Consumer Credit in Review

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By Alvin C. Harrell

1996"(Institute), in Dallas, Texas. 'This report on the Institute is based on your author's perceptions and reflections regarding matters covered at the program. These perceptions are necessarily personal and subjective, and should not necessarily be attributed to the program speakers. Nonetheless, the issues covered at this program provide a glimpse of recent trends and developments affecting consumer credit transactions.

II. The Purposes of Truth in Lending

Ed Harrell began the 1996 Institute with a retrospective view of the Truth in Lending Act (TILA). He noted that the economic boom of the 1950s, which contributed to predictions of an economic depression, was created by an explosion of consumer credit, which permitted workers to buy in large quantities the goods they produced. He should also be noted that the economic booms of the late 1960s, 1970s, and 1980s were accompanied by explosions of consumer credit, and that the growth recession of 1989-1992 was characterized by a crusade against the banking institutions that temporarily impaired the financial system and constrained the availability of credit. Following the election of President Clinton in 1992, this changed in two ways: the market was already adjusting as non-bank creditors (particularly sub-prime lenders and credit card issuers) expanded to fill the gaps left by a contracting banking system, and at the same time federal banking policy shifted from a focus on safety and soundness to a focus on credit expansion. The result was another credit expansion and a return to economic growth.

This history is relevant to the current debate on the future and purposes of consumer credit and the TILA. Ed Harrell noted that the TILA was promoted not only as a means to allow comparison shopping for credit terms, but as a way to restrain what was perceived as runaway consumer borrowing in the 1960s (on the theory that if consumers knew what it was costing them, they wouldn’t make as much ‘bad’ individual decisions). He presented graphics indicating that in this regard the TILA has failed: consumer credit has increased in the range of 1,500% since the TILA became effective in 1969. In the 1950s and 1960s the explosion was in secured credit (due in part, no doubt, to the efficacy of the TILA in constraining the increase in new bank charters granted in the early 1960s). Since then, the biggest increases have been in credit card debt, which has increased more than 4,000% since the TILA was enacted, and sub-prime credit. Clearly the relatively high cost of this credit and its disclosure under the TILA has not deterred consumer borrowing. Nor has the TILA constrained the cost of this borrowing: Consumer interest rates generally have increased in the aftermath of comprehensive federal consumer credit regulation.

Consumer advocacy has now entered a new and possibly more controversial phase. In contrast to the past four years to expand credit availability, a number of consumer advocates are now warning of the need to restrain credit availability in order to avoid over-borrowing consumers with excessive debt. This effort is consistent with one of the original purposes of the TILA, and is manifested in consumer representative advocacy of revisions to Article 9 that will add to the cost and complexity of secured credit transactions (and increase the potential liability of consumer creditors under Article 9). In response to aliminations that these proposals will add to the cost and reduce the availability of consumer credit, an increasingly common response is that the cost of credit is precisely what is needed.

One manifestation of this trend includes efforts before the National Bankruptcy Review Commission to expand the consumer bankruptcy discharge criteria, which would likely generate increased default rates and lead to higher consumer credit costs and reduced credit availability. Finally, note should be taken of arguments for including virtually all credit-related and loan closing costs within the finance charge and APR under the Truth in Lending Act (TILA). This proposal is of some interest, as a way to avoid Redbox-type litigation, but it is probably expected that the resulting consumer ‘sticker shock’ would cause the higher APR disclosures that would result, would discourage consumer borrowing.

Perhaps much of this reflects a reaction against the credit expansion of 1990-96, based on previous experience such a reaction can be expected at any time there is a major change in consumer credit expansion. But it is important that the implications of this reaction be fully considered by those involved.

The debates on the TILA, bank regulation, bankruptcy reform, credit card and sub-prime lending, and even the revision of the UCC Article 9 are inter-related, and need to be joined together by a focus on the potential impact of the proposed changes on economic policy and the cost and availability of consumer credit. Underlying these debates should be consideration of whether it is appropriate for the law to undertake to restrain the level of consumer credit, and whether such efforts to reduce credit availability are desirable if they tend to increase the cost of the credit that is available. Plans to reduce credit availability also must confront the danger of increased loan sharking, as a means to fill unmet credit demands by large expansions of the definition of credit. Reduced economic growth that is likely to result from any significant credit contraction should not be ignored.

However framed, this debate seems likely to intensify over the next few years and the outcome will help shape our future financial system and consumer credit laws into the next century.

III. TILA, RESPA, ECOA, FCRA and EGPRRA

At the 1996 Institute Sheldon Goodman, a staff attorney in the Fair Lending Section of the Division of Consumer and Community Affairs of the Federal Reserve Board (FRB) provided an update on a variety of federal regulations. She noted that this task seemed easier before the September 30, 1996 enactment of comprehensive financial legislation. Ms. Goodman noted that the new finance charge and APR tolerance under revised Regulation Z, implemented under the Federal Reserve Act of 1995 (partly in response to Redbox) are very complex and require a studied effort to master. She noted that the same Regulation Z revisions provide new rules governing debt consolidation contracts, and that these rules have been challenged by the insurance industry. She also noted the Consolidated Bankruptcy Act, which regulates when the words ‘immediately preceding examination’ in the TILA of the Fair Credit Reporting Act are limited to ordering restitutions on transactions since the last examination of any kind, or may go back to the previous compliance exam.

Turning to EGRPRRA, Ms. Goodman noted the new directive to the FRB to stand a new examination of the extent to which the TILA is of value to consumers in shopping for credit. This study has tremendous potential importance, but is currently limited to profit-making credit to consumers as against the tremendous

"This article is based on a presentation at the 1997 Conference on Consumer Finance Law presented at the 1997 Institute on 'Consumer Credit'"
compliance costs and burdens of TILA. She also described a directive to the FRB in ECOPRA to study privacy issues and the extent to which parties other than credit reporting agencies are making personal information available to the public (e.g., on the Internet). The concern is that such information has has many uses, from fraud and other "identity theft" crimes. She noted that the FRB is soliciting input on these issues from interested parties.

Ms. Goodman reported that the proposed rule of the ban on collection of monitoring information relating to ECOA-prohibited bases for discrimination in non-mortgage lending was still under consideration at that time and had not been finalized. The new Regulation B Commentary was finalized in September 1996, dealing primarily with credit scoring and the rules governing spousal signatures and guarantors. She also noted that ECOPRA amends the ECOA with regard to self-testing, requiring protection of the results to some extent. The FRB was required to issue an implementing regulation by March 1997 and to coordinate with HMDA regarding equivalent amendments to the Fair Housing Act.

Regarding RISP, Ms. Goodman noted that the HUD experiment with the potenti- al rule-making was not a success, as no consensus could be reached by the consulting parties. Seven somewhat con- tradictory approaches were presented, and no consensus was achieved. It was report- edly an educational experience for all involved. She also noted that ECOPRA requires the FRB and HUD to coordinate and streamline the TILA and RISP, with a proposal due by March 1997. Everyone agrees that RISP is broken, but there is no consensus on how to fix it.

ECOPRA also made changes to the Fair Credit Reporting Act. The proposed regulation for the requirement for the annual percentage rate and finance charge. Dealers usually disclose the charge for the annualized rate as a cost to the consumer, in addition to the charge to the dealer (e.g., $400), and this seems consistent with the requirements of the TILA. But the very difficulty of the TILA requires that the amount to be paid off in the finance charge is to be paid off in the fair market value of the vehicle. The amount financed has led to litigation claiming that the difference between the retail price and dealer cost is a dealer fee which must be separately disclosed.

A proposed Regulation to Regulation Z was issued by the Federal Reserve Board, stating that the traditional means of disclosure is sufficient and the dealer does not have to separately disclose the profit margin on an extended warranty. This was not clearly correct under the law. The proposed Commentary also stated that the dealer could also be "in its option" disclose the profit without violating the TILA requirements. When the Federal Com- mentary was issued, however, the language was used in its option.
This superseded earlier cases such as Fairman v. Schaumberg, Zephyr, Inc.,49 where the court dismissed a TILA claim on the grounds that the gap insurance premium was not "unsecured" on the debt under the TILA. In Johnson v. Rule-Vite Motors, Inc.,50 the court similarly dismissed the gap insurance claim on the ground that disclosure of gap insurance coverage was required, on grounds that a voluntary gap insurance premium is not part of the finance charge.

G. Assignee Limitity

Alexander v. Continental Motors Works, Inc.,51 held that the assignee of a credit contract was not liable for TILA violations by the assignee dealer unless those violations were apparent on the face of the contract. In Ritter v. Durand Chevrolet, Inc.,52 the court held that a dealer's failure to disclose in retention of part of the face for an extended warranty was a TILA violation; however, the court dismissed the claim against the assignee of the dealer because the violation was not apparent from the documents.

F. Gap Coverage

Gap insurance coverage is designed to protect the debtor (and the creditor) from "pap" (the debtor's other insurance coverage), for example, if the collateral is lost or stolen and the other insurance is insufficient to repay the debt. Gap insurance premiums are part of the finance charge for purposes of the TILA disclosures, assuming the gap insurance is voluntary. The summer 1996 FRB revisions to the Regulation Z Commentary53 state that gap insurance is like credit life insurance, and is therefore excluded from the finance charge if separately disclosed.

I. Open v. Closed End Credit

The characterisation of consumer contracts as open or closed has become a hot issue, because the outrageous rates for "high cost" (TILA Section 32 mortgage) goers don't apply to open end credit. This has led to allegations that certain open-end credit plans are a mere subterfuge to avoid the Section 32 rules, and that the key problems are disguised open-end credit plans that should be subject to Section 32 and other closed end credit rules. In Premier Federal Credit Union v. Dougher,54 the borrower was allowed to use the open-end credit plan as a means to avoid Section 32. The court considered this to be an open-end credit plan. The borrower claimed that this violated the TILA requirements and the closed-end disclosures were applicable, because repeated transactions were not contemplated. The appellate court restricted on grounds that a factual determination was needed, so summary judgment was not appropriate.

In Westin v. Murray,55 a loan to finance the borrower's law practice was secured in part by the home of the borrower's 83 year old grandmother. When the loan went into default, the borrower filed bankruptcy, and the lender commenced foreclosure, the grandmother sought to rescind. The court agreed, first concluding that the consumer loan as regards the grandmother even though the purpose was to finance a commercial enterprise (the law practice). The court then held that the right of rescission should be allowed even though more than three years had passed, because it was rescinded in recognition as a response to the bank's foreclosure action.

In In re Feltchel,56 the lender used the wrong rescission notice form (the refill form was not used instead of the new transaction form). More than three years later, the borrower filed bankruptcy shortly after giving notice of rescission. The lender argued that rescission was barred by Section 103(b), but the court held that rescission is permitted in bankruptcy after three years.57 The Boulware court also discussed the Truth in Lending Act Amendments of 1995,58 concluding that before the 1995 amendments 12 U.S.C. section 1685 (which deals with rescission) did not allow rescission, unlike section 1640 on monetary remedies. However, the court denied rescission in this distinction with out a difference.59 The court also cited the language in new section 1635(c)(3)[6] ("Nothing in this subsection affects a consumer's right of rescission in support of its decision.")

In Carriots a date with a Bait Money Corporation,60 the consumer purposely waited two years and 11 months before giving notice of rescission, in order to maximize the restructuring recovery at the expense of the creditor. The court saved the creditor by concluding that the violations (the escrow company failed to disclose that the borrower had not five days to rescind and failed to include the certification date in the rescission notice) fell within the bona fide error defense.

J. Miscellaneous

O'Brien v. J.I. Kostik Mortgage Corporation,61 the Right of Rescission, the plaintiff...
sought to overcome the effects of the Truth in Lending Amendments Act of 1980 by arguing that the Act was unconstitutional, particularly with regard to the retroactive provisions. In a thorough analysis, the court rejected these allegations.

Colb v. Monarch Financial Corp. was a class action involving high rate loans (100% plus interest rates) that were to be repaid through lump-sum payments of wages and designation of a special bank account to enable the creditor to directly receive wage deposits. The plaintiffs alleged that this arrangement constituted a security interest, undisclosed under the TILA and therefore a TILA violation. The court rejected this argument, though other state law and EFTA claims survived the motion for summary judgment.

V. The Scope of the TILA

A. Introduction

James C. Conboy, Jr. covered important issues relating to the scope of TILA. For example, it is possible to extend a credit line based on the TILA. The answer is unclear.

Mr. Conboy noted that credit payable in more than one installment is covered even if there is no finance charge. Common informal arrangements are often covered but sometimes there is no compliance with TILA because the parties are unaware of TILA coverage. One example is real estate loans on rental property with up to four units, covered by the TILA if a unit is owner-occupied. He noted that purchase of up to two units is covered, along with improvement loans on up to four units. These are case-by-case rules for three and five unit dwellings.

Regarding the TILA exceptions, Mr. Conboy noted that a loan exceeding $25,000 and not secured by real estate or a principal dwelling is excluded from the TILA. This will exclude many car loans from the TILA requirements. However, fuel budget plans and public utility credit plans are also excluded. But state TILA laws may cover transactions excluded under federal law.

B. Refinancing

Refinancings are covered under the TILA if a closed-end credit obligation is satisfied and replaced by a new obligation of the same consumer. If the note is not nullified but rather is renewed, there is no refinancing and no TILA disclosure requirement. Generally, subsequent events which do not constitute a refinancing include modification, extensions, and renewals that do not satisfy the old obligation or create a new one.

C. Rescission

A creditor's failure to meet the technical requirements of the TILA (e.g., a failure to provide all the necessary copies of the rescission notice) may entitle the debtor to rescind the transaction. But suppose the creditor gives a notice of the right to rescind where no such right exists. Does this contractually create a right of rescission outside of the TILA? Again, the answer is unclear.

There are exceptions to the right of rescission for loans to acquire or construct a consumer's principal dwelling. The right of rescission does not apply if the TILA disclosures are not applicable. Generally, it is dangerous to give a notice of a right to rescind if not required, because of the danger of creating new substantive rights where note otherwise exist.

A refinancing is rescindable only if there is an advance of new funds, and then only to the extent of the new advances. Charges such as reasonable closing costs (e.g., attorney fees, title examination fees, and insurance fees) do not count as a new advance for this purpose.

D. Restitution

Mr. Conboy noted the Joint Policy Statement (FPS) of the federal banking agencies on TILA restitution. Under TILA section 108, U.S. Code section 1667, there is no private right of action to redress violation, and the Federal Trade Commission (FTC) has jurisdiction. Section 101B provides that the enforcement agencies have the authority to require reimbursement for inaccurate disclosure of the APR or finance charge, and requires restitution where the error resulted from a clear and consistent pattern or practice of violation, gross negligence, or a willful violation designed to deceive the debtor. The FTC contemplates that the agencies will use their cease and desist power to compel compliance as needed. In addition, the agencies may assist the borrower to impose civil monetary penalties for regulatory violations. All of this increases the exposure of federally regulated banking institutions to a high risk of liability for disclosure violations discovered during regular compliance examinations.

E. Exemptions

Under the TILA there is a 60 day expiration rule: If the creditor completes within 60 days of discovery of the error (by notifying the consumer and making the needed adjustment), the agency will not issue an order requiring restitution.

The following tolerances are recognized, however, as the trigger of one percent for all loans with a term of ten years or less; one eightieth of one percent for regular transactions with a term of ten years or less (one fourth of one percent for irregular transactions) closed after April 1, 1982. For a willful violation the amount is one eightieth of one percent regardless of the loan term. These tolerances apply for restitution purposes only, as provided in the FPS, and do not apply for rescission purposes. Additional tolerances were provided in the Truth in Lending Amendments Act of 1995 and the resulting Regulation Z revisions.

Charges for credit life, accident, and health insurance are excluded from the Finance Charges, but only if discounted and agreed to separately. TILA section 108(e)(2)(B), U.S. Code section 1667a(e)(2)(B), provides that no adjustment will be required if the understated APR or finance charge is ten percent or less of the amount that should have been disclosed. And TILA section 108(e)(3)(i) provides that restitution will not be required for violations that occurred before the previous agency examination.

As of the Consumer Credit Code 1996 Institute, the banking agencies were still rejecting the mandate of TILA section 108(e)(3)(i) and the Eighth Circuit decided in First National Bank of Council Bluffs, as a result the matter was being litigated again in the Consolidated Bank case.

F. Unacceptable Defenses

Mr. Conboy described several defenses to TILA liability which in the view of many lenders represent legitimate defenses that should be recognized by the courts and federal agencies, but which are not formally recognized. These "unacceptable" defenses include:

1. Size of the institution (unlike some federal compliance laws and regulations, there is no connection in the TILA or Regula- tion Z for small institutions with limited compliance resources—perhaps a factor in the consolidation of the industry and the decline of community banking).

2. Impact of reimbursement on the institution's reputation. (This illustrates a basic conflict in the modern mission of the bank regulatory agencies—the agency responsible for the safety and soundness of the institution has directed its examiners to ignore the well-being of the institution in this context.)

3. Previous examination did not find the violation (see supra Part III E. discussion of First National Bank of Council Bluffs and 15 U.S.C. section 1667a(e)(3)(i)).

4. Examiners previously gave erroneous advice. (This is particularly frustrating to bankers and legal counsel who have established compliance procedures and standards at the direction of a prior examiner, only to be cited for serious errors in these procedures when the next examiner takes a different view. Your author is aware of an instance when formal enforcement was taken against a small lender partly on this basis.)

5. Redisclosure was made to con- sumers (but reimbursement was not).

The FDC Compliance Manual also notes that reimbursement is required when a "pattern or practice" of reimbursable violations occurs, but it was noted that this is an undefined term that is essentially in the eye of the beholder. Again, some bankers and legal counsel experience this area of law by believing that this is an example of a highly discretionary regulatory authority that has led to uneven application of the law. In addition, as noted above, some feel that the defenses listed as "unacceptable" in the FDC Compliance Manual ought instead to be specifically recognized as acceptable defenses, based on either existing statutory language or traditional principles of American law.

G. Questions and Answers

Mr. Conboy noted the "questions and answers" regarding the FPS, beginning at page 12 of Appendix E of the FDC Compliance Manual. These important issues for example providing that a purchaser or assignee of loans originated by another will not be liable for violations of the originator, even if the obligation by its terms is essentially pay- able to a third party and simultaneously assigned to the financial institution. The originating lender is considered the "creditor" for purposes of liability for reimbursement. These "questions and answers" are an important tool for creditors and their counsel; a complete copy...
VI. Mail Order Kombat

Chris Jones spoke on "Mail Order Kombat," i.e., the pressures encountered by lenders in the context of intermediate lending. He noted the difficulty of reconciling the concerns and agendas of the lender, in-house counsel, outside counsel, federal regulators and state law administrators, competitive pressures, the marketing department, consumers and, of course, consumer attorneys seeking to find violations on which to sue. He noted that the average consumer needs to understand credit cards and credit card applications in 1995, reflecting the high level of competition in this segment of the consumer credit market.

He noted that the choice of entity is an important consideration. Federally regulated banking institutions enjoy the benefits of federal deposit insurance and preemption of many state laws under "Smiley," but pay a heavy price in terms of regulatory burdens, restrictions, and liabilities. Credit card issuers, on the other hand, are now called "market funded creditors," enjoy a superior regulatory environment, but do not have the benefits of federal preemption or deposit insurance. Interestingly, the ability of market funded creditors to finance themselves through securitization, the importance of deposit insurance as the line of demarcation between banks and other lenders is becoming less important; instead it is federal preemption of consumer state laws that increasingly is the primary consideration in the choice of a federal chartered, at least for intermediate lenders.

Interestingly, the charter decision is being viewed as a choice between the cost of complying with variations in state laws versus the cost and burden of a federallty regu- grated charter. In this regard Mr. Jones noted that while states such as Arkansas permit reasonable rates and charges on consumer transactions, permitting a uniform state law strategy based on forms complying with the "lowest common denominator" of state requirements. The basic rule remains that the law of the debtor's state controls issues of consumer protection (absent federal preemption). But in the consumer credit arena, it appears that forms are often more important than substance, so that proper forms and procedures can be effective to overcome disputes in state law.

For consumer loans, the lender may need to be licensed in the borrower's state. The Consumer Commerce of the U.S. Constitution does not require this, but state laws on this subject vary considerably. State administrators may or may not be helpful, and questionable assertions of state jurisdiction may not be worthy of defense. But in any event obtaining a state license is cheap insurance. For sales finance programs, fewer than half of the states require state licensing; but again, a license is cheap insurance.

This raises the question whether the seller should be the initial lender, subsequently assigning its rights to the financier. Characterization of the transaction as a credit sale may be advantageous to both the seller and the ultimate creditor, for business as well as legal reasons. This calls for a carefully drafted agreement between the seller and the creditor, for example to provide for indemnification of the creditor by the seller for any claims or defenses asserted by the consumer against the assignee. In view of the Long Beach settlement, fair lending concerns are also implicated. Pre- screening issues have been somewhat resolved by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

Direct lending is more likely to remain subject to state licensing requirements, un- solicited mail statutes, and state telemarketing laws. In the case of either direct or indirect lending, state debt collection laws need to be considered, particularly where default or prior to enforce- ment of default remedies. Mr. Jones cited a list in his materials of potential state law problems area.

VII. Federal Preemption

Marc Litfet and Laura Brown then discussed federal preemption. Mr. Litfet cited eight potential corollaries of federal preemption:

1. Complete preemption.
2. Express mention preemption.
3. Anti-express mention preemption.
4. Reverse express mention preemption.
5. Preservation of state law.
6. Preservation by statute of state law.
7. Reverse preemption.
8. Double secret preemption.

Ms. Brown described the extensive preemption authority of the Office of Thrift Supervision (OTS) under the Home Owner's Loan Act, which comes close to complete preemption, which is otherwise mostly unattainable.

She also noted that RESPA and ECOA do not impose a "meaningful" state law that is less protective than the federal law. This is a partial preemption principle. The Fair Debt Collection Practices Act also illustrates partial preemption pattern on the ECOA and RESPA model. State law may also be able to apply for an exemption if state law is substantially similar. The Fair Credit Reporting Act is simil- ar, though the 1996 amendments contain some express preemption mention.

Ms. Litfet noted that the TILA also provides partial preemption of state laws inconsistent with the TILA. He noted the problems that can arise when state law requires inconsistent disclosures or the extent of preemption in unclear.

Ms. Brown described the presumption against preemption in great traditionally regulated by the states, absent specific statutory preemption. Mr. Litfet then described statutory preemption and contrasted it to regulatory preemption, noting that regulatory preemption may not be entitlement to deference or not authorized by statute. But if the statute is ambiguous, deference will be given to reasonable agency interpretations. The best current example is the recent U.S. Supreme Court decision in Smiley v. Citibank (South Dakota). Ms. Litfet noted that state banks are entitled to similar statutory preemption but have no direct equivalent of the OCC regula- torial preemption at this time.

The corollaries were then described as follows:

Double secret preemption—e.g., section 501 of DIBA pre- empts state law limits on mort- gage loans, but not state limits on compounding.

VIII. Securitization Issues

Ronald Ehinger spoke on securitiza- tion of consumer finance receivables, focusing on automobile receivables under state law. He distinguished between two-party paper (direct lending, which can involve a third party dealer, at least periodically) and three-party paper (origi- nated by the dealer and assigned to the creditor). He noted that frequently this will determine the applicable state law: consumer loans laws or retail installment sales act. The transaction may need to be structured accordingly. He mentioned (as had Chris Jones) the importance of state licensing requirements. Mr. Ehinger reported that the OTS has recently held that thrift operating subsidiaries are covered by the OTS preemp- tion rule.

Mr. Ehinger then discussed the securitization process and related legal is- sues. He described the use of a trust to hold ownership of the receivables and provide protection against the assignor's bankruptcy. He noted that some states require that the trust be exempt from the chain to be li- censed, including not only the originator but secondary purchasers, the servicing entity, and the collection entity, though other states do not require licensing of secondary parties. He noted that loan as- sumptions, modifications, and bank- ruptcy negotiations may convert a se- condary purchaser into a direct lender. Rates and charges involve other issues. As noted supra at 20th state law on this may be preempted by federal law or regulations. Direct lending may sub- ject the creditor to liability for state law violations that would otherwise be im- plated to the credit seller under the state law.
retal installment sales act or consumer credit code.

Treatment of origination fees varies from state to state. Some states prohibit such fees on installment transactions, and some treat such fees as interest while others do not. These issues arise separately from the issue of disclosure under the TILA. Late charge and finance fee disclosures are similar in these respects. 100

Mr. Ehringer urged caution when buying products from automobile dealers, as well as installment sales contracts. Mr. Ehringer described the recent rise in consumer interest in privacy and the consequences of new state laws and regulations that govern advertising. He warned that these laws and regulations are becoming more stringent and could have a significant impact on the automobile industry. He also discussed the need for dealers to be aware of the requirements of the Truth in Lending Act and the Consumer Credit Protection Act.

IX. Consumer Satisfaction and Consumer Advocacy

Dick Moskowitz of Ford Motor Credit Company concluded the first day of the Institute by discussing governmental affairs issues and consumer satisfaction policies. He focused on consumer learning issues, including disclosure of the total capitalized cost, and lending issues such as the rule of 78s.

Mr. Moskowitz described the rise and importance of customer satisfaction policies, deriving from surveys indicating that it is less costly to retain current customers than to acquire new ones. The cost of compliance violations is also a factor, though he noted that compliance costs have also tended to increase the cost of credit and therefore are a mixed blessing for consumers.

Mr. Moskowitz noted that, to date, consumer service policies and the accompanying customer assistance policies of consumer car dealerships have had little or no effect on public policy choices or the positions of those claiming to represent consumer and consumer advocates. It is likely that the efforts of consumer advocates to position consumer services and satisfaction were factored into formulation of consumer laws and regulations, rather than the more direct participation of consumer advocates as a part of the consumer protection movement.

Mr. Moskowitz noted the general rise in complaints about consumer service policies and satisfaction. He emphasized that it may be that consumer advocates are not effective in their efforts to improve satisfaction. He suggested that there is a need for a more structured approach to addressing consumer service and satisfaction issues.

Mr. Moskowitz specifically noted the total capitalized cost disclosure as an example of a disclosure promoted by the industry as a result of customer satisfaction and sales (and subsequently supported by the Federal Reserve Board). As a second example he cited the rule of 78s, which has not been a problem in consumer satisfaction surveys, but has been a target for consumer advocates, and thus deems it necessary to use disclosure practices and processes that can improve consumer satisfaction and sales, and that can be used to improve the process of selling the product to the consumer.

Mr. Moskowitz noted that when a dispute arises the consumer may be unable to get their money back, or if they get their money back, it may be insufficient to cover the cost of repairs or the cost of replacement parts. He concluded by suggesting that there is a need for a more structured approach to addressing consumer service and satisfaction issues.

X. Home Equity and Home Improvement Lending

Carrie Carlin began her presentation by highlighting the importance of direct lending and the secondary purchase of retail installment contracts from, say, a home improvement contractor. An advantage to such purchasers is avoidance of lender licensing requirements, but a disadvantage is material liability for misdeeds of the contractor.

Mr. Carlin noted that when a dispute arises the consumer may be unable to get their money back, or if they get their money back, it may be insufficient to cover the cost of repairs or the cost of replacement parts. He concluded by suggesting that there is a need for a more structured approach to addressing consumer service and satisfaction issues.

Mr. Carlin noted the alleged practice of "slipping," where the home improvement contractor does work on the debtor's home before the recission period has run but then, when the homeowner feels obligated, is encouraged not to rescind. Secondary purchasers have a difficult time monitoring this kind of fraudulent activity. He also noted recent litigation over this issue, asserting that mortgage brokerage is somehow an ill-legal function that should be prohibited.

The yield spread premium and over- life use is based on the basic theory that fees paid to the mortgage broker and the consumer are necessary. The legal theories are sometimes based on the RIBA or TILA, though recently these raters have been clarified somewhat. RIBA regulations make it illegal to charge fees on grounds these fees are illegal referral fees or are not reasonable in relation to the services rendered. 101

Among the unusual arguments are those urging that auto dealers are loan brokers who owe a fiduciary duty and a duty of disclosure to obtain the best financial available. 102

XI. Privacy, Fair Credit Reporting, and Fair Lending

Anne Foreman, former director of the Division of Credit Reform for the Federal Trade Commission, discussed the 1996 amendments to the Fair Credit Reporting Act (FCRA). These changes become effective September 30, 1997, but compliance is optional until then. These revisions clarify a number of previous uncertainties and resolve debates that have gone on for years. Among other things, Ms. Foreman noted that under the amendments the term "adverse action" will have the same meaning under FCRA and ECOA. There are also new affirmative duties for users and furnishers of consumer reports, 103 and new rules allowing the use of "dark file" information to be shared amongst credit bureaus against certain notice to the consumer. 104

Apparently there are no civil liability provisions for those new requirements. Enforcement will be with the FTC and state attorneys general. 105 Importantly for some creditors, state law is extensively preempted. 106

100. See supra, note 45.
101. See supra, note 46.
102. See supra, note 47.
103. See supra, note 48.
104. See supra, note 49.
105. See supra, note 50.
106. See supra, note 51.
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XII. Yield Spread Premiums, Loan Acquisition Fees, and the Dealer-Lender Relation

David McCrea described the extraordinary developments leading to the infamous Meritex Finance decision,108 a case which has come to epitomize the politicization of the relationship between the dealer and lender.109 He noted that the National Conference of Commissioners on Uniform State Laws has formed a drafting committee to draft uniform state law on consumer credit.110 He also reported that the National Conference of Commissioners on Uniform State Laws has formed a drafting committee to draft uniform state law on consumer credit.111 He noted that a model consumer leasing act was formulated several years ago, and that this has been enacted wholly or in part in several states. Mr. Hudson noted that the introductory information for new Regulation M presents strong arguments against requiring a disclosed lease rate (as an equivalent APR), on grounds that there is no such uniform rate and the proposed method is not sufficiently rigorous to be meaningfully used as a meaningful basis. Mr. Hudson also noted the increased popularity of used car leasing and “one way” leasing.

XIV. Consumer Litigation

George Magen provided, as written materials for the Institute, a nearly 700 page compendium of recent case law developments affecting consumer credit, including recent auto finance and mortgage lending cases, forced placed insurance cases, loan flipping and mortgage substitution cases, back to back booking, and class action insurance actions, fair lending settlements, and arbitration clauses.107 The auto finance litigation includes cases on service contract fees,108 lease termination fee disclosures,109 and securities.

Mr. Foytsey also described the recent upsurge in administrative fair lending enforcement actions, including the well known Long Beach settlement and some that are less well known but equally important.110 Mr. Foytsey joined the rising chorus of concern over the consumer branch of the government's approach in imposing questionable theories of law by administrative enforcement, with no public debate or judicial review. Mr. Foytsey noted that the sanctions used in these cases are easily manipulated and are not reliable. It has been noted elsewhere that the administrative powers confering these sanctions, such as fines, have been used in an effort to create new law outside the traditional legislative and judicial processes. Mr. Foytsey cited several examples of the way statistics can be manipulated in these cases. While she strongly supported the deconstruction of incorrect resources to fair lending, there is a growing consensus that the tactics that have been used by the Justice Department are being used indigenously.

Mr. Foytsey noted that Long Beach Mortgage Company was criticized for soliciting low income borrowers by offering loans with low payments without disclosing that lower interest rates might be available elsewhere. This was cited as an unfair practice. There is no apparent basis for the law as charged and it is not clear that it was designed to reflect little more than a bias at the Justice Department against loan brokers.

In your analysis, this illustrates the represent an abuse of federal administrative authority, in pursuit of an unheeded political agenda. It is ironic that the U.S. Department of Justice is the body being used to circumvent the appropriate legal and democratic processes.


XVI. Repossessions and Enforcement

Michael Dunagan described the legal pitfalls that may arise in the process of repossessing consumer goods. These issues have been previously covered in the Quarterly Report and the discussion will be repeated here. Mr. Dunagan emphasized that some courts have held the lender vicariously liable for violations by repossession agents, even though the agents were clearly independent contractors. Stealth and trickery generally are allowed, so long as there is no breach of the peace, but breaking and entering or anything damaging the debtor's property or implicitly threatening violence will be deemed a breach of the peace.111 Mr. Dunagan argued that the recent upsurge in consumer bankruptcies is a result of attorney marketing efforts rather than consumer needs or economic conditions.112 This represents a potential threat to consumer creditors and, ultimately, the availability of consumer credit. Some reports from the National Bankruptcy Review Commission also may be viewed by some as cause for concern.


XVII. Conclusion

Generally, and despite some dramatic exceptions, 1996 was a good year for the rule of law in consumer transactions. EGRPRA provides some actual and prospective (though limited) relief at the federal level. The more egregious state law decisions, such as those in Alabama, have come to be recognized as legal aberrations that reflect more on a local judicial system than on the state of the law. Hopefully such cases can be consigned to the dustbin of judicial oddities. Creditors doing business in Alabama and some districts of Illinois, Tennessee and Texas know what they are up against and may simply have to adjust their loan terms and underwriting practices accordingly. And in Alabama, as noted elsewhere in this issue, there has been a serious effort at legislative reform.

But the states have not yet moved to confront the challenge of federal preemption, by developing a reasonable and uniform system of state consumer credit law. As long as this failure continues, the states will be jeopardizing their ability to maintain a viable state-chartered credit industry as an alternative to the national system being created by means of federal preemption and bankruptcy law. Hopefully the states will some day be as vigorous in this respect as they are in preserving state insurance laws and state banking charters (both of which also may be threatened by the prospect of federal preemption).

Along with continuing problems regarding abuse of the jury system in some states, and the problems associated with the combination of statutory penalties for technical violations in conjunction with prevailing party attorney fees, creditors should be carefully monitoring the bankruptcy law revisions being considered by the National Bankruptcy Review Commission. The UCC Article 9 revisions also bear watching and may warrant efforts to support nonuniform revisions at the state level.

Subprime lenders may always be somewhat more susceptible to attempts by courts to effect social engineering under the guise of adjudication, because of a natural human instinct to seek justice in the case by favoring sympathetic parties regardless of the law. Ironically this merely increases the risk of lending to already risky borrowers and thereby may raise the already high cost of such loans. One can only hope that most judges will have a sufficient respect for the rule of law as a counterweight to this human instinct.

The cost-effectiveness of most consumer credit laws and regulation remains at issue and increasingly is being questioned. The Justice Department approach to fair lending enforcement has been widely criticized but probably there is little hope for fundamental reform in either of these areas. State and federal consumer credit laws are badly in need of reform to achieve greater simplicity, clarity and uniformity.

It may get worse. Some consumer advocates are attacking the very foundations of contract law in consumer transactions, on grounds that consumers inherently do not understand the nature of the contracts they sign. This conclusion argues for even more detailed regulation of consumer credit, and thus far the political response at both state and federal levels has been to pile more and more disclosure requirements and substantive limitations on creditors. At some point the result will be creditor and consumer bewilderment and the absence of any real system of law, as the requirements in total become so complex that no one can fully comply. Consumer advocates may tolerate this trend in part because it creates the potential for new technical violations that can be alleged in litigation and as a basis for class actions, recovery of attorney fees, and/or punitive damages. But it also makes it more difficult for judges to identify and analyze the issues, and for lawyers to adequately represent their consumer clients.

In short, consumer credit law remains desperately in need of reform. It is quite extraordinary that the system works as well as it does in terms of allocating available credit, in view of the generally difficult legal environment. The American system is now close enough to legal overload that no one can seriously advocate additional disclosures as the solution to any problem. At some point, society may finally have to confront these issues and decide whether consumer choices should be made by consumers (pursuant to the common law model based on contract law), with reasonable disclosures, or by legislators, regulators, administrators, and other third parties claiming to represent consumer interests.

181. See Harwell, supra note 61.
183. See Mauk et al., Alfonso's Battle to Reform Ins Consumer Finance Law, in this issue.
184. See articles in this issue.

**CONFERENCE SCHEDULES ANNUAL MEETING**

The Conference has scheduled the 1997 Annual Meeting for Sunday, August 3, 1997 from 4:00-6:00 p.m. in San Francisco, California. This will be followed by the traditional wine and cheese reception from 6:00-7:00 p.m. The precise location will be announced as that information becomes available.