

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 10254]
[August 15, 1988]

CREDIT PRACTICES RULE
Amendments to Staff Guidelines

To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:

The Board of Governors of the Federal Reserve System has amended its Staff Guidelines on the Credit Practices Rule (Subpart B of Regulation AA, "Unfair or Deceptive Acts or Practices"), effective August 1, 1988. In announcing the amendments, the Board of Governors issued the following statement:

The Federal Reserve Board has published the second update to its staff guidelines on the Credit Practices Rule under Regulation AA. The updated guidelines are effective August 1, 1988.

The Board's Credit Practices Rule, applicable to all banks and their subsidiaries, addresses unfair or deceptive acts or practices in the extending of consumer credit. The rule does not apply to loans for the purchase of real property. Banks are prohibited from using certain remedies to enforce consumer credit obligations and from using a late-charge practice commonly referred to as pyramiding. The rule also provides protections for cosigners of consumer credit obligations.

Printed below is the text of the amendments as published in the *Federal Register* of August 3. Questions regarding Regulation AA or the Credit Practices Rule may be directed to our Compliance Examinations Department (Tel. No. 212-720-8136); copies of Regulation AA or the Credit Practices Rule will be furnished upon request directed to our Circulars Division (Tel. No. 212-720-5215 or 5216).

E. GERALD CORRIGAN,
President.

12 CFR Part 227

[Reg. AA]

**Unfair or Deceptive Acts or Practices;
Update of Staff Guidelines on the
Credit Practices Rule**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Update of staff guidelines on
the Credit Practices Rule.

SUMMARY: The Board is publishing an update to the staff guidelines on the Credit Practices Rule, Subpart B of Regulation AA (Unfair or Deceptive Acts or Practices). The rule prohibits banks and their subsidiaries from using certain creditor remedies in connection with a consumer credit obligation, from using a late-charge practice commonly referred to as pyramiding, and from obligating a cosigner prior to giving a required notice explaining the cosigner's

obligations. The update addresses questions on the use of multi-purpose credit documents, the acquisition of a security interest in household goods from a purchase-money lender, and exemptions from the rule.

EFFECTIVE DATE: August 1, 1988.

FOR FURTHER INFORMATION CONTACT: Adrienne D. Hurt, Senior Attorney, or Linda Vespereny, Staff Attorney, Division of Consumer and Community Affairs, at (202) 452-2412; for the hearing impaired *only*, contact Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (TDD) at (202) 452-3544, Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

1. Background

In March 1984, the Federal Trade Commission (FTC) adopted its Credit Practices Rule, effective March 1, 1985,

pursuant to the authority granted the FTC under sections 18(a)(1)(B) and 5(a)(1) of the Federal Trade Commission Act (FTC Act), 15 U.S.C. 57a(a)(1)(B) and 15 U.S.C. 45(a)(1). Under this statute the FTC is authorized to promulgate rules that define and prevent "unfair or deceptive acts or practices" in or affecting commerce. Section 18(f) of the FTC Act, 15 U.S.C. 57a(f), provides that whenever the FTC promulgates a rule prohibiting acts or practices that it had deemed to be unfair or deceptive, the Board of Governors of the Federal Reserve System must adopt a substantially similar rule prohibiting such acts or practices by banks unless the Board finds that such acts or practices by banks are not unfair or deceptive, or that the adoption of similar regulations for banks would seriously conflict with essential monetary and payments systems policies of the Board. In April 1985, the Board adopted a rule

substantially similar to the FTC's Credit Practices Rule (50 FR 16695) as an amendment to the Board's Regulation AA, Unfair or Deceptive Acts or Practices (12 CFR Part 227). The Board modified certain provisions of the FTC's rule to take into account the needs and characteristics of the banking industry. The Board's rule went into effect on January 1, 1988.

2. Summary of the Rule

The Board's rule applies to all consumer credit obligations other than those for the purchase of real property. It prohibits banks from using certain remedies to enforce consumer credit obligations. Under the rule, banks may not include these remedies in their consumer credit obligations, and if banks purchase obligations that contain a prohibited provision, banks are prohibited from enforcing them. The prohibited provisions are: (1) Confessions of judgment; (2) waivers of exemption; (3) wage assignments; and (4) non-possessory, nonpurchase-money security interests in household goods. In addition, the rule prohibits a certain late charge practice, and provides protections for cosigners in consumer credit transactions.

The Board's rule applies to all banks and their subsidiaries. Institutions that are members of the Federal Home Loan Bank System and nonbank subsidiaries of bank holding companies are covered by the rules of the Federal Home Loan Bank Board and the FTC, respectively.

3. Staff Guidelines

Staff guidelines on the Board's Credit Practices Rule were issued in November 1985 (50 FR 47038). The guidelines focus on information of general application that will be useful to most banks, and provide the vehicle for answering questions about the rule. The guidelines are updated periodically, as necessary. The first update was in October 1986 (51 FR 39646). This notice contains the second update.

4. Explanation of Revision to Guidelines

Following is a brief description of the revisions to the staff guidelines on the Board's Credit Practices Rule.

Section 227.13 Unfair Credit Contract Provisions.

Question 13(a)-2 has been added to clarify the rule regarding the inclusion of a confession of judgment clause in a multi-purpose credit document. Some

creditors use multi-purpose credit contracts for consumer, business, and other types of credit obligations. The issue is whether these forms may contain a confession of judgment clause with qualifying language indicating that the clause is not applicable in a consumer credit obligation (for example, stating that a confession of judgment is effective only "in nonconsumer purpose loans," "in business or agricultural purpose loans," or "to the extent permitted by law"). Given the public policy purpose of the rule—to eliminate the use of prohibited contract provisions in consumer credit obligations—§ 227.13(a) is strictly construed to mean that a confession of judgment clause may not be contained in consumer credit documentation, even with qualifying language. Therefore, if a bank uses a multi-purpose credit document for a consumer purpose loan, the bank must cross out, blacken in, or otherwise indicate removal of the clause from the credit document.

Question 13(d)-3a explains that when a bank refinances a purchase-money obligation originated by another lender, the acquisition of the purchase-money lender's security interest in household goods does not violate the rule.

Section 227.16 State Exemptions.

Section 227.16 allows a state agency to apply for an exemption from all or part of the provisions of the Board's rule. Question 16(b)-3 has been added to indicate the exemptions that have been granted.

List of Subjects in 12 CFR Part 227

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

5. Text of Revisions

The revisions to the staff guidelines on the Credit Practices Rule read as follows:

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Section 227.13 Unfair Credit Contract Provisions.

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13(a) Confessions of Judgment

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Q13(a)-2: *Language limiting confession of judgment provision.* If a bank uses multi-purpose credit contracts, may the bank include a confession of judgment clause with qualifying language indicating that the clause is not applicable in a consumer purpose loan—such as, "You confess

judgment to the extent the law allows." or "This clause applies only in business purpose loans"?

A: No. Given the public policy purpose of the rule, a bank may not have a confession of judgment clause in a consumer credit contract, even with limiting language. Therefore, when a multi-purpose form is used for a consumer purpose loan, the bank must cross out, blacken in, or otherwise indicate clearly the removal of the prohibited clause from the loan document.

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13(d) Security Interest in Household Goods

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Q13(d)-3a: *Refinancing (new creditor)—original loan purchase money.* On the same facts as those detailed in Q13(d)-3, assume that the consumer refinances the loan with a different bank. May that bank acquire the security interest of the purchase-money lender in household goods without violating the rule?

A: Yes, the bank may acquire the security interest of the purchase-money lender without violating the rule.

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Section 227.16 State Exemptions.

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Q16(b)-3. *Exemption granted.* What states have been granted an exemption from the Board's rule?

A: The state of Wisconsin was granted an exemption from all provisions of the Board's rule effective November 20, 1986, for transactions of \$25,000 or less. The state of New York was granted an exemption from the cosigner provisions of the Board's rule effective January 21, 1987, for transactions of \$25,000 or less. In both Wisconsin and New York, transactions over \$25,000 are subject to the Board's rule but compliance with state law is deemed compliance with the federal law. The state of California was granted an exemption from the cosigner provisions of the Board's rule effective August 1, 1988. These exemptions do not apply to federally-chartered institutions.

Board of Governors of the Federal Reserve System, July 28, 1988.

William W. Wiles,
Secretary of the Board.

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