of other, innocent Smiths. As data became automated, and as the files of different credit bureaus were interconnected by telecommunication techniques using direct access remote terminals, errors in the process of coding, keypunching, programming, or transmission became more likely, entirely apart from the problem of multiple John Smiths. Cases of abuse or misuse of consumer credit information also came to light in the course of Congressional hearings.[7]

The Fair Credit Reporting Act was designed to provide remedies for consumers adversely affected by false or inaccurate consumer reports and to limit the uses of such reports to legitimate business purposes. However, the statute is complex, and its effect in any particular factual situation depends upon three key definitions: (1) of "consumer report"; (2) of "investigative consumer report"; and (3) of "consumer reporting agency."[8]

A bank may well become a "consumer reporting agency" unless it is scrupulously careful in limiting the types of information about consumers it communicates to third parties. But even where this classification is avoided, every bank is a regular *user* of information about consumers obtained from third parties; and the statute imposes a number of duties upon users, regardless of whether the information comes from a consumer reporting agency or from other third parties who do not fall within this classification.

Every user must inform the consumer orally or in writing if information received in a consumer report from a consumer reporting agency causes the user to deny, or increase the cost of, credit or insurance or to deny employment. The user must also inform the consumer of the name and address of the consumer reporting agency issuing the report. The user is *not* required, however, to tell the consumer the nature of the information in the report.

In turn, every consumer reporting agency must, upon request and proper identification by any consumer, clearly and accurately disclose the nature and substance of all information (except medical information) in its files on the consumer at the time of its request. In addition, the agency must reveal the sources of any information unless it is to be used in an "investigative consumer report."[9] The agency must also disclose the names of recipients of any report on the consumer that it has furnished for employment purposes within the two-year period preceding the request, and for any other purposes within the six-month period preceding the request.

A different rule applies to information obtained by a creditor, insurance company, or employer from a source other than a consumer reporting agency. No disclosures of any kind need be made to the consumer in this situation unless credit is involved. If credit is denied, however, or if its cost is increased either wholly or partly because of information bearing upon the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, then the user of the information must disclose its nature to the consumer if, within 60 days after learning of the adverse action, the consumer asks in writing to know the reasons for it. The statute specifically requires the user clearly and accurately to disclose to the consumer his right to make a written request at the time the adverse action is communicated to him.

A bank or other financial institution may become a "consumer reporting agency" if it regularly passes on information in its files about consumers, other than information solely confined to its own transactions or experiences with the consumer.[10] The bank or financial institution may, however, relate information based solely upon its own transactions or experiences with the consumer without becoming a

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[7] *Supra*, note 5, pp. 42-430.

[8] "(d) The term 'consumer report' means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for (1) credit or insurance to be used primarily for personal, family, or household purposes, or (2) employment purposes, or (3) other purposes authorized under section 604. The term does not include (A) any report containing information solely as to transactions or experiences between the consumer and the person making the report; (B) any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device; or (C) any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer conveys his decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made and such person makes the disclosures to the consumer required under section 615.

(e) The term 'investigative consumer report' means a consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information. However, such information shall not include specific factual information on a consumer's credit record obtained directly from a creditor or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.

(f) The term 'consumer reporting agency' means any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part 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, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports." Public Law 91-508, Section 603 (d), (e), and (f) (October 26, 1970); 84 Stat. 1128 (1970).

[9] The sources of information acquired solely for use in an "investigative consumer report" and used for no other purpose need *not* be disclosed except in the event of litigation.

[10] See note 8, *supra*, for definition of "consumer reporting agency."

consumer reporting agency, even if it regularly furnishes such information to a consumer reporting agency.

If a bank or other financial institution becomes a consumer reporting agency, it must comply with a number of duties to the consumer. First, information about consumers may not be disclosed to anyone except as authorized by Section 604 of the Act.[11] Second, certain types of obsolete information may not be furnished to anyone except in connection with a credit transaction expected to involve $50,000 or more in principal, or the underwriting of insurance expected to involve a face amount of $50,000 or more, or employment at an annual salary of $20,000 or more. Third, reasonable procedures must be maintained to assure maximum possible accuracy of all information in every consumer report, and certification must be obtained from all users that the information disclosed will only be used for authorized purposes. Fourth, a consumer reporting agency may not furnish a consumer report to any person if it has reasonable grounds to believe that the report will not be used for an authorized purpose. Finally, the identity of all new users must be verified by the agency.

Banks and other financial institutions that wish to avoid becoming consumer reporting agencies must be particularly cautious in discounting installment paper for retail dealers. When a dealer calls the bank or other institution *before* credit is extended to inquire whether the contract will be purchased or credit will be extended to the consumer directly, and the bank or institution denies the credit or increases the cost even partially because of information obtained from outside sources, then the dealer and the bank or other financial institution must *each* make certain disclosures to the consumer if the bank or other institution is not to become a consumer reporting agency. First, the dealer must advise the consumer of the name and address of the bank.[12] The bank must then follow the normal procedure a user of information follows. If the bank's decision is based on information in a consumer report, the bank must give the consumer the name and address of the agency. If the information comes from a third party, other than a consumer reporting agency, the bank must disclose to the consumer his right to make a written request within 60 days for the nature of the information. If, however, the bank's decision was based on its own prior experience with the consumer or its own internal credit policies, then it need not make any disclosures at all.

Special rules apply to a bank or other financial institution that uses or prepares an "investigative consumer report." As a user, if a bank requests such a report from a consumer reporting agency, the bank must mail or deliver written notice to the consumer within three days that an investigative consumer report may be made and that it may include information regarding the character, general reputation, personal characteristics, and mode of living of the consumer. The consumer must also be informed that he may make a written request for disclosure of the "nature and scope" of the investigation. If the consumer then requests this information within a reasonable time thereafter, the bank must within five days furnish the consumer with a complete and accurate written description of the "nature and scope" of the investigation.

If a bank or other financial institution denies or increases the cost of credit or insurance or denies employment based upon information in an investigative consumer report, it must make the same disclosures a user must make if it takes such action on the basis of an ordinary consumer report. No disclosures at all need be made, however, if an investigative consumer report is to be used for employment purposes and the consumer has *not* specifically applied for the position, or if the bank or other institution conducts the investigation for its own purposes, using its own employees.

These and many other important questions relating to the Fair Credit Reporting Act are discussed in two documents, both of which should be in the file of every bank or affiliated institution engaged in extending consumer credit. The first is a pamphlet containing the text of the Act and 61 specific questions and answers, entitled "Guidelines for Financial Institutions in Complying with the Fair Credit Reporting Act." The pamphlet was prepared jointly by

[11] Section 604 provides: "A consumer reporting agency may furnish a consumer report under the following circumstances and no other:
(1) In response to the order of a court having jurisdiction to issue such an order.
(2) In accordance with the written instructions of the consumer to whom it relates.
(3) To a person which it has reason to believe—
(A) intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer; or
(B) intends to use the information for employment purposes; or
(C) intends to use the information in connection with the underwriting of insurance involving the consumer; or
(D) intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status; or
(E) otherwise has a legitimate business need for the information in connection with a business transaction involving the consumer."

[12] 4 CCH *Consumer Credit Guide*, ¶99,486; Section 603(d)(3)(C) of the Fair Credit Reporting Act.

the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. Copies may be obtained free of charge from any of the foregoing organizations or from any Federal Reserve Bank. The second useful document, entitled "Compliance with the Fair Credit Reporting Act," may be obtained free of charge from the Bureau of Consumer Protection, Federal Trade Commission, Washington, D. C. 20580. Both publications represent the informed views of the staffs of the agencies publishing them, but are *not* substantive rules having the force and effect of law. As a matter of fact, none of the agencies charged with enforcement of the Act has the authority to issue substantive rules, as does the Board of Governors with respect to Truth in Lending.[12a]

Consumers may bring legal actions for money damanges against users of information and consumer reporting agencies who fail to comply with the Act, if they can prove that the agency or user was either *willful* or *negligent* in its noncompliance. This stands in sharp contrast to Truth in Lending where, as shown in Part II published last month, monetary penalties may be assessed for inadvertant violations. Moreover, no user or consumer reporting agency may be held liable for any violation of the provisions of the Fair Credit Reporting Act pertaining to investigative consumer reports if it can prove that at the time of the alleged violation it maintained "reasonable procedures" to assure compliance.[13]

Once again, then, the new consumer protection laws favor companies that take positive steps to comply. For users of consumer information who are not "consumer reporting agencies," this involves the following procedures, at minimum.

(1) Instruct credit personnel in writing that consumer reports may only be obtained for permissible purposes, and list these purposes.

(2) Establish procedures to insure that proper disclosures are made to consumers when credit is denied or the charge is increased based on information in a consumer report or received from third parties. Even though the Act does not require it, it is good practice to develop forms for making the required disclosures and to retain copies showing that the disclosures were made.

(3) Maintain records, even if only in the form of handwritten notations, of information received from others so that such information will be available in the event the consumer asks for it.

Banks and other financial institutions face much more formidable compliance problems if they become consumer reporting agencies. The document prepared by the FTC entitled "Compliance with the Fair Credit Reporting Act," mentioned above, is one essential source of information on this subject. Another useful one, entitled "How to Comply with the Fair Credit Reporting Act," has been prepared by Associated Credit Bureaus, Inc. Copies may be obtained free of charge by sending a stamped, self-address envelope to Associated Credit Bureaus, Inc., 6767 Southwest Freeway, Houston, Texas 77036.

Credit Cards and the Proposed Fair Credit Billing Act No survey of current consumer protection laws affecting banks would be complete without brief reference to recent and pending legislation relating to credit cards. Approximately 25 million bank cards are now in use, involving about 375 million purchases and over seven million loans annually. Outstanding charges based on bank credit cards at the end of 1971 approached $4 billion, a dramatic increase from the level of $633 million reported by the Federal Reserve System as recently as September 1967. Even though credit extended on the basis of bank cards accounts for something less than 10 percent of total consumer credit extended by banks at the present time, nearly 200 million statements were sent to consumers in connection with bank credit card programs in 1971.

Most credit card plans permit the cardholder to obtain a direct cash advance, up to a certain stated amount, from a participating bank, or to use the card as a substitute for currency or a check to pay for merchandise or services purchased from participating retailers. Where cash is advanced directly by a bank, an initial transaction charge of approximately 2 to 4 percent of the amount of the advance may be assessed, depending upon the particular credit card plan. In addition, finance charges may begin to accrue from the date the funds are initially made available to the cardholder, or at some later date. Where merchandise or services are purchased, the cardholder is ordinarily allowed a "free ride" period averaging about 45 days from the date of the purchase before finance charges begin to accrue. No charge is assessed if payment is received before the

[12a] Nevertheless, the courts are likely to give great weight to established administrative practices of the agencies responsible for enforcing compliance. *F.T.C.* v. *Mandel Brothers, Inc.*, 359 U.S. 385 (1959). Although, as discussed in Part I, FTC does not appear to have jurisdiction over banks themselves, it may have over bank holding companies and other affiliates of banks.

[13] Section 615(c), 84 Stat. 1133 (1970).

end of the "free ride". Finance charges (exclusive of transaction and minimum charges) on both cash advances and retail purchases range from around 10 to about 18 percent per year, depending upon the particular plan.

Acceptance and use of a bank credit card is regulated by a complex network of contractual arrangements among banks and individual cardholders, on the one hand, and among banks and retail merchants, on the other. Under their agreements with merchants, banks take all of the credit risks associated with sales of merchandise or services by retailers honoring bank cards. Retailers accepting the cards for purchases discount the sales drafts with a participating bank, usually receiving immediate credit in their account for somewhere between 92 and 100 percent of the face amounts of the drafts depending upon the particular agreement between retailer and bank in individual cases. The average discount for credit card sales handled by mechants is said to be about 3 percent of the face amount of the sales drafts, or 54 cents on the average sale. Currently, income to banks from bank credit card programs, based upon finance and other charges paid by cardholders, is said to account for about 77 percent of total revenues of such banks from their credit card programs, while the remaining 23 percent results from merchant discounts in connection with sales transactions involving credit cards.[14]

A key feature of the cardholder's agreement with the issuing bank (a feature, by the way, that may be changed by pending legislation and by a proposed regulation of the Federal Trade Commission, as discussed below) is the cardholder's undertaking to look to the merchant from whom the goods or services were purchased for warranties of performance and not to the bank to whom payment is to be made.[15] Three states, Massachusetts, California, and New Jersey, have recently enacted legislation making such banks responsible for claims by consumers against merchants arising out of credit card sales.

In the neighborhood of 30 percent of the 382 million annual purchase and loan transactions by means of credit cards involve more than one bank, and many of these may be subject to the law of more than one state. Some 1,450 banks are now issuing bank credit cards, in cooperation with about 8,000 "agent" banks, approximately 4,200 of which are in the Master Charge system and about 3,600 of which are associated with the BankAmericard group. The functions and powers of agent banks vary according to the terms of their individual agreements with card-issuing banks, subject, however, to controlling interchange regulations governing the exchange of debits and credits among all the participating banks. These interchange rules are administered by the Interbank Card Association, in the case of Master Charge cards, and by National BankAmericard, Inc., in the case of BankAmericards. Interchange regulations are essential to bank credit operations for two reasons. First, a substantial (and increasing) use of the cards is in connection with interstate transactions, where the issuing or agent bank is in one state and the bank extending credit or the merchant selling to the cardholder is in a different state. Second, such regulations are needed for intrastate transactions if more than one bank is involved.

Prior to October 26, 1970, the legal status of individuals holding credit cards depended almost entirely upon their contractual agreements with participating banks under the laws of the 50 states, except for disclosure requirements imposed by the Truth in Lending Act. On that date, Title V of the Consumer Credit Protection Act became law.[16] This statute prohibits issuance of a credit card except in response to a request or application, although the prohibition does not apply to issuance of a card in renewal of, or in substitution for, an accepted card. It also limits the liability of a cardholder for unauthorized use of his card to a maximum of $50. Even this liability does not exist unless the card issuer has given adequate notice to the cardholder of his potential liability for unauthorized use and unless two additional conditions are met. These are: (1) that the card issuer has provided the cardholder with a self-addressed, prestamped notification to be mailed by the cardholder in the event of loss or theft of the card; and (2) that the unauthorized use occurs before the cardholder has notified the issuer that an unauthorized use may occur as the result of loss or theft. Furthermore, after January 25, 1972, no liability for unauthorized use exists with respect to any credit card unless the card issuer has provided

[14] For a comprehensive review of current financial aspects of bank credit cards, see Andrew F. Brimmer, "Growth and Profitability of Credit Card Banking," paper presented at the 1971 National Credit Card Conference of the American Bankers Association (October 27, 1971).

[15] Interestingly, when the FTC issued its Trade Regulation Rule proscribing the issuance of unsolicited credit cards in March of 1970, it took the position that "the activity of issuing credit cards by banks appears to fall within the jurisdiction of the Commission." This seems exceedingly doubtful in view of the specific language of Section 5 of the FTC Act excluding banks from the Commission's jurisdiction. It is understood that most bank credit card plans are operated by banks directly, and not through nonbanking subsidiaries or affiliated corporations.

[16] Public Law 91-508, 84 Stat. 1126 (1970).

a method whereby the user of the card can be identified as the person authorized to use it.[17]

As pointed out in a letter from the three Federal bank supervisory agencies to all insured banks in the autumn of 1971, many card issuers have continued to issue cards with statements imprinted on the reverse side such as the following:

> In case the credit card is lost or stolen, the customer shall be responsible for any extensions of credit to anyone through use of the card until the card issuer receives written notice of its loss or theft.

The letter advised banks that continued issuance of cards with statements such as the above would not appear to be justified under present law.

Except for the above provisions of Federal law, and except for more general Federal authority under antitrust and trade regulation laws, state laws now control the legal relationships among cardholders, banks, and merchants. This situation is said to be unsatisfactory to both the credit card industry and to consumer groups, but for different reasons.

The principal objections of the credit card industry to the present state of the law center around the lack of uniformity of state laws and the high proportion of credit card transactions involving two or more states.[18] Serious conflict-of-law problems may arise when disputes occur in multi-state transactions, and this situation is aggravated by the tendency of states to enact different types of consumer protection laws or to enact similar types but with significantly different provisions. Vexing questions arise regarding which state laws should apply, and such controversies may well wind up in the courts. The credit card industry is said to believe that as credit cards evolve from the present concept of a currency substitute with a credit feature into an identity card by means of which the holder can gain access to a wide range of financial services on a nationwide scale, more uniform legal rules throughout the United States will become increasingly necessary.

Consumer groups advocate greater Federal regulation of credit card practices on the ground that many historic provisions of state law are unfair to consumers. Under particularly heavy attack are the so-called "holder-in-due-course" doctrine and the "waiver of defense" clause, both of which have the legal effect of preventing cardholders from refusing to pay issuing or agent banks when merchandise or services, purchased by means of the cards, turn out to be defective. Pending in Congress is S. 652, the "Fair Credit Billing Act," sponsored by Senators Proxmire and Brooke, which, among other things, contains the following provision:

> **§169 Rights of Credit Customers**
> A card issuer who has issued a credit card to a cardholder shall be subject to all claims and defenses arising out of any transaction in which the credit card is used as a method of payment or extension of credit.

Presumably, this section is designed to increase the consumer's leverage by permitting him to withhold payment from the bank in the event of disputes with merchants regarding products or services purchased. Conceivably, however, the broad language might be construed to render card issuers subject to liability for tort claims arising out of use of the merchandise. Moreover, in many situations, particularly involving interstate transactions or small purchases, a credit card is not used to obtain credit in the traditional sense, but instead is merely a convenient substitute for cash or a check. Probably no finance charges are imposed in the vast majority of interstate sales or sales involving small purchases because the cardholders pay before expiration of the "free ride" period. It seems questionable, therefore, whether there is any rational basis for using a statute purportedly dealing with the regulation of consumer credit as a means of eliminating state-created legal rights where the transactions have only a distant relationship, at best, to the extension of consumer credit. This section of the proposed Act is under heavy fire from creditors, many of whom argue that it would force them out of business.[19]

Other significant provisions of the proposed "Fair Credit Billing Act" are summarized in the footnote below.[20] An informative and extensive review of

[17] The statute places the burden of proof upon the card issuer to show that the use was authorized or, if the use was unauthorized, to show that the conditions of liability set forth above have been met. In a separate provision, the statute declares that any person who, in a transaction affecting interstate or foreign commerce, uses any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain goods or services, or both, having a retail value aggregating $5,000 or more, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

[18] *The American Banker* (October 27, 1971).

[19] *The American Banker* (October 28, 1971). Apart from S. 652, and the new state statutes in Massachusetts, California, and New Jersey referred to earlier, the Federal Trade Commission has proposed a "Trade Regulation Rule," which would require a merchant's "promissory note or other instrument of indebtedness" in a credit sale to provide that any holder in due course who takes the instrument takes it subject to all claims and defenses of the merchant's customer arising out of the sale. 16 *C.F.R.* §433, 36 *Fed. Reg.* 1211 (1971).

[20] The proposed bill would also: (1) amend §127(b)(2) of the Truth in Lending Act by adding a requirement that the card issuer identify on the periodic statement the "vendors and/or creditors involved"; (2) amend §127(b) to require that periodic statements contain an address or telephone number for use by the cardholder in making inquiries about his billing statement; (3) require the card issuer to acknowledge complaints about billing statement errors within 10 days and correct the account within 30 days, or send the cardholder an explanation with documentary evidence of the accuracy of the account; (4) prohibit open-end creditors offering a "free ride" period from imposing a finance charge unless the billing statement was mailed at least 21 days prior to the date payment must be made; (5) require the creditor, in determining the balance upon which the finance charge is computed, to reduce the opening balance in the account at the beginning of the billing cycle by deducting all payments and credits made during the cycle; (6) prohibit open-end creditors from imposing minimum finance charges; (7) prohibit credit card issuers from offsetting a cardholder's indebtedness against funds of the cardholder held on deposit with the card issuer; and (8) assure the consumer of his right to refund of any credit balance in his account.

pending Federal and state regulatory developments affecting the credit card industry may be found in *The Business Lawyer, 27,* No. 1 (November 1971), 93-138.

The National Commission on Consumer Finance

Basic research of great potential significance for the future of the consumer credit industry in the United States is now in progress by the staff of the National Commission on Consumer Finance. Created in 1968 by Title IV of the Consumer Credit Protection Act,[21] the Commission is composed of Senators John J. Sparkman (D.-Ala.), William Proxmire (D.-Wisc.), and William E. Brock (R.-Tenn.); Representatives Henry B. Gonzales (D.-Tex.), Leonor K. Sullivan (D.-Mo.), and Lawrence G. Williams (R.-Pa.); and Dr. Robert W. Johnson, Professor of Industrial Administration, Purdue University, Douglas M. Head, Minneapolis attorney and former Attorney General of Minnesota, and Ira M. Millstein, New York City attorney, who is Chairman. The Commission's principal duty is to ". . . study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit transactions generally." The law requires it to report to Congress on or before July 1, 1972, on ". . . the adequacy of existing arrangements to provide consumer credit at reasonable rates."

In an interview with this writer in Washington, D. C., Mr. Milton W. Schober, General Attorney for the Commission, and Professor Robert P. Shay, Professor of Banking and Finance, Columbia University, and consulting economist to the Commission, described two major data-gathering projects now in progress by the Commission's staff. The first is a massive survey of consumer creditors, entitled "Survey of Consumer Credit Volume, Outstandings, and Rates." Designed by Dr. Shay, the objective of the survey is to determine the amounts of all of the various types of consumer installment credit outstanding in each state and the corresponding finance charges. The initial purpose is to assess the influence of state laws and regulations on the price and availability of consumer installment credit. The survey is based upon questionnaires approved by the Office of Management and Budget, which were sent to 2,325 commercial banks; 490 mutual savings banks; 1,375 finance companies, including the large nationwide sales finance companies as well as approximately 30 large, diversified finance companies operating on a national or regional basis; about 2,000 credit unions; and approximately 1,500 retailers. All 50 states and the District of Columbia were represented in the sample.

Among other things, the questionnaires call for information on the volume of consumer credit extended during the second quarter of 1971 and the amount of such credit outstanding on June 30, 1971. It is understood that the response rate has been well over 90 percent for every class of creditor except credit unions, whose response rate has been somewhat lower. Most of the data was collected by the Bureau of the Census, and all of it was processed and tabulated by that Bureau's data processing facilities and personnel. It is now being analyzed by the Commission's staff.

The second important project is an evaluation of the effectiveness, under the laws of the 50 states, of creditors' legal remedies to enforce payment of consumer debt. One objective of this survey, entitled "Survey of Consumer Collection Practices and Creditors' Remedies," is to find out which legal remedies of creditors are actually used and which ones are not. A questionnaire running to 30 legal-size pages, also approved by the Office of Management and Budget, has been distributed to 1,250 commercial banks, 600 credit unions, 650 finance companies, 380 retail creditors, and 300 collection agencies. Here again, it is understood that the response rate has been high. The data is currently being analyzed by the Commission's staff.

In conjunction with the gathering of data, the Commission held public hearings in Washington, D. C., in June of 1970, on methods used to collect consumer debts. In announcing the hearings, Mr. Robert Braucher, Professor of Law at Harvard and Chairman of the Commission at the time, stated: "We believe there are widespread abuses of creditor remedies which place a particularly harsh burden on unsophisticated or uneducated low-income families. Indications are that these abuses have had severe economic and social consequences on thousands of American families." Subjects explored at the hearings included (1) legal tactics or devices that may be used to circumvent the consumer's ability to contest claims against him, including the holder-in-due-course doctrine, (2) confessions of judgment, (3) wage assignments, (4) postbankruptcy suits, (5) debtors' prisons, and (6) misuse of the small claims court. Additional public hearings were held in June of 1971 to determine the extent

[21] 82 Stat. 164 (1968) as amended 84 Stat. 440 (1970).

of Federal and state enforcement of existing consumer credit protection laws.[22]

The next step planned by the staff is the preparation of an econometric model that will include demographic data of the consumer credit market in each state. The Commission's staff will then attempt to tie together the results of its two surveys. In particular, the staff plans to look closely at "convenience and advantage" laws in many of the states, which have the effect of limiting freedom of entry into the consumer finance industry. The staff plans to evaluate the possible effects of these laws on availability of consumer credit, as well as rates of finance charges for consumer credit.

Another responsibility of the Commission is to study the adequacy of existing Federal and state enforcement mechanisms to prevent violations of consumer credit protection laws. The Commission is itself reviewing enforcement practices of Federal regulatory agencies. In cooperation with the Commission, the National Conference of State Bank Supervisors is undertaking to study the capability of state banking departments to enforce state laws. The Commission's report to Congress may be expected to comment on both Federal and state enforcement laws and practices, and their effectiveness.

Concluding Comments Until 1968, banks and bank holding companies had little reason to be concerned about Federal consumer protection laws. The Federal Trade Commission Act was the principal Federal statute dealing with prevention of unfair and deceptive business practices, but it did not apply to commercial banks (and still does not). Multibank holding companies were severely restricted in the performance of consumer credit functions, and the activities of unregulated one-bank holding companies were only beginning to be of importance.

A combination of events commencing in 1968 drastically changed the entire situation. The Truth in Lending Act was enacted that year, applying equally to commercial banks and their affiliates engaged in extensions of consumer credit and to other, nonbanking enterprises. The rapid expansion of unregulated one-bank holding companies, beginning in the spring of 1968, led to extensive changes in bank holding company regulation in 1970, greatly enlarging the permissible range of activities for all types of bank holding companies both functionally and geographically. Although banks themselves continue to be specifically exempt by statute from the enforcement jurisdiction of the Federal Trade Commission, bank holding companies and their affiliates may not be.

In 1970, the Fair Credit Reporting Act was enacted. Like Truth in Lending, it covered banks, bank holding companies and other bank affiliates, as well as nonbanking organizations, and imposed affirmative disclosure requirements. Credit card usages were also brought under certain Federal restrictions, and more extensive legislation may be enacted. The work of the National Commission on Consumer Finance may lead to greatly expanded Federal legislation in the area of consumer finance.

Banks and bank holding companies that fail to establish and maintain effective internal compliance programs to deal with the broadening requirements of Federal and state consumer protection laws may find that the risks they have assumed far outweigh the effort and expense they have avoided. This will be even more probable if Congress accepts the recommendation of the Board of Governors in its *Annual Report to Congress for the Year 1971* that the Truth in Lending Act be amended to provide for a "good faith" defense such as is contained in the Securities and Exchange Act of 1934—one which would apply not only to the Board's Regulation Z, but also to all interpretations of it by the Board.[23]

William F. Upshaw

[22] At this hearing commercial banks and savings and loan associations were criticized by the Chairman of the Federal Trade Commission, Miles W. Kirkpatrick, for their alleged failure to refuse to discount retail installment paper not in full compliance with the Truth in Lending Act. As discussed in Part II, the Federal supervisory agencies have taken positive action to call to the attention of regulated financial institutions their responsibilities in connection with dealer paper.

[23] The relevant section of the Securities and Exchange Act states: "No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason." 12 *U.S.C.* §77s(a).

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