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Credit Cost Disclosure: Truth in Lending, Regulation Z, and the UCCC

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Comment

CREDIT COST DISCLOSURE: TRUTH IN LENDING, REGULATION Z, AND THE UCCC

OUTLINE

I. AN INTRODUCTION TO TRUTH IN LENDING LEGISLATION

Although this comment is written to deal specifically with the credit rate disclosure requirements of the Truth in Lending Act and the Uniform Consumer Credit Code, a general description of those acts provides an important background to such a discussion. Although disclosure requirements have often been regarded as the heart of those acts, other provisions dealing with closely related aspects of consumer protection will be included in this comment.

The Truth in Lending Act[1] is the name commonly given to Title I of the Consumer Credit Protection Act.[2] It is within Title I that the disclosure provisions of the Consumer Credit Protection Act are contained. The Truth in Lending Act and Regulation Z will be discussed together in this comment for the reason that these two pieces of legislation, when analyzed together, reveal a complete picture of the federal consumer credit disclosure regulations.

This Act, which became effective on July 1, 1969, contains four titles other than Title I. These additional titles contain provisions dealing with extortionate credit transactions, restrictions on garnishment, and the establishment of a national commission on consumer finance. To implement the provisions of Truth in Lending, the Board of Governors of the Federal Reserve System formulated specific disclosure requirements which must be met by the creditor. These requirements were incorporated into a regulatory provision entitled Regulation Z, which also became effective on July 1, 1969.

It is Regulation Z which provides the specific practical guidelines with which the creditor must comply in order to meet his specific disclosure responsibilities under the Truth in Lending Act.

> The Federal Reserve Board has wide latitude to make regulations as to contract disclosures and advertising. Board regulations may broaden or narrow the definition of finance charge, exclude insurance and other charges from the finance charge, determine annual rates, approve rate charts, permit tolerances, and determine equivalent state laws. Board regulations may also establish classifications, differentiations, adjustments, and exceptions for any class of transaction.[3]

Both the Truth in Lending Act and Regulation Z were designed to apply to any individual or organization which, during the course of business, regularly extends or arranges for the extension of credit

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1 15 U.S.C. § 1601 (Supp. IV, 1969), provides that Title I may be cited as the Truth in Lending Act.

2 Hereinafter cited as Truth in Lending or the Act.

3 Barrett, *An Introduction to Truth in Lending*, 14 PRAC. LAW. 83, 91 (1969).

to consumers for personal, family, household, or agricultural purposes provided that any resulting finance charge is or may be payable, or if the debt is repayable, in more than four installments.[4] The extent of the application of the Truth in Lending Act, Regulation Z, and the Uniform Consumer Credit Code are discussed in section three of this article in greater detail.

The Uniform Consumer Credit Code[5] is the product of the National Conference of Commissioners on Uniform State Laws. This Code, designed to be a comprehensive uniform body of consumer credit law, is intended to replace inconsistent and conflicting state laws with one uniform body of state consumer protection law which would exempt the adopting state from the application of the Federal Consumer Credit Protection Act.[6]

The drafters of the Uniform Consumer Credit Code have attempted to exempt the enacting state from the jurisdiction of the Truth in Lending Act and Regulation Z by complying with section 123 of the Consumer Credit Protection Act.[7]

> To gain the exemption, the Federal law requires (1) substantial similarity between state and federal substantive statutes, (2) substantial similarity between the state and federal substantive regulations, and (3) adequate state provisions for enforcement.[8]

It should be emphasized that, at the present time, adoption of the Code by a state does not mean automatic exemption from compliance with the provisions of the federal act. However, in view of the fact that the Code was revised to conform with the federal act, it is anticipated "that the Federal Reserve Board will in time certify the Consumer Credit Code as being in substantial compliance with the federal legislation."[9] Whether the Code is actually in substantial compliance with the federal law is one of the questions which will be considered within the scope of this article.

The Code is divided into nine articles which include provisions, other than disclosure requirements, dealing with maximum charges,

4 15 U.S.C. §§ 1602(f), (h) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. §§ 226.2(k), (m).

5 Hereinafter cited as Uniform Code or Code.

6 CCH CONSUMER CREDIT GUIDE ¶ 4001 (1969).

7 15 U.S.C. § 1633 (1964), *as amended*, (Supp. IV, 1969). "The Board shall by regulation exempt from the requirements of this part any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this part, and that there is adequate provision for enforcement."

8 COMMERCE CLEARING HOUSE, NEW RULES ON CONSUMER CREDIT PROTECTION ¶ 4001 (1969).

9 Warren, *The Uniform Consumer Credit Code*, 24 BUS. LAW. 209, 212 (1968).

rate ceilings, contract terms, enforcement rights, advertising requirements, and administrative control. Unlike the Act, the Code treats separately the disclosure requirements for credit sales and loans. The disclosure requirements for credit sales appear in article two while the requirements for loans appear in article three.

The reader will notice the use of the term "administrator" within this comment in relation to the Code. Unlike the Act, where enforcement of the federal law is in the hands of a great many governmental agencies,[10] the Code vests responsibility for enforcement in the hands of a single administrator located within each adopting state.

Both the Act and the Code contain major consumer protection provisions apart from disclosure. A brief description and comparison of these provisions may prove helpful in comparing the total effect that these pieces of legislation will have on the consumer. Only the Code sets rate ceilings for the consumer credit transactions subject to regulation. This fact does much to distinguish the Code from the Act. Identical ceilings are set under the Code for credit charges arising out of consumer sales and consumer loans. Maximum charges are thirty-six percent per annum on the unpaid balance of the first three hundred dollars worth of credit, twenty-one percent on the unpaid balance of the next seven hundred dollars, and fifteen percent on the unpaid balance of any amount exceeding one thousand dollars. The Code also allows an alternative ceiling rate of eighteen percent per annum on the unpaid balance of the entire amount financed.[11]

The fact that the Code sets ceilings on credit charge rates should not be considered as an attempt to fix rates. As stated in the comment following section 2.201: "The intent of this Act is to provide even more effective competition." That the Code attempts to increase competition as a natural control on credit rates is exemplified by the liberal licensing rules provided for under the Code.[12]

[10] While placing responsibility for the enforcement of the Truth in Lending Act in the Federal Reserve Board, the Act placed enforcement in the hands of the Federal Trade Commission for those businesses not currently subject to federal regulations. For those businesses currently subject to regulation, the appropriate federal regulatory agency will be responsible for the enforcement of the Act. For a more complete discussion of the division of enforcement responsibility among the several federal agencies, *see* 15 U.S.C. § 1607 (1964), *as amended*, (Supp. IV, 1969).

[11] UCCC §§ 2.201, 3.508.

[12] UCCC § 3.503(2). A person is entitled to a license if the Administrator finds "that the financial responsibility, character and fitness of the applicant . . . are such as to warrant belief that the business will be operated honestly and fairly within the purpose of this Act."

Both the Code and the Act contain provisions which attempt to curb extortionate extensions of credit. While the Code deems extortionate extensions of credit unenforceable through civil judicial processes,[13] Title II of the Act wages war on extortionate credit practices on several fronts. Not only does Title II deem unenforceable extortionate extensions of credit, but any person who extends, finances, or attempts to collect extortionate extensions of credit is subject to severe criminal penalties.[14]

Both the Code and the Act provide restrictions on garnishment and the discharge of employees by reason of their wages being garnished. It should be noted that the Code exempts slightly more of the wage earners' wages from garnishment than does the Act.[15] The Code prohibits the discharge of an employee for any number of garnishments,[16] while the Act protects the employee from discharge only to the extent of one garnishment.[17] In addition, the Code takes an extra step and prohibits garnishment before judgment in an action against the debtor.[18]

The Code and the Act contain provisions which provide the consumer an opportunity to rescind certain types of credit agreements. The consumer is given the right to rescind, under certain conditions, when a security interest is taken in the consumer's residence.[19]

Except for the provisions mentioned above, the Act and Regulation Z deal only with disclosure.

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13 UCCC § 5.107.

14 18 U.S.C. § 892 (1964), *as amended*, (Supp. IV, 1969), provides for a fine of not more than $10,000 and/or imprisonment of up to 20 years for anyone who makes, or conspires to make an extortionate extension of credit. Sections 893 and 894 provide the same penalty for those who finance extortionate extensions of credit, or attempt to collect extensions of credit by extortionate means.

15 15 U.S.C. § 1673 (1964), *as amended*, (Supp. IV, 1969), exempts 75% of the wage earnings for the week, or the amount of disposable earnings for the week which does not exceed thirty times the federal minimum hourly wage, whichever amount is greater. UCCC § 5.105, on the other hand, exempts any wages which do not exceed *forty times* the federal minimum hourly wage.

16 UCCC § 5.106.

17 15 U.S.C. § 1674(a) (1964), *as amended*, (Supp. IV, 1969).

18 UCCC § 5.104.

19 15 U.S.C. § 1635 (1964), *as amended*, (Supp. IV, 1969) and 12 C.F.R. § 226.9 provide the details concerning the federal law. The Code provisions on rescission are found in UCCC § 5.204.

> Basically the [Act] is only a disclosure law. It does not regulate or control finance charges, contract provisions or limitations, debtor's remedies, or any of the substantive features of a consumer credit transaction.[20]

The Code, however, provides some restrictions on deficiency judgments in consumer credit sale situations. Under the Code, if the creditor chooses to repossess either the goods or the collateral of the credit sale in which the price of the goods sold was one thousand dollars or less, the creditor is not entitled to a deficiency judgment.[21]

It should also be noted that the Code provides the consumer with a civil remedy against the creditor for violation of certain of his obligations under the Code. These remedies arise from a failure of the creditor to meet the disclosure requirements of the Code,[22] or from other violations of the rights of the consumer under the Code.[23]

The Administrator, as provided for under article six of the Code, is also supplied with certain powers to enforce the provisions of the Code. Aside from broad investigatory powers,[24] the Administrator is empowered to issue cease and desist orders against violators of the Code, although such orders are not enforceable unless a judicial enforcement order has been secured.[25] The Code also empowers the Administrator to seek civil relief against the creditor who violates the Code's provisions. This relief may take the form of injunctions, as well as civil actions for refunds to debtors, and civil penalties.[26]

II. THE NEED FOR CREDIT COST DISCLOSURE

The disclosure provisions of the Truth in Lending Act and the Code were adopted in response to developing consumer credit problems in this country. Although this article deals primarily with the technical nature of disclosure provisions, some mention should be made of the situation which created a need for the disclosure legislation now under consideration.

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20 Moo, *Legislative Control of Consumer Credit Transactions*, 33 LAW & CONTEMP. PROB. 657, 662 (1968).

21 UCCC § 5.103.

22 UCCC § 5.203.

23 UCCC § 5.202.

24 UCCC § 6.106. The administrator is given the power to subpoena witnesses and compel the production of any books and records necessary to an investigation.

25 UCCC § 6.108.

26 UCCC § 6.113.

One factor which created an urgent demand for consumer credit disclosure reform was the tremendous growth of the consumer credit industry. "The total outstanding balance on consumer credit transactions has risen from $5.6 billion in December, 1945, to $92.5 billion in March, 1967."[27] At least part of this growth can be attributed to the change of the consumer's viewpoint concerning the use of credit. The use of credit, once conceived by the majority of Americans as a device to be used in moderation, has become an acceptable method of family and personal finance.

> Acquiring consumer goods and services on credit has become an integral part of a way of life for many persons in the United States. Enjoying the use of goods or services in the present in exchange for a promise to pay for them out of future earnings is as acceptable a method of financing as saving a portion of one's earnings in the present to purchase enjoyment of goods and services in the future.[28]

The increased use of consumer credit has also been due to an increased availability of credit to persons of all economic classes. "Credit is available in some form to most consumers regardless of their social or economic strata . . . ."[29] The increased availability of credit to consumers of lower economic classes has had a profound effect on the buying habits of the low income consumer.[30]

The increased use of consumer credit by all classes of consumers, and particularly the consumer in the lower economic classes, has intensified the problem of lack of understanding by the consumer of credit costs.

> In a recent study of 800 families involved in credit transactions, it was discovered that the average family felt it was paying 8% per year for its credit. In fact, the average cost of credit was 24% per year. It is doubtful that many persons could figure the true cost of credit, particularly when the transactions in varying combinations involve discounts, add-ons, balloon payments, credit insurance, varying rates for different amounts of credit, and the cost of credit reports and credit investigations.[31]

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27 Bluhm, *The Truth in Lending Act Analyzed*, WIS. B. BULL., June, 1969, at 7 [hereinafter cited as Bluhm].

28 B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 1-2 (1965) [hereinafter cited as CURRAN].

29 *Id.* at 2.

30 "Two thirds of the purchases of major durables made by low income consumers involve the use of credit or loans, a portion comparable to that of middle income consumers. Seventy-five percent of low income consumers have used credit for at least one purchase of a major durable, and a lesser number of them use it for food or clothing." Comment, *Consumer Legislation and the Poor*, 76 YALE L.J. 745, 761 (1967).

31 Bluhm, note 27 *supra*, at 7.

This problem is particularly serious in the case of the low income consumer, who in all probability has less sophistication in financial matters than do those of the middle and higher income groups. The lack of understanding by the low income consumer of the costs of the credit he or she uses can have very serious effects.

> At the time of purchase, the low-income customer is often unaware of the exorbitant price he is charged and the actual total amount and cost he will pay for something he may not really need. . . . Many low-income consumers realize—too late—that they have paid dearly for their purchases. When this realization occurs, they are resentful and prone to default on installment payments.[32]

Even when relevant credit costs are thoroughly disclosed to the consumer in the modern credit market, an additional problem has plagued the consumer. The problem can be simply defined as a lack of any uniform method of making credit cost disclosure. Different methods of computing credit costs between different facets of the credit industry rob the consumer of the ability to credit shop between competitive sources of consumer credit.[33] The consumer needs to know if it is less expensive to finance the purchase of goods on a department store charge account, for instance, or borrow the money from a bank and make the purchase from the store in cash. An informed decision in such a case can only result if the consumer is able to make a meaningful comparison of the credit costs disclosed by different sources of consumer credit. This problem of confused credit disclosure is further complicated by the fact that existing state laws governing the credit industry vary drastically from state to state.[34]

The Truth in Lending Act and the Uniform Code state as part of their objectives a meaningful disclosure of credit terms to foster competition among the suppliers of consumer credit.[35] The extent to which they achieve those goals, and enable the consumer to make intelligent use of credit, will depend upon their ability to solve some of the basic consumer credit problems pointed out in this section.

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32 Dixon, *Government, Consumers and Retailers: Togetherness or Conflict*, 4 NEW ENGLAND L. REV. 75 (1969).

33 Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285, 1286 (1966).

34 CURRAN, note 28 *supra*, is a good source of information concerning the many different types of state disclosure provisions.

35 15 U.S.C. § 1601 (1964), *as amended*, (Supp. IV, 1969); UCCC § 1.102.

III. APPLICABILITY OF THE FEDERAL ACT AND THE UNIFORM CODE

Broadly stated, Truth in Lending applies "[t]o all persons who in the ordinary course of business regularly extend, or offer, or arrange or offer to arrange, for the extension of consumer credit."[36] The disclosure provisions of the Uniform Code appear at sections 2.301 through 2.313 and 3.301 through 3.312. The Code generally does not approach consumer credit as a homogeneous subject, but rather divides the subject into sales and loan transactions and treats each separately. Therefore, the disclosure requirements under the Code are also split on the loan-sale basis and are applicable to consumer credit sales[37] and consumer loans.[38] In most transactions, the creditor is given an option under the Code to disclose information in accordance with either the federal act or the Code.[39]

Consumer credit under Truth in Lending is the credit extended to a natural person for personal, family, household, or agricultural purposes and which is repayable in *more* than four installments pursuant to an agreement, or for which a finance charge is or may be imposed.[40] The Code definitions of consumer credit sale and consumer loan largely conform to the above statement from Regulation Z.[41] Except for real property transactions,[42] neither the Uniform Code nor the federal act disclosure provisions apply to credit transactions exceeding twenty-five thousand dollars.[43]

From the foregoing definition of consumer credit, it is apparent that regular thirty day accounts on which no finance charge is levied are not subject to the federal act. Truth in Lending applies only where a finance charge is levied or when the debt is payable in more than four installments. Where the account is billed as being fully due in thirty days, and the customer is dilatory and strings out his payments in a series of more than four installments, the transaction still is not subject to the federal act. "The fact that some customers may not pay their bills in full each month is their unilateral action and such action alone would not place [the cred-

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36 12 C.F.R. § 226.1(a).
37 UCCC § 2.301(1).
38 UCCC § 3.301(1).
39 UCCC §§ 2.301(2), 3.301(2).
40 15 U.S.C. § 1602(h) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.2(k).
41 UCCC §§ 2.104, 3.104.
42 *See* text accompanying section IV c *infra.*
43 15 U.S.C. § 1603(3) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. 226.3(c); UCCC §§ 2.104(1)(e), 3.104(1)(d).

itor] within the purview of the Regulation."[44] Installment payments must be made pursuant to an agreement in order for Truth in Lending to be applicable.[45] Under the Uniform Code, any debt which is to be paid in installments or upon which a finance charge is levied is subject to disclosure.[46] Unlike the Act, the Code is applicable to any debt which is to be repaid in installments, regardless of the number of installments.

Section 226.2(m) of Regulation Z defines "creditor" as meaning "a person who in the ordinary course of business regularly extends or arranges for the extension of consumer credit." If the individual extending credit does not meet the above definition, he is not subject to the disclosure requirements of Truth in Lending, and this is true even though a finance charge may be made or the debt is payable in more than four installments. It is under this definition that an out-of-pocket loan to a neighbor is exempt from the federal act. It is presumed that such a lender is not a person who in the ordinary course of business regularly extends consumer credit.

Small businesses operating on a cash basis, professional persons, and nonprofit institutions may also be excused from compliance by way of the Act's definition of "creditor," but caution should be exercised when determining whether the circumstances fit the definition. It has been suggested that such an organization or person will be exempt only if the credit transaction is "an extremely isolated instance . . . . On the other hand, if such arrangements were more frequent, they would be subject to Truth in Lending."[47]

The Code definition of creditor is subsumed in its definitions of "consumer credit sale" and "consumer loan." Among other requisites to a customer credit sale, the credit must be "granted by a person who regularly engages as a seller in credit transactions of the same kind."[48] Before a loan may qualify as a consumer loan, it must

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[44] Correspondence from J. L. Robertson, Vice Chairman, Federal Reserve Board, June 5, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3722. Mr. Robertson also cautioned: "Should a high incidence of customer accounts reflect more than 4 periodic payments, even though not pursuant to an agreement, and these accounts are not considered to be in a delinquent state, then it is our feeling that the enforcement agency might well consider them under the provisions of Regulation Z."

[45] 12 C.F.R. § 226.2(k).

[46] UCCC 2.104(1)(d).

[47] Correspondence from Frederic Solomon, Director, Federal Reserve System, July 8, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3773 (1969). Mr. Solomon's letter was in response to a hospital's inquiry concerning the applicability of Truth in Lending to its credit operations.

[48] UCCC § 2.104(1)(a).

be "made by a person regularly engaged in the business of making loans . . . ."[49] From these provisions, it would seem that the above suggested test for exemption of a transaction conducted "in an extremely isolated instance" would also apply under the Uniform Code.

While the "credit arranger" is within the disclosure provisions of the federal act,[50] the Uniform Code apparently has no revision governing the disclosures by such a person.[51] Regulation Z sets forth two tests, either of which will qualify an individual as a credit arranger.[52] First, if the individual receives any form of consideration for his services, he is a credit arranger. Second, if the individual has knowledge of the credit terms and participates in the preparation of the contract documents he is an arranger of credit.

It is apparent that at least in some situations a real estate broker, building contractor, or auto dealer might easily fall within the provisions of the federal act. If the individual does qualify as an arranger of credit, he is considered a creditor for Truth in Lending purposes and he is responsible for making all required disclosures.

Truth in Lending applies only to those transactions where credit is extended for "personal, family, household, or agricultural purposes."[53] The Uniform Code provides for the same application under the definitions of consumer credit sale and consumer loan.[54] The purpose of a given transaction may present a factual question not always capable of easy solution.

> There seems to be no clear cut line between credit for personal, family, household or agricultural purposes and credit for business or commercial purposes where the obligor is a natural person. In situations where there is an element of doubt as to which course to follow, it would seem to be in the creditor's interest to err on the side of making unnecessary disclosure rather than risk the possible consequences of failing to make them.[55]

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49 UCCC § 3.104(1).

50 15 U.S.C. § 1602(f) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. §§ 226.2(f), (m).

51 *See* text accompanying section IV A *infra.*

52 12 C.F.R. § 226.2(f).

53 15 U.S.C. § 1602(h) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.2(k).

54 UCCC §§ 2.104(1)(c), 3.104(1)(b).

55 Correspondence by Milton W. Schober, Assistant Director, Federal Reserve System, October 17, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3806-73 (1969).

Although it is not listed as a regulatory exemption, credit extended to anyone other than a natural person is not consumer credit, and neither the federal act nor the Uniform Code are applicable to the transaction.[56] In many instances, credit extended for agricultural purposes would be exempt on this basis.[57] Section 226.3 of Regulation Z provides for the exemption of credit extended to an organization,[58] or for business or commercial purposes.[59] Transactions in securities or commodities accounts with a broker-dealer registered with the Securities and Exchange Commission are exempt.[60] Also exempt under the federal act are certain transactions under public utility tariffs[61] and non-real property transactions in excess of twenty-five thousand dollars.[62] The Uniform Code provides the same exemption in the case of non-real property transactions over twenty-five thousand dollars.[63]

As noted above, the distinction between credit for business purposes and credit for personal, family, household, or agricultural purposes can be very fine. Perhaps one of the most difficult questions has been whether loans for investment purposes are subject to Truth in Lending. As of this writing, no authoritative statements have been issued by the Federal Reserve on this matter:

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[56] 15 U.S.C. § 1602(h) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.2(k); UCCC §§ 2.104(1)(b), 3.104(1)(a).

[57] 12 C.F.R. § 226.2(c) provides: "'Agricultural Purpose' means a purpose related to production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products. 'Agricultural Products' includes agricultural, horticultural, viticultural and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shell fish, and any products thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof."

[58] 15 U.S.C. § 1603(1) (1964), *as amended*, (Supp IV, 1969); 12 C.F.R. § 226.2(s) provides: "'Organization' means a corporation, trust, estate, partnership, cooperative, association, government, or governmental subdivision, agency, or instrumentality."

[59] 15 U.S.C. § 1603(1) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.3(a).

[60] 15 U.S.C. § 1603(2) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.3(b).

[61] 15 U.S.C. § 1603(4) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.3(d).

[62] 15 U.S.C. § 1603(3) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.3(c). *See* text accompanying section IV C *infra*.

[63] UCCC §§ 2.104(1)(e), 3.104(1)(d).

> Your final question requested guidelines for determining when an investment is for personal purposes and under Regulation Z and when it is for a business or commercial purpose and excluded. The answer, at this time, is similar to that given your first inquiry [we have not reached a conclusion]: The problem is under advisement, but, until there is a resolution, the best rule is to disclose in those cases where doubt exists.[64]

In response to an inquiry concerning the applicability of Truth in Lending to bank loans, the proceeds of which are invested in leasehold properties by the customer, it was said:

> Clearly, if the customer receives most or all of his income from the leasehold rentals, the transaction can probably be considered for business or commercial purposes. On the other hand, if the income received does not represent a primary source of revenue for the customer, the credit could be construed as for "personal purposes." The distinction is a fine one which will probably require judicial decision at some future date.[65]

In nearly all the published correspondence on this matter, the Federal Reserve has strongly advised that Truth in Lending disclosures be made in transactions which cannot clearly be classified as being for business or commercial purposes. On the other hand, it has been suggested that the creditor might take a "Declaration of Purposes" statement from the customer showing that the purpose of the credit transaction is commercial and not for a personal use.

> A creditor choosing to rely on the business or commercial purposes exemption would have to satisfy himself that, in fact, the extension of credit was for these purposes. The task is not an easy one, and certainly a Declaration of Purpose would aid the creditor in making this determination. However, the extent to which a [creditor] could rely on a signed Declaration of Purpose, would, of course, be determined by whether or not it accurately reflected the actual purpose for which the credit was being extended as determined through the best efforts of the [creditor].[66]

IV. CLOSED END CONSUMER CREDIT TRANSACTIONS

A. The Consumer Credit Sale

As defined in the federal act, a consumer credit sale is one where consumer credit is extended or arranged by the seller.[67] By

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[64] Correspondence from Milton W. Schober, Assistant Director, Federal Reserve System, Nov. 5, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3806-93 (1969).

[65] *Id.* at ¶ 3806-90.

[66] Correspondence from Frederic Solomon, Director, Federal Reserve System, May 14, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3806-90 (1969).

[67] 15 U.S.C. § 1602(g) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.2(n).

placing the "credit arranger" within the Act and requiring his compliance, Truth in Lending averts the possibility of easy evasion. It is not unusual for the seller who primarily deals on a cash basis, to arrange loan financing for the majority of his customers. Witness that many new and used car dealerships are essentially engaged in "branch banking" with the exception that the credit extension must be approved by the bank. Certainly such practices would permit the seller to obligate a consumer on a purchase agreement prior to any disclosure of credit costs.[68] By bringing the credit arranger within the disclosure requirements of Truth in Lending, the possibility of such practices would seem to have been greatly inhibited.

Section 103(f) of Truth in Lending defines "creditor" to include any person or type of organization who regularly arranges for the extension of credit. Section 226.2(f) of Regulation Z defines the phrase "arrange for the extension of credit," and under this definition a person arranges for credit only when he is compensated for his service or where he has knowledge of the credit terms and participates in the preparation of the contract documents. Such limiting tests are unfortunate where the seller otherwise regularly arranges customer credit, for the merchant may still be in a position to obligate the customer on a purchase agreement before there is opportunity for the purchaser to consider credit financing and its added costs. The seller, in all circumstances, should either be required to make disclosure under Truth in Lending or allow the customer to arrange his own financing as a condition to becoming obligated on a purchase contract.

Section 2.104 of the Uniform Consumer Credit Code defines a "consumer credit sale" as one where credit is extended by a seller to a person in a transaction for the sale of goods, services or an interest in land. The purchase must be intended for personal, family, household, or agricultural purposes by the customer; and the debt must be payable in installments or a service charge must be levied. If the amount financed exceeds twenty-five thousand dollars, the transaction is not a consumer credit sale. This definition is neither limited in the same manner as in Regulation Z nor as inclusive as section 103(f) of the Act.

While the Uniform Code purports to apply to the same transactions governed by section 103(f) of the Act,[69] it does not prescribe conduct for the seller who arranges for the extension of credit. Such a loophole opens the door for easy evasion by any seller who wishes to avoid disclosure completely. Such an omission militates against

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[68] 12 C.F.R. § 226.2(f).

[69] *See* UCCC § 2.104, Comment 1.

the argument that the Code conforms to Title I of the federal act or that any state adopting the Code would receive exemption from federal regulation. On the other hand, the Act exempts credit transactions on which no finance charge is levied and is payable in less than five installments.[70] The Code requires disclosure whenever the debt is payable in installments. There is no "four installment" limitation in the Code. Therefore, under the Code, disclosure would be required in many more credit transactions than is required by the Act.

Included within the definition of consumer credit sale under the Act and Regulation Z are bailments and lease contracts, wherein the bailee or lessee agrees to pay a sum substantially equal to or in excess of the value of the property involved, and in which it is agreed that the bailee or lessee shall become owner of the property, or where he has the option of becoming owner upon payment of a nominal consideration.[71] Substantially similar provisions are made in the Uniform Code.[72] These provisions are intended to achieve compliance by the seller who enters into disguised sales arrangements. In bailment and lease situations, substance rather than form determines the applicability of Truth in Lending.

1. *The Amount Financed*

The following items must be known in order to calculate the amount financed in a consumer credit sale transaction: the cash price, the total downpayment, any charges which are not a part of the finance charge, and any prepaid finance charge or required deposit balance. Each of the foregoing must be disclosed to the purchaser.[73]

The cash price charged for the property or service is that price which the seller charges in the ordinary course of his business to customers dealing on a cash basis. Included in the cash price are those charges normally made in a cash sale for accessories or services such as delivery, installation, alterations, modification or im-

70 12 C.F.R. § 226.2(k).

71 15 U.S.C. § 1602(g) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.2(n).

72 UCCC § 2.105(4) provides that a "'[s]ale of goods' includes any agreement in the form of a bailment or lease of goods if the bailee or lessee agrees to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods involved and it is agreed that the bailee or lessee will become, or for no other or a nominal consideration has the option to become, the owner of the goods upon full compliance with his obligation under the agreement."

73 15 U.S.C. § 1638(a) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.8(c).

provements. Taxes normally imposed on a cash sale may be included in the cash price, but charges which are incident to the credit extension may not be so included.[74] A downpayment made in money is a cash downpayment while downpayments made in property are trade-ins.[75] Cash downpayments and trade-ins must be itemized and their sum disclosed as the total downpayment. The difference between the cash price and the total downpayment is disclosed under the term unpaid balance of cash price.[76]

Occasionally a portion of a downpayment is deferred to some point in time after the credit transaction is entered into and often carries no finance charge. Such delayed downpayments are frequently referred to as "pick-up payments." A creditor may exclude a pick-up payment from the amount financed and treat it as a regular downpayment if the finance charge is not otherwise increased on account of the delay in payment. Further, to enjoy this treatment, the pick-up payment must fall due sometime prior to the due date of the second regularly scheduled payment.[77] If the pick-up payment is more than twice the amount of any regularly scheduled payment, it must be disclosed as a balloon payment, and the creditor must disclose the conditions upon which it may be refinanced.[78]

Charges included in the amount financed which are not a part of the finance charge must be individually itemized and added to the unpaid balance of the cash price. This sum must be disclosed as the unpaid balance.[79] Any required deposit balance or prepaid finance charge, or the total of such amounts where appropriate, disclosed under the phrase total prepaid finance charge and required deposit balance, are deducted from the unpaid balance to arrive at the amount financed.[80]

A prepaid finance charge is any finance charge which is paid separately, in cash or otherwise, where the payment is made directly or indirectly to the seller or where it is paid to another person with the seller's knowledge. The term includes any finance charge which is withheld from the proceeds of the credit extended.[81] Such prepaid charges, which are deducted for disclosure purposes, must nonetheless be included in the finance charge.[82]

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74 12 C.F.R. § 226.2(i).
75 12 C.F.R. § 226.8(c)(2).
76 12 C.F.R. § 226.8(c)(3).
77 12 C.F.R. § 226.504.
78 *See* text accompanying section IV B 4 *infra*.
79 15 U.S.C. § 1638(a)(5) (1964), *as amended*, (Supp. IV, 1969).
80 12 C.F.R. § 226.8(c)(6).
81 12 C.F.R. § 226.8(e)(1).
82 12 C.F.R. § 226.8(e)(1).

Investments and deposit balances made by the customer and required by the creditor as a condition to the credit extension must not be included in the amount financed. However, certain investments and deposit balances are exempt from this treatment. Amounts held in escrow in real property transactions for the future payment of taxes, insurance, and water, sewer and land rents need not be deducted from the unpaid balance in arriving at the amount financed.[83] Also, deposit balances which will be wholly applied towards satisfaction of the debt[84] or which were in existence before the credit transaction and are offered by the customer as security for the credit need not be deducted from the unpaid balance.[85] Also within the exception is any investment or deposit balance made from the proceeds of credit extended for that purpose upon written request of the debtor.[86]

2. *The Sales Finance Charge*

The sales finance charge is essentially the sum of all charges and expenses incurred by the customer as an incident to or as a condition of the extension of credit. Section 226.4 of Regulation Z spells out numerous examples of credit charges which must be included in the finance charge, but the list is by no means exclusive of those charges not named but which must be included if they are an incident to or a condition of the credit extension.

Those charges specifically set forth in the Regulation at section 226.4(a) are interest, time price differential, amounts payable under a discount or other system of additional charge; service, transaction, activity, or carrying charges; loan fees, points, finder's fees and similar charges; and fees for appraisal, investigation, or credit reports.

Where credit life, health, accident or loss of income insurance is written in connection[87] with the credit transaction and is required by the creditor as a condition to the transaction, the charges and

83 12 C.F.R. § 226.4(e)(3).

84 12 C.F.R. § 226.8(e)(2)(ii). This exemption is designed to accomodate the Morris Plan type transaction whereby payments are accumulated in a deposit account and the balance is applied toward satisfaction of the debt. "Unless the deposit balance account is created for the sole purpose of accumulating payments and then being applied toward satisfaction of the customer's obligation in the transaction, such deposit balance does not fall within the exception provided in subdivision (ii)." Any deposits made in such an account must be treated the same "as a payment on the obligation for the purpose of computations and disclosures." 12 C.F.R. § 226.806.

85 12 C.F.R. § 226.8(e)(2)(iii).

86 12 C.F.R. § 226.8(e)(2) (iv).

87 *See* text acccompanying section IV B 2 *infra*.

premiums thereon must be included in the finance charge. If such insurance is not required and this fact is clearly disclosed by the creditor in writing and if the customer desires such insurance and clearly expresses this desire in a separately dated, written indication of his desire, the charges and premiums for the credit insurance need not be included in the finance charge.[88]

The cost of property insurance written in connection with the credit transaction must also be disclosed unless the creditor furnishes a written statement to the customer indicating the cost of such insurance if obtained from or through the creditor and clearly stating that the customer has the right to choose the person or agency through which the property insurance may be purchased. Otherwise, the charges and premiums must be included in the finance charge.[89] It should be noted that property insurance may be required as a condition to the credit extension and, at the same time, the cost thereof may still be excluded from the finance charge by meeting the above requirements.

Any charge or premium levied against the customer for the guarantee of the obligation or insurance against the customer's default must be included in the finance charge.[90] Also, charges imposed by a creditor on another creditor for the purchase or acceptance of the customers obligation must be included where the customer is required to pay any portion of that charge in the form of a reduction in the credit proceeds, as an increase in the obligation, or in cash.[91]

Section 226.4(b) of Regulation Z describes certain charges which are excludable from the finance charge provided they are itemized and disclosed to the customer. Fees and charges prescribed by law and which will be paid to a public official need not be included in the finance charge where such charges are for the purpose of "determining the existence of or for perfecting or releasing or satisfying any security related to the credit transaction."[92] Where the security interest is required by the creditor and is not perfected, the premium of any insurance in lieu thereof may be excluded from the finance charge, provided the amount of the premium does not exceed the fees and charges prescribed by law under section 226.4(b) (1) of Regulation Z.[93]

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88 12 C.F.R. § 226.4(a) (5).
89 12 C.F.R. § 226.4(a) (6).
90 12 C.F.R. § 226.4(a) (7).
91 12 C.F.R. § 226.4(a) (8).
92 12 C.F.R. § 226.4(b) (1).
93 12 C.F.R. § 226.4(b) (2).

Taxes which are not included in the cash price[94] and fees imposed by law for licenses, certificates of title and registrations[95] are not required to be included in the finance charge. Charges for late payment, delinquency, default, and reinstatement are also exempt from inclusion in the finance charge provided they are unanticipated by the creditor.[96] Also, certain charges arising in real estate sales transactions are excludable from the finance charge under section 106(e) of the Act and section 226.4(e) of Regulation Z.[97] In the sale of a dwelling the finance charge need not be disclosed at all.[98]

3. *The Deferred Payment Price*

In addition to finance charge disclosures, the seller must disclose to the customer the total amount of the obligation using the term "deferred payment price."[99] The deferred payment price is the sum of the cash price, finance charge, and any other charges which are included in the amount financed but which are excluded from the finance charge.[100] It should be noted that this disclosure is computed without deduction for downpayments, prepaid charges, or deposit balances. The deferred payment price need not be disclosed where the transaction involves the sale of a dwelling.[101]

4. *The Annual Percentage Rate*

With very few exceptions, the finance charge on a consumer credit transaction must be disclosed as an annual percentage rate.[102] If the finance charge does not exceed five dollars and the amount financed is seventy-five dollars or less, the annual percentage rate disclosure is not required. Likewise, where the amount financed exceeds seventy-five dollars and the applicable finance charge is seven dollars and fifty cents or less, the annual percentage rate is not required.[103] Under these exemptions, the creditor is forbidden to divide a credit transaction into two or more transactions in order

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94 12 C.F.R. § 226.4(b)(3).
95 12 C.F.R. § 226.4(b)(4).
96 12 C.F.R. § 226.4(c). *See* text accompanying section IV B 4 *infra* for a suggested interpretation of "unanticipated."
97 *See* text accompanying section IV C 2 *infra.*
98 12 C.F.R. § 226.8(c)(8). *See* text accompanying section IV C 2 *infra.*
99 12 C.F.R. § 226.8(c)(8)(ii).
100 *Id.*
101 12 C.F.R. § 226.8(c)(8). *See* text accompanying section IV C 2 *infra.*
102 15 U.S.C. § 1638(a)(7) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.8(b(2).
103 15 U.S.C. §§ 1638(a)(7)(A), (B) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. §§ 226.8(b)(2)(i), (ii).

to avoid disclosure, and where no annual percentage rate is disclosed in accordance with these exemptions, the creditor is forbidden to disclose any other percentage rate.

Section 107(a)(1)(A) of the Act states that the annual percentage rate shall be:

> that nominal annual percentage rate which will yield a sum equal to the amount of the finance charge when it is applied to the unpaid balances of the amount financed, calculated according to the actuarial method of allocating payments made on a debt between the amount financed and the amount of the finance charge, pursuant to which a payment is applied to the unpaid balance.

Subparagraph (B) grants discretion to the Federal Reserve Board to prescribe any alternative methods which will materially simplify the computation "while retaining reasonable accuracy as compared with the rate determined under Subparagraph A."[104]

Section 226.5(b) of Regulation Z provides that the United States rule may also be used as a method of computing the annual percentage rate:

> Under this rule, the finance charge is computed on the unpaid balance for the actual time the balance remains unpaid and if the amount of a payment is insufficient to pay the accumulated finance charge, the unpaid accumulated finance charge continues to accumulate to be paid from the proceeds of subsequent payments and is not added to the amount financed.[105]

Both the actuarial method and the United States rule yield the same result, and that result must be accurate to within the nearest one-quarter of one percent[106] of the true annual percentage rate.

Rate disclosures stated on an annual basis assume that the debtor has full use of the credit proceeds for the duration of the financial transaction. But where the debt is liquidated through installment payments, the debtor does not have the full use of the credit proceeds, and the true annual rate must necessarily increase. As each installment period elapses, the credit proceeds available for the debtor's use will diminish; hence, for each installment period, a decreasing rate must be charged to yield an amount equal to the

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[104] The constant ratio method of computing the annual percentage rate has been prescribed by the Board for use in exceptional situations. *See* text accompanying note 107 *infra*.

[105] 12 C.F.R. § 226.5(b)(2). *See also* FINANCIAL HANDBOOK § 24.42 (J. Bogen ed. 1964): "In general, the foregoing rule in computing interest is followed by the courts if the contracts of the parties or the usages of the trade do not indicate the use of some other theory or method of computing interest. In the *administration of estates and relations with the government*, this method is also followed."

[106] 12 C.F.R. § 226.5(b).

finance charge. Under the actuarial method and the United States rule, the creditor must calculate a uniform rate which will yield an amount equal to the finance charge when applied to the outstanding balance of the amount financed at the end of each installment period. Where the creditor knows only the amount financed, the finance charge, and the duration of the credit extension, the uniform rate applicable to each installment period must be calculated from tables showing the present value of an annuity. The uniform rate must then be converted to an annual rate by multiplying by the number of installment periods in a year.

Supplement I to Regulation Z contains equations and technical instructions for computing the annual percentage rate under the actuarial method. As indicated in the supplement, the precise method of computation varies with the nature of the transaction. Where the transaction involves a single advance, the method of computation will vary depending upon whether payments are made at equal intervals and in equal amounts, at equal intervals in unequal amounts, at unequal intervals in equal amounts, and unequal intervals in unequal amounts. Computations will also vary where installment periods are greater than one year or where a debt is to mature in less than one year and is to be liquidated by a single payment. Formulas are also prescribed for transactions involving required deposit balances and multiple advances by the creditor. Whether the computation is made using the equations or annuity tables, the entire process is quite tedious.

In exceptional circumstances involving highly irregular transactions[107] where the creditor is unable to compute the annual percentage rate under the actuarial or United States rule methods, the Federal Reserve Board has prescribed the constant ratio method of computation.[108] This method is conceptually artificial to the extent that it is assumed that all payments are equal in amount and are to be paid at equal intervals.[109] However, computation under

[107] 12 C.F.R. § 226.5(d) deals with minor irregularities whereby the creditor may treat certain specified irregular payments as being regular for purposes of computing the annual percentage rate. Generally, the irregularity must involve only one payment, other than any downpayment, and the installment periods and amounts must otherwise be equal.

[108] 12 C.F.R. § 226.5(e). The annual percentage rate calculated under this method is only an approximation of the true rate. The constant ratio method may not be used for evading disclosure under the actuarial method or United States rule. Where the constant ratio or any other method is prescribed by state law, § 226.5(e) does not justify the creditor's failure to disclose rates computed under the actuarial method or United States rule.

[109] 1 CCH CONSUMER CREDIT GUIDE ¶ 1222 (1969).

the constant ratio method is materially less complex than those required under the actuarial method or United States rule. The constant ratio method of computing rates has been used by the Federal Housing Administration in calculating the rates of charge on Title I loans and is therefore not a new concept to the credit industry.[110]

5. *The Use of Charts and Tables*

To facilitate computation of the annual percentage rate, tables have been produced by the Federal Reserve which are currently available from the Federal Reserve Banks. Rates, properly ascertained from the tables, will be held to comply with Truth in Lending requirements and will absolve the creditor from the risks of erroneous computations.[111]

But the creditor is not limited to following the tables published by the Federal Reserve.[112] Any chart or table may be used to find the applicable rate so long as it is prepared in accordance with the actuarial method or the United States rule[113] and provided further that the requirements of section 226.5 (c) (2) of Regulation Z are complied with.[114] Where an error in disclosure of the finance charge or annual percentage rate is caused by a corresponding error in a table prepared or obtained by the creditor in good faith, the erroneous statement will not be considered a disclosure violation.[115] But to enjoy this protection, the creditor is required to report the error immediately to either the Federal Reserve Board or to a Federal Reserve Bank. The report must be written and it must contain the name and address of the person who prepared the table and the identification number of the table.

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110 JOHNSON, *Methods of Stating Consumer Finance Charges*, in STUDIES IN CONSUMER CREDIT, No. 2 at 110 (1961). Johnson's comparison of the constant ratio method to the actuarial method indicates that the constant ratio computation tends to produce a higher rate than does the actuarial method and this disparity increases as the maturity of the contract increases.

111 12 C.F.R. § 226.5(c) (3).

112 12 C.F.R. § 226.5(c) (2).

113 *Id.*

114 The principal requirements are that the name and address of the person responsible for the table's preparation be disclosed on the table along with an identification number which must be affixed to all tables containing like numerical content. If the table is prepared for use in irregular transactions, the disclosure of whether the United States rule or the actuarial method was used in preparation must be made.

115 12 C.F.R. § 226.5(c) (3).

Criminal sanctions are provided under the federal act for any willful and knowing misuse of a chart or table whereby the annual percentage rate is consistently understated. For any such violation, the creditor may be held liable for a maximum fine of five thousand dollars or one year in prison or both.[116] Under section 130 of the Act, the creditor may incur civil liability up to twice the amount of the finance charge with a minimum of one hundred dollars and a maximum of one thousand dollars plus costs and reasonable attorney's fees for failure to disclose any information required under Chapter II of Truth in Lending. While use of charts is prescribed in Chapter I, Chapter II information includes the annual percentage rate. Where the rate is understated by more than one-quarter of one percent, the maximum tolerance permitted,[117] such misstatement should be held to constitute a failure to disclose required information under section 130 of the Act. Furthermore, there appears to be no reason why a class action under Federal Rule of Civil Procedure 23 could not be maintained to recover penalties under section 130.

6. *Delayed Disclosure Involving Mail or Telephone Orders*

Required disclosures must generally be made to the customer before the agreement is consummated and the customer is bound by a contract.[118] But where the creditor receives purchase orders by mail or telephone without personal solicitation, disclosure may be postponed to a date not later than when the first payment is due.[119] To enjoy this benefit of delayed disclosure, the sales creditor's catalog and any other printed material distributed to the public must contain a statement of the cash price, downpayments, finance charge, the annual percentage rate, and the number, frequency and amount of payments.[120] Where this information is not available to the customer, disclosure must be made not later than the first delivery of the goods or the first performance of services ordered.[121]

It is evident that section 128(c) of the Act was designed for the benefit of the mail order house and the vendor who generally

[116] 15 U.S.C. § 1611(2) (1964), *as amended,* (Supp. IV, 1969).
[117] *See* note 106 *supra.*
[118] 15 U.S.C. § 1638(b) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.8(a).
[119] 15 U.S.C. § 1638(c) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.8(g).
[120] 12 C.F.R. § 226.8(g)(1).
[121] 12 C.F.R. § 226.802(b)(1). But if the transaction is of a kind governed by 12 C.F.R. § 226.9, wherein the customer is given a right of rescission, full disclosure must be made before consummation.

publishes and circulates merchandise catalogs. With regard to this purpose, section 128(c) and the accompanying regulations should be narrowly construed. The limiting test contained in the statute and regulations is whether a "personal solicitation" was a factor which induced the customer to place his order. If the order is prompted by a "personal solicitation," the general rule applies that disclosure be made before consummation of the agreement. The term "personal solicitation" is not defined in either the Act or Regulation Z, but it should be interpreted to include both printed matter distributed by the seller without the required disclosures and phone solicitations which prompt the buyer to make a telephone or mail order. In reference to printed materials lacking the required disclosures, much of this would also be in direct violation of the provisions governing credit advertising.[122]

7. *Delayed Disclosure Involving a Series of Sales*

In addition to disclosure delays in phone and mail order transactions, disclosure is not required before an extension of credit is made in accordance with an add on installment sales plan.[123] If, under such a plan, a series of sales is contemplated whereby the amount financed and the finance charge of a current sale is to be added to a total outstanding balance, disclosure may be delayed to a time not later than when the first payment on the current sale is due. To exercise this right of delayed disclosure, the creditor must have the customer's written approval of the annual percentage rate and "the method of treating any unearned finance charge on an existing outstanding balance in computing the finance charge or charges."[124] Furthermore, no security interest may be retained by the creditor in goods sold and upon which payments have been made aggregating to an amount equal to the sales price and finance charge thereon.[125]

In the above transactions, the creditor must exercise care in complying with the regulatory requirements. "Section 226.8(h) is applicable *only* when a credit sale is made pursuant to an agreement which provides for the addition of a current (or new) sale to an existing outstanding balance."[126] If there is no agreement or

122 *See* text accompanying section VI A *infra. See also* 15 U.S.C. §§ 1661 to 1665 (1964), *as amended*, (Supp. IV, 1969).

123 12 C.F.R. § 226.8(h).

124 12 C.F.R. § 226.8(h)(1).

125 12 C.F.R. § 226.8(h)(2). For purposes of subparagraph 2, payments are to be applied to individual sales on a fifo basis. Where two or more purchases are made on the same date, payments shall first be applied to the lowest priced purchase.

126 12 C.F.R. § 226.805.

if the customer's required approval is lacking on any of the specified matters, then disclosures on all subsequent sales must be made in accordance with section 226.8 (j) of Regulation Z.[127]

8. *Credit Sale Discounts*

Section 226.8 (o) of Regulation Z prescribes the method of disclosure applicable to discounts given on credit sales transactions. This section governs all credit sale transactions in which a discount is given for payment on or before a specified date. The disclosures set forth under section 226.8 (o) may appear on the billing statement.[128] To this extent, the requirement of disclosure at or before consummation of the transaction is again superseded and a delay in disclosure is the result.[129]

Section 226.8 (o) requires disclosure of the date of the sale or invoice, the rate of discount, the date by which the discount may be taken, the date by which the full amount falls due, the method of computing the charge on a delayed payment or the amount of the charge, and an identification of any security interest retained or acquired in connection with the transaction. The amount of the discount must be disclosed and labeled finance charge, and the annual percentage rate must be given where the finance charge is over five percent of the obligation.[130] In transactions involving multiple discount rates, the largest discount must be used in computing the finance charge and the annual percentage rate.[131]

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[127] *Id.* 12 C.F.R. § 226.8 (j) provides: "If any existing extension of credit is refinanced, or two or more existing extensions of credit are consolidated, or an existing obligation is increased, such transaction shall be considered a new transaction subject to the disclosure requirements of this part." An increase in an existing obligation to reimburse the creditor for assuming the debtor's duty to perfect, protect or preserve a security interest will not be considered a new transaction under this section. Similar treatment is provided for in loan transactions. *See* text accompanying section IV B 6 *infra.*

[128] 12 C.F.R. § 226.8 (o) (8).

[129] 12 C.F.R. § 226.803 (a) (b). Where the customer possesses a right of rescission under 12 C.F.R. § 226.9, the disclosures required under 12 C.F.R. § 226.8 (o) must be made at the time of or before the transaction is consummated.

[130] "[T]he annual percentage rate shall be determined by dividing the amount of the finance charge by the least amount payable in satisfaction of the obligation and multiplying the quotient (expressed as a percentage) by a fraction in which the numerator is 12, and the denominator is the number of whole months (but not less than 1) between the first day of the monthly billing cycle in which the transaction is consummated and the first day of the monthly billing cycle in which the obligation becomes due." 12 C.F.R. § 226.8 (o) (2).

[131] 12 C.F.R. § 226.8 (o) (3).

9. *Agricultural Sales Credit*

Section 226.8(p) of Regulation Z recognizes that in agricultural transactions, the date and amount of an advance or payment is frequently determined by the production or seasonal needs of the debtor and that such dates and amounts are often not determinable at the time of the agreement. In these circumstances, the following information must be disclosed at the time of agreement: the method of computation in figuring the finance charge and each component of the charge;[132] disclosures required under section 226.8(b)(3) of Regulation Z when determinable at the time of agreement, to include the number, amount and due dates or periods for repayment of the obligation and the sum of such payments; the amount or method of computing charges for default, delinquency or late payment;[133] a description of any security interest to be acquired or retained;[134] disclosure of any penalty charges to be levied in the event of early payment;[135] description of the method to be used in figuring rebates of unearned finance charges arising from early payment;[136] and disclosure of any required deposit balances or prepaid finance charges.[137]

The foregoing disclosures need only be made in the agreement or in a separate statement given to the customer at that time.[138] If the credit extension involves multiple advances from the creditor, and the disclosure requirements of section 226.8(p) are complied with, subsequent disclosures at the time of each advance are not required.[139]

B. The Consumer Loan

Among those lending institutions affected by Truth in Lending and the Uniform Code are finance companies, savings and loan associations, industrial banks, savings banks, and credit unions. When any of the foregoing institutions extend credit to a natural

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132 *See* text accompanying section IV A 2 *supra*.
133 12 C.F.R. § 226.8(b)(4).
134 12 C.F.R. § 226.8(b)(5).
135 12 C.F.R. § 226.8(b)(6).
136 12 C.F.R. § 226.8(b)(7).
137 12 C.F.R. § 226.8(e).
138 12 C.F.R. § 226.8(p)(3). If discounts for early payment under 12 C.F.R. § 226.8(o) are involved, disclosure in the billing statement must be provided for in that section. If the creditor who discloses under 12 C.F.R. § 226.8(p) issues periodic statements (*see* text accompanying section IV B 7 *infra*) such statements must be in a form which the debtor may retain and they must disclose the date by which payment must be made in order to avoid late payment and delinquency charges.
139 12 C.F.R. § 226.812.

person, and that person uses the proceeds for primarily a family, household, or agricultural purpose and where a finance charge is or may be imposed by the lender or if the loan is payable in more than four installments, then that transaction is subject to complete disclosure under the federal act[140] and the proposed Uniform Consumer Credit Code.[141] The lender must usually disclose to the consumer the amount financed, the finance charge, the annual percentage rate, repayment procedures, and security interests.

1. *The Amount Financed*

The amount financed in a loan transaction is the dollar amount which the consumer actually receives.[142] It includes the amount of the loan plus all other charges, individually itemized, which are not a part of the finance charge. "Prepaid finance charges" which are payable separately either to the creditor or, with the creditor's knowledge, to another person are to be stated separately along with any "required deposit balances." Where both terms are applicable to the same transaction, they should be combined in one caption. Amounts withheld from the proceeds of the credit extended are treated as a prepaid finance charge and would include a lender's commission for making the loan. "Deposit balances" include any investments which the creditor requires the debtor to make as a condition to the loan, but it does not include escrow accounts arising out of real estate transactions,[143] balances which will be wholly applied towards satisfaction of the consumer's debt, pre-existing deposits offered by the consumer as security for the loan, or deposits or investments made from the proceeds of the loan and made for that purpose upon the written request by the consumer. Prepaid finance charges deducted for disclosure purposes are nevertheless included in the finance charge for purposes of computing the annual percentage rate.[144] Under the Uniform Consumer Credit Code, the Truth in Lending label, "amount financed," is replaced by the term "principal."[145] Of course, under the policies of the federal act, uniformity of disclosure extends beyond uniform methods of computation and encompasses uniform labeling to prevent ambiguity and confusion to the consumer. Uniform terminology is as equally important as uniform methods of calculation and is essential if the consumer is to be given the opportunity to shop for credit and compare the costs of various credit sources.

[140] 12 C.F.R. § 226.2(k).
[141] UCCC §§ 3.104, 3.101.
[142] 12 C.F.R. § 226.8(d)(1).
[143] 12 C.F.R. § 226.4(e).
[144] 12 C.F.R. §§ 226.8(d), (e).
[145] UCCC § 3.107(3).

The "principal" of a loan is defined as the net amount payable for the account of the debtor. To the extent that charges for the following items are paid by the creditor and payment by the debtor is deferred, they may be included as part of the principal: registrations, certificates of title, license fees,[146] official fees and taxes, property insurance,[147] and credit life, health, accident or loss of income insurance.[148]

The Uniform Code permits the inclusion of the above additional costs as a part of the principal except where the consumer makes cash payment to the lender at the time the credit is obtained; then such costs are not deferred and may not be included as principal.[149] Under Truth in Lending, such costs would be included as a part of the amount financed, but both the Regulations and the Code require that they be described and itemized.[150]

2. *The Loan Finance Charge*

The total finance charge is disclosed as a dollars and cents figure and is the sum of all charges levied by the creditor as an incident to the extension of credit. A description of each component charge must be given.[151] Typically, finders fees when paid directly or indirectly by the consumer, loan fees, credit report costs, service charges and interest would all be included in the finance charge. When the lender requires that insurance be written in connection with the credit extension covering the consumer's life, health, loss of income or injury, the charges or premiums on such insurance must be included in the finance charge. However, if the insurance, owned by the borrower, was not purchased for the purpose of obtaining

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146 UCCC § 3.107(3)(c).

147 Where insurance against loss or damage to property is required as a condition to the loan, the creditor must furnish the debtor with a written statement disclosing the cost of such insurance if obtained through the creditor and explaining to the customer that he is free to choose the person through which the insurance may be obtained. *See* UCCC § 3.202(2)(a); 12 C.F.R. §§ 226.4(a)(6), 226.403(a). If such disclosures are not made to the customer, the charges must be included as a part of the finance charge.

148 Such credit insurance must not be required as a condition of the loan and this fact must be clearly disclosed to the debtor in writing. Otherwise, its cost must be included as a part of the finance charge. Further, where the debtor desires such insurance, a dated, written indication of such a desire must be given after the creditor has disclosed in writing the cost of such insurance if such costs are to be excluded from the finance charge. *See* 12 C.F.R. § 226.4(a)(5); UCCC § 3.202(2)(b).

149 *See* UCCC § 3.107(3), Comment 3.

150 12 C.F.R. § 226.4(b); UCCC § 3.306(2).

151 12 C.F.R. § 226.8(d)(3).

the credit, but is assigned or made payable to the creditor, the premiums and charges thereon are not includable in the finance charge since such insurance was not written in connection with the loan transaction.[152]

It is at least questionable to exclude the cost of insurance from the finance charge based on a test of whether the insurance was written in connection with the loan transaction. Where the debtor is required to assign or make payable to the lender an insurance policy previously held, the creditor receives the same benefits as where the policy was written in connection with the transaction. Similarly, one might categorize the cost of insurance before the assignment. After the policy is rewritten for the creditor's benefit, its costs become expenses incurred in the obtaining of credit. In essence, the benefit to the lender and expense to the debtor are the same regardless of whether the insurance was written in connection with the credit transaction. Where two customers obtain identical financing from a lender who requires credit insurance, and one customer carries insurance while the other does not, the finance charge and annual percentage rate disclosed to the latter will exceed those charges and rates imposed upon the former. This does not promote a policy of uniform, comparable disclosure.

The total finance charge need not be disclosed where the loan is secured by a first lien or an equivalent security interest on a dwelling and the loan is made to finance the purchase of that dwelling.[153] Where the lender takes a security interest in real property by financing the initial construction of a dwelling, such interest will be considered a first lien. Likewise, where a security interest is acquired in connection with a loan to satisfy a construction loan, that interest is also considered a first lien.[154]

Another exception to the disclosure of finance charges involves interim student loans made under certain federally insured student loan programs.[155] This exemption has been extended by interpretation of the Federal Reserve Board to similar loans made to students which are administered by or under agreement with the Department of Health, Education and Welfare.[156] Such an exemption is dictated by the nature of such student loans. Frequently, it is not

[152] 12 C.F.R. § 226.4(a)(5).
[153] 15 U.S.C. § 1639(a)(4) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(d)(3).
[154] 12 C.F.R. § 226.8(f).
[155] The exemption applies to those programs governed by 20 U.S.C. § 1071 *et. seq.* (Supp. IV, 1969).
[156] 12 C.F.R. § 226.809.

known how much credit will eventually be extended to the student pursuant to the agreement; nor is the duration of the credit extension known. Further, disclosure is virtually impossible due to the constantly changing rules and policies promulgated by the regulating agencies.

3. *The Loan Annual Percentage Rate*

The total finance charge must also be expressed as an annual percentage rate.[157] Because the base to be used in computing the annual percentage rate is smaller than the face amount of the loan due to the exclusion of loan fees, deposit balances and other items in arriving at the amount financed, the consumer will be confronted with a rate disclosure much in excess of any stated interest rate. The degree of disparity between a pure interest rate and the annual percentage rate will depend upon the nature of the loan, its duration and amount, and the credit worthiness of the borrower. The reason for the disparity is apparent—the annual percentage rate reflects the true cost of the credit to the consumer at the time of the loan agreement. Whether this cost will actually be realized by the debtor will often depend upon whether the loan is carried to maturity and paid off at that time. If the loan is refinanced or if penalties are incurred by the consumer, the realized cost to the debtor may vary from the cost as reflected in the annual percentage rate disclosure, but this is immaterial under the basic premises of Truth in Lending and the Code providing for uniform disclosure to allow comparison between sources of credit.

Percentage rate disclosure does not apply to the closed end transaction where the finance charge does not exceed five dollars and is applicable to an amount financed not exceeding seventy-five dollars. Also, where the amount financed exceeds seventy-five dollars and the finance charge is seven dollars and fifty cents or less, disclosure is not required. But the lender is forbidden to divide any credit transaction into two or more extensions of credit to avoid disclosure requirements[158]

In stating the percentage rate, the lender is not required to make a disclosure accurate to the last decimal point; however, he is held to disclosing a rate accurate to the nearest one-quarter of one percent.[159] The rate computation may be made in accordance with

[157] 15 U.S.C. § 1639(a) (5) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(b) (2).

[158] 15 U.S.C. § 1639(a) (5) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(b) (2).

[159] 15 U.S.C. § 1606(c) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.5(b) (1).

either the United States rule or the actuarial method. Formulas and technical instructions for determining the rate under the latter method appear in Supplement I to Regulation Z. The Uniform Code also provides for the disclosure of the annual percentage rate calculated by the actuarial method or by any other method prescribed by the administrator which would simplify computations. Where the administrator prescribes simplified methods of computation, the rate disclosed thereunder must be comparable to rates calculated under the actuarial method. Under the federal act, such rates would have to be accurate to the nearest one-quarter of one percent.[160]

4. *Loan Repayment Procedures*

The lender is required to disclose the number, amount and due dates of all payments plus their sum which must be labeled total payments.[161] However, where the loan is made for the purchase of a dwelling and the lender acquires a first lien or an equivalent security interest therein, the total payments disclosure is not required. Also, where the subject of the transaction is an interim student loan,[162] none of the above disclosures are required.[163]

Special disclosure is required where any balloon payment is to be made by the consumer. For purposes of the Act, a balloon payment is any payment which is twice the amount of any otherwise regularly scheduled equal payment. Such amounts must be clearly labeled with the term "balloon payment." Where the agreement provides for such payments, the lender must clearly spell out the conditions, if any, under which the balloon may be refinanced if not paid when due.[164] The balloon payment has been a technique, employed by some creditors, to get the consumer to refinance and thereby increase the lender's earnings and yield on any given credit transaction. When used, balloons are typically provided for in the last installment payment of the loan. Certain difficulties confront the lender under the above regulation. If refinancing becomes necessary, is the lender required to disclose the finance charge and the annual percentage rate which would govern the second transaction at the time of the initial loan? This would be quite difficult in times of tight money and rising interest rates. If the lender discloses the conditions under which the balloon payment may be refinanced, is he bound to provide the extended credit if it is decided that the consumer has become a bad credit risk? It would seem that the

160 UCCC § 3.304(2) (a).
161 12 C.F.R. § 226.8(b) (3).
162 *See* text accompanying note 155 *supra*.
163 12 C.F.R. § 226.8(d) (3).
164 12 C.F.R. § 226.8(b) (3).

creditor could certainly condition the refinancing of a balloon payment upon the continued credit worthiness of the consumer-debtor.

The Uniform Code goes beyond the disclosure provisions of the Act and severely limits the lender's practice of ballooning. The Code definition of balloon payment is identical to that provided for in Truth in Lending, but the Code gives the debtor the right to refinance the balloon payment at the time it is due and without penalty. Further, the terms of the refinancing must be as favorable to the debtor as were the terms of the original loan.[165] However, the Code limitations do not apply when payment schedules are tailored to the irregular or seasonal income of the debtor or where the loan is made for agricultural purposes pursuant to an open end agreement. Hence, in many situations, the farmer or farm laborer would not receive the protections of section 3.402. In some school systems, teachers are compensated on a seasonal basis and would not be protected; and the common laborer whose income fluctuates seasonally would, perhaps, have problems in bringing himself under the benefits of this Code provision.

In addition to disclosing the number of payments, their amount and date, the lender must disclose any default, delinquency or other similar charges which the debtor will incur in the case of late payment.[166] The Code provides the debtor with a ten day grace period following the scheduled due date in which to make full payment. No charges are permitted for delinquency if the payment is met within this period. Furthermore, such charges are limited to the larger of five percent of the unpaid installment but not to exceed five dollars or the deferral charge that would be applicable to defer the unpaid amount.[167]

Section 226.4(c) of Regulation Z provides that delinquency and default charges need not be included as a part of the finance charge where such charges are not anticipated. Whether a default or delinquency charge is anticipated by the lender might be determined by examination of the creditor's records. Where such charges are frequently collected by the lender, he should be held to have anticipated their assessment. Also, where installment payments are excessive in amount, as determined by the debtor's reasonably anticipated ability to meet those payments, any resulting delinquency or default, and charges thereon, should be held to have been anticipated and therefore includable in the finance charge. The creditor

[165] UCCC § 3.402.
[166] 15 U.S.C. § 1639(a) (7) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(b) (4.
[167] UCCC § 3.203(1).

should not be permitted to disclose a low finance charge and annual percentage rate with the intention of requiring large installments which will, in effect, increase his yield on the loan by way of foreseeable delinquencies and defaults.

Where any penalty charge will be assessed for early payments of principal, either by the lender or his assignee, this must be clearly stated. The conditions under which such charges will be assessed and the method of computing the penalty must be explained to the consumer.[168] Under the Code, the debtor has the right to prepay in full the unpaid balance of the loan at any time and without penalty. But partial prepayments may subject the customer to penalties, for such payments can be made only with the creditor's consent and under the conditions of the loan agreement.[169]

When early payments are made, unearned finance charges will accrue to the lender if such charge is included in the total amount of the obligation. Under these circumstances, the creditor must rebate the unearned finance charges and he must disclose to the debtor the method that will be used in calculating the refund. Any charges which might be deducted from the rebate must also be disclosed.[170]

5. *Loan Security Interests*

Any security interest acquired by the lender in connection with the extension of credit must be disclosed, and the property to which this interest will attach must be described. Where after-acquired property will be subject to the security interest or if any future indebtedness will be secured by the same property, these facts must also be fully disclosed.[171] At times property subject to the

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[168] 12 C.F.R. § 226.8(b)(6).

[169] UCCC § 3.209, Comment.

[170] 12 C.F.R. § 226.8(b)(7). The Rule of 78, commonly referred to as the sum-of-the-digits method, is the most frequently used computation in determining the amount of the rebate on finance charges. This method of computation is acceptable under Truth in Lending and the Uniform Code. In the Rule of 78, the creditor takes the summation of the number of periods over which the debtor will make payments. If the debt is to be paid off over a period of one year in monthly installments, the sum-of-the-digits is 78, *i.e.*, the numbers 1 through 12 added together. If the debtor pays off the entire debt at the end of the first month, 12/78 of the finance charge has been earned, and the creditor would be required to rebate 66/78 of the total finance charge. If, at the end of the fourth month, the debt is paid off, the creditor has earned the sum of the numbers 12 through 9 inclusive taken over 78 or 42/78 of the finance charge, and 36/78 of the total finance charge must be refunded to the debtor.

[171] 15 U.S.C. § 1639(a)(8) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(b)(5); UCCC § 2.306(2)(n).

security interest will not be easily identified, and where this should occur the disclosure must explain the manner in which the lender will retain or acquire the security interest in such unidentified property. Where clear identification is impossible because of the length of the identification, the debt instrument or disclosure statement must contain a clear reference to a separate pledge agreement, mortgage, deed of trust, or any similar document evidencing the security interest. A copy of this separate document must be given to the borrower.[172]

6. *Continued Dealings Between Lender and Consumer*

Where an agreement contemplates that a series of advances be made by the lender to his customer up to a specified amount of credit, the disclosures are required only at the time the agreement is executed, and disclosure on any particular advance is not required. But in these circumstances, the borrower must approve in writing the annual percentage rate, the method of computing the finance charge plus all other terms of the agreement. In this instance where all required disclosures are provided, the initial agreement and all subsequent advances are considered a single transaction.[173]

But where the loan is equivalent to refinancing or consolidating an existing loan obligation, it shall be considered a new transaction subject to the required disclosures under the Act. The same is true where an existing loan obligation is increased. If an unearned portion of the finance charge on the first obligation is not applied towards reducing that debt, it must be included as part of the new finance charge. Such an unearned finance charge cannot be included as a part of the new amount financed.[174] But if an existing obligation is increased to reimburse the creditor for undertaking the customer's obligation in perfecting, protecting or preserving the security, such an increase will not be considered a new transaction subject to disclosure. Likewise, advances for agricultural purposes made under an open end real estate mortgage or similar lien will not be considered a new transaction requiring disclosure where the maturity on the advance does not exceed two years and no increase is made in the annual percentage rate initially disclosed. However, all required disclosures must have been made at the time the security interest was acquired.[175]

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172 12 C.F.R. § 226.8(b)(5).

173 12 C.F.R. § 226.8(i).

174 12 C.F.R. § 226.8(j).

175 *Id.*

Where a payment on an existing obligation is deferred or extended and a charge is levied for such deferral or extension, the creditor must disclose the amount deferred or extended, the date or time period for which the deferral is granted, and the amount of the charge for permitting such extension.[176]

7. *Periodic Statements*

When periodic statements are given to the consumer-debtor under a closed end credit extension, the statement must contain the annual percentage rate and the date by which payment must be made so that late payments and delinquency charges may be avoided. Any statement, notice or reminder mailed or delivered to the borrower may be considered a periodic statement. But a delinquency notice, payment coupon book, payment passbook, or a statement, billing, or advice relating exclusively to amounts to be paid by the customer as escrows for payments of taxes, insurance, and water, sewer and land rents are not considered disclosures. Of course, unlike open end credit transactions, periodic statements are not required in closed end extensions of credit.[177]

C. Closed End Real Estate Transactions

Regardless of the amount financed in a real estate transaction, both Truth in Lending and the Uniform Code require full disclosure. There is no exemption in this area for transactions exceeding twenty-five thousand dollars.[178] However, total exemption from disclosure is retained where the credit is extended for a commercial or business purpose.

A real property transaction is any extension of consumer credit whereby the creditor acquires, retains or will acquire a security interest in real property.[179] The creditor must clearly describe the type of security interest taken and identify the property to which that interest relates.[180] The determination of what constitutes real property is governed by state law.[181] Therefore, credit transactions secured by an interest in fixtures will be a real property transaction depending upon the law of the state in which the security is

[176] 12 C.F.R. § 226.8(1); UCCC § 3.308. Such disclosure is not required where the amount of the finance charge is determined by the application of a percentage rate to the unpaid balance.
[177] 12 C.F.R. § 226.8(n).
[178] 15 U.S.C. § 1603(3) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.3(c); UCCC §§ 2.301(1), 2.301(2)(b).
[179] 12 C.F.R. § 226.2(x).
[180] 12 C.F.R. § 226.8(b)(5). *See* text accompanying section IV B 5 *supra*.
[181] 12 C.F.R. § 226.2(w).

located. Mortgage loans are perhaps the most obvious form of a real property transaction. But such services as repairs, renovations, alterations and other services performed in or on the real estate generally result in a lien against the property where credit is extended. Such credit services are also real property transactions subject to full disclosure.

The definitions of dwelling and residence are also significant in real estate transactions. A residence is any real property or parcel of land on which the debtor resides or expects to reside.[182] Thus a security interest in land on which the debtor intends to build his home will be treated as a lien on a residence. A dwelling is any residence-type structure which will house one or more families. A residential condominium unit is also a dwelling regardless of where it is situated. The above definitions are important in determining the creditor's exemption from disclosure of the finance charge on loans made for the purchase of a dwelling[183] and for the purpose of deciding whether the debtor possesses a right of rescission.[184]

1. *Finance Charges in Real Property Transactions*

Much confusion remains as to what costs should be included in the finance charge in a real property transaction. The creditor may require the debtor to incur certain costs which that debtor, as a particular individual, might not otherwise desire. It might reasonably be argued that such costs, imposed by the debtor as a condition to the transaction, are an incident of the credit extension and should therefore be disclosed as a part of the finance charge. But should the costs of a title examination and title insurance be treated as finance charges when required by the creditor? Where the debtor is required to meet such conditions, the creditor's security is protected and substantial benefit may accrue to the creditor where the title examination reveals adverse claims against the property. But it is equally valid to admit that the debtor's interests are also protected and that the same benefits accrue to the debtor as to the lender. Further, such expenses would probably be incurred by any reasonably prudent individual even if credit financing was unnecessary, and for this reason, the cost should not be considered an incident of the credit transaction.

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[182] 12 C.F.R. § 226.2(y).

[183] *See* text accompanying section IV C 2 *infra*; 15 U.S.C. §§ 1638(a)(6), 1639(a)(4) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(d)(3).

[184] 15 U.S.C. § 1635(a) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.9(g).

Because of this problem, the biggest difficulty in real property transactions is to determine which costs need *not* be disclosed as a part of the finance charge. Regular real estate transaction closing costs normally do not have to be included in the finance charge. Included in this catagory would be fees for title examinations, title insurance, property surveys, preparation of deeds and settlement statements. Credit reports and notary and appraisal fees are also excludable from the finance charge along with taxes, insurance and land rent type escrows.[185] The regulations require that these charges be itemized if they are added to the amount of the loan. Otherwise, itemization is not a required prerequisite to excluding such charges from the finance charge. But full disclosure and itemization is nonetheless desirable as evidence of their exemption from the finance charge.

Those charges specifically included in the finance charge are interest, service charges, finder's fees, loan fees, credit insurance and guarantee premiums, and points. The inclusion of points and other charges will naturally cause the annual percentage rate to exceed the normally disclosed contract rate of interest.

2. *Exempted Disclosures in Real Property Transactions*

There is no exemption for the annual percentage rate disclosure in real estate transactions. However, in certain situations, the disclosure of the total finance charge, total payments, the deferred payment price and the debtor's right to rescind need not be made.

Where the subject of a real estate transaction is the credit sale of a dwelling, the creditor is not required to disclose the total amount of the finance charge,[186] the total payments,[187] or the deferred payment price which is the sum of the cash price, finance charge, and any charges not included in the finance charge.[188] The Uniform Code provides for a similar exemption.[189] Under the Code, the credit service charge[190] need not be disclosed until the rate of charge exceeds ten percent per annum. The Code's theory is that since the bulk of land credit sales are long term, high balance trans-

[185] 15 U.S.C. § 1605(e) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.4(e).
[186] 15 U.S.C. § 1638(a)(6) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.8(c)(8).
[187] 12 C.F.R. § 226.8(b)(3).
[188] 12 C.F.R. § 226.8(c)(8).
[189] UCCC § 2.306(2)(j).
[190] The credit service charge is the Code equivalent to finance charge. *Compare* UCCC § 2.109 *with* 15 U.S.C. § 1605(a) (1964), *as amended,* (Supp. IV, 1969).

actions which will remain within the ten percent exemption, the buyer is more interested in comparative percentage rates than in the total dollar amount of credit costs spread over a large number of years.[191]

Loans secured by a first lien or some equivalent security interest [192] on a dwelling and made for the purchase of that dwelling do not require disclosure of the finance charge[193] or the total payments.[194] Again, under the Uniform Code, disclosure of the finance charge and the unpaid balance is not required, provided the finance charge is ten percent per annum or less.[195] The typical purchase money first mortgage would be exempt from disclosure. The presumption, under the Code, is that in small balance short term mortgage loans, the debtor is interested in comparing the costs thereof with rates offered by small loan companies and that knowledge of the total finance charge is important in making such a comparison.[196]

V. THE CONSUMER'S RIGHTS OF RESCISSION AND CANCELLATION

A. The Right of Rescission and Exceptions Thereto

Under sections 125 of the Act and 5.204 of the Uniform Code, the consumer is given the right to rescind certain transactions in which a security interest is taken or retained in any real property which is used or expected to be used as the consumer's principal place of residence. The right of rescission is limited to the first three business days following consummation of the transaction, or, if the disclosures required under section 226.9 of Regulation Z are not made at the time of consummation, the three day period does not begin to run until such required disclosures are made.[197] The consumer must notify the creditor in writing of his intention to rescind. Where the intent to rescind is given by mail or telegram, the creditor is deemed to have notice at the time the communication is mailed or filed for transmission. Notification by other means are effective at the time of delivery to the creditor.[198]

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191 *See* UCCC § 2.306, Comment 2.
192 *See* text accompanying note 153 *supra*.
193 15 U.S.C. § 1639(a)(4) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.8(d)(3).
194 12 C.F.R. § 226.8(b)(3).
195 UCCC § 3.306(2)(g).
196 *See* UCCC § 3.306, Comment 2.
197 15 U.S.C. § 1635(a) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.9(a); UCCC § 5.204(1).
198 *Id.* UCCC § 5.204(1) provides that notice shall be given "in accordance with rules of the Administrator."

Where a security interest has been taken on an obligation and the consumer wishes to refinance, the right to rescind does not apply to the new transaction if the amount of the new obligation does not exceed the unpaid balance plus any accrued and unpaid finance charge of the obligation which is refinanced. If the amount of the new transaction is in excess of the unpaid balance and charges thereon, the right of rescission applies; however, the rescission right is limited to the amount of the excess and has no affect on the original obligation and its related security.[199]

The creditor must give the consumer a separate written notice of his right to rescind the transaction. Section 226.9(b) of Regulation Z sets forth the requirements of this notice[200] and prescribes the exact wording to be used.[201] The notice statement must also set forth verbatim the provisions of section 226.9(d) of Regulation Z relating to the effect of rescission.

The creditor is required to wait until the three day rescission period has elapsed before he disburses any money, makes any physical change in the customer's property, performs any work or service for the customer or makes a delivery of goods.[202] This in itself would not pose any difficulty, but the creditor is also required to reasonably satisfy himself that the customer has not exercised his right of rescission.[203] By requiring the creditor to be reasonably satisfied that no rescission has been made, the drafters of Regulation Z certainly must have contemplated something more than the creditor's abstention from the proscribed conduct for a three day period. It has been suggested that "reasonable satisfaction" would impose no other requirement on the creditor than to wait an extra day beyond time in which rescission would normally be communicated through the mails.[204]

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199 12 C.F.R. § 226.903(c), *as corrected*, 34 Fed. Reg. 12255 (1969). No correlative provisions appear in the Uniform Code.

200 The notice must be printed in capital and lower case letters which are at least 12 point bold face type and must identify the transaction to which it relates.

201 No specified form of disclosure is set forth in the Uniform Code. The UCCC requires that such disclosure be made "in accordance with rules of the Administrator." UCCC § 5.204(1).

202 12 C.F.R. § 226.9(c). UCCC § 5.204(1) provides: "The creditor shall also provide, in accordance with rules of the Administrator, an adequate opportunity to the obligor to exercise his right to rescind any transaction subject to this section."

203 12 C.F.R. § 226.9(c). The UCCC contains no such requirement.

204 Correspondence by Governor Robertson of the Federal Reserve Board, July 3, 1969, 1 CCH CONSUMER CREDIT GUIDE ¶ 3771 (1969). Governor Robertson suggests that if further assurances are desired by the creditor, there would be nothing to prevent a requirement that the customer attest to the fact that he has not rescinded the agreement.

Sections 226.9 (d) of Regulation Z and 5.204 (2) of the Uniform Code give identical interpretations to the effects of rescission. Where the customer elects to exercise his right of rescission within the three day period, any security interest taken in the transaction becomes void and the creditor must return any property or money taken as a downpayment on the obligation. If property has been delivered the customer may retain its possession until the creditor has fulfilled his obligations of returning any downpayment and taking such actions as are necessary to reflect the termination of any security interest acquired in the transaction. Upon completion of such obligations by the creditor, the customer must tender the return of the property if practicable. This may be done either at the customer's residence or at the location of the property. If return of the property is impracticable or inequitable, the customer must tender the reasonable value of the property. If the creditor does not take possession of the property within ten days following the customer's tender, ownership of the property passes to the customer free of any obligation to the creditor.

Under certain circumstances, the customer's right of rescission may be modified or waived. Section 226.9 (e) of Regulation Z provides for such a waiver or modification where the credit is needed to meet a personal financial emergency and the customer has determined that a delay of three business days would endanger the health or safety of natural persons or property which the customer either owns or for which he is responsible. Section 5.204 (4) of the Code merely gives the administrator the discretion to implement such rules governing emergency situations if he finds that such action is necessary.

It has been suggested that section 226.8 (e) will be one of the most litigated sections of Regulation Z.[205]

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[205] Roisman, *Truth in Lending: Regulation Z—Its Limitations and Applicability*, 37 GEO. WASH. L. REV. 1154, 1169 (1969) (wherein this section is erroneously referred to as § 226.9(c). In testifying before the House Subcommittee on Consumer Affairs, the Hon. J. L. Robertson, Vice Chairman, Board of Governors of the Federal Reserve System stated: "I would say perhaps the biggest problem that is going to be encountered is going to be in connection with the right of rescission of contracts. This is going to be a lulu. We have attempted to make this a workable proposition by permitting the waiver of a rescission right. For example, if my furnace breaks down in midwinter and I want someone to come in and put in a new furnace, and he wants a lien on my property, he will have to wait for three days under this statute unless I waive my right of rescission. Now that is an emergency, and that involves a question of help. I can't afford to have a cold house for three days. So we allow a waiver of the right of rescission. We think it has to be done in order to protect the consumer.

For the customer's right of rescission to be effectively waived or modified, the creditor must obtain a dated and signed statement from the customer describing the circumstances which have brought about such an immediate need for the credit extension. The creditor is expressly prohibited from using printed or standardized forms for this purpose.[206]

Where property is held in joint ownership, and the joint owners enter into a credit transaction as customers, the right of rescission may be exercised by any one of them.[207] Where there is a waiver or modification of the right to rescind, it will not be valid unless signed by all joint owners.[208]

> [W]here there are joint owners, the right to receive disclosures and notice of the right of rescission, the right to rescind, and the need to sign a waiver of such right, apply only to those joint owners who are parties to the transaction.[209]

The regulations do not define or describe the type of joint ownership referred to in section 226.9(f), but the term apparently is used in reference to property held in joint tenancy, tenancy by the entirety, and tenancy in common.

Federal Reserve Board interpretations of section 226.9 indicate that where the creditor effectively waives his right to a security interest, the customer's right of rescission may or may not be destroyed. The problem arises where subcontractors, workers, and other persons also acquire a security interest in the property as a result of services rendered or goods furnished to the consumer. In such a situation, the transaction is rescindable even though the creditor waived his right to a security interest and the subcontractors are not obligated to deliver rescission notices to the customer.[210] But if all security interests are waived, there is no right of rescission by the customer. Section 226.2(z) of Regulation Z defines security interest to include, among other things, mechanic's liens, materialmen's liens, artisan's liens, and other interests in property which secure payment on an obligation. The Act provides that: "[W]hen an obligor exercises his right to rescind under subsection (a) . . . he is

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But I think there will be instances where real problems arise as a result of this rescission right. All we can do is to watch carefully how it functions, how it operates, and if we have to come back to congress, or if we have to change the regulation, we are going to do it fast." *Subcomm. on Consumer Affairs of the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. Part 2, p. 391 (1969).

206 12 C.F.R. § 226.9(e)(3).
207 12 C.F.R. § 226.9(f)(1).
208 12 C.F.R. § 226.9(f)(2).
209 12 C.F.R. § 226.902(b).
210 12 C.F.R. § 226.901(b).

not liable for any finance or other charge, and any security interest given by the obligor becomes void upon such a rescission."[211] It should at least be noted that mechanic's liens and other similar liens arise by operation of statutory law and are not given by the obligor in a credit transaction. Legislation[212] has recently been introduced in the Congress to limit the consumer's right of rescission in the above situation. The sponsors of the legislation assert that the Federal Reserve Board misconstrued the intent of Congress when it applied rescission rights to liens arising by operation of law. Representative David T. Martin made the following comments when H.B. 12876 was introduced:

> What is now section 125 originated in a floor amendment. The discussion surrounding the introduction of the amendment clearly indicates that the purpose of section 125 was to end the fraudulent schemes of second mortgage racketeers and other fly-by-night operators who victimize homeowners with their fastsell and quick-exit schemes. . . .
>
> Liens which arise by operation of law are not generally assignable under State law. Thus, for the second mortgage racketeer to operate effectively, he must acquire a lien by contract, in other words a security interest given by the consumer. This is clearly what the Congress intended to protect against when it enacted section 125, and unlike the interpretation in regulation Z, the language of section 125(b) is both inconsistent with and a clear indicator of that intention.[213]

There is no right of rescission where a first mortgage is taken to finance the purchase or construction of a dwelling in which the customer resides or expects to reside.[214] An exception is also provided at section 226.9(g)(3) of Regulation Z for "[a]ny lien by reason of its subordination at any time subsequent to its creation, if that lien was exempt from the provisions of this section when it was originally created." Under certain circumstances, exceptions are also provided for advances for agricultural purposes under section 226.9(g)(4). These latter exceptions provided for in Regulation Z apparently have no correlative counterparts under the Uniform Code.

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211 15 U.S.C. § 1635(b) (1964), *as amended,* (Supp. IV, 1969).

212 H. R. Doc. No. 12876, 91st Cong., 1st Sess. (1969).

213 2 CCH CONSUMER CREDIT GUIDE ¶ 99918 (1969).

214 15 U.S.C. § 1635(e) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.9(g); UCCC § 5.204(5). Section 125(e) of the federal act has been incorporated verbatim into the Uniform Code.

B. The Right of Cancellation Under the Code—Home Solicitation Sales

While the federal act and the Uniform Code are substantially the same in their treatment of the consumer's right of rescission in real estate transactions, the Uniform Code "singles out for special treatment consumer credit sales in which the transaction is negotiated face-to-face at a residence of the buyer."[215] Sections 2.501 through 2.505 of the Code provide the consumer with a right of cancellation where the creditor makes a "home solicitation sale." A home solicitation sale is one where credit is extended on a sale of goods or services and the seller or his agent personally solicits the sale and obtains the buyer's agreement or offer to purchase at the consumer's residence.[216] The underlying theory of the buyer's right to cancel a home solicitation sale is that, while high pressure sales techniques may be applied to the consumer at any time or place, the consumer is particularily susceptible to such practices as they are applied in his home.[217] It should be noted that two conditions must be present to meet the above definition. First, there must be a personal contact between the buyer and the seller or his agent. Second, the buyer must either commit himself to an agreement or make an offer to purchase at his residence. These limitations afford the creditor an easy opportunity to avoid the application of the law.

> Sellers who sell by means of solicitation in the home can avoid the application of Part 5 by having the contract or offer to purchase signed by the buyer at the office of the seller or at some place other than the buyer's residence. If the buyer must go to the seller's office or some other place to sign the contract or offer there is no less likelihood that he is acting because of undue pressure by the seller.[218]

Where a transaction meets the requirements of a home solicitation sale, the buyer is given three business days in which to cancel the agreement.[219] However, under section 2.503, this three day period does not commence to run until the seller gives the buyer a written

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215 UCCC § 2.501, Comment 1.

216 UCCC § 2.501. This section does not apply to farm equipment sales, a sale made pursuant to a preexisting revolving charge account, or a sale made pursuant to prior negotiations between the parties at a business establishment at a fixed location where goods or services are offered or exhibited for sale.

217 UCCC § 2.501, Comment 2.

218 *See* UCCC § 2.501, Comment 3.

219 UCCC § 2.502(1). Such a cancellation period is commonly referred to as a "cooling-off" period. Several states have enacted cooling-off legislation. *See* Ga. Code Ann. § 96-906(a) (Supp. 1969); Ill. Ann. Stat. ch. 121½, § 262B (Smith-Hurd Supp. 1969); Mass. Ann. Laws ch. 255D, § 14 (Supp. 1969); Wash. Rev. Code Ann. § 63.14.04Q(2)(e) (Supp. 1969).

statement[220] disclosing the right of cancellation and obtains the buyer's signature to the written purchase agreement or offer to purchase. These documents must contain the seller's mailing address and the date of the transaction as being the date which the buyer actually signs the agreement. Cancellation occurs when the buyer gives the seller written notice of cancellation.[221] The buyer's notice of cancellation need not conform to any particular format. All that is required is that the notice be in writing and convey to the seller the buyer's intention not to be bound by the agreement.[222]

The consumer's right of cancellation in no way affects his right to revoke an unaccepted offer to purchase. The right of cancellation is cumulative with any rights the consumer may have independent of the Code, and it in no way affects the rights of rescission for fraud, duress, or breach of warranty.[223] In those instances where the right of cancellation and rescission arise out of the same transaction, the consumer may elect either method of avoiding the agreement.[224]

Under certain circumstances, the buyer may not have the right of cancellation even though the transaction meets all the requirements of a home solicitation sale. If the seller is requested to perform without delay because of an emergency situation, the buyer may be deemed to have waived his right of cancellation. Under Section 2.502(5), if the seller makes substantial beginning performance before the buyer gives notice of cancellation, and if such performance is rendered by the seller in good faith reliance upon the buyer's statement that an emergency situation exists, the buyer loses his right of cancellation. If the transaction involves the sale of goods, cancellation rights are lost if "the goods cannot be returned to the seller in substantially as good condition as when received by the buyer."[225] The theory is that:

> Goods and services are frequently sold on credit to a buyer at his home because of an emergency. Common examples are emergency repairs to broken water pipes, furnaces, appliances and the like. Since such transactions may come within the definition of home solicitation sales, sellers may be reluctant to perform services or deliver goods before expiration of the 3-day cancellation period. Application of the right to cancellation to emergency situations would have the undesirable effect of seriously deterring credit sellers from performing in time to deal with emergencies.[226]

[220] The seller must use the statement prescribed in UCCC § 2.503(2).
[221] UCCC § 2.502(2). Subsection (3) provides that cancellation by mail is effective upon deposit by the buyer.
[222] UCCC § 2.502(4).
[223] *Id.* at Comment 4.
[224] UCCC § 2.502(6).
[225] UCCC § 2.502(5)(b).
[226] *Id.* at Comment 3.

Unlike Truth in Lending, which requires the seller to obtain a written statement signed by the buyer relating the exact nature of the emergency, no statement describing the nature of the emergency is required by the Code. This is unfortunate, for such a statement protects both the creditor and debtor. The prudent seller should certainly require such a statement as evidence of his good faith reliance upon the buyer's representations.

When the consumer effectively cancels a home solicitation sale, the seller has ten days in which time he must tender to the buyer any payments made and any evidence of indebtedness taken by the seller.[227] The ten day period runs from the time of cancellation. Therefore, while a sale may be effectively cancelled by the buyer through the use of the mails without the seller's knowledge, it is contemplated that ten days is a sufficient period in which the seller may receive actual notice and tender to the buyer any payments or notes taken on the obligation.[228] The payments which the seller must tender include downpayments and trade-ins. Where the seller has taken goods as a trade-in, they must be tendered to the cancelling buyer in substantially as good condition as when received by the seller.[229] Until the seller meets these obligations, the buyer is permitted to retain possession of any goods delivered to him by the seller. During such retention, the buyer is given a lien in the retained property as security for the seller's performance.[230] The risk of loss and damage is upon the buyer during this period as it is at all other times before cancellation or within a reasonable time thereafter.[231] Section 2.505(1) of the Code specifically sets forth that forty days shall be presumed to be a reasonable time. During this period the buyer must tender any goods delivered to the seller upon demand. The buyer is not obligated to make such a tender except at his residence, and if the seller fails to demand possession within a reasonable time ownership of the property will vest in the consumer free of any claim by the seller.[232]

Upon effective cancellation, the seller is permitted to retain a cancellation fee equal to five percent of the cash price, but this fee may not exceed the amount of the downpayment and is therefore

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[227] UCCC § 2.504(1).

[228] *Id.* at Comment 1.

[229] UCCC § 2.504(2). If the seller fails to tender the goods or such property is tendered in a defective condition, the buyer may elect to recover an amount equal to the trade-in allowance.

[230] UCCC § 2.504(4).

[231] UCCC § 2.505(2).

[232] UCCC § 2.505(1).

limited to transactions where a downpayment is required.[233] The reasoning of this Code provision is that:

> [M]any home solicitation sales are freely entered into by buyers without coercion; in such cases a buyer should not be encouraged to cancel simply because of a change of mind. Subsection (3) attempts to strike a balance by allowing the seller to protect his interest by requiring the buyer to make a cash down payment. If the buyer makes a cash down payment and then cancels, the seller may retain a part of the down payment not in excess of 5% of the cash price. Section 2.110. If the seller does not obtain a cash down payment he is not entitled to receive anything as a fee for cancellation. The objective of sellers who rely on coercion by high pressure techniques normally is to obtain the buyer's signature to the sale contract. The requirement of a substantial down payment can be expected to limit the ability of a seller to obtain signatures of reluctant buyers.[234]

VI. OPEN END CONSUMER CREDIT TRANSACTIONS

Open end credit or revolving credit, as it is sometimes called, falls under two major headings: the revolving charge account, and the revolving loan account. The revolving charge account, the more common of the two forms of open end credit, is best exemplified by the retail store charge account. As can be imagined, creating a separate closed end credit sales agreement for each sale is not practical for the retailer who does a large scale business in relatively low cost items. "For a creditor who extends credit on a mass basis and has computer facilities, clerical and record-keeping costs are much lower for revolving credit extensions than for separate one shot extensions."[235]

> The modern shopper wants to be able to buy on credit many small items on many separate occasions. Clerical costs and convenience make it impractical to assign a time price to each item bought and to enter into a separate contract providing for the payment in installments of each time price.[236]

The revolving charge credit arrangement takes the form of an agreement between the customer and the merchant whereby the customer may make periodic purchases from the merchant. The merchant then periodically bills the customer for purchases made during the preceding period, usually monthly, and the customer

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233 UCCC § 2.504(3). The five percent fee is not permitted where the buyer revokes an offer to purchase or where the contract is avoided by the buyer independent of the right of cancellation.

234 *Id.* at Comment 3.

235 Buerger, *Revolving Credit and Credit Cards*, 33 LAW & CONTEMP. PROB. 707 (1968) [hereinafter cited as Buerger].

236 Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387, 403 (1968) [hereinafter cited as Jordan & Warren].

may pay the balance, or any part thereof. If the customer chooses to pay only part of the balance, a credit charge is added to the remainder of the debt which is carried on the customer's account for another accounting period.

> The carrying charge is usually calculated on each billing date on the basis of the total amount of the unpaid balance outstanding on that date exclusive of those charges added for purchases made during the period immediately preceding such date. The purchaser may at any time pay the entire outstanding balance in full and no further carrying charges are assessed. On the other hand, he may make additional purchases, the cost of which will be added to the balance outstanding on the installment credit account on the next billing date.[237]

The revolving loan account is very similar to the revolving charge account in that the borrower and lender agree that the borrower will be authorized to make a number of loans over a period of time from the lender, based upon that agreement. Under such an agreement, the credit charge is not calculated in advance of each individual loan and added to the amount of the loan, but the credit charge is calculated on the unpaid balance under such a borrowing agreement, which may include the balance from more than one loan. Not surprisingly, the line between revolving credit transactions and revolving loan transactions can be very unclear.

> The familiar credit card purchase of goods or services is treated as a credit sale or a loan to the cardholder depending upon whether the issuer of the card is also the seller. A purchase of goods or services from the issuer of the credit card is a credit sale. If the card is used to buy from someone other than the issuer, the sale in which the card is used is treated as a cash sale, as regards the seller, but a loan of money equal to the sales price as regards the issuer of the card.[238]

The disclosure requirements for open end credit under Truth in Lending are presented separately from other credit disclosure requirements, primarily because of the basic differences between open end credit and other forms of consumer credit.

To qualify as open end credit under the Act and Regulation Z, the credit plan must meet three distinctive tests. First, the plan must provide for the customer to make periodic purchases or obtain periodic loans, directly from the creditor, or indirectly by the use of an identification device, such as a credit card.[239] Secondly, the customer must be able to pay the balance in full or in installments.

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[237] CURRAN, note 28 *supra*, at 12.

[238] Jordan & Warren, note 236 *supra*, at 404.

[239] The Act makes no express reference to credit cards.

Thirdly, the finance charge may be computed periodically by the creditor on an outstanding unpaid balance.[240]

It should also be noted that the disclosure requirements under the Act do not void any state law dealing with this area, except to the extent that the law of the state is inconsistent.[241] The determination of what state law falls into the category of being inconsistent with the Act or Regulation Z will probably present many problems for both the states and the federal agencies responsible for the administration and enforcement of Truth in Lending.

A high degree of accuracy is required in determining the annual percentage rate which will be disclosed by requirement of the Act. Regulation Z requires that disclosure of the annual percentage rate for open end credit accounts must be accurate to the nearest one-quarter of one percent.[242]

The Uniform Code, like the Act, requires detailed disclosure at two different times by the creditor. The first disclosure must take place before a consumer credit sale or loan is made pursuant to an open end account, and the second disclosure must be made at the end of each billing cycle. The Code disclosure provisions, while being similar to the Act's provisions in many respects, makes a slightly more distinct division between the disclosure provisions required for open end sales and open end loan accounts.[243] This difference is primarily in the way the disclosure provisions are presented under the Code and not in the type of disclosure required for each.

Although not directly related to disclosure, it should be mentioned at this point that unlike the Truth in Lending Act, the Code places an upper limit on the credit charge which may be levied in

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[240] 12 C.F.R. § 226.2(r) contains the definition for ascertaining the existence of an open end credit plan. This definition does not include negotiated advances under an open end real estate mortgage or a letter of credit.

[241] 15 U.S.C. § 1610(a) (1964), *as amended*, (Supp. IV, 1969).

[242] 12 C.F.R. § 226.5(a).

[243] "The parallel definitions of 'revolving charge account' and 'revolving loan account' reflect the UCCC's deliberate separation of the treatment of sales credit and loan credit into two separate articles, articles 2 (sales) and 3 (loans). These two articles imply a different terminology and provide for some, but not many, substantive differences in the treatment of the two types of credit. The basic purpose of the decision to treat the two types of credit separately was to avoid encouraging the courts of a state which did not enact the UCCC to rely on the Code's provisions as a basis for rejecting the time-sale price doctrine." Buerger, note 235 *supra*, at 708.

open end charge accounts.[244] It should be noted that no such provision deals exclusively with maximum rates for revolving loan accounts.

The Code places certain limitations on the creditor's right to change the terms of revolving charge and loan accounts. The creditor must also comply with special requirements if he wishes to change the terms of the revolving charge or loan account within the prescribed limitations.[245]

A. Disclosure in Advertising

Both the Act and the Code contain disclosure provisions which apply to the advertising of open end credit arrangements. The reader should note that the treatment of this particular area of disclosure differs substantially between the Act and the Code. Under the Act, no advertisement of any open end credit plan may set forth any specific terms of that plan unless it clearly sets forth several items.[246] The creditor must state the time period within which the customer may repay the credit extended without incurring a finance charge, if such a time period exists. The creditor must also disclose the balance upon which the charge will be imposed and the method of determining the amount of the finance charge. Where periodic rates are used to compute the finance charge, the creditor must disclose the corresponding annual percentage rate.[247]

The open end credit advertising section of the Act also includes an enabling provision. This section provides that the Federal Reserve Board may, by regulation, provide for additional disclosure requirements not provided for by the Act.[248] As a result of this provision, two additional advertising disclosure requirements are included under Regulation Z. Regulation Z now requires that the creditor disclose the conditions under which any other finance charge may be imposed, and the method by which they are to be determined.[249] Regulation Z also requires that the minimum periodic payment required under the open end credit agreement be disclosed.[250]

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[244] A detailed disclosure of these provisions may be found at UCCC § 2.207.

[245] UCCC § 2.416 for charge accounts; § 3.408 for loan accounts.

[246] Open end credit advertising is also subject to the general rules of advertising disclosure found in 12 C.F.R. § 226.10(a).

[247] 15 U.S.C. § 1663 (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.10(c).

[248] 15 U.S.C. § 1663(5) (1964), *as amended*, (Supp. IV, 1969).

[249] 15 U.S.C. § 1663(5) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. 226.10(c)(5).

[250] 12 C.F.R. § 226.10(c)(6).

It appears that the above requirements need not be included in the advertisement unless "any of the specific terms of that plan"[251] are included. This exception still allows a creditor to make some limited mention in his advertisements of the fact that he offers a revolving credit plan to the customer.

> Copy wording such as 'charge accounts available,' 'open a revolving budget account,' 'just say charge it,' . . . or other general terms such as these may be used in advertising without bringing the Act or Regulation Z into play.[252]

There are no special provisions of the Code dealing with disclosure requirements in advertising for open end credit charge accounts, or open end loans. There are, however, provisions dealing generally with disclosure in advertising credit sales and credit loans.

In the case of open end charge accounts, advertising must not state false or misleading terms or conditions of credit.[253] There is no such general prohibition to be found in the Act. In the case of open end loan accounts, the same type of general prohibition as stated above is applicable.[254] Also, note that the Code's general disclosure provisions for credit advertising applicable to open end credit accounts are not as demanding as the requirements under the Act and Regulation Z. Indeed, it appears that the Code was not seriously designed to take the regulation of credit advertising out of the hands of the federal government.

B. Disclosure Required Before Completion of an Open End Credit Agreement

Both the Act and the Code require disclosure before an open end credit agreement is completed. The type of disclosure required by the Code closely parallels the requirements of the Act and Regulation Z. The requirements of each, however, will be treated in their entirety.

The Act requires that disclosure be made before the customer opens an account whereby an open end credit plan will be established.[255] Regulation Z seems to modify the time of disclosure slightly by requiring that the disclosure be made before the first transaction is executed under the terms of the open end credit agreement.[256] This is no great practical problem, however, because

[251] 15 U.S.C. § 1663 (1964), *as amended,* (Supp. IV, 1969).
[252] Kintner, Henneberger & Neill, *A Primer on Truth in Lending,* 13 St. Louis U.L.J. 501, 511 (1969) [hereinafter cited as Kintner].
[253] UCCC § 2.313(1).
[254] UCCC § 3.312(1).
[255] 15 U.S.C. § 1637(a) (1964), *as amended,* (Supp. IV, 1969).
[256] 12 C.F.R. § 116.7(a).

the customer is generally not bound to make purchases or borrow money simply because he enters into an open end credit plan.[257] Therefore, it seems that the purposes of the Act are served as long as disclosure is made before the customer makes his first purchase under the new account.[258]

As the following descriptions will show, the initial disclosures required for open end credit transactions are primarily procedural, as opposed to the substantive dollars and cents disclosures required before the making of a closed end credit transaction. In the case of closed end credit transactions, the amount of the credit to be extended is known, whereas in the open end credit agreement it is not. To the extent applicable, each of the following items must be disclosed by the creditor: the creditor must include a statement of the conditions under which a finance charge may be imposed, as well as the time period, if any, in which the customer may repay the extended credit without incurring a finance charge; the creditor must also disclose the method of determining the balance upon which a finance charge will be imposed, and the method of determining the amount of the finance charge; and where one or more periodic rates are used to compute the finance charge, the rates of each, plus the resulting simple annual percentage rate, must be disclosed.[259]

The Act provides the creditor with an opportunity of choosing between two optional methods of disclosure. The creditor may disclose the annual percentage rate of return received from like accounts for a representative period; or, where this choice is not practical, a projected rate of return will be disclosed upon a sample amount.[260] The first choice would be most often impractical in the case where the creditor has just gone into business, and has not conducted sufficient open end credit transactions to make use of the first alternative. To make sure that all charges are disclosed,

[257] "Certainly it cannot be said that the purchaser incurs any liability when he opens a flexible account, a budget account, or a revolving charge account. Nor can it be said that one incurs any liability when he initially obtains a gasoline credit card or a credit card from a multipurpose credit agency. However, this is the initiation of a relationship of mutual convenience in the purchase and sale of many separate items. Kintner, note 252 *supra*, at 516.

[258] 12 C.F.R. § 226.6(a) contains the form requirements which must be complied with when making the disclosures on the open end credit agreement forms.

[259] 15 U.S.C. § 1637(a) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.7(a).

[260] 15 U.S.C. § 1637(a)(5) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.7(a)(5). The exact requirements of this second alternative are set out in 12 C.F.R. § 226.11(a).

the conditions under which any additional charges may be imposed must be disclosed, as well as how they are to be determined. An additional disclosure requirement before the account is opened is a statement of the conditions by which the creditor may retain or acquire a property interest in any property to secure payment of the extended credit, and a description of those interests.[261]

The final disclosure required before the first transaction was not included in the Act, but was later included in Regulation Z. This disclosure requirement is that the minimum periodic payment required must be disclosed.[262] The Code requires that a different set of disclosure requirements be satisfied *before* making a sale pursuant to an open end charge account or an open end loan account. The disclosure provisions dealing with disclosure before sale pursuant to an open end charge account will be considered first.

In order to qualify as an open end charge account under the Code, the account must meet the following criteria: first, the seller must permit the buyer to purchase goods and services from the seller, or pursuant to a credit card; secondly, the unpaid balances and credit charges arising under the agreement are entered as a debit to the account; thirdly, the credit service charge is computed on the outstanding unpaid balance of the buyer's account from time to time; and fourthly, the buyer may pay the balance in installments.[263]

The Code provides that disclosure must be made before a revolving account sale takes place. The Code requires the disclosure of items very similar to the disclosure required under Truth in Lending and Regulation Z. The creditor must divulge, before making the sale, the conditions under which a credit charge may be made, and the time period within which the credit may be repaid by the customer to avoid such a charge. In addition, the creditor must disclose the method of determining the amount of the credit service charge, including the amount of any minimum service charge.[264]

The creditor is required to disclose the nominal annual percentage rate.[265] If there is more than one nominal annual percentage

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261 15 U.S.C. § 1637(a)(7) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.7(a)(7).

262 12 C.F.R. § 226.7(a)(8).

263 UCCC § 2.108.

264 UCCC §§ 2.310(1)(a) to (c).

265 The method of calculating the nominal annual percentage rate is provided in UCCC § 2.304(3): "'Corresponding nominal annual percentage rate' is the percentage or percentages used to calculate the credit service charge for one billing cycle or other period pursuant to a revolving charge account multiplied by the number of billing cycles or periods in a year."

rate which may apply to the account, the amount of the balance to which each applies must be disclosed.[266]

As in the Truth in Lending and Regulation Z provisions, the Uniform Code provides for the creditor, at his election, to pick one of two alternatives for disclosing the annual percentage rate of return from open end credit accounts. The first choice available to the creditor is to disclose the annual effective rate of return which was received from open end accounts for a representative period of time. If the first choice is not feasible or practical, the Code provides for the Administrator to create another way of disclosing to the consumer a projected annual effective rate of return.[267] It should again be noted in comparison that the Truth in Lending Act and Regulation Z have provided a "Comparative Index of Credit Cost"[268] for the creditor to use in case the first type of alternative is not practical. It can only be assumed at this point that the Administrator under the Code provisions will adopt an alternative which closely resembles the Regulation Z provision.

As under Truth in Lending and Regulation Z, the creditor under the Code must disclose to the consumer the conditions by which any additional charges will be made for the use of credit under the agreement, and the method by which each charge will be determined. The creditor must also disclose to the consumer the conditions by which the creditor may retain or acquire a security interest in the property to regain the extended credit, and a description of such interests.[269]

Unlike Truth in Lending, the Code provides a separate section dealing with disclosures that must be made by the creditor before making a consumer loan pursuant to an open end loan account. These requirements need not be outlined, however, because the disclosure requirements for open end loan accounts are the same as the requirements for open end credit accounts as previously outlined.[270]

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[266] UCCC § 2.310(1)(d). If the balance on which a charge is calculated is $800.00, and the creditor's monthly percentages are 1½% on the first $500.00 and 1% on any balance over $500.00, the corresponding nominal annual percentage rate would be disclosed as 18% on the first $500.00 and 12% on the remaining $300.00.

[267] UCCC § 2.310(1)(e).

[268] 12 C.F.R. § 226.11(b).

[269] UCCC §§ 2.310(1)(f), (g).

[270] UCCC § 3.309(1).

C. PERIODIC STATEMENTS

Unlike the case of closed end credit transactions, periodic statements with respect to open end sales are mandatory under both the provisions of the Act and the Code. The relevant provisions of the Act and Regulation Z will be discussed first, followed by a discussion of the periodic statement disclosure requirements of the Code.

The Act and Regulation Z require that a periodic statement must be made for any open credit account upon which a finance charge is imposed.[271] This of course relieves the creditor from the burden of supplying periodic statements at the end of each billing cycle if the account was not used during that period. Neither must disclosure be made in the case of those accounts which are termed by the creditor as uncollectable, or against which delinquency procedures have been instituted.[272] Disclosure in a periodic billing statement serves a distinct function apart from the disclosures previous to the first purchase.

> It is in the periodic statement, however, that the percentage rate declaration is particularly meaningful because it may reflect the application of the periodic rate against the actual dollars and cents amount.[273]

The periodic statement must include a statement of the outstanding balance of the account at the beginning of the statement period, as well as the amount and date of each extension of credit during the period. The periodic statement must also include a brief identification of the goods or services purchased during the period, and a disclosure and identification of the total amounts credited to the account during the billing cycle for any reason. The statement must also disclose the amount of any finance charge added to the account during the period. This disclosure must be itemized to show any amounts due to the application of the percentage rates and/or resulting from a minimum fixed charge.[274] Each periodic rate, and the range of balances to which it applies, must be disclosed on the periodic statement.[275]

The most complicated and confusing part of disclosure in the periodic statement are the disclosure requirements dealing with

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[271] 15 U.S.C. § 1637(b) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.7(b).

[272] 12 C.F.R. § 226.7(b).

[273] 1 CCH CONSUMER CREDIT GUIDE ¶ 1210 (1969).

[274] 15 U.S.C. §§ 1637(b)(1) to (4) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. §§ 226.7(b)(1) to (4).

[275] 15 U.S.C. § 1637(b)(5) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.7(b)(5).

annual rates. A disclosure of the annual percentage rate, or rates, is authorized by the Act,[276] and a separate special section of Regulation Z has been included which describes the particulars of determining the annual percentage rates for different types of periodic credit rates.[277] If the finance charge is based solely on periodic rates, the rate is found by multiplying the periodic rate by the number of periods in a year.[278] If the creditor uses two or more periodic rates, the creditor has a choice on how he discloses the annual rate on the periodic statement. The creditor may express each as a separate annual rate, or express it:

> by dividing the total finance charge for the billing cycle by the sum of the balances to which the periodic rates were applied and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year.[279]

This requirement is for the creditor who applies two or more rates in an accounting period to separate portions of the balance. For example, the rate may be one and one-half percent of the first two hundred dollars of the balance, and one percent above that balance.

If the creditor imposes his periodic finance charges as set amounts, based upon a range of balances, he must, of course, first convert that amount into a meaningful periodic percentage rate. Regulation Z requires in this case that the amount of the finance charge be divided by the median balance within the range of balances to which it was applicable, and the resulting percentage multiplied by the number of billing cycles in a year.[280]

In some revolving credit situations, the finance charge is wholly or partially based on a minimum or fixed charge, not dependent upon the amount of the balance. The situation most commonly found is where a minimum service charge is only added to the balance of the periodic statement if the amount of the balance has not created a total finance charge (based on a periodic rate) which exceeds the amount of the service charge. In those situations where a minimum or fixed charge is not due to the application of a periodic rate, another type of computation is required.

> Obviously, if the opening balance were very small and a minimum charge were applied, the annualization of that minimum charge could produce extremely high rates—perhaps as much as two or three or four hundred percent.[281]

[276] 16 U.S.C. §§ 1637(b)(5), (6) (1964), *as amended,* (Supp. IV, 1969).
[277] 12 C.F.R. § 226.5(a).
[278] 12 C.F.R. § 226.5(a)(1)(i).
[279] 12 C.F.R. § 226.5(a)(1)(ii).
[280] 12 C.F.R. § 226.5(a)(2).
[281] McLean, *The Federal Consumer Credit Protection Act,* 24 Bus. Law. 199, 202 (1968).

If the charge exceeds fifty cents for a monthly, or longer, billing cycle (or a pro rata part of fifty cents for less than a monthly billing cycle), the creditor must compute the finance charge by dividing the finance charge for the period by the balance of the debt for the period. The answer, expressed as a percentage, must then be multiplied by the number of billing cycles in a year.[282] If the charge does not meet the minimum amounts stated above, the annual rate is not determined by using the credit charge for that month. The annual rate is determined by multiplying the applicable periodic rate by the number of periods in a year.[283]

The final type of disclosure situation raising questions concerning the determination of an accurate annual rate is found where the creditor of an open end account imposes finance charges in the case of specific transactions during the billing cycle. Regulation Z requires that the annual rate be disclosed by combining that charge with the other finance charges imposed for the period, and dividing that amount by the total balance for the cycle. The creditor must then disclose the result as an annual rate, expressed as a percentage, by multiplying the result by the number of billing cycles in a year.[284]

In addition, the creditor may, if he chooses, disclose the "Comparative Index of Credit Cost."[285] The "Comparative Index of Credit Cost" is nothing more than a standardized example in which the creditor's terms are applied to a set of standard hypothetical factors.[286]

In all cases, the balance upon which the finance charge was computed must be clearly disclosed. If the balance of the periodic statement was determined without deducting the credits during the cycle, this fact must be disclosed. The creditor must also disclose the amounts of such credits.[287] The creditor must further disclose the closing date of the billing cycle, and the outstanding balance on that date. This is necessary to allow the customer to check the accuracy of the results compiled by the creditor in the statement. The time within which the customer must pay the bill to avoid

[282] 12 C.F.R. § 226.5(a) (3) (i).

[283] 12 C.F.R. § 226.5(a) (3) (ii).

[284] 12 C.F.R. §§ 226.7(b) (6) (i), (ii).

[285] 15 U.S.C. § 1637(b) (7) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.7(b) (7).

[286] *See* 12 C.F.R. § 226.11(b), for the method that is required for computing the "Comparative Index of Credit Cost."

[287] 15 U.S.C. § 1637(b) (8) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.7(b) (8).

incurring an additional finance charge must also be disclosed by the creditor.[288]

The periodic disclosure requirements found in the Code closely parallel the disclosure requirements found under the provisions of the Act and Regulation Z. Certain differences do exist, however, which are pointed out in the following discussion of the Code provisions.

Disclosure must be made in those cases where an outstanding balance is owed at the end of a billing cycle, or if a credit charge has been made during that cycle. The creditor must make these disclosures to the consumer within a reasonable time after the billing cycle has ended.[289] Unlike disclosure under Regulation Z, it does not appear that the creditor is excused from making the periodic disclosures because the creditor has deemed the account uncollectable, or where collection procedures have been instituted against the account.[290]

Under revolving charge accounts, the creditor must disclose in the periodic statement the outstanding balance at the beginning of the billing cycle. The creditor must also disclose the cash price and date of each sale during the billing cycle, and a brief description or identification of each of the goods or services sold.[291]

The creditor must include in the periodic statement the amount credited to the account during the billing cycle, and the dollars and cents amount of the service charges debited during the billing cycle. This statement of the total service charge must be itemized and explained to show the amount due to the application of one or more periodic and/or minimum charges.[292] Unless "minimum charges" is

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288 15 U.S.C. §§ 1637(b)(9), (10) (1964), *as amended,* (Supp. IV, 1969); 12 C.F.R. § 226.7(b)(9).

289 UCCC § 2.310(2) for sales, and § 3.309(2) for loans.

290 12 C.F.R. § 226.7(b).

291 UCCC §§ 2.310(2)(a), (b). "A number of alternative methods are open to the seller for compliance with subsection 2(b): (1) he may briefly describe each item purchased on the periodic statement with the amount and date of each purchase stated; (2) he may describe it on a sales slip given to the buyer at the time of the sale or enclosed with a billing statement; or (3) he may identify it on either the periodic statement on the sales slip by use of a symbol which is explained by an accompanying identification list." COMMERCE CLEARING HOUSE, NEW RULES ON CONSUMER CREDIT PROTECTION ¶ 5090, Comment 3 (1969).

292 UCCC §§ 2.310(2)(c), (4).

meant to include fixed charges, the UCCC does not require disclosure of fixed charges levied periodically against an account.[293]

The creditor must also disclose the periodic percentage, or percentages, which were used to calculate the credit charge, and the balance upon which the credit charge is computed. If the creditor discloses the balance without deducting the amounts credited to the account during the period, that fact and the amounts credited, must be disclosed.[294]

If the credit service charge exceeds fifty cents for a monthly, or longer, billing cycle (or a pro rata part of fifty cents for less than a monthly billing cycle), the creditor must disclose the credit charge to the consumer as a single annual rate.[295] If more than one rate is used during a period, each must be disclosed to the consumer as an annual rate, and the balance to which each applies.[296]

If the credit service charge for the period does not exceed fifty cents for a monthly, or longer, billing cycle (or a pro rata part of fifty cents for less than a monthly billing cycle), the creditor discloses the rate in a different way. He is to disclose the corresponding nominal annual percentage rate to the consumer.[297]

The reason why the creditor in this latter case does not calculate the annual rate by using the finance charge for the period is because the resulting annual rate disclosed would be inaccurate. This is primarily true because many creditors in open end account situations charge a minimum annual charge for keeping an account open. This minimum charge is only levied when the finance charge for the period, based on the balance for the period, falls below the amount of the minimum charge. It is easy to see how using the minimum charge in relation to a very small periodic balance would result in the disclosure of a completely inaccurate annual rate.

As in disclosure before making a consumer credit sale, the creditor may also disclose in the periodic statement either of two representative rates. He may disclose the effective annual percentage

[293] The parallel section in the Act contains the word "fixed." *See* 15 U.S.C. § 1637(b)(4) (1964), *as amended*, (Supp. IV, 1969).

[294] UCCC §§ 2.310(2)(e), (f).

[295] This annual rate is found by dividing the amount of the service charge for the period by the amount upon which the service charge is based for the period, and multiplying that result by the number of periods in a year. The answer is expressed as a percentage.

[296] UCCC § 2.310(2)(g).

[297] UCCC § 2.310(2)(h). The corresponding nominal annual percentage rate is the percentage or percentages used to calculate the credit service charge for one cycle, multiplied by the number of billing cycles in the year.

rate of return on open end charge accounts for a representative period of time or, if this is not feasible or practical, the administrator shall prescribe rules by which a truly representative annual percentage rate may be disclosed.[298]

The creditor must also disclose, in every periodic statement, the outstanding balance at the end of the cycle, and the date before which the consumer may pay the balance to avoid additional credit charges.[299]

As is the case of disclosure before making an open end credit transaction, disclosure in periodic statements is the same for loans as it is for credit sales.[300] The only difference that should be mentioned is that there is no need to disclose the cash price and date of each sale as well as a description of the goods or services sold[301] in the case of periodic statements for open end loans. Under loans, the applicable disclosure provision requires disclosure of a brief description or identification of the loans made during the period.[302]

D. Criticism of Open End Disclosure

Two specific criticisms are often lodged against legislation which requires disclosure of a revolving credit charge as a yearly rate. Both of these criticisms are relevant in discussing the effectiveness of both the Act and the Code.

One criticism is that under most revolving credit situations, reasonably accurate disclosure of annual credit rates, as a percentage, is not possible. Unlike the non-revolving credit situation, retail store revolving charge accounts do not usually levy a credit charge from the very time credit is extended. The carrying charge is usually calculated on each billing date on the basis of the total amount of the unpaid balance outstanding on that date exclusive of those charges added for purchases made during the period immediately preceding such date.[303]

What this means, in simple terms, is that the consumer may gain as much as fifty-nine days of free credit, depending upon when the consumer makes his purchase. If the consumer makes his purchase on the first day of a new billing cycle, he will not be billed for that purchase until the end of the billing cycle, which is usually thirty days. No credit charge is levied for this period.

298 UCCC § 2.310(2)(h).
299 UCCC §§ 2.310(2)(j), (k).
300 UCCC § 3.309(2).
301 UCCC § 2.310(2)(b).
302 UCCC § 3.309(2)(b).
303 Curran, note 28 *supra*, at 12.

After the consumer has received the first statement, he has an option to pay the total purchase price, or to pay the purchase price in installments. If he decides to pay the total purchase price, he may usually pay anytime before the end of the next billing cycle. In other words, the consumer may receive a minimum of thirty days of free credit before he is subject to a credit charge. As pointed out, exactly how much free credit the consumer receives depends upon when during the billing cycle the purchase is made.

In view of this information, a disclosure requirement that the seller disclose the annual credit charge will force the creditor to disclose a higher interest rate than is actually being collected. Such a method would only give an accurate disclosure of the annual credit charge if the charge was begun at the time of the purchase which, as has been pointed out, is not true in the case of most revolving charge accounts.[304]

This problem in calculating an accurate annual credit rate is largely responsible for special disclosure provisions under Truth in Lending, Regulation Z, and the UCCC. These provisions, previously discussed, provide for disclosure, at the discretion of the creditor, either of an actual annual percentage rate of return on like accounts to the one subject to the disclosure, or the annual projected rate of return upon a sample amount.[305] It is hoped that these alternative methods of disclosure will provide the consumer with a more accurate idea of the credit rate he will be paying.

It has been forcefully argued, in any case, that the significant time in terms of calculating the credit charge is not when the goods were purchased, but rather at the time when the credit charge begins. If the consumer takes the "free ride" period into consideration when comparing the relative cost of credit as between the revolving charge account and other sources of credit, a meaningful comparison of credit rates is still possible.[306]

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304 An example of how service charges can vary was disclosed in a study conducted by J. C. Penney Co. in which the annual rates for service charges actually paid by the consumers varied between a low of .8% and a high of 17.1%, with an average of 10.5%. Penney's service charge would be 18% if disclosed as an annual percentage rate. Statement of William M. Batten, Chairman of the Board, J. C. Penney Co., Inc., *Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess., p. 204 (1967).

305 15 U.S.C. § 1637(a)(5)(B) (1964), *as amended*, (Supp. IV, 1969); 12 C.F.R. § 226.7(a)(5); UCCC § 2.310(2)(h).

306 "[A]n 18-percent annual rate is the exact equivalent of a 1½ percent monthly rate and is a fair and meaningful figure if one assumes that the credit begins at the end of the free ride period. We believe

Another specific criticism in revolving credit stiuations is that disclosure of such rates will not cause the consumer to shop for the best credit deal among retail sellers. This criticism goes to the heart of disclosure legislation, because the concept of disclosure relies on the hope that customers will shop more effectively for credit if rates and other facets of the consumer credit transaction are clearly disclosed to them before the signing of the contract.[307]

It has also been pointed out that there is seldom rate competition among stores in a given locality in revolving credits, and purchases are frequently too small to warrant paying cash and financing elsewhere.[308] If this is true, it appears that one of the attractive things about revolving store credit is its convenience, and that the consumer may not be motivated to shift his shopping allegiance on the mere basis of slight differences in the credit rates between stores. This viewpoint is further strengthened by the belief that even if rate competition existed, the particular merchandise sold by the particular store is more likely to determine the place of shopping than slight variations in revolving credit rates.[309]

VII. WILL DISCLOSURE CHANGE CREDIT SHOPPING HABITS?

As has been pointed out, one of the goals of both Truth in Lending and the UCCC is to give the consumer the ability to compare credit rates as a result of the more meaningful disclosure of credit terms. It is hoped that the average consumer, with meaningful credit cost information available, will use that information in shopping for credit. The success of disclosure legislation then depends upon the willingness of the customer to make use of the credit information with which disclosure laws have provided him and the belief that the average consumer actually is concerned enough about the comparative cost of credit to shop for the least expensive credit available.

There is little actual information available to indicate how consumer credit shopping habits will change under the influence of

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that this is the significant date from the point of view of a customer who is considering whether to pay the entire balance or avoid a finance charge." Testimony of J. L. Robertson, Vice Chairman of the Federal Reserve System, *Hearings on H.R. 11601 Before the Subcomm. on Consumer Affairs of the House Comm. on Banking and Currency*, 90th Cong., 2d Sess., pp. 125-26 (1968).

307 Murphy, *Lawyers for the Poor View the UCCC*, 44 N.Y.U.L. REV. 298, 323 (1969). *See also* UCCC § 1.102(1)(c).

308 Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 466 (1968).

309 *Id.* at 466, 467.

the type of disclosure provisions which the Act and the Code contain. Some indications have been gained as a result of studies made of the effectiveness of Massachusetts' credit disclosure law[310] which was written with approximately the same type of disclosure provisions as are contained in the Act and the Code. Information gained from Massachusetts indicated some change in consumer credit buying, with a shift particularly toward more economical supplies of credit.[311]

Estimates by authorities as to the true effect of disclosure on the consumer's credit shopping habits have varied considerably. Some warn not to expect much change in buying habits as a result of the passage of the Act, and the passage of the Code, while others expect significant changes. One view is that consumers, at least of the middle and upper economic classes, know where they can get credit at the lowest possible cost, even without new and more effective disclosure laws:

> The consumer may not know exactly how much he pays for credit, but he knows where it is the cheapest. Thus, consumers who qualify for the lower rates have already moved to the banks and the credit unions, which administer credit far more selectively than the finance company trying to serve the dealer.[312]

It is also argued that the low income consumer, even though credit charges are made more clear to him, simply does not have the mobility within the credit market to utilize credit supplies whose charge for credit is more favorable than the poor consumer's past sources of credit. The low income consumer is strictly limited as to his potential sources of credit and, in all probability, low credit rating. For this kind of consumer, it is unlikely that disclosure in writing, in a different prescribed form, is going to make any difference.[313]

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310 MASS. GEN. LAWS ANN. ch. 255D, § 27 (1969).

311 "A recent report by the Federal Reserve Bank in Boston revealed that in the two year period following the enactment of the Massachusetts law, consumer credit at commercial banks rose five percent and increased 43 percent at savings banks, whereas consumer credit at finance companies and consumer loan companies remained stable. The increase in bank credit business was attributed to the increased competitive activities of the banks coupled with their lower credit rates and the inability of many finance companies to conceal their less favorable rates under the full disclosure advertising requirements of the Massachusetts law." Jones, *The Importance of Credit in Our Competitive Economy and the Role of the Federal Trade Commission*, 4 NEW ENGLAND L. REV. 111, 117 (1969).

312 Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 462 (1968).

313 Kripke, *Gesture and Reality in Consumer Credit Reform*, 44 N.Y.U.L. REV. 1, 5 (1969).

Even some proponents of the positive worth of credit term disclosure realize that such provisions would not have immediate effects upon the credit shopping habits of American consumers. They argue, as do the opponents of disclosure legislation, that many consumers now realize where they can get the best credit deal among sources of credit available to them. But they argue further that the impact of disclosure will become noticeable as other sources of credit become available and the consumer becomes more adjusted to the use of disclosure provisions. "Experience in Massachusetts with disclosure has suggested that it will take time for borrowers to begin to shop for credit. Further, it will not be until additional alternatives appear that there will be appreciable gains to them from shopping."[314]

Truly meaningful data concerning changes in the credit shopping habits of consumers resulting from increased disclosure of the true credit charges is yet to become available. It is too early to draw conclusions concerning the true effectiveness of credit charge disclosure provisions. It should be kept in mind, however, that "consumers in North America are numbered in the tens of millions, and if the legislation assists only a fraction of them to make more rational decisions it will have more than justified itself."[315]

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314 Curran, *Administration and Enforcement Under the Uniform Consumer Credit Code*, 33 LAW & CONTEMP. PROB. 737, 761 (1968).
315 Ziegel, *Consumer Credit Regulation: A Canadian Consumer-Oriented Viewpoint*, 68 COLUM. L. REV. 488, 508 (1968).