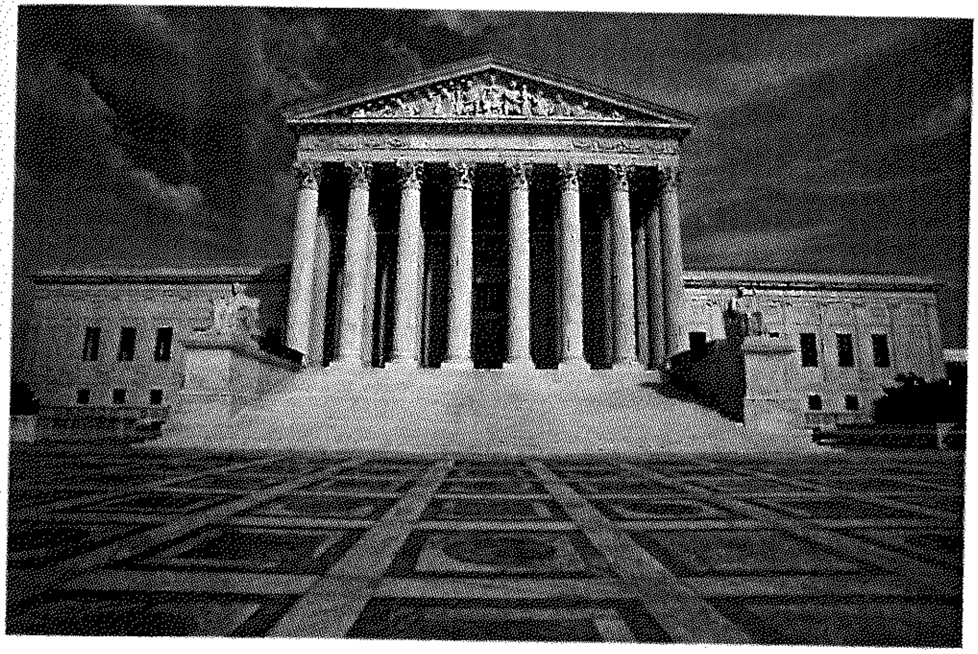
LESSON 6.4

CREDIT AND THE LAW



GOALS

EXPLAIN the purpose of consumer protection laws in lending

IDENTIFY important laws associated with consumer loans

CONSUMER PROTECTION

At best, credit policies are not always easy to understand, but in the past lenders sometimes made it purposely difficult. In a wave of consumer protection legislation during the 1960s, '70s, and '80s, Congress enacted several important laws to guarantee the rights of consumers. These *disclosure laws* require that details of lending agreements be specified in writing. Other important laws require far more than disclosure, guaranteeing equal access to credit for qualified consumers, accurate credit reporting, and freedom from unfair or deceitful collection practices. Banks are required not only to conform to federal and state laws, but also to document their compliance.

BANKING *Scene*

As Jamar Brown signs the papers on his car loan, he is asked to initial several places in the contract that point out terms and definitions. He also receives an itemized list of all charges, including the sale price of the car, APR, finance charge, total payments, and schedule of payments. He received similar forms relating to his credit application when he applied for the loan. Jamar was mostly interested in how much his payments were and when they were due. Why couldn't he just sign the whole package once? What was the purpose of so many forms and so many initialings and signatures?

In small groups, collect three sample copies of disclosure notices from local banks. Share your samples with each other. Study the wording of each carefully to see how it conforms to the requirements of TILA. Report your findings to the class.

Truth in lending

The **Truth in Lending Act** (TILA), Title I of the Consumer Credit Protection Act of 1968, was landmark legislation. Amended many times, it guarantees that all information about costs of a loan is provided in writing to consumers. Items that must be disclosed include the following.

- Total sales price
- Amount financed
- Annual percentage rate (APR)
- Variable rate information
- Total payments
- Schedule of payments
- Prepayment policies
- Late payment policies
- Security interest

In addition, the act provides for a *right of rescission*, which allows a consumer to change his or her mind about a loan until midnight of the third business day following the signing of papers. The law also prescribes complaint procedures and penalties.

Equal Credit Opportunity Act

The **Equal Credit Opportunity Act** (ECOA) prohibits the use of race, color, religion, national origin, marital status, age, receipt of public assistance, or exercise of any consumer right against a lender as a factor in determining creditworthiness. If a credit request is denied, the law also requires that the lender provide the reasons for the denial upon request.

CONSUMER LENDING IN JAPAN

The Japanese economic system, the most westernized of Asian economies, also depends on credit. From the first store card issued by Marui Department Store in 1960 to the present, the use of credit has grown dramatically in Japan. Japanese consumers face issues similar to Americans with their use of credit. Japanese bankruptcies are on the rise, especially as Japan has faced several waves of recession.

There are three primary consumer reporting agencies in Japan, one for banks, one for companies doing their own financing, and one for credit-granting companies. Although there are no laws limiting credit reporting in Japan, agencies abide by voluntary guidelines. According to *Credit and Collections World Magazine*, the guidelines do not allow reports to be used for employment screening or any purpose other than credit evaluation.

THINK CRITICALLY

What factors in a nation's economy would lead to a sophisticated system of credit reporting? What would likely be the result if the voluntary guidelines were not followed?

Fair Credit Reporting Act

The **Fair Credit Reporting Act** (FCRA) aims to protect the information that credit bureaus, medical information companies, and tenant screening services may collect. First enacted in 1971, the legislation provided the first legal oversight of the credit information industry. The FCRA establishes the following rights.

- Consumers must be told what is in their file and who has had access to the information.
- Consumers must be told if information in their file has been used against them. Anyone using a report to deny credit must supply the name, address, and telephone number of the agency that supplied the report.
- Consumers can dispute inaccurate information in their reports. The agency must investigate disputes within 30 days. The source must respond and advise all agencies of errors. If disputes cannot be resolved, consumers can add rebuttal statements to their files, a summary of which must appear in all future reports.
- Inaccurate information must be corrected or deleted. Although consumers cannot compel an agency to remove accurate data, agencies cannot reinsert disputed information without notifying the consumer.
- Credit bureaus cannot report information more than seven years old in most cases, or more than ten years old for bankruptcies.
- Access to consumer files is limited. The law specifies who may view the files and for what purpose. Penalties are imposed for violations.
- Consumers must authorize the release of reports to employers and the release of reports that contain medical information.
- Consumers may exclude themselves from credit-bureau lists sold for unsolicited credit or insurance offers. Telephone requests remove consumers from such lists for two years. Written requests remove names indefinitely.
- Consumers can seek damages for violations of the law.

Fair Debt Collection Practices Act

The **Fair Debt Collection Practices Act** (FDCPA) protects consumers from unfair collection techniques. Third-party collectors may not use deceptive or abusive tactics as they try to collect overdue bills. Such collectors may not contact debtors at odd hours, call repeatedly or in a harrassing manner, or threaten them in any way, even with legal action, unless it is actually contemplated. Nor may collectors reveal the debts or collection actions to other people, such as employers, in an attempt to embarrass the debtor. Penalties are prescribed for violations of the act.

CHECKPOINT

Name four important pieces of consumer protection legislation.

OTHER LEGISLATION

The preceding four laws are the foundation of consumer protection, but there are many other laws that apply as well.

- **Fair Credit Billing Act** An amendment of TILA, specifies fair procedures for resolving billing disputes and prevents creditors from taking adverse action until the dispute is resolved.
- **Fair Credit and Charge Card Disclosure Act** Also an amendment of TILA, requires credit and charge card issuers to provide information about open-end credit in direct mail or telephone solicitations.
- **Home Equity Loan Consumer Protection Act** Also amending TILA, requires lenders to make appropriate disclosures about open-end loans that are secured by homes and places limitations on such plans.
- **Credit Repair Organization Act** Prohibits credit repair companies from misleading consumers about their services and costs and requires agreements to be in writing.
- **Gramm-Leach-Bliley Act** Compels banks and other financial institutions to protect the privacy of consumers. Institutions must develop written policies, notify consumers of them, and allow consumers the opportunity to "opt out" before a bank can sell some forms of personal information to others.

In addition to these federal regulations, many states have enacted similar laws intended to protect the rights and privacy of consumers.

Compliance

Authority for enforcing consumer protection acts varies with the individual law and the government agency associated with it. Some federal statutes are enforced by the Federal Reserve, some by the Federal Deposit Insurance Corporation (FDIC), some by the Federal Trade Commission (FTC), and some by courts in actions brought by consumers.

In addition, audits are conducted to test compliance at banks and other financial institutions. Examiners typically review randomly selected loan files for completeness of documentation. They also watch for patterns of credit granting and denial, look at the way disputes are resolved, and check to see that privacy regulations are being observed.

Banks spend an ever-increasing amount of time and money ensuring well-documented compliance with complex sets of regulations under various jurisdictions. Bank customers might be surprised to learn the amount of time that bank officers spend every day assuring that their banks follow consumer protection laws.

CHECKPOINT

Name three other pieces of lending legislation.

____

____

CHAPTER 6 REVIEW

CHAPTER SUMMARY

LESSON 6.1 Consumer Loans

A. Installment loans are the most common form of consumer lending. They may be secured or unsecured. The principal, interest, fees, finance charge, total payments, and schedule of payments must be fully explained by law.

B. The amount owed on an open-end loan is flexible, as is the term. Open-end loans include credit cards and lines of credit.

LESSON 6.2 Granting and Analyzing Credit

A. A lender must determine whether extending credit is a sound decision.

B. Many lenders base credit decisions on reports from consumer reporting agencies (CRAs). CRAs and lenders often use credit-scoring systems.

LESSON 6.3 Cost of Credit

A. The cost of credit varies with annual percentage rate and term and depends on the method of calculation. Minimum payments reduce balances slowly.

B. Consumers should pay close attention to their credit standing because poor credit can result in numerous long-running financial problems.

LESSON 6.4 Credit and the Law

A. Four main laws (TILA, ECOA, FCRA, and FDCPA) provide the foundation for consumer protection in lending. Other federal and state laws apply as well.

B. Banks must document their compliance with all applicable state and federal regulations and spend considerable resources doing so.

VOCABULARY BUILDER

a. collateral
b. consumer reporting agency (CRA)
c. Equal Credit Opportunity Act
d. Fair Credit Reporting Act
e. Fair Debt Collection Practices Act
f. FICO score
g. grace period
h. installment loan
i. lien
j. open-end loan
k. secured loan
l. subprime rate
m. Truth in Lending Act
n. underwriting
o. unsecured loan

Choose the term that best fits the definition. Write the letter of the answer in the space provided. Some terms may not be used.

____ **1.** Period for which no interest charges accrue if balance is paid in full by due date
____ **2.** Guarantees that all information about costs of a loan is provided in writing
____ **3.** Loan with fixed amount of payments, rate of interest, and length of term
____ **4.** Loan backed by some item of value in case the borrower defaults
____ **5.** Dominant credit-scoring system
____ **6.** Loan backed by only the reputation and creditworthiness of the borrower
____ **7.** Company that compiles and sells credit records
____ **8.** Item used to secure a loan
____ **9.** Reviewing a loan for soundness
____ **10.** Loan with flexible principal and term
____ **11.** Protects consumers from unfair collection techniques