

Credit Practices Rule (Regulation AA)

Introduction

The Credit Practices Rule (Rule), contained in Subpart B of the Federal Reserve Board's Regulation AA, was adopted to prohibit certain unfair and deceptive practices related to consumer credit contracts. The prohibitions contained in the Rule apply to all credit contracts originated or purchased by financial institutions other than those for the purchase of real estate.

Regulation Overview

The Credit Practices Rule applies to all consumer credit contracts other than those for the purchase of real estate. It prohibits banks from using certain remedies to enforce consumer credit obligations. Under the Rule, banks may not include these remedies in their consumer credit contracts, and, if banks purchase contracts that contain a prohibited provision(s), banks are prohibited from enforcing the provision(s).

The prohibited provisions are: (1) A confession of judgment clause, (also known as a *cognovit* or *warrant of attorney*) which permits a creditor to obtain a judgment based on the borrower's agreement in advance that, in the event of a suit on the obligation, the borrower waives the right to notice and the opportunity to be heard; (2) a waiver of exemption in which the consumer relinquishes a statutory right protecting his or her home and other necessities from seizure to satisfy a judgment, unless the waiver applies solely to property that serves as security for the obligation; (3) an irrevocable assignment of future wages which gives the bank the right to receive the consumer's wages or earnings directly from the consumer's employer, unless the assignment constitutes a payroll deduction plan or other preauthorized payment plan; and (4) the taking of nonpossessory security interests in household goods, unless such goods are purchased with the credit extended by the bank.

The Rule also prohibits a practice known as "pyramiding late charges." Under the pyramiding provision, a bank is prevented from assessing multiple late charges based on a single late payment that is subsequently paid. This provision applies only to closed-end credit contracts.

Finally, the Rule prohibits a bank from misrepresenting a cosigner's liability and requires the bank to give a cosigner, prior to becoming obligated in a consumer credit transaction, a disclosure notice which explains the nature of the cosigner's obligations and liabilities under the contract.

Examination Procedures

1. Determine through discussion with financial institution management and staff if the financial institution attempts to enforce confessions of judgment, assignments of wages, security interests in household goods, or waivers of exemption in originated or acquired consumer contracts. (227.13)
2. Review the financial institution's collection policies, procedures, and practices to ensure that staff members are not using an assignment of wages except where permissible. (227.13(c))
3. Review past due loans to determine if the financial institution collects or attempts to collect overdue payments through assignments of wages. 227.13(c)
4. Review past due loans to determine if the financial institution collects, or attempts to collect, a late charge on a timely payment because of the consumer's failure to pay a late charge attributable to a prior delinquent payment. This prohibited practice is known as pyramiding of late charges. (227.15)
5. Determine, through a review of procedures, policies, and practices, whether the financial institution takes steps to prevent its staff from engaging in prohibited co-signer practices on loans. (227.14(a))
6. Determine through discussions with financial institution management and staff, if there is evidence that the financial institution engages in prohibited co-signer practices. Examples include misrepresentation of a co-signer's liability and contractually obligating co-signers prior to informing them of their liability. (227.14(a))
7. Determine through discussions with financial institution management and staff and a review of loan files, whether the co-signer is informed prior to becoming obligated, of the nature and extent of the co-signer's liability in accordance with Section 227.14(a).

References

Regulation AA, Unfair or Deceptive Acts or Practices, Part 227

12 CFR §227, 15 USC §57a

Staff Guidelines on the Credit Practices Rule

Job Aids

See Examiner Checklist—Credit Practices Rule on next page.

VII. Abusive Practices – Regulation AA

Examiner Checklist—Credit Practices Rule

	Yes	No
1. Do the consumer contracts or related documents originated by the institution contain any of the following prohibited provisions:		
• Confession of judgment? (227.13(a))		
• Waiver of statutory property exemption, (unless the waiver applies solely to the property which will serve as security for the loan)? (227.13(b))		
• Assignment of wages or other earnings (except where permitted)? (227.13(c))		
• Blanket security interests in household goods? (227.13(d))		
2. Does the institution acquire loans originated by other creditors?		
If so, does it attempt to enforce any of the following prohibited practices:		
• Confession of judgment? (227.13(a))		
• Waiver of statutory property exemption, (unless the waiver applies solely to the property which will serve as security for the loan)? (227.13(b))		
• Assignment of wages or other earnings (except where permitted)? (227.13 (c))		
• Blanket security interests in household goods? (227.13(d))		
3. Does the institution take a nonpossessory security interest in household goods (as defined in Section 227.12(d)) not purchased with the loan proceeds? (Review financial institution security agreement forms.)		
4. Has the institution attempted to enforce any prohibited practices with respect to the consumer credit contracts it has originated? (227.13(a) or 227.13(b))		
5. Does the institution collect or attempt to collect a late charge on a timely payment because of the consumer's failure to pay a late charge attributable to a prior delinquent payment? (227.15)		
6. Has the institution engaged in any prohibited cosigner practices (for example, misrepresenting the cosigner's liability or obligating cosigners prior to providing the required notification)? (227.14(a))		
7. Does the institution provide each cosigner, prior to becoming contractually obligated, the required notice or one that is substantially similar (whether separate or contained in the credit document)? (227.14(b))		