

The Credit Practices Rule

fast facts

Under the Rule, creditors cannot:

- Require you to use as collateral certain household items and uniquely personal items of significant value to you but which are of little economic value to a creditor.
or
- Permit you to agree in advance to wage deductions that would pay the creditor directly if you default on the debt, unless you can cancel that permission at any time.
or
- Require you to give up your state-law protections that allow you to keep certain personal belongings even if you do not pay your debt as agreed.

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If you are one of the millions of Americans who borrows money, buys items on installment credit, or cosigns for another person's debt, you may want to know about the Federal Trade Commission's Credit Practices Rule. The Rule, which became effective March 1, 1985, prohibits many creditors from including certain provisions in consumer credit contracts. It also requires creditors to provide a written notice to consumers before they cosign obligations for others about their potential liability if the other person fails to pay. Finally, it prohibits one method of assessing late charges.

What Contracts are Covered?

The Rule applies to consumer credit contracts offered by finance companies, retailers (such as auto dealers and furniture and department stores), and credit unions for any personal purpose except to buy real estate. It does not apply to banks or bank credit cards; to savings and loan associations; or to some non-profit organizations. (However, similar rules for banks — under the Federal Reserve Board — and for savings and loans — under the Office of Thrift Supervision — went into effect January 1, 1986.) The Rule does not apply to business credit.

What Contract Provisions are Prohibited?

The Rule prohibits creditors from including certain provisions in their consumer credit contracts. Specifically, credit contracts no longer can include provisions that:

- Require you to agree in advance, should the creditor sue you for non-payment of a debt, to give up your right to be notified of a court hearing to present your side of the case or to hire an attorney to represent you. (These clauses were often called "confessions of

judgment" or "cognovits.")

- Require you to give up your state-law protections that allow you to keep certain personal belongings even if you do not pay your debt as agreed. (These clauses were called "waivers of exemption.") State law generally allows you to keep your home, clothing, dishes, and other belongings of a fixed minimum value. However, when the debt incurred is to purchase an item and that item is used as security for the debt, it is permissible under the Rule for a creditor to repossess that item.
- Permit you to agree in advance to wage deductions that would pay the creditor directly if you default on the debt, unless you can cancel that permission at any time. (These clauses were called "wage assignments.") However, a wage or payroll deduction plan, through which you arrange to repay a loan, is a common payment method and is permissible under the Rule.
- Require you to use as collateral certain household and uniquely personal items that are of significant value to you but are of little economic value to a creditor. Such items include appliances, linens, china, crockery, kitchenware, wedding rings, family photographs, personal papers, the family Bible, and household pets. (These were called "household goods security" clauses.) However, if you borrowed money to buy any of these household or personal items, and use the items as collateral, the creditor can repossess the purchased item if you do not repay the loan.

What Notices Must be Given to Cosigners?

When you agree to be a cosigner for someone else's debt, you are guaranteeing to pay if that person fails to pay the debt. The Rule requires that you be given a notice that explains the responsibility you are undertaking. Under the Rule, the cosigner notice must say:

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The creditor can collect this debt from you without first trying to collect from the borrower.* The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.

This notice is not the contract that makes you liable for the debt.

*Depending on your state, this may not apply. If state law forbids a creditor from collecting from a cosigner without first trying to collect from the primary debtor, this sentence may be crossed out or omitted on your cosigner notice.

This notice is not required when you receive benefits from the contract, such as when you buy goods, take out a loan, or open a joint credit-card account with another person. In these cases, you would be a co-buyer, co-borrower, or co-applicant (co-cardholder) rather than a cosigner. Therefore, the creditor would not be required to provide the notice.

How Can Late Charges Be Assessed?

A creditor can charge a late fee if you do not make your loan payment on time. However, it is illegal under the Rule for a creditor to charge you late fees or payments simply because you have not yet paid a late fee you owe. This practice is called "pyramiding late fees." Under the Rule, this means that if you do not include the late fee you owe with your next regular payment, it is illegal for a creditor to subtract the late fee from your payment and then charge you a second late fee because the current payment is insufficient. For example, your loan contract may state that your monthly payments are \$100 and that you will be assessed a \$10 late fee if you pay after the grace period. If you make your \$100 loan payment after that time and you do not include the \$10 late fee with your next \$100 payment, a creditor cannot first deduct the missing \$10 late fee from the \$100 payment, claim you have now paid \$90, and then charge you an additional late fee. But, if you skip one month's payment entirely, the creditor can charge late fees on all subsequent payments until you bring your account up to date.

For More Information

For more information about the Credit Practices Rule, write: Consumer Response Center, Federal Trade Commission, Washington, D.C. 20580.