

# Regulation M

## Consumer Leasing

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### Background

Regulation M, Consumer Leasing, implements the Consumer Leasing Act (15 USC 1667 et seq.), which was enacted in 1976. A major purpose of the act is to ensure that consumers receive meaningful and accurate disclosure of the terms of a lease before entering into a contract to lease personal property. Such disclosure is intended to help consumers compare one lease with another, as well as compare the cost of leasing with the cost of buying on credit or the opportunity cost of paying cash. The act also sets limits on balloon payments sometimes due at the end of a lease and regulates advertising.

The Consumer Leasing Act, which is part of the Truth in Lending Act, was originally implemented by Regulation Z, Truth in Lending. When Regulation Z was revised in 1981, the provisions of the regulation governing consumer leases were moved to Regulation M. In 2007, Regulation M was updated to incorporate guidance on the electronic delivery of disclosures consistent with the E-Sign Act.<sup>1</sup>

Today, a relatively small number of banks engage in consumer leasing. The trend seems to be for leasing to be carried out through specialized bank subsidiaries, vehicle finance companies, other finance companies, or directly by retailers.

### Key Definitions

Understanding certain key terms plays an integral role in understanding the requirements imposed by the Consumer Leasing Act.

#### Lessee

A *lessee* is a natural person who enters into or is offered a consumer lease.

#### Lessor

A *lessor* is a natural person or organization who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who leased or offered to lease more than five times in the preceding calendar year or the current calendar year meets this definition.

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<sup>1</sup> The Electronic Signatures in Global and National Commerce Act, 15 USC 7001 et seq.

### Consumer Lease

A *consumer lease* is a lease contract between a lessor and a lessee

- For the use of personal property by an individual (natural person)
- For personal property to be used primarily for personal, family, or household purposes
- For a period of more than four months (week-to-week and month-to-month leases do not meet this criterion, even though they may be extended beyond four months) and with a total contractual cost of no more than \$25,000

Specifically *excluded* from coverage by Regulation M are leases

- For business, agricultural, or commercial purposes or made to an organization
- For real property
- For personal property incidental to the lease of real property, subject to certain conditions
- For credit sales, as defined in Regulation Z, section 226.2(a)(16)

A lease meeting all the criteria for a consumer lease is covered by the Consumer Leasing Act and Regulation M. If any one of the criteria is not met, for example, if the leased property is to be used primarily for business purposes or the total contractual cost exceeds \$25,000, the act and the regulation do not apply.

Consumer leases fall into one of two categories: closed-end and open-end. The information that must be disclosed to consumers varies according to the category of lease, so it is important to note the differences between the categories. To understand the differences, one must first understand “realized value” and “residual value.”

#### Realized Value

The *realized value* is (1) the price received by the lessor of the leased property at disposition, (2) the highest offer for disposition of the leased property, or (3) the fair market value of the leased property at the end of the lease term.

#### Residual Value

The *residual value* is the value of the leased property at the end of the lease, as estimated or assigned by the lessor at consummation of the lease.

## Open-End Lease

An *open-end lease* is a lease in which the amount owed at the end of the lease term is based on the difference between the residual value and the realized value of the leased property. If the realized value is less than the residual value, the consumer may have to pay all or part of the difference; if the realized value is greater than the residual value, the consumer may receive a refund.

## Closed-End Lease

A *closed-end lease* is any lease other than an open-end lease. This type of lease allows the consumer to “walk away” at the end of the contract period with no further payment obligation—unless the property has been damaged or has sustained abnormal wear and tear.

## Gross Capitalized Cost

The *gross capitalized cost* is the amount agreed upon by the lessor and lessee as the value of the leased property, plus any items that are capitalized or amortized during the lease term, such as taxes, insurance, service agreements, and any outstanding prior credit or lease balance.

## Capitalized Cost Reduction

The *capitalized cost reduction* is the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost.

## Adjusted Capitalized Cost

The *adjusted capitalized cost* is the gross capitalized cost less the capitalized cost reduction. It is the amount used by the lessor in calculating the base periodic payment.

## General Disclosure Requirements

### Format of Disclosures

Lessors are required to provide the consumer with leasing cost information and other disclosures in a format similar to the model disclosure forms in appendix A to Regulation M. Certain pieces of this information must be kept together and must be segregated from other lease information. All the information stated must be accurate, clear and conspicuous, and provided in writing in a form that the consumer may keep.

With the consumer’s consent, Regulation M disclosures may be provided electronically. Before consent can be given, consumers must be provided with a clear and conspicuous statement,

informing the consumer of

- Any right or option to have the information provided in paper or non-electronic form;
- The right to withdraw the consent to receive information electronically and the consequences, including fees, of doing so;
- The scope of the consent (for example, whether the consent applies only to a particular transaction or to identified categories of records that may be provided during the course of the parties’ relationship);
- The procedures to withdraw consent and to update information needed to contact the consumer electronically; and
- The methods by which a consumer may obtain, upon request, a paper copy of an electronic record after consent has been given to receive the information electronically and whether any fee will be charged.

The consumer must consent electronically or confirm consent electronically in a manner that “reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent.”

If an institution makes subsequent changes to the hardware or software requirements that would prevent a consumer from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

## Content of Disclosures

Disclosure requirements are outlined in section 213.4 of the regulation. Briefly, leasing disclosures must contain the following information, as applicable:

- Description of the leased property
- Amount due at lease signing or delivery
- Payment schedule and total amount of periodic payments
- Other charges
- Total of payments
- Payment calculation
- Early-termination information
- Maintenance responsibilities
- Purchase option
- Statement referencing nonsegregated disclosures
- Liability resulting from a difference between the

residual value and the realized value

- Right of appraisal
- Liability at the end of the lease term based on the residual value
- Fees and taxes
- Insurance
- Warranties or guarantees
- Penalties and other charges for delinquency
- Security interest
- Limitations on rate information
- Additional disclosures for non-motor-vehicle open-end leases

### Timing of Disclosures

A dated disclosure statement must be given to the consumer before the lease is signed. The disclosure must contain all the information detailed in section 213.4 of the regulation.

### Renegotiations and Extensions

New disclosures must generally be provided when a consumer renegotiates or extends a lease beyond six months.

### Multiple Lessors and Lessees

In the event of multiple lessors, one lessor may make the required disclosures on behalf of all the lessors. If the lease involves more than one lessee, the required disclosures may be given to any lessee who is primarily liable.

### Advertising

Advertisements concerning consumer leases must also comply with certain disclosure requirements. All advertisements must be accurate. If a printed ad includes any reference to certain triggering terms—the amount of any payment or a statement of a capitalized cost reduction (that is, a down payment) or other payment required before or at lease signing or delivery (or that no such payment is required)—the ad must also state the following:

- That the transaction is a lease
- The total amount due prior to or at lease signing or delivery
- The number, amounts, and due dates or periods of the scheduled payments
- Whether or not a security deposit is required

Advertisements for open-end leases must also include a statement that extra charges may be

imposed at the end of the lease based on the difference between the residual value and the realized value at the end of the lease term.

If a percentage rate is given in an advertisement, the rate must not be more prominent than any of the other required disclosures, with the exception of the notice described in section 213.4(s). Such an ad must also include the statement, “This percentage may not measure the overall cost of financing this lease.” The term “annual percentage rate” or “annual lease rate,” or any equivalent term, may not be used.

Some fees (license, registration, taxes, and inspection fees) may vary by state or locality. An advertisement may exclude these third-party fees from the disclosure of a periodic payment or a total amount due at lease signing or delivery, provided that the ad states that these fees have been excluded. Otherwise, an ad may include these fees in the periodic payment or total amount due, provided that it states that the fees are based on a particular state or locality and indicates that the fees may vary.

Disclosures for electronic advertisements (such as an advertisement on an Internet website) may be provided in the advertisement without regard to the consumer consent or other provision of the E-Sign Act. As with a catalog or multi-page advertisement, an electronic advertisement that includes a table or schedule of the required disclosures is considered a single advertisement if, for the lease terms that appear without all the required disclosures, the advertisement clearly refers the consumer to the location where the additional required information begins. For example, a term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional disclosures.

### Limits on Balloon Payments

To limit balloon payments that may be required of the consumer, certain sections of the regulation call for reasonable calculations and estimates. These provisions protect the consumer at early termination of a lease, at the end of the lease term, or in the event of delinquency, default, or late-payment status. They limit the lessee’s liability at the end of the lease term and set reasonableness standards for wear and use charges, early-termination charges, and penalties or fees for delinquency.

### Penalties and Liability

Criminal and civil liability provisions of the Truth in Lending Act also apply to the Consumer Leasing Act. Actions alleging failure to disclose the required information or to otherwise comply with the Con-

sumer Leasing Act must be brought within one year of the termination of the lease agreement.

### **Record Retention**

Lessors are required to maintain evidence of

compliance with the requirements of Regulation M, other than the advertising requirements under section 213.7, for a period of at least two years after the date the disclosures are required to be made or an action is required to be taken.

# Regulation M

## Examination Objectives and Procedures

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### EXAMINATION OBJECTIVES

1. To assess the quality of the financial institution's compliance management system for the Consumer Leasing Act
2. To determine that lessees of personal property are given meaningful and accurate disclosures of lease terms
3. To determine if the limits of liability are clearly indicated to lessees and are correctly enforced by the institution
4. To ensure that the institution provides accurate disclosures of its leasing terms in all advertising

### EXAMINATION PROCEDURES

#### General Disclosure Requirements

- A. Review the institution's procedures for providing disclosures to ensure that it has adequate controls and procedures to effect compliance.
- B. Review the disclosures provided by the institution.
  1. Are the disclosures clear and conspicuous and provided in writing in a form the consumer can keep?
    - a. For disclosures provided electronically (other than for advertising requirements), are the disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)?<sup>2</sup>
    - b. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 213.7 provided to the consumer in electronic form in the advertisement? (§ 213.3(a))
  2. Are the disclosures given in a dated statement and in the prescribed format? (§ 213.3(a)(1))
  3. Is the information required by sections 213.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in appendix A to Regulation M? (§ 213.3(a)(2))

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2. The final amendments to Regulation M on the electronic delivery of disclosures, consistent with the requirements of the E-Sign Act, became effective December 10, 2007, and require mandatory compliance by October 1, 2008.

4. Are the disclosures timely? (§ 213.3(a)(3))
5. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§ 213.3(c))
6. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§ 213.3(b))
7. Are all estimates clearly identified and reasonable? (§ 213.3(d))
8. Are the disclosures accurate, and do they contain the information required by sections 213.4(a)–213.4(t)?
9. Are disclosures given to lessees when they renegotiate or extend their leases? (§ 213.5)

#### Lessee Liability

Review the lease estimates and calculations to ensure that no unreasonable balloon payment is expected of the lessee in the following circumstances:

- A. At early termination
  1. Does the lessor disclose the conditions under which the lease may be terminated early and the amount, and method of determining the amount, of any early-termination charges? (§ 213.4(g)(1))
  2. Are any early-termination charges reasonable? (§ 213.4(g)(1))
- B. At end of lease term (for wear and use)
  1. If the lessor sets standards for wear and use of the leased vehicle, are the amounts of, or method of determining the amounts of, any charge for excess mileage disclosed? (§ 213.4(h)(3))
  2. Are standards for wear and use reasonable? (§ 213.4(h)(2))
- C. At end of lease term (for open-end leases)
  1. Does the lessor disclose the limitations on the lessee's liabilities at the end of the lease term? (§ 213.4(m)(2))
  2. Are the lessee and lessor permitted to make a mutually agreeable final adjustment regarding excess liability? (§ 213.4(m)(3))
- D. In the event of delinquency, default, or late payment
  1. Does the lessor disclose penalties or other charges for delinquency, default, or late

payments? (§ 213.4(q))

2. Are the penalties or other charges reasonable? (§ 213.4(q))

## Advertising

- A. Review advertising policies and procedures used by the institution to ensure that it has adequate controls and procedures to effect compliance.
- B. Review a sample of the institution's advertisements.
  1. Do the advertisements contain terms that are usually and customarily available? (§ 213.7(a))
  2. Are the disclosures contained in the advertisements clear and conspicuous? (§ 213.7(b))
  3. Do catalog or multiple-page advertisements comply with the page-reference requirements? (§ 213.7(c))

4. When triggering terms are used, do the advertisements contain the additional required information? (§ 213.7(d))

Do merchandise tags that use triggering terms refer to a sign or display that contains the additional required disclosures? (§ 213.7(e))

5. If television or radio advertisements that use triggering terms do not contain the additional terms required by section 213.7(d)(2), do they use alternative disclosure methods (that is, do they direct consumers to a toll-free number or a written advertisement)? (§ 213.7(f))

## Miscellaneous

1. Are records and other evidence of compliance retained for at least two years? (§ 213.8)

# Regulation M Examination Checklist

1. Does the institution engage in consumer leasing or purchase consumer leases from lessors? (§ 213.2(h)) (If it does not, there is no need to complete this checklist.)	Yes	No
2. Are the disclosures made prior to consummation of the lease (that is, at the time a binding order is made or the lease is signed)? (§ 213.3(a)(3))	Yes	No
3. Are the disclosures clear and conspicuous and provided in writing in a form the consumer can keep? (§ 213.3(a))	Yes	No
4. Are disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)? (§ 213.3(a))	Yes	No
5. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 213.7 provided to the consumer in electronic form in the advertisement? (§ 213.3(a))	Yes	No
6. Are the disclosures given in a dated statement and made in either (i) a separate statement that identifies the consumer lease transaction, (ii) the contract, or (iii) other document evidencing the lease? (§ 213.3(a)(1))	Yes	No
7. Is the information required by sections 213.4(b)–(f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in appendix A to Regulation M? (§ 213.3(a)(2))	Yes	No
8. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§ 213.3(c))	Yes	No
9. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§ 213.3(b))	Yes	No
10. Are disclosures provided to at least one lessee when there are multiple lessees and by at least one lessor when there are multiple lessors? (§ 213.3(c))	Yes	No
11. Are all estimates clearly identified and reasonable? (§ 213.3(d))	Yes	No
12. Are the following disclosures made in the lease?		
A. Description of property (§ 213.4(a))	Yes	No
B. Amount due at lease signing or delivery (§ 213.4(b))	Yes	No
C. Payment schedule and total amount of periodic payments (§ 213.4(c))	Yes	No
D. Other charges (§ 213.4(d))	Yes	No
E. Total of payments (§ 213.4(e))	Yes	No
F. Regarding payment calculations,		
i. Gross capitalized cost (§ 213.4(f)(1))	Yes	No
ii. Capitalized cost reduction (§ 213.4(f)(2))	Yes	No
iii. Adjusted capitalized cost (§ 213.4(f)(3))	Yes	No
iv. Residual value (§ 213.4(f)(4))	Yes	No
v. Depreciation and any amortized amounts (§ 213.4(f)(5))	Yes	No
vi. Rent charge (§ 213.4(f)(6))	Yes	No
vii. Total of base periodic payments (§ 213.4(f)(7))	Yes	No
viii. Lease payments (§ 213.4(f)(8))	Yes	No
ix. Base periodic payment (§ 213.4(f)(9))	Yes	No
x. Itemization of other charges (§ 213.4(f)(10))	Yes	No
xi. Total periodic payment (§ 213.4(f)(11))	Yes	No
G. Regarding early termination,		
i. Conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term (§ 213.4(g)(1))	Yes	No

ii. The amount of or description of the method for determining the amount of any penalty or other charges for early termination (§ 213.4(g)(1))	Yes	No
iii. In a form substantially similar to the sample (§ 213.4(g)(2))	Yes	No
H. Regarding notice of wear and use,		
i. Whether the lessor or the lessee is responsible for maintaining or servicing the leased property, with a description of the responsibility (§ 213.4(h)(1))	Yes	No
ii. Lessor's standards for wear and use, which must be reasonable (§ 213.4(h)(2))	Yes	No
iii. In a form substantially similar to the sample (§ 213.4(h)(3))	Yes	No
I. Purchase option (§ 213.4(i))	Yes	No
J. Statement referencing other nonsegregated disclosures (§ 213.4(j))	Yes	No
K. Liability between residual and realized values (§ 213.4(k))	Yes	No
L. Right of appraisal (§ 213.4(l))	Yes	No
M. For open-end leases,		
i. The rent and other charges paid by the lessee (§ 213.4(m)(1))	Yes	No
ii. Liability at end of lease term based on residual value and any excess liability (§ 213.4(m)(2))	Yes	No
iii. Mutually agreeable final adjustment (§ 213.4(m)(3))	Yes	No
N. Fees and taxes (§ 213.4(n))	Yes	No
O. Regarding insurance,		
i. Types and amounts of insurance that the lessee is required to have (§ 213.4(o))	Yes	No
ii. If the lessor provides insurance, types, amounts, and cost (§ 213.4(o)(1))	Yes	No
P. Warranties or guarantees (§ 213.4(p))	Yes	No
Q. Penalties and other charges for late payments, delinquency, or default (§ 213.4(q))	Yes	No
R. Security interest other than a security deposit (§ 213.4(r))	Yes	No
S. Regarding any information on rates,		
i. Does the lessor use the term "annual percentage rate," "annual lease rate," or any equivalent term in the lease disclosure? (§ 213.4(s))	Yes	No
ii. If so, does a statement that "This percentage may not measure the overall cost of financing this lease" accompany the rate? (§ 213.4(s))	Yes	No
13. Are disclosures given to lessees when they renegotiate or extend their lease? (§ 213.5)	Yes	No
14. Does the bank advertise its leasing program? If it does,		
A. Do the advertisements contain terms that are usually and customarily available? (§ 213.7(a))	Yes	No
B. Are the advertisements clear and conspicuous? (§ 213.7(b))	Yes	No
i. Are any affirmative or negative references to a charge that is part of the disclosure required under section 213.7(d)(2)(ii) less prominent than the disclosure (except for the statement of a periodic payment)? (§ 213.7(b)(1))	Yes	No
ii. Are the advertisements of lease rates less prominent than any disclosure required by section 213.4 (except the notice of the limitations on the rate)? (§ 213.7(b)(2))	Yes	No
C. Do catalog and multiple-page advertisements comply with the page-reference requirements? (§ 213.7(c))	Yes	No
D. If any triggering terms are used, are all the following disclosures made? (§ 213.7(d)(2))		
i. That the transaction advertised is a lease	Yes	No



<ul style="list-style-type: none"> <li>ii. The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation</li> <li>iii. The number, amounts, and due dates or periods of scheduled payments under the lease</li> <li>iv. Whether or not a security deposit is required</li> <li>v. A statement that an extra charge may be imposed at the end of the lease term when the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term</li> </ul>	<p>Yes</p> <p>Yes</p> <p>Yes</p> <p>Yes</p>	<p>No</p> <p>No</p> <p>No</p> <p>No</p>
15. Do merchandise tags that use triggering terms refer to a sign or display that contains the additional required disclosures? (§ 213.7(e))	Yes	No
16. Do television and radio advertisements that do not contain the additional information required by section 213.4(d)(2) direct consumers to a toll-free number or a written advertisement for additional information when triggering terms are used? (§ 213.7)	Yes	No
A. Is the toll-free number listed along with a statement that the number may be used by consumers to obtain the information? (§ 213.7(f)(1)(i))	Yes	No
B. i. Is the written advertisement in a publication that is in general circulation in the community served by the station?	Yes	No
ii. Does the broadcast include the name and date of the publication?	Yes	No
iii. Is the publication published beginning at least three days before, and ending at least ten days after, the broadcast? (§ 213.7(f)(1)(ii))	Yes	No
C. Was the toll-free telephone number available for at least ten days, beginning on the date of broadcast? (§ 213.7(f)(2)(i))	Yes	No
D. Does the lessor provide the information required by section 213.7(d)(2) via the toll-free number orally, or in writing upon request? (§ 213.7(f)(2)(ii))	Yes	No
17. Are records and other evidence of compliance retained for at least two years? (§ 213.8)	Yes	No