UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF THE SECRETARY

February 4, 1994

William W. Wiles, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

The Federal Trade Commission ("Commission") appreciates this opportunity to comment on the Federal Reserve Board's ("Board") proposed revisions to Regulation M,[1] which implements the Consumer Leasing Act ("CLA").[2] The Board is planning to review Regulation M to determine whether it can be simplified and clarified to carry out the purposes of the CLA more effectively without diminishing the consumer protections that the statute affords.[3] The Board is presently soliciting general comment on the proposal to review the regulation as well as comment on several specific issues. The Commission's comments address both of these topics.

I. GENERAL NEED FOR REVISION OF REGULATION M

The CLA became law in 1976, based on Congressional findings that there was a trend toward leasing as an alternative to purchasing consumer items on credit and that consumers were not receiving adequate disclosures about leasing costs. Regulations

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[1] 12 C.F.R. § 213.

[2] 15 U.S.C. §§ 1667-1667e. The Commission enforces the CLA, an amendment to the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 et seq., and its implementing Regulation M, for leasing companies, finance companies and the vast majority of other nonfederally chartered or nonfederally insured lessors. See Section 108(c) of the TILA, 15 U.S.C. § 1607(c).

[3] 58 Fed. Reg. 61035 (November 19, 1993).

implementing the CLA's lease disclosure requirements (now contained in Regulation M) were enacted the next year.[4]

Regulation M mandates numerous disclosures, both in advertising and before a lease is consummated (typically, when a lease is signed), to help consumers understand the costs and terms that lessors are offering. These requirements are intended to ensure that consumer lessees are given "meaningful disclosures of lease terms . . . and . . . meaningful and accurate disclosures of lease terms in advertising."[5] The disclosure requirements are extensive and often technical. Unlike their credit counterparts in the TILA and its implementing Regulation Z, the lease disclosure rules have not been revisited in over seventeen years.[6]

During the intervening period, the lease industry has seen considerable change. Since the CLA was enacted, leasing transactions have increased substantially. In 1984, only 11.6 percent of new car deliveries involved leases; however, by 1993, that figure had increased to almost 25 percent.[7] Lease offers have also become more diverse as the lease market share has grown. Consumers are now even offered manufacturer's rebates and price subsidies for leases, as they have been for financing transactions for many years.[8] Some lessors provide a menu of lease choices, with lease terms ranging up to ten years, service and maintenance options, various purchase options, and other special offers. When the CLA first became effective, leases were

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[4] The lease disclosure requirements were initially added to Regulation Z. When the Board issued revised Regulation Z in 1981, the lease rules were placed in new Regulation M.

[5] Section 213.1(b) of Regulation M, 12 C.F.R. § 213.1(b).

[6] In 1981, the Board issued revised Regulation Z, following enactment of the Truth in Lending Simplification and Reform Act. Title VI of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("Simplification Act"), Pub. L. 96-221, 94 Stat. 168. The Simplification Act's disclosure requirements were implemented through revised Regulation Z. 46 Fed. Reg. 20848 (1981).

[7] See "Leasing is Major Factor in Carmakers' Comeback," Advertising Age (June 7, 1993) at 13.

[8] See, e.g., "For Some Pocketbook Peace, Try an Automobile Lease," The Washington Post (November 21, 1993) at H3.

promoted primarily through print advertisements; today, however, lease promotions involve all types of media, including print, radio and television, broadcast and cable.

For these reasons, the Commission supports the Federal Reserve Board's decision to review Regulation M. In view of the increase in lease transactions and other changes in the lease market, the Board's decision is especially timely.

II. SPECIFIC ISSUES UNDER REGULATION M

The Board has solicited comment on three specific issues: disclosure of early termination charges; broadcast media advertising; and segregation of leasing disclosures. The Commission addresses these issues below.

A. Early Termination Charges

Under the CLA and Regulation M, lessors must disclose either the amount of charges for early termination or the method of determining that amount.[9] Most lessors choose to disclose the method, rather than state the amount of the charges. The Board has raised the issue of early termination charges in response to the recent decision in Lundquist v. Security Pacific.[10] There, the court found that an early termination formula was overly complex and beyond the understanding of the average consumer, and hence violated the regulation's "reasonably understandable" standard.[11]

Some lessors have asked the Board to amend the regulation to permit disclosure simply of the name of the method used in determining charges for early termination, rather than a description of the method. Some consumer groups have argued, however, that the formulas could be made more understandable, and that allowing disclosure of the name of the method alone would not be enough to enable consumers themselves to determine the amount of early termination charges. The Board is interested in this issue, including whether disclosure of the name of the method along with a representative example of a lease termination

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[9] Section 182(11) of the CLA, 15 U.S.C. § 1667a(11); Section 213.4(g)(12) of Regulation M, 12 C.F.R. § 213.4(g)(12).

[10] 993 F.2d 11 (2d Cir. 1993).

[11] Id. at 15. The court described the early termination formula as "Byzantine." Id.

charge, should be adequate to inform consumers of the consequences of terminating a lease early.

Consumers may terminate a lease transaction early for a variety of reasons, including trade-in for another vehicle, dissatisfaction with the lease, purchase of the leased vehicle, and involuntary reasons such as accident or theft. Although consumers may intend to carry the lease through its full term upon signing of the transaction, as many as half of all lessees are likely to terminate their leases prior to conclusion of the lease term.[12] Thus, disclosures regarding early termination charges may be particularly important to many consumers.

The Commission has, from time to time, received consumer inquiries about early termination charges.[13] Most consumers who have inquired have been concerned with their inability to calculate accurately the total costs of terminating a lease early. Not until they sought to end the lease did they discover the true termination expenses. Some consumers have noted that, although the procedures for determining these charges were disclosed, they were scattered throughout the lease agreement.[14] As a result, the consumers failed to review critical information.[15] Other consumers have questioned the amount of the early termination charges imposed.[16] The offices of some

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[12] See "The True Costs of Leasing," Forbes (February 1, 1993) at 98.

[13] The number of complaints to the Commission about leasing is relatively small. In 1993, for example, the Commission received 72 complaints about leasing; by contrast, the Commission received 17,121 complaints about credit and 37,064 complaints in total. Some of these complaints involved business leases, which are not governed by the CLA. Most other complaints about leasing concerned contractual issues that the CLA and Regulation M do not cover, such as insurance and the amount of the downpayment and certain other lease costs or charges. Lease complaints regarding early termination are discussed in the text above.

[14] See Section II.C. infra.

[15] An example of a recent complaint regarding the difficulty of understanding the termination formula is appended to this letter as Attachment A.

[16] The latter issue is pertinent to Section 183(b) of the CLA, 15 U.S.C. § 1667b, which requires charges for default,

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state attorneys general have also raised with the Commission's staff the need to clarify these disclosure requirements.

One alternative, suggested by the Board, would be to require disclosure of the name of the method used to calculate the early termination charge, along with a representative example of such a charge. Certainly, if consumers are aware of, or have access to accurate information regarding, these different methods, this disclosure could be an effective approach.[17] Although the Commission has limited information about this topic, the complaints it has received regarding early termination issues suggest that consumers may not be well-informed about payoff calculation methods. The Board may, therefore, want to consider gathering information on how much consumers understand about these methods in determining which disclosure would be appropriate.

Another alternative that the Board might consider is to require disclosure of the name of the calculation method and of the name and amount of any other termination charges imposed. This approach may be useful if lessors vary the early termination formula by adding other costs to the calculation.[18] In this event, stating the name of the method alone might not ensure that all termination charges are adequately disclosed, even if an example of an early termination charge is provided. If the Board requires disclosure of the name and amount of any other charges imposed for early termination, as well as disclosure of the name of the calculation method used, it would more likely ensure that consumers are apprised of the full charges imposed by lessors.

If after reviewing the early termination issue, the Board finds that consumers are unfamiliar with the names of the methods used to calculate early termination charges, it may want to

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delinquency and early termination to be reasonable. The "reasonableness" of these charges is determined on a case-by-case basis, considering the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

[17] There is, however, at least a question as to whether this approach would be sufficient under the statute, as the CLA requires disclosure of the amount of, or the method of determining, any charge for early termination.

[18] Some industry members and state and local enforcement agencies have raised this issue with Commission staff.

retain the present disclosure mandate. If the Board decides to maintain the present approach, the current early termination disclosure would be more effective if coupled with a new segregation requirement for consumer lease disclosures, discussed below.[19]

Finally, regardless of what disclosure requirements it ultimately adopts, the Board should consider providing an example of a complying disclosure in Regulation M's Official Staff Commentary ("Commentary") and model forms.[20] This information would facilitate reasonable uniformity among disclosures, fostering consumers' understanding of critical information and comparison of costs. It would also give lessors guidance about the type of textual disclosure that would comply with the law.

B. Broadcast Media Advertising

As noted by the Board, if any advertised lease transaction states certain terms (such as the amount or number of payments), as many as five additional disclosures are required to be included in the promotion. Due to time and space constraints in television and radio advertisements, some disclosures appear only in small print at the bottom of the screen or at the end of the advertisement. The Board has solicited comment on offering, as an alternative, a requirement that a toll-free number be provided for consumers to call to obtain more complete disclosures, in lieu of some or all of the disclosures that are now required in the advertisement itself. The Board has requested views on this

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[19] Another possibility might be to develop a disclosure that apprises consumers that terminating a lease early could result in substantial additional costs, as well as to require lessors to provide a representative example of such a charge. If this approach is adopted, the Board may also wish to require lessors to provide the actual early termination costs prior to execution of the lease, if consumers request this information, and to notify consumers of their right to do so. However, because the CLA -- as well as Regulation M -- require disclosure of the amount or method of determining any charge for early termination, use of this type of disclosure may require statutory changes.

[20] At present, although the model forms to Regulation M provide guidance to lessors regarding the type of information required under the early termination disclosure, they do not provide an example of an early termination calculation method that complies with the law. See, e.g., "Item 13" of Appendix C-2 to Regulation M.

topic, although it believes that this type of change may be more appropriately within the purview of Congress.[21]

Under both Regulation M and the CLA, advertisers in all media must disclose specific information when certain terms are stated, both to facilitate comparison shopping and to prevent the promotion's claims from misstating the true offer. Radio and television audiences may depend on and have the need for the information provided regarding lease offers, just as do consumers viewing lease advertisements in print. Certainly, consistency and uniformity of disclosures can help consumers to comparison shop for lease terms among advertisements, regardless of media.

Nonetheless, the Commission recognizes that media differ in the manner in which they convey messages. Thus, the burdens of Regulation M's current disclosure requirements on advertisers in different media may vary. Some media, such as radio and television, may be more adversely affected than the print media, particularly because of time and space constraints. Indeed, many radio and television advertisers provide the required disclosures about lease terms through "rapid fire" or "rapid scrolling" information at the end of the radio advertisement or at the bottom of the television screen and in barely visible fine print.[22]

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[21] Recently, the United States House of Representatives passed a bill (H.R. 3474) that would modify the advertising disclosure requirements under the TILA, CLA and Truth in Savings Act ("TISA"). This bill would allow a toll-free telephone number, or a referral to a print advertisement, to be provided in lieu of certain currently required terms, if certain other information is included in the advertisement. This bill applies only to radio advertisements. A somewhat similar bill was introduced in the Senate (S. 1447) that would modify the advertising disclosure requirements under the TILA, CLA and TISA by allowing a toll-free number or other means to provide the required disclosures prior to the transaction. This bill also applies only to radio promotions.

The Commission does not address the issue of the Board's authority for the changes being considered.

[22] See "Now you seem them . . . Terms of deal go by in blink of an eye." Chicago Tribune (December 12, 1993) at 7.

The advertising disclosures required by the CLA and Regulation M must be provided "clearly and conspicuously." Section 184(a) of the CLA, 15 U.S.C. § 1667c(a); Section 213.5(c)

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The advertising disclosure requirements in the CLA and Regulation M also recognize what the Commission has observed -- that there is a danger that consumers may rely to their detriment on incomplete or misleading advertising and invest considerable time and effort seeking to consummate a lease transaction, based on representations in the promotion. Consumers may be encouraged by advertising incentives to visit a retailer, such as an automobile dealership, only to discover that the offered lease contains material terms and conditions that the advertisement had not disclosed. Because attracting showroom visitors is an essential element of new car sales, these practices can hinder competition as well as raise consumer protection concerns.

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of Regulation M, 12 C.F.R. § 213.5(c). However, neither the CLA nor Regulation M specifies any particular format for this standard; there is no uniform type size or placement required for compliance. See Section 213.5(c)-1 of the Regulation M Commentary ("Commentary"), 12 C.F.R. § 213.5(c)-1, Supp.I.

In enforcing the advertising requirements, the Commission has sought to balance the need to provide the disclosures in a manner that is comprehensible to consumers with the need for flexibility in the manner in which advertisers meet those disclosure mandates. In the past, and in the absence of specific regulatory guidance on "clear and conspicuous" disclosure, the Commission has applied a flexible standard regarding this issue, for purposes of compliance with the TILA. See Chicago Metro. Pontiac Dealer's Ass'n, 101 F.T.C. 854 (1983) (consent order requiring TILA credit disclosures to appear for at least five seconds in the video portion of television advertisements). In Chicago Metropolitan Pontiac, the complaint charged that the required credit terms were not displayed "clearly and conspicuously," because the advertisements failed to display the required information long enough for viewers to read the material. Id. at 855.

Since that time, and based upon the lack of regulatory standards for clarity and conspicuousness, the five-second standard articulated in Chicago Metropolitan Pontiac has continued as the unwritten rule for both credit and lease advertisements. In this regard, and with respect to lease promotions, the Commission recommends that the Board consider providing through Regulation M and the Commentary specific guidance about what constitutes "clear and conspicuous" advertising. Based on its experience generally regarding advertising issues, the Commission would be pleased to work with the Board in developing guidelines in this area.

Thus, the disclosure requirements contained in the CLA and Regulation M are designed to prevent consumers from being misinformed or misled about lease offers, as well as to foster informed decisionmaking. For example, an advertised offer to lease an automobile for only "$150 per month" could mislead consumers if other, less attractive terms are not stated in that promotion, or if the fact that the transaction involves a lease, rather than a financed purchase, is not stated.[23] Further, an incomplete representation could also divert consumers from another dealer's promotion that may appear less advantageous because it includes all required disclosures, when in fact the latter dealer's lease may be the better offer. There are, therefore, advantages to having the CLA and Regulation M's rules apply uniformly and to all advertising media.

However, to the extent that there are other more efficient means of providing disclosures that are effective in achieving the goals of the CLA and Regulation M, these alternatives certainly should be considered. Indeed, it may be that relatively short disclosures in broadcast advertisements that apprise consumers of the need to seek additional information may be equally, or more, effective than longer, more elaborate ones. In this regard, the Board's suggestion of using a toll-free number to provide some of the required disclosures may warrant consideration if there is enough information in the advertisement to facilitate comparison shopping or otherwise foster an effective alternative.[24]

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[23] Indeed, last year, the Commission accepted a consent agreement with a Kentucky auto dealership that involved both credit and lease advertisements in print, radio and television. Collins Buick and its CEO were charged with making deceptive claims under the Federal Trade Commission Act and with multiple violations of both the TILA and CLA. Collins was charged, inter alia, with stating certain terms in the promotion (such as low monthly payments) but failing to provide all the required CLA disclosures, including the fact that the transaction promoted was a lease. See Collins Buick, Docket No. C-3426 (May 10, 1993).

[24] The Commission does question whether it is advisable to permit all mandatory lease disclosures to be provided through a toll-free number. It is unclear whether consumers could be adequately protected, as well as whether the purposes of the CLA could be served, through this approach. Such an approach could permit lessors to state only the most attractive terms, without disclosing other, less advantageous requirements, in the advertisement. For example, automobile lessors could state "only $99 per month," without disclosing in the advertisement that the

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Adopting such an approach would require a conclusion that consumers could be adequately protected by requiring certain limited information in the advertisement and requiring other more detailed information be provided prior to purchase. In some circumstances, this conceptual approach has been used remedially in Commission orders not involving the TILA or CLA.[25] The Commission has also recognized in other circumstances that different disclosures may be appropriate in different media.[26]

The Commission had made no determination whether this type of approach would be appropriate in the context of the CLA and Regulation M. Clearly, the approach has both advantages and disadvantages. It might allow provision of disclosures at lower cost to the industry, but it might also reduce communication of important information to consumers by shifting to consumers the burden of obtaining that information. Further, consideration must be given to what information is "essential" or "material" and, hence, must be contained in the advertisement itself.[27]

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[24](...continued)
transaction involved a lease, that a $5,000 downpayment was required to qualify, and that only the first 12 payments were $99 per month, while the remaining 24 payments were $300 per month. Such an approach could mislead consumers and seriously detract from comparison shopping.

[25] See, e.g., Dollar Rent-A-Car Systems, Inc., C-3421 (March 29, 1993), and Value Rent-A-Car, Inc., C-3420 (March 29, 1993) (price advertisements permitted to disclose that "other" or "additional" charges apply, while telephone and rental location discussions must include disclosure of actual cost of additional charges); Southwest Sunsites, Inc., 105 F.T.C. 7 (1985), aff'd, 785 F.2d 1431 (9th Cir.), cert. denied, 479 U.S. 828 (1986) (brief disclosure regarding risk in land purchases allowed in radio, TV and short print advertisements, while more detailed disclosures required in larger print advertisements, promotional materials and oral sales presentations).

[26] Id., 105 F.T.C. 7 (1985). See also Sorga, Inc., 97 F.T.C. 205 (1981) (more detailed disclosures required in print advertisements for contraceptive product, while fewer and more abbreviated disclosures allowed in TV and radio advertisements; radio advertisement disclosure shorter than TV advertisement disclosure).

[27] This approach could require inclusion in the advertisement of those items determined to involve critical costs and terms of the lease, such as the downpayment and complete payment schedule.

These and other costs, benefits and considerations would need to be weighed carefully in making such a change to Regulation M.

If the Board decides that the advertising disclosures currently required by the CLA and Regulation M should be modified, the Board may wish to consider conducting consumer research on these issues, including the comprehensibility of any proposed changes. It may want to ascertain how well the current disclosure requirements are achieving the goals of the CLA and what specific types of modifications to these disclosures might achieve these goals even more efficiently.

C. Segregation of Leasing Disclosures

The CLA, unlike most consumer credit provisions of the TILA, does not require that the required disclosures be segregated from contractual information and other items that the lessor provides. The Board has asked whether the absence of a segregation requirement limits the disclosures' effectiveness in meeting the consumer protection goals of the CLA. The Board has asked whether a segregation requirement should be proposed for Regulation M.

Some consumers have telephoned the Commission's staff regarding their leases and complained of difficulty in understanding their contracts. Some have expressed surprise at how leases operate. Other consumers have confused leases with credit transactions and had difficulty locating information that would clarify the specific requirements applicable to their lease.[28] There is, of course, no one place that the disclosures must appear, and many lessors intersperse lease disclosures with related contractual provisions.

Leases are distinct from financing, although they may have some similar provisions.[29] Generally, however, different types

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[28] Some consumers have made statements to the effect that "But my loan [or credit agreement] doesn't work that way." Other consumers have indicated that they could not locate the lease disclosures and asked the Commission's staff where they could be found on the lease form.

[29] For example, both credit and lease obligations describe the vehicle model and type, usually at the beginning of the form. Both credit and leases state the downpayment and the payment schedule (the number and amount of periodic -- usually monthly -- payments) near the top or on the front of the contract. Both credit contracts and leases also discuss default

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of charges may be imposed on leases than credit plans. Certainly, a clear understanding of those charges can foster greater appreciation of the true and complete obligation under consideration and can also foster comparison shopping.

In contrast, Regulation Z imposes a segregation requirement for most credit disclosures.[30] Thus, consumers can refer to one section of their credit form to ascertain the costs and terms of their credit transaction. This requirement serves to facilitate understanding of the credit transaction being considered and enhance comparison shopping among competing lenders. As a result, even if other contractual information is included on the same form, the credit disclosures required under the TILA and Regulation Z are prominent and can be easily discerned.

From the standpoint of consumer protection, there appears to be no advantage to permitting lease disclosures to be interspersed in a contractual document. Indeed, segregation of lease disclosures could benefit consumers by making the information provided readily apparent and easily accessible. Moreover, certainly in the motor vehicle industry -- where consumer leases are becoming more and more common -- consumers may be considering both credit and lease transactions at the same time.[31] In this context, segregation of the disclosures could clarify, in leases as it already does for credit plans, the transaction's specific costs and terms. It would also highlight that the obligation being signed is, in fact, a lease.

In determining the particular format applicable to a segregation requirement, the Board may also wish to consider conducting consumer research on the most effective approach. This research could be particularly helpful in ensuring that any

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[29](...continued)
or delinquency, impose a charge for late payments, and discuss repossession of the vehicle.

[30] See, e.g., Section 226.17 of Regulation Z, 12 C.F.R. § 226.17 (regarding closed-end format requirements).

[31] In discussions with the Commission's staff, some consumers have indicated that they first sought to finance an automobile purchase, but after talking with the dealer's sales personnel, they ultimately decided on leasing. Other consumers have discussed both credit and lease plans with retailers (primarily automobile dealers) and became confused when they ultimately signed the contractual documents. Although these consumers thought they had agreed to financing, they actually signed a lease agreement.

revised disclosure requirements under Regulation M are useful to less financially sophisticated consumers.[32] The Commission also has experience regarding disclosure format requirements, and it would also be pleased to work with the Board on this issue.

However, adding a segregation requirement for leases would impose a one-time additional cost on lessors, primarily related to the redesign, reprinting and redistribution of their lease forms.[33] The Board may, therefore, wish to obtain information on the extent of these costs in considering this change; if it chooses to amend Regulation M to require segregation of disclosures, it should provide sufficient lead time for the leasing industry to implement these changes.

The Commission appreciates your consideration of these views and looks forward to working with the Board in its continuing review of Regulation M.

By direction of the Commission.

Donald S. Clark
Secretary

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[32] The Commission notes that the Food and Drug Administration has recently conducted consumer research as a basis for changes in the format of required disclosures on food labels. See 58 Fed. Reg. 2079, 2115 (January 6, 1993).

[33] Of course, lessors periodically revise their lease forms to incorporate new programs and address changing state requirements.