

Truth in Lending Developments

By Deborah Freye, Judith M. Scheiderer, Timothy P. Meredith and
Barbara S. Mishkin*

INTRODUCTION

Last year the Truth in Lending Act (TILA)¹ and its implementing regulation, Federal Reserve Board (FRB) Regulation Z,² revisions to the FRB Official Staff Commentary to Regulation Z, which is a substitute for individual staff interpretations, and case law interpreting the statute, regulation and commentary provided guidance to creditors seeking to apply TILA requirements to specific circumstances.

Yet, in many ways, 2003 was a quiet year for the TILA. In some ways, it is more remarkable for what did not happen rather than what did. What did not happen is any sort of TILA/Real Estate Settlement Procedure Act (RESPA) reform. The FRB continued, however, to polish Regulation Z. On the litigation front, one case stood out among all others. In *Pfennig v. Household Credit Services, Inc.*,³ the U.S. Court of Appeals for the Sixth Circuit indicated that the FRB does not know an overlit fee from a transaction fee, changing an earlier propensity of the courts not to decide issues like this.⁴ These and other major developments impacting the TILA and Regulation Z in 2002 and 2003 are outlined below.

2003 FINAL REVISION TO THE REGULATION Z COMMENTARY

The FRB issued its final rule revising the Official Staff Commentary to Regulation Z in 2003 ("final rule") to address in large part credit card lending, effective

*Deborah Freye and Judith M. Scheiderer practice law with Dreher Langer & Tomkies L.L.P., in Columbus, Ohio, in the area of banking and financial services. Ms. Freye is a member of the American Bar Association and the Ohio and Michigan bars. Ms. Scheiderer is a member of the Consumer Financial Services Committee of the American Bar Association. Timothy P. Meredith is a partner in the Maryland office of the firm of Hudson Cook, LLP. Barbara S. Mishkin is a partner in the Philadelphia, Pennsylvania office of Reed Smith, LLP. Mr. Meredith is chair and Mrs. Mishkin is Vice Chair of the Truth in Lending Subcommittee of the American Bar Association Section of Business Law. This Article reflects the personal views of the authors, has been prepared for informational purposes only, and does not constitute legal advice. This Article is not intended to create, and the receipt of it does not create, an attorney-client relationship.

1. 15 U.S.C. §§ 1601-1666j (2000).
2. 12 C.F.R. pt. 226 (2003).
3. 286 F3d 340 (6th Cir. 2002).
4. *Id.* at 347.

April 1, 2003, with mandatory compliance required by October 1, 2003.⁵ The final rule was adopted as proposed, except that a proposed comment regarding expedited payment fees was not adopted.⁶ In addition, the FRB is continuing to gather information about overdraft or "bounced check" protection services and did not address these services in this final rule.⁷

EXPEDITED PAYMENT SERVICE FEE

The December 6, 2002 proposal described an expedited payment service fee as a fee that generally is charged for an electronic funds transfer or a draft on a consumer's checking account and typically is paid by a consumer to avoid being assessed a late payment fee.⁸ Based on these assumptions, and provided that the method of payment was not authorized in advance as the regular payment method for the account, the 2002 proposal stated that the fee should be disclosed as an "other charge,"⁹ which the Official Staff Commentary describes as "significant charges related to the plan."¹⁰ Financial institutions that commented on the proposal, however, argued that the fee should not be disclosed as either a "finance charge"¹¹ or an "other charge" under the TILA, but instead "should be considered separate from the credit plan as though it were imposed by a third-party courier or wire transfer service."¹² Based on these comments, the FRB concluded that an expedited payment fee, as described in the proposal, is not a "finance charge" "because the consumer has a reasonable means for making payment on the account without paying a fee to the creditor" and the fee "does not clearly meet the standard for treatment as an 'other charge.'"¹³ The final rule amending the Official Staff Commentary provides that creditors are not required to disclose the fee until the service is requested by a consumer.¹⁴

EXPEDITED CARD DELIVERY FEE

The final rule also revised existing comment 6(b)-2 to add a card issuer's fee for expediting delivery of a card upon request as an example of a charge that is neither a "finance charge" nor an "other charge."¹⁵ An expedited card delivery fee may be imposed when the consumer requests delivery of the card other than by the standard mail service generally available to consumers. The FRB stated that this service is not incidental to the extension of credit and thus is not a "finance

5. Truth in Lending, 68 Fed. Reg. 16,185 (Apr. 3, 2003).

6. *Id.*; see also Truth in Lending, 67 Fed. Reg. 72,618 (Dec. 6, 2002).

7. Truth in Lending, 68 Fed. Reg. at 16,185. See generally Sam Davis & Stanley D. Mabbitt, *Checking Account Bounce Protection Programs*, 57 CONSUMER FIN. L.Q. REP. 26 (2003).

8. Truth in Lending, 67 Fed. Reg. at 72,618.

9. *Id.*; see also 12 C.F.R. § 226.6(b) (2003).

10. 12 C.F.R. pt. 226, supp. I, § 226.6(b) cmt. 1.

11. *Id.* §§ 226.4, 226.6(a).

12. Truth in Lending, 68 Fed. Reg. at 16,186.

13. *Id.*

14. *Id.*

15. *Id.*

charge” where the consumer requests the service and the card is available by standard mail service (or another means just as fast) without a fee.¹⁶ The FRB also stated that the service did not appear to be significant or related to the credit plan because it is provided only occasionally, such as when a card is lost or stolen, and thus is not an “other charge.”¹⁷ Thus, an expedited card delivery fee need not be disclosed as a “finance charge” or an “other charge” provided the consumer requests expedited delivery and the issuer does not charge for delivery by standard mail service or any other means that is at least as fast.¹⁸

REPLACEMENT CARDS

The final rule amending the Official Staff Commentary provides guidance regarding replacement cards issued in different sizes and formats that are intended only to supplement, but not replace, an existing, traditional credit card.¹⁹ Card issuers now can replace an accepted card with more than one renewal or substitute card under the following circumstances: (i) the replacement cards access only the accounts previously accessed by the consumer’s accepted card; (ii) all replacement cards are subject to the same terms and conditions, meaning those required to be disclosed under section 226.6 of Regulation Z and permitting a creditor to vary terms provided no change in terms notice is required under section 226.9(c) of Regulation Z; and (iii) the consumer’s total liability for unauthorized use with respect to the account does not increase.²⁰ In addition, the FRB staff plan to recommend to the FRB an amendment of the unsolicited card rule, to permit the issuance of additional cards on existing accounts outside of renewal or substitution under certain circumstances.²¹

PMI AND THE PAYMENT SCHEDULE DISCLOSURE

The final rule provides guidance on the impact of private mortgage insurance (PMI) premiums on the disclosure of the payment schedule required under section 226.18(g) of Regulation Z. If they are part of the monthly payment, PMI premiums must be included in the payment schedule.²² Under the Homeowners Protection Act of 1998,²³ creditors are required to terminate PMI under certain conditions. Those terms must also be reflected in the payment schedule.²⁴ The rule provides an example of how PMI premiums should be disclosed on the payment schedule when some premiums are collected in advance and escrowed at the time the loan is closed.²⁵

16. *Id.* at 16,186–87.

17. *Id.* at 16,187.

18. *Id.* at 16,186–87.

19. *Id.* at 16,187.

20. *Id.* at 16,187–88.

21. *Id.* at 16,188.

22. 12 C.F.R. pt. 226, supp. I, § 226.18(g) cmt. 1.

23. 12 U.S.C. §§ 4901–10 (2000).

24. *Id.* § 4903.

25. Truth in Lending, 68 Fed. Reg. at 16,189–90 (amending Official Staff Commentary, 12 C.F.R. pt. 226, supp. I, § 226.18(g) cmt. 5 (2003)).

INDEX VALUES ON HOEPA LOANS

The final rule included changes to the Official Staff Commentary rules for determining when a home equity loan is subject to the requirements of the Home Ownership and Equity Protection Act of 1994 (HOEPA).²⁶ Creditors offering HOEPA loans must give consumers additional pre-closing disclosures and comply with certain substantive limits on loan terms. HOEPA applies to home equity loans carrying rates or points and fees above certain specified triggers.²⁷ The HOEPA rate trigger applies HOEPA to loans where the annual percentage rate (APR) exceeds the yield on U.S. Treasury securities with a comparable maturity by a specified number of percentage points, specifically eight percentage points for first lien loans or ten percentage points for subordinate lien loans.²⁸ The APR is compared to the yield on the comparable Treasury security as of the fifteenth day of the month immediately preceding the month of the loan application.²⁹ The final rule eliminates the option previously given to creditors to use the actual results of Treasury auctions to determine the comparable yield on Treasury securities. Instead, creditors must use the yields on actively traded issues adjusted to a constant maturity that are listed in the FRB's "Selected Interest Rates" (statistical release H-15), which is published daily and posted on the FRB's Internet Web site.³⁰

The FRB had offered two reasons for this change in the proposed rule. First, the longest maturity for auctioned Treasury securities is ten years while residential mortgage loans commonly have terms of fifteen years or more.³¹ As a result, the maturities were not well matched. Second, Treasury auctions are held infrequently whereas the H-15 is updated daily.³² As a result, the values set out in the H-15 publication will afford a more precise determination of the yield for the comparable Treasury security as of any particular date. The FRB was of the view that a rule that requires all creditors to use the H-15 would make the implementation of HOEPA more uniform because it would eliminate the possibility that some creditors could use yields from auctions held several months before the loan application (which might differ significantly from the daily H-15 yields).³³

Responding to the decision of the Treasury Department to discontinue auctions for thirty-year securities, the final rule advises creditors how to compare the APR on thirty-year loans (and other loans longer than twenty years) with a Treasury yield. The revised Official Staff Commentary provides that in such circumstances,

26. 15 U.S.C. §§ 1601-66 (2000); *see also* 12 C.F.R. §§ 226.31-34.

27. 15 U.S.C. § 1647.

28. 12 C.F.R. § 226.32(a)(1)(i).

29. *Id.*

30. <http://www.federalreserve.gov/releases/h15/update>; *see also* Truth in Lending, 68 Fed. Reg. at 16,185, 16,190 (Apr. 3, 2003) (amending Official Staff Commentary, 12 C.F.R. pt. 226, supp. I., § 226.32(a)(1) cmt. 4 (2003)).

31. Truth in Lending, 67 Fed. Reg. at 72,620.

32. *Id.*

33. *Id.*

creditors should compare the APR on loans longer than twenty years with the yield on a Treasury security with a twenty-year constant maturity.³⁴

2002 FINAL REVISION TO REGULATION Z COMMENTARY

The FRB issued its final rule revising the Official Staff Commentary to Regulation Z in 2002 regarding closed-end credit.³⁵ The final rule was effective April 9, 2002, with mandatory compliance required immediately.³⁶ According to the FRB, the revisions represent only clarifications to the existing law and not any new requirements.³⁷

TILA DISCLOSURES

Reacting to several recent non-uniform court decisions regarding the practice of putting TILA disclosures on the same document with the credit contract in motor vehicle installment sales, the FRB added comment 17(b)-3 to clarify the requirements.³⁸ The comment provides that creditors can satisfy the TILA requirement that a consumer be provided with the disclosures in a form the consumer may keep before consummation of the transaction by giving only one copy of the document containing the disclosures to the consumer to read and sign.³⁹ It is not sufficient for the creditor merely to show the document to the consumer before the consumer signs; rather, a creditor must give the disclosures to the consumer so that the consumer can take possession of and read the disclosures before signing.⁴⁰ The FRB stated that it is essential to meaningful disclosure that the consumer be able to keep the document, regardless of whether the consumer ever signs the form and becomes obligated on the credit contract.⁴¹ The consumer may sign the same document that he or she was given to review, however, so creditors need not provide the consumer with two copies of the document (one to keep and a second to execute).⁴²

Although the FRB stated that this new comment only clarifies existing law, it certainly may change the actions of some creditors who commented in response to the proposed rule that providing consumers with the required copy of the TILA disclosures within a reasonable time after consummation of the transaction or merely showing the document to a consumer should comply with the TILA. The FRB did make clear, however, that the requirement that consumers be able to take possession of the document containing the TILA disclosures was not

34. Truth in Lending, 68 Fed. Reg. at 16,190 (amending Official Staff Commentary, 12 C.F.R. pt. 226, supp. I, § 226.32(a)(1)(i) cmt. 4 (2003)).

35. Truth in Lending, 67 Fed. Reg. 16,980 (Apr. 9, 2002).

36. *Id.*

37. *Id.*

38. *Id.* at 16,981.

39. *Id.* at 16,981; see also 12 C.F.R. § 226.17(a), (b) (2003).

40. Truth in Lending, 67 Fed. Reg. at 16,981.

41. *Id.* at 16,982.

42. *Id.* at 16,981.

intended to affect the rules governing the use of electronic communications under Regulation Z.⁴³

BUSINESS DAY

The FRB also provided a more precise explanation for what is considered to be a "business day"⁴⁴ with regard to the right of rescission.⁴⁵ The precise definition is important because generally under the TILA and Regulation Z, when consumers have a right to rescind a loan secured by a home, they may do so until midnight of the third business day following the later of consummation or delivery of certain disclosures.⁴⁶ Comment 2(a)(6)-2 was added to clarify that where a holiday is identified by a specific date as an exception to the definition of "business day" (i.e., New Year's Day, January 1; Independence Day, July 4; Veterans Day, November 11; and Christmas Day, December 25), "only the date specified in the statute is considered a legal holiday for purposes of rescission."⁴⁷ Accordingly, if the specified date falls on a Saturday or Sunday and government offices close in observance of the holiday on the Friday before or the Monday after the holiday, such weekdays will be considered "business days" and will count toward the rescission period of three days.⁴⁸

INSURANCE AND DEBT CANCELLATION

Finally, the FRB adopted comment 4(d)-12, to clarify the disclosures required in order to exempt from the "finance charge" insurance premiums and debt cancellation fees. Section 226.4(d) of Regulation Z provides that such premiums and fees may be excluded from the finance charge if the creditor discloses, *inter alia*, the fee or premium for the initial term of coverage.⁴⁹ The comment more precisely provides that creditors have the option of providing this disclosure on the basis of one year of coverage where the fee or premium is assessed periodically and the consumer is under no obligation to continue and may cancel the coverage.⁵⁰

CASES

CERTAIN OVERLIMIT FEES CONSTITUTE FINANCE CHARGES

In *Pfennig v. Household Credit Services, Inc.*, a credit card disclosure class action case regarding overlimit fees under the TILA, plaintiff originally was issued a credit card by defendant Household, and MBNA acquired the account when MBNA bought Household's credit card portfolio.⁵¹ The plaintiff's credit limit was origi-

43. *Id.* at 16,982.

44. 12 C.F.R. pt. 226, supp. I, §226.2(a)(6).

45. Truth in Lending, 67 Fed. Reg. at 16,981.

46. See 15 U.S.C. § 1635; 12 C.F.R. § 226.15.

47. Truth in Lending, 67 Fed. Reg. at 16,981.

48. *Id.*

49. 12 C.F.R. § 226.4(d).

50. Truth in Lending, 67 Fed. Reg. at 16,981.

51. 286 F.3d 340, 342-43 (6th Cir. 2002).

nally set at \$2,000, but the defendants allowed her to exceed the credit limit when she used her card to make a purchase and then charged her an “overlimit” fee of \$29 a month for every month her balance remained over the \$2,000 limit. The plaintiff alleged a TILA violation because the overlimit fee was posted to her account as a new purchase or debit on which additional finance charges were calculated and was not included in the finance charge calculation on her monthly billing statement.⁵²

The U.S. Court of Appeals for the Sixth Circuit found 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”⁵³ as “incident to the extension of credit.”⁵⁴ According to the court, Regulation Z’s exclusion of such overlimit fees from the definition of “finance charge” conflicts with the express language of the TILA.⁵⁵ For this reason, the court struck down Regulation Z’s definition of “finance charge,” which expressly excludes overlimit fees.⁵⁶ The court held that the creditor should have disclosed the fees as part of the finance charge on the periodic billing statements.⁵⁷ The court 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.⁵⁸

On July 2, 2002, the Sixth Circuit amended its April 11, 2002 opinion in *Pfennig v. Household Credit Services, Inc.*,⁵⁹ by adding a footnote indicating that the defendants and several amici filed petitions for rehearing and suggestions for rehearing en banc, but that the court denied those petitions because it is barred from a procedural standpoint from considering the new factual issues raised by the amici.⁶⁰ On September 3, 2002, the entire court for the Sixth Circuit denied Household Credit’s petition for an *en banc* rehearing.⁶¹ In response, the defendants petitioned the U.S. Supreme Court for a writ of certiorari and on June 27, 2003, the Supreme Court granted certiorari.⁶² Oral arguments were heard on February 23, 2004. At the time of writing this Article, no decision had been announced.

PETITION FOR CERTIORARI ON \$1,000 DAMAGE LIMIT

*Nigh v. Koons Buick Pontiac GMC, Inc.*⁶³—a case that began with a tortuous story of motor vehicle financing at a dealership in which three different retail installment

52. *Id.* at 343.

53. *Id.* at 346.

54. *Id.* at 345–46 (quoting 15 U.S.C. § 1605(a)).

55. *Id.* at 347.

56. *Id.*

57. *Id.* at 346.

58. *Id.* at 347–48.

59. 295 F.3d 522 (6th Cir. 2002), *cert. granted*, 123 S.Ct. 2639 (2003).

60. *Id.* at 529 n.2.

61. *Id.* at 522.

62. 123 S.Ct. 2639 (2003).

63. 319 F.3d 119 (4th Cir. 2003), *cert. granted*, 124 S.Ct. 1144 (2004).

sale contracts were signed by the buyer before an assignee could be found and ended in repossession of both the newly purchased and traded vehicles—could result in resolution of a conflict between the circuits as to whether the TILA “caps” statutory damages in individual actions at \$1,000. The U.S. District Court for the Eastern District of Virginia granted summary judgment to Koons Buick on several claims, but preserved for trial Nigh’s TILA claim of inaccurate disclosure.⁶⁴ At trial, a jury awarded Nigh \$24,192.80 for his TILA claim.⁶⁵

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)⁶⁶ of the TILA caps statutory damages in certain individual actions at \$1,000.⁶⁷ The U.S. Court of Appeals for the Fourth Circuit disagreed, however, pointing out that section 1640(a)(2)(A) was amended in 1995 to add subsection (iii), as follows:

[A]ny [TILA violator] is liable to such person in an amount equal to the sum of— . . . (2)(A)(i) in the case of an individual action twice the amount of any finance charge in connection with the transaction, (ii) in the case of an individual action relating to a consumer lease under part E of this subchapter, 25 per centum of the total amount of monthly payments under the lease, except that the liability under this subparagraph shall not be less than \$100 nor greater than \$1,000, or (iii) in the case of an individual action relating to a credit transaction not under an open end credit plan that is secured by real property or a dwelling, not less than \$200 or greater than \$2,000[.]⁶⁸

Whereas before the amendment the \$1,000 cap was understood to modify subsections (i) and (ii), the addition of subsection (iii) appears to have limited the \$1,000 cap to subsection (ii). The Fourth Circuit held that regardless of whether Congress intended to alter the statutory cap or committed a drafting error, “[a]s a consequence of the 1995 amendment, the damages that may be awarded under subparagraph (i) are now simply ‘twice the amount of any finance charge in connection with the transaction,’” and thus the district court’s award of damages was correct.⁶⁹ Petition for Certiorari has been granted.⁷⁰

COURT FINDS “NO ANNUAL FEE” DISCLOSURE MISLEADING

On February 8, 2002, in *Rossman v. Fleet Bank (R.I.) National Ass’n*, the U.S. Court of Appeals for the Third Circuit reversed the dismissal of a consumer’s “no annual fee” credit card solicitation claim under the TILA against the issuing

64. *Id.* at 121–23.

65. *Id.*

66. 15 U.S.C. § 1640(a)(2)(A).

67. *Nigh*, 319 F.3d at 126 (citing *Mars v. Spartanburg Chrysler Plymouth*, 713 F.2d 65 (4th Cir. 1983)).

68. *Id.* (quoting 15 U.S.C. § 1640(a)(2)(A)) (alteration in original).

69. *Id.* at 127.

70. *Id.*, cert. granted, 124 S.Ct. 1144 (2004).

