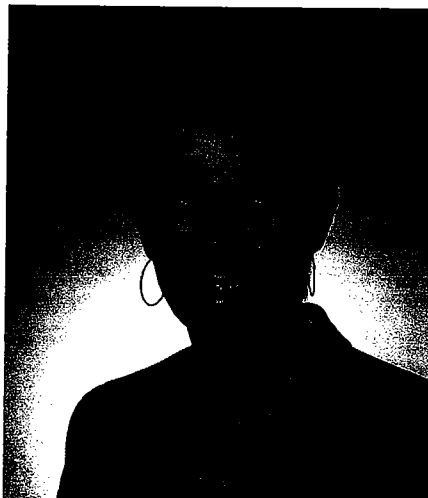


Federal Law Issues: TILA, FCRA, Bankruptcy, and Debtor-Creditor Law

## TILA Regulation and Litigation Update

By Judith M. Scheiderer



Judith M. Scheiderer is a partner with the law firm of Dreher Langer & Tomkies L.L.P. She practices in the area of banking and financial services and is engaged in the representation of banks, finance companies, and other financial institutions nationally. Her practice focuses on: state and federal regulatory matters; multistate compliance and development of lending programs, including credit card, retail credit, home improvement, and business-purpose credit and charge card programs; and general banking matters. She is the Managing Editor of the firm's *Credit Card Digest*. She is a graduate of The Ohio State University (B.A. 1967; M.S. 1973; J.D. *summa cum laude* 1991; Order of the Coif, Editor, *Ohio State Law Journal*). She is a member of the Consumer Financial Services Committee of the Business Law Section of the American Bar Association.

sumer Credit Cost Disclosure) of the federal Consumer Credit Protection Act.<sup>1</sup>

### 2. Fair Credit Billing

The TILA was amended on October 28, 1974 to add the Fair Credit Billing Act.<sup>2</sup>

### 3. Consumer Leasing

The TILA was amended again on March 23, 1976, to add the Consumer Leasing Act of 1976.<sup>3</sup>

### 4. Simplification and Reform

The TILA underwent substantial revision with the enactment on March 31, 1980 of the Truth in Lending Simplification and Reform Act, as Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980.<sup>4</sup>

### 5. Credit and Charge Card Disclosure and Home Ownership Protection

The TILA was amended on November 3, 1988 to add the Fair Credit and Charge Card Disclosure Act of 1988,<sup>5</sup> and again on November 23, 1988 to add the

Home Equity Loan Consumer Protection Act of 1988.<sup>6</sup>

### 6. Home Ownership and Equity Protection

On September 23, 1994, the Home Ownership and Equity Protection Act of 1994 (HOEPA) was enacted as Subpart B of Title I of the Riegle Community Development and Regulatory Improvement Act of 1994.<sup>7</sup>

### 7. 1995 Amendments Respond to Litigation

The TILA was revised substantively again on September 30, 1995 with the enactment of the Truth in Lending Act Amendments of 1995.<sup>8</sup>

#### B. Purpose and Scope

The TILA is intended to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The TILA and its implementing regulation (Regulation Z) do not limit the charges for consumer credit. Key parts address Credit Transactions (Open-end Credit, Closed-End Credit, and Mortgage Transactions), Credit Advertising, Credit Billing, and Consumer Leases.

## I. Introduction to the Truth in Lending Act

### A. A Brief Historical Perspective

#### 1. Consumer Credit Cost Disclosures

The Truth in Lending Act (TILA) was enacted on May 29, 1968 as Title I (Con-

1. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601 *et seq.*). For a further history of the TILA, including the subsequent amendments cited below, see RALPH J. ROHNER AND FRED H. MILLER, TRUTH IN LENDING Ch. 1 (2000 and 2004 suppl.).

2. Pub. L. No. 93-495, 88 Stat. 1511 (1974) (codified at 15 U.S.C. §§ 1666-1666i).

3. Pub. L. No. 94-240, 90 Stat. 257 (1976) (codified at 15 U.S.C. §§ 1667-1667e).

4. Pub. L. No. 96-221, 94 Stat. 168 (1980) (codified at 15 U.S.C. § 1646).

5. Pub. L. No. 100-583, 102 Stat. 2960 (1988).

6. Pub. L. No. 100-709, 102 Stat. 4725 (1988) (codified at 15 U.S.C. §§ 1637a, 1647, 1665b).

7. Pub. L. No. 103-325, 108 Stat. 2160 (1994) (codified at 15 U.S.C. §§ 1639, 1648).

8. Pub. L. No. 104-29, 109 Stat. 271 (1995) (codified at 15 U.S.C. § 1649). See generally Alvin C. Harrell, 1996 Regulation Z Changes Implement Truth in Lending Amendments Act, 50 Consumer Fin. L. Q. Rep. 470 (1996).

**C. Applicability**

The TILA generally applies to individuals or businesses that offer or extend credit: (1) to consumers; (2) on a regular basis; (3) that is subject to a finance charge or is payable by written agreement in more than four installments; and (4) that is primarily for personal, family, or household purposes (certain provisions apply to credit cards even if not subject to a finance charge, payable in more than four installments, or for business purposes).

**II. Regulation Z**

**A. Introduction**

Under the authority of TILA,<sup>9</sup> the Federal Reserve Board (FRB) promulgated the implementing regulations for TILA (Regulation Z),<sup>10</sup> and issued the Official Staff Commentary to Regulation Z.<sup>11</sup> The FRB revises Regulation Z and the Commentary from time to time.

**B. Organization of Regulation Z**

Regulation Z is organized roughly as follows:

- Subpart A—General.
- Purpose/Coverage/Organization.
- Definitions.
- Exempt Transactions.
- Finance Charges.
- Subpart B—Open-End Credit.
- Subpart C—Closed-End Credit.

- Subpart D—Miscellaneous.
- Record Retention.
- APR in Oral Disclosures.
- Language of Disclosures.
- Effect on State Laws.
- State Exemptions.
- Limitation on Rates.
- Subpart E—Special Rules for Certain Home Mortgage Transactions.
- Appendices.

**III. 2004 Regulatory Developments**

**A. HOEPA Dollar Amount Adjustments**

The FRB published a 2004 final rule amending the Official Staff Commentary, interpreting certain requirements of Regulation Z concerning home loans under HOEPA.<sup>12</sup> This included annual dollar adjustments for the HOEPA trigger.<sup>13</sup>

**1. Special HOEPA Rules**

The TILA requires creditors to disclose credit terms and the cost of consumer credit as a dollar amount and as an Annual Percentage Rate (APR). For loans secured by a consumer's home, the TILA requires additional disclosures and permits consumers to cancel certain transactions that involve their principal dwelling. The HOEPA imposes limitations and additional disclosure requirements on certain closed-end home mortgage loans bearing rates or fees

above a certain percentage or amount.<sup>14</sup> Creditors must comply with the HOEPA rules if the total points and fees payable by the consumer at or before loan consummation exceed the greater of \$400 or eight percent of the total loan amount. These are commonly called the HOEPA "triggers." The TILA and Regulation Z provide that the \$400 figure must be adjusted annually on January 1 based on the annual percentage change in the Consumer Price Index (CPI) that was reported on the preceding June 1.

**2. 2005 Dollar Amount Adjustment**

On August 16, 2004, the FRB published its announcement that the adjusted dollar amount for the HOEPA trigger for 2005 is \$510.<sup>15</sup> Effective January 1, 2005, for purposes of determining whether a home mortgage transaction is covered by the HOEPA and Regulation Z section 226.32 (based on the total points and fees payable by the consumer at or before loan consummation), a loan is covered if the points and fees exceed the greater of \$510 or eight percent of the total loan amount. The FRB Commentary, at Comment 32(a)(1)(ii)-2, lists the adjustments for each year, and was amended to reflect the dollar adjustment for 2005. Because the timing and method of the adjustment is set by statute, the FRB concluded that notice and public comment on the change were not necessary.

**B. Revisions to Regulation Z**

The FRB issued final 2004 revisions to Regulation Z and the Official Staff Commentary effective April 1, 2004 with mandatory compliance beginning October 1, 2004.<sup>16</sup>

9. 15 U.S.C. § 1604.

10. 12 CFR pt. 226.

11. *Id.*, pt. 226, Supp. 1. See generally Robert a. Cook, *A Primer on Closed-End Credit Transactions Under the Truth in Lending Act and Regulation Z*, 53 Consumer Fin. L. Q. Rep. 315 (1999).

12. 69 Fed. Reg. 50,298-01 (Aug. 16, 2004).

13. See *infra* Pt. III.A.2.

14. See 12 CFR §§ 226.32, 226.34. See generally Donald C. Lampe and Stephen F.J. Ornstein, *Federal Reserve Board Amendments to Regulation Z/HOEPA Regulations*, 55 Consumer Fin. L. Q. Rep. 223 (2001).

15. See *supra* note 12.

16. 69 Fed. Reg. 16,769-03 (Mar. 31, 2004).

### 1. "Clear and Conspicuous" Standard

Most notable in the final 2004 revisions to Regulation Z was the absence of any new or revised "clear and conspicuous" standard for providing disclosures under Regulation Z. The FRB opined in proposed rules published on December 10, 2003 that the equivalent standard in Regulation P (*i.e.*, requiring that a disclosure be "reasonably understandable and designed to call attention to the nature and significance of the information" in the disclosure)<sup>17</sup> is "articulate[d] with greater precision" than the standards set forth in the other regulations, including Regulation Z.<sup>18</sup> The FRB proposed adding the Regulation P definition of "clear and conspicuous" to several other regulations (Regulation B, Regulation E, Regulation M, Regulation Z, and Regulation DD) to provide consistent guidance among the regulations.

While the FRB's proposal may have been intended to articulate a more precise standard, most of the 150 comment letters received by the FRB were from creditors strongly opposed to the FRB's proposal, generally asserting that "the revisions would establish more burdensome standards that would be costly to implement and expose them to litigation."<sup>19</sup> Thus, while continuing to review the issues regarding the "clear and conspicuous" standard, the FRB explicitly did not adopt in final form the proposed revisions to the standard contained in the proposed rules.<sup>20</sup> The FRB officially withdrew its proposal to establish more uniform standards effective June 22, 2004, but indicated that it planned to issue other proposed rules in 2004, 2005 and 2006.<sup>21</sup>

### 2. Debt Cancellation and Debt Suspension Products

In the December 10, 2003 proposed rule, the FRB also requested information regarding the nature of debt cancellation and debt suspension products and comment on the FRB's existing guidance.<sup>22</sup> The FRB reported in the March 31, 2004 final rule that the comments it received generally confirmed that debt cancellation and debt suspension products are being made available by an increasing number of creditors in connection with many types of credit and on a wide variety of terms. In addition, most commenters argued that creditors converting credit insurance to a debt cancellation or debt suspension product should be permitted to use the same procedures used by credit card issuers when notifying consumers of a change in the credit insurance provider under Regulation Z section 226.9(f). The FRB did not address debt cancellation or debt suspension products in the 2004 final rule.

### 3. Clarification of "Amount"

The 2003 proposed rule<sup>23</sup> provided that an interpretive rule of construction would be added to Regulation Z to clarify that the word "amount" represents a numerical amount and does not permit a narrative description of the "amount."<sup>24</sup> The proposed rule was adopted in 2004 with a revision for clarity providing that the numerical amount required to be disclosed must be expressed as a dollar amount unless the text of the regulation or Commentary indicates otherwise.<sup>25</sup>

### 4. Home-Secured Loans

With regard to certain home-secured loans, the FRB adopted with revisions the

proposed rule that addressed situations where a creditor fails to provide the required rescission form or to designate an address for sending the rescission notification. The 2004 final rule provides that where the creditor fails to give the consumer an address for sending the notification of rescission, the consumer's delivery of notification to the person or address to which the consumer has been directed to send payments constitutes delivery to the creditor or assignee.<sup>26</sup>

### 5. Advance Notice of Proposed Rulemaking

On December 3, 2004, the FRB issued for comment an Advance Notice of Proposed Rulemaking to commence a review of the open-end (revolving) credit rules of Regulation Z.<sup>27</sup> The FRB was seeking comments regarding the format and content of open-end credit disclosures, the substantive protections provided under the regulation, and the scope of its review.

Specifically mentioned in the Advance Notice are: the principles reflected in the previously proposed and later withdrawn definition of the "clear and conspicuous" standard; the classification of fees as "finance charges" or "other charges"; the effect of balance calculation methods, the size of minimum payments and a creditor's allocation of payments on the cost of credit; special disclosures for certain types of credit, such as sub-prime or secured credit card accounts; the extension of credit card protections to transactions made without use of a credit card; and a creditor's cut-off hours for receipt of payments under the prompt crediting of payments rule. Comments were required to be received on or before March 28, 2005.

17. 12 CFR § 216.3(b)(1).

18. 68 Fed. Reg. 68,793-01, 68,794 (Dec. 10, 2003).

19. 69 Fed. Reg. at 16,770.

20. *Id.*

21. 69 Fed. Reg. 35,541-01 (June 25, 2004).

22. 68 Fed. Reg. at 68,795-68,796.

23. *Id.*

24. 68 Fed. Reg. at 68,794.

25. 69 Fed. Reg. at 16,771.

26. *Id.*

27. 69 Fed. Reg. 70,925-01 (Dec. 8, 2004).

**C. Interagency Guidance on Overdraft Protection Programs**

**1. Introduction**

In June, 2004 the member agencies of the Federal Financial Institutions Examination Council (FFIEC), namely the Office of the Comptroller of the Currency (OCC), the FRB, the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (the Agencies), requested comments on a proposed Interagency Guidance on Overdraft Protection Programs (proposed Guidance). The Agencies issued the final Joint Guidance on Overdraft Protection Programs (Interagency Guidance) in early 2005.<sup>28</sup> This interagency Guidance is intended to assist insured depository institutions in the responsible disclosure and administration of overdraft protection services.

**2. The Interagency Guidance**

The Interagency Guidance: (1) identifies the traditional approaches to providing consumers with protection against deposit account overdrafts, and contrasts these with the overdraft protection services that have been marketed to consumers more recently; (2) identifies existing and potential concerns surrounding such overdraft protection services; and (3) provides guidance in areas labeled Safety and Soundness Considerations, Legal Risks, and Best Practices.

The "Safety and Soundness Considerations" focus on ensuring that financial institutions offering overdraft protection services adopt policies and procedures to adequately address the credit, opera-

tional, and other risks associated with these services. The "Legal Risks" materials alert institutions to the need to ensure overall compliance with all applicable federal and state laws before implementation of an overdraft protection program. The "Best Practices" materials serve as positive examples of practices that currently are observed in, or recommended by, the industry or the Agencies, including marketing of overdraft protection services and the disclosure and operation of program features.

**3. Regarding the TILA**

Institutions should be aware that whether a written agreement exists is a matter of state law and, when overdrafts are paid, credit is extended. Fees for paying overdraft items are not considered finance charges under Regulation Z if the institution has not agreed in writing to pay overdrafts. Because this exception to Regulation Z was created for the occasional payment of overdrafts, its application to automated and marketed overdraft protection programs may be re-evaluated in the future.

If the institution agrees in writing to pay overdrafts as part of the deposit account agreement, fees assessed against the deposit account for overdraft protection services are finance charges, but only to the extent the fees exceed the charges imposed for paying or returning overdrafts on a similar transaction account that does not have overdraft protection.

Overdraft repayment loans, which may be offered to consumers who are unable to repay their overdrafts so as to bring their accounts to a positive balance within a specified time period, are closed-end loans that will trigger the Regulation Z disclosure requirements if the loan is payable under a written agreement in more than four installments or is subject to a finance charge.

**IV. Recent Case Law Addressing Key TILA Provisions**

**A. United States Supreme Court**

**1. Supreme Court Decision on the TILA Statutory Damages Cap**

On October 5, 2004, the United States Supreme Court heard oral arguments in a case representing a conflict between the United States Courts of Appeals for the Fourth and Seventh Circuits over whether statutory damages in an individual action under the TILA are capped at \$1,000. The Court had granted Koons Buick Pontiac GMC, Inc.'s petition for a writ of *certiorari*, thus agreeing to review the decision of the United States Court of Appeals for the Fourth Circuit in *Nigh v. Koons Buick Pontiac GMC, Inc.*<sup>29</sup> In *Nigh*, the United States District Court for the Eastern District of Virginia had granted summary judgment to Koons Buick on several claims made by Nigh with respect to his motor vehicle financing, but preserved for trial Nigh's TILA claim of inaccurate disclosure.<sup>30</sup> At trial, a jury awarded Nigh \$24,192.80 for his TILA claim. On appeal, Koons Buick argued that the district court erred in allowing statutory damages of twice the finance charge in connection with the transaction because section 1640(a)(2)(A) of the TILA caps statutory damages in all individual actions at \$1,000.<sup>31</sup> The United States Court of Appeals for the Fourth Circuit disagreed, holding that the district court's award of damages was correct—a decision that is in apparent conflict with a 1997 opinion of the United States Court of Appeals for the Seventh Circuit.<sup>32</sup>

28. 69 Fed. Reg. 31,858-01 (June 7, 2004) (proposed Guidance); Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005) (Interagency Guidance). The Interagency Guidance was issued by the OCC, FRB, FDIC, and NCUA. The OTS separately issued its Guidance on February 18, 2005.

In May 2005 the FRB adopted amendments to Regulation DD, which implements the Truth in Savings Act, to impose new requirements on overdraft protection programs.

29. See 319 F.3d 119 (4th Cir. 2003), *cert. granted*, Koons Buick Pontiac GMC, Inc. v. Nigh, 124 S. Ct. 1144 (2004). See *infra* this text and note 33; *infra* this text and notes 35-37.

30. See *Nigh v. Koons Buick Pontiac GMC, Inc.*, 143 F. Supp. 2d 535 (E.D. Va. 2001).

31. 319 F.3d at 126.

32. See *Strange v. Monogram Credit Card Bank of Ga.*, 129 F.3d 943 (7th Cir. 1997).

The Fourth Circuit held that as a consequence of the 1995 amendment to the TILA, the statutory damages that may be awarded under 15 U.S.C. section 1640(a)(2)(A)(i) are now simply twice the finance charge in connection with the transaction and are not capped at \$1,000.<sup>33</sup> Thus, the question before the Supreme Court was whether the \$1,000 statutory limit originally adopted in 1968 as a cap on TILA recoveries under 15 U.S.C. section 1640(a)(2)(A)(i) was rendered inapplicable to that subpart by subsequent amendments to section 1640(a)(2)(A)—though there is no evidence of any Congressional intent to effect such a change—so that the parties who suffer no actual damages now may recover far in excess of the previous \$1,000 cap.<sup>34</sup>

On November 30, 2004, the Supreme Court resolved the conflict between the Fourth and Seventh Circuits, holding that the amendments to the TILA's damages provision had not repealed the cap and that damages available under the TILA are limited to \$1,000.<sup>35</sup> In reversing the Fourth Circuit and overturning the \$24,192.80 award to Mr. Nigh, the Supreme Court agreed that the "[l]ess-than-meticulous drafting of the 1995 amendment created an ambiguity," but found that there was "scant indication" that Congress sought to remove the \$1,000 cap when it amended the recoveries available for closed-end loans secured by real property.<sup>36</sup> The Supreme Court stated that "[i]t would be passing strange to read the statute to cap recovery in connection with a closed-end, real-property-secured loan at an amount *substantially lower* than the recovery available when a violation occurs in the context of a personal-property-secured

loan or an open-end, real-property-secured loan."<sup>37</sup>

## 2. Regulation Z's Characterization of Overlimit Fee Upheld

In a unanimous opinion, the United States Supreme Court upheld the FRB's exclusion of overlimit fees from the definition of "finance charge" in Regulation Z.<sup>38</sup> The case arose from a decision by the United States Court of Appeals for the Sixth Circuit, which held that overlimit fees imposed after a credit card holder is permitted to make purchases beyond the established credit limit fall "squarely within the statutory definition of a finance charge" as "incident to an extension of credit," and found Regulation Z's exclusion of such overlimit fees from the definition of "finance charge" to be invalid.<sup>39</sup> The Sixth Circuit limited its holding to those creditors who knowingly permit the credit card holder to exceed the established credit limit and then impose a fee incident to that extension of credit.<sup>40</sup>

In disagreeing with the Sixth Circuit's characterization of the credit transaction under consideration, the Supreme Court stated that "[b]ecause overlimit fees, regardless of a creditor's particular billing practices, are imposed only when a consumer exceeds his credit limit, it is perfectly reasonable to characterize an overlimit fee not as a charge imposed for obtaining an extension of credit over a consumer's credit limit, but rather as a penalty for violating the credit agreement."<sup>41</sup>

Regardless of this characterization, however, the Supreme Court recognized a connection between the overlimit fee and an extension of credit. Still, because the phrase "incident to" used in the

TILA's definition of "finance charge" does not make clear whether a substantial or remote connection is required, the Supreme Court determined that it could not conclude that the term "finance charge" standing alone unambiguously includes overlimit fees.

Because there is ambiguity in the definition of "finance charge," the Supreme Court determined that it was bound to follow the FRB's regulation unless it is "procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute."<sup>42</sup> Because, as it had stated earlier, an overlimit fee reasonably can be characterized as a penalty for defaulting on a credit agreement, the Supreme Court found the FRB's regulation to be reasonable.<sup>43</sup>

## B. United States Courts of Appeals

### 1. Reasonable Portion of Insurance Fee Excluded From "Finance Charge"

The United States Court of Appeals for the Seventh Circuit affirmed a decision of the United States District Court for the Northern District of Illinois holding that only the portion of a fee for title insurance and endorsements deemed "unreasonable" must be included as part of the finance charge under the TILA.<sup>44</sup> The TILA exempts fees for title examination, title insurance or similar purposes from the computation of the finance charge, and Regulation Z provides that such fees are not finance charges if they are "bona fide and reasonable."<sup>45</sup> The Seventh Circuit reasoned that the plaintiff's argument for requiring disclosure of the entire fee as a finance charge would be inconsistent with the TILA and would artificially inflate the finance charge by including the alleged unreasonable portion with the

33. *Nigh*, 319 F.3d at 127.

34. Petition for a Writ of Certiorari, *Koons Buick Pontiac GMC, Inc. v. Nigh*, 2003 WL 22428976 (No. 03-377) (Sept. 4, 2003), cert. granted, 124 S. Ct. 1144 (2004). See *supra* this text and note 33; *infra* this text and notes 35-37.

35. *Koons Buick Pontiac GMC, Inc. v. Nigh*, 2004 WL 2707418 (No. 03-377) (U.S. Nov 30, 2004).

36. 2004 WL 2707418 at \*3.

37. *Id.*

38. *Household Credit Servs., Inc. v. Pfennig*, 124 S. Ct. 1741 (2004).

39. *Pfennig v. Household Credit Servs., Inc.*, 295 F.3d 522, 528-530 (6th Cir. 2002).

40. *Id.* at 531, n.5.

41. 124 S. Ct. at 1747.

42. *Id.* at 1748, quoting *United States v. Mead Corp.*, 533 U.S. 218, 227 (2001).

43. *Id.*

44. *Guise v. BMW Mortgage, LLC*, 377 F.3d 795 (7th Cir. 2004).

45. 15 U.S.C. § 1605(e)(1); 12 CFR § 226.4(c)(7)(i).

