
PRESERVATION OF CONSUMER CLAIMS AND DEFENSES

(HOLDER IN DUE COURSE)

OVERVIEW

Overview

The rule often referred to as the "holder in due course" rule is actually titled "Preservation of Consumer Claims and Defenses." It is a rule issued by the Federal Trade Commission and applies to entities that sell and finance consumer goods. The rule provides that anyone purchasing the credit instrument does so subject to all claims and defenses that the consumer might have against the seller of goods.

The rule eliminates the purchaser's right to claim "Holder in Due Course" status. As a holder in due course, the holder of the note was immune from the consumer's claims and defenses. The rule prevents the creation of sham arrangements between sellers and purchasers of notes (often a related party) that were designed for the sole purpose of cutting off the consumer's ability to sue for damages under the note.

Exemptions

Any seller who has taken or received an open end consumer credit contract before November 1, 1977, is exempt from the requirements of 16 CFR part 433 with respect to that contract, provided the contract does not cut off consumers' claims and defenses.

Associated Risks

Compliance risk can occur when the credit union fails to implement the necessary controls to comply with the Preservation of Consumer Claims and Defenses rule.

Additional Information

Additional information can be obtained from the Federal Trade Commission online at <http://www.ftc.gov>

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OPERATIONAL REQUIREMENTS

Disclosures/Notices

- The consumer credit contract must contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

- The creditor must not accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Enforcement / Liability

Administrative Enforcement Authority

The Federal Trade Commission is responsible for enforcement in all credit unions.

Penalties and Liabilities

There are no penalties or liabilities in the regulation.