Regulation AA

Unfair or Deceptive Acts or Practices: Credit Practices Rule

Background

The Credit Practices Rule, which was adopted by the Federal Reserve Board under section 18(f)(1) of the Federal Trade Commission Act (15 USC 45) in response to a similar rule adopted by the Federal Trade Commission, is contained in subpart B of Regulation AA.[1] It became effective in January 1986.

The rule prohibits banks and their subsidiaries from using (1) certain provisions in their consumer credit contracts, (2) a late-charge accounting practice known as pyramiding, and (3) deceptive cosigner practices. It also requires that a disclosure notice be given to a cosigner prior to the cosigner's becoming obligated. Finally, the rule prohibits banks and their subsidiaries from enforcing in purchased contracts the same provisions they are prohibited from including in their own consumer credit contracts.

Scope of the Rule

The Credit Practices Rule applies to consumer credit contracts other than those for the purchase of real estate. Dwellings such as mobile homes and houseboats are not considered real estate if they are considered personal property under state law. A *consumer* is defined as a natural person who seeks or acquires goods, services, or money for personal, family, or household purposes. There is no monetary limit on the coverage of the rule.

Prohibited Contract Provisions

In general, banks are prohibited from entering into credit contracts that contain any of the provisions described in the following paragraphs.

Confession of Judgment

A *confession of judgment* is a contract clause (sometimes also known as a cognovit or a warrant of attorney) in which the borrower waives the right to notice and the opportunity to be heard in court in the event of a creditor-initiated lawsuit to enforce an obligation.

The following are not prohibited:

- Confessions executed after default or the filing of a suit on the debt
- Powers of attorney contained in a mortgage or deed of trust for foreclosure purposes
- Powers of attorney given to expedite the disposal of repossessed collateral or the transfer of pledged securities
- Confessions in Louisiana for the purpose of executory process

Waiver of Exemption

Under a *waiver of exemption*, a consumer relinquishes the right granted under state law to protect his or her home (a right known as the homestead exemption), possessions, or wages from seizure to satisfy a judgment. Under the rule, a waiver is permitted if it pertains solely to the property given as collateral in connection with a consumer credit obligation.

Any other types of waivers (for example, waivers of demand, presentment, protest, notice of dishonor, and notice of protest) are not prohibited.

Assignment of Wages

An *assignment of wages* is a contract provision that gives banks the right to receive the consumer's future wages or earnings directly from the consumer's employer in the event the consumer defaults on the loan.

The following are not prohibited:

- An assignment that by its terms is revocable at will by the consumer
- A payroll deduction or preauthorized-payment plan (whether or not revocable by the consumer) commencing at loan consummation and authorized for the purpose of making periodic payments on the debt
- A revocable preauthorized-payment plan (subject to the Electronic Fund Transfer Act) for electronic fund transfers to accounts from wages
- An assignment of wages already earned at the time of the assignment
- Garnishment

Earnings are defined as compensation paid or payable to an individual, or for the individual's account, for personal services rendered or to be rendered by the consumer, whether in the form of wages, salary, commission, or bonus, including periodic payments pursuant to a pension, retirement, or disability program.

1. The Office of Thrift Supervision has a rule for savings banks identical to the Federal Reserve's rule for state member banks and their subsidiaries.

Security Interest in Household Goods

A nonpossessory security interest in household goods is prohibited unless such goods are purchased with credit extended by the financial institution.

The following are not prohibited:

- Security interests in household goods not purchased with credit extended by the bank if the goods are placed in the bank's possession
- Security interests in all other real and personal property of the consumer other than household goods as defined in the rule

Household goods include the clothing, furniture, appliances, linens, china, crockery, kitchenware, and personal effects of the consumer and the consumer's dependents. The following are not household goods:

- Works of art
- Electronic equipment (other than one television and one radio)
- Items acquired as antiques, including such items that have been repaired or renovated without changing their original form or character (To be considered an antique, an item must be more than 100 years old.)
- Jewelry (other than wedding rings)
- Automobiles, boats, snowmobiles, cameras and camera equipment (including darkroom), pianos, home workshops, and the like

Examples of Prohibited Contract Provisions

Confession of Judgment

- *If you fail to carry out the terms of this notice, you appoint ________ or ________ as your attorney-in-fact for the purpose of confessing judgment against you, and you authorize either of them to confess judgment against you in favor of us in the Clerk's Office of the City/County of Powatan, Virginia, or in any other court of proper jurisdiction for the unpaid balance of this Note plus costs, expenses, and attorney's fees as provided on the reverse side of this Note.*
- *You and any CoMaker, jointly and severally, authorize the Prothonotary, Clerk, and any attorney of any court of record to appear for you and any CoMaker and confess judgment in our favor or in favor of any other holder of this Note. Judgment by confession may be entered either prior to or after an event of default, as often as necessary, for such sums as are or may become due on this Note, with costs of suit and 20 percent added as actual and reasonable attorney's fees. You and CoMaker agree, to the extent permitted by law, to all rights of appeal, appraisement, stay of execution, and exemption now or later enforced. If a copy of this Note is filed in connection with the entry of judgment, it shall not be necessary to file the original Note as a Warrant of Attorney, if the copy is verified by affidavit.*

Waiver of Exemption

- *I waive my homestead exemption.*
- *In consideration of the credit extended, Mortgagor waives and relinquishes, with respect to the Property and all other property now or hereafter owned by Mortgagor, the benefit of any and all stay and extension laws, and further expressly waives notice and delay accorded by Louisiana Code of Civil Procedure Articles 2331, 2639, and 2722 and La. R. S. 12:4363–4366, including, but not limited to, any and all homestead and other claims to exemption from seizure that under existing or future laws might be asserted against enforcement of payment of the indebtedness secured hereby, and consents to the immediate seizure, advertisement, and sale of said property in the event of institution of executory or other legal proceedings.*
- *Debtor hereby acknowledges express intent to hereby waive and abandon all personal property exemptions granted by law upon the goods, which are the subject of this Agreement. Notice: By signing this Agreement, Debtor waives all rights provided by law to claim such goods exempt from process.*
- *I waive (to the extent permitted by law) certain rights I might otherwise have. All exemptions in and to any of the property are hereby waived.*

Prohibited Practices

Pyramiding of Late Charges

Pyramiding is an accounting method that results in the assessment of multiple delinquency charges as a consequence of a single delinquent payment for the current month. For example, when a borrower's payment is received late, the lender deducts a late charge directly from the payment received, which then results in an insufficient payment. Although the next payment may be received on time, because the first payment was considered insufficient, a late charge is again applied. This continues until either the borrower pays the late charge separately or the loan matures. The examiner should not confuse this situation with one in which a payment is missed and never made up, triggering late charges each month until the entire payment is made and the account is brought entirely up to date or is paid in full.

Cosigner Deception

The institution may not misrepresent the nature and extent of a cosigner's liability to any person.

Disclosures to Cosigners

A financial institution must provide, either in a separate document or in the credit obligation, a clear and conspicuous notice that is substantially similar to the example below. This notice must be given to the cosigner prior to the time he or she becomes obligated. In the case of open-end credit plans, the notice must be given prior to the time the cosigner becomes obligated for fees or transactions on the account.

Sample Notice to Cosigner

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay the debt if you have to, and that you want to accept this responsibility.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which may increase this amount.

The bank can collect this debt from you without first trying to collect from the borrower. The bank can use the same collection methods against you that can be used against the borrower, such as suing you or garnishing your wages. If this debt is ever in default, that fact may become a part of your credit record.

This notice is not the contract that makes you liable for the debt.

A *cosigner* is defined as

- Any person who assumes personal liability, in any capacity, for the obligation of another consumer without receiving goods, services, or money in return for the obligation. This includes any person whose signature is requested to allow a consumer to obtain credit or to prevent collection of a consumer's obligation that is in default.
- A person who meets the above definition, whether or not he or she is designated as such in the contract
- For open-end credit, a person who signs the debt instrument but does not have the contractual right to obtain credit under the account

A cosigner is not

- A spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law
- A person who does not assume personal liability, but rather only provides collateral for the obligation of another person
- A person who has the contractual right to obtain credit under an open-end account, whether exercised or not

Civil Liability

There is no express provision for civil liability in either the Federal Trade Commission Act or Regulation AA.

Administrative Enforcement

Regulation AA is to be enforced for banks through section 8 of the Federal Deposit Insurance Act (12 USC 1818). In addition, the Federal Reserve may enforce compliance through any other authority conferred on it by law (15 USC 57a(f)(4)).

Regulation AA

Interagency Guidance concerning Unfair or Deceptive Practices by State-Chartered Banks

Purpose

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (the Board and the FDIC, or, collectively, the agencies) are issuing this statement to outline the standards that will be considered by the agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices found in section 5 of the Federal Trade Commission Act (FTC Act)[1] as they apply to acts and practices of state-chartered banks. The agencies will apply these standards when weighing the need to take supervisory and enforcement actions and when seeking to ensure that unfair or deceptive practices do not recur.

This statement also contains a section on managing risks relating to unfair or deceptive acts or practices that includes best practices, as well as general guidance on measures that state-chartered banks can take to avoid engaging in such acts or practices.

Although the majority of insured banks adhere to a high level of professional conduct, banks must remain vigilant against possible unfair or deceptive acts or practices both to protect consumers and to minimize their own risks.

Coordination of Enforcement Efforts

Section 5(a) of the FTC Act prohibits ‘‘unfair or deceptive acts or practices in or affecting commerce’’[2] and applies to all persons engaged in commerce, including banks. The agencies each have affirmed their authority under section 8 of the Federal Deposit Insurance Act to take appropriate action when unfair or deceptive acts or practices are discovered.[3]

A number of regulators have authority to combat unfair or deceptive acts or practices. For example, the Federal Trade Commission has broad authority to enforce the requirements of section 5 of the FTC Act against many non-bank entities.[4] In addition, state authorities have primary responsibility for enforcing state statutes against unfair or deceptive acts or practices. The agencies intend to work with these other regulators as appropriate in investigating and responding to allegations of unfair or deceptive acts or practices that involve state banks and other entities supervised by the agencies.

1. 15 USC 45.
2. 15 USC 45(a).
3. 12 USC 1818(b)(1), (e)(1), and (i)(2). See letter from Chairman Alan Greenspan to the Hon. John J. LaFalce (May 30, 2002) and ‘‘Unfair or Deceptive Acts or Practices: Applicability of the Federal Trade Commission Act,’’ FIL 57-2002 (May 30, 2002).
4. 15 USC 45(a)(2) and Gramm–Leach–Bliley Act, section 133, published in notes to 15 USC 41.

Standards for Determining What Is Unfair or Deceptive

The FTC Act prohibits unfair or deceptive acts or practices. Congress drafted this provision broadly in order to provide sufficient flexibility in the law to address changes in the market and unfair or deceptive practices that may emerge.[5]

An act or practice may be found to be *unfair* where it ‘‘causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.’’[6] A representation, omission, or practice is *deceptive* if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer’s conduct or decision regarding a product or service.

The standards for unfairness and deception are independent of each other. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is *either* unfair *or* deceptive. Whether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances. In analyzing a particular act or practice, the agencies will be guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the courts and the FTC. The agencies will also consider factually similar cases brought by the FTC and other regulators to ensure that these standards are applied consistently.

Unfair Acts or Practices

Assessing Whether an Act or Practice Is Unfair

An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers,

5. See FTC Policy Statement on Unfairness (December 17, 1980) and FTC Policy Statement on Deception (October 14, 1983).
6. This standard was first issued as a policy by the FTC and later codified into the FTC Act as 15 USC 45(n).

(2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

- *The act or practice must cause or be likely to cause substantial injury to consumers*—To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.
- *Consumers must not reasonably be able to avoid the injury*—A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

The agencies will not second-guess the wisdom of particular consumer decisions. Instead, the agencies will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision making.

- *The injury must not be outweighed by countervailing benefits to consumers or to competition*—To be unfair, the act or practice must be injurious in its net effects—that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

  Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.
- *Public policy may be considered*—Public policy, as established by statute, regulation, or judicial decisions, may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

Deceptive Acts and Practices

Assessing Whether an Act or Practice Is Deceptive

A three-part test is used to determine whether a representation, omission, or practice is "deceptive." First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- *There must be a representation, omission, or practice that misleads or is likely to mislead the consumer*—An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

  In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The agencies will evaluate it in the context of the entire advertisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

- *The act or practice must be considered from the perspective of the reasonable consumer*—In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.

  If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer's interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer's interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

  In evaluating whether a representation, omission, or practice is deceptive, the agencies will look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

- *The representation, omission, or practice must be material*—A representation, omission, or practice is material if it is likely to affect a consumer's decision regarding a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. Similarly, the materiality of an implied claim will be presumed when it is demonstrated that the institution intended that the consumer draw certain conclusions based upon the claim.

  Claims made with the knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

Relationship to Other Laws

Acts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act may also violate other federal or state statutes. On the other hand, there may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. Banks should be mindful of both possibilities. The following laws warrant particular attention in this regard.

Truth in Lending and Truth in Savings Acts

Pursuant to the Truth in Lending Act (TILA), creditors must "clearly and conspicuously" disclose the costs and terms of credit.[7] The Truth in Savings Act (TISA) requires depository institutions to provide interest and fee disclosures for deposit accounts so that consumers can compare deposit products.[8] TISA also provides that advertisements must not be misleading or inaccurate and must not misrepresent an institution's deposit contract. An act or practice that does not comply with these provisions of TILA or TISA may also violate the FTC Act. On the other hand, a transaction that is in technical compliance with TILA or TISA may nevertheless violate the FTC Act. For example, consumers could be misled by advertisements of "guaranteed" or "lifetime" interest rates when the creditor or depository institution intends to change the rates, whether or not the disclosures satisfy the technical requirements of TILA or TISA.

Equal Credit Opportunity and Fair Housing Acts

The Equal Credit Opportunity Act (ECOA) prohibits discrimination against persons in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Similarly, the Fair Housing Act (FHA) prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. Unfair or deceptive practices that target or have a disparate impact on consumers who are members of these protected classes may violate the ECOA or the FHA, as well as the FTC Act.

7. 15 USC 1632(a).
8. 12 USC 4301 et seq.

Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although this statute does not by its terms apply to banks that collect their own debts, failure to adhere to the standards set by this act may support a claim of unfair or deceptive practices in violation of the FTC Act. Moreover, banks that either affirmatively or through lack of oversight permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for approving or assisting in an unfair or deceptive act or practice.

Managing Risks Related to Unfair or Deceptive Acts or Practices

Since the release of the FDIC's statement and the Board's letter on unfair and deceptive practices in May 2002, bankers have asked for guidance on strategies for managing risk in this area. This section outlines guidance on best practices to address some areas with the greatest potential for unfair or deceptive acts and practices, including advertising and solicitation, servicing and collections, and the management and monitoring of employees and third-party service providers. Banks should also monitor compliance with their own policies in these areas and should have procedures for receiving and addressing consumer complaints and monitoring activities performed by third parties on behalf of the bank.

To avoid engaging in unfair or deceptive activity, the agencies encourage use of the following practices, which have already been adopted by many institutions:

- Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements, or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.
- Draw the attention of customers to key terms, including limitations and conditions, that are important in enabling the customer to make an informed decision regarding whether the product or service meets the customer's needs.
- Clearly disclose all material limitations or conditions on the terms or availability of products or services, such as a limitation that applies a special interest rate only to balance transfers; the expiration date for terms that apply only during an introductory period; material prerequisites for obtaining particular products, services, or terms (for example, minimum transaction amounts, introductory or other fees, or other qualifications); or conditions for canceling a service without charge when the service is offered on a free trial basis.
- Inform consumers in a clear and timely manner about any fees, penalties, or other charges (including charges for any force-placed products) that have been imposed, and the reasons for their imposition.
- Clearly inform customers of contract provisions that permit a change in the terms and conditions of an agreement.
- When using terms such as ''preapproved'' or ''guaranteed,'' clearly disclose any limitations, conditions, or restrictions on the offer.
- Clearly inform consumers when the account terms approved by the bank for the consumer are less favorable than the advertised terms or terms previously disclosed.
- Tailor advertisements, promotional materials, disclosures, and scripts to take account of the sophistication and experience of the target audience. Do not make claims, representations, or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.
- Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend, or is not able, to provide the service to account holders.
- Clearly disclose when optional products and services—such as insurance, travel services, credit protection, and consumer report update services that are offered simultaneously with credit—are not required to obtain credit or considered in decisions to grant credit.
- Ensure that the costs and benefits of optional or related products and services are not misrepresented or presented in an incomplete manner.
- When making claims about amounts of credit available to consumers, accurately and completely represent the amount of potential, approved, or usable credit that the consumer will receive.
- Avoid advertising terms that are not available to most customers and using unrepresentative examples in advertising, marketing, and promotional materials.

- Avoid making representations to consumers that they may pay less than the minimum amount required by the account terms without adequately disclosing any late fees, over-limit fees, or other account fees that will result from the consumer's paying such a reduced amount.
- Clearly disclose a telephone number or mailing address (and, as an addition, an e-mail or web site address if available) that consumers may use to contact the bank or its third-party servicers regarding any complaints they may have, and maintain appropriate procedures for resolving complaints. Consumer complaints should also be reviewed by banks to identify practices that have the potential to be misleading to customers.
- Implement and maintain effective risk and supervisory controls to select and manage third-party servicers.
- Ensure that employees and third parties who market or promote bank products, or service loans, are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.
- Review compensation arrangements for bank employees as well as third-party vendors and servicers to ensure that they do not create unintended incentives to engage in unfair or deceptive practices.
- Ensure that the institution and its third-party servicers have and follow procedures to credit consumer payments in a timely manner. Consumers should be clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.

The need for clear and accurate disclosures that are sensitive to the sophistication of the target audience is heightened for products and services that have been associated with abusive practices. Accordingly, banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated. In addition, creditors should pay particular attention to ensure that disclosures are clear and accurate with respect to the points and other charges that will be financed as part of home-secured loans; the terms and conditions related to insurance offered in connection with loans; loans covered by the Home Ownership and Equity Protection Act; reverse mortgages; credit cards designed to rehabilitate the credit position of the cardholder; and loans with prepayment penalties, temporary introductory terms, or terms that are not available as advertised to all consumers.

Conclusion

The development and implementation of policies and procedures in these areas and the other steps outlined above will help banks ensure that products and services are provided in a manner that is fair, allows informed customer choice, and is consistent with the FTC Act.

Examination Objectives and Procedures

EXAMINATION OBJECTIVES

1. To determine if the financial institution has established an effective system for ensuring that it
   a. Does not originate, acquire, or enforce contracts that contain prohibited provisions
   b. Does not ‘‘pyramid’’ late charges
   c. Does not engage in deceptive cosigner practices
   d. Provides the required disclosure to cosigners prior to their becoming obligated
2. To determine whether the credit contracts originated or purchased by the institution contain prohibited provisions
3. To determine whether the institution used impermissible late-charge accounting practices
4. To determine if the institution advised cosigners prior to their becoming contractually liable of the nature and extent of their liability
5. To determine if the institution provides the required notices to cosigners prior to their becoming obligated or, in the case of open-end credit plans, prior to the time they become obligated for fees or transactions on the account
6. To determine if the institution has attempted to enforce prohibited provisions in contracts it has originated or acquired

EXAMINATION PROCEDURES

1. Obtain and review blank notes (contracts) and disclosures (including those furnished to dealers) used by the financial institution in extending consumer credit for the following prohibited contract provisions:
   a. Confession of judgment—A waiver by the consumer of the right to notice and the opportunity to be heard in court in the event of a suit on the obligation (§ 227.13(a))
   b. Waiver of statutory property exemption—A waiver by the consumer of the statutory right to protect his or her home (known as the homestead exemption), possessions, or wages from seizure to satisfy a judgment unless the waiver is given on property that will serve as security for the obligation (§ 227.13(b))
   c. Assignment of wages—A provision giving the bank the right to receive the consumer’s wages or earnings directly from the consumer’s employer (§ 227.13(c)). However, such an assignment is permitted if
      i. It is revocable at will by the consumer
      ii. It is a payroll deduction plan or a preauthorized payment plan (whether or not revocable by the consumer), commencing at consummation, for the purpose of making loan payments
      iii. It applies only to wages or earnings already earned at the time of the assignment
   d. Blanket security interest in household goods—A provision that allows the institution to hold as collateral the clothing, furniture, appliances, and personal effects of the consumer’s dependents (§ 227.13(d))
2. Determine through discussions with management and staff if the institution attempts to enforce confessions of judgment, waivers of exemption, assignments of wages, or security interests in household goods in originated or acquired contracts.
3. Review the bank’s collection policies, procedures, and practices to ensure that staff members are not using an assignment of wages except where permissible. (§ 227.13(c))
4. Judgmentally sample an adequate number of loan files to ensure that prohibited contract provisions are not included in contracts (or related documents) originated by, or enforced in contracts acquired by, the institution.
5. Judgmentally sample an adequate number of overdue loans to determine if the institution collects or attempts to collect overdue payments through assignment of wages. (§ 227.13(c))
6. Judgmentally sample an adequate number of overdue loans to determine if the institution collects or attempts to collect a late charge on a timely payment because of the consumer’s failure to pay a late charge attributable to a prior delinquent payment. (§ 227.15))
7. Determine through a review of procedures, policies, and practices whether the institution takes steps to prevent its staff from engaging in prohibited cosigner practices on loans it originated or acquired. (§ 227.14(a))
8. Determine through discussions with management and staff if there is evidence that the institution engages in prohibited cosigner practices (for example, misrepresenting a cosign-

er's liability or contractually obligating cosigners prior to informing them of their liability).

9. Determine through discussions with management and staff whether the nature and extent of a cosigner's liability is properly represented to cosigners prior to the time signatures are obtained. (§ 227.14(a))
10. Judgmentally sample the documents evidencing the credit obligation and determine if they contain the required notice to cosigners. (§ 227.14(b))
    a. If the notice to cosigners is contained in the note or disclosure, it must be clear, conspicuous, and substantially similar to that provided in the regulation and must be provided before the cosigner becomes obligated.
    b. If the notice to cosigners is contained in a separate document, also
        i. Interview applicable employees to determine if they are aware that the notice must be provided prior to the cosigner's becoming obligated.
        ii. Review the institution's polices, procedures, and practices to ensure that staff members are aware that cosigners must be provided with the notice prior to their becoming obligated.

Regulation AA
Examination Checklist

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1. Do the consumer contracts originated by the bank contain any of the following prohibited provisions?

    a. Confession of judgment (§ 227.13(a)) Yes No

    b. Waiver of statutory property exemption (unless the waiver applies solely to the property that will serve as security for the loan) (§ 227.13(b)) Yes No

    c. Assignment of wages or other earnings (except where permitted) (§ 227.13(c)) Yes No

    d. Blanket security interests in household goods (§ 227.13(d)) Yes No

2. Does the bank acquire loans originated by other creditors? Yes No

    If so, does it attempt to enforce any of the following prohibited practices?

    a. Confession of judgment (§ 227.13(a)) Yes No

    b. Waiver of statutory property exemption (unless the waiver applies solely to the property that will serve as security for the loan) (§ 227.13(b)) Yes No

    c. Assignment of wages or other earnings (except where permitted) (§ 227.13(c)) Yes No

    d. Blanket security interests in household goods (§ 227.13(d)) Yes No

3. Does the bank take a nonpossessory security interest in household goods (as defined in section 227.12(d)) not purchased with the loan proceeds? (Review bank security agreement forms.) Yes No

4. Has the bank attempted to enforce any prohibited practices with respect to the consumer credit contracts it has originated? (§ 227.13(a) or 227.13(b)) Yes No

5. Does the bank collect or attempt to collect a late charge on a timely payment because of the consumer's failure to pay a late charge attributable to a prior delinquent payment? (§ 227.15) Yes No

6. Has the bank engaged in any prohibited cosigner practices (for example, misrepresenting the cosigner's liability or obligating cosigners prior to providing the required notification)? (§ 227.14(a)) Yes No

7. Does the bank provide to each cosigner, prior to his or her becoming contractually obligated, the required notice or one that is substantially similar (whether separate or contained in the credit documents)? (§ 227.14(b)) Yes No