

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580



Office
of
the
Chair

man

January 10, 1997

Griffith L. Garwood, Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Dear Mr. Garwood:

This letter responds to your request for information regarding the enforcement activities of the Federal Trade Commission under the Truth in Lending, Consumer Leasing, Equal Credit Opportunity, and Electronic Fund Transfer Acts ("Acts") during the past year for use in preparing the Federal Reserve Board's ("Board") Annual Report to Congress. You have asked for information concerning the Commission's enforcement activities pursuant to these Acts, including methods of enforcement and enforcement actions, and the compliance level of creditors subject to the Commission's enforcement authority. You have also asked whether the Commission recommends any changes to these Acts or their implementing regulations.

**I. A DESCRIPTION OF THE COMMISSION'S ENFORCEMENT ACTIVITIES
UNDER THE ACTS DURING THE PAST YEAR**

Truth in Lending Act and Consumer Leasing Act

In the 1996 calendar year, the Commission issued a final consent order in one case alleging, inter alia, the issuance of unsolicited credit cards to consumers, in violation of the Truth in Lending Act ("TILA") and Regulation Z. The Commission also accepted for public comment consent agreements in six cases. Five of these cases allege deceptive lease and/or credit advertising claims, in violation of the Federal Trade Commission Act ("FTC Act"), and failure to clearly and conspicuously provide required lease and/or credit advertising disclosures, in violation of the FTC Act and the Consumer Leasing Act ("CLA") and Regulation M and/or the TILA and Regulation Z. The other case alleges deceptive disclosures and understated credit terms, including the annual percentage rate ("APR") and payment schedule, in violation of the FTC Act and the TILA and Regulation Z. These cases are discussed below. Other investigations of potential TILA and/or CLA violations are ongoing.

In The May Department Stores Co. ("May Co."),¹ the Commission issued a decision and order against a major St. Louis-based retailer. The order, inter alia, settled charges that May Co., through an aggressive telemarketing effort, established credit accounts for consumers who had not received or approved the offer of credit or had specifically declined the offer and, therefore, issued or caused to be issued unsolicited credit cards to consumers, in violation of the TILA and Regulation Z. The order prohibits May Co. from engaging in the conduct described in the complaint, including the issuance of credit cards to any person except in response to an oral or written request or application for the card or as a renewal of or substitute for an accepted credit card.

In General Motors Corp. ("GM"),² American Honda Motor Co., Inc. ("Honda"),³ Mitsubishi Motor Sales of America, Inc. ("Mitsubishi"),⁴ American Isuzu Motors Inc. ("Isuzu"),⁵ and Mazda Motor of America, Inc. ("Mazda"),⁶ the Commission accepted for public comment five consent agreements with major automobile manufacturers. The proposed orders would settle charges that the five companies violated the FTC Act and the CLA and Regulation M, and that two of these companies also violated the TILA and Regulation Z, in connection with lease and/or credit promotions that featured low monthly payments or low amounts "down" in large, bold print, while hiding additional costs and sometimes contradictory information in "mouse print" that is difficult or impossible to read.

In all five cases, the complaints alleged that respondents engaged in deceptive lease practices in violation of the FTC Act by: 1) representing in lease advertisements that low or no amounts "down" are the total amount consumers must pay at lease

¹ FTC Docket No. C-3676 (July 9, 1996).

² FTC File No. 952-3093 (Nov. 21, 1996).

³ FTC File No. 952-3094 (Nov. 21, 1996).

⁴ FTC File No. 952-3096 (Nov. 21, 1996).

⁵ FTC File No. 952-3095 (Nov. 21, 1996).

⁶ FTC File No. 952-3450 (Nov. 21, 1996).

inception for the advertised vehicles when, in fact, consumers must pay significant additional fees at lease signing; and 2) failing to adequately disclose the significant additional fees, such as the first month's payment, a security deposit, and/or an acquisition fee, that consumers are required to pay at lease signing. In two cases (GM and Mitsubishi), the complaints also alleged that respondents engaged in deceptive credit practices in violation of the FTC Act by: 1) representing in credit advertisements that consumers can buy advertised vehicles at the terms stated when, in fact, consumers are responsible for a final balloon payment of several thousand dollars; and 2) failing to adequately disclose the additional terms required for the purchase of the vehicle, including the final balloon payment and the APR. The complaints in all of these cases also charged respondents with violating the CLA and Regulation M and/or the TILA and Regulation Z by failing to clearly and conspicuously disclose various required lease and/or credit costs and terms.

The proposed orders in all five cases would prohibit the companies from misrepresenting the total amount a consumer must pay at lease inception. The proposed orders would also require the companies' ads that highlight an amount "down" or other amounts due at lease inception or state that there is no such charge to provide an equally prominent statement of the total amount due at lease inception. The proposed orders would further require the companies' ads referencing any initial payment or that no initial payment is due to disclose clearly and conspicuously (defined in the orders as "readable or audible and understandable to a reasonable consumer"), as applicable: that the deal is a lease; the total amount due at lease inception; that a security deposit is required; the number, amount and timing of scheduled payments; and the fact that an extra charge may be imposed at lease end based on the vehicle's residual value.

The proposed orders against GM and Mitsubishi also would prohibit the companies from misrepresenting the existence or amount of any balloon payment or the APR for the loan and require credit ads stating the amount of any payment to disclose prominently the amount of any balloon payment in close proximity to the most prominent of the payment statements. The proposed orders against GM and Mitsubishi would also require any ad that states the downpayment, the amount of any periodic payment, the period of repayment, or the amount of the finance charge to state clearly and conspicuously the amount or percentage of the

downpayment, the terms of repayment, the amount of any balloon payment and the correct APR for the financing.⁷

In Progressive Mortgage Corp. ("Progressive Mortgage"),⁸ the Commission accepted for public comment a consent agreement with a mortgage banking company and its President, Sanford Cramer. The order settled charges that Progressive Mortgage engaged in unfair and deceptive disclosure practices in violation of the FTC Act by: 1) failing to include the entire cost of required mortgage insurance in determining the finance charge and APR and, therefore, understating these terms in its TILA disclosures; and 2) failing to accurately calculate other required TILA disclosures, including the payment schedule and total of payments. In addition, the complaint charged respondent Progressive Mortgage with several counts of violating the TILA and Regulation Z by failing to disclose accurately to consumers various required credit terms, such as the finance charge, APR and others. The complaint charged respondent Sanford Cramer with providing false and misleading representations to consumers of various credit costs and terms, in violation of the FTC Act.

The proposed order would prohibit respondents Progressive Mortgage and Sanford Cramer from misrepresenting the APR, finance charge, payment schedule and total of payments in written disclosures to consumers and from misrepresenting any term or condition of financing for any consumer credit transaction. The proposed order would also prohibit respondent Progressive Mortgage from failing to: 1) include the entire premiums for required mortgage insurance in determining the finance charge and APR; 2) disclose accurately those terms to consumers; 3) disclose accurately the payment schedule and total of payments; and 4) provide to consumers other disclosures as required by the TILA and Regulation Z.

⁷ The consent agreements in all five cases were placed on the public record for public comment for sixty days, after which the Commission will decide whether to make them final. See 61 Fed. Reg. 64524 (Dec. 5, 1996).

⁸ FTC File No. 932-3143 (Nov. 25, 1996).

In 1996, the Commission dismissed its complaint against Dillard Department Stores, Inc. ("Dillard's").⁹ The Commission brought this case primarily under the TILA and Regulation Z, regarding the unauthorized use of a credit card. The complaint charged that Dillard's had violated the TILA and Regulation Z by imposing "unreasonable burdens" on cardholders who claimed their cards were used without authorization and by holding consumers who failed to meet its requirements liable for the unauthorized charges.¹⁰ After the complaint's filing, the Board staff amended the Official Staff Commentary to Regulation Z ("Regulation Z Commentary") to include a standard for investigating claims of unauthorized use under Regulation Z. As a result, and in response to FTC staff counsel's motion, the Commission dismissed the complaint because the standard adopted by the Board staff "appears to differ from the standard reflected in the complaint," and it would not be in the public interest to continue the case.¹¹

In January 1996, the Commission filed comments with the Board on its proposed changes to lease requirements in Regulation M and the Official Staff Commentary ("Regulation M Commentary"). These comments were submitted in response to the Board's request for comments and notice of proposed rulemaking.

The Commission's comments endorsed the Board's plans to simplify and clarify the disclosures required in consumer lease transactions, in view of the rising popularity of leasing (which now accounts for over thirty percent of retail vehicle deliveries). The Commission's comments supported proposed changes in the lease requirements and indicated that the changes would help lessors, advertisers and consumers. The Commission's comments also supported the proposed new requirement that major lease cost items be segregated from other information disclosed to consumers in writing prior to lease signing and noted that some consumers have not understood that the document they signed was, in fact, a lease. The Commission stated that segregation of lease disclosures would better help consumers understand the lease obligation.

⁹ FTC Docket No. D-9269 (filed Sept. 14, 1994).

¹⁰ Id.

¹¹ FTC Docket No. 9269, 1996 FTC LEXIS 49, at *4 (Mar. 7, 1996).

The Commission's comments also supported requiring written disclosure of certain new items, including the "gross cost" and "estimated lease charge" and expanding disclosure of other currently required terms, such as early termination fees, which provide critical information to consumers. The Commission noted that additional information regarding items included in the gross cost disclosure could also be useful to consumers, and it made several suggestions regarding cost-effective ways to improve consumer understanding of this term.

The Commission supported revising requirements for lease advertising and particularly endorsed the Board's "clear and conspicuous" and "equal prominence" rules, which require that important disclosures be conspicuously displayed in ads and that certain critical elements of required disclosures be equally prominent. The Commission recommended that the Board require all lease advertising disclosures to be "reasonably understandable" -- a standard established by the proposed revisions for written lease disclosures provided to consumers prior to lease consummation. The Commission also recommended that the Board provide advertisers with specific guidance to assure clarity of lease disclosures, such as rules concerning the placement, size, length and timing of required information. For televised lease advertisements, the Commission suggested that the required disclosures should appear on the screen in a size, shade, contrast, prominence and location, and for a duration, as to be readily noticeable, readable and comprehensible to an ordinary consumer. The Commission noted that this approach would provide lease advertisers with standards and needed guidance without being overly restrictive in format and presentation of information to consumers.

The Commission's comments suggested several other modifications to the proposed rules, including those pertaining to the model forms proposed by the Board as guides for lessors to use in their lease disclosures. The Commission's comments also urged the Board to review the limitation of the regulation to transactions under \$25,000. The Commission observed that because prices of consumer goods, including leased items, have risen substantially in the past two decades, this dollar limitation could significantly limit the utility of important consumer protections established by Regulation M.

In February 1996, the Commission filed comments with the Board on its proposed changes to the Regulation Z Commentary regarding credit card issuers' obligation to investigate credit

card charges disputed by consumers contained in the "claims and defenses" provision of the TILA and Regulation Z. These comments were submitted in response to the Board's request for comments and notice of proposed rulemaking.

The Commission's comments supported the Board's proposal to clarify that credit card issuers must conduct a reasonable investigation when consumers dispute charges on their credit card bills -- and the disputes remain unresolved with the merchants -- before the credit card issuers can consider the disputes settled, report the disputed amounts as delinquent or begin collection efforts regarding these amounts from consumers. In its comments, the Commission noted that Congress' intent in including the claims and defenses provision in the TILA was to allow consumers to withhold payment from the card issuer while an amount remains disputed and to preserve their rights in any future legal action involving the creditor or issuer and the disputed amount. The latter objective, the Commission stated, can be achieved only if card issuers are genuinely held accountable for their response to a consumer's claim in the first instance. The Commission's comments noted that if card issuers can thwart cardholders' assertion of claims and defenses by, as noted in some instances, causing cardholders to believe their only recourse is with the merchant, the law's aims are frustrated with respect to individual cardholders' disputes.

The Commission's comments recommended several changes to the proposed Regulation Z Commentary. First, the Commission suggested the Board should amplify the meaning of a "reasonable investigation" to indicate it is a flexible standard but that it also requires the card issuer to do more than convey the merchant's view of the dispute to the consumer and declare the dispute settled. The Commission suggested the card issuer should be required to make an independent assessment of the cardholder's claim based on factual data obtained where possible from the merchant and cardholder with other data the card issuer may have available. Second, the Commission recommended that the Board prohibit collection efforts and credit bureau reporting until a reasonable investigation is completed and the dispute is settled, so that card issuers cannot thwart the assertion of claims and defenses. Third, the Commission suggested that card issuers should be required to give consumers a statement of their rights, each time the card issuer notifies a consumer that it has

resolved a "claims and defenses" dispute against the cardholder and resumes billing for the charges.¹²

The Commission continues to view consumer and business education efforts as important to its enforcement activities. In 1996, the Commission released a new brochure, "Look Before You Lease," which highlights points for consumers to consider when deciding whether to lease or purchase a vehicle. The Commission also released a new brochure, "Focus on Phone Leasing," that provides information to consumers regarding the purchase or lease of residential telephones. The Commission also released a brochure on "High Rate, High Fee Loans," regarding consumer protections of the TILA and Regulation Z for Section 32 mortgages. In addition, the Commission's staff is continuing to participate in the ongoing Federal Reserve Board-sponsored "Leasing Education Program Team," which includes various consumer, industry and governmental groups and is working on developing new education materials for consumers and business to spur awareness and understanding of lease concepts.

Equal Credit Opportunity Act

In 1996, the Commission concluded an investigation of a major retailer and subsequently obtained a consent decree against the company for violating the notification provisions of the Equal Credit Opportunity Act ("ECOA") and its implementing Regulation B. This case is discussed below. Other enforcement efforts continue.

¹² Commissioner Mary L. Azcuenaga dissented from the Commission's vote (4-1) to file these comments, stating that the reasonable investigation requirement "could impose substantial costs on card issuers that likely would be passed on to consumers." She added: "It would have been prudent first to determine whether a problem exists under the current incentive-based scheme before advocating the imposition of this regulatory requirement." Commissioner Azcuenaga also dissented from the Commission's recommendation that the Board require card issuers to send cardholders a statement of their rights when a dispute remains unresolved after an investigation, saying that a "more direct and less regulatory solution" might be to prohibit the misrepresentations, instead of requiring the recommended disclosure of information each time card issuers resolve the merits of a dispute.

In September 1996, a consent decree was entered in United States v. The J.C. Penney Company, Inc.¹³ to resolve allegations that this retailer failed to provide denied applicants with a statement of the specific reasons for denial or with notice of their right to receive specific reasons for the denial, failed to provide denied applicants with the correct, principal reasons for the denial, and failed to provide adverse action notices to applicants who made oral requests for an increase in their line of credit. The defendant agreed to pay a civil penalty of \$225,000 and to the entry of a permanent injunction.

The Commission continued its consumer and business education efforts. The staff worked with other governmental agencies and with creditor and consumer organizations to increase awareness of and compliance with the ECOA. The Commission also continued its active participation in the Interagency Task Force on Fair Lending.

Electronic Fund Transfer Act

In 1996, the Commission accepted for public comment a consent agreement in Budget Marketing, Inc. (Budget Marketing).¹⁴ The proposed order would settle charges that this telemarketing company, inter alia, violated Section 907(a) of the Electronic Fund Transfer Act ("EFTA") and Section 205.10(b) of Regulation E by failing to obtain written authorization from consumers for preauthorized transfers. The proposed order would require Budget Marketing, inter alia, to comply with Section 205.10(b) of Regulation E and correlative provisions of the Official Staff Commentary to Regulation E. The consent agreement was placed on the public record for public comment for sixty days, after which the Commission will decide whether to make it final. If accepted, the proposed order would be incorporated into settlement of a Commission civil penalty action, currently

¹³ No. CV-96-4696 (E.D.N.Y. filed Sept. 24, 1996).

¹⁴ 61 Fed. Reg. 53378 (Oct. 11, 1996).

pending, in Federal district court against Budget Marketing and its dealers.¹⁵

II. AN ASSESSMENT OF THE EXTENT TO WHICH COMPLIANCE IS BEING ACHIEVED BY CREDITORS SUBJECT TO THE COMMISSION'S ENFORCEMENT AUTHORITY

Truth in Lending Act and Consumer Leasing Act

The Commission is continuing to receive many inquiries regarding lease issues, particularly from consumers seeking information about the costs and terms of leases and how they differ from credit obligations. Consumers also have requested information about their federal rights concerning "high rate, high fee loans" (found in Section 32 of Regulation Z). The Commission also received many requests for compliance materials, particularly from many businesses seeking information about the Board's new lease rules in revised Regulation M. Many mortgage companies contacted the Commission's staff with questions about their responsibilities under Regulation Z and the Regulation Z Commentary, including those pertaining to Section 32 mortgages and those affected by revisions to Regulation Z to implement the Truth in Lending Amendments of 1995, Pub. L. 104-29, 109 Stat. 271.

Equal Credit Opportunity Act

The Commission received some inquiries about antidiscrimination protections of the ECOA and fair lending issues. The Commission also received many requests for compliance materials from creditors and mortgage brokers.

Electronic Fund Transfer Act

The Commission received some inquiries about consumers' rights in electronic fund transfer transactions. However, the Commission receives a relatively small number of inquiries about these rules in comparison to inquiries under the credit and lease requirements.

¹⁵ No. 88-1698 E (S.D. Iowa filed Dec. 12, 1988).

Griffith L. Garwood
January 10, 1997
Page 11

**III. ANY SUGGESTIONS FOR CHANGES IN THE ACTS OR THEIR
IMPLEMENTING REGULATIONS**

As noted above, in 1996, the Commission filed comments concerning the Board's proposed consumer lease revisions to Regulation M and the Regulation M Commentary, including various suggested changes in these requirements. The Commission looks forward to continuing to work with the Board on the important issue of consumer leasing.

The Commission also understands that the Board expects to undertake a regulatory review of credit rules under Regulations B and Z in the near future. Because Regulations B and Z cover many types of financing transactions and diverse issues, the Commission also would support the effort to update and clarify these critical rules.

The Commission hopes that the information contained in this letter responds to your inquiry and will assist in preparation of the Board's Annual Report to Congress. If any other information would be useful or if you request additional assistance, please contact David Medine, Associate Director, Division of Credit Practices, at (202) 326-3025.

By direction of the Commission.

Robert Pitofsky
Chairman