

FS Regulatory Briefs*

Federal Regulators Issue New Credit Card Rules

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Target Audience: Banks and Credit Card Companies

On December 18, 2008, Federal Regulators issued new rules that will significantly impact the credit card industry. The Federal Reserve Board (Board), Office of Thrift Supervision (OTS), and National Credit Union Association (NCUA) have concurrently issued final rules under the Federal Trade Commission Act banning certain credit card practices. The far reaching rules would prohibit unfair practices including limiting interest rate increases, preventing certain payment allocation methods, and banning "two-cycle billing" interest calculations.

The Federal Reserve also adopted comprehensive final rules under Regulation Z, Truth in Lending, which will revamp the disclosures that credit card companies must provide to consumers. According to Federal Reserve Chairman Ben Bernanke "the revised rules represent the most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts. These protections will allow consumers to access credit on terms that are fair and more easily understood."

However, at a time when significant efforts are focused on promoting credit availability, industry advocates argue that the new rules go too far and may further tighten consumer's access to credit. The new rules go into effect on July 1, 2010.

Unfair Credit Card Practices

The Board, OTS, and NCUA have exercised their authority under section 5(a) of the Federal Trade Commission Act to prohibit unfair or deceptive acts or practices. The final rules prohibit institutions from engaging in certain acts or practices in connection with consumer credit card accounts including:

- *Time to make payments* - Creditors must allow consumers a reasonable time to make payments. Rule provides for a "safe harbor" if periodic statements are provided at least 21 days in advance of the payment due date
- *Payment Allocation* - Payments made in excess of the minimum payment must be applied first to balances with the highest interest rates or pro rata among all balances.
- *Rate Increases* - Requires the disclosure at account opening of all interest rates that will apply to the account and prohibits increases in those rates except in certain circumstances such as: the operation of an index with variable rate plans; consumer is more than 30 days delinquent; and for new transactions - by providing at least 45 days advance notice.
- *Two-cycle Billing* - Prohibits calculating interest utilizing the practice commonly referred to as "two-cycle billing" where interest is calculated using account balances for days in the previous and current billing cycles.
- *Subprime Cards* - Prohibits the financing of fees for the issuance or availability of credit (e.g. account-opening fees or membership fees) if charges assessed during the first 12 months would exceed 50 percent of the initial credit limit.

Credit Card Disclosures

The final rules include comprehensive changes to the disclosures consumers must receive in connection with credit card accounts and other revolving (non home-secured) credit plans. This includes changes to the format, content, and timing of applications and solicitations and for the disclosures that consumers

receive at account opening, with their monthly periodic statements, and for account changes.

- *Applications and Solicitations* - Significant changes have been made to the disclosures that must accompany credit and charge card applications and solicitations. The disclosures must be provided in the form of a table that summarizes key account terms. Changes include:

- New format requirements for the summary table including rules regarding type size, use of boldface type for certain key terms, and placement of information.
- Content revisions including disclosure of the duration that penalty rates may be in effect, shorter disclosure relating to variable rates, revised grace period disclosures, and reference to education materials on the Board's Web site.

- *Account Opening Disclosures* - Requirements for cost disclosures provided at account opening are revised with the goal to make the information more conspicuous and easier to read. This includes:

- Disclosing certain key terms in a summary table that is substantially similar to the table required for applications and solicitations.
- New rules regarding how charges are disclosed. The final rule specifies the charges that creditors must disclose in writing (interest, minimum charges, transaction fees, annual fees, and penalty fees), which must be listed in the summary table. The rule also permits the disclosure of other less critical charges orally or in writing before the consumer agrees to the charge

- *Periodic Statement Disclosures* - Revisions have been made to the disclosures that must be on periodic statements. Changes include:

- Interest charges and fees must be grouped separately, with a monthly total for each. Interest charges and fees must also be identified by type (for example, interest on

purchases or cash advance or late payment fee).

- Requirement to disclose an "effective APR" has been eliminated.
- New disclosure of the effect of making only the minimum required payment on the time to repay balances as required by the Bankruptcy Abuse Prevention and Consumer Protection Act.

- *Change in Terms* - Expands the circumstances under which consumers receive written notice of changes in terms and increases the amount of time these notices must be sent before the change becomes effective. This includes:

- Increasing advance notice before a change can be imposed from 15 to 45 days.
- Requiring 45 days' prior notice before the creditor can increase a rate due to the consumer's delinquency or default.
- When a change-in-terms notice accompanies a periodic statement, requiring a tabular disclosure on the front side of the periodic statement of the key terms being changed.

- *Advertisements* - Permits advertisements to refer to a rate as "fixed" only if the advertisement specifies a time period for which the rate is fixed or if the rate will not increase for any reason while the plan is open.

- *Other Requirements* - The final rule defines 5 p.m. as a reasonable cut-off hour for mailed payments to be considered timely received on the due date. The final rule also requires creditors that do not accept mailed payments on the due date, such as weekends or holidays, to treat a mailed payment received on the next business day as timely.

Conclusion

The new rules will require institutions to undertake significant effort to assess the impact of the changes and fully implement by the effective date. In the interim, Congress may impose even stricter credit card protections. House Financial Institutions and Consumer Credit Subcommittee Chairwomen Rep. Carolyn Maloney indicated that she still plans to pursue credit legislation when the Congress reconvenes.

In addition, Senate Banking Committee Chairman Chris Dodd, indicated that he plans to reintroduce the Credit Card Accountability, Responsibility and Disclosures Act. Senator Dodd indicated in a statement that "This comprehensive legislation bans a number of practices that the federal regulators do not."

We will continue to monitor legislative and regulatory activity in this area and will communicate any key developments to our clients.

Additional Information

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