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Consumer Credit - Proposed Truth-in-Lending Legislation

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or criminal action. The committee may also be allowed to review codes of ethics prepared by state agency heads, recommending changes or improvements as well as recommending legislation to the general assembly relating to ethics. All or some of these authorizations can be entrusted to a committee on ethics depending upon how much responsibility the various legislatures choose to delegate.

CONCLUSION

High ethical standards stem primarily from individual conscience, and resolution of ethical problems must rest basically within the individual himself. Nevertheless, legislation can define ethical standards and hopefully set out guidelines which will aid the legislator to know the limits he is expected to operate within. They can serve as a reminder to him as to the areas of real or apparent impurity. The conflict of interest provision should be precise and clear, and at the same time avoid rigid application in an attempt to cover every possible kind of situation. We must be careful not to make it more difficult to attract the competent and virtuous into public service.

The acclivity of the quality of men into public office offers perhaps the best hope for the answer to the problem of honesty in government. The evils and influences that attend conflicts of interest can never be completely eradicated, and are not going to dissolve by legislation alone.[52] Those officials that are determined to wrongfully take advantage of their private interests through their position in government are not going to repent because of the passage of conflict of interest legislation. However, hopefully this legislation might to some degree have an inhibitory result.

Gary Topper

[51] Report by the ILLINOIS CONFLICT OF INTEREST LAWS COMMISSION on statements given by New York Senator Whitney North Seymour, Jr., given before the New York Investigative Committee. Senator Seymour stated that he could not be in the legislature and not be a member of his law firm as it would be too great of a financial sacrifice.

[52] Davis, *supra* note 14, at 83: "You cannot get a man to substitute for the totality of his private and professional past, a public attitude. Not, at least, by making a law. It's futile to seek a public life for a man without conflicts of interest. Modern psychiatric knowledge and common sense tells us he does not exist. . . ."

CONSUMER CREDIT—PROPOSED TRUTH-IN-LENDING LEGISLATION

During the past fifty years consumer credit has had a profound and lasting influence on many aspects of economic activity within the United States. Consumer installment financing, which began before World War I and rapidly developed during the 1920's, played an important part in the development and maintenance of a wide market for consumer durable goods. In recent years there has been an increasing tendency to use consumer credit for purchases of non-durable goods and services. At the end of 1919 total consumer credit was 2.6 billion dollars. By 1946 this sum had grown to 8.3 billion dollars. From 1946 to 1950 total consumer installment credit reached 21 billion dollars. This growth continued until consumer credit had reached a total level of 34 billion dollars at the end of 1954. From 1954 until 1963 total consumer credit increased twofold, to 69.6 billion dollars.[1] This tremendous growth of consumer credit has not yet abated. Consumers across the country are not only flocking to stores, but often are purchasing the more expensive items.[2] Furthermore, loan costs do not stop the consumer.[3] For example, during the month of June, 1966, loan costs increased without any appreciable letup in demand for consumer credit.[4] The only effect of such increase in loan costs was greater selectivity of customers on the part of lenders. Also, acceptance of credit cards by commercial banks promises to engender tremendous new pressure for future debt accumulation.[5] Thus, the growth of consumer credit spirals.

This fantastic growth of consumer credit has attributed substantially to economic and social problems. These problems center upon the fact that the average consumer does not know the effective cost of consumer credit. In 1961, former Senator Paul H. Douglas emphasized this when he stated:

> Various devices are used to conceal from the consumer just what he is required to pay. Department stores ordinarily provide credit at the rate of 1½ per cent per month, which works out at about 18 per cent per year. The financing of an automobile will cost the consumer at least 12 per cent. Often it is very much more. But he ordinarily thinks he is getting credit at an interest rate of 5 or 6 per cent. Small loan companies, with stated charges of 2 to 3 per cent per month, are actually receiving from 24 to 36 per cent. The "add on" or "discount" method used by commercial banks makes the effective rate of interest nearly double that which the consumer or borrower thinks he is paying.[6]

The effect of such non-disclosure is human tragedy at its lowest form. After discussing the case of William Rodriguez, a family man who had committed suicide due to pressure from creditors, Mr. Hillel Black in his account of consumer credit practices said: "The tragedy of the Rodriguez family is unusual but not unique. Arthur K. Young, director of the Legal Aid Bureau of United Charities, told the Douglas Committee he knew of a

[1] BOARD OF GOVERNORS OF THE FEDERAL RESERVE, SUPPLEMENT TO BANKING AND MONETARY STATISTICS, § 16 (new) CONSUMER CREDIT, 32 (Sept. 1963).

[2] See *Shopper's Spree Goes on Unabated,* Business Week, Sept. 3, 1966, p. 32.

[3] *Loan Costs Don't Stop the Consumer,* Business Week, June 25, 1966, p. 32.

[4] *Ibid.*

[5] 35 The Reporter 14, Dec. 15, 1966.

[6] BLACK, BUY NOW, PAY LATER xiii (William Morrow ed. 1961).

second debtor's suicide and possibly a third in Chicago since 1957. Not uncommon, however, are the depredations practiced by the credit gouger. Their victims almost invariably are people with low incomes, usually unsophisticated, and frequently those whose need for credit is greatest."[7] This clearly demonstrates the need for consumer protection in the field of consumer credit.

Protection can take two possible forms. One is through self regulation by the consumer credit industry itself;[8] the other is legislative controls. The increased growth of consumer credit, unaccompanied by any protective devices on the part of the industry reinforces the need for legislatures to enact more stringent consumer protection laws.[9] Therefore, it is the purpose and objective of this paper to review consumer credit legislation in general and installment loan disclosure statutes in particular.

CONSUMER CREDIT LAWS IN GENERAL

All laws protecting borrowers from unscrupulous lenders are ultimately derived from the Bible. "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury."[10] "Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase."[11] These usury prohibitions in the Bible led the English in 1494 to enact a usury statute, prohibiting the taking of any interest upon a loan of money.[12] In 1545 increased commercial trade impelled Parliament to enact a usury statute allowing both merchants and lenders to charge up to 10 per cent interest on credit sales and loans[13] thus abrogating the total prohibition of interest charges that had existed since 1494. But the English landmark case of *Beete v. Bidgood*,[14] limited the English usury statute solely to loans of money, thereby removing installment sale debtors, as distinguished from direct loan debtors, from the protection of the law. In *Hogg v. Ruffner*,[15] the United States Supreme Court applied the doctrine of *Beete v. Bidgood* in holding that an Indiana usury statute did not apply to an installment sales contract. The court's theory was that such a contract had none of the characteristics of usury; it was not for the loan of money or the forbearance of a debt, but rather, it was the current selling price of goods to be paid for at a later date, as distinguished from a current cash sale.

[7] *Supra* note 6, at 126.

[8] See Hopkins, *New Battleground-Consumer Interest*, Harvard Business Review, Sept.-Oct. 1964, p. 97.

[9] See generally, *supra* note 8.

[10] DEUTERONOMY 23: 19, 20.

[11] LEVITICUS 25: 35–37.

[12] 11 Hen. 7, c. 8 (1495).

[13] 37 Hen. 8, c. 9 (1545). See generally 2 LAW AND CONTEMP. PROB. 148 (1935).

[14] 108 Eng. Rep. 792 (K-B 1827).

[15] 66 U.S. 115 (1864).

As a result of *Hogg v. Ruffner*,[16] many states have enacted Installment Sales Statutes for the protection of the consumer who purchases on a time-credit plan. These laws are commonly referred to as control acts or disclosure statutes. Their provisions control the installment sales transaction by requiring the installment seller to list and disclose in minute detail the essentials constituting the sale.[17] These installment sales statutes have adequately protected the consumer in installment sales transactions, but have failed to reach debtors in a direct loan situation.[18] Consequently, the area of consumer loans was without adequate legislative protection except for the state's usury statute which often times set only maximum and minimum rates a lender could charge per loan. To rectify this dilemma, many states have enacted installment loan statutes or have amended their usury and interest statutes to include various consumer protective devices in a direct loan of money.[19]

TRUTH IN LENDING

Installment loan laws generally allow a lender to receive a rate of interest greater than the legal or contract rate either directly by prescribing a higher rate of interest, or indirectly by allowing the lender to add the interest charges to or deduct it in advance from the legal or contract interest rates. Approximately four-fifths of the states have enacted special installment loan laws. The defect, however, with the bulk of such legislation is that it does not contain mandatory full disclosure provisions that enable the consumer-borrower to determine his true or actual annual rate of interest in terms he can readily understand. These full disclosure provisions are commonly referred to as truth in lending. Only thirteen states having installment loan statutes have any truth in lending provisions either within the installment loan statute itself or in an interest or usury statute. Truth in lending provisions can be classified into four types based upon their disclosure provisions.

Two states have enacted installment loan statutes with a disclosure pro-

16 *Ibid.*

17 See generally Warren, *Regulation of Finance Charges in Retail Instalment Sales*, 68 YALE L. J. 839 (1959); Hogan, *A Survey of State Retail Instalment Sales Legislation*, 44 CORNELL L. Q. 38 (1958); Comment, *Limiting Consumer Credit Charges by Reinterpretation of General Usury Laws and by Separate Regulation*, 55 NW. U. L. REV. 303 (1960).

18 Wernick v. National Bond and Inv. Co., 276 Ill. App. 84 (1934).

19 COL. REV. STAT. § 73-2-5 (1963); CONN. GEN. STAT. tit. 36, § 97 (1961); Hawaii Laws 1963, Act. No. 139; ILL. REV. STAT. ch. 74, § 24(a) (1965); IND. ANN. STAT. § 19-13-106 (1951); KY. REV. STAT. ch. 287, § 215 (1962); MASS. ACTS ch. 587, §§ 1-4 (1966); MINN. STAT. ch. 48.157 (1965); N.J. STAT. ANN. § 17.9A-59-36 (Cum. Supp. 1966); PENN. BANKING CODE, § 309, P.L. No. 356, (1966); S.C. CODE § 8-800.11 (1966); S.D. CODE § 6.04A06 (1960); WISC. STAT. ANN. ch. 115, § 05(4) (Cum. Supp. 1963).

vision that requires notes evidencing a loan to contain the statement that the loan was made pursuant to the Installment Loan Act.[20] These disclosure provisions, without more, leaves the consumer uninformed as to his specific undertaking, thus falling far short of the disclosure objective in effectual truth in lending legislation.

Other states' disclosure statutes[21] require the lender to furnish the borrower with a written statement of all the charges made by the lender on the loan. These statutes are designed to inform the borrower of the amount of his loan and the service charges made in connection with the loan. The disclosure statute adopted by South Carolina[22] represents one of the more effective disclosure provisions in this classification. It provides that the lender disclose to the borrower, at the time the loan is made, the original principal amount of the loan, a description of the payment schedule and various other features of the loan relating to prepayment and security. This provision, however, fails to provide the consumer with a principal to interest rate that he can use to determine the true annual cost of the loan in terms whereby he can compare costs of other loans he may have the option to undertake.

In an attempt to meet the full disclosure problem, a small minority of the states have enacted truth in lending provisions[23] that express the interest charges as a simple annual rate. The Wisconsin Money and Rates of Interest Act,[24] which is representative of such legislation, provides that the

20 IND. ANN. STAT. § 19-13-106 (1964); N.J. STAT. ANN. § 17:9A-59.36 (Cum. Supp. 1966).

21 COL. REV. STAT. § 13-2-5 (1963); CONN. GEN. STAT. tit. 36, § 97 (1961); ILL. REV. STAT. ch. 74, § 24(a) (1965); KY. REV. STAT. ch. 287, § 215 (1962); MINN. STAT. ch. 48.157 (1965); S.C. CODE § 8-800.11 (1966); S.D. CODE § 6.04A06 (1960); PENN. BANKING CODE, § 309, P. L. No. 356, (1966). Pennsylvania limits their disclosure provision to revolving credit plans. VT. STAT. ANN. tit. 9, § 31 (1961).

22 S.C. CODE § 6.04A06 (1960): "(a) The licensee shall disclose, at the time a loan is made, the following to the obligor on a loan transacted pursuant to this chapter, (if there are two or more obligors on the loan contract, delivery to one of them shall be sufficient) in a written statement in conspicuous type: (1) The amount and date of the note or loan contract and of its maturity; (2) the original principal amount of the loan excluding any charge made under 88-100.10; (3) the original dollar charge for the loan; (4) a description of the payment schedule; (5) the right of the obligor to repay the loan in full prior to maturity, and the fact that such prepayment in full will reduce the charge for the loan; (6) the nature of the security, if any; (7) every deduction from the loan or payment made by the obligor through the licensee for insurance, and a description of the insurance coverage for which each deduction or payment was made; (8) the name and address of the obligor and of the licensee; (9) signature of principal borrower directly beneath amount of cash borrower actually received . . ." Compare COL. REV. STAT. § 73-2-5 (1963).

23 HAWAII LAWS, Act No. 139, 1963; MASS. ACTS ch. 587, §§ 1-4 (1966); WISC. STAT. ANN. ch. 115, § 05(4) (Cum. Supp. 1963).

24 WISC. STAT. ANN. ch. 115, § 05(4) (Cum. Supp. 1963): "(4) Any person making a loan for which interest is agreed to be paid at a rate exceeding . . . of $10 upon $100

lender deliver to the borrower a statement of the terms of the loan, including the rate of interest expressed in terms of simple interest and prepayment privileges, if any. This type of statute enables the sophisticated borrower to compare the costs of various loans available. But the average consumer who borrows money still has difficulty in understanding how to compare one interest rate against another. Thus, this type of statute fails to reach the debtor whose need for full disclosure is the greatest.

In order to apprize the unsophisticated borrower of the cost of his loan in terms he can understand, some states have enacted disclosure provisions requiring the lender to express the actual or maximum rate used in computing charges as dollars per one hundred dollars per month per annum.[25] This expression of interest rates in terms of dollars enables the average consumer to see in the simplest possible terms the cost of his loan, thereby giving him a basis to compare the costs of other loans which may be available to him. The New York Banking Laws[26] require that each borrower receive evidence of the loan stating the charges as a rate in dollars per one hundred dollars principal amount of loan. Although this provision adequately informs the bank borrower of the true cost of his loan, in terms he can understand, it nevertheless fails in two respects. First, the statute applies solely to consumer loans made by a commercial bank and thereby excludes all other types of financial institutions. A consumer undertaking a loan at a finance company would not fall under this provision. Second, this New York statute does not require detailed disclosure to the borrower of the nature of his loan. The Nebraska Interest Laws[27] are quite similar to the New York Banking Laws in that they both require interest on loans to be expressed as dollars per one hundred dollars per year. Nebraska's law

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for one year computed upon the declining principal of the loan shall, at or prior to making such loan, deliver to the borrower a statement, which may be incorporated in a copy of the evidence of indebtedness, setting forth all of the terms of the transaction in clear and distinct language, including: (a) the rate of interest agreed upon in terms either of simple interest computed on the declining principal balance or of the actual interest cost in money, (b) a statement that the loan may be prepaid in full or in part and that, if the loan is prepaid in full, the borrower may receive a refund of interest charged."

[25] KAN. STAT. ANN. 16-202(c) (Cum. Supp. 1965); NEB. REV. STAT. § 45-501–45-502 (Cum. Supp. 1965); N.Y. BANKING LAW, § 108-4d (1965).

[26] N.Y. BANKING LAW § 108-4d (1965): "In each application for a loan under this division and in each note, instrument or other evidence of debt given by a borrower to evidence such a loan, the rate of charge (stating any minimum as permitted by this subdivision form), shall be expressed: (i) as a rate in dollars per annum discount per one hundred dollars face amount of loan, or (ii) as a rate not exceeding six dollars per annum discount per one hundred dollars face amount of loan; provided, however, that if the loan has a maturity exceeding thirty-seven months, at a rate not exceeding five dollars per annum discount per one hundred dollars face amount of loan."

[27] NEB. REV. STAT. §§ 45-501–45-502 (Cum. Supp. 1965).

further provides that "if any other charges are exacted of the debtor in such a contract, such items shall be so itemized as to clearly show the nature thereof."[28] Another provision in the Nebraska act is that a penalty is imposed upon the violation of the act.[29] This statute also differs from most other Interest and Loan statutes in that it applies to both loans and sales thereby covering all aspects of consumer credit.

The Kansas statute represents the most comprehensive and all inclusive truth in lending legislation thus far enacted. It provides:

Borrower to receive a copy of contract, or statement of contents. At the time the loan is made under the provisions of subsection (b) hereof, there will be delivered to the borrower, or if there be two (2) or more borrowers, to one (1) of them a copy of the loan in the English language showing in clear and distinct terms:

(1) the name and address of the lender and of one of the borrowers or a maker of the loan;
(2) the date of the loan contract;
(3) the schedule of installments or description thereof;
(4) the principal amount of the loan excluding changes;
(5) *the rate of charges expressed in dollars per one hundred dollars per year and the dollar amount of charges as the contract may provide;*
(6) the amount collected or paid out for each kind of insurance, if any;
(7) the amount collected or paid out for filing and other fees or charges made or assessed, and added to the indebtedness to be paid by the borrower, regardless whether they shall be retained by the lender or paid to another, if said fees or charges arise out of and in connection with the loan;
(8) a general description of the collateral or security for the loan including all other accommodation or other joint makers (co-makers);
(9) that the borrower may prepay the loan in whole or in part at any time during the lender's regular business hours, and in the case the charges have been added to the principal of the loan that such charges are subject to the refund requirements in subsection (b)(2) herein, if such loan is prepaid in full.[30]

This statute fully informs the borrower as to the cost of his loan and the detailed nature of his undertaking. This is as specific as any honest businessman should be required to be in disclosure to a borrower.

[28] *Supra* note 27.

[29] NEB. REV. STAT. § 45-502 (Cum. Supp. 1965): "Contract of loan or sale; charges; violation; penalty. If any contract of loan or sale shall be entered into in violation of section 45-501, or if the rate actually used in computing charges exceeds the rate stated in the contract, the lender shall have no right to collect or receive any interest or charges on such contract. If any interest or other charges have been collected, the lender shall forfeit to the debtor all interest and other charges collected on the contract. There shall also be allowed to the debtor such reasonable attorney's fee as the court shall determine for services rendered in obtaining a judicial determination of the fact of any such violation." *Supra* note 27.

[30] KAN. STATE ANN. § 16-202(c) (Cum. Supp. 1965) (emphasis added).

CONCLUSION

From the foregoing analysis, it is apparent, that the only states with adequate truth in lending legislation are Kansas[31] and Nebraska.[32] Presently many of the states have truth in lending bills pending in their legislatures;[33] the likelihood of these bills becoming law in the near future seems doubtful.

Because of the state's failure to enact their own truth-in-lending legislation, there have been a number of attempts to enact such legislation at the federal level.[34] In 1963 former Senator Paul H. Douglas stated five reasons why a truth in lending statute was necessary. First, protecting the consumer; second, protecting the businessman; third; invigorating competition; fourth, stabilizing the economy; and fifth, encouraging economic growth.[35]

In the present 90th Congress there is a Senate bill pending the purpose of which is to promote "the informed use of credit to the benefit of the national economy."[36] This bill would apply to both direct loans and installment credit sales. The bill provides for full disclosure in great detail by requiring the creditor to state all charges and to express such costs in terms of an annual percentage rate. It further provides that the Board of Governors of the Federal Reserve System shall regulate the disclosure of credit costs. In addition, the bill imposes a civil penalty of $100, or in an amount equal to twice the finance charge required, whichever is greater, but not to exceed $2000 in any credit transaction.[37] It should be noted that although this federal proposal covers the complete gamut of truth in lending legislation, it nevertheless fails to require credit costs to be expressed in terms of dollars per one hundred dollars. Consequently, the unsophisticated borrower would not benefit from its passage.

Only truth in lending statutes with full disclosure provisions will alleviate the economic and social problems arising from the great increase in consumer credit. This form of legislation is mandatory to enable the unsophisticated consumer to determine the actual cost of any loans he may undertake. As a guide to both Congress and state legislatures, the comprehensive Kansas disclosure legislation[38] should be considered as a model truth-in-lending statute.

Errol Halperin

31 *Supra* note 27. 32 *Supra* note 30.

33 For example the bill now pending in the Illinois General Assembly, S.B. 30, 75th General Assembly (1967), which is comparable to the Kansas statute, *supra* note 30.

34 See generally note 5 *supra*. See also Kelly, *Expert Views Credit Bill,* Nation's Business, June, 1965, p. 104.

35 Speech of Hon. Paul H. Douglas of Ill. in the U.S. Senate, Thursday, Feb. 7, 1963.

36 S. 5, 90th Cong., 1st Sess. (1967). 37 *Supra* note 36. 38 *Supra* note 30.