



Complying with the Credit Practices Rule

Tags: [Automobiles](#) | [Finance](#) | [Credit and Finance](#) | [Credit and Loans](#)

- [Introduction](#)
- [How the Credit Practices Rule Affects Consumer Contracts](#)
- [What the Rule Requires](#)
- [Who Must Comply](#)
- [What Transactions Are Covered](#)
- [How Penalties Are Assessed](#)
- [How Exemptions Are Granted](#)
- [How to Comply with the Rule](#)
- [Prohibited Contract Provisions](#)
- [Confessions of Judgment](#)
- [Waivers of Exemption](#)
- [Wage Assignments](#)
- [Security Interest in Household Goods](#)
- [Notice to Cosigners](#)
- [Late Charges](#)

Introduction

The Federal Trade Commission staff prepared this business booklet to help finance companies, retailers, and other creditors comply with the Credit Practices Rule, which went into effect March 1, 1985. This booklet tells you what the Credit Practices Rule requires, who must comply, and what transactions are covered. It also discusses liability for rule violations and how exemptions are granted.

How the Credit Practices Rule Affects Consumer Contracts

What the Rule Requires

The Credit Practices Trade Regulation Rule has three major provisions. First, it prohibits creditors from using certain contract provisions that the Federal Trade Commission found to be unfair to consumers. The prohibited contract provisions are confessions of judgment, waivers of exemption, wage assignments, and security interests in household goods. Second, the Rule requires creditors to advise consumers who cosign obligations about their potential liability if the other person fails to pay. Third, the Rule prohibits late charges in some situations.

Who Must Comply

This Rule applies to all creditors subject to the jurisdiction of the Federal Trade Commission. It includes all finance companies, retailers (such as auto dealers and furniture and department stores), and credit unions that offer consumer credit contracts. Similar rules have been passed by the Federal Reserve Board and the Federal Home Loan Bank Board for banks, savings and loan associations, and other institutions under their jurisdiction.

What Transactions Are Covered

The Rule covers all consumer credit transactions, except those involving the purchase of real estate. It covers loans made to consumers who purchase goods or services for personal, family, or household uses, even though those loans may be secured by real estate owned by the consumers. The Rule also applies to the sale of goods or services under lease-purchase plans.

However, contracts with your customers signed before March 1, 1985, which contain the four prohibited provisions -- confessions of judgment, waivers of exemption, wage assignments, or security interests in household goods -- are enforceable and not in violation of the Rule. Similarly, you may collect debts from cosigners who became obligated before the effective date of the Rule, even though they did not receive the notice that the Rule requires. On the other hand, after March 1, 1985, you may not collect late fees that are prohibited by the Rule, even if the contract was signed before that date.

How Penalties Are Assessed

The Federal Trade Commission can sue violators of the Credit Practices Rule in federal court. The court can impose civil penalties of up to \$46,517 for each violation and can issue an order prohibiting further violations.

How Exemptions Are Granted

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A state may petition the Commission at any time for a state-wide exemption from any of the Rule's provisions, as noted under 16 C.F.R. Section 444.5 of the Rule. If the Commission finds that the state law affords a level of protection to consumers that is substantially equivalent to, or greater than the protection afforded by the Rule and the state has the ability to enforce and administer that law effectively, an exemption may be granted. Filing an exemption petition, however, does not stay the Rule, which remains in effect in that state until the exemption is granted.

Any person to whom the Credit Practices Rule applies, including creditors, also may petition the Commission for exemption from any of the Rule's provisions (Federal Trade Commission's Rules of Practice, 16 C.F.R. Section 1.16).

How to Comply with the Rule

This section points out the important parts of the Rule and explains how to comply. It discusses the prohibition against certain contract provisions; the required use of a certain cosigner notice; and the prohibition against late charges in certain situations.

Prohibited Contract Provisions

Certain consumer provisions, which you may have used in consumer credit contracts, are now prohibited. These include: confessions of judgment; waivers of exemption; wage assignments; and security interests in household goods. If your consumer credit contracts contain language that requires a debtor to confess judgment, to waive exemptions, to assign wages or income, or to give you a blanket security interest in all household goods, you should remove that language from all contracts signed on or after March 1, 1985. If you have not done so, you are in violation of the Rule.

Confessions of Judgment

In states that have not specifically outlawed the practice, certain consumer credit contracts have contained language taking away certain rights that consumers being sued would ordinarily have. These include the right to receive notice of the suit, to appear in court, and to raise any defenses that they may have. This provision, usually called a "confession of judgment," allowed judgment to be entered for the creditor automatically when the creditor sued the debtor for breach of the contract. The Rule now prohibits creditors from including confession of judgment provisions, such as the following, in consumer credit contracts:

To secure payment hereof, the undersigned jointly and severally irrevocably authorize any attorney of any court of record to appear for any one or more of them in such court in term or vacation, after default in payment hereof and confess a judgment without process in favor of the creditor hereof for such amount as may then appear unpaid hereon, to release all errors which may intervene in any such proceedings, and to consent to immediate execution upon such judgment, hereby ratifying every act of such attorney hereunder.

The Rule's prohibition against "confessions of judgment," however, does not prohibit power-of-attorney provisions that allow you to repossess and sell collateral, as long as these provisions do not interfere with the consumer's right to be heard in court. The Rule also does not prohibit a consumer from acknowledging liability after suit has been filed and

the consumer has been duly notified. The Rule is not intended to interfere with whatever rights you have to repossess secured property.

Waivers of Exemption

Previously, some consumer credit contracts contained "waiver of exemption" provisions that permitted creditors to seize (or threaten to seize) specific possessions or possessions of a specified value, even if state law treated them as exempt from seizure. Every state has a law that defines certain property (generally, property considered necessities) that a debtor is allowed to keep even if a creditor sues and obtains a judgment. By signing a waiver of exemption, a debtor made that property available to a creditor who obtained a judgment to satisfy a debt. Clauses such as the following are no longer permissible under the FTC Rule:

Each of us hereby both individually and severally waives any or all benefit or relief from the homestead exemption and all other exemptions or moratoriums to which the signers or any of them may be entitled under laws of this or any other State, now in force or hereafter to be passed, as against this debt or any renewal thereof.

The Rule's prohibition against "waiver of exemption" provisions does not prevent you from using particular kinds of collateral. However, if state law provides an exemption for certain kinds or amounts of property, the contract cannot contain a provision causing the consumer to give up that protection. In that case, an unsecured creditor who obtained a judgment could not seize that property. Nonetheless, if you have a valid security interest in property, your security interest would not be affected, even if that property is exempt by state law. However, this provision of the Rule should be considered with another Rule provision that prohibits the taking of a security interest in certain property defined as household goods.

Wage Assignments

Previously, if consumers did not pay as agreed, some consumer credit contracts permitted creditors to go directly to the consumers' employers to have their wages, or some part of them, paid directly to the creditors. Under the Rule's prohibition against "wage assignments," your consumer contracts may not provide for the irrevocable advance assignment to you of any money due consumers because of their personal services (usually through employment) if they do not pay as agreed. The Rule prohibits irrevocable assignments to creditors of salaries, commissions, bonuses, pensions, and disability benefits, as well as wages due to consumers.

Below is an example of a wage assignment provision that is no longer permitted in consumer credit contracts:

If default be made in payment of the above-described debt, which is the time balance (Total of Payments) due on a retail installment contract, each of the undersigned hereby assigns, transfers and sets over to the above-named assignee, wages, salary, commissions, bonuses and periodic payments pursuant to a retirement or pension plan due or subsequently earned from his present employer or from any future employer within a period of two (2) years from the date of execution hereof. This assignment shall remain effective as to all of the undersigned Debtors.

The amount that may be collected by assignee here on shall not exceed the lesser of (1) 15% of the gross amount paid assignor for any week, or (2) the amount by which disposable earning for a week exceed thirty times the Federal Minimum Hourly Wage in effect at the time the amounts are payable; and shall be collected until the total amount due under this assignment is paid or until expiration of employer's payroll period ending immediately prior to 30 days after service of the demand hereon, which first occurs. This Wage Assignment shall be valid for a period of three years from date hereof.

The term "disposable earnings" means that part of the earnings remaining after deduction of any amounts required by law to be withheld.

The assignor(s) hereby authorize, empower, and direct his/their said employer(s) to pay assignee any and all moneys due or to become due assignor(s) hereon, authorize assignee to receipt for the same and release and discharge employer from all liability to assignor(s) on account of moneys paid in accordance herewith. no copy hereof shall be served on employers(s) except in conformity with applicable law.

However, the Rule specifically permits you to use payroll deduction plans where consumers choose to pay by regular deductions from paychecks. Such payroll deduction plans may provide that, if borrowers change employers, final paychecks will be assigned to you to be credited toward balances due on loans, without notice to debtors and without allegations of default or delinquency. Your contracts also may provide for wage assignments that can be revoked at will by consumers and for assignments of wages already earned at the time of the assignment. In addition, you may require that the revocation of a voluntary wage assignment be in writing.

The Rule's prohibition against "wage assignments" does not prohibit garnishment. If a creditor obtains a court judgment against a debtor, the creditor may continue to use wage garnishment to collect that judgment, subject to the consumer protections provided by federal (and sometimes state) law.

Security Interests in Household Goods

Previously, some consumer credit contracts contained non-purchase money security agreements that allowed a

creditor to repossess many household goods in the consumer's home if the consumer did not pay as agreed. Now your contracts cannot use language, such as the following, that provide for repossession of certain household goods specified in the Rule:

This not is secured by a security interest in consumer goods consisting of all household goods, furniture, appliances, and bric-a-brac, now owned and hereinafter acquired, including replacements, and located in or about the premises at the Debtor's residence (unless otherwise stated) or at any other location to which the goods may be moved. In addition, all other goods and chattels of like nature hereafter acquired by the Debtor and kept or used in or about said premises and substituted for any property mentioned. Proceeds and products of the collateral are also covered.

The Rule's definition of "household goods" includes household necessities such as clothing, appliances, and linens, and some items of little economic value to you, but of unique, personal value to the consumer .These may include items such as family photographs, personal papers, the family Bible, and household pets. Excluded from the definition of household goods are:

Works of art, electronic entertainment equipment (except one television and one radio), items acquired as antiques (more than 100 years old), and jewelry (except wedding rings).

The rule permits consumers to offer as security these valuable possessions to obtain credit as well as pianos or other musical instruments, boats, snowmobiles, bicycles, cameras, hoe workshops, and similar items.

Under the Rule, you may continue to take "purchase money security interests" in any household goods when the consumer uses the loan proceeds or the credit advanced to purchase the household goods. If you refinance or consolidate an agreement with a purchase money security interest in household goods, you may retain the purchase money security interest as a part of the refinanced or consolidated agreement to the extent permitted by state law. If you take possession of the secured property (as in pledge agreements that pawnbrokers commonly use), the Rule permits a security interest even if the property pledged is household goods.

Notice to Cosigners

If you require a cosigner for a loan applicant who does not meet your standards of creditworthiness or for debtors in default, the Rule requires you to inform each cosigner of the potential liability involved before the cosigner becomes obligated for the debt. You must use the following statement:

Notice to Cosigner

1. I understand that I am being asked to sign as a cosigner on a loan for _____.

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 debt.

If a state statute or regulation requires a different notice to cosigners, you may include that notice on the document if it is not inconsistent with the notice required by the Rule. If a statement in the FTC notice (such as one that says you can collect from the cosigner without first trying to collect from the primary debtor) is inaccurate under state law, you may omit it from the notice used in that state.

You need not give the notice to someone who signs a security agreement, when there is no personal liability for the debt. On a revolving charge account, you only need to give the notice to a cosigner once, when the account is opened.

You may print the cosigner notice on your letterhead and include identifying information, such as the credit account number, the name of the cosigner, the amount of the debt, and the date. You also may provide a signature line for the cosigner to acknowledge receipt of the notice. However, you may not include any additional statement in the notice that would distract the cosigner's attention from the message in the notice (But you may add whatever additional information you wish to your own file copy of the notice.) You may not attach the notice form to other documents unless it appears before any other document in the package.

The cosigner notice should be in the same language as the agreement to which it applies. For example, if the agreement is in Spanish, the cosigner notice also should be in Spanish.

If you use cosigners in your consumer credit contracts and these contracts were signed on or after March 1, 1985, you should provide those cosigners with the notice required by the Rule. If you are not doing so, you are in violation of the Rule.

A "cosigner" is different from a co-buyer, co-borrower, or co-applicant because a cosigner receives not tangible benefit from the agreement, but undertakes liability as a favor to the main debtor who would not otherwise qualify for credit. On the other hand, a co-buyer (one who shares in the purchased goods), a co-borrower (one who shares in the loan proceeds), or a co-applicant or co-cardholder (a person who is authorized to use a credit card account) do receive benefits. Therefore, they are not considered cosigners under the Rule, and you are not required to provide the notice to them.

Late Charges

Some creditors previously calculated late fees for delinquent payments using a practice called "pyramiding" of late charges. When one payment was made after its due date and a late fee was assessed but not paid promptly, all future payments were considered delinquent even though they were, in fact, paid in full within the required time period. As a result, late fees were assessed on all future payments. In other words, each successive payment was considered "short" by the amount of the previous late charge, with the result that another late charge was imposed.

For More Information

The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them. To file a [complaint](#) or to get [free information on consumer issues](#), visit ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters consumer complaints into the [Consumer Sentinel Network](#), a secure online database and investigative tool used by hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

[Note: Edited January 2022 to reflect [Inflation-Adjusted Civil Penalty Maximums](#).]

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