1st Anniversary Issue

Consumer Compliance Outlook®

Second Quarter 2009

Inside

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

Interview with Sandra Braunstein

Director, Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System

Consumer Compliance Outlook *celebrated its one-year anniversary in May 2009, and what an interesting and challenging year it has been. When we published our first issue in May 2008, we were beginning to witness the fallout from problems in the subprime mortgage market. Delinquencies were rising, and the debate about foreclosure and foreclosure-prevention activities was intensifying while various stakeholders, such as Congress and community groups, were focusing on how consumer protection failures contributed to the subprime crisis. Apropos of this debate,* Outlook*'s inaugural issue included an article on foreclosure-prevention activities and the Community Reinvestment Act.*

Since then, we have lived through a tumultuous year that included the failures of Bear Stearns, Fannie Mae, Freddie Mac, and Lehman Brothers and an alphabet soup of government initiatives to respond to the crisis, including AMLF, CPFF, MMIFF, PDCF, TAF, TALF, TARP, and TSLF.[1]

To mark this one-year anniversary, the Outlook Advisory Board recently conducted an interview with Sandra Braunstein, director of the Division of Consumer and Community Affairs at the Board of Governors in Washington, D.C., to discuss the effects of the financial crisis on consumer protection issues.

Advisory Board (AB): Given the events of the past year, what has surprised you the most with respect to consumer protection?

Sandra Braunstein (SB): What surprised me the most was that in many ways the crisis with respect to consumer protection began a full year before the impact was felt in other areas. Consumer groups will tell you that the problems began before 2006. Even though we knew it was serious by the middle of 2006, and the downward trend accelerated through 2007, the extent to which the crisis has worsened has surprised me. Another issue that we have discussed over the years but has come into full focus now is the strong intersection between consumer protection problems in financial institutions and prudential supervision. We now understand that problems

continued on page 13

[1] AMLF (Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility), CPFF (Commercial Paper Funding Facility), MMIFF (Money Market Investor Funding Facility), PDCF (Primary Dealer Credit Facility), TAF (Term Auction Facility), TALF (Term Asset-Backed Securities Loan Facility), TARP (Troubled Asset Relief Program), and TSLF (Term Securities Lending Facility).

Consumer Compliance Outlook *is published quarterly and is distributed to state member banks and bank holding companies supervised by the Board of Governors of the Federal Reserve System. The current issue of* Consumer Compliance Outlook *is available on the web at http://www.consumercomplianceoutlook.org.*

Suggestions, comments, and requests for back issues are welcome in writing, by telephone (215-574-6500), or by e-mail (Outlook@phil.frb.org). Please address all correspondence to:

Kenneth Benton, Editor
Consumer Compliance Outlook
Federal Reserve Bank of Philadelphia
Ten Independence Mall
SRC 7th Floor NE
Philadelphia, PA 19106

The Regulation Z Amendments for Open-End Credit Disclosures: Part Two

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

This article is the second installment of *Outlook's* review of the December 2008 amendments to Regulation Z's open-end credit sections made by the Board of Governors of the Federal Reserve System (Board).[1] In the First Quarter 2009 issue, we reviewed the extensive changes to credit card application and solicitation disclosures. In this issue, we review the remaining changes for account-opening disclosures, periodic statements, change-in-terms notices, and advertising. Other changes involving convenience checks and payment cut-off times are also discussed.

ACCOUNT-OPENING DISCLOSURES

The Board's final rule amends §226.6 of Regulation Z regarding account-opening disclosures that creditors must provide for open-end consumer credit products (excluding home-secured open-end credit). The amendments respond to the problem of information overload, whereby creditors provide consumers with account disclosures that are lengthy, dense, and complex. The Board found through consumer testing that the Schumer box disclosures currently required for solicitation and application of credit cards are very effective in combating information overload by succinctly disclosing critical information about the terms and fees of credit card products in a one-page table format. The final rule requires creditors to disclose critical information at account opening in a table similar to the Schumer box. This requirement to provide certain information in a table at account opening applies not only to credit card accounts but also to other types of open-end plans. The information required to be disclosed in the account-opening table is similar to the information required to be disclosed in the Schumer box for credit card applications and solicitations, including annual percentage rates (APRs), fees for issuance or availability of credit, minimum or fixed finance charges, transaction fees, and penalty fees. A creditor is permitted to disclose additional account information outside the account-opening table but is not required to do so. Model form G-17(D) on page 3 provides an example of an account-opening table for an open-end plan not involving a credit card.

Section 226.6 currently requires creditors to disclose finance charges and other charges in the account-opening disclosures. Certain fees do not have to be disclosed under Regulation Z because they are not considered finance charges or other charges. However, it is not always clear when a charge falls within the category of finance charge or other charge or is not subject to disclosure under Regulation Z. To address this issue, the final rule identifies the charges that must be included in the account-opening table.

[1] The Board's December 18, 2008 announcement with a link to the final rulemaking is available at http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm.

Form G-17(D) Account-Opening Sample	
Interest Rate and Interest Charges	
APR for Cash Advances	**18.00%**
Minimum Interest Charge	If you are charged interest, the charge will be no less than $1.50.
Paying Interest	You will be charged interest from the transaction date.
Fees	
Annual Fee	**$20**
Penalty Fees	
• **Late Payment**	$10
• **Over-the-Credit Limit**	$29

How We Will Calculate Your Balance: We use a method called "average daily balance (including new purchases)." See your account agreement for more details.

Billing Rights: Information on your rights to dispute transactions and how to exercise those rights is provided in your account agreement.

The account-opening table must be given in writing and before the first transaction under the plan. For charges not required to be disclosed in the account-opening table, creditors are given the option of disclosing those charges before the first transaction or later, as long as they are disclosed before the cost is imposed. These disclosures can be made orally or in writing. For example, a fee to receive a copy of an old periodic statement is not required to be disclosed in the account-opening table. Thus, a creditor could either disclose that fee at account opening or a relevant later time, such as when the consumer requests the old periodic statement.

The Board's rationale for this change is that many years can pass between the time a consumer receives initial account disclosures and the time the consumer requests a service subject to a fee listed in the account disclosures. Few consumers can recall the details of initial account disclosures provided to them many years ago. By allowing creditors the option of not disclosing certain fees in the initial account-opening disclosures but allowing those fees to be disclosed when the consumer requests the service that is subject to a fee, the final rule permits disclosures that are much more timely and relevant for consumers.

Finally, to help consumers who have applied for a subprime credit card without realizing it involves a low credit limit and substantial fees to open the account, the final rule requires issuers to provide a notice to consumers at account opening of their right to reject the card when account-opening fees have been charged to the account but the consumer has not used the card. Consumers exercising this right would not be responsible for the fees.

PERIODIC STATEMENT DISCLOSURES

The final rule makes significant changes to §226.7's disclosure requirements for periodic statements. Consumer testing revealed that consumers better understand the information disclosed on a periodic statement about interest and fees when the items in each category are grouped together. Accordingly, the final rule requires creditors to itemize separately all interest charges according to transaction type (e.g., interest on purchases or interest on cash advances) and to group all fees together and separately identify them (e.g., over-the-credit-limit fee).

Testing also showed that consumers more easily understand the cost of credit during the billing cycle when the total dollar amounts incurred for fees and interest are each disclosed. Therefore, the final rule requires periodic statements to provide separate listings of the total fees and total interest incurred, both for the period covered by the periodic statement and for the year-to-date. Model form G-18(A) on page 17 provides an example of how these disclosures would appear on the periodic statement.

Another important change to the periodic statement is that the Board eliminated the effective APR disclo-

CONTINUED ON PAGE 16

Escrow Accounting Rules: Are You in Compliance?

By Richele S. Brady, Senior Examiner, Federal Reserve Bank of San Francisco

Because of two recent amendments to Regulations X and Z, compliance with the escrow accounting requirements for mortgage loans will likely become an important issue for financial institutions and consumers. This article reviews the amendments, highlights some compliance issues for escrow statements, and discusses best practices.

AMENDMENTS TO REGULATIONS X AND Z

In November 2008, the Department of Housing and Urban Development (HUD) announced a final rule amending Regulation X, the implementing regulation for the Real Estate Settlement Procedures Act (RESPA).[1] The amendments include a revised three-page good faith estimate (GFE) form that requires lenders to disclose whether borrowers must maintain an escrow account for the loan. The effective date for the revised GFE is January 1, 2010. The portion of the revised form that pertains to maintaining escrow accounts is shown below.

The final rule also includes a minor technical change to §3500.17(b) of Regulation X concerning the escrow accounting provisions of the rule. The amendment eliminates definitions used for the phase-in period for a prior escrow accounting change from single-item accounting to aggregate accounting.

A more significant regulatory change affecting escrow compliance is the July 2008 amendments to Regulation Z, the implementing regulation for the Truth in Lending Act. The Board amended the regulation in response to the mortgage crisis, using its rulemaking authority under the Home Ownership and Equity Protection Act of 1994 (HOEPA). One amendment addresses the concern that some lenders misled borrowers about the affordability of the monthly mortgage payment by not requiring an escrow account for property taxes and insurance. This practice enabled lenders to quote a lower monthly payment to borrowers relative to competing lenders who did require escrow accounts. Many borrowers shop for mortgages based on the monthly payment, which they rely on to determine if they can afford a mortgage. Mortgages without escrow accounts created problems for some borrowers who were surprised to learn later that the mortgage payment did not include an escrow account for property taxes and insurance.

To address this problem, §226.35(b)(3) of the amended Regulation Z requires escrow accounts for all "higher-priced" first-lien mortgages secured by a borrower's principal dwelling.[2] A loan qualifies as higher priced if it is a consumer-purpose loan secured by a consumer's principal dwelling with an annual percentage rate

HUD's Revised GFE Disclosures for Escrow Accounts

Escrow account information	Some lenders require an escrow account to hold funds for paying property taxes or other property-related charges in addition to your monthly amount owed of $ ____ Do we require you to have an escrow account for your loan? ☐ No, you do not have an escrow account. You must pay these charges directly when due. ☐ Yes, you have an escrow account. It may or may not cover all of these charges. Ask us.

[1] HUD issued the final rules on November 12, 2008; go to http://www.hud.gov/news/release.cfm?content=pr08-175.cfm. The *Federal Register* notice is available at http://edocket.access.gpo.gov/2008/pdf/E8-27070.pdf.

[2] The Board issued the rules on July 14, 2008; go to http://www.federalreserve.gov/newsevents/press/bcreg/20080714a.htm. The *Federal Register* notice is available at http://edocket.access.gpo.gov/2008/pdf/E8-16500.pdf. The Fourth Quarter 2008 issue of *Outlook* contained a detailed article about the recent Regulation Z changes; the issue is available at http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2008/fourth-quarter/q4_01.cfm.

that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 points for first-lien loans or 3.5 points for subordinate lien loans.[3] After the first year, a borrower can ask the lender to opt out of the escrow account, but the lender has the right to reject the request. The effective date for the HOEPA escrow requirements is April 1, 2010, with an extension to October 1, 2010 for manufactured homes.

Financial institutions offering loans qualifying as higher-priced mortgage loans will be required to provide escrow accounts for those loans. Setting up the systems and infrastructure necessary to collect and administer escrow accounts will present challenges for financial institutions planning to make higher-cost loans after the final rule's effective date.

ESCROW COMPLIANCE ISSUES

Because of the impending changes to the escrow rules, a review of frequent escrow compliance issues is in order, including the following: understanding escrow accounting methods, preparing escrow disclosure statements and determining escrow deposit amounts, and ensuring that annual analyses result in correct account balances.

Escrow Accounting Methods

When establishing and maintaining escrow accounts, financial institutions must do the following:

- Conduct an escrow account analysis, before establishing an escrow account, to determine the amount the borrower must deposit into the escrow account at inception and the amount of the borrower's periodic payments into the escrow account;
- Prepare and deliver an initial escrow account statement to the borrower;
- Conduct an escrow account analysis at the completion of each escrow account computation year to determine the borrower's monthly escrow account payments for the next computation year;
- Use the initial and annual escrow account analyses to determine whether a surplus, shortage, or deficiency exists and adjust the account; and
- Prepare and submit an annual escrow account statement to the borrower.

These escrow tasks must be conducted in accordance with the accounting rules outlined in §3500.17 of Regulation X. In addition, the regulation contains rules and limitations with regard to the amounts that may be held in escrow accounts as well as specific requirements for the contents of the initial and annual statements. Of particular note is the requirement in §3500.17(c)(4) that lenders conduct an aggregate analysis rather than a single-item analysis when conducting the account analysis. A single-item analysis accounts for each escrow item separately, while an aggregate analysis considers the account as a whole to compute the sufficiency of escrow account funds.[4] The latter rule has engendered confusion resulting in incorrect amounts being held in escrow accounts.

Initial Escrow Account Analysis and Disclosure

The initial escrow account analysis and disclosure statement set the foundation for the escrow account. Therefore, it is important to consider the following when establishing the account:

Initial Escrow Account Analysis. Compliance with aggregate accounting rules is necessary to accurately calculate the required escrow amounts. Errors can result from a combination of overreliance on automated systems to perform the required calculations and staff not sufficiently versed in the rules. Examples of specific causes include:

- Relying unduly on automated systems without periodic testing to ensure that the system is operating correctly;
- Lacking an understanding of the limitations of these automated systems;
- Having system defaults that do not match the institution's actual practice;

---

[3] Higher-priced mortgage loans do not include loans for second homes or investment properties, short-term construction loans, or home equity lines of credit. The Federal Financial Institutions Examination Council (FFIEC) publishes current average prime offer rates on its website along with a rate spread calculator to determine if a loan qualifies as higher priced. Go to http://www.ffiec.gov/ratespread/.

[4] For more information on aggregate analysis, refer to §3500.17(d) of Regulation X, as amended, the examples in Exhibit E, and the public guidance information on HUD's website available at http://www.hud.gov/offices/hsg/sfh/res/respagui.cfm.

- Making manual overrides or alterations to automated systems inconsistent with the institution's actual practices; and
- Failing to adequately train staff regarding the differences between single-item and aggregate analysis and when the different analyses can or must be used.

Initial Escrow Account Statements. Errors in the initial analysis can lead to incorrect initial escrow account statements. Errors on these statements can also occur because of discrepancies between the escrow analysis and the initial escrow disclosure statement or amounts on the HUD-1 settlement statement (HUD-1). Common errors include:

- Failing to include flood insurance premiums in required escrow accounts;
- Disclosing amounts on the initial escrow statement different from those amounts collected at closing for the initial escrow deposit;
- Collecting lesser amounts of individual escrow line items to reduce the amount of the aggregate adjustment on the HUD-1; and
- Failing to disclose the aggregate adjustment on the HUD-1.

Initial Escrow Deposits. Overcharges in the collection of initial escrow deposits generally result when errors are made in the initial analysis. Other calculation or system entry errors can result in errors in the escrow deposit amounts. Some examples include:

- Using incorrect cushion amounts in excess of the regulatory limitations;
- Collecting excess funds when a property tax installment is paid at settlement;
- Including mortgage insurance (MI) premiums in cushion amounts when MI premiums are paid monthly; and
- Rounding adjustments to create an even dollar amount.

Annual Escrow Account Analysis and Statement

Errors in the annual account analysis can lead to incorrect calculations, which often result in incorrect surplus, shortage, or deficiency amounts. Some typical causes include:

- Using incorrect disbursement dates in projecting activity for the next year (e.g., changing the dates of projected disbursements can result in account balance projections that are incorrect);
- Projecting surpluses, shortages, or deficiencies based on incorrect account balances;
- Maintaining incorrect cushion amounts in excess of regulatory requirements or lower limitations placed in mortgage loan documents; and
- Failing to refund borrower(s) surplus amounts in excess of $50, as required by §3500.17(f)(2) of Regulation X.

Similarly, incorrect annual escrow statements generally result from missing information, such as not including all the required elements, or from errors in the annual analysis. Examples of information that is often missing or incorrect on the annual statement include:

If your institution currently offers escrow accounts, review your escrow accounting systems and disclosures to ensure compliance with the requirements of §3500.17 of Regulation X.

- The reason the projected low balance (i.e., cushion) was not reached;
- The total amounts paid into and out of the escrow account in the previous year; and
- One or more estimated payments or disbursements missing from the account analysis.

BEST PRACTICES

If your institution currently offers escrow accounts, review your escrow accounting systems and disclosures to ensure compliance with the requirements of §3500.17 of Regulation X. If your institution will be required to offer escrow accounts under the new rules, you should begin planning now. Significant system changes, disclosure forms, and training are required. Revisions to policies, procedures, and controls will also be necessary. Analyzing the escrow accounting issues discussed in this article and their causes as you begin this process will help ensure that you do not make the same mistakes. Lenders holding or servicing loans with escrow accounts may also want to consider the following best practices:

- Understand the differences between single-item and aggregate analyses. This distinction is a key factor in complying with the escrow accounting requirements.
- Conduct regular staff training on escrow requirements. Include training on the proper usage of the software platform used to generate escrow account disclosures.
- Perform periodic system testing to ensure systems are accurately performing escrow account analyses.
- Review mortgage loan documents for wording regarding cushion limits and ensure that systems comply with either the regulatory or the contractual cushion limitations, whichever are lower.
- Develop policies and procedures for escrow account requirements.
- Conduct periodic compliance reviews and audits that include escrow accounting as well as escrow account statements.

CONCLUSION

The potential impact on consumers and the associated risks to lenders make compliance with the requirements for initial and annual escrow account statements particularly important. While this article does not exhaustively address all of the complexities of the escrow accounting rules, it discusses aspects of the requirements of the recent RESPA changes, the Regulation Z amendments, and best practices to help institutions achieve compliance. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

Revisiting the Community Reinvestment Act (CRA)

by John Olson, District Manager, Community Development Department, Federal Reserve Bank of San Francisco

The financial services industry has changed dramatically since the passage of the CRA in 1977. In today's environment, policymakers face several key questions about the CRA: Has it solved the problem it was originally intended to address? Is it still an effective way to address access to credit issues in low- and moderate-income neighborhoods and for low- and moderate-income people? How does the CRA fit into the modern financial services world? Should the CRA be expanded to nonbank financial institutions?

To address these questions in a systematic way, the Federal Reserve Banks of Boston and San Francisco jointly published a volume called "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act." The aim of the book is to inform the CRA discussion with a set of facts about the state of the financial services industry and to offer a range of proposals for how the CRA can be made more effective. The book's contributors include bankers, community advocates, former regulators, and academics.

To further inform the discussion and to spark new ideas, the Board of Governors of the Federal Reserve System partnered with Boston and San Francisco to host a policy forum on February 24. The forum brought together the book's contributors and other commentators to discuss these important issues.

The book is available for download from both the Boston and San Francisco websites at http://www.bos.frb.org/commdev/cra/index.htm and http://www.frbsf.org/publications/community/cra/index.html. To order hard copies of the book, please e-mail Ian Galloway at Ian.Galloway@sf.frb.org. An audio recording of the February 24 policy forum is available at http://www.frbsf.org/cdinvestments/conferences/0902_2/index.html.

For additional highlights from the policy forum, visit http://www.consumercomplianceoutlook.org.

News From Washington: Regulatory Updates

The Board of Governors of the Federal Reserve System (Board) approved final rules revising disclosure requirements for mortgage loans under Regulation Z.

On May 8, 2009, the Board approved final rules that revise the disclosure requirements for mortgage loans under Regulation Z. These revisions implement the Mortgage Disclosure Improvement Act (MDIA), which was enacted in July 2008. The MDIA, an amendment to the Truth in Lending Act (TILA), seeks to ensure that consumers receive cost disclosures earlier in the mortgage process. The MDIA broadens and adds to the requirements of the Board's final Regulation Z rules issued in July 2008. Among other things, the MDIA requires early, transaction-specific disclosures for mortgage loans secured by dwellings other than the consumer's principal dwelling and requires waiting periods between the time disclosures are given and consummation of the mortgage transaction. Moreover, these requirements of the MDIA will become effective on July 30, 2009, about two months earlier than the Board's regulatory amendment adopted in the July 2008 final rule. The Board's press release and *Federal Register* notice can be found at http://www.federalreserve.gov/newsevents/press/bcreg/20090508a.htm.

The Board, the Office of Thrift Supervision, and the National Credit Union Administration (the Agencies) propose clarifications to credit card rules.

On April 21, 2009, the Agencies proposed clarifications to certain aspects of their December 2008 final rules under the Federal Trade Commission Act prohibiting unfair credit card practices. In addition, the Board also proposed clarifications to its December 2008 final rule under TILA amending Regulation Z to improve the disclosures consumers receive in connection with credit card accounts and other revolving credit plans. The proposals are intended to improve compliance with the rules by clarifying areas of uncertainty and making technical corrections to ensure that institutions are able to come into compliance with the rules on or before the July 1, 2010, effective date without reducing protections for consumers. The closing date for comments was June 4, 2009. The press release can be found at http://www.federalreserve.gov/newsevents/press/bcreg/20090421a.htm.

The Board releases interagency examination procedures for the Servicemembers Civil Relief Act.

On March 24, 2009, the Board released interagency examination procedures that will be used when determining a financial institution's compliance with the Servicemembers Civil Relief Act (SCRA). The procedures were recently approved by the Federal Financial Institutions Examination Council Task Force on Consumer Compliance. The SCRA was signed into law on December 19, 2003, and seeks to strengthen the national defense by providing a number of protections to servicemembers, including the temporary suspension of judicial and administrative proceedings and certain financial obligations that may adversely affect servicemembers during their military service. The SCRA and the examination procedures are available at http://www.law.cornell.edu/uscode/html/uscode50a/usc_sup_05_50_10_sq9_20_sq1.html and http://www.federalreserve.gov/boarddocs/caletters/2009/0902/caltr0902.htm, respectively.

The Board proposes amendments to Regulation Z to revise disclosure requirements for private education loans.

On March 11, 2009, the Board proposed amendments to Regulation Z (Truth in Lending) that would revise the disclosure requirements for private education loans. Under the amendments, creditors that extend private education loans would provide disclosures about loan terms and features on or with the loan application and would also have to disclose information about federal student loan programs that may offer less costly alternatives. In addition, disclosures would also have to be provided when the loan is approved and when the loan is consummated. The amendments would implement provisions of the Higher Education Opportunity Act, which was signed into law on August 14, 2008. The comment period for the proposed amendments ended on May 26, 2009. The Board's press release and the *Federal Register* notice are available at http://www.federalreserve.gov/newsevents/press/bcreg/20090311a.html.

Department of Housing and Urban Development (HUD) will seek comment on RESPA's "required use" definition.

On March 6, 2009, HUD announced that it is soliciting further public comment on how it should define the scope of a prohibited practice under RESPA called "required use," which was revised in a final rule issued by HUD in November 2008. HUD will delay implementing this final rule until July 16, 2009, as it solicits public comment on whether to withdraw its new definition, which would have taken effect on January 16, 2009. The new rule established a definition of required use that would have effectively prohibited nonsettlement service providers from providing discounts to consumers for using affiliates of settlement service providers. The comment period ended on April 9, 2009. Further information and HUD's press release can be found at http://www.hud.gov/news/release.cfm?content=pr09-020.cfm.

Federal Trade Commission (FTC) warns consumers about economic stimulus scams.

In a press release issued on March 4, 2009, the FTC warned consumers of the threat of economic stimulus scams. The scams have taken many forms, including e-mail and fraudulent websites. These solicitations often request consumers to provide personal information and pay for fictitious services that purport to help individuals qualify for a payment from President Obama's economic stimulus package. The FTC advises consumers who may have already fallen victim to these attempts to check their credit reports and credit card bills carefully and report the scam to the FTC. The FTC's press release as well as information about reporting an issue can be found at http://www.ftc.gov/opa/2009/03/stimulusscam.shtm.

Agencies issue statement in support of the "Making Home Affordable" loan modification program.

On March 4, 2009, the Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision released a joint statement encouraging all federally regulated financial institutions that service or hold residential mortgage loans to participate in the "Making Home Affordable" loan modification program. The Treasury Department announced guidelines for the program on March 4, 2009. The Treasury announced that institutions receiving financial assistance in the future under the Financial Stability Plan established under the Troubled Asset Relief Program will be required to implement loan modification programs in accordance with the Treasury Department's guidelines. By providing servicers and holders of eligible residential mortgages with incentives to modify loans at risk of foreclosure, the program seeks to promote sustainable alternatives to foreclosures on owner-occupied residential properties. The program also provides incentives for homeowners whose mortgages are modified to remain current on their mortgages after modification. Taken together, these incentives should help responsible homeowners remain in their homes and avoid foreclosure, thereby easing downward pressure on house prices in many parts of the country and averting the costs to families, communities, and the economy from avoidable foreclosures. The Treasury's press release and the modification program's guidelines are available at http://www.ustreas.gov/press/releases/tg48.htm.

On the Docket: Recent Federal Court Opinions*

REGULATION Z - TRUTH IN LENDING ACT (TILA)

Finance charge disclosure for inflated title insurance fee. *McCutcheon v. America's Servicing Co.,* 560 F.3d 143 (3d Cir. 2009). The Third Circuit held that when a creditor charges an inflated fee for title insurance in a mortgage loan, the amount of the overcharge must be disclosed as a finance charge. The borrower was charged $2,383 for title insurance, $668 of which was an overcharge. Under §226.4(c)(7) of Regulation Z, a fee for title insurance is not a finance charge unless the fee is not "bona fide and reasonable in amount." The court had to determine when analyzing an inflated title insurance fee whether the entire fee should be considered a finance charge or only the amount of the overcharge. The Third Circuit concluded that only the portion of a title insurance fee constituting an overcharge must be disclosed as a finance charge because §1605(e)(1) of TILA specifically states that a title insurance fee is not a finance charge.

Change-in-terms notice for discretionary rate increase applied retroactively. *Swanson v. Bank of America, N.A.* 559 F.3d 653 (7th Cir. 2009) and *McCoy v. Chase Manhattan Bank, U.S.A., N.A.* 559 F.3d 963 (9th Cir. 2009). The Seventh and Ninth Circuits recently published conflicting decisions in considering whether a credit card issuer has a duty to provide consumers with notice before applying a penalty rate increase that is specified in the account agreement. In *Swanson*, the cardholder agreement authorized Bank of America (BOA) to increase the periodic rate applicable to Swanson's account if her outstanding balance exceeded her credit limit at the end of two months in any rolling 12-month period. BOA later amended the contract terms to provide that the increased penalty rate would become effective at the beginning of the billing cycle to which the over-limit penalty applied. The Seventh Circuit noted that the plaintiff agreed to these terms by continuing to use her card. BOA later raised the plaintiff's rate when she exceeded her credit limit and applied the increased rate at the beginning of the billing cycle in which the default occurred. Swanson claimed that under Regulation Z, the rate increase could not become effective until the date that BOA mailed or delivered a notice informing her of the increase. The Seventh Circuit affirmed the trial court's dismissal of the plaintiff's claim. The court held that card issuers are not required to provide separate notice before applying a rate increase that has been pre-authorized under the contract terms. The Seventh Circuit indicated that this holding was in agreement with the decisions of several other courts. The court also noted that the Federal Reserve Board recently revised Regulation Z to prohibit this practice precisely because the existing regulation does not prohibit creditors from applying penalty rates at the start of the billing cycle in which the default occurs.

Reaching the opposite conclusion, the Ninth Circuit in *McCoy* concluded that a card issuer must provide a separate change-in-terms notice at or before the effective date of the penalty rate increase. Chase Manhattan Bank (Chase) had raised the cardholder's rate retroactively to the beginning of the billing cycle as a result of a late payment. McCoy alleged that the rate increase violated TILA because Chase gave no notice of the increase until the next periodic statement, after the increase had already taken effect. The court agreed with the plaintiff and stated its belief that the Staff Commentary to Regulation Z and the Federal Reserve's recent regulatory revisions reflect the Board's intent to require contemporaneous notice when rates are raised because of a consumer's delinquency or default on the account.

It should be noted that this issue will become moot when the Board's recent amendments to Regulation Z become effective. Under §226.9(g), as amended, creditors must provide a change-in-terms notice 45 days in advance before applying a penalty rate increase.

---

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

Rescission period extended to three years because lender asked borrowers to sign false statement. *Rand Corporation v. Moua*, 559 F.3d 842 (8th Cir. 2009). The Eighth Circuit held that a creditor who required borrowers to sign a statement at loan closing acknowledging receipt of the rescission notice and falsely confirming that the three-day rescission period had passed and that the borrowers had not rescinded the transaction violated TILA and extended the rescission period from three business days to three years. Section 226.23(b)(1) of Regulation Z requires lenders to disclose to borrowers, clearly and conspicuously, notice of their right to rescind a loan secured by their primary residence until midnight of the third business day following consummation or delivery of the material disclosures and rescission forms, whichever occurs later. The Eighth Circuit found that asking borrowers to sign a statement at closing that falsely stated that the three-day period had passed and that they were not rescinding the loan on the same day they signed a statement acknowledging receipt of the rescission notice violated the clear and conspicuous requirements. "Requiring borrowers to sign statements which are contradictory and demonstrably false is a paradigm for confusion.…The average borrower would be confused when instructed to certify a falsehood, and as to the effect of the falsehood." As a result of the violation, the court held that the three-day rescission period was extended to three years, as provided in §226.23(a)(3).

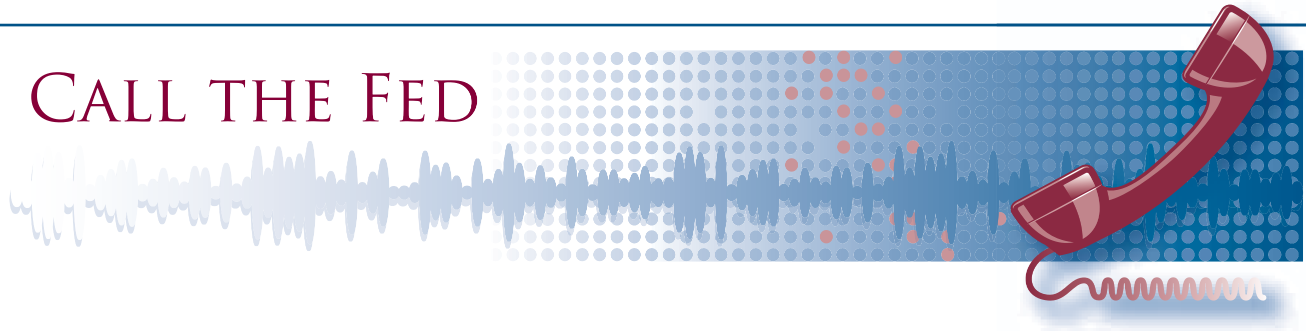
REGULATION X – REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Overhead is not a compensable settlement service under RESPA. *Cohen v. J.P. Morgan Chase*, 2009 U.S. Dist. LEXIS 5823 (E.D.N.Y. Jan. 28, 2009). In *Cohen v. J.P. Morgan Chase*, 498 F.3d 111 (2d Cir. 2007), which was discussed in the Second Quarter 2008 issue of *Outlook*, the Second Circuit reversed and remanded a trial court's ruling that RESPA does not apply to unearned, undivided fees. On remand, the trial court wrote a decision in response to a motion for summary judgment by J.P. Morgan Chase to dismiss the case. At issue in this case is whether J.P. Morgan Chase provided any RESPA compensable settlement services for a "post processing fee" it imposed on all mortgages. The court denied J.P. Morgan Chase's motion after concluding that the fee was not in exchange for specific settlement services but represented a fee to cover overhead expenses, which the court found is not a compensable settlement service under RESPA. The court created a legal test for "settlement services" under RESPA: The service either must benefit the borrower or be performed at or before closing. The court concluded that the post-closing service was not done for the benefit of a particular borrower and rejected J.P. Morgan Chase's alternative argument that the borrowers benefited because the service helped ensure the salability of the mortgage on the secondary market. The court found this argument too tenuous and would allow lenders to charge for all of their overhead.

PREEMPTION

U.S. Supreme Court agrees to review enforcement preemption case under the National Bank Act (NBA). *Cuomo v. Clearing House Association, L.L.C.,* 129 S. Ct. 987 (2009). In 2005, after the Board of Governors of the Federal Reserve System released loan data under the Home Mortgage Disclosure Act showing that African-American and Hispanic borrowers had a significantly higher percentage of higher-cost loans than white borrowers, New York's attorney general sought loan data from several large national banks using his legal authority to enforce New York's fair lending laws. In response, the Office of the Comptroller of the Currency (OCC) and the Clearing House Association obtained an injunction in federal district court halting the investigation based on the OCC's visitorial powers preemption regulation, 12 C.F.R. §7.4, which prevents state officials from enforcing federal or state laws for activities permitted under the NBA. A divided panel of the Second Circuit affirmed the district court's ruling in *Clearing House Association, L.L.C. v. Cuomo*, 510 F.3d 105 (2d Cir. 2007). The New York attorney general sought review in the U.S. Supreme Court, which has agreed to review the case on an expedited basis. A decision is expected by the end of the court's current term in June 2009.

Call the Fed



Join the Federal Reserve Bank of San Francisco for an audio conference highlighting consumer compliance regulatory matters. The conference is scheduled for July 22 and will cover spousal signature rules, fair lending in a declining economic environment, and a host of new mortgage lending rules. There will also be a Q & A session where you can ask experts compliance-related questions.

You can register online for the free audio conference at http://www.frbsf.org/banking/events/index.html. You will receive the "Call the Fed" dial-in instructions and a link to presentation materials via e-mail at least one week before the conference.

Past conference topics include new mortgage lending rules, CRA performance challenges in the current economic environment, flood insurance challenges, CRA and HMDA data accuracy, and implications of third-party lending arrangements. To review presentation materials or to listen to past conferences, go to http://www.frbsf.org/banking/events/index.html.

Consumer Compliance Outlook

Third Quarter 2008

Inside

A federal reserve system publication with a focus on consumer compliance issues

Reverse Mortgages and Consumer Protection Issues

by John S. Insley, Jr.
Principal Examiner, Bank Supervision and Regulation, Federal Reserve Bank of Richmond

The growth in the number of seniors in the U.S. population in conjunction with housing market developments, notably private securitization, has stimulated broad interest and substantial growth in reverse mortgages in recent years. As a result, it is increasingly likely that many banks and others involved in the traditional mortgage business may consider originating reverse mortgages or be afforded opportunities to participate indirectly in the reverse mortgage market. Despite recent troubles in the national mortgage market, reverse mortgages are growing at a rapid rate: "Expansion of this hot spot in mortgage lending is expected to continue owing to increasingly flexible products, new sources of capital, and a growing supply of potential borrowers. As the reverse mortgage market develops, it is important that potential borrowers be educated about this complex product to protect them from taking out unsuitable loans."[1]

WHAT IS A REVERSE MORTGAGE?
As the name suggests, reverse mortgages share similarities with traditional mortgages, but the flow of payments during the loan term is reversed. The borrower receives payments or access to funds with no obligation to repay the principal or interest until the loan is due. The U.S. Department of Housing and Urban Development (HUD) describes a reverse mortgage as "a special type of home loan that lets a homeowner convert a portion of the equity in his or her home into cash. The equity built up over years of home mortgage payments can be paid to you. But unlike a traditional home equity loan or second mortgage, no repayment is required until the borrower(s) no longer use the home as their principal residence."[2]

According to the National Reverse Mortgage Lenders Association (NRMLA), home equity conversion mortgages (HECM), the reverse mortgage product insured by the Federal Housing Administration (FHA), a federal agency within HUD, account for 90 percent of all such loans extended.[3] Under the FHA

continued on page 8

[1] Heidi Kaplan, "Reverse Mortgages—the Next Hot Spot," *Bridges*, Federal Reserve Bank of St. Louis (Spring 2008). http://www.stlouisfed.org/publications/br/2008/a/pages/1-article.html

[2] http://www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm

[3] http://www.nrmlaonline.org/rms/statistics/default.aspx?article_id=601

Subscribe to *Consumer Compliance Outlook*

Consumer Compliance Outlook is a Federal Reserve System publication that focuses on consumer compliance issues. A subscription to *Consumer Compliance Outlook* is a valuable financial services industry resource that will keep you informed of consumer regulatory matters. To order *Consumer Compliance Outlook*, please visit *Outlook's* website at http://www.consumercomplianceoutlook.org. There, you can choose to receive future editions of the publication in electronic or paper format.

CONTINUED FROM PAGE 1...

Interview with Sandra Braunstein

in the consumer protection realm often serve as a bellwether or leading indicator for financial problems that will surface later.

In 2006 it seemed as if subprime lending was an isolated problem. People thought the economy was strong, and it would only impact a small part of the market. As we know, that's not what happened, and it became very widespread. What I hope we have learned is the importance of being diligent with respect to consumer protection issues — even when the market is strong and banks are profitable.

AB: In light of what we have already experienced, what currently concerns you most?

SB: When consumer protection issues initially started to surface, the market was functioning quite well. What keeps me awake is the optimum point of intervention — when do we go in and write stronger regulations, even though there is the potential to negatively impact the market or tighten credit availability. I am not sure we have the answer. I do not know if we will ever get it exactly right, but I am confident that the next time we will do it better.

What keeps me awake is the optimum point of intervention — when do we go in and write stronger regulations, even though there is the potential to negatively impact the market or tighten credit availability.

AB: Would we be willing to take action sooner?

SB: I think from what we have learned we would intervene sooner but people have short memories. When markets become "normal" again, in whatever form that may take, it will be interesting to see if there is support for early intervention even though there may be unintended consequences with respect to profitability.

From the beginning of the economic downturn, a debate emerged over how or if weaknesses in our approach to consumer protection contributed to the crisis. The Federal Reserve, along with other agencies, has been very busy as a result. In the past year we have had new mortgage lending rules, new credit card rules, proposals for new substantive overdraft protection rules along with enhanced overdraft program disclosures, and proposed student loan rules, to name just a few. Even with these new and enhanced consumer protections, the House Financial Services Committee and the Senate Banking Committee continue to conduct hearings and draft bills with further consumer protection for these and other products and services.

— Advisory Board —

AB: Can you tell us what went into the new rules and how the Board's focus and processes have changed?

SB: We have learned several things with respect to the rule-writing process. Up until recently, rules written by the Federal Reserve relative to consumer protection centered on disclosure: making sure the public had good, accurate information about financial products and services in order to make informed decisions. The attorneys would write the regulations along with sample disclosures using the applicable statute as a guide. But over time we discovered that the information contained in these disclosures was not always well understood by consumers.

Actually, even before the crisis began we had already started to incorporate consumer testing into our rule-writing process. We have hired professionals to conduct consumer interviews and run consumer focus group meetings, and this input from the public has made a tremendous difference in the clarity of our disclosures. In fact, we have been so pleased with this approach that the Board has made a pledge not to issue new disclosures unless they have been consumer-tested. Our new Regulation

Z credit card disclosures are a good example of the success of this new approach. Certainly, this process is more time-consuming, but the quality of the final product is well worth the additional effort.

Another thing we have learned from consumer testing is that certain characteristics of financial products in today's market are so complex that it is very difficult to use disclosures to adequately explain these concepts. Due to the complexity of these products or product features, disclosure alone may even confuse consumers such that they cannot reasonably avoid the harm from these products. As a result, rules need to be written to address unfair or deceptive practices in order to adequately protect consumers, which is why we developed the recent credit card rules.

AB: In April the "Today" show did a segment on overdraft protection services, which concluded with an announcement of the Board's proposed rulemaking and information on how to comment on the proposal. What's your reaction to this type of publicity with respect to the Board's rulemaking function?

SB: I think it's terrific! Anything that raises the visibility of consumer protection issues with the public is very positive, whether it's the "Today" show or another venue. In fact, I have recently seen a number of stories on local and national news programs on consumer protection issues, particularly on credit cards, and in my opinion a well-informed consumer will ultimately make better decisions.

AB: Is there anything else on your radar screen that you can share with us regarding potential policy or regulatory changes?

SB: Right now we are working feverishly to address the regulatory changes required by the credit card reform legislation that President Obama signed into law in May. While the new law tracks with the credit card regulations that the Board approved last year in many respects, there are many differences, some of which will require amendments to those regulations. In addition, there are some new provisions that will require us to issue proposals for notice and comment. Finally, some of the provisions in the legislation go into effect this August, and the rest go into effect in February 2010 and August 2010. The Board's rules were to go into effect in July 2010. Consequently, this work is taking priority at the moment and will likely affect the timing of our final rules on overdraft protection, for example. With regard to our proposed overdraft protection rules, we received 18,000 comment letters on overdraft protection, which is far less than the 66,000 we received on our proposed credit card rules but is still quite high. Most of the letters came from individual consumers. The proposed rule offered two different approaches to overdraft protection services: opt out or opt in. Most consumers preferred the opt-in approach, in which they would have to ask to have this feature added to their account, while the industry preferred the opt-out approach.

> ANOTHER THING WE HAVE LEARNED FROM CONSUMER TESTING IS THAT CERTAIN CHARACTERISTICS OF FINANCIAL PRODUCTS IN TODAY'S MARKET ARE SO COMPLEX THAT IT IS VERY DIFFICULT TO USE DISCLOSURES TO ADEQUATELY EXPLAIN THESE CONCEPTS.

We also hope to issue final student loan rules under Regulation Z by late summer. We are also conducting a significant amount of consumer testing on mortgage disclosures, both closed-end and HELOCs [home equity lines of credit]. We hope to have proposed rules out for comment during the same time frame.

AB: Is there anything else you have learned from recent comment letters?

SB: The comment letters have been extremely helpful, and in addition to the impressive volume, the comment letters on credit cards have been particularly fascinating. In today's world, credit cards are such a ubiquitous product – almost everyone has at least one. What was so interesting was that the vast majority of these comment letters were written by individual consumers. They typically shared with us their actual experiences with their cards or card issuers. These letters provided significant anecdotal evidence, which we used to craft our UDAP [Unfair or Deceptive Acts or Practices] credit card rules.

AB: There has been some discussion regarding the possible role that the Community Reinvestment Act [CRA] played in the recent financial crisis. Where do you see the debate regarding the future of CRA headed?

SB: First, let me clearly state that the CRA was not to blame for the current financial crisis, and we are not in doubt on that point. However, because the CRA and its implementing regulation were enacted in 1977, it is not as relevant as it could be, since significant changes in the banking industry have occurred over the past 32 years.

The CRA is a priority for the House, and I believe [Representative] Barney Frank is interested in reviewing it from a legislative perspective. When I testified before Congress last year, he was interested in possibly expanding CRA coverage to include other entities, such as credit unions, insurance companies, and other financial services providers.

AB: What is your perspective on how or if the CRA should change given the evolution of the financial services industry?

SB: We have also been looking at the CRA from a regulatory perspective. While no decisions have been made, we have discussed issues such as the relevance of assessment areas for our largest institutions and whether race should be considered as part of the performance evaluation. The statute is very clear in that the CRA focuses on low- and moderate-income individuals and geographies and not race, but a number of community groups are proponents of this type of expansion. We have also discussed the possibility of additional enforcement tools for noncompliance as well as the issue of affiliate lending, and whether it should continue to be optional or should be included as a mandatory part of the performance evaluation process.

We are getting input from the industry as well as community groups, and these are just some of the issues currently being discussed.

AB: Moviegoers in select cities recently saw a public service advertisement sponsored by the Federal Reserve to raise awareness about mortgage foreclosure scams. Can you tell us more about these advertisements and why the Board chose this approach?

SB: I think it is fantastic. Our partner NeighborWorks and industry representatives have shared information with us about scams that are targeting homeowners who might be facing foreclosure. For instance, these individuals will slightly change the name of a legitimate organization such as HOPE Now and set up a copycat website that could easily fool unsuspecting consumers.

This is the worst type of fraudulent activity that preys on vulnerable people who are already facing rough financial times and are in danger of losing their homes. People are being asked to pay out large sums of money up front in order to receive a loan modification, but we know that no third party can promise that will happen if the borrower is not eligible. We have heard of fees that can range from $2,500 to $3,000, and in the best case scenario, some assistance may be provided; but in the worst case, the borrowers lose their money, receive no help, and are still facing foreclosure.

As an organization, we wanted to find a way to increase public awareness about these scams. People do not think of the Federal Reserve as a resource for consumers, but we have a great deal of information on our website[2] that can be very helpful, such as "5 Tips for Avoiding Foreclosure Scams."[3]

While we recognize that commercials are out of character for the Fed, we thought this would be an effective way to reach a broad segment of the population so we launched these advertisements in April in select cities with high foreclosure rates.

[2] http://www.federalreserve.gov/consumerinfo/default.htm

[3] http://www.federalreserve.gov/pubs/foreclosurescamtips/default.htm

We were very pleased with the final product and will continue to explore using various forms of media to deliver important messages for the public.

Over the past year we have seen financial institutions take steps to reduce their credit risk exposure (e.g., reducing limits on home equity credit lines) and/or move into new lines of business (e.g., reverse mortgages) now that subprime mortgage lending has virtually disappeared. Outlook *has published articles on both of these topics. Since the inception of the publication in May 2008, our theme has been to remind our readers that consumer protection issues remain in the forefront of the crisis and that rules and expectations are rapidly changing. As a result, consumer protection and compliance need to be a part of all major business decisions.*

— Advisory Board —

AB: If you had one piece of advice for bankers at this time – as it relates to consumer protection – what would it be?

SB: Right now, bankers are understandably focused on prudential supervision, the results of the stress tests, and capital requirements. But it is very important that bankers stay focused on consumer protection. Bankers need to continue to look for opportunities to make credit available for qualified borrowers. We have all seen the consequences when bankers are not focused on consumer issues, so bankers need to do what is necessary to mitigate that risk.

AB: And what would be your advice to examiners?

SB: I would give the same advice to examiners: Stay focused on consumer issues and use sound judgment in making your assessments. I would also add that now more than ever it is extremely important to keep the lines of communication open with our safety and soundness counterparts.

AB: Finally, given the division's many initiatives over the past year, which ones are you most proud of?

SB: I am most proud of the people who work at the Board who have continued to remain dedicated to our role in consumer protection during a time when it seemed we were being attacked from all sides. So many individuals rose to the challenge and were creative in terms of finding solutions for difficult problems.

I am also very proud of the new rules we have developed and the process we have used to develop those rules. We have made significant progress toward putting a better infrastructure in place to help consumers get responsible credit.

CONTINUED FROM PAGE 3...

Regulation Z Amendments for Open-End Credit Disclosures: Part Two

sure (also referred to as the historical APR). The effective APR was intended to disclose to consumers their total annualized cost of credit during each billing cycle. In the proposed rulemaking notice, the Board solicited comment on whether to eliminate this disclosure because it is not well understood by consumers. During the rulemaking period, the Board attempted to improve consumer understanding of the effective APR by testing modified versions of this disclosure, but most consumers still did not understand it. However, testing revealed that consumer comprehension of the total cost of credit increased significantly when information about fees and interest charges were separately listed in the periodic statement for both the period and for the year-to-date, as the final rule requires and as shown on the following page in model form G-18(A). The Board, therefore, eliminated the requirement for the effective APR disclosure.

Another important change concerns two new warnings that must appear on periodic statements as a result of amendments to the Truth in Lending Act (TILA) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[2] Section 1305 of

Example from Form G-18(A) Periodic Statement Transactions; Interest Charges; Fees Sample

Reference Number	Trans Date	Post Date	Description of Transaction or Credit	Amount
Transactions				
5884186PS0388W6YM	2/22	2/23	Store #1	$2.05
0544400060ZLV72VL	2/24	2/25	Store #2	$12.11
854338203FS8000Z5	2/25	2/25	Pymt Thank You	-$450.00
55541860705RDYDOX	2/25	2/26	Store #3	$4.63
Fees				
9525156489SFD4545Q	2/23	2/23	Late Fee	$35.00
56415615647OJSNDS	2/26	2/26	Cash Advance Fee	$5.00
84151564SADS8745H	2/27	2/27	Balance Transfer Fee	$23.55
256489156189451516L	2/28	2/28	Cash Advance Fee	$5.90
			TOTAL FEES FOR THIS PERIOD	$69.45
Interest Charged				
			Interest Charge on Purchases	$6.31
			Interest Charge on Cash Advances	$4.58
			TOTAL INTEREST FOR THIS PERIOD	$10.89

2012 Totals Year-to-Date	
Total fees charged in 2012	$90.14
Total interest charged in 2012	$18.27

BAPCPA requires a warning about the possible consequences of making a late payment, while §1301 requires a warning about the consequences of making only the minimum payment.

For the late payment warning, the final rule requires creditors to disclose on the front of the periodic statement the due date and, in close proximity, the late fee and the penalty APR that could be triggered by a late payment.

For the minimum payment warning, the final rule requires three new disclosures on periodic statements for credit cards only:[3] (1) a warning that making only the minimum payment will increase the interest paid and the time it takes to repay the balance, (2) a hypothetical example of how long it would take to pay a specified balance in full if only minimum payments are made, and (3) a toll-free number consumers can call to obtain an estimate of how long it would take to repay their account balance using minimum payments. The minimum payment disclosure must be grouped together with the due date and late payment disclosure above. Model form G-18(D) below provides an example of how the hypothetical warning could be displayed along with the late payment warning.

Form G-18(D) Periodic Statement: New Balance, Due Date, Late Payment, and Minimum Payment Sample (Credit Cards)

Payment Information	
New Balance	**$1,784.53**
Minimum Payment Due	$48.00
Payment Due Date	4/20/12

Late Payment Warning: If we do not receive your minimum payment by the date listed above, you may have to pay a $35 late fee and your APRs may be increased up to the Penalty APR of 28.99%.

Minimum Payment Warning: If you make only the minimum payment each period, you will pay more interest and it will take you longer to pay off your balance. For example, if you had a balance of $1,000 at an interest rate of 17% and always paid only the minimum required, it would take over 7 years to repay this balance. For an estimate of the time it would take to repay your actual balance making only minimum payments, call 1-800-XXX-XXXX.

[2] http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:s256enr.txt.pdf

[3] The Board used its rulemaking authority under §105(a) of TILA to exempt other types of open-end credit, such as HELOCs or a line of credit, from the warning.

Testing revealed that consumers better understand the consequences of making only minimum payments when the disclosure is based on their actual account balance instead of a hypothetical balance. The final rule therefore encourages card issuers to make the minimum payment disclosures based on cardholders' actual balances instead of a hypothetical balance. As an incentive, the final rule provides that if card issuers use actual balances, they do not have to disclose the warning, the hypothetical example, or a toll-free number on the periodic statement. Instead, the issuer must disclose how long it will take to pay off the current balance if only minimum payments are made.

CHANGE-IN-TERMS NOTICE

Regulation Z currently requires creditors to provide a 15-day notice for changes to most account terms required to be disclosed on the initial account-opening disclosures. However, if the change resulted from a customer's default or delinquency, creditors do not have to provide the 15-day notice, although they still have to provide written notice. Certain other events require no notice at all, including late payment charges, over-the-credit-limit charges, and changes that were disclosed in the initial account disclosures, such as an increase in the APR if the customer makes late payments. Testing revealed that consumers typically did not read change-in-terms notices because they were in small print and used dense text. As a result, consumers are often surprised to learn that important account terms have changed. The Board also determined that for some changes, such as an increase in the purchase APR, 15 days was an insufficient amount of time to allow the consumer to respond to the change.

The final rule addresses these problems in several ways. First, if the change-in-terms notice pertained to a key term that must be disclosed in the account-opening table, the change-in-terms notice must use a similar tabular format. Many creditors send change-in-terms notices along with the periodic statement. Because testing revealed that consumers tend to disregard notices sent with the periodic statement, the notice included with a periodic statement must appear on the front of the periodic statement, though not necessarily on the first page. Model form G-20 below shows a change-in-terms notice.

The final rule also requires creditors to send a change-in-terms notice 45 days in advance of the change instead of the current 15 days and expands the circumstances triggering a notice. When a creditor increases an APR because of a default or delinquency, it will have to send a notice 45 days before the change, even if it had disclosed this possible change in the initial account disclosures. The purpose of this change is to allow consumers adequate time to shop for new credit before the rate increase takes effect or to stop making purchases with the card to avoid increasing the balance that will be subject to a higher APR.

Another important amendment for the change-in-terms rules concerns reductions in credit limits. Under new §226.9(c)(2)(v), a creditor who decreases a consum-

Form G-20 Change-in-Terms Sample

Payment Information

The following is a summary of changes that are being made to your account terms. You have the right to opt out of these changes. For more detailed information, please refer to the booklet enclosed with this statement.

These changes will impact your account as follows:

Transactions made on or after 4/2/12: As of 5/10/12, any changes to APRs described below will apply to these transactions.

Transactions made before 4/2/12: Current APRs will continue to apply to these transactions.

If you are already being charged a higher Penalty APR for purchases: In this case, any changes to APRs described below will not go into effect at this time. These changes go into effect when the Penalty APR no longer applies to your account.

Revised Terms, as of 5/10/12	
APR for Purchases	16.99%
Late Payment Fee	$32 if your balance is less than or equal to $1,000; $39 if your balance is more than $1,000

er's credit limit must provide 45 days' notice of the decrease before the creditor can apply an over-the-credit-limit fee or penalty rate that resulted solely because the consumer exceeded the decreased credit limit.

Card issuers should also be aware that §227.24(b)(3) of Regulation AA prohibits issuers from raising rates during the first year an account is open, unless another rate increase exception applies, such as failing to make a payment within 30 days of the due date.

ADVERTISING PROVISIONS

The final rule contains two new restrictions on advertisements for open-end credit. The first concerns advertisements offering financing for products or services that mention a periodic payment amount (such as a minimum monthly payment) if financing is selected. The final rule requires creditors to disclose, in equal prominence to the periodic payment amount, the time period required to pay the balance if only the periodic payments are made and the total dollar amount of payments assuming only the periodic payments are made.

The second restriction applies to advertisers using the term fixed rate. Under the final rule, if the advertiser uses the term fixed rate, it must identify the period during which the rate is fixed and cannot be increased. If a time period is not identified, the advertiser cannot use the term fixed rate unless the rate cannot increase while the credit plan is open.

OTHER CHANGES

The final rule contains two other significant changes to Regulation Z. The first concerns disclosures for convenience checks, that is, checks creditors provide to consumers who access a credit card account. The final rule requires creditors to disclose in a tabular format on the front of the page containing convenience checks the following information: (1) any discounted initial rate and when that rate will expire, if applicable; (2) the type of rate that applies to the checks after expiration of any discounted initial rate and the applicable APR; (3) any transaction fees; (4) whether a grace period applies to the checks and, if one does not apply, that interest will be charged immediately; and (5) any date by which the consumer must use the checks in order to receive any discounted initial rate offered on the checks.

The Board noted that creditors typically send out convenience checks to consumers during the life of a credit account. As a result, significant time can elapse between the time consumers receive initial account disclosures about rates and fees applicable to convenience checks and the time customers receive the convenience checks. The new disclosures ensure that consumers will receive the critical information about the checks at the time they are mailed to the consumer so that consumers can make an informed choice about whether to use them.

The second change concerns the cut-off times and due dates for mailing payments. Regulation Z currently permits creditors to specify reasonable cut-off times for receiving mailed payments on the due date. The final rule defines reasonable and describes a 5 p.m. cut-off time for mailed payments as an example of a reasonable cut-off time for payments. In addition, if the payment date falls on a weekend, holiday, or other day on which the creditor does not receive payments, a payment received on the next business day must be deemed timely.

CONCLUSION

The Board's final rule on Regulation Z open-end credit was a significant undertaking. Because of the considerable changes to the regulation, banks should begin now to review the amendments and work on updating and testing their systems so that they are in compliance by the July 1, 2010, effective date. Readers interested in more details can consult the rulemaking notice. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

Consumer Compliance Outlook®

Ten Independence Mall
Philadelphia, Pennsylvania 19106-1574
www.consumercomplianceoutlook.org

ADDRESS SERVICE REQUESTED

PRESORTED STANDARD
U.S. POSTAGE
PAID
PHILADELPHIA, PA
PERMIT #7046

Calendar of Events

July 16-18	Interagency Minority Depository Institution National Conference The Federal Financial Institution Regulatory Agencies Westin Michigan Avenue, Chicago, IL
July 22	Bank Supervision Community Bankers Forum Federal Reserve Bank of Richmond Inn of Martha Washington, Abingdon, VA
August 2-7	School of Bank Card Management American Bankers Association Emory University Conference Center Hotel, Atlanta, GA
September 13-15	2009 Home Equity Lending Conference Consumer Bankers Association Westin Diplomat, Hollywood, FL
September 24-25	Recent Developments in Consumer Credit and Payments Federal Reserve Bank of Philadelphia Ten Independence Mall, Philadelphia, PA