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Inside

A Federal Reserve System publication with a focus on consumer compliance issues

Disclosure Requirements for Reverse Mortgages

By Alan Dombrow, Examining Officer, and Ken Shim, Senior Examiner, Federal Reserve Bank of New York

In a previous issue of *Consumer Compliance Outlook*, John S. Insley from the Federal Reserve Bank of Richmond discussed a fast-growing credit product called a reverse mortgage and its potential compliance risks.[1] This article will review the disclosure requirements under Regulation Z for reverse mortgage transactions and also explain the steps in computing the total annual loan cost rate, or TALC rate, required by Regulation Z using the examples found in Appendix K to Regulation Z.

What is the TALC rate?

The TALC rate is an annual percentage cost of a reverse mortgage. Unlike the annual percentage rate (APR), which takes into account only the finance charges in a credit transaction, the TALC rate considers all costs, which is why it is named the total annual loan cost. In addition to finance charges, the TALC rate may reflect other costs, such as annuity premiums, appraisal fees and other closing costs, and a percentage of any appreciation in the consumer's house.

The following scenario illustrates the difference between an APR and the TALC in calculating the amount financed.

	APR	TALC
Loan requested	$105,000	$105,000
Nonfinance charges financed	3,000	3,000
Prepaid finance charges	2,000	2,000
Loan amount	$110,000	$110,000
Nonfinance charges financed		**-$3,000**
Prepaid finance charges	-$2,000	-$2,000
Amount financed	**$108,000**	**$105,000**

The amount financed for the APR is higher because only the prepaid finance charges are subtracted from the $110,000 loan amount, whereas the

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[1] John S. Insley, Jr., "Reverse Mortgages and Consumer Protection," *Consumer Compliance Outlook* (Third Quarter 2008). The article is available at http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2008/third-quarter/q3_01.cfm.

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Managing Consumer Compliance Risks in Today's Economic Environment

By Phyllis L. Harwell, LFI/LBO and Complaints Manager, Board of Governors of the Federal Reserve System

> *"The current environment certainly presents some fundamental challenges for banking institutions of all types and sizes. Their boards of directors and senior management, who bear the responsibility to set strategy and develop and maintain risk management practices, must not only address current difficulties, but must also establish a framework for the inevitable uncertainty that lies ahead. Notably, the ongoing fundamental transformation in financial services offers great potential opportunities for those institutions able to integrate strategy and risk management successfully, and I will argue that survival will hinge upon such an integration in what I will call a 'strategic risk management framework.' "* [1]
>
> Former Governor Randall S. Kroszner, "Strategic Risk Management in an Interconnected World," at the Risk Management Association Annual Risk Management Conference, Baltimore, Maryland, October 20, 2008, and the National Conference on the Securities Industry, New York, New York, October 30, 2008.

COMPLIANCE RISK POLICY BACKGROUND AND HIGHLIGHTS

On October 16, 2008, the Board of Governors of the Federal Reserve System issued a policy on "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles."[2] The policy recognizes compliance as a risk for which the principles of sound risk management apply to all banking organizations. It endorses the principles set forth in Basel's April 2005 paper entitled "Compliance and the Compliance Function in Banks" and clarifies Federal Reserve expectations regarding compliance risk management and oversight at certain large, complex banking organizations. While the policy focuses on banking organizations with $50 billion or more in consolidated total assets, smaller entities will find the policy helpful when designing their compliance risk management programs.

The new compliance risk policy highlights and expands upon three key areas noted in the Basel paper: independence of compliance staff, compliance monitoring and testing, and responsibilities of the board of directors and senior management. This article highlights the policy's key principles.

Independence of Compliance Staff

Compliance staff should be independent of the business lines for which they have compliance oversight. Accountability should exist between corporate

[1] The full speech is available at http://www.federalreserve.gov/newsevents/speech/kroszner20081020a.htm.

[2] The policy is available at http://www.federalreserve.gov/boarddocs/srletters/2008/sr0808.htm.

compliance staff and compliance staff in the business lines. Compliance staff in the business lines should either directly or indirectly report to corporate compliance. In addition, the ultimate authority for compliance matters, compliance staff, and budgeting should reside with corporate compliance to avoid conflicts of interest.

Compliance Monitoring and Testing

The scope and frequency of monitoring and testing should be based on a comprehensive risk assessment. These risk assessments should be completed for all business lines and staff functions such as human resources, information systems, or other areas responsible for ensuring compliance with applicable laws and regulations, as appropriate. The risk assessments should be based on the overall compliance risk associated with a particular business activity and should consider the inherent level of risk, as well as the controls in place to mitigate the risks. If compliance testing is performed solely by the internal audit function, areas with higher compliance risks should not be adversely affected by overall lower risk ratings of an audit entity.

Responsibilities of the Board of Directors and Senior Management

The board and senior management should ensure that all employees understand the importance of compliance through performance management, compensation, and even disciplinary action, when necessary. The board should ensure that appropriate incentives and compensation are in place to effectively implement the compliance program. In addition, the board should ensure that the corporate compliance function has a prominent status within the organization. Senior management should communicate and reinforce the compliance culture established by the board.

As former Federal Reserve Governor Randall Kroszner stated, institutions must be able to integrate strategy and risk management successfully. Likewise, institutions must be able to integrate compliance risk management, including consumer compliance risks, into their strategy and ultimately their daily operations. Compliance risk management, unlike other types of risks such as market and credit risk, is not easily quantified, a fact that often makes it difficult to monitor and provide adequate reports to senior management and the board of directors.

Nonetheless, many larger financial institutions have created models to manage and quantify compliance risks as evidenced through supervisory oversight. The models differ among the institutions with regard to compliance risk management and oversight, compliance independence, monitoring activities, and testing activities. While models were in varying degrees of maturity, none rose to the level of "better practices and expectations" in their totality; however, two important elements of a successful compliance management program stood out: a culture of compliance and a firm-wide risk management approach.

Culture of Compliance. A successful compliance risk management program starts at the "top of the house." The board and senior management set the tone of compliance for the organization. They must convey a culture of compliance not only in words but also in actions. Culture is also evidenced by the organization's risk appetite, the stature of corporate compliance, the emphasis on full compliance, the compensation of compliance staff, and the penalties for noncompliance, to name a few.

> THE BOARD AND SENIOR MANAGEMENT SHOULD ENSURE THAT ALL EMPLOYEES UNDERSTAND THE IMPORTANCE OF COMPLIANCE THROUGH PERFORMANCE MANAGEMENT, COMPENSATION, AND EVEN DISCIPLINARY ACTION, WHEN NECESSARY.

Firm-Wide Risk Management. An effective firm-wide risk management program includes aligning risk appetite and strategy, enhancing risk response decisions, reducing losses, and identifying and managing risks across business units or entities. It became evident following the recent economic events that institutions

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The Regulation Z Amendments for Open-End Credit Disclosures

By Kenneth J. Benton, Consumer Regulations Specialist, Federal Reserve Bank of Philadelphia

In 2004, the Board of Governors of the Federal Reserve System (Board) initiated a comprehensive review of Regulation Z, the Board's implementing regulation for the Truth in Lending Act (TILA), with the principal goal of producing revised disclosures "that consumers will be more likely to pay attention to, understand, and use in their decisions, while at the same time not creating undue burdens for creditors."[1] Because of the regulation's complexity, the Board divided the project into two phases: the open-end credit review (excluding home-secured open-end credit) followed by the reviews of home-secured open-end credit and closed-end credit.

After the Board completed its review and its revision of open-end credit disclosures, including extensive consumer testing, it published a rulemaking notice of the proposed amendments in the *Federal Register*.[2] The Board revised the proposal after reviewing numerous public comments and considering its effect on the May 2008 proposal to amend Regulation AA to define certain credit card practices as unfair or deceptive. On December 18, 2008, the Board's extensive work on this complex project came to fruition when it published final rules of the amendments to Regulation AA for prohibited credit card practices and to Regulation Z's open-end credit sections.[3] The effective date for both final rules is July 1, 2010.

The Regulation Z amendments focus on five areas of open-end credit: (1) credit and charge card application and solicitation disclosures; (2) account-opening disclosures; (3) periodic statement disclosures; (4) change-in-terms notices; and (5) advertising provisions. To ensure that consumers understand the revised disclosures, the Board retained Macro International, Inc. (Macro), a research and testing consultant, to conduct extensive consumer testing of existing open-end credit disclosures and the Board's proposed changes.[4] Many changes were made to the disclosures based on feedback from the testing.

The Regulation Z amendments will be reviewed in two installments. In this issue, we will discuss the extensive changes to credit card application and solicitation disclosures under §226.5a of the regulation. In the Second Quarter 2009 issue, we will discuss the remaining changes for account-opening disclosures, periodic statement disclosures, change-in-terms notices, and advertising.

CREDIT AND CHARGE CARD APPLICATION AND SOLICITATION DISCLOSURES

Section 226.5a of Regulation Z requires credit and charge card issuers[5] to provide information to consumers at application and solicitation about key costs and terms. The final rule contains significant changes for these disclosures. Regulation Z requires card issuers to disclose key costs and terms in a prominent table known as the Schumer box.[6] The final rule changes the

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[1] 74 Fed. Reg. 5246 (January 29, 2009), available at: http://edocket.access.gpo.gov/2009/pdf/e8-31185.pdf

[2] The Administrative Procedure Act requires federal agencies to publish their proposed rulemakings in the *Federal Register* to provide notice to the public and to allow comments by interested parties.

[3] The Board's December 18, 2008, announcement, with links to both of the final rulemakings, is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm. In a separate article on page 6, we discuss the Regulation AA final rule prohibiting unfair credit card practices.

[4] Macro prepared three detailed reports about its testing: 1) "Design and Testing of Effective Truth-in-Lending Disclosures" (May 16, 2007) http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf; 2) "Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study," (December 15, 2008) http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf; and 3) "Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research,"(December 15, 2008) http:/www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a8.pdf.

[5] A "charge card" is a type of credit card in which the full balance is due upon receipt of the billing statement.

Schumer box requirements with respect to disclosures for penalty rates, fees, balance computation method, variable-rate information, grace period, and subprime credit cards. In addition, the final rule requires card issuers to make a reference in the Schumer box to the Board's consumer credit education website. These changes are discussed below.

Penalty Rates

Section 226.5a(b)(1) currently requires card issuers to disclose in the Schumer box annual percentage rates (APRs) applicable to the account for purchases, cash advances, and balance transfers. Many credit cards specify different APRs for different card transactions, such as a purchase APR, a cash advance APR, and a high-rate penalty APR that is triggered when a cardholder defaults. The current regulation does not require issuers to use specific terminology to identify a penalty APR. Many issuers use the term "default APR." The current regulation also requires that the circumstance triggering a penalty APR be disclosed outside the Schumer box. At their option, issuers may include outside the Schumer box an explanation of the period for which the penalty rate will remain in effect, such as "until you make three timely payments."

The final rule requires card issuers to identify inside the Schumer box (1) the penalty APR using the specific term "penalty APR," (2) a brief description of the circumstances that may trigger the penalty rate; and (3) a brief description of how long the penalty rate will remain in effect. These changes resulted from consumer testing, which revealed that many consumers do not understand the concept of a "penalty APR" when the term "default APR" is used to describe it but are able to comprehend it when the term "penalty APR" is used. Testing also revealed that many consumers do not read information outside the Schumer box because they do not believe it is important. As a result, the events triggering default pricing must now be disclosed inside the box. Also, the Board believed that information about how long the penalty rate may apply could help consumers better understand the consequences of triggering the penalty rate. Model form G-10(B) provides an example below.[7]

Fees

Section 226.5a(a)(2)(ii) currently requires card issuers to disclose cash advance fees, late payment fees, over-the-limit fees, and balance transfer fees in solicitations

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Example from Model Form G-10(B) for Credit Card Applications and Solicitations

Interest Rates and Interest Charges	
Annual Percentage Rate (APR) for Purchases	**8.99%** to **19.99%** when you open your account, based on your creditworthiness. After that, your APR will vary with the market based on the Prime Rate.
APR for Balance Transfers	**15.99%** This APR will vary with the market based on the Prime Rate
APR for Cash Advances	**21.99%** This APR will vary with the market based on the Prime Rate
Penalty APR and When it Applies	**28.99%** This APR may be applied to your account if you: 1) Make a late payment; 2) Go over your credit limit twice in a six-month period; 3) Make a payment that is returned; or 4) Do any of the above on another account that you have with us. **How Long Will the Penalty APR Apply?:** If your APRs are increased for any of these reasons, the Penalty APR will apply until you make six consecutive minimum payments when due and do not exceed your credit limit during that time period.

[6] The box is named after New York Senator Charles Schumer, who introduced the bill in Congress (the Fair Credit and Charge Card Disclosure Act of 1988) that amended TILA to require the use of a table format for these disclosures.

[7] The model forms are available at http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm.

Final Rules on Credit Card and Overdraft Practices

By Barry L. Cutler, Consumer Regulations Specialist, Federal Reserve Bank of Philadelphia

> *"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."*
>
> — Federal Reserve Chairman Ben S. Bernanke, December 18, 2008[1]

On December 18, 2008, the Board of Governors of the Federal Reserve System (Board), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (the agencies) jointly announced a final rule[2] banning five unfair credit card practices using their rulemaking authority under §18(f)[3] of the Federal Trade Commission Act (FTC Act) to prohibit unfair or deceptive acts or practices (UDAP) by banks, savings and loan associations, and federally chartered credit unions, respectively.[4] The rulemaking was closely followed by consumers, the banking industry, other regulators, Congress, and the media. The Board received more than 60,000 comments on the proposal, the highest number the Board has ever received on a rulemaking proposal. The final rule is effective July 1, 2010.

On the same day, the Board announced three complementary consumer protection rulemakings: 1) a final rule under Regulation Z, the implementing regulation for the Truth in Lending Act (TILA), making comprehensive changes to the regulation's open-end credit sections (excluding home-secured open-end credit); 2) a final rule under Regulation DD, the implementing regulation for the Truth in Savings Act, requiring new disclosures for financial institutions that offer overdraft protection services on deposit accounts; and 3) a rulemaking proposal under Regulation E, the implementing regulation for the Electronic Fund Transfer Act, prohibiting two overdraft protection practices. This article will review the events leading up to these rulemakings and highlight the major changes under the final rules, except for the Regulation Z amendments, which are discussed in detail in a separate article on page 4.

FROM PROPOSAL TO FINAL RULE

The agencies' rulemaking notice discusses the events that influenced their decision to exercise their UDAP rulemaking power to prohibit unfair acts and practices. For the Board, this process began with its project to conduct a comprehensive review and update of Regulation Z. To assist with the review, the Board retained Macro International, a research and testing consul-

> **Although the testing assisted the Board in developing improved disclosures, the testing also identified the limitations of disclosure, in certain circumstances, as a means of enabling consumers to make decisions effectively.**

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[1] http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm

[2] *Id.* While the rulemaking was done jointly, each agency codified its substantially similar version of the final rule in its own regulations. The Board's version is codified in its Regulation AA, 12 C.F.R. §§227.21-227.26.The *Federal Register* notice, 74 Fed. Reg. 5498 (January 29, 2009), is available at http://edocket.access.gpo.gov/2009/pdf/E8-31186.pdf.

[3] http://www4.law.cornell.edu/uscode/html/uscode15/usc_sec_15_00000057---a000-.html

[4] The rules do not apply to credit cards issued by state-chartered credit unions and nondepository institutions. The FTC enforces UDAP compliance for those institutions, and it did not participate in the rulemaking.

tant, to conduct consumer testing of the regulation's existing disclosures. Testing revealed that consumers' understanding of many of the disclosures could be enhanced by modifying their layout and wording.

Testing also revealed the limitations of disclosure-based consumer protection, namely, that it is not always possible to disclose a complex credit practice in a meaningful manner that most consumers can understand. Disclosure-based protection assumes that if the terms and conditions of a product or service are properly disclosed, consumers can make informed decisions. However, consumers cannot make informed decisions about products or services whose terms and conditions they do not understand and that are too complex to explain through disclosure. As the Board noted in the final rule: "Although the testing assisted the Board in developing improved disclosures, the testing also identified the limitations of disclosure, in certain circumstances, as a means of enabling consumers to make decisions effectively."[5]

A second influence on the Board's decision to consider using its UDAP rulemaking authority was the extensive public comments it received in response to its proposed amendments in June 2007 to the open-end credit sections of Regulation Z. Many commenters "urged the Board to take additional action with respect to a variety of credit card practices, including late fees and other penalties resulting from perceived reductions in the amount of time consumers are given to make timely payments, allocation of payments first to balances with the lowest annual percentage rate, application of increased annual percentage rates to pre-existing balances, and the so-called two-cycle method of computing interest."[6]

The OTS was also considering exercising its UDAP rulemaking authority for the institutions it regulates. In August 2007, it published an advance notice of proposed rulemaking to determine whether it should expand its current UDAP prohibitions to include rules for credit cards, mortgage lending, gift cards, and deposit accounts.[7] During the comment period, the OTS heard from consumers and some members of Congress, who urged the OTS to adopt the "principles-based standards" used by the FTC for its credit card rulemaking. Commenters also suggested that the OTS specifically address certain practices, including universal default, over-the-limit fees caused solely by penalty fees, payment allocation rules, subprime cards with high fees and small credit limits, and payment cut-off times.

The agencies also obtained additional information about credit card practices by examining their consumer complaint files for the institutions they supervise, by conducting outreach with industry and consumers, by reviewing several studies of credit card practices (such as the 2006 U.S. Government Accountability Office report *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*),[8] and by monitoring several congressional hearings held in 2007 about credit card practices.

The agencies recognized the importance of consistency in their FTC Act regulations for credit cards. Credit card consumer protections should not vary simply based on the charter of the card issuer. As a result, they decided to jointly participate in an FTC Act rulemaking in May 2008. On December 18, 2008, they announced their joint final rule to prohibit five unfair credit card practices. The details are discussed below.

REGULATION AA: FIVE PROHIBITED UNFAIR CREDIT CARD PRACTICES

§227.22: Unfair Time to Make Payment

The final rule provides that card issuers cannot treat a payment as late for any purpose unless the consumer was given a reasonable amount of time to make payment. To ease the compliance burden, the rule contains a safe harbor for card issuers that mail or deliver periodic statements at least 21 days before the payment due date. The Official Staff Commentary for §227.22 clarifies that treating a payment as late "for any purpose" includes negative reporting to consumer reporting agencies, imposing any kind of fee, and increasing a cardholder's annual percentage rate (APR).

The rule addresses the problem experienced by some consumers who receive their credit card periodic statements too close to the payment due date, without sufficient time to review the charges and mail the payment, taking into account delays caused by mail

[5] 74 Fed. Reg. 5499

[6] *Id.*

[7] http://edocket.access.gpo.gov/2007/pdf/E7-15179.pdf

[8] http:/www.gao.gov/new.items/d06929.pdf

delivery. While the industry protested that the rule was unnecessary because many consumers check their statements online and pay their bills electronically or by telephone, the agencies noted that their rules are designed to protect all consumers and that a large number of consumers still pay their bills by mail.

One complexity the agencies had to address in fashioning this rule is a provision in §163(a) of TILA stating that card issuers offering a grace period to avoid finance charges must allow at least 14 days between the time periodic statements are mailed and payments are due. As noted above, the new rule concerning time to make payment establishes a safe harbor if the issuer mails the periodic statement at least 21 days before the due date. Thus, card issuers theoretically could have two deadlines for consumers on the periodic statement: one for the grace period to avoid finance charges (at least 14 days) and one to avoid a late fee (21-day safe harbor). The final rule states that issuers can identify two different deadlines on the periodic statement, though the agencies anticipate that many issuers will simply choose one deadline (21 days or longer) to avoid consumer confusion arising from two separate due dates.

§227.23: Unfair Allocation of Payments

This rule addresses the common card issuer practice of allocating payments first to the balance with the lowest APR when an account has multiple balances and APRs. This practice results in maximizing interest charges that consumers pay. The final rule requires that when a consumer sends a payment that exceeds the minimum payment on an account with multiple balances and APRs, the issuer must allocate the payment in excess of the minimum payment using one of two allocation methods: 1) applying the payment to the balance with the highest APR first and any remaining portion to the other balances in descending order based on the applicable APR; or 2) distributing the payment pro rata to all of the balances, i.e., in the same proportion as each balance bears to the total balance.

To ease the compliance burden for issuers using the pro rata method, the agencies clarify that issuers are not required to deduct the minimum payment from the total balance when allocating among the balances. Issuers also have the option of simplifying the allocation process by applying one of the permissible allocation methods to the entire payment instead of using one allocation method for the minimum payment and another for the excess amount. To further aid compliance, the agencies include examples of payment allocation in the Official Staff Commentary to §227.23 of the final rule.

§227.24: Unfair Acts or Practices Regarding Increases in Annual Percentage Rates

Many card issuers reserve the right in their cardholder agreements to increase a card's APR at any time, for any reason. Such increases can cause hardship for consumers who rely on the APR in effect when selecting a card and when using that card for transactions. To address this concern, the final rule prohibits issuers from raising APRs except in certain circumstances. Specifically, the rule is subject to five exceptions: 1) if a rate disclosed at account opening expires after a specified period of time, issuers may apply an increased rate that was also disclosed at account opening (for example, "5 percent on purchases for six months, then 15 percent"); 2) issuers may increase a rate due to the operation of an index (in other words, the rate is a variable rate); 3) after the first year for a new account, issuers may increase a rate for new transactions but only after complying with the 45-day advance notice requirement in the amended Regulation Z;[9] 4) issuers may increase a rate if the minimum payment is received more than 30 days after the due date; and 5) when an issuer lowers the APR as part of a workout and the consumer defaults, the issuer can restore the APR in effect before the workout.

The final rule will affect credit card deferred interest plans because issuers will no longer be permitted to assess interest retroactively if the consumer does not pay a balance in full by the end of a specified period. However, issuers could offer plans where interest is assessed on purchases at a disclosed rate for a period of time but the interest charges are waived or refunded if the principal is paid in full by the end of the period.

§227.25: Unfair Balance Computation Method

When the Board published its June 2007 proposed

[9] The *Federal Register* notice of the Regulation Z final rule is available at http://edocket.access.gpo.gov/2009/pdf/E8-31185.pdf. The 45-day rule appears in amended §226.9(c), which is discussed on page 5344 of the *Federal Register* notice.

amendments to Regulation Z, it received comments from consumers, consumer groups, and a member of Congress urging the Board to prohibit the double-cycle (also known as two-cycle) billing method. This method averages a cardholder's balances for the last two billing cycles. In certain situations, double-cycle billing results in consumers paying finance charges on balances that were already paid. This occurs when a consumer pays off a balance entirely in one billing cycle, thus avoiding finance charges, but then makes a partial payment on the balance in the next billing cycle. Because double-cycle billing examines two billing cycles, finance charges are being assessed in part on a balance the consumer already paid in full. Double-cycle billing does not harm consumers who avoid finance charges by paying their bills in full each month or revolvers, who always incur finance charges because they make only partial payments on their bill each month.

The final rule prohibits institutions from imposing finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle as a result of the loss of a grace period. An exception is made for adjustments to finance charges as a result of a dispute resolution and adjustments to finance charges resulting from a returned payment for insufficient funds.

§227.26: Unfair Charging of Security Deposits and Fees for the Issuance or Availability of Credit

The last rule addresses concerns about subprime credit cards. These cards, which are marketed to consumers with low credit scores and weak credit histories, typically offer very small credit limits (e.g., $300) and high mandatory fees. The final rule prohibits card issuers from financing security deposits and fees for credit availability (for example, account-opening fees) if the charges assessed during the first 12 months would exceed 50 percent of the initial credit limit. The rule also prohibits issuers from imposing during the first billing cycle security deposits and fees that exceed 25 percent of the initial credit limit. Any additional amounts, up to 50 percent, must be distributed evenly over at least the next five billing cycles.[10]

Four Proposed Rules That Were Not Adopted

Readers who followed the agencies' May 2008 proposal will recall that the agencies had originally proposed prohibiting seven credit card practices and two overdraft protection service practices. Two of the proposed credit card rules and the two overdraft practice rules were not adopted.

> THE FINAL RULE REQUIRES THAT WHEN A CONSUMER SENDS A PAYMENT THAT EXCEEDS THE MINIMUM PAYMENT ON AN ACCOUNT WITH MULTIPLE BALANCES AND APRS, THE ISSUER MUST ALLOCATE THE PAYMENT IN EXCESS OF THE MINIMUM PAYMENT USING ONE OF TWO ALLOCATION METHODS....

The first proposed credit card rule not adopted would have prohibited card issuers from imposing a fee for exceeding a credit limit that results solely from a hold placed on the account. The agencies stated that based on the comments they received, fees resulting from holds on credit card accounts are not a significant issue. The second proposed credit practice concerned "firm offers of credit" under §1681b(c)(1) of the Fair Credit Reporting Act that stated multiple or a range of APRs. The agencies stated that their concerns about these types of offers are sufficiently addressed by the Board's final amendment to §226.5a(b)(1)(v) of Regulation Z, making a separate UDAP rule unnecessary.

Regarding overdraft protection services, the agencies had proposed two rules. The first proposed rule would have prohibited financial institutions from imposing overdraft fees unless consumers were offered a partial or complete opt-out of the service. The sec-

[10] The Board also made a complementary amendment to §226.5a(b)(14) of Regulation Z that requires new disclosures for subprime credit cards during solicitation and application. The new disclosures are discussed on pages 21-22 of the article titled "The Regulation Z Amendments for Open-End Credit Disclosures."

ond proposed rule would have prohibited institutions from imposing an overdraft fee when it resulted solely from a hold placed on an account in excess of the actual transaction amount.

After reviewing comments, the agencies decided that greater consumer protections would be provided if the rules regarding overdraft protection services were adopted by amending Regulation E using the Board's authority under the Electronic Fund Transfer Act rather than by using the agencies' UDAP authority under the FTC Act. For example, state-chartered credit unions are not covered by the agencies' UDAP rulemaking but are subject to Regulation E.

NEW OVERDRAFT PROPOSAL UNDER REGULATION E

The two rules concerning overdrafts that the agencies originally proposed under their UDAP rulemaking authority are now contained in a new Regulation E proposal. The new proposal modifies the proposed UDAP overdraft rule concerning opt-outs. Financial institutions would be prohibited from imposing overdraft fees unless they offered an opt-out but only for overdrafts resulting from ATM withdrawals and one-time debit card transactions. They would not have to offer an opt-out that also applied to checks (as originally proposed). Testing revealed that consumers found overdraft fees acceptable in the context of checks because if they opted out of the check service, the check would not be paid, yet they still would be charged an insufficient funds fee that is generally equivalent to an overdraft fee. Another change is that the new proposal includes, as an alternative approach, an opt-in. Under this approach, institutions could assess overdraft fees only to consumers who affirmatively consented to the service. The Board will review public comments in deciding which approach, if any, to adopt in the final Regulation E rule.

The Board indicated that it would specifically like to receive comments on a number of issues, including 1) whether the scope of the proposed opt-out should be expanded from ATM withdrawals and one-time debit transactions to also include recurring debit card transactions and ACH transactions; 2) whether 30 days is sufficient time to opt out or whether a shorter time frame, such as 15 or 20 days, may be more appropriate; 3) whether the Board should require institutions to provide a toll-free telephone number to ensure that consumers can easily opt out; 4) whether the Board should add examples of methods of opting out that would not satisfy the requirement to provide a reasonable opportunity to opt out, such as requiring the consumer to write a letter to opt out; 5) whether there are more effective means of ensuring that consumers are not discouraged from opting out of an institution's overdraft service for ATM withdrawals and one-time debit card transactions; and 6) an appropriate implementation period for the final rule.

The second rule in the new proposal is similar to the one originally proposed under the FTC Act. It would prohibit financial institutions from imposing an overdraft fee that would not have occurred but for a debit hold placed on funds in the consumer's account that exceeds the actual amount of the transaction. The revised proposal is limited to debit holds placed in connection with transactions for which the actual purchase amount can be determined within a short period of time following authorization (e.g., a gasoline purchase at the pump).

REGULATION DD

Overdraft Disclosure

To help alert consumers to the cost of incurring overdraft services on deposit accounts, the Regulation DD final rule requires financial institutions that offer overdraft services on deposit accounts and provide periodic statements to list on the statement the total amount of overdraft fees and the total amount of returned item fees incurred during the statement period as well as for the calendar year-to-date. The regulation already imposes this requirement for institutions that promote overdraft services. The new rule applies to all institutions offering overdraft services on deposit accounts, regardless of whether they promote the service.

Overdraft Account Balances

The second requirement under the final rule is that when an institution discloses a single account balance through an automated system, such as an ATM receipt, automated telephone banking, or website, it cannot include any of the following in the account balance: the amount of overdraft protection, funds that will be paid by the institution under a service subject to the Board's Regulation Z (e.g., a line of credit), or funds transferred from another account. However, the final rule does permit institutions to list two balances: one with the actual account balance that does not include these funds, and a second balance that includes these funds, provided the institution prominently states that the second balance includes these funds.

CLOSING COMMENTS

This article summarizes the key changes in the new consumer protection rules under the final amendments to Regulations AA and DD as well as the issues raised by the Regulation E proposal. Readers interested in more details can consult the final and proposed rulemaking notices on the Board's website.

Because of the significant changes to these regulations, banks should begin to assess their impact on the banks' systems, and begin working on updating and testing their systems to ensure they are in compliance by the July 1, 2010 effective date. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

CONTINUED FROM PAGE 1...

DISCLOSURE REQUIREMENTS FOR REVERSE MORTGAGES

amount financed for the TALC rate calculation subtracts all charges, including nonfinance charges. Typically, this difference translates to a higher TALC rate compared to the APR.

DISCLOSING REVERSE MORTGAGES

Section 226.33 of Regulation Z requires reverse mortgage creditors to disclose a good faith projection of the total cost of the credit to the consumer in a tabular format similar to the matrix disclosure currently required by the Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM) program, a reverse mortgage insured by the Federal Housing Administration.

The regulation also requires creditors to use the term "total annual loan cost rate" to avoid any confusion with the APR and to more accurately describe the percentage cost of reverse mortgages. In projecting the total cost of credit, TALC rates must be based on three credit transaction periods: two years, a period equal to the youngest consumer's life expectancy, and a period equal to 1.4 times the youngest consumer's life expectancy. Appendix L[2] to Regulation Z provides life expectancy figures based on U.S. Decennial Life Tables published by the Department of Health and Human Services. The regulation also adds an optional loan period that the creditor may disclose equal to one-half of the youngest consumer's life expectancy.

In addition to the loan periods mentioned above, TALC rates must also be based on assumed annual house appreciation rates of 0 percent, 4 percent, and 8 percent. The 4 percent annual appreciation rate comes from HUD's assessment of long-term averages of historical housing appreciation. The 0 percent and 8 percent annual appreciation rates were included to help consumers understand the potential costs and benefits if the dwelling does not appreciate in value at all or if it appreciates at a rate faster than the average.

The projected total cost of credit must reflect all costs and charges to the consumer, including the costs of any annuity that the consumer purchases as part of the reverse mortgage transaction. Some creditors require or allow consumers to purchase an annuity as part of the transaction that immediately, or at some time in the future, supplements or replaces the creditor's payments. The regulation requires that the amount paid by the consumer for the annuity must be included as a cost to the consumer, regardless of whether the purchase is made through the creditor or a third party and regardless of whether the purchase is mandatory or voluntary.

[2] http://edocket.access.gpo.gov/cfr_2008/janqtr/pdf/12cfr226AppL.pdf

All advances made for the benefit of the consumer, including annuity payments, must be reflected in the projected total cost of credit. Also, any shared appreciation or equity that the creditor is entitled to receive pursuant to the credit contract, and any limitation on the consumer's liability, such as equity conservation agreements, must be considered. An equity conservation agreement is an agreement limiting the consumer's liability to a specific percentage of the net proceeds available from the sale of the home. If a contract does not specify a percentage for net proceeds, creditors must assume 7 percent, which approximates the amount paid for typical brokerage fees and other incidental costs.

In addition to the good faith projection of the total cost of the credit as explained above, the regulation requires creditors to provide the following information in a form substantially similar to the model form found in paragraph (d) of Appendix K:[3]

- A statement that the consumer is not obligated to complete the reverse mortgage transaction because the consumer has received the disclosures or has signed an application for a reverse mortgage loan.
- An itemization of loan terms, charges, the age of the youngest borrower, and the appraised property value.
- An explanation of the table of total annual loan cost rates.

The disclosures must be provided to the consumer at least three business days before consummation of a closed-end credit transaction or before the first transaction under an open-end credit plan.[4]

CALCULATING THE TALC RATE

Before discussing an example from Appendix K,[5] four important assumptions must be made in order to calculate the TALC rate:

1) Assume that reverse mortgage transactions begin on the first day of the month in which consummation is estimated to occur. In other words, assume no odd days.

2) For those reverse mortgages in which the consumer controls the timing of advances made after consummation (such as in a credit line), assume that 50 percent of the principal loan amount is advanced and that no further advances are made during the remaining term of the loan. In that regard, the transaction is treated as closed-end credit for TALC rate calculation purposes.

3) For variable-rate reverse mortgage transactions, assume that the initial interest rate will not increase. If the initial interest rate is a discounted rate, the discounted rate must first be applied for the period that it will be in effect. For the remaining term, apply the original rate without the discount to compute the TALC rate, similar to the requirements set forth in section §226.17(c).

4) Assume that all closing and other consumer costs are financed.

The last example in Appendix K [(d)(2), Sample Form] is the combination of a lump-sum advance, monthly advances, and a credit line. The borrower receives a lump-sum advance of $1,000, plus a $301.80 monthly advance at consummation. The borrower will receive a monthly payment of $301.80 for the 12-year term of the loan. In addition, the borrower has a $4,000 line of credit.

Lump-sum to borrower	$1,000
Monthly payments to borrower	$301.80
Total loan costs financed	$5,000
Credit line	$4,000
Contract interest rate	9%
Assumed annual dwelling appreciation rate	4%
Appraised value of property	$100,000
Age of the youngest borrower	75
Estimated loan term	12 years
Equity reserved	7%

[3] http://edocket.access.gpo.gov/cfr_2008/janqtr/pdf/12cfr226AppK.pdf

[4] 12 CFR 226.31(c)(2)

[5] Additional examples are available online at http://www.consumercomplianceoutlook.org.

STEP 1 –
CALCULATE FUTURE VALUE OF ALL ADVANCES

Future Value of All Advances

N	I	PV	PMT	FV
144 months	0.75% (HP 12c) 9% (HP 17bII)		$301.80	?
144 months	0.75% (HP 12c) 9% (HP 17bII)	$1,000 (initial advance)		?
144 months	0.75% (HP 12c) 9% (HP 17bII)	$2,000 (1/2 of credit line)[6]		?
144 months	0.75% (HP 12c) 9% (HP 17bII)	$5,000 (total loan costs)		?

$$I = \frac{\text{9\% contract rate}}{\text{12 months in a year}} = 0.75\%$$

When calculating the future value of monthly payments, the calculator must be set to BEG mode (payments made at the beginning of the month).

For the HP 17bII, the P/YR must be set to 12 (12 payments per year).

FV ($301.80 monthly for 12 years)	=	$78,360.68
FV ($1,000 after 12 years)	=	$2,932.84
FV ($2,000 after 12 years)	=	$5,865.67
FV ($5,000 after 12 years)	=	$14,664.18
FV of all advances	**=**	**$101,823.37**

STEP 2 –
CALCULATE FUTURE VALUE OF THE DWELLING

Future Value of the Dwelling

N	I	PV	FV
12	4%	$100,000	?

I = Assumed annual dwelling appreciation rate

For the HP 17bII, the P/YR must be set to 1 (one payment per year).

FV = $160,103.22

STEP 3 – CALCULATE REPAYMENT AMOUNT

The repayment amount is the lesser of the FV of all advances **($101,823.37)** or the FV of the dwelling minus the equity reserved:
($160,103.22–$11,207.23[7% of FV of dwelling]= **$148,895.99).**

Repayment Amount = $101,823.37

STEP 4 – CALCULATE THE TALC RATE USING THE APRWIN PROGRAM

Below are the entries for the APRWin program:

Loan Information

Amount Financed:	$3,301.80 ($1,000 lump-sum + $301.80 first monthly advance + one-half of $4,000 credit line)
Disclosed APR:	11.03% (If the disclosed TALC rate is being verified, enter the disclosed rate here. If the TALC rate is being calculated, enter an estimated rate, e.g., 1.)
Disclosed Finance Charge:	Leave blank
Loan Type:	Installment Loan
Payment Frequency:	Monthly

Payment Schedule

	Payment Stream #	Payment Amount	Number of Payments	Unit Periods	Odd Days
▶	1	-301.8	143	1	0
	2	**101823.37**	**1**	**144**	**0**

Payment Stream #1 – **The payment amount must be entered as a *negative* value.** The number of payments is the remaining number of advances left after the initial advance at consummation.

Payment Stream #2 – The payment amount is the repayment amount from Step 3.

APR = 11.03% (This is the TALC rate based on the multiple advances to the borrower [$301.80 x 144 = $43,459.20], $1,000 initial advance, $2,000 credit line outstanding, and the $101,823.37 payment.)

[6] For a credit line, the TALC must be based on the assumption that 50 percent of the line of credit is outstanding at closing. TALC rate calculations effectively treat the transaction as a closed-end credit transaction after that.

DISCLOSING REVERSE MORTGAGES

In the previous example, the TALC rate was calculated based on a 12-year loan term with an assumed annual appreciation rate of 4 percent, but that is just one of nine TALC rates that must be disclosed. Section 226.33(c) of Regulation Z requires creditors to disclose TALC rates based on three loan terms as determined by the life expectancy of the youngest borrower in accordance with Appendix J to Regulation Z, and to assume annual appreciation rates of 0 percent, 4 percent, and 8 percent for the dwelling.

Below is the reverse mortgage disclosure for the example. (Note that the TALC rates based on a six-year loan term, which is one-half of the life expectancy of the youngest borrower, are optional):

TOTAL ANNUAL LOAN COST RATE

Loan Terms

Age of youngest borrower:	75
Appraised property value:	$100,000
Interest rate:	9%
Monthly advance:	$301.80
Initial draw:	$1,000
Line of credit:	$4,000

Initial Loan Charges

Closing costs:	$5,000
Mortgage insurance premium:	None
Annuity cost:	None

Monthly Loan Charges

Service fee:	None

Other Charges

Mortgage insurance:	None
Shared appreciation:	None

Repayment Limits

Net proceeds estimated at 93% of projected home sale

Assumed Annual Appreciation	2-year loan term	[6-year loan term]	12-year loan term	17-year loan term
0%	39.00%	[14.94%]	9.86%	3.87%
4%	39.00%	[14.94%]	11.03%	10.14%
8%	39.00%	[14.94%]	11.03%	10.20%

The cost of any reverse mortgage loan depends on how long you keep the loan and how much your house appreciates in value. Generally, the longer you keep a reverse mortgage, the lower the total annual loan cost rate will be.

The table above shows the estimated cost of your reverse mortgage loan, expressed as an annual rate. It illustrates the cost for three [four] loan terms: two years, [half of life expectancy for someone your age], that life expectancy, and 1.4 times that life expectancy. The table also shows the cost of the loan, assuming the value of your house appreciates at three different rates: 0 percent, 4 percent, and 8 percent.

The total annual loan cost rates in this table are based on the total charges associated with this loan. These charges typically include principal, interest, closing costs, mortgage insurance premiums, annuity costs, and servicing costs (but not disposition costs—costs when you sell the home).

The rates in this table are estimates. Your actual cost may differ if, for example, the amount of your loan advances varies or the interest rate on your mortgage changes.

SIGNING AN APPLICATION OR RECEIVING THESE DISCLOSURES DOES NOT REQUIRE YOU TO COMPLETE THIS LOAN.

CONCLUSION

Creditors who fail to comply with the requirements of §226.33 may face civil liability under the Truth in Lending Act. Regulation Z does not provide an accuracy tolerance for TALC rate disclosures, as it does for APR disclosures. As a result, the smallest deviation from the actual rate may trigger a violation.

In a successful action brought by a borrower, creditors may be assessed a penalty in an amount equal to the sum of any actual damage sustained by the borrower, in addition to attorney's fees and court costs. In the case of individual actions, the penalty can be twice the amount of the finance charge (minimum $100, maximum $1,000 for open-end credit; minimum $400, maximum $4,000 for closed-end credit), and in the case of a class action, up to the lesser of $500,000 or 1 percent of the creditor's net worth. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

CONTINUED FROM PAGE 3...

Managing Consumer Compliance Risks in Today's Economic Environment

with a firm-wide risk management approach and independent risk management functions fared somewhat better through the economic crisis.

CONCERNS IN THE CURRENT ECONOMIC ENVIRONMENT

Many financial institutions are engaging in cost-cutting in this tough economic environment. This sometimes results in a reduction in staff in the control functions such as corporate compliance and internal audit. It is important to gauge when reductions are warranted, such as the sale of a business line, versus when the reductions could result in a lack of adequate monitoring and testing and independent oversight. In some cases greater reliance is placed on internal audit to test for compliance if layoffs occur in corporate compliance. As previously mentioned, if compliance testing is performed solely or primarily by the internal audit function, higher risk areas of compliance should not be adversely affected by overall lower risk ratings of an audit entity. In addition, many institutions are outsourcing some compliance functions. All outsourced functions must be closely monitored in the same way institutions monitor any other third-party vendor relationships. The ultimate responsibility for compliance rests with the institution and cannot be delegated to a third party.

SUMMARY

In conclusion, a financial institution should establish and promote a strong culture of compliance and implement a firm-wide compliance risk management program. Even during troubling economic times, it is equally or more important to promote compliance enterprise-wide and ensure that the program is effectively executed by all employees. Cutbacks and cost-cutting measures in the short term could ultimately cost the institution more and lead to greater reputational risk in the long term. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

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On the Docket: Recent Federal Court Opinions*

REGULATION Z - TRUTH IN LENDING ACT (TILA)

Flat finance charge is not unearned interest under §1615 of TILA. *Davis v. Pacific Capital Bank*, 550 F.3d 915 (9th Cir. 2009). The Ninth Circuit held that a flat finance charge assessed on a tax refund anticipation loan (RAL) does not constitute unearned interest under §1615 of TILA. The plaintiff obtained a RAL in the amount of $1,115 from Pacific Capital Bank, for which she was assessed a flat finance charge of $85. The loan agreement provided that if she repaid the loan early, she would not receive a refund of any part of the prepaid finance charge. The plaintiff repaid the loan 10 days early and sought a pro rata refund of the finance charge. When the bank refused, the plaintiff filed suit alleging a violation of §1615 of TILA, which provides that "if a consumer prepays in full the financed amount under any consumer credit transaction, the creditor shall promptly refund any unearned portion of the interest charge to the consumer." After examining TILA's legislative history, the court concluded that §1615's refund requirement applies only to interest charges and not to finance charges. Because the bank's finance charge was a flat fee that did not vary with the amount borrowed, it was not an interest charge. The court therefore affirmed the dismissal of the case.

Intent to breach credit agreement with accurate disclosures does not violate TILA. *Hauk v. JP Morgan Chase Bank USA*, 552 F.3d 1114 (9th Cir. 2009). The Ninth Circuit held that a creditor's intent to act inconsistently with its TILA disclosures does not state a claim under TILA but may be actionable under state law. The plaintiff accepted a credit card balance transfer offer from Chase with a low promotional rate. Chase's TILA disclosures reserved the right to increase the rate because of a late payment. Chase raised the rate the following month because of a prior late payment. The plaintiff filed suit for TILA and state law violations, alleging that Chase had actual or constructive knowledge of the late payment when it made the offer and intended to increase the rate once the offer was accepted. The Ninth Circuit affirmed dismissal of the TILA claim, holding that Chase's intent was irrelevant as long as its disclosures were accurate. Chase's disclosures accurately stated that a past late payment could trigger a rate increase. The court acknowledged that Chase might have waived the right to raise the rate for a late payment if it knew about the late payment when it accepted the offer and did not raise the rate. The court nevertheless concluded that even if Chase had breached the cardholder agreement, the breach would not be actionable under TILA because TILA regulates disclosures and does not substantively regulate consumer credit. The court noted that its approach conflicted with a Third Circuit decision but disagreed with that court's analysis. However, the court reversed and remanded the trial court's dismissal of the plaintiff's California state law claims for consumer protection and false advertising violations because of unresolved fact issues that could potentially allow the plaintiff to prevail on those claims.

Effect of grace period for late fee on payment due date. *Cunningham v. National City Bank*, (No. 08-10936 D. Mass. January 7, 2009). This case examines whether a 10-day grace period for a home equity line of credit (HELOC) to avoid late fees implicitly extends the payment due date by 10 days for determining TILA disclosures about the timing of payments. The borrowers in this case had obtained a $100,000 HELOC from National City Bank (National). In January and February 2008, they made two draws against the HELOC. Because their payment for the first draw was nine days late, National terminated the HELOC. The borrowers filed a class action against National, alleging that its termination of the HELOC violated §226.5b(d)(5)(ii) of Regulation Z, regarding the HELOC disclosure for the timing of payments. They relied on the late fee provision in the note, which provided that late fees would not be assessed if payment were received within 10 days of the due date. They argued that the 10-day grace period to avoid late fees implicitly created a 10-day grace period for the payment due date. The court rejected this argument based on the plain language in the note that clearly defined the due date without any exceptions.

REGULATION X – REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Standing to file RESPA claim. *Carter v. Welles-Bowen Realty, Inc.* 553 F.3d 979 (6th Cir. 2009). The Sixth Circuit ruled that a plaintiff alleging RESPA violations for kickbacks or referral fees has standing to file a lawsuit, even though the plaintiff did not suffer a concrete injury such as an overcharge. The plaintiffs in this class action used the services of WB Realty, a real estate agency, in connection with their real estate purchase. WB Realty referred the plaintiffs to its affiliate, WB Title, to perform settlement services. The plaintiffs sued WB Realty and WB Title, alleging that WB Title was a sham company and that all title work was referred to Chicago Title in exchange for a kickback or fee-splitting in violation of §§8(a) and 8(b) of RESPA. The trial court dismissed the case, finding that the plaintiffs lacked standing because they failed to allege a specific injury. After examining the statute's purpose, its legislative history, its implementing regulations, and general standing principles, the court concluded that Congress intended to confer standing on consumers to file lawsuits for section 8 violations, even if they did not suffer a specific injury. The court therefore reversed the trial court's dismissal of the case.

FAIR CREDIT REPORTING ACT (FCRA)

Furnisher's reporting duty to consumer reporting agencies for disputed debt. *Gorman v. Wolpoff & Abramson*, LLP, 552 F.3d 1008 (9th Cir. 2009). This case examines a furnisher's obligation under §1681s-2(b) of the FCRA to respond to notices from consumer reporting agencies (CRAs) that a consumer disputes a debt. The CRAs notified MBNA that the plaintiff disputed MBNA's listing of his account as charged off. MBNA investigated and responded that the delinquency was not an error. The plaintiff sued MBNA, alleging that it violated §1681s-2(b), which requires a furnisher, after receiving a CRA notice of a consumer's dispute of an account, to investigate and to report the results of the investigation to the CRAs. If the furnisher finds that the information is incomplete or inaccurate, it must report those results to the CRAs. The court affirmed the dismissal of the investigation claim, finding that MBNA's investigation was reasonable. However, the court found that MBNA's failure to notify the CRAs that the consumer continued to dispute the charged-off account could violate §1681s-2(b). The court placed limitations on this claim by stating that simply failing to report a meritless dispute does not give rise to liability "because reporting an actual debt without noting that it is disputed is unlikely to be materially misleading. It is the failure to report a bona fide dispute, a dispute that could materially alter how the reported debt is understood, that gives rise to a furnisher's liability under §1681s-2(b)." The court reversed and remanded the dismissal of the claim.

Permissible purpose for use of consumer report for a closed account. *Levine v. World Financial Network National Bank*, 554 F.3d 1314 (11th Cir. 2009). The Eleventh Circuit held that a CRA's sale of a consumer credit report to a creditor in connection with a closed account did not constitute a willful violation of §1681b of the FCRA. A credit card issuer purchased the credit report of a former customer whose account was closed from Experian. The plaintiff sued Experian and other involved parties, alleging that the sale of a report in connection with a closed account was a willful violation of §1681b, concerning permissible purposes for furnishing a consumer report. The Eleventh Circuit affirmed the dismissal of the case. Under the Supreme Court's decision in *Safeco Ins. Co. of America v. Burr*, 127 S.Ct. 2201, 2208-09 (2007), a plaintiff alleging a willful violation must establish that a company has acted in an objectively unreasonable manner. A company has not committed a willful violation if its interpretation of the FCRA is erroneous but not objectively unreasonable. The court found that the FCRA's text is not a model of clarity and that Experian's interpretation of the FCRA to permit the sale of a consumer report in connection with a closed account was not objectively unreasonable. The plaintiff also argued that Experian subjectively knew that the FCRA did not permit the sale of a consumer report in connection with a closed account. The court rejected this argument because subjective bad faith is not relevant to a willful violation if the company's interpretation of the statute is reasonable.

* Links to the court opinions are available in the online version of *Consumer Compliance Outlook* at http://www.consumercomplianceoutlook.org.

News From Washington: Regulatory Updates

Department of Housing and Urban Development (HUD) delays effective date of new "required use" RESPA final rule.
On January 15, 2009, HUD delayed the effective date of the "required use" section of its RESPA final rule until April 16, 2009. The rule establishes a new definition of "required use" that would effectively prohibit nonsettlement service providers from providing discounts to consumers for using affiliates of settlement service providers. The required use rule was scheduled to become effective on January 16, 2009. The *Federal Register* notice is available at http://edocket.access.gpo.gov/2009/pdf/E9-852.pdf.

HUD provides guidance on implementing SAFE Mortgage Licensing Act.
On January 8, 2009, HUD issued new guidance on how it will interpret state compliance with the SAFE Mortgage Licensing Act (Safe Act). The Safe Act is designed to enhance consumer protection and reduce fraud by encouraging states to establish minimum standards for the licensing and registration of state-licensed mortgage loan originators. The Safe Act also requires the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) to establish and maintain a nationwide mortgage licensing system and registry. The guidance provides that HUD has reviewed the state model bill prepared by the CSBS and AARMR and found that states adopting that bill will be in compliance with the Safe Act requirements. For further information, visit HUD's website at http://www.hud.gov/offices/hsg/sfh/mps/smlicact.cfm.

HUD issues supplemental guidance regarding Hope for Homeowners Program.
On January 6, 2009, HUD issued Mortgagee Letter 2009-3 (ML 09-03), which describes procedures for originating and servicing Federal Housing Administration-insured mortgages authorized under the Hope for Homeowners (H4H) program. The letter incorporates changes to the H4H program made by the Emergency Economic Stabilization Act of 2008 (EESA) by supplementing and modifying Mortgagee Letters 2008-29 and 2008-30 in three ways. First, the letter gives lenders additional flexibility in calculating a borrower's debt-to-income ratio in adjustable-rate mortgage transactions. Second, the letter allows lenders to provide qualifying borrowers with mortgages that have terms between 30 and 40 years. However, in order for the loan to qualify for a securitization pool, the term must be either 30 or 40 years. Third, the letter expands the types of properties eligible under the program to include two-, three-, and four-unit properties, provided that the borrower occupies one of the units as a primary residence. The letter also clarifies previous program requirements. To view the letter, visit HUD's website at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-03ml.doc.

Final interagency questions and answers on community reinvestment issued.
On January 6, 2009, the federal financial institution regulatory agencies (the agencies) announced the publication of the final Interagency Questions and Answers (Q&As) Regarding Community Reinvestment that, among other things, encourages financial institutions to take steps to help prevent home mortgage foreclosures. The questions and answers interpret the agencies' Community Reinvestment Act (CRA) regulations and provide guidance to financial institutions and the public. The agencies proposed the Q&As on July 11, 2007. After considering the comments, the agencies adopted the majority of the Q&As as they were proposed or with revisions in response to the comments. The agencies' announcement is available at http://www.federalreserve.gov/newsevents/press/bcreg/20090106a.htm.

Federal Trade Commission (FTC) reports to Congress on credit report complaint referral program.
On December 29, 2008, in accordance with Section 611(e) of the Fair Credit Reporting Act (FCRA), the FTC submitted its Report on Complaint Referral Program. Section 611(e) of the FCRA directs the commission to transmit certain consumer complaints to the nationwide consumer reporting agencies (CRAs) that are the subject of complaints, obtain information from the CRAs related to resolving those complaints, and sub-

mit a report to Congress about the complaint referral program. The report covers the period from the start of the program in 2004 through the end of 2007. The report is available on the FTC's website at http://www.ftc.gov/os/2008/12/P044807fcracmpt.pdf.

Board of Governors of the Federal Reserve System (Board) approves rules that will better protect credit card users.

On December 18, 2008, the Board approved final rules that will prohibit certain unfair acts or practices and improve the disclosures consumers receive in connection with credit card accounts and other revolving credit plans. The final rules prohibiting certain credit card practices were adopted under the Federal Trade Commission Act and are being issued concurrently with substantially similar final rules by the Office of Thrift Supervision and the National Credit Union Administration. In addition, the Board also adopted extensive changes to Regulation Z dealing with open-end (non-home-secured) plans. For further information on these topics, please refer to the articles that begin on page 4 and page 6, respectively, of this issue. The Board's announcement is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm

Agencies release annual CRA asset-size threshold adjustments for small and intermediate small institutions.

On December 17, 2008, the federal bank regulatory agencies announced the annual adjustment to the asset-size thresholds used to define small bank, small savings association, intermediate small bank, and intermediate small savings association under the CRA regulations. The new asset-size thresholds are as follows: Small bank or small savings association means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than \$277 million. Intermediate small bank or intermediate small savings association means a small institution with assets of at least \$277 million as of December 31 of both of the prior two calendar years and less than \$1.109 billion as of December 31 of either of the prior two calendar years. The joint notice is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081217a.htm.

Agencies issue final rule to implement Unlawful Internet Gambling Enforcement Act.

On November 12, 2008, the Department of the Treasury and the Board announced the release of a joint final rule to implement the Unlawful Internet Gambling Enforcement Act of 2006. The act prohibits gambling businesses from knowingly accepting payments in connection with unlawful Internet gambling, including payments made through credit cards, electronic funds transfers, and checks. The act requires the Board and the Treasury to develop a joint rule in consultation with the Department of Justice. Compliance with the rule is required by December 1, 2009. The notice and final rule are available at http://www.federalreserve.gov/newsevents/press/bcreg/20081112b.htm.

Agencies issue statement on meeting the needs of creditworthy borrowers.

On November 12, 2008, the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision issued a joint press release to emphasize the importance of banking organizations and their regulators working together to ensure that the needs of creditworthy borrowers are met. The news release noted that the Board, the Treasury Department, and the FDIC had recently put into place several programs designed to promote financial stability and to mitigate the effects of current market conditions. These programs make new capital widely available to U.S. financial institutions, broaden and increase the guarantees on bank deposit accounts and certain liabilities, and provide backup liquidity to U.S. banking organizations. These actions are designed to help support responsible lending activities of banking organizations, enhance their ability to fund such lending, and enable banking organizations to better meet the credit needs of households and businesses. All banking organizations are expected to adhere to the principles set forth in this statement. The statement is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

continued from page 5...

The Regulation Z Amendments for Open-End Credit Disclosures

and applications either in the Schumer box or clearly and conspicuously elsewhere in the application or solicitation. The final rule requires these fees to always appear inside the Schumer box because consumer testing revealed that consumers often did not notice fees disclosed outside the table. The amendment also requires disclosures for the following fees: returned payment fee, foreign transaction fee, and a fee for any required insurance, debt suspension, or debt cancellation coverage. See the example from model form G-10(B) below.

The June 2007 rulemaking proposal would have required card issuers that impose penalty fees and penalty rates to cross-reference disclosures about penalty rates with the disclosure for penalty fees. This proposal was not adopted in the final rule because consumer testing suggests that cross-references from penalty fees to the penalty APR did not improve consumers' understanding of the circumstances in which penalty pricing can be applied to their accounts. The Board was also concerned about information overload in light of the testing results.

Balance Computation Method

Regulation Z currently requires issuers to disclose inside the Schumer box the name of the balance computation method used by the card issuer to calculate the balance for purchases on which finance charges are computed. In the final rule, issuers must now disclose this information directly below the box because testing revealed that consumers do not rely on this information when shopping for a credit card. The Board did not want to include information inside the box that is not important to consumers and that would detract from information that is important.

Variable-Rate Information

Section 226.5a(b)(1)(i) of the regulation and comment 5a(b)(1)-4 of the Official Staff Commentary currently require card issuers whose applications or solicitations include a variable APR to disclose inside the Schumer box that a variable APR is used, how it is determined, the index or formula used to make adjustments, and the amount of any margin added. Additional information about variable rates may be disclosed outside the box.

Example from Model Form G-10(B) for Credit Card Applications and Solicitations

Fees	
Annual Fee	**None**
Transaction Fees	
• **Balance Transfer**	Either **$5** or **3%** of the amount of each transfer, whichever is greater (maxumum fee: $100).
• **Cash Advance**	Either **$5** or **3%** of the amount of each cash advance, whichever is greater.
• **Foreign Transaction**	**2%** of each transaction in U.S. dollars
Penalty Fees	
• **Late Payment**	**$29** if balance is less than or equal to $1,000; **$35** if balance is more than $1,000
• **Over-the-Credit Limit**	**$29**
• **Return Payment**	**$35**
Other Fees	
• **Required Account Protector Plan**	**$0.79** per $100 of balance at the end of each statement period. See back for details.

The final rule simplifies these disclosures based on consumer testing. Under the final rule, issuers must disclose in the box only that the APR varies and identify the index used to compute the APR, such as the prime rate. Issuers may not disclose the amount of the margin or index inside the box; however, they may disclose this information outside the box. In the consumer testing conducted by the Board, many consumers were confused by the variable-rate margins, often interpreting them erroneously as the actual rate being charged. In addition, very few participants indicated that they would use the margins in shopping for a credit card account. The Board's Model Form G-10(B), illustrated on page 5, shows disclosures for solicitations and applications for variable-rate credit card products.

Grace Period

Section 226.5a(b)(5) currently requires card issuers to disclose in the Schumer box the date or period within which credit extended for purchases may be repaid without incurring a finance charge. If the issuer does not offer a grace period, it must disclose this fact. Section 226.5a(a)(2)(iii) requires that issuers use the term "grace period."

Consumer testing prompted changes in how grace periods are described in the headings in the Schumer box. Testing revealed that consumers did not understand the phrase "grace period" to describe actions the consumer must take to avoid interest charges. Under the final rule, if a card issuer offers a grace period for all purchases, it must use the heading "How to Avoid Paying Interest on Purchases" to describe the grace period. But if an issuer does not offer a grace period, it must use the phrase "Paying Interest" in the heading to describe this. Model Form G-10(B) below provides the example for issuers that offer a grace period.

Subprime Credit Cards

These cards are marketed to consumers with low credit scores or weak credit records. A typical card offers a low credit limit (for example $300) and a high amount of required fees to open the account. The fees are immediately billed at account opening and reduce the amount of the credit limit.[8]

Federal banking agencies frequently receive consumer complaints about offers for these cards. Consumers state that they did not understand when they applied for the cards that significant fees were required to open the account and that the cards have low credit limits. The Board cited an example of a subprime card with a $250 credit limit and $100 in required fees that left a credit limit of $150 at account opening.

In the consumer testing conducted by the Board, many consumers were confused by the variable-rate margins, often interpreting them erroneously as the actual rate being charged.

The Board's final rule addresses this issue by requiring that when mandatory fees are equal to or greater than 15 percent of the minimum credit limit offered on the account, the card issuer must include an example in the Schumer box of the amount of available credit after paying the required fees based on the minimum credit limit. For example, if the minimum credit limit for a card was $300, and the card required start-up fees or a security deposit of $50 that is charged to the account, the disclosure would be triggered because the required fees exceed 15 percent of the minimum credit limit. The 15 percent trigger is limited to mandatory fees or security deposits that are charged to the account.

Example from Model Form G-10(B) for Credit Card Applications and Solicitations

How to Avoid Paying Interest on Purchases	Your due date is at least 25 days after the close of each billing cycle. We will not charge you interest on purchases if you pay your entire balance by the due date each month.

[8] Section 227.26 of the Regulation AA rulemaking also addresses consumer protection issues for subprime cards. The changes under §227.26 are discussed on page 9 of this issue.

However, if the 15 percent threshold is triggered by the amount of mandatory fees,[9] and the card issuer also had optional fees not necessary to open the account but which are billed to the account if selected (for example, a fee for an additional card), the issuer must make two disclosures in the Schumer box: the amount of available credit after deducting mandatory fees, and the amount of available credit after deducting both the mandatory and optional fees that are charged to the account. Model form G-10(C) below provides an example of how the available credit dual disclosure may be made.

Another important change is the treatment of a fee to apply for a card that is imposed regardless of whether the application is approved. Currently, the fee would not have to be disclosed in the Schumer box because it is not considered a fee imposed for the issuance or availability of credit. The final rule specifies that these application fees are fees imposed for the issuance or availability of credit and requires disclosure of the fee in the Schumer box because the Board believes consumers should be aware of it when shopping for credit.

Reference to the Board's Website

All card issuers will now have to include a reference to the Board's website[10] in the Schumer box for credit card applications and solicitations. The website provides resources and information about credit cards and consumer credit. During the rulemaking, several commenters recommended that the Board consider nonregulatory approaches to educating consumers about credit.

CONCLUDING REMARKS

The Board's Regulation Z open-end credit final rule was a significant undertaking. This article provided a summary of the key changes to §226.5a for credit card application and solicitation disclosures. Readers interested in more details can consult the rulemaking notice. In the next quarter, we will review the remaining changes for account-opening disclosures, periodic statement disclosures, change-in-terms notices, and advertising.

With the open-end review completed, the Board is now working on reviews of home-secured lines of credit and closed-end credit, which will include revised mortgage loan disclosures. Like the open-end disclosures, the home equity lines of credit and closed-end disclosures will be subject to consumer testing to ensure that the disclosures are accomplishing their goal.

Because of the significant changes to the regulation, as well as the final rule for amendments to Regulation AA that was issued simultaneously, banks should begin to review the changes to these regulations and work on updating and testing their systems so that they are in compliance by the July 1, 2010, effective date for both rules. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

Example from Model Form G-10(C) for Credit Card Applications and Solicitations

Fees	
Set-up and Maintenance Fees	NOTICE: Some of these set-up and maintenance fees will be assessed before you begin using your card and will reduce the amount of credit you initially have available. For example, if you are assigned the minimum credit limit of $250, your initial available credit will be only about $187 (or about $172 if you choose to have an additional card).
• Annual Fee	**$30**
• Account Set-up Fee	**$30** (one-time fee)
• Participation Fee	**$30** annually ($2.50 per month)
• Additional Card Fee	**$15** annually (if applicable)
• Account Maintenance Fee on Closed Accounts	**$30** annually ($2.50 per month on closed accounts with an outstanding balance of $30 or more)

[9] "Mandatory fees" refers to fees required for the issuance of credit and would not include late fees or over-the-credit-limit fees.

[10] http://www.federalreserve.gov/creditcard

Consumer Compliance Resources

Listed below are important compliance resources for financial institutions. A more comprehensive list of resources and the corresponding links are available on *Consumer Compliance Outlook's* web page at: www.consumercomplianceoutlook.org.

RESOURCE	DESCRIPTION
Overall Consumer Compliance	
Federal Reserve's Consumer Compliance Handbook	Manual used to conduct compliance examinations of state member banks
Federal Reserve Board's Regulations	Compilation of the Board's regulations
Federal Reserve Board's Consumer Affairs Letters	Letters addressing policy and procedural matters related to Federal Reserve System's consumer compliance supervisory responsibilities
Fair Lending and Equal Credit Opportunity Act (ECOA) — Regulation B	
Interagency Fair Lending Examination Procedures	Procedures used for conducting fair lending examinations
Justice Department's Fair Lending/Fair Housing Resource Page	Collection of fair housing and fair lending resources from the Justice Department
HUD's Fair Lending Page	Collection of fair lending resources from HUD
Banker's Guide to Risk-Based Fair Lending Examinations	Overview of the interagency fair lending examination procedures from the Federal Reserve Bank of Chicago
Home Mortgage Disclosure Act (HMDA) — Regulation C	
FFIEC HMDA Resource Page	Collection of HMDA resources
HMDA Getting It Right	Guide to recording and reporting HMDA data
FFIEC Geo-Coding Page	Web-based geo-coding system
Flood Insurance — Regulation H	
FEMA's Mandatory Purchase of Flood Insurance Guidelines	FEMA requirements when purchasing flood insurance
FEMA's Flood Manual	FEMA's in-depth guidance for flood insurance
FEMA's Flood Insurance Regulation	FEMA's regulation about flood insurance coverage and rates
Floodsmart: FEMA's Flood Purchase Page	Information about FEMA's flood insurance program
National Flood Insurance Act of 1968 and Flood Disaster Protection Act of 1973	Text of the two flood insurance statutes
Real Estate Settlement Procedures Act (RESPA) — Regulation X	
HUD's RESPA Page	Collection of RESPA resources
Truth in Lending Act — Regulation Z	
OCC APR Calculator	Software to verify annual percentage rates
Community Reinvestment Act (CRA) — Regulation BB	
FFIEC CRA Resource Page	Collection of CRA resources
CRA Interagency Questions & Answers	Frequently asked questions about the Community Reinvestment Act
CRA Examinations	Collection of resources for CRA examinations from the FFIEC
Truth in Savings Act (TISA) — Regulation DD	
OCC APY Calculator	Software to verify annual percentage yields
Payment Cards Center	
Payment Cards Center	Collection of resources for payment card issues
Fair Credit Reporting Act (FCRA)	
FTC Fair Credit Reporting Act Page	Collection of FCRA resources
Electronic Banking	
FFIEC Guidance on Electronic Financial Services and Consumer Compliance	Guide to compliance issues for electronic banking

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Calendar of Events

April 16-17	The Federal Reserve System's Sixth Biennial Community Affairs Research Conference Innovative Financial Services for the Underserved: Opportunities and Outcomes Board of Governors of the Federal Reserve System Renaissance Washington, D.C. Hotel, Washington, D.C.
May 4-5	Consumer Deposits Conference Consumer Bankers Association Ballantyne Resort, Charlotte, NC
June 7-10	Regulatory Compliance Conference American Bankers Association Walt Disney World Dolphin, Orlando, FL
June 7-12	Compliance Institute Independent Community Bankers of America Embassy Suites Hotel, Bloomington, MN