FEDERAL RESERVE BANK OF NEW YORK

ATCIR No 10098A

October 31, 1986

CREDIT PRACTICES RULE

Application by the State of New York For an Exemption under Regulation AA

Comments Due by November 28, 1986

To All State-Chartered Banking Institutions in the State of New York:

The Board of Governors of the Federal Reserve System has requested public comment on an application by the State of New York for an exemption from Section 226.14 of the Board's Credit Practices Rule, Regulation AA, "Unfair or Deceptive Acts or Practices."

Printed below is the text of the Board's notice in this matter, which has been reprinted from the *Federal Register* of October 24. Comments may be sent to the Board of Governors, as specified in the notice, or to our Compliance Examinations Department by November 28, 1986.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

12 CFR Part 227

[Reg. AA; Docket No. R-0581]

Unfair or Deceptive Acts or Practices; Exemption Application From the State of New York

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of intent to make an exemption determination.

SUMMARY: The Board has received from the state of New York an application for an exemption from § 226.14 of the Board's Credit Practices Rule Regulation AA (Unfair or Deceptive Acts or Practices). The rule prohibits banks from entering into consumer credit obligations that contain certain prohibited provisions, from using a certain late charge practice, and from obligating a cosigner prior to providing a required notice explaining the cosigner's obligations. The Board is publishing notice of the New York application, with an opportunity for public comment, in accordance with § 227.16(b) of Regulation AA. That section provides that the exemption procedures detailed in Appendix B to Regulation Z (Truth in Lending, 12 CFR Part 226) are to be followed in applying for an exemption from the Credit Practices Rule.

DATE: Comments must be received on or before November 28, 1986.

ADDRESSES: Comments should be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, or delivered to the 20th Street courtyard entrance, 20th Street, between C Street and Constitution Avenue NW, Washington, DC between 8:45 a.m. and 5:15 p.m. weekdays. Comments should include a reference to Docket No. R-0581. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays.

FOR FURTHER INFORMATION CONTACT: Adrienne D. Hurt or Heather L. Hansche, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551 (202) 452-3867, or Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (TDD) at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

(1) Background

In April 1985 the Board adopted its Credit Practices Rule, 12 CFR 227 (50 FR 16695), thereby amending its Regulation AA (Unfair or Deceptive Acts or Practices). The Board's rule, which became effective on January 1, 1986, followed the adoption by the Federal Trade Commission (FTC) of its Credit Practices Rule in March 1984 (49 FR

7740), effective March 1, 1985.[1] The Board's rule applies to all banks and their subsidiaries. Staff guidelines (in question and answer format) designed to aid banks in complying with the Credit Practices Rule were issued in November 1985.

The Credit Practices Rule prohibits banks from entering into any consumer credit obligation that contains a confession of judgment clause, a waiver of exemption, an assignment of wages, or a nonpossessory, nonpurchase money security interest in certain types of household goods. The rule prohibits the enforcement of these provisions in a consumer credit obligation purchased by a bank.

The rule also prohibits a practice known as "pyramiding" of late charges. Under the late charges provision, a bank is prevented from assessing multiple late charges based on a single delinquent payment that is subsequently paid. In addition, the rule prohibits a bank from misrepresenting a cosigner's liability and requires the bank to give a cosigner, prior to becoming obligated in a consumer credit transaction, a disclosure notice which explains the nature of the cosigner's obligations and liabilities under the contract.

Administrative enforcement of the rule for banks may involve actions under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), including the issuance of cease and desist orders and the imposition of penalties of up to $1,000 per day for violation of an order.

(2) New York's Exemption Application

The state of New York, through its Superintendent of Banks, has applied to the Board for an exemption from § 227.14 of the Board's Credit Practices Rule.[2] The application contains copies of certain provisions under New York's General Obligations Law (G.O.L.) and General Business Law and a comparison of the provisions of the Board's Credit Practices Rule and the New York statutory provisions. The application also contains information about the enforcement activities of the state's Banking Department.[3]

The Board's rule (§ 227.16) states that, in applying for an exemption from its Credit Practices Rule, the procedures to be followed are the same as those detailed in Appendix B to Regulation Z (Truth in Lending, 12 CFR Part 226) for applying for an exemption from that regulation. In accordance with those procedures, the Board is publishing for comment notice of this application for an exemption determination on the New York application. The notice summarizes the New York exemption application, and includes a comparison of the relevant provisions of New York law and the Board's Credit Practices Rule. In order to expedite final action on the New York exemption request, the notice is being published for a 30 day comment period. Subject to the Board's Rules Regarding Availability of Information (12 CFR Part 261), copies of the New York application are available from the Board in Washington or from the Federal Reserve Bank of New York.

Section 227.16 of the Credit Practices Rule provides that if a state applies for an exemption from a provision of the rule, such an exemption may be granted if the Board determines that: (i) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of the Credit Practices Rule applies; and (ii) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by the rule's provision. If the Board makes such a determination, the prohibition or requirement in the Board's rule will not be in effect in that state to the extent specified by the Board in its determination, for so long as the state effectively administers and enforces the state requirement for prohibition. The effect of an exemption is that banks and their subsidiaries (other than federally chartered institutions) that are subject to the Board's rule will be subject solely to state law and enforcement.

Applicable state law provisions need not be the same as the comparable federal requirement in order to meet the rule's substantially equivalent standard. Variations, however, should not deprive consumers of the protections provided by federal law. An analysis of a state's enforcement activities focuses on the ways in which the state demonstrates a commitment to enforcement and administration of the state's law; factors such as staffing, training activities, examination and administrative procedures, and other indicators of enforcement efforts may be considered, as well as the existence under state law of any private right of action by aggrieved consumers.

(3) A Comparison of New York Law and the Board's Credit Practices Rule

The state of New York asserts that the provisions of New York's General Obligations Law Section 15–702 and those of General Business Law Section 349 offer protection if not greater than, then at least substantially equivalent to the Board's Credit Practices Rule and, therefore, an exemption should be granted by the Board under Regulation AA for as long as the New York provisions remain in effect. A comparison of the relevant provisions of New York law (as described by the New York exemption application) and the cosigner provision of the Board's rule is set forth below. In particular, the Board solicits comment on the following:

- The degree to which differences in coverage between the New York law and the Board's rule affect the level of protection afforded by New York law;
- The degree to which differences in the cosigner provision of the New York law and the Board's rule affect the level of protection afforded by New York law;
- Whether the remedy for violation of the cosigner provision of the New

[1] Under section 18(a)(1)(B) and section 5(a)(1) of the Federal Trade Commission Act (FTC Act), the FTC is authorized to promulgate rules that define and prevent "unfair or deceptive acts or practices" in or affecting commerce with respect to extensions of credit to consumers. Section 18(f) of the FTC Act provides that whenever the FTC promulgates a rule prohibiting practices which it has deemed to be unfair or deceptive, the Board, with certain limited exceptions, must adopt a substantially similar rule prohibiting such practices by banks. The Federal Home Loan Bank (FHLBB) is also required under section 18(f) to adopt a rule substantially similar to that of the FTC for institutions that are members of the Federal Home Loan Bank System; the FHLBB did so in May 1985 (50 FR 19325), with its rule also taking effect on January 1, 1986.

[2] The state of New York in its application requested an exemption from § 227.14(b) of Regulation AA. Section 227.14(b) sets forth the cosigner disclosure requirements under the rule. After a review of the exemption application in its entirety and discussions with a representative of the New York State Banking Department, it is apparent that the state of New York is requesting an exemption from all of § 227.14 of Regulation AA.

[3] The state of New York submitted an application to the FTC for an exemption from the cosigner provisions of the FTC's Credit Practices Rule, § 444.3. The FTC granted New York's exemption request for transactions of $25,000 or less on August 7, 1986. 51 FR 28328 (1986).

York law affords a level of protection substantially equivalent to, or greater than, that afforded by the Board's rule; and

- Whether New York administers and enforces its law effectively.

A. Coverage

New York's General Obligations Law Section 15–702(2) (a) and (b) provides that before a cosigner becomes obligated on a consumer credit transaction or account, the creditor must notify the cosigner in writing of the nature of his or her obligation. Under the New York law a consumer credit transaction includes a loan or sale where credit is extended to a consumer primarily for personal, family or household use. A consumer credit account includes an account established pursuant to an agreement where the consumer makes purchases or obtains loans for personal, family or household purposes, from time to time, either directly from the creditor, or indirectly by use of a credit card, check or other device as the agreement may provide. The New York law does not apply to consumer credit transactions in excess of $25,000 or consumer credit accounts with a credit limit in excess of $25,000.

The Credit Practices Rule requires a bank to provide a cosigner with a written notice of his or her obligation before the cosigner becomes obligated for an extension of credit to a consumer. Consumer credit transactions (which include credit accounts as separately defined under New York law) made primarily for personal, family or household use are covered by the rule. The Credit Practices Rule does not exclude consumer credit transactions or accounts over $25,000 from the rule's coverage; the dollar amount is, however, one of the factors that can be considered in determining whether a transaction is for a business purpose (and therefore, not covered by the rule) rather than a consumer purpose. (Staff Guidelines, 012(a)—2.)

B. Cosigner Provisions

Under the Credit Practice Rule, it is a deceptive act or practice for a bank to misrepresent the nature or extent of a cosigner's liability (§ 227.14(a)(1)). New York General Business Law Section 349 prohibits deceptive acts or practices generally. Section 349 has been interpreted by New York case law to prohibit any act or practice declared deceptive under the rules and regulations of the FTC or under any federal case law construing the rules and regulations of the FTC.[4] A consumer may bring a private cause of action or violation of the New York deceptive acts and practices law to enjoin an unlawful act or practice and to recover actual damages or $50, whichever is greater. For willful violations, a court may award treble damages, up to $1,000, in an action brought by a consumer. In addition, the Attorney General of the State of New York may bring an action to enjoin a deceptive practice and may seek restitution of money or property obtained as a result of the unlawful act or practice.

Under the Credit Practices Rule, it is an unfair act or practice for a bank to obligate a cosigner in connection with an extension of credit to a consumer unless cosigner is informed prior to becoming obligated of the nature of his or her liability as a cosigner (§ 227.14(a)(2)). The rule contains a prescribed disclosure statement that must be provided to a cosigner. A bank must provide a statement which is substantially similar to that in the rule (§ 227.14(b)). Under the rule the cosigner notice must be clear and conspicuous, and may be contained in a separate document or in the documents evidencing the credit obligation. The rule does not require that the cosigner be given copies of the documents evidencing the obligation.

New York law requires a creditor to provide a cosigner with: (1) A written notice that informs the cosigner of the nature of his or her liability, and (2) a complete copy of each document evidencing the credit obligation. The notice given must be substantially similar to that provided in G.O.L. section 15–702(3) and must be printed in at least 10-point type. The notice may be on a separate document or included in the documents evidencing the consumer credit obligation.

If a creditor fails to comply with the cosigner provisions of the New York law, the cosigner cannot be obligated as a payment guarantor as described in the Uniform Commercial Code, section 3–416(1). The creditor may not proceed directly against the cosigner, but rather must first exhaust all remedies (including judgment and execution) against the primary obligor. Once all remedies against the primary obligor are exhausted, the creditor may sue the cosigner as a collection guarantor.

Noncompliance with the provisions of the Credit Practices Rule is dealt with through administrative enforcement. Failure to comply with the cosigner provisions of the rule does not alter the obligation between the bank and the cosigner. Administrative enforcement of the rule for banks may involve actions under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), including the issuance of cease and desist orders and the imposition of penalties of up to $1,000 per day for violation of an order.

The cosigner notice required by the Credit Practices Rule states that: (1) The cosigner may have to pay the full amount of the debt and late fees or collection costs; (2) the creditor can collect from the cosigner without first trying to collect from the borrower; (3) the same collection remedies may be used against the cosigner as against the borrower; (4) the notice is not the contract that makes the cosigner liable; (5) if the debt goes into default that fact could become a part of the cosigner's credit history; and (6) the cosigner should think carefully before becoming obligated. A bank may include additional information in the notice (such as the date of transaction, the loan amount, information identifying the debt, names and addresses, and an acknowledgment of receipt) and still meet the substantially similiar requirement of § 227.14(b)(2). (Staff Guidelines, Q14(b)–9.) Minor editorial changes may also be made to the notice, such as changing the word "borrower" to "accountholder" or changing the word "debt" to "account" as appropriate. (Staff Guidelines, Q14(b)–7.)

Two model cosigner notices are contained in New York's General Obligations Law, section 15–702(3); one is to be used in a consumer credit transaction and the other is for use in connection with a consumer account. The notices state that: (1) The cosigner is obligated to pay the debt identified even though the cosigner may not personally receive any property,

[4] *State v. Colorado State Christian College of the Church of the Inner Power, Inc.*, 76 Misc. 2d 50, 346 N.Y.S. 2d 482 (Sup. Ct. 1973).

services or money; (2) the cosigner may be sued even though the primary obligor may be able to pay; and (3) the notice is not the contract that makes the cosigner liable. The notice also requires the identification of the debt or account (the names of the debtor and creditor, the date, the kind of debt or account, and the total of payments or limit of liability). A separately signed written acknowledgment of receipt in a form substantially similar to the model form contained in G.O.L. section 15–702(3) is prima facie proof of receipt of the notice by the cosigner in any action by or against the cosigner.

C. Administrative Enforcement

The New York State Banking Department is empowered by Banking Law section 10 to supervise and regulate New York state-chartered banks. According to the Banking Department, this includes responsibility for 116 commrical banks and 71 savings banks, as well as 17 savings and loan associations and 77 credit unions.

The department maintains a staff of over 300 examiners to conduct field examinations of financial institutions chartered in New York. Annual safety and soundness examinations are conducted on a divided, concurrent, or separate basis by agreement with the Federal Reserve Bank of New York and the Federal Deposit Insurance Corporation (FDIC). The Consumer Service Compliance Examination, which covers compliance with G.O.L. section 15–702 and other federal and state laws and regulations, is part of and scheduled with the annual examination of financial institutions. In 1985, the department completed 137 consumer compliance examinations. The department has been certified by the Conference of State Bank Supervisors and cooperates with the Federal Reserve Bank of New York in alternate year examination programs.

Examiners assigned to the Consumer Services Division are expected to attend the Consumer Protection School sponsored by the FDIC and other compliance schools or seminars as necessary. The Banking Department's Legal Division periodically holds conferences for examiners on changes to federal and state laws that affect the compliance examination and complaint areas. The Banking Department states that most of compliance examiners have been employed by banks prior to their service with the department and have numerous years of experience in various divisions within the department.

Compliance with G.O.L. section 15–702 is verified by a review of credit files and the completion of an examiner's questionnaire. The field examiner has the discretion to determine the number of credit files to be reviewed in connection with G.O.L. section 15–702 and all other federal and state laws and regulations. Factors considered in the selection process are the number of violations discovered during previous state and federal examinations, the rating from previous state and federal examinations, the number of violations being discovered in the current examination, the type of examination (compacted or regular), the size of the institution, and the number of credit transactions entered into by a financial institution between examinations. The Banking Department asserts that it found no violations of G.O.L. section 15–702 in the 137 consumer compliance examinations conducted in 1985.

The state of New York indicates that if a financial institution is unwilling to comply with G.O.L. section 15–702 the matter would be referred to the Attorney General for enforcement. Such action could involve (1) the issuance of a cease and desist order and/or (2) after notice and hearing, the fining of the institution for its unwillingness to comply with the law.

(4) Comments Requested

Interested persons are invited to submit written comments on the state of New York's application for an exemption from § 226.14 of the Board's Credit Practices Rule. After the close of the comment period, based upon its own analysis and analysis of the comments received, the Board will publish, in the **Federal Register**, notice of the final action on the exemption request.

List of Subjects in 12 CFR Part 227

Banks, Banking, Consumer protection, Credit, Federal Reserve System, Finance.

Board of Governors of the Federal Reserve System, October 20, 1986.

James McAfee,

Associate Secretary of the Board.

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