Consumer Leasing

Introduction

For consumers, leasing is an alternative to buying either with cash or on credit. A lease is a contract between a lessor (the property owner) and a lessee (the property user) for the use of property subject to stated terms and limitations for a specified period and at a specified payment.

The Consumer Leasing Act (15 USC 1667 et. seq.) (CLA) was passed in 1976 to assure that meaningful and accurate disclosure of lease terms is provided to consumers before entering into a contract. It applies to consumer leases of personal property. With this information, consumers can more easily compare one lease with another, as well as compare the cost of leasing with the cost of buying on credit or the opportunity cost of paying cash. In addition, the CLA puts limits on balloon payments sometimes due at the end of a lease, and regulates advertising.

Originally, the CLA was part of the Truth in Lending Act, and was implemented by Regulation Z. When Regulation Z was revised in 1981, Regulation M was issued, and contained those provisions that govern consumer leases.

The Electronic Signatures in Global and National Commerce Act (the E-Sign Act), 15 U.S.C. 7001 et seq., was enacted in 2000 and did not require implementing regulations. On November 9, 2007, amendments to Regulation M and the official staff commentary were issued to simplify the regulation and provide guidance on the electronic delivery of disclosures consistent with the E-Sign Act.[1]

Today a relatively small number of banks engage in consumer leasing. The trend seems to be for leasing to be carried out through specialized bank subsidiaries, vehicle finance companies, other finance companies, or directly by retailers.

Key Definitions

The definition of certain terms is necessary to understand the requirements imposed by the CLA. These terms include lease, lessor, lessee, consumer lease, open-end lease, closed-end lease, realized value, residual value, gross capitalized cost, capitalized cost reduction, and adjusted capitalized cost.

"Lessee"—A lessee is a natural person who enters in to or is offered a consumer lease.

"Lessor"—A lessor is a natural person or organization who regularly leases, offers to lease, or arranges for the lease of personal property under a consumer lease. A person who leases or offers to lease more than five times in the preceding or current calendar year meets this definition.

"Consumer Lease"—A consumer lease is a contract between a lessor and a lessee:

- for the use of personal property by an individual (natural person),
- to be used primarily for personal, family, or household purposes,
- for a period of more than 4 months (week-to-week and month-to-month leases do not meet this criterion, even though they may be extended beyond 4 months), and
- with a total contractual cost of no more than $25,000.

Specifically excluded from coverage are leases that are:

- for business, agricultural or made to an organization or government,
- for real property,
- for personal property which are incidental to the lease of real property, subject to certain conditions, and
- for credit sales, as defined in Regulation Z. §1026.2(a)(16).

A lease meeting all of these criteria is covered by the CLA and the Consumer Financial Protection Bureau's Regulation M. If any one of these criteria is not met, for example, if the leased property is used primarily for business purposes or if the total contractual cost exceeds $25,000, the CLA and Regulation M do not apply.

Consumer leases fall into one of two categories: closed end and open end. Since the information required to be disclosed to the consumer will vary with the kind of lease, it is important to note the difference between them. However, to properly understand the difference, realized value and residual value must first be defined.

"Realized Value"—The realized value is the price received by the lessor of the leased property at disposition, the highest offer for disposition of the leased property, or the fair market value of the leased property at the end of the lease term.

"Residual Value"—The residual value is the value of the leased property at the end of the lease, as estimated or assigned at consummation of the lease by the lessor.

"Open-end Lease"—An open-end lease is a lease in which the amount owed at the end of the lease term is based on the difference between the residual value of the leased property and its realized value. The consumer may pay all or part of the difference if the realized value is less than the residual value or he may get a refund if the realized value is greater than the residual value at scheduled termination.

1 72 FR 63456, November 9, 2007. These amendments took effect December 10, 2007, with a mandatory compliance date of October 1, 2008.

"Closed-end Lease"—A closed-end lease is a lease other than an open-end lease. This type of lease allows the consumer to "walk away" at the end of the contract period, with no further payment obligation—unless the property has been damaged or has sustained abnormal wear and tear.

"Gross Capitalized Cost"—The gross capitalized cost is the amount agreed upon by the lessor and lessee as the value of the leased property, plus any items that are capitalized or amortized during the lease term. These items may include taxes, insurance, service agreements, and any outstanding prior credit or lease balance.

"Capitalized Cost Reduction"—This term means the total amount of any rebate, cash payment, net trade-in allowance, and noncash credit that reduces the gross capitalized cost.

"Adjusted Capitalized Cost"—This is the gross capitalized cost less the capitalized cost reduction and the amount used by the lessor in calculating the base periodic payment.

General Disclosure Requirements

Lessors are required by federal law to provide the consumer with leasing cost information and other disclosures in a format similar to the model disclosure forms found in Appendix A to the regulation. Certain pieces of this information must be kept together and must be segregated from other lease information. All of the information stated must be accurate, clear and conspicuous, and provided in writing in a form that the consumer may keep.

The general disclosures required by Part 1013 may be provided to the lessee in electronic form, subject to compliance with the consumer consent and other applicable provisions of the E-Sign Act. The E-Sign Act does not mandate that institutions or consumers use or accept electronic records or signatures. It permits institutions to satisfy any statutory or regulatory requirements by providing the information electronically after obtaining the consumer's affirmative consent. But before consent can be given, consumers must be provided with the following information:

- any right or option to have the information provided in paper or non-electronic form;
- the right to withdraw the consent to receive information electronically and the consequences, including fees, of doing so;
- the scope of the consent (for example, whether the consent applies only to a particular transaction or to identified categories of records that may be provided during the course of the parties' relationship);
- the procedures to withdraw consent and to update information needed to contact the consumer electronically; and
- the methods by which a consumer may obtain, upon request, a paper copy of an electronic record after consent has been given to receive the information electronically and whether any fee will charged.

The consumer must consent electronically or confirm consent electronically in a manner that "reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent."

After the consent, if an institution changes the hardware or software requirements such that a consumer may be prevented from accessing and retaining information electronically, the institution must notify the consumer of the new requirements and must allow the consumer to withdraw consent without charge.

Disclosures are to be provided in the following circumstances. (Advertisement requirements are discussed in the advertising section.)

Prior to or Due at Lease Signing

A dated disclosure must be given to the consumer before signing the lease and must contain all of the information detailed in Section 4 of the regulation.

Renegotiations and Extensions

New disclosures also must be provided when a consumer renegotiates, or extends a lease, subject to certain exceptions.

Multiple Lessors/Lessees

In the event of multiple lessors, one lessor on behalf of all the lessors may make the required disclosures. If the lease involves more than one lessee, the required disclosures should be given to any lessee who is primarily liable.

Advertising

Advertisements concerning consumer leases must also comply with certain disclosure requirements. All advertisements must be accurate.

If an advertisement includes any reference to certain "trigger terms"—the amount of any payment, statement of a capitalized cost reduction (i.e., down payment), or other payment required prior to or at lease signing or delivery, or that no such payment is required—then the ad must also state the following:

- that the transaction is for a lease;
- the total amount due prior to or at lease signing or delivery;
- the number, amounts and due dates or periods of the scheduled payments;

- a statement of whether or not a security deposit is required; and
- a statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term. (§ 1013.7(d)(2)).

An advertisement for an open-end lease also must include a statement that extra charges may be imposed at the end of the lease based on the difference between the residual value and the realized value at the end of the lease term.

If lessors give a percentage rate in an advertisement, the rate cannot be more prominent than any of the other required disclosures. They must also include a statement that "this percentage may not measure the overall cost of financing this lease." The lessor cannot use the term "annual percentage rate," "annual lease rate," or any equivalent term.

Some fees (license, registration, taxes, and inspection fees) may vary by state or locality. An advertisement may exclude these third-party fees from the disclosure of a periodic payment or total amount due at lease signing or delivery, provided the ad states that these have been excluded. Otherwise, an ad may include these fees in the periodic payment or total amount due, provided it states that the fees are based on a particular state or locality and indicates that the fees may vary.

For an advertisement accessed by the consumer in electronic form, the required disclosures may be provided to the consumer in electronic form in the advertisement, without regard to the consumer consent or other provisions of the E-Sign Act. An electronic advertisement (such as an advertisement on an Internet web site) that provides a table or schedule of the required disclosures is considered a single advertisement if the advertisement clearly refers the consumer to the location where the additional required information begins. For example, in an electronic advertisement, a term triggering additional disclosures may be accompanied by a link that directly connects the consumer to the additional disclosures.

Limits on Balloon Payments

In order to limit balloon payments that may be required of the consumer, certain sections of the regulation call for reasonable calculations and estimates. These provisions protect the consumer at early termination of a lease, at the end of the lease term, or in delinquency, default, or late payment status. The provisions limit the lessee's liability at the end of the lease term and set reasonableness standards for wear and use charges, early termination charges, and penalties or fees for delinquency.

Penalties and Liability

Criminal and civil liability provisions of the Truth in Lending Act also apply to the CLA. Actions alleging failure to disclose the required information, or otherwise comply with the CLA, must be brought within one year of the termination of the lease agreement.

Record Retention

Lessors are required to maintain evidence of compliance with the requirements imposed by Regulation M, other than the advertising requirements under Section 7 of the regulation, for a period of not less than two years after the date of the disclosures are required to be made or an action is required to be taken.

Examination Objectives

1. To assess the quality of the institution's compliance management system for the Consumer Leasing Act.
2. To determine that lessees of personal property are given meaningful and accurate disclosures of lease terms.
3. To determine if the limits of liability are clearly indicated to the lessees and correctly enforced by the institution.
4. To ensure that the financial institution provides accurate disclosures of its leasing terms in all advertising.

Examination Procedures

General Disclosure Requirements

A. Review the institution's procedures for providing disclosures to ensure that there are adequate controls and procedures to effect compliance.

B. Review the disclosures provided by the institution.

1. Are the disclosures clear and conspicuous and provided in writing in a form the consumer may keep?
   a. For disclosures provided electronically, (other than for advertising requirements) are the disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)?[2]
   b. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 1013.7 provided to the consumer in electronic form in the advertisement? (§1013.3(a))
2. Are the disclosures given in a dated statement and in the prescribed are in the format prescribed? (§1013.3(a)(1))

2 The final amendments to Regulation M on the electronic delivery of disclosures, consistent with the requirements of the E-Sign Act, became effective December 10, 2007 and require mandatory compliance by October 1, 2008.

3. Is the information required by §1013.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in Appendix A? (§1013.3(a)(2))
4. Are the disclosures timely? (§1013.3(a)(3))
5. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§1013.3 (c))
6. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§1013.3(b))
7. Are all estimates clearly identified and reasonable? (§1013.3(d))
8. Are the disclosures accurate and do the disclosures contain the information required by §1013.4 (a) through (t)? (§1013.4)
9. Are disclosures given to lessees when they "renegotiate" or "extend" their leases? (§1013.5)

Lessee Liability

A. Review the lease estimates and calculations to ensure that there is not any unreasonable balloon payment expected of the lessee in the following circumstances:
   - at early termination,
     1. Does the lessor disclose the conditions under which the lease may be terminated early and the amount and method of determining the amount of any early termination charges? (§1013.4(g)(1))
     2. Are any early termination charges reasonable? (§1013.4(g)(1), 4(q))
   - at end of lease term, for wear and use,
     1. If the lessor sets standards for wear and use of the leased vehicle are the amounts or method of determining any charge for excess mileage disclosed? (§1013.4(h)(3))
     2. Are standards for wear and use reasonable? (§1013.4(h)(2))
   - at end of lease term (for open-end leases), and
     1. Does the lessor disclose the limitations on the lessee's liabilities at the end of the lease term? (§1013.4(m)(2))
     2. Are the lessee and lessor permitted to make a mutually agreeable final adjustment regarding excess liability? (§1013.4(m)(3))
   - in delinquency, default or late payment.
     1. Does the lessor disclose penalties or other charges for delinquency, default or late payments? (§1013.4(q))
     2. Are the penalties or other charges reasonable? (§1013.4(q))

Advertising

A. Review advertising policies and procedures used by the institution to ensure that there are adequate controls and procedures to effect compliance.

B. Review a sample of the institution's advertisements.
   1. Do the advertisements advertise terms that are usually and customarily available? (§1013.7(a))
   2. Are the disclosures contained in the advertisements clear and conspicuous? (§1013.7(b))
   3. Do catalog/multiple page advertisements comply with the page reference requirements? (§1013.7(c))
   4. When triggering terms are used, do the advertisements contain the additional required information? (§1013.7(d))
   5. Do merchandise tags which use triggering terms refer to a sign or display that contains the additional required disclosures? (§1013.7(e))
   6. If television or radio advertisements use triggering terms, if they do not contain the additional terms do not include the additional terms required by §7(d)(2) when triggering terms are used, do they use alternative disclosure methods (direct consumers to a toll free number or written advertisement)? (§1013.7(f))

Miscellaneous

A. Are records and other evidence of compliance (other than for advertising requirements under §1013.7) retained for a period of no less than two years? (§1013.8)

References

12 CFR 1013 - Regulation M—Consumer Leasing (CFPB's regulation and official staff interpretation (commentary))
Consumer Credit Protection Act: Title 1, Chapter 5—Consumer Leases

Applicable Financial Institution Letters (FIL)

15 USC 1667 et seq: Consumer Leasing Act
15 USC 7001 et seq: Electronic Signatures in Global and National Commerce Act

Examination Checklist – Consumer Leasing		
	Yes	**No**
1. Does the Bank engage in consumer leasing or purchase consumer leases from lessors? (§1013.2(h)) **(If no, there is no need to do further work on Consumer Leasing. If yes, complete the following checklist, answering yes (Y) or no (N) for each item.)**		
2. Are the disclosures made prior to consummation of the lease, that is, at the time a binding order is made or the lease is signed? (§1013.3(a)(3))		
3. Are the disclosures clear and conspicuous and provided in writing in a form the consumer may keep? (§1013.3(a))		
4. Are disclosures in electronic form provided in compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)? (§1013.3(a))		
5. For an advertisement accessed by the consumer in electronic form, are the disclosures required by 12 CFR 1013.7 provided to the consumer in electronic form in the advertisement? (§1013.3(a))		
6. Are the disclosures given in a dated statement and (i) made either in a separate statement that identifies the consumer lease transaction, (ii) in the contract or (iii) other document evidencing the lease? (§1013.3(a)(1))		
7. Is the information required by §1013.4(b) through (f), (g)(2), (h)(3), (i)(1), (j), and (m)(1) segregated and in a form substantially similar to the model in Appendix A? (§1013.3(a)(2))		
8. If the lease involves more than one lessee, are the disclosures provided to any lessee who is primarily liable? (§1013.3(c))		
9. If additional information is provided, is it provided in a manner such that it does not mislead or confuse the lessee? (§1013.3(b))		
10. Are disclosures provided to at least one lessee where there are multiple lessees and by at least one lessor when there are multiple lessors? (§1013.3(c))		
11. Are all estimates clearly identified and reasonable? (§1013.3(d))		
12. Are the following disclosures made in the lease?		
A. Description of property (§1013.4(a))		
B. Amount due at lease signing or delivery (§1013.4(b))		
C. Payment schedule and total amount of periodic payments (§1013.4(c))		
D. Other charges(§1013.4(d))		
E. Total of payments(§1013.4(e))		
F. Regarding payment calculations:		
i. Gross capitalized cost (§1013.4(f)(1)))		
ii. Capitalized cost reduction (§1013.4(f)(2)		
iii. Adjusted capitalized cost (§1013.4(f)(3))		

Examination Checklist – Consumer Leasing		
	Yes	**No**
iv. Residual value (§1013.4(f)(4))		
v. Depreciation and any amortized amounts (§1013.4(f)(5))		
vi. Rent charge (§1013.4(f)(6))		
vii. Total of base periodic payments (§1013.4(f)(7))		
viii. Lease payments (§1013.4(f)(8))		
ix. Basic periodic payment (§1013.4(f)(9))		
x. Itemization of other charges (§1013.4(f)(10))		
xi. Total periodic payment (§1013.4(f)(11))		
G. Regarding early termination:		
i. Conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term (§1013.4(g)(1))		
ii. The amount or description of the method for determining the amount of any penalty or other charges for early termination (§1013.4(g)(1))		
iii. In a form substantially similar to the sample (§1013.4(g)(2))		
H. Regarding notice of wear and use:		
i. A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, with a description of the responsibility (§1013.4(h)(1))		
ii. A statement of the lessor's standards for wear and use, which must be reasonable (§1013.4(h)(2))		
iii. In a form substantially similar to the sample (§1013.4(h)(3))		
I. Purchase option (§1013.4(i))		
J. Statement referencing other nonsegregated disclosures (§1013.4(j))		
K. Liability between residual and realized values (§1013.4(k))		
L. Right of appraisal (§1013.4(l))		
M. For open-end leases:		
i. The rent and other charges paid by lessee (§1013.4(m)(1))		
ii. Liability at end of lease term based on residual value and any excess liability (§1013.4(m) and (m)(2))		
iii. Mutually agreeable final adjustment (§1013.4(m)(3)		

Examination Checklist – Consumer Leasing		
	Yes	**No**
N. Fees and taxes (§1013.4(n))		
O. Regarding insurance:		
i. Are the types and amounts of insurance that the lessee is required to have disclosed?(§1013.4(o))		
ii. If the lessor provides insurance, are the types, amounts, and cost also disclosed? (§1013.4(o)(1))		
P. Warranties or guarantees (§1013.4 (p))		
Q. Penalties and other charges for late payments, delinquency, or default (§1013.4(q))		
R. Security interest other than a security deposit (§1013.4(r))		
S. Regarding any information on rate:		
i. Does the lessor provide a percentage rate in an advertisement or in documents evidencing the lease transaction? (§1013.4(s))		
ii. If so, does the lessor refrain from using the term "annual percentage rate," "annual lease rate," or any equivalent term in the lease disclosure? (§1013.4(s))		
iii. Does a statement that "this percent may not measure the overall cost of financing this lease" accompany the rate? (§1013.4(s))		
13. Are disclosures given to lessees when they "renegotiate" or "extend" their leases? (§1013.5)		
14. If the institution provides disclosures via electronic communication does it do the following: (§1013.6(b))		
A. Obtain a consumer's affirmative consent when providing disclosures related to a transaction? (§1013.6(c))		
B. Provide disclosures either by: (§1013.6(d))		
i. Sending to consumer's electronic address? (§1013.6(d)(1)) OR		
ii. Making the disclosures available at another location (such as a website)? (§1013.6(d)(2))		
C. If making the disclosure available at another location, does the institution: (§1013.6(d)(2))		
i. Alert the consumer of the availability of disclosures by sending a notice to their electronic address or postal address? (§1013.6(d)(2)(i))		
ii. Reference the account involved (if applicable) and the address of location where the disclosure is available? (§1013.6(d)(2)(ii)) AND		
iii. Is the disclosure available for at least 90 days from the date the disclosure first becomes available or from the date the notice alerting the consumer of the disclosure, whichever comes later? ((§1013.6(d)(2)(ii))		
D. If the electronic communication is returned, takes reasonable steps to attempt redelivery of disclosures		

Examination Checklist – Consumer Leasing		
	Yes	**No**
returned undelivered? (§1013.6(e)		
15. Does the bank advertise its leasing program? If so,		
A. Do the advertisements advertise terms that are usually and customarily available? (§1013.7(a))		
B. Are the advertisements clear and conspicuous? §1013.7(b))		
i. Are any affirmative or negative references to a charge that is part of the disclosure required under paragraph (d)(2)(ii) less prominent than the disclosure (except for the statement of a periodic payment? (§1013.7(b)(1))		
ii. Are the advertisements of lease rates less prominent than any disclosure required by section 4 (except the notice of the limitations on rate)? (§1013.7(b)(2))		
C. Do catalog and multiple page advertisements comply with the page reference requirements? (§1013.7(c))		
D. If any triggering terms are used, are all the following disclosures made? (§1013.7(d)(2))		
i. That the transaction advertised is a lease .		
ii. The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation.		
iii. The number, amounts, and due dates or periods of scheduled payments under the lease.		
iv. A statement of whether or not a security deposit is required.		
v. A statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term.		
16. Do merchandise tags which use triggering terms refer to a sign or display that contains the additional required disclosures (§1013.7(e))		
17. Do television or radio advertisements that do not contain the additional information required by section 4(d)(2) direct consumers to a toll-free number or written advertisement for additional information when triggering terms are used? (§1013.7)		
A. Is the toll free number listed along with a reference that the number may be used by a consumer to obtain the information? (§1013.7(f)(1)(i))		
B. Does the written advertisement that is in general circulation in the community served by the station including the name and date of the publication, and is published beginning at least three days before and ending at least ten days after broadcast? (§1013.7(f)(1)(ii))		
C. Has the toll-free telephone number been available for no fewer than ten days, beginning on the date of broadcast? (§1013.7(f)(2)(i))		
D. Does the lessor provide the information required by paragraph (d)(2) over the toll-free number, orally or in writing upon request? (§1013.7(f)(2)(ii))		

Examination Checklist – Consumer Leasing		
	Yes	**No**
18. Are records and other evidence of compliance retained for a period of no less than two (2) years as required by the CLA? (§1013.8)		

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