

SUBJECT: Credit Practices Rule

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INTRODUCTION

This release applies to both state and federal chartered credit unions. It describes the Federal Trade Commission's Credit Practices Rule, relating to late fees, wage assignments, cosigners, prohibited security interests, etc. It includes discussion of important state law provisions that overlap with the Rule. It also discusses how Wisconsin state-chartered credit unions are exempt from the Rule for transactions subject to the Wisconsin Consumer Act, because it has somewhat similar restrictions, described herein. The NCUA Credit Practices Rule has been repealed, but the regulator states that actions once prohibited by the rule may still be deemed to violate the Federal Trade Commission Act and the Dodd-Frank Act. For example, the NCUA states that federal credit unions properly disclose a cosigner's liability if, prior to consummation of the obligation, they provide a "Notice to Cosigner."

EXECUTIVE SUMMARY

The Credit Practices Rule applies to any credit extended to a consumer (a natural person who seeks or acquires goods, services or money for personal, family, or household use), except for credit granted to acquire real estate.

The Credit Practices Rule prohibits the following practices:

- *Use of cognovit (confession of judgment)* clauses, or any other waiver of the right to notice and opportunity to be heard in the event of a lawsuit,
- *Wage assignments*, with certain exceptions including payroll deduction under the procedures commonly used by credit unions,
- Waiver of exemption from execution,
- Security interests in household goods,
- Pyramiding of late charges,
- Taking a cosigner on a loan without providing the required *Notice to Cosigners*.

The prohibited contract provisions apply to credit transactions purchased by credit unions as well as those they originate.

PARTIAL EXEMPTION FROM THE CREDIT PRACTICES RULE

State-chartered credit unions are subject to the Federal Trade Commission's Credit Practices Rule (16 CFR Part 444) for some transactions. Federal credit unions were subject to an NCUA Credit Practices Rule that was once found in Part 706 of the NCUA Rules & Regulations. The NCUA Credit Practices Rule has been repealed, but the regulator states that actions once prohibited by the rule may still be deemed to violate Section 5 of the Federal Trade Commission Act and Sections 1031 and 1036 of the Dodd-Frank Act. For example, the NCUA states that federal credit unions properly disclose a cosigner's liability if, prior to consummation of the obligation, they provide a "Notice to Cosigner."

Wisconsin financial institutions are exempt from the FTC's Credit Practices Rule, but only for transactions under the Wisconsin Consumer Act (WCA). This partial exemption was granted to avoid duplication, since the WCA provides many of the same or substantially equivalent protections. (FTC exemption for Wisconsin; 51 FR 24304, July 3, 1986)

Credit union staff should be well-versed in the criteria for determining whether a given transaction is subject to the WCA (review *ii Release No. B001* if necessary).

- If the credit transaction is subject to the Act, and thus documented on Consumer loan paper such as the Consumer Note and TIL (#82014), or the Consumer Note (#82073), follow the guidelines imposed by the Wisconsin Consumer Act.
- If the credit transaction is not subject to the Wisconsin Consumer Act, determine if it is nevertheless for personal, family, or household purposes. If the answer to this is yes and if the credit is not for the purpose of acquiring real estate, the transaction is subject to the Credit Practices Rule. The League offers the Non-Consumer Note (#82031) for such loans, if not secured by real estate or a dwelling.

COGNOVIT (CONFESSION OF JUDGMENT) CLAUSES PROHIBITED

Such a clause permits a lender to take judgment in the event of default without giving the borrower the benefit of prior notice or the right to defend an action in court. The Credit Practices Rule prohibits using lending forms with such clauses. We are not aware of any Wisconsin credit unions using such clauses.

Wisconsin law prohibits use of a "confession of judgment" clause for Wisconsin Consumer Act transactions. Wis. Stats. § 422.405.

Wisconsin credit unions should make sure they are in compliance with this requirement if using forms other than those produced by the Wisconsin Credit Union League Services Corporation.

WAGE ASSIGNMENT CLAUSES RESTRICTED

The Credit Practices Rule restricts the use of clauses providing for an assignment of wages unless:

- The assignment is, by its terms, revocable by the borrower,
- The assignment is a payroll deduction plan authorized by the borrower as a method of making payment, commencing at the time of the transaction, or
- The assignment applies only to wages or earnings already earned as of the date of the assignment.

Wisconsin Consumer Act rules require any payroll deduction authorization form to state that the customer may terminate the arrangement at any time without penalty. Furthermore, if that requirement is violated, another law requires that notices be sent out every six months, reminding the member that the arrangement is revocable.

We believe the current practices of most Wisconsin credit unions utilizing payroll deduction programs or revocable wage assignments comply with the FTC Rule. However, recently a situation came to light in which the employer was providing payroll deduction forms which did not have the required statement regarding revocation without penalty. The WCA still penalizes the credit union for accepting a payroll deduction form that does not comply. Credit unions should review their current procedures in this regard to insure compliance. See *ii Release No. 0066*.

WAIVER OF EXEMPTION FROM EXECUTION

The Credit Practices Rule prohibits lenders from including waiver of exemption from execution clauses in their contracts.

State laws have provisions which allow creditors (even unsecured) to enforce a judgment by execution, having the sheriff seize and sell property of the defaulted borrower. However, certain types of property are exempt from execution under the statutes, at least to a given value. The Credit Practices Rule prohibits lenders from requiring borrowers to waive their exemption rights, except for property subject to a security agreement executed in connection with the loan.

The Wisconsin Consumer Act prohibits the waiver of any right of or benefit to the consumer under any provision of the Act, including exemptions from execution on (1) household goods, (2) real estate used as the principal residence of the borrower or dependents (up to \$15,000), and (3) wages (within limits). See Wis. Stats. § 425.106.

SECURITY INTERESTS IN HOUSEHOLD GOODS

The Credit Practices Rule prohibits taking a security interest in household goods, except for purchase-money security interests or pledges whereby the credit union actually takes possession of the collateral. Thus, the credit union cannot take household goods as collateral for a loan unless the goods are purchased with the loan proceeds or the credit union has possession of the collateral for the term of the loan. The refinancing of a purchase-money loan may also be secured by the household goods.

The Credit Practices Rule defines “household goods” as clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings) of the consumer and his or her dependents. Household goods, under the federal rule, does not include works of art, electronic entertainment equipment (other than one radio and television), items acquired as antiques, and jewelry (other than wedding rings).

The Wisconsin Consumer Act prohibits lenders from taking a non-purchase money security interest in the clothing of the consumer (or his or her dependents) and any of the following, if they are not fixtures: dining table and chairs, refrigerator, heating stove, cooking stove, radio, beds and bedding, cooking utensils and kitchenware, or (if the loan is less than \$1,000) real property. The WCA does not have an exception allowing the credit union to take a security interest in household goods by taking a pledge (actually holding the property). The WCA permits the refinancing of a purchase-money loan to still be secured by the household goods, but payments are deemed to be applied to pay off the portion secured by the household goods first.

The Wisconsin Consumer Act has interest restrictions that apply to credit sales (e.g., credit union financing the sale of its own property, such as repossessed collateral) or to consumer leases (e.g., automobile leases). Consult your copy of the WCA at § 422.417(1) and (2) respectively for the details.

PYRAMIDING OF LATE CHARGES

As a preliminary matter, any late fee to be charged must be allowed for in both the note and disclosure. Also, many data processors are incapable of assessing late charges without violating the law. If such is the case with your processor, DO NOT ASSESS LATE FEES.

A. When the Loan is Subject to the Credit Practices Rule and/or Truth in Lending ONLY

The Credit Practices Rule prohibits lenders from assessing a delinquency charge when the only delinquency on the account is a prior delinquency charge or late fee. This practice is known as the “pyramiding” of late charges.

For example, a credit union loan document might require monthly payments of \$100 and assess a late fee of \$5 for payments made after the “grace period.” If the \$100 January 1st payment is made on the 16th, after the grace period, the credit union can assess a late fee in January. However, if the February payment is not accompanied by the \$5 late fee, the credit union cannot deduct the \$5 fee from the February payment, then claim the member has only paid \$95 of the \$100 due in February, and assess a new late fee.

Please remember, the Rule’s restriction on late charges does not apply unless the only delinquency on an account is a prior late fee. If the member in the example had skipped the January payment entirely and made the regular payments of \$100 in subsequent months, the credit union can charge late fees on all the subsequent payments until the missing \$100 payment is made.

The Credit Practices Rule does not restrict the amount of a late fee or require any grace period.

Truth in Lending.

Like the Credit Practices Rule, the Federal Reserve’s Truth in Lending rules (Reg. Z § 1026.36) also prohibit pyramiding late charges. The Reg. Z rules apply to closed-end consumer mortgage loans secured by the consumer’s principal dwelling as of October 1, 2009. They do not apply to home equity lines of credit.

A “principal dwelling” does not necessarily need to be real property. The Federal Reserve’s Official Staff Commentary to Reg. Z says that mobile homes, boats and trailers are dwellings if they are in fact used as residences – whether or not the residence is real property under state law.

Reg. Z says that a loan a servicer (which includes the loan originator if the originator also services the loan) may not impose a late fee or delinquency charge when it is due only to the borrower’s failure to include a similar charge that was

imposed on an earlier payment. This would apply to payments that otherwise would be a full payment that is paid on time, but for the previously charged late fee or delinquency charge.

Regulators say the Reg. Z pyramiding rule should be construed consistently with the Credit Practices Rule.

Reg. Z generally applies to credit extended primarily for personal, family, or household (not business or agricultural) purposes unless:

- The loan is to an organization (corporation, partnership, association, union, etc.); or
- The loan is over **\$73,400, effective Jan. 1, 2026 (up from \$71,900 in 2025)**. Although consumer credit transactions above the threshold are generally exempt, loans secured by real property or by personal property used or expected to be used as the principal dwelling of a consumer and private education loans are covered by TILA regardless of the loan amount.

See The League's *ii Release No. B042* for the basic requirements of Reg. Z relating to closed-end credit.

B. When the Loan is Subject to the Credit Practices Rule/Truth in Lending AND § 138.052

Additional restrictions on late charges apply to first mortgage lien or equivalent real estate loans to individuals by state-chartered credit unions, or any dollar amount, by virtue of Wis. Stats. § 138.052. That section and the Credit Practices Rule will both apply to some loans, while sometimes only one or the other provision will apply. (★Second mortgages are excluded from § 138.052 unless the credit union also holds the first mortgage, in which case the second mortgage is considered equivalent to the first. Purchase money mortgages are exempt from the Rule.★)

Section 138.052 regulates the amount of a late charge and mandates a minimum grace period: "The parties may agree to imposition of a late payment charge not exceeding 5% of the unpaid amount of any installment not paid on or before the 15th day after its due date."

Thus, a late fee of \$25 can be assessed if a \$500 payment is still due after the 15 day grace period. However, if the member had paid half of the \$500 payment before the end of the grace period, only a \$12.50 fee can be charged. That is because the 5% is calculated on the unpaid amount of the installment rather than on the whole scheduled payment.

Section 138.052 goes beyond merely prohibiting the pyramiding of late charges. This provision says the lender cannot charge more than one late fee on a given installment, even if the installment goes unpaid for many months. Furthermore, for purposes of determining late charges, payments are applied first to current installments and then to delinquent installments.

Assume a member misses the January payment completely, but makes regular payments from February through December. The lender can only charge a late fee on the missed January installment. It cannot apply the February payment to the January installment, the March payment to the February installment, etc., claiming a new late charge each month. Section 138.052 would only permit one late fee. Compare this to "When the Loan is Subject to the Credit Practices Rule ONLY."

Federal credit unions are not subject to Wis. Stats. § 138.052 as it relates to late fees. Federal credit union late fees are governed by Article XII Section 8 of the Federal Credit Union Bylaws.

C. When the Loan is Subject to the Wisconsin Consumer Act

The Wisconsin Consumer Act no longer restricts late charges on *open-end plans*.

The WCA restricts late fees on *closed-end loans* to \$10 or 5% of the unpaid amount of the installment, whichever is less. Only a 10-day grace period is required. Also, just as under § 138.052, the lender cannot charge more than one late fee on a given installment, even if the installment goes unpaid for many months.

Like § 138.052, the Wisconsin Consumer Act prohibits collecting more than once on an installment, no matter how long it is in default, and requires applying payments to current installments before delinquencies (for purposes of determining late fees). For these aspects, refer to the § 138.052 discussion above.

Although federal law again preempts state laws that would govern late charges by federal credit unions, FCUs using Wisconsin Consumer Act loan forms may be deemed to have submitted to the requirements of the Wisconsin Consumer Act.

Late fees and periodic statements

Under Reg. Z 1026.5(b)(2)(ii), credit unions cannot treat payments on open-end credit as late for any reason unless they have reasonable procedures in place to make sure that periodic statements are mailed or delivered at least 14 days before payment is due. This provision applies to all open-end consumer credit plans, including multi-featured open-end lending, HELOCs, lines of credit and credit cards—unless they have a *grace period or credit card access*.

If the open-end plan has a grace period or credit card access, the periodic statements must be mailed or delivered at least 21 days before due.

For purposes of this rule, "grace period" means a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate. Such a grace period is common on credit cards, but is not featured in The League's Kwik-Cash or R.E.A.P.® documentation. Such a grace period is different than a "courtesy period" which may be provided before a late fee is charged.

WCA limit on late fees after maturity

After a closed-end consumer loan matures, the credit union may either charge late fees on the final installment or interest, not both. The Wisconsin Consumer Act bars charging a late fee on the final scheduled installment of a closed-end loan if interest will continue to be assessed. Wis. Stats. §422.203(4).

As of 2014, the League's closed-end Consumer Note forms (WCUL #82014, #81101 and #82073) give credit unions the option, when they complete the forms, either to require interest after the loan matures or to allow late fees on the last installment. Credit unions must take care to complete the forms properly, to reflect their procedures for handling loan payments and interest accrual.

Older versions of League forms did not have this flexibility; they automatically required interest to accrue after maturity and did not allow for the late fee. For existing loans using these older forms, the credit union should not charge late fees after maturity.

Credit unions using forms from other vendors should review them to see how they address this issue.

NOTICE TO COSIGNERS

Consumers who do not meet a creditor's standards for creditworthiness are often required to obtain one or more "cosigners" who agree to be liable for the debt. A cosigner is required to pay if the debtor defaults, but the cosigner receives no monetary consideration for undertaking the obligation, which can become onerous.

Although some lenders warn cosigners of the potential losses they may face (one lender told the FTC "I generally tell any cosigner that a cosigner is a damn fool with a pencil"), the FTC and the Wisconsin legislature responded to claims that some lenders misrepresent the nature of liability of cosigners.

A person may become a cosigner by signing a promissory note or by signing a separate written guarantee. The FTC Notice to Cosigners and Wisconsin Consumer Act Explanation of Personal Obligation, discussed below, are only disclosures. Just giving the disclosures does not obligate the recipient on the loan. They do not make the person a cosigner.

FTC notice to cosigners

The Credit Practices Rule seeks to prevent creditors from failing to disclose or misrepresenting the nature and extent of liability of people who cosign on loans. Such acts are prohibited as unfair or deceptive practices under the Credit Practices Rule. The FTC requires lenders to provide a "Notice to Cosigner" prior to the cosigner becoming obligated on the transaction. The same form is used for both open and closed-end credit.

For purposes of the Credit Practices Rule, a cosigner is:

- A natural person,
 - That is, a living breathing human being, as opposed to a corporation or other business organization.
- Who renders himself or herself liable for the obligation of another person,

- The term shall include any person whose signature is requested as a condition to granting credit to another person, or as a condition for forbearance on collection of another person's obligation that is in default.
- Without compensation.
- A person who does not receive goods, services, or money in return for a credit obligation does not receive compensation within the meaning of this definition.

The Credit Practices Rule also provides, "A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation."

Merely giving the FTC Notice to Cosigners does not make a person a cosigner. They must sign the note or a separate written guarantee agreement.

The League offers WCUL #83007 Notice to Cosigner for sale to credit unions, to aid in compliance with the FTC rule.

WCA explanation of personal obligation

Wisconsin Consumer Act loans are subject to the requirement for an "Explanation of Personal Obligation" (EPO) found in Wis. Stats. § 422.305, instead of the FTC Notice to Cosigner. Furthermore, a cosigner may not be required to pay any fee or charge in addition to those imposed on the customer, or waive any WCA rights extended to the customer. Wis. Stats. § 422.420.

The EPO form is required for cosigners or guarantors not sharing in the benefit of the loan, who is personally liable unless that person receives a copy of each instrument, document, agreement, and contract which is signed by the customer and evidences the customer's obligation to pay.

The credit union has the choice of giving the obligor either:

- An EPO, or
- A copy of the note, all disclosures, and all security agreements or mortgages evidencing the obligation. (If using this second option, you must be able to prove that the co-signer received his/her own copy of the documents.)

It's probably easier to use the EPO, even when the obligor gets copies of the other documents.

Merely giving the Wisconsin Consumer Act Explanation of Personal Obligation does not make a person a cosigner. They must sign the note or a separate written guarantee agreement.

EPO requirement for certain loans secured by first lien real estate mortgage or equivalent security interest

Wis. Stats. § 428.103(1)(b), applies to loans secured by a first lien real estate mortgage loans or equivalent security interest. The law states that "any cosigner, other than the spouse of the customer, shall be given a notice substantially the same as that required by § 422.305, and the cosigner shall be entitled to a copy of any document evidencing the obligation to pay the debt."

Dealing with cosigners

Caution should be used in dealing with cosigners and guarantors. In addition to providing any required notice and taking care not to mislead the cosigner, the credit union may keep the guarantor fully informed of the status of the loan as any problems develop. For example, send the cosigner copies of any delinquency notices or notices to replace lapsed insurance or collateral.

Other suggestions are:

- Be sure any security interest in collateral is property perfected (recorded) and that such perfection is maintained.
- Do not release or exchange collateral without the cosigners consent.
- Notify the cosigner of any proposed sale of collateral, e.g., after repossession.
- Maintain insurance on collateral.
- Do not modify the loan or defer payments without the cosigner's consent.

COMPARISON OF PROVISIONS

The table below provides a quick reference chart comparing the application of the FTC Credit Practices Rule to Wisconsin Consumer Act provisions.

Comparison of Provisions		
Regulated Practices	Wisconsin Consumer Act	Credit Practices Rule
Confession of Judgment	Prohibited	Prohibited
Wage Assignments	Prohibited. Payroll deduction okay if it states it is revocable at any time without penalty	Prohibited. Payroll deduction okay if it states it is revocable at any time
Waiver of Exemption from Execution	Prohibited for exemption (and other) rights under the WCA	Prohibited
Security Interest in Household Goods	Prohibited, except for purchase-money security interests. <i>Goods Affected:</i> Clothing of the customer and dependents, and the following, if not fixtures: dining table and chairs, refrigerator, heating stove, cooking stove, radio, beds and bedding, couch and chairs, cooking utensils and kitchenware.	Prohibited, except for purchase-money and possessory security interest. <i>Goods affected:</i> Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware and personal effects (including wedding rings) of the consumer and his/her dependents. Certain exceptions apply.
Late Fees	No pyramiding. If closed-end: \$10 or 5% whichever is less after 10 days. Only 1 fee per installment	No pyramiding. If Ch. 138 loan: 5% after 15 days. 1 fee per installment.
Co-signers	Use EPO, or provide copy of each document used to evidence the transaction (preserve proof of providing copies)	Use FTC Notice to Cosigners

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Legal Affairs Department

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