

# CONSUMER COMPLIANCE OUTLOOK®

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A FEDERAL RESERVE SYSTEM  
PUBLICATION WITH A  
FOCUS ON CONSUMER  
COMPLIANCE ISSUES

## RULES REGARDING OVERDRAFT SERVICES: QUESTIONS AND ANSWERS

BY ALEX KUNIGENAS, COMPLIANCE RISK COORDINATOR,  
FEDERAL RESERVE BANK OF SAN FRANCISCO

### INTRODUCTION

On December 10, 2009, the Federal Reserve System held its first Outlook Live audio conference. Outlook Live is intended to be an ongoing series of teleconferences focused specifically on consumer compliance issues. In December, David Stein and Dana Miller, both with the Federal Reserve Board's legal staff, presented the new overdraft rules issued by the Board of Governors, primarily covering changes to Regulation E but also touching on previously proposed Regulation AA rules and the final Regulation DD disclosure rules effective January 2010.

This inaugural session of Outlook Live had a large number of participants and triggered a significant number of questions. While many of these questions were addressed during the call, time and other practical considerations limited the number of specific questions that could be answered. To address the hundreds of questions received during and after the call, *Outlook* is providing an overview of the new Regulation E rule and answers to the most common questions.

### GENERAL INFORMATION

#### *Applicability*

The new overdraft service rules apply to consumer accounts only. As described in §205.17(a) of Regulation E, "The term 'overdraft service' means a service under which a financial institution assesses a fee or charge on a *consumer's* account held by the institution for paying a transaction (including a check or other item) when the consumer has insufficient or unavailable funds in the account" (emphasis added). The regulation identifies three types of services that are not considered "overdraft services," including transfers from a line of credit, such as a credit card account, home equity line of credit, or an overdraft line of credit; transfers from another account held by the consumer, such as a savings account; or a line of credit or other transaction exempt from the Federal Reserve Board's Regulation Z (12 C.F.R. §226) pursuant to 12 C.F.R. §226.3(d) (i.e., securities or commodities accounts).

#### *Scope of Opt-In*

Generally, the new rule prohibits an institution that holds a consumer's ac-

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## Outlook Staff

Editors ..... Kenneth Benton  
Sally Burke  
Robin Myers

Designer ..... Dianne Hallowell  
Research Assistant ..... Amy Armstrong

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Suggestions, comments, and requests for back issues are welcome in writing, by telephone (215-574-6500), or by e-mail ([Outlook@phil.frb.org](mailto: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

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# CRA AND CONSUMER PROTECTION ISSUES IN BANKING APPLICATIONS

BY CHARLES S. FLEET,

SENIOR SUPERVISORY CONSUMER FINANCIAL SERVICES ANALYST,  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

This article provides information about how the Federal Reserve considers an applicant's Community Reinvestment Act (CRA) and consumer compliance performance in making decisions on applications for bank mergers and acquisitions. Because examination ratings serve as a measure of performance in these areas, this article focuses particularly on the role of CRA and consumer compliance ratings in the application decision process.

## HOW IS CRA PERFORMANCE FACTORED INTO DECISIONS ON BANKING APPLICATIONS?

The CRA requires the Federal Reserve to consider a depository institution's record of helping to meet the credit needs of its local communities in evaluating applications for mergers and acquisitions and branches.<sup>1</sup> According to interagency guidance on the CRA,<sup>2</sup> information from a CRA examination is a particularly important consideration in the applications process because it represents a detailed evaluation of the institution's CRA performance by its supervisory agency. The guidance further states that an examination is an important, and often controlling, factor in evaluating an institution's record. However, the guidance also notes that, in some cases, an examination may not be sufficiently recent. In other situations, a specific issue raised during the application process (such as progress in addressing weaknesses identified by examiners, progress in implementing commitments previously made to the reviewing agency, or a supported allegation from a commenter) is relevant to CRA performance under the regulation but may not have been addressed in the examination. In these circumstances, the applicant may be asked to present sufficient information to supplement its record of performance and to respond to the substantive issues raised.

## HOW IS CONSUMER COMPLIANCE PERFORMANCE FACTORED INTO DECISIONS ON BANKING APPLICATIONS?

The statutes governing the processing of applications for bank holding company mergers and acquisitions, bank mergers, and bank branches require the Federal Reserve to assess certain managerial factors when considering such proposals.<sup>3</sup> In making this assessment, the Federal Reserve reviews the record of compliance with laws and regulations by the institutions involved

<sup>1</sup> Regulation BB, 12 C.F.R. §228.29; see also 12 U.S.C. §2903(a).

<sup>2</sup> Interagency Questions and Answers Regarding Community Reinvestment (January 6, 2009), p. 31, available at <http://www.ffiec.gov/cra/pdf/2010-4903.pdf>. The Federal Reserve's website provides additional information on the CRA and the applications process: <http://www.federalreserve.gov/generalinfo/applications/afi/cra.htm>.

<sup>3</sup> These statutes include the Bank Holding Company Act, the Federal Deposit Insurance Act, and the Federal Reserve Act.



in the proposal. The institution's most recent consumer compliance rating is central to this review.

#### WHAT ARE THE CONSEQUENCES OF ADVERSE CRA OR CONSUMER COMPLIANCE RATINGS FOR BANKING APPLICATIONS?

Applicants are best positioned to receive favorable action by the Federal Reserve when they have sound CRA and consumer compliance risk management programs in place and working well. A less than satisfactory CRA rating can pose a formidable and often insurmountable hurdle for an applicant. Denials are made public and therefore carry significant reputational risk.

Proposals involving an application by a state member bank with a less than satisfactory consumer compliance rating or by a bank holding company with a depository institution subsidiary that has a less than satisfactory consumer compliance examination rating raise significant concerns relating to the managerial factors considered by the Federal Reserve. Such proposals, if entertained, would require substantial analysis and justification. The Federal Reserve would consider a number of factors, including the nature and severity of the weaknesses that led to the rating; the corrective action taken to date, including the primary regulator's view of such action; the size of the problem institution relative to the organization's consolidated total assets; and whether the proposal would pose a material distraction to management in its efforts to achieve corrective action.

#### HOW COULD AN ADVERSE RATING AFFECT AN APPLICATION FOR MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM?

On July 1, 2009, the Federal Financial Institutions Examination Council issued a Statement on Regulatory Conversions<sup>4</sup> that encompasses situations in which the institution has a rating of 3, 4, or 5 for consumer compliance or safety and soundness (or "Needs to Improve" or "Substantial Noncompliance" for CRA) or in which the institution has a serious or material corrective program in place or being contemplated. The statement reaffirms that supervisors will consider only applications undertaken for legitimate reasons. It also

reaffirms that conversion requests submitted while serious or material enforcement actions are pending with the current chartering authority or primary federal regulator should not be entertained because such requests could delay or undermine supervisory actions.

The statement also conveyed the expectation that the prospective supervisor would consult with the current supervisor and follow that supervisor's examination and enforcement actions, including consumer protection and safety and soundness issues. The statement further provides that if the last examination is not recent or if other circumstances warrant, the prospective supervisor may conduct an eligibility examination and invite the current supervisor to help ensure continuity in the bank's supervision.

**APPLICANTS ARE BEST POSITIONED TO RECEIVE FAVORABLE ACTION BY THE FEDERAL RESERVE WHEN THEY HAVE SOUND CRA AND CONSUMER COMPLIANCE RISK MANAGEMENT PROGRAMS IN PLACE AND WORKING WELL.**

#### WHAT ARE THE BENEFITS TO MAINTAINING A SATISFACTORY OR BETTER CRA AND CONSUMER COMPLIANCE RATING?

Organizations whose banks are rated satisfactory or better for CRA and consumer compliance may be eligible for streamlined processing of applications, provided the banks involved are also rated satisfactory for safety and soundness, the Federal Reserve has not received any substantive comments on the proposal, and the application otherwise meets the criteria for expedited action. Streamlined processing can reduce the paperwork and the processing time for applications.<sup>5</sup>

#### WHAT IS THE ROLE OF PUBLIC COMMENT IN THE APPLICATIONS PROCESS?

The opportunity for public comment is an important

<sup>4</sup> [http://www.ffiec.gov/pdf/pr070109\\_statement.pdf](http://www.ffiec.gov/pdf/pr070109_statement.pdf)

<sup>5</sup> Regulation Y, 12 C.F.R. §225.14 (expedited action for certain bank acquisitions by well-run bank holding companies)


aspect of the applications process because comments can provide a valuable perspective on an institution's CRA or consumer compliance performance. Public notice of applications is published in local newspapers and/or the *Federal Register*, generally for a 30-day comment period. The Federal Reserve also provides on its public website a list of pending applications and notices subject to public comment.<sup>6</sup> Comments that are considered timely and substantive (i.e., that do not involve individual complaints or that raise frivolous, previously considered, or wholly unsubstantiated claims or irrelevant issues) trigger the need for review by the Board of Governors of the Federal Reserve System (Board). Cases requiring Board action are processed within 60 days unless the applicant is notified that the period has been extended and is told the reasons for the extension.

#### WHEN DOES THE BOARD HOLD PUBLIC MEETINGS ON APPLICATIONS?

The Board decides whether to hold a public meeting on a case-by-case basis. The decision is based on a number of factors, including the size and expect-

ed impact of the transaction on the communities affected; the potential to gather useful information for purposes of deciding on the application; and the level of public interest. Since 1990, the Federal Reserve has held 13 public meetings related to banking applications, which represents a very small percentage of the total applications filed. Most of those public meetings involved applications by very large institutions with potentially significant and wide-ranging effects, such as the 2008 proposal by Bank of America to acquire Countrywide.<sup>7</sup>

#### CONCLUDING REMARKS

The Federal Reserve takes its consumer protection responsibilities seriously, including closely scrutinizing consumer compliance and CRA records as part of the applications process. Accordingly, it is very important that applicants devote appropriate resources to building and maintaining strong CRA and consumer compliance risk management programs. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator. 

<sup>6</sup> <http://www.federalreserve.gov/releases/h2a/h2aindex.cfm>

<sup>7</sup> <http://www.federalreserve.gov/events/publicmeeting/20080428/>

## COMPLIANCE ALERT

**The Board of Governors of the Federal Reserve System (Board) announced amendments to Appendix A of Regulation CC – Routing Number Guide to Next-Day Availability Checks and Local Checks on December 31, 2009.** These amendments reflect the restructuring of the Federal Reserve Banks' check-processing operations. Appendix A of Regulation CC provides a routing symbol guide that helps depository institutions determine the maximum permissible hold periods for most deposited checks. The amendments delete the reference to the head office of the Federal Reserve Bank of Atlanta and reassign the routing symbols currently listed under that office to the head office of the Federal Reserve Bank of Cleveland. **Effective February 27, 2010, the Federal Reserve Bank of Cleveland will process checks for the entire country, which will eliminate nonlocal check holds.** Previously, a check was defined as "nonlocal" if the depository bank was not in the same check-processing region as the payor bank based on the banks' respective routing numbers. **Checks considered nonlocal before the change will be considered local as of February 27, 2010, and subject to the two-business-day funds availability requirement under §229.12(b).** Banks\* should update their disclosures and adjust their systems to reflect this change. Additionally, §229.18(e) requires that when a bank changes its availability policy for consumer accounts that expedites the hold for checks, it must send a notice of the change not later than 30 days after the change becomes effective. The announcement is available on the Board's website at <http://www.federalreserve.gov/newsevents/press/bcreg/20091231a.htm>.

\* Regulation CC applies to "banks," as defined in §229.2(e).

# AN OVERVIEW OF THE REGULATION Z RULES IMPLEMENTING THE CARD ACT

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BY KENNETH J. BENTON, SENIOR CONSUMER REGULATIONS SPECIALIST,  
FEDERAL RESERVE BANK OF PHILADELPHIA

On May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act).<sup>1</sup> This law contains the most significant changes in credit card regulation since enactment of the Fair Credit and Charge Card Disclosure Act of 1988,<sup>2</sup> which amended the Truth in Lending Act (TILA) to add specific requirements for credit and charge cards. Historically, TILA relied on disclosures as its primary tool for consumer protection, assuming that if creditors fully, clearly, and conspicuously disclose the terms and conditions of their products, consumers could make informed credit decisions. But because of the growing complexity of credit card products,<sup>3</sup> with voluminous disclosures often written in dense legal prose, this assumption has been questioned.<sup>4</sup> Thus, the CARD Act relies heavily on substantive provisions that ban or restrict certain credit card practices as its primary mechanism for protecting consumers.

The CARD Act has three implementation dates: August 20, 2009, February 22, 2010, and August 22, 2010. On January 12, 2010, the Board of Governors of the Federal Reserve System (Board) published final rules<sup>5</sup> un-

der Regulation Z, TILA's implementing regulation, to implement phases 1 and 2 of the CARD Act.<sup>6</sup> On March 5, 2010, the Board issued a rulemaking proposal under Regulation Z to implement phase 3.<sup>7</sup> This article provides an overview of the changes to Regulation Z to implement the first two phases of the CARD Act.

## PHASE 1 RULES: EFFECTIVE AUGUST 20, 2009

### **§226.9(c)(2): 45-Day Change-in-Terms Notice**

The CARD Act requires card issuers to provide written notice to consumers at least 45 days before the effective date of an increase in an annual percentage rate (APR) or any other "significant change."<sup>8</sup> This requirement addresses the concern that some issuers were increasing APRs or adversely changing other account terms shortly before the changes became effective or sometimes with no notice at all. The 45-day advance notice rule is designed to provide consumers with sufficient time to respond to a change-in-terms notice. For example, a consumer notified of a rate increase might shop for a new card with lower APRs.

The Board implemented this provision in §226.9(c)

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<sup>1</sup> Public Law 111-24 (2009). Available at: [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111\\_cong\\_public\\_laws&docid=f:publ024.111.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ024.111.pdf)

<sup>2</sup> Public Law 100-583 (1988)

<sup>3</sup> See, e.g. Government Accountability Office, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," 06-929 (September 2006); "The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers," hearing before the U.S. House Subcommittee on Financial Institutions and Consumer Credit, 110th Cong., 2nd Sess. (April 17, 2008) (testimony of Sandra Braunstein)

<sup>4</sup> "Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers," hearing before the U.S. Senate Committee on Banking, Housing and Urban Affairs, 110th Cong., 1st Sess. (January 25, 2007) (testimony of Elizabeth Warren) ("These laws and proposals acknowledge that there are simply some practices that are wrong and should be banned.")

<sup>5</sup> <http://www.federalreserve.gov/newsevents/press/bcreg/20100112a.htm>

<sup>6</sup> The Board published an interim final rule for phase 1 to provide guidance for card issuers while soliciting comments for a final rule. In addition, the Board announced its intention to withdraw its Regulation AA final rule for credit cards under the Federal Trade Commission (FTC) Act because the CARD Act covers those practices. The Board also made changes to its previous rulemaking for open-end credit (not home-secured) that becomes effective July 1, 2010.

<sup>7</sup> <http://www.federalreserve.gov/newsevents/press/bcreg/20100303a.htm>

<sup>8</sup> The Board defined "significant change" to include an increase in the minimum payment, the acquisition of a security interest, and changes to the APR, issuance fees, fixed finance charge/minimum interest charge, transaction charges, grace period, balance computation method, cash advance fee, late payment fee, over-the-limit fee, balance transfer fee, returned-payment fee, required credit insurance debt cancellation/suspension coverage, amount of available credit, and the reference for billing error rights.

(2)(i)(A) by requiring that when a significant change is made to a term required to be disclosed under §226.6(b)(3), (b)(4), or (b)(5) or the required minimum periodic payment is increased, a creditor must provide a written notice of the change at least 45 days before the date of the change. As detailed in footnote 8, the Board defined significant change broadly to capture credit account terms that are likely to be important to consumers.

Additional rules apply if a card's APRs or fees are increased because the consumer failed to make a minimum payment within 60 days of the due date. Under §226.9(g)(3)(B), the issuer must provide a notice stating the reason for the increase and stating that if the consumer makes six consecutive required minimum payments after the effective date of the change, the issuer will restore the rate or fee in effect before the change for previous transactions.

The CARD Act also allows the consumer to reject the change, subject to certain exceptions. Under §226.9(c)(2)(iv)(D), the change-in-terms notice must (1) notify the consumer of the right to reject the change before its effective date; (2) provide instructions for rejecting the change, and, if applicable, (3) contain a statement that if the consumer rejects the change, his ability to use the account for further advances will be terminated or suspended. However, the right to reject the change does not apply if the change is an increase in the minimum payment, a change or an increase in an APR, a change in the balance computation method because of the new rule in §226.54 banning double-cycle billing, or a change imposed because the consumer failed to make a minimum payment within 60 days of its due date.

If the consumer rejects a significant change, card issuers are subject to restrictions on the terms and conditions they may impose for repayment of the balance in effect when the consumer rejected the change, known as the protected balance.<sup>9</sup> To ensure that consumers have a reasonable period of time to repay the protected balance, §226.9(h)(2) specifies that the

issuer cannot require its repayment by a method less beneficial than the following acceptable methods: (1) the repayment method that was in place before the effective date of the increase; (2) an amortization period of not less than five years, beginning no earlier than the effective date of the increase; or (3) a required minimum periodic payment that includes a percentage of the balance that is equal to no more than twice the percentage required before the effective date of the increase. These requirements ensure that a consumer's decision to reject a future change is not hampered by the burden of having to pay the protected balance in a short period of time.

#### *§226.5(b)(2)(ii): 21-Day Rule for Delivery of Periodic Statements*

Both the Board and Congress received comments from consumers that they often received their credit card statements with insufficient time to review the charges and mail a payment before the due date, taking into account the delay caused by using the mail. To ensure that cardholders have adequate time to review their bills and send payments, §226.5(b)(2)(ii) requires card issuers to establish reasonable procedures to ensure that periodic statements are delivered at least 21 days before the payment due date. In addition, an issuer cannot treat a required minimum periodic payment received within that period as late for any purpose (for example, imposing a penalty or reporting to the credit bureau).<sup>10</sup>

#### **PHASE 2 RULES: EFFECTIVE FEBRUARY 22, 2010**

To implement phase two of the CARD Act, which contains most of the act's provisions, the Board amended certain existing sections of Regulation Z and added a new subpart G with eight new sections (§§226.51-.58). These new and amended sections are discussed below.

#### *§226.5(a)(2)(iii), §226.16(f): Use of the Term "Fixed" for APRs*

Section 226.5(a)(2)(iii) addresses consumer protection issues that can arise when an APR is labeled fixed. For APRs that must appear in a tabular format (for example, APRs for charge and credit card advertisements

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<sup>9</sup>This term is defined in §226.55(c).

<sup>10</sup>The CARD Act originally specified that this rule applied to all open-end credit accounts (not just credit cards). However, Congress amended the law in November 2009 to limit the provision to credit cards. Congress did not change the CARD Act's requirement that periodic statements generally be mailed at least 21 days before the expiration of the grace period for all open-end credit accounts that include a grace period to avoid finance charges.

and solicitations), §226.5(a)(2)(iii) prohibits a creditor from describing an APR as fixed unless the time period during which the rate will be fixed is specified, or the rate will not increase while the plan is open. This restriction applies to all open-end (not home-secured) credit. In addition, the Board amended the open-end credit advertising rules in §226.16 to impose an identical rule for credit advertising that describes an APR as fixed.

#### *§226.7(b)(12): Repayment Disclosure*

While the CARD Act relies primarily on substantive provisions, it also includes some new disclosures. Card issuers must include disclosures on consumers' periodic statements warning them that if they make only minimum payments on their accounts, they will pay more in interest, and it will take longer to pay off their account balance. Section 226.7(b)(12) also requires issuers to include a balance repayment table detailing repayment information specific to the account on each periodic statement.

Also, if the minimum payment does not amortize the balance or results in negative amortization, this information must be disclosed.

#### *§226.10: Cut-off Time for Crediting Payment*

For all open-end credit, a consumer's payment must be credited on the date of receipt as long as it is received before 5 p.m. However, a creditor may impose reasonable payment requirements, such as specifying the address to which payments must be sent or that payment be made in U.S. dollars. Section 226.10(b)(3) also includes an additional restriction that applies only to credit card issuers that are financial institutions. If a consumer makes a card payment in person or at a branch of a financial institution before it is closed, the payment must be considered timely, and the issuer cannot specify a time earlier than the branch closing time.

#### *§226.10(e): Limitations on Fees Related to Method of Payment*

The CARD Act prohibits issuers from charging a fee for payments. Under §226.10(e), issuers cannot charge a fee for any payment method, including by mail, electronically, or by telephone. An exception is made for

expedited service involving a customer service representative (for example, calling the issuer the day before the payment due date and speaking with a representative to make an expedited payment).

#### *§226.11(c): Timely Settlement of Estate Debts*

The CARD Act required the Board to write a regulation to ensure that estate administrators can resolve outstanding credit card balances in a timely manner. Under §226.11(c), issuers must adopt written policies

CARD ISSUERS MUST INCLUDE DISCLOSURES ON CONSUMERS' PERIODIC STATEMENTS WARNING THEM THAT IF THEY MAKE ONLY MINIMUM PAYMENTS ON THEIR ACCOUNTS, THEY WILL PAY MORE IN INTEREST, AND IT WILL TAKE LONGER TO PAY OFF THEIR ACCOUNT BALANCE.

and procedures that allow an estate administrator for a deceased cardholder to determine the amount owed and pay it in a timely manner. Issuers must also respond to a request from the administrator for the account balance in a timely manner, with a safe harbor if the information is provided within 30 days of the request. If the administrator pays the account balance within 30 days, the issuer must stop assessing fees and waive any accrued interest.

#### *§226.51: Ability to Pay*

The CARD Act prohibits card issuers from opening a credit card account or increasing the credit limit of an existing account without considering the consumer's ability to make the required payments. Section 226.51 requires issuers to consider repayment ability for the required minimum periodic payments under the terms of the account based on the consumer's income or assets and current obligations.

Issuers must establish reasonable policies and procedures that consider one of the following: the ratio of debt obligations to income; the ratio of debt obligations to assets; or the income the consumer will have

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## ON THE DOCKET: RECENT FEDERAL COURT OPINIONS\*

### REGULATION Z - TRUTH IN LENDING ACT (TILA)

**Change-in-terms notice for default pricing.** *Shaner v. Chase Bank USA, N.A.*, 587 F.3d 488 (1st Cir. 2009). The First Circuit held that under the rules applicable in 2006, a credit card issuer does not have to provide a change-in-terms notice before applying a penalty rate increase that was already specified in the account agreement. After the consumer's payment due in mid-December was late, Chase determined on December 24, 2006, to apply the default interest rate to the account as of the beginning of that billing cycle, which began November 25, 2006. After recognizing that there were conflicting decisions on this issue in the Seventh and Ninth Circuits, the First Circuit invited the Federal Reserve Board to file a friend-of-the-court brief. (The previous cases were discussed in the Second Quarter 2009 issue of *Outlook*.) The First Circuit, agreeing with the Seventh Circuit, treated the Board's interpretation of its own regulation as "controlling" and cited the Board's position that "at the time of the transactions at issue in this case, Regulation Z did not require a change-in-terms notice to be provided when a creditor increased a rate to a figure at or below the maximum allowed by the contract in the event of default." It should be noted, however, that effective August 20, 2009, a credit card issuer must provide written notice 45 days in advance before a rate is increased as a penalty or due to delinquency or default. The new requirement is discussed in the CARD Act article on page 5.

On a related note, Chase petitioned the United States Supreme Court to review the Ninth Circuit's contrary decision, and the Supreme Court recently invited the Solicitor General's office to express its views on whether to grant the petition.

**Claim for actual damages requires proof of detrimental reliance.** *Vallies v. Sky Bank*, 591 F.3d 152 (3d Cir. 2009). The Third Circuit ruled that a plaintiff seeking actual damages because of a TILA or Regulation Z disclosure violation must establish detrimental reliance, meaning the plaintiff suffered a loss from relying on an inaccurate disclosure. The plaintiff in this class action obtained a car loan with Sky Bank, and the transaction included a charge of \$395 for guaranteed auto protection, a form of debt cancellation coverage. Under Regulation Z, creditors may exclude charges for debt cancellation coverage from the finance charge if the coverage is optional and certain required disclosures are made. (See 12 C.F.R. §226.4(d)(3).) The proper disclosures were made by the automobile dealer but not the creditor, which was Sky Bank. The plaintiff sought both actual damages and statutory damages in light of the Third Circuit's previous ruling that Sky Bank had violated TILA because the disclosures were issued in the name of the car dealer instead of the creditor. (See *Vallies v. Sky Bank*, 432 F.3d 493, 495 (3d Cir. 2005).) After the bank settled the borrower's claim for statutory damages, the trial court dismissed the remaining claim for actual damages, finding that the plaintiff did not allege and could not establish detrimental reliance. The Third Circuit affirmed, noting that the lower court's ruling is supported by TILA's legislative history and by decisions in the Courts of Appeals for the First, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits.

**Update: *Cunningham v. National City Bank* (D. Mass. 2009).** *Outlook* previously discussed this case concerning HELOCs and grace periods. The First Circuit recently affirmed the lower court's ruling in *Cunningham v. National City Bank*, 588 F.3d 49 (1st Cir. 2009).





## FAIR HOUSING ACT (FHA)

**Standing.** *City Council of Baltimore v. Wells Fargo Bank, N.A.*, 2010 WL 46401 (Dist. M.D. Jan. 6, 2010). A federal district court in Baltimore dismissed a lawsuit filed under the FHA by the Baltimore City Council and the Mayor of Baltimore against Wells Fargo Bank and Wells Fargo Financial Leasing, Inc. The lawsuit alleged that the bank violated the FHA by engaging in reverse redlining against minorities in Baltimore with loans that were likely to fail and end in foreclosure. As a result of the reverse redlining, the city alleged that it sustained millions of dollars in damages in terms of decreased property tax revenues from foreclosures, increased police and fire protection services for vacant buildings, and increased spending for administrative, legal, and social services. The court noted that the number of vacant houses in Baltimore, according to the city's own estimate, ranged from 16,000 to 30,000 but that Wells Fargo made only 163 loans in minority neighborhoods where the property later became vacant after foreclosure. Of the 163 properties, only 80 are currently vacant. The court therefore found that Wells Fargo is only potentially responsible for a negligible portion of the city's vacant housing stock. The court also noted that many other factors could have contributed to the vacancies unrelated to the alleged reverse redlining. The court therefore dismissed the case without prejudice to the plaintiffs' right to refile it if the complaint were narrowed. For example, the court suggested that the complaint could be narrowed to allege a claim for damages sustained with regard to specific houses that became vacant because of Wells Fargo's lending activity or damages caused to specific neighborhoods in which Wells Fargo made a large number of loans.

## REGULATION X – REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

**Standing to litigate §8 violations when there's no monetary harm.** *Alston v. Countrywide Financial Corp.*, 585 F.3d 753 (3rd Cir. 2009). The Third Circuit reversed a trial court's ruling that plaintiffs lacked standing to pursue a RESPA class action lawsuit because they did not allege they were overcharged for settlement services. The plaintiffs purchased private mortgage insurance (PMI) for their loans made by Countrywide. They alleged that Countrywide violated RESPA's ban on kickbacks and unearned fees in §§8(a) and 8(b), respectively, because Countrywide had an arrangement under which the PMI carriers agreed to purchase reinsurance from Countrywide's affiliate for PMI policies the carriers issued for Countrywide mortgages. The plaintiffs alleged that the purchase of reinsurance from the Countrywide affiliate was a sham resulting in unearned fees being paid to Countrywide because the affiliate never paid any claims under the reinsurance agreements. The Justice Department intervened in the appeal and filed a brief supporting the borrowers. The trial court dismissed the case, holding that the plaintiffs lacked standing because they did not allege they were overcharged for the PMI. The Third Circuit reversed, finding that an overcharge is not a required element of a private lawsuit. The court noted that RESPA permits plaintiffs to recover three times the amount charged for the service if there is a violation of §8, even if the consumer is not injured by an overcharge.

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

## NEWS FROM WASHINGTON: REGULATORY UPDATES

### **Federal Trade Commission (FTC) issues final rule for free credit report services.**

On February 23, 2010, the FTC announced a final rule that requires certain advertisements for “free credit reports” to include a prominent disclosure to prevent confusion with the free annual credit reports available to consumers under the Fair and Accurate Credit Transactions Act of 2003. The disclosure for print advertisement states: “THIS NOTICE IS REQUIRED BY LAW. You have the right to a free credit report from AnnualCreditReport.com or 877-322-8228, the ONLY authorized source under federal law.” Slightly different disclosures apply for radio, telemarketing solicitations, and Internet advertisements. The rule also prohibits nationwide consumer reporting agencies from advertising other products or services to consumers seeking free credit reports until after consumers receive their free report. The effective date for the rule is April 2, 2010, except for certain disclosure requirements, which take effect September 1, 2010. The FTC’s announcement and the final rule are available on the FTC’s website at <http://www.ftc.gov/opa/2010/02/facta.shtm>.

### **The U.S. Department of Housing and Urban Development (HUD) releases new home-buying handbook in anticipation of new RESPA rules.**

On December 28, 2009, HUD released a new home-buying handbook entitled *Shopping for Your Home Loan: HUD’s Settlement Cost Booklet*. The Real Estate Settlement Procedures Act (RESPA) requires lenders and mortgage brokers to provide this booklet to applicants within three days after receiving or preparing the application. The booklet will assist consumers in becoming familiar with how interest rates, points, balloon payments, and prepayment penalties will affect their monthly mortgage payments. The booklet also has important information about the loan after settlement, including how to resolve loan servicing problems and steps to take to avoid foreclosure. The booklet along with additional information regarding RESPA can be found on HUD’s website at [http://www.hud.gov/offices/hsg/ramh/res/respa\\_hm.cfm](http://www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm).


### **The Board and the FTC issue final rules on risk-based pricing notices.**

On December 22, 2009, the Board and the FTC announced final rules that generally require a creditor to provide a consumer with a notice when, based on the consumer’s credit report, the creditor provides credit to the consumer on less favorable terms than it provides to other consumers. Consumers who receive this risk-based pricing notice will be able to obtain a free credit report to check the accuracy of the report. In addition, as an alternative to providing risk-based pricing notices, the final rules permit creditors to provide consumers who apply for credit with a free credit score and information about that score. The final rules implement §311 of the Fair and Accurate Credit Transactions Act of 2003, which amends the Fair Credit Reporting Act and will be effective January 1, 2011. The press release and the *Federal Register* notice can be found at <http://www.ftc.gov/opa/2009/12/rbpricing.shtm>.

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

On December 22, 2009 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. Annual adjustments to these asset-size thresholds are based on the year-to-year change in the average of the consumer price index (CPI) for urban wage earners and clerical workers, not seasonally adjusted, for each 12-month period ending in November, with rounding to the nearest million.

As a result of the 0.98 percent decrease in the CPI index for the period ending in November 2009, the definitions of small and intermediate small institutions for CRA examinations will change as follows: (1) 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 \$1.098 billion; and



(2) intermediate small bank or intermediate small savings association means a small institution with assets of at least \$274 million as of December 31 of both of the prior two calendar years, and less than \$1.098 billion as of December 31 of either of the prior two calendar years.

These asset-size threshold adjustments were effective January 1, 2010. The announcement is available on the website of the Federal Financial Institutions Examination Council (FFIEC) at <http://ffiec.gov/cra/pdf/assetthreshold2010.pdf>.

**The Board publishes HMDA asset-size exemption threshold for depository institutions.**

On December 22, 2009, the Board published its annual notice of the asset-size exemption threshold for depository institutions under Regulation C, which implements the Home Mortgage Disclosure Act (HMDA).

The asset-size exemption for depository institutions will remain \$39 million based on the annual percentage change in the CPI for the 12-month period ending in November 2009. As a result, depository institutions with assets of \$39 million or less as of December 31, 2009, are exempt from collecting HMDA data in 2010. An institution's exemption from collecting data in 2010 does not affect its responsibility to report the data it was required to collect in 2009. The adjustment was effective January 1, 2010.

The Board's announcement is available at <http://www.federalreserve.gov/newsevents/press/bcreg/2009i222a.htm>.

**Financial regulators propose guidance on reverse mortgage products.**

On December 17, 2009, the FFIEC, on behalf of its members, released proposed guidance on reverse mortgage products. The guidance addresses the general features of reverse mortgage products, relevant legal requirements, and consumer protection concerns raised by reverse mortgages. It is designed to

help financial institutions ensure that their risk management and consumer protection practices adequately address the compliance and reputation risks raised by reverse mortgage lending. The proposed guidance focuses on the need for banks, thrifts, and credit unions to provide clear and balanced information to consumers about the risks and benefits of these products. The deadline for submitting comments was February 16, 2010. The press release is available at <http://www.ffiec.gov/press/pr121709.htm>.

**The Division of Consumer and Community Affairs (DCCA) of the Board issues Consumer Affairs Letter 09-13: Mortgage Loan Modifications and Regulation B's Adverse Action Requirement.**

On December 4, 2009, DCCA issued Consumer Affairs Letter 09-13 (CA 09-13) to address questions regarding whether adverse action notices under Regulation B (Equal Credit Opportunity Act) are required for mortgage loan modification declarations, including those made pursuant to the U.S. Department of Treasury's Making Home Affordable Modification Program (HAMP). Regulation B requires an adverse action notice when a creditor declines an application for an extension of credit from a borrower who is not delinquent or in default on that loan. The letter details a four-part analysis, using HAMP as an example, that examiners should use when determining whether adverse action notices are required. CA 09-13 is available at <http://www.federalreserve.gov/boarddocs/caletters/2009/0913/caltr0913.htm>.

## RULES REGARDING OVERDRAFT SERVICES: QUESTIONS AND ANSWERS

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count from assessing *any* fee or charge on a consumer's account for paying an ATM or a one-time debit card transaction as part of the institution's overdraft service, unless:

1. The consumer is provided with a notice in writing, (or if the consumer agrees, electronically) segregated from all other information, explaining the institution's overdraft service;
2. The consumer is given a reasonable opportunity to affirmatively consent (opt in);
3. The consumer affirmatively consents (opts in) to the service; and
4. The institution provides the consumer with confirmation of the consumer's consent in writing (or if the consumer agrees, electronically), which includes a statement informing the consumer of the right to revoke such consent.

The opt-in requirement applies to *any* ATM transaction (e.g., withdrawing cash, inter-account transfers, bill payments, and postage stamp purchases) at *any* location (e.g., institution-owned and operated, third party, proprietary, and foreign ATMs), and *any* one-time debit card transaction (e.g., at a merchant or store, online, or by telephone). The opt-in requirement applies to all accounts covered by Regulation E, including payroll card accounts. The final rule does not apply to check transactions, recurring debits, or ACH transactions.

### *Timing*

The final rule has a mandatory compliance date of July 1, 2010. The opt-in requirement applies to both new and existing accounts. For accounts opened before July 1, 2010 (existing accounts), an institution must not assess any fees or charges on or after August 15, 2010, for paying an ATM or one-time debit card transaction, unless the consumer has affirmatively consented to the overdraft service for those transactions. For accounts opened on or after July 1, 2010 (new accounts), institutions must obtain affirmative consent before assessing fees or charges on the con-

sumer's account for paying an ATM or one-time debit card transaction pursuant to the institution's overdraft service.

### *Anti-Coercion Provisions*

The final rule prohibits institutions from conditioning the payment of check, ACH, and other types of transactions on the consumer's consenting to the payment of ATM and one-time debit card transactions. In addition, institutions cannot decline to pay checks, ACH, and other types of transactions that overdraw the account simply because the consumer has not consented to

THE FINAL RULE DOES NOT INCLUDE ANY EXCEPTIONS TO THE PROHIBITION ON CHARGING OVERDRAFT FEES FOR ATM AND ONE-TIME DEBIT CARD TRANSACTIONS WITHOUT THE CONSUMER'S AFFIRMATIVE CONSENT.

the overdraft service for ATM and one-time debit card transactions. Finally, institutions are required to provide the same account terms, conditions, and features, including pricing, to those consumers who do not opt in that they provide to consumers who do opt in.

### *Exceptions*

The final rule does not include any exceptions to the prohibition on charging overdraft fees for ATM and one-time debit card transactions without the consumer's affirmative consent. However, the final rule includes an exception to the notice and opt-in requirements for institutions that have a policy and practice of declining to authorize and pay any ATM or one-time debit card transactions when the institution has a reasonable belief at the time of the authorization request that the consumer does not have sufficient funds available to cover the transaction. The Board recently issued a proposal to clarify that the fee pro-



hibition applies to all institutions, including institutions that have a policy and practice of declining to authorize and pay any ATM or one-time debit card transactions when there are insufficient funds in the account.<sup>1</sup>

### Resources

The final rule was published in the *Federal Register* on November 17, 2009. The complete text of the *Federal Register* notice, a one-page highlights document, Model Form A-9, and a presentation of the consumer testing of overdraft disclosures are available at <http://www.federalreserve.gov/newsevents/press/bcreg/20091112a.htm>.

### Relation to Regulation DD

The final rule for disclosures about overdraft programs was published in the *Federal Register* on January 29, 2009, and went into effect on January 1, 2010.<sup>2</sup> This rule includes requirements for disclosures on periodic statements of the aggregate dollar amounts charged for overdraft fees and for returned item fees (for the statement period and the year-to-date). The final rule also requires institutions that provide account balance information through an automated system to provide a balance that excludes any additional funds that may be made available to cover overdrafts. Model Form B-10 provides an example of the required periodic statement disclosures.

## QUESTIONS AND ANSWERS

1. Do the new rules apply to institutions that do not offer a formal overdraft program, but that merely pay overdrafts on an ad hoc basis and charge overdraft fees when that happens?

Yes, the new rules apply even if the institution does not have a formal overdraft program, but occasionally pays overdrafts and charges fees when it does, regardless of what the program is called or its informal nature. However, depending on their specific practices, these institutions may not have to provide opt-in notices to consumers or obtain consumer opt-ins if they do not charge overdraft fees.

2. What is meant by a “reasonable opportunity” to affirmatively consent or opt in?

Comment 205.17(b)-4 of the Official Staff Commentary addresses the question of reasonable opportunity to provide affirmative consent. It states that a financial institution provides a consumer with a reasonable opportunity to provide affirmative consent when, among other things, it provides reasonable methods by which the consumer may affirmatively consent, including:

1. By mail. The institution provides a form that the consumer can fill out and mail to affirmatively consent to the service.
2. By telephone. The institution provides a readily available telephone line that consumers may call to provide affirmative consent.
3. By electronic means. The institution provides an electronic means for the consumer to affirmatively consent. For example, the institution could provide a form that can be accessed and processed on its website, where the consumer may click on a check box to indicate consent and confirm that choice by clicking on a button that affirms the consumer’s consent.
4. In person. The institution provides a form that the consumer can complete and present at a branch or office to affirmatively consent to the service.

3. Is it possible for consumers to opt in electronically, such as through an online banking portal?

Yes, see question 2. However, the institution must first provide the consumer with an opt-in notice in writing or, if the consumer agrees, electronically. The consumer should also be given the right to revoke the opt-in agreement in the same manner he or she used to opt in.

4. For joint account holders, do both parties have to opt in?

<sup>1</sup> The Board’s announcement and the proposed clarifications of the Regulation E final rule are available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100219a.htm>.

<sup>2</sup> <http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm>. The Board recently issued a proposal to clarify this rule, which is available at <http://www.federalreserve.gov/newsevents/press/bcreg/20100219a.htm>.

If two or more consumers jointly hold an account, the financial institution must treat the affirmative consent of any of the joint consumers as affirmative consent for that account. Similarly, the financial institution must treat a revocation of affirmative consent by any of the joint consumers as revocation of consent for that account. (§205.17(e))

**5. What are the permissible ways in which a financial institution can obtain the consumer's affirmative consent?**

Comment 205.17(b)-6 states that a consumer's affirmative consent, or opt-in, to a financial institution's overdraft service must be obtained separately from other consents or acknowledgments obtained by the institution, including a consent to receive disclosures electronically. An institution may obtain a consumer's affirmative consent by providing a blank signature line or check box that the consumer could sign or select to affirmatively consent, provided that the signature line or check box is used solely for purposes of evidencing the consumer's choice whether or not to opt into the overdraft service and not for other purposes.

An institution does not obtain a consumer's affirmative consent by including preprinted language about the overdraft service in an account disclosure provided with a signature card or contract that the consumer must sign to open the account and that acknowledges the consumer's acceptance of the account terms. Nor does an institution obtain a consumer's affirmative consent by providing a signature card that contains a pre-selected check box indicating that the consumer is opting into the overdraft service.

**6. Are institutions required to provide an opt-in notice to customers who have a traditional overdraft line of credit associated with their accounts?**

No, the final rule does not apply to the payment of overdrafts pursuant to an overdraft line of credit. See the definition of "overdraft service" in §205.17(a).

**7. How can an institution comply with the requirement to provide written confirmation of the consumer's affirmative consent?**

A financial institution may comply with the written confirmation requirement in §205.17(b)(1)(iv) by providing to the consumer a copy of the consumer's completed opt-in form or by sending a letter or notice to the consumer acknowledging that the consumer has elected to opt into the institution's service. The written confirmation must include a statement informing the consumer of his or her right to revoke the opt-in at any time. To the extent that the institution complies with the written confirmation requirement by providing a copy of the completed opt-in form, the institution may include the statement about revocation on the initial opt-in notice. (Comment 205.17(b)-7). The final rule requires institutions to provide the written confirmation before overdraft fees may be charged. The proposed clarifications to the final rule would amend Comment 205.17(b)-7 to clarify that the written confirmation must be sent before overdraft fees may be charged.

**8. Can a financial institution provide existing customers with opt-in notices before July 1, 2010, but not implement their choices until August 15, 2010?**

Yes, a financial institution may provide the notice required by §205.17(b)(1)(i) and obtain the consumer's affirmative consent to the financial institution's overdraft service for ATM and one-time debit card transactions before July 1, 2010, provided that the financial institution complies with all of the requirements of §205.17. (Comment 205.17(c)) However, to avoid misleading consumers, the institution should modify its notice to include a statement such as "After August 15, 2010, we will not authorize and pay overdrafts for the following types of transactions unless you ask us to (see below)." (§205.17(d)(6))

**9. If an existing customer does not opt in by August 15, 2010, what happens?**

For existing customers, an institution will no longer be able to assess fees or charges for paying overdrafts of ATM and one-time debit transactions after August 15, 2010, unless the customer has affirmatively consented.

10. Can a customer opt in at the customer level or must he or she opt in individually for each account he or she has with an institution?

Opt-in occurs at the account level, not at the customer level. Moreover, it can only occur for accounts that are already open, not for accounts that may be opened in the future.

11. If a consumer revokes his or her affirmative consent, does the institution have to waive or reverse any overdraft fees assessed on the consumer's account prior to the implementation of the revocation request?

A consumer may revoke consent at any time in the manner made available to the consumer for providing consent. A financial institution must implement a consumer's revocation of consent as soon as reasonably practical. If a consumer does so, the final rule does not require the financial institution to waive or reverse any overdraft fees assessed on the consumer's account prior to the institution's implementation of the consumer's revocation request. (§205.17(f) and Comment 205.17(f)-1)

12. Can a financial institution refuse to open a checking account when a consumer does not opt into the institution's overdraft service or can the institution offer different stand-in limits for those customers that opt in and those that opt out?

Section 205.17(b)(3) explains that an institution must provide the same account terms, conditions, and features to those consumers who do not opt in as to those who do. Based on this section, conditioning the opening of a checking account on opting in or creating different standards, such as stand-in limits, would be prohibited.

13. Can a financial institution include a description of its overdraft service in the account agreement or in supplemental materials that accompany the opt-in notice in addition to the opt-in notice describing its overdraft service?

Yes, a financial institution may include a description of its overdraft services in account agreements or in other documents that accompany the opt-in notice, as long as the notice required by

§205.17(b) is provided. However, documents that accompany the opt-in notice may constitute an advertisement promoting the payment of overdrafts. In that case, the institution must comply with the requirements of §230.11(b)(1) of Regulation DD by clearly and conspicuously disclosing in such advertisement: (1) the fee or fees for the payment of each overdraft; (2) the categories of transactions for which a fee for paying an overdraft may be imposed; (3) the time period by which the consumer must repay or cover any overdraft; and (4) the circumstances under which the institution will not pay an overdraft.

14. Is there any limit to the number or amount of overdraft fees an institution can impose once the consumer has opted in?

The final rule under Regulation E does not limit the number or amount of overdraft fees that an institution can impose once the consumer has opted in. However, §205.17(d)(3) states that the notice required by §205.17(b)(1)(i) must disclose the maximum number of overdraft fees or charges that may be assessed per day or, if applicable, that there is no limit. Nevertheless, the February 2005 Interagency Joint Guidance on Overdraft Protection Programs identified daily limits on consumer costs as a best practice: "Consider imposing a cap on consumers' potential daily costs from the overdraft programs. For example, consider limiting daily costs from the program by providing a numerical limit on the total overdraft transactions that will be subject to a fee per day or by providing a dollar limit on the total fees that will be imposed per day." 70 Fed. Reg. 9127, 9132 (February 24, 2005)

15. If a financial institution pays a check into overdraft, is it allowed to charge a fee even if the customer has not opted in?

Yes. Checks are not covered by the mandatory opt-in or fee prohibition rules in §205.17(b).

16. If a financial institution does not charge a fee when it pays an item into overdraft, does it have any obligations under the new rules?

The final rules prohibit a financial institution that holds a consumer's account from assessing a fee

or charge on a consumer's account for paying overdrafts in connection with ATM or one-time debit card transactions unless it has met the four requirements in §205.17(b)(1)(i)-(iv). If the institution never assesses such fees or charges, the notice and opt-in requirements do not apply.

**17. Do the new rules prevent an institution from charging for ATM or one-time debit card transactions that are declined?**

The final rule does not address declined transaction fees. However, the supplementary information discussion in the *Federal Register* notice for the final rule notes that such fees could raise significant fairness issues under the FTC Act because the institution bears little, if any, risk or cost to decline authorization of an ATM or one-time debit card transaction.

**18. Does the prohibition on fees apply to all fees, such as nonsufficient funds (NSF) fees, daily fees, negative balance fees, or sustained overdraft fees?**

Yes, the new rule prohibits the assessment of any fee or charge — regardless of the name ascribed to the fee — on a consumer's account for pay-

**19. How can a financial institution distinguish between a recurring debit card transaction and a nonrecurring one?**

Comment 205.17(b)-1.ii, which addresses the coding of transactions, states that a financial institution complies with the rule if it adapts its systems to identify debit card transactions as either one-time or recurring. If it does so, the financial institution may rely on the transaction's coding by merchants, other institutions, and other third parties as a one-time or preauthorized or recurring debit card transaction.

**20. Do the new rules address the order in which charges are posted?**

No. However, the *Federal Register* notice for the final rule states that "the Board recognizes that additional consumer protections may be appropriate with respect to overdraft services, for example, rules to address transaction posting order. Therefore, the Board continues to assess whether additional regulatory action relating to overdraft services is needed." 74 Fed. Reg. 59050

**21. What are the record retention requirements for the opt-in notice?**

The final rule does not contain record retention requirements specifically for overdraft services and opt-in notices. However, Regulation E does contain record retention rules in §205.13(b) that require financial institutions to retain evidence of compliance with the requirements imposed by the act and regulation for a period of not less than two years from the date disclosures are required to be made or action is required to be taken. Comment 205.13(b)-1 explains that a financial institution need

not retain records that it has given disclosures and documentation to each consumer; it need only retain evidence demonstrating that its procedures reasonably ensure consumers' receipt of required disclosures and documentation. Accordingly, the general record retention requirements of Regulation E apply to overdraft services and opt-in notices.

THE NEW RULE PROHIBITS THE ASSESSMENT OF ANY FEE OR CHARGE — REGARDLESS OF THE NAME ASCRIBED TO THE FEE — ON A CONSUMER'S ACCOUNT FOR PAYING AN ATM OR A ONE-TIME DEBIT CARD TRANSACTION AS PART OF THE INSTITUTION'S OVERDRAFT SERVICE.

ing an ATM or a one-time debit card transaction as part of the institution's overdraft service. The proposed clarifications to the final rule would, if adopted, provide additional guidance on when daily, negative balance, sustained overdraft, and similar fees may and may not be charged.



22. Must the new Regulation DD periodic statement disclosures include grid lines consistent with Sample Form B-10? Must the phrases “Total Overdraft Fees” and “Total Returned Item Fees” be used exactly as printed in the model form, or can other descriptions be used for an institution’s fees?

The periodic statement disclosures must be disclosed using a format substantially similar to Sample Form B-10 in Appendix B of Regulation DD, including graphical elements such as the box and gridlines. Comment 230.11(a)(1)-3 states that institutions may use terminology such as “returned item fee” or “NSF fee” to describe fees for returning items unpaid. Proposed clarifications to the final rule under Regulation DD, if adopted, would clarify that use of the term “Total Overdraft Fees” is required.

23. How do these new regulatory provisions relate to the 2005 Joint Guidance on Overdraft Protection Programs? There are some differences between the two, aren’t there?

Although the Regulation E provisions and the Joint Guidance have some differences (among other things, “opt-in” versus “opt-out” for certain types of transactions), the concepts that formed the basis for both — transparency, fairness, and clear communication of program fees and fea-

tures — are consistent. Consequently, the Federal Reserve expects the banks it supervises to consider the Joint Guidance when developing internal procedures, training personnel, and changing systems to incorporate the new regulatory provisions. The “best practices” contained in the guidance should be of assistance when developing and overseeing an overdraft protection compliance program.

24. Are you preparing examination procedures for the new rules? If so, when will they be released? Will they include compliance with the 2005 Joint Guidance on Overdraft Protection Programs?

The Federal Reserve is currently working on revised Regulation E procedures that will address the new overdraft protection rules. Those procedures will be publicly available prior to the July 1, 2010 effective date of the new rules. The Federal Reserve’s release of the procedures will reinforce the expectations of the Joint Guidance.

## CONCLUSION

In advance of the July 1, 2010 effective date for the final overdraft rule, financial institutions should carefully review the compliance requirements and test their systems. 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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## AN OVERVIEW OF THE REGULATION Z RULES IMPLEMENTING THE CARD ACT

after paying debt obligations. The underwriting must be based on the minimum periodic payments the consumer would be required to pay under the terms of the account. The rule includes a safe harbor if the issuer calculates the minimum payment based on the full credit limit, mandatory fees, and any expected interest rate.

Comment 226.51(a)(1)-4 of the Official Staff Commentary (OSC) includes examples (intended to be illustrative, not exhaustive) of the types of income and assets

card issuers may consider, including information obtained through any empirically derived, demonstrably and statistically sound model that reasonably estimates a consumer’s income or assets. The OSC clarifies that issuers may rely on information provided by the consumer.

Another important point is the compliance requirements when a card issuer considers increasing a cardholder’s credit limit. Comment 226.51(a)(1)-3 of the OSC clarifies that repayment ability must be analyzed

for a credit limit increase, regardless of whether the consumer or the card issuer initiates the request. The rule also clarifies that issuers must update a consumer's income and assets prior to considering a credit limit increase to prevent reliance on stale information.

Section 226.51 includes special rules for consumers under 21 years of age (young consumers), as determined on the date the application or request to increase a credit limit is submitted. A card issuer generally cannot issue a card to a young consumer unless the consumer has submitted information showing an independent ability to make the minimum payments, as determined in §226.51(a). As an alternative, an account can be opened for a young person if a person who is at least 21 years of age agrees to be secondarily or jointly liable with the young person for the account and provides financial information indicating the ability to make the required minimum periodic payments, as set forth in §226.51(a).

#### ***§226.52: Limitations on Fees***

The CARD Act includes a provision regulating subprime credit cards. These cards are marketed to consumers with poor credit histories and are characterized by low credit limits (usually less than \$300) and high fees to open the account. After required fees are charged to the card at account opening, the available credit for these cards can be less than \$100. Section 226.52 addresses this issue by restricting the amount of required fees that can be billed during the first year a credit card account is opened (other than any late fee, over-the-limit fee, or fee for a payment returned for insufficient funds) to no more than 25 percent of the credit limit.

The 25 percent restriction applies to fees for the issuance or availability of credit but does not apply to discretionary fees. For example, if a card issuer charges an optional fee to obtain an extra credit card, the fee would not be included in the 25 percent calculation. If the issuer increases the credit limit during the first year an account is opened, the issuer cannot raise the amount of required fees. Similarly, if the issuer decreases the amount of credit during the first year, it must remove or waive any fees charged that exceed the 25 percent limit.

#### ***§226.53: Allocation of Payments***

The CARD Act imposes a statutory payment alloca-

tion rule: When a consumer makes a payment that exceeds the issuer's minimum payment, the card issuer must first allocate the excess amount to the balance with the highest APR and any remaining portion to the other balances in descending order based on the APR. The Board has implemented this requirement in §226.53(a), subject to two exceptions related to deferred interest programs. First, payments above the minimum made during the final two months of a deferred interest program must first be allocated to the deferred interest balance. Second, if the consumer has a deferred interest program, a card issuer may allocate a payment in the manner requested by the consumer. To facilitate compliance, Comment 226.53-5 of the OSC includes payment allocation examples.

These requirements address the consumer protection concerns for payment allocation rules. Finance charges are maximized if a cardholder agreement specifies that when a consumer has multiple balances with different APRs and a payment is made for less than the entire balance, the payment is first applied to the balance with the lowest APR. This type of provision in a cardholder agreement can burden consumers. For example, if the cardholder obtains a cash advance with a high-rate APR and does not pay his balance in full each month (that is, he is a revolver), the cash advance balance will continue accruing high-rate finance charges indefinitely, unless the cardholder pays off the entire balance. For revolvers with large balances, paying the entire balance may not be feasible. Section 226.53 addresses this issue by requiring that high-rate balances be paid first.

#### ***§226.54: Limitations on the Imposition of Finance Charges***

This new section of Regulation Z contains two limitations on assessing finance charges. First, §226.54(a) (i) bans double-cycle billing (also known as two-cycle billing). Under this balance computation method, card issuers charge interest from the date of each transaction during the two most recent billing cycles. In certain situations, this method results in consumers paying finance charges on a balance previously paid in full during the grace period. In particular, when a consumer pays the entire balance in one billing cycle on time, thus avoiding finance charges, but makes a partial payment on a balance in the next billing cycle, 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 always 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.

To address this problem, §226.54 prohibits card issuers from assessing finance charges for balances based on days in billing cycles prior to the current billing cycle. Issuers are permitted to make adjustments to finance charges because of a resolved dispute under §§226.12 or .13 or because of a returned payment. Second, un-

trigger repricing refers to the practice of imposing penalty pricing shortly after a cardholder defaults, even if the default is minor. A good example is imposing penalty APRs because a payment is one day late. Universal default refers to the practice of a repricing to the default rate because a consumer defaults on another creditor's account.

These two practices were criticized during the CARD Act hearings. Default pricing for some issuers can exceed 30 percent. Repricing a consumer's existing bal-

ances can be particularly burdensome for cardholders with large balances. For example, if a cardholder had an existing balance of \$25,000, and the pre-default APR for purchases was 12 percent, with a 28 percent default APR, the change in pricing would increase the annual finance charges by approximately \$4,000. When this occurs because of a relatively minor default (for example, exceeding the credit limit by a small amount), the penalty seems disproportionate. Indeed, some issuers do not impose default pricing unless a material

default occurs. Similarly, with universal default, any minor default with any creditor can be invoked to apply the default pricing rate.

To address these concerns, the CARD Act prohibits card issuers from increasing rates for new balances during the first year an account is open and on existing card balances. However, §226.55(b) contains six exceptions to this rule (shown in the box on the next page.)

***§226.56: Requirements for Over-the-Limit Transactions***  
The practice of imposing fees for exceeding the credit limit raises consumer protection issues. For example,

A CARD ISSUER GENERALLY CANNOT  
ISSUE A CARD TO A YOUNG CONSUMER  
UNLESS THE CONSUMER HAS SUBMITTED  
INFORMATION SHOWING AN INDEPENDENT  
ABILITY TO MAKE THE MINIMUM PAYMENTS,  
AS DETERMINED IN §226.51(a).

der §226.54(a)(ii), when a consumer makes a timely partial payment on a balance subject to a grace period, the card issuer cannot assess finance charges on the partial payment if the consumer satisfies the issuer's eligibility requirements for the grace period.<sup>11</sup>

***§226.55: Limitations on Increasing APRs, Fees, and Charges***

Congress heard testimony<sup>12</sup> and received a report from the Congressional Research Service<sup>13</sup> about the practices of repricing credit card APRs because of a hair-trigger default of the cardholder agreement or because of universal default. For card issuers, hair-

<sup>11</sup> Comment 226.54(a)(1)-1 discusses in detail how a card issuer's requirements for a grace period affect a consumer's ability to avoid finance charges on a partial payment and provides several examples for illustrative purposes.

<sup>12</sup> H.R. 627, the Credit Cardholders' Bill of Rights Act of 2009; and H.R. 1456, the Consumer Overdraft Protection Fair Practices Act of 2009, Subcommittee on Financial Institutions and Consumer Credit, 111th Cong., 1st Sess. (March 19, 2009) (statement of Travis B. Plunkett and Edmund Mierzewski), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/consumergrouptestimony19mar09\\_hr627\\_hr1456.doc](http://www.house.gov/apps/list/hearing/financialsvcs_dem/consumergrouptestimony19mar09_hr627_hr1456.doc); "Credit Card Practices: Unfair Interest Rate Increases," testimony before the Senate Permanent Subcommittee on Investigations, 110th Cong., 2nd Sess. (December 4, 2007) (statement of Bruce Hammonds), available at: [http://hsgac.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore\\_id=a49ec129-d045-4c44-83da-9435fbe50301](http://hsgac.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=a49ec129-d045-4c44-83da-9435fbe50301).

<sup>13</sup> "The Credit Card Market: Recent Trends, Funding Cost Issues, and Repricing Practices," Congressional Research Service, February 27, 2008, available at: [http://assets.opencrs.com/rpts/RL34393\\_20080227.pdf](http://assets.opencrs.com/rpts/RL34393_20080227.pdf).

## SIX EXCEPTIONS TO RULE §226.55(b): LIMITATIONS ON INCREASES IN APRs, FEES, AND CHARGES

*Temporary Rate Exception.* This exception allows issuers to raise the APR for new transactions and existing balances after a temporary rate expires, provided the temporary rate lasts at least six months and the issuer discloses clearly and conspicuously the rate that will apply after the temporary rate expires.

*Variable Rate Exception.* The CARD Act recognizes that the rate on a variable rate card varies with market conditions. The act permits rate increases for existing balances and new transactions, provided the increase results because of an increase in an index on which the rate is based that is available to the public and over which the issuer has no control (for example, the prime rate).

*Advance Notice Exception.* Card issuers are permitted to raise rates, fees, and charges for future transactions (but not past transactions) if they provide an advance change-in-terms notice required under §226.9(b), (c) or (g). However, this exception cannot be used during the first year an account is open. In addition, the exception does not permit rate increases on existing balances.\*

*Delinquency Exception.* This exception permits a card issuer to raise rates and fees on both future and existing balances if the cardholder has not made a required minimum payment within 60 days of the due date. However, before this exception can be implemented, the issuer must provide a 45-day change-in-terms notice, as discussed earlier. It is important to note that the card issuer must wait until the end of the 60-day period before it can send out the 45-day change-in-terms notice. Thus, the shortest period before an issuer could implement a rate increase because of the delinquency exception is 105 days.

*Workout and Temporary Hardship Arrangement Exception.* When a consumer experiences financial hardship, card issuers will sometimes temporarily lower the rate on the consumer's balances to facilitate repayment. This exception permits the issuer to raise the rate after the workout or temporary hardship arrangement ends or the consumer fails to comply with the terms of the arrangement. This exception has two requirements: the issuer must have clearly and conspicuously disclosed the terms of the workout before the arrangement began, and the higher rate that applies after the arrangement cannot, with respect to any existing balance at the time the arrangement began, exceed the rate that applied before the arrangement became effective. For example, if a consumer had an account with a \$10,000 balance with a purchase APR of 10 percent, and the consumer ran into financial difficulty and arranged for the rate to be lowered to 5 percent for six months, the issuer could raise the rate to 15 percent after completion of the six-month arrangement for future transactions but could not increase the rate on the existing \$10,000 balance at the time of the arrangement above 10 percent. This rule is designed to facilitate workout arrangements while preventing card issuers from using the exception to circumvent the rule against raising rates on existing balances. The workout exception permits a rate increase for future transactions after the workout arrangement expires but not for the existing balance when the workout was initiated.

*Servicemembers Civil Relief Act (SCRA) Exception.* Under §527(a) of the SCRA, interest on obligations of service members, who are defined in 10 U.S.C. §101(a)(5), cannot exceed 6 percent during the period of military service. This exception permits the issuer to raise the rate once the requirement of §527 no longer applies, provided that the new rate cannot, for transactions incurred before the rate decrease because of §527, exceed the rate that previously applied; that is, §527 cannot be used to circumvent the prohibition on raising the rate on an existing balance but does permit a rate increase on future transactions.

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\* Some media reports about the CARD Act have stated that it bans universal default. This is not entirely true. Because §226.55(b)(3) permits increases in the APR for future transactions, except for the first year an account is opened, it is more accurate to state that the CARD Act eliminates universal default for existing balances but it does not affect issuers' ability to raise rates for future transactions after the first year an account is opened.



these fees can be confusing to consumers because some consumers assume that they have not exceeded their credit limit when a credit card transaction is approved. Moreover, issuers can define default to include exceeding the credit limit, which can trigger costly default pricing. Consumer advocates have suggested that if issuers do not want consumers to exceed a credit limit, the issuers should decline a transaction that would exceed it instead of permitting it and then imposing fees.

To address these concerns, the CARD Act prohibits issuers from imposing an over-the-limit fee for exceeding the credit limit unless the cardholders elected to participate or opt in to the program. In particular, the card issuer must satisfy these requirements for the opt-in:

- (i) provide the consumer with an oral, written, or electronic notice that describes the consumer's right to consent to the issuer's payment of an over-the-limit transaction. The opt-in notice must disclose the fee for exceeding the credit limit, any increase in APRs that can result, and the procedure to opt in;
- (ii) provide a reasonable opportunity to consent;
- (iii) obtain the consumer's affirmative consent;<sup>14</sup>
- (iv) provide the consumer with confirmation of the consent; and
- (v) provide the consumer with a notice in writing of the right to revoke that consent following the assessment of an over-the-limit fee or charge.

The issuer must also notify the consumer of the right to revoke an opt-in and republish the notice on the front of any page of a periodic statement showing the assessment of an over-the-limit fee.

Even when a cardholder opts in, the CARD Act places restrictions on the fees that can be assessed. A card issuer may not impose more than one over-the-limit fee per billing cycle. Also, the fee cannot be imposed for

more than three billing cycles for the same over-the-limit transaction, in cases where the consumer has not reduced the account balance below the credit limit by the payment due date for either of the last two billing cycles. However, this last rule does not apply if another over-the-limit transaction occurs.

In addition, issuers cannot impose an over-the-limit fee if the only reason the cardholder exceeded the credit limit is fees or interest incurred during the billing cycle or because the issuer failed to promptly replenish the credit limit after crediting a payment. Finally, the issuer may not make the amount of a consumer's credit limit conditional on the consumer's agreeing to the issuer's payment of over-the-limit transactions if the card issuer assesses a fee for such service.

#### ***§226.57: Reporting and Marketing Rules for College Student Open-End Credit***

The CARD Act prohibits card issuers from providing tangible inducements (such as a gift card, a t-shirt, or a magazine subscription) to college students to apply for or open an open-end consumer credit plan offered by the creditor either at a college campus, near it, or at a college-sponsored event. The OSC clarifies, however, in Comment 226.57(c)-2 that the regulation is not violated if the tangible item is offered regardless of whether a person applies or opens an open-end consumer credit plan. Additionally, issuers must annually submit a report to Congress detailing any affinity agreements the issuer has with an institution of higher learning.

#### ***§226.58: Internet Posting of Credit Card Agreements***

Because credit card accounts are open-ended, with no scheduled expiration, consumers often have accounts with card issuers over a long period of time. This can create a challenge for consumers who want to review their cardholder agreement. To provide easy access to cardholder agreements, §226.58 requires issuers to post cardholder agreements with current cardholders on their website and to submit to the Board all credit card agreements offered to the public as of December 31, 2009, followed by quarterly submissions thereafter, beginning August 2, 2010. The Board will make these agreements available to the public on its website.

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<sup>14</sup> Oral consent is permitted; however, the card issuer must provide the opt-in notice immediately before obtaining the consent.

The Board created three exceptions to these requirements, as permitted by the CARD Act:

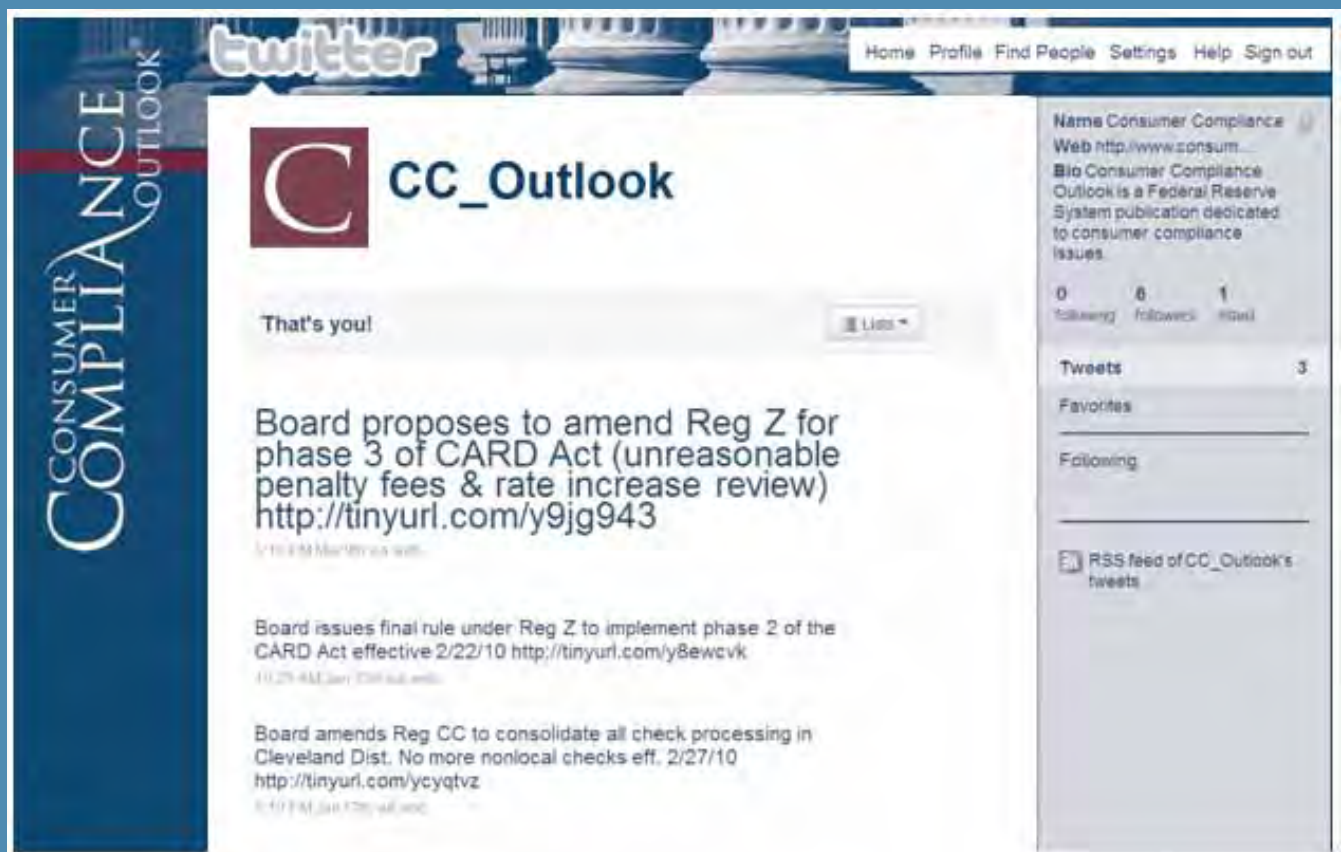
- a de minimis exception for issuers with fewer than 10,000 open credit card accounts;
- an exception for private label card plans, each of which has fewer than 10,000 open accounts that are not offered to the public except under the private label; and
- a testing exception for cards offered to only a limited group of consumers for a limited period of time to conduct product testing, where the card is not offered to the public apart from the testing and fewer than 10,000 open accounts are involved.

## CONCLUDING REMARKS

The Regulation Z final rules not only implemented phases 1 and 2 of the CARD ACT but also made some changes to the Board's previous rulemaking on non-home-secured open-end credit. This article focused only on the CARD Act requirements, which provide protections for consumers by banning or restricting certain credit card practices and requiring new credit card disclosures. Financial institutions should review these requirements carefully, including the additional guidance provided in the OSC, and test their systems to ensure compliance. 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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## REGULATORY CALENDAR

Effective Date	Implementing Regulation	Regulatory Change
1/6/2009	Reg. BB (CRA)	Interagency Q&As Regarding Community Reinvestment
5/20/2009		Protecting Tenants at Foreclosure Act of 2009
7/2/2009	Reg. D. (FRA)	Limitations on transfers/withdrawals for savings accounts
7/23/2009	Reg. Z (TILA)	Significant proposed amendments: HELOC & closed-end credit rules
7/30/09	Reg. Z (TILA)	MDIA rules for early TILA disclosures
9/21/2009	Reg. H (flood )	Interagency Q&As Regarding Flood Insurance
10/1/2009	Reg. Z (TILA)	HOEPA rules for mortgage loans
10/1/2009	Reg. C (HMDA)	New definition of HMDA rate-spread loan
12/31/2009	Reg. P (GLBA)	Model Privacy Form under GLBA
1/1/2010	Reg. Z (TILA)	HOEPA Trigger Amounts Revised for 2010
1/1/2010	Reg. V (FACTA)	Affiliate Marketing Model Form C-6
1/1/2010	Reg. DD (TISA)	Overdraft protection disclosures
1/1/2010	Reg. X (RESPA)	Revised GFE and HUD-1
1/1/2010	Reg. BB (CRA)	CRA asset-size threshold adjustments
1/1/2010	Reg. C (HMDA)	CRA asset-size exemption threshold
1/19/2010	Reg. Z (TILA)	Mortgage transfer notice to borrower
2/14/2010	Reg. Z (TILA)	New disclosures for private education loans
2/22/2010	Reg. Z (TILA)	Phase 2 CARD Act rules for credit cards
2/27/2010	Reg. CC (EFAA)	Nonlocal checks eliminated
4/1/2010	Reg. Z (TILA)	HOEPA escrow requirements for nonmanufactured homes
6/1/2010	Reg. GG (UIGEA)	Compliance with Unlawful Internet Gambling Enforcement Act
7/1/2010	Reg. V (FACTA)	Accuracy/integrity rules for furnishers and direct disputes
7/1/2010	Reg. E (EFTA)	Overdraft opt-in for accounts opened on July 1, 2010 or later
7/1/2010	Reg. Z (TILA)	Open-end credit revisions
8/15/2010	Reg. E (EFTA)	Overdraft opt-in for accounts opened before July 1, 2010
8/22/2010	Reg. Z (TILA)	Phase 3 of CARD ACT (future rulemaking)
8/22/2010	Reg. E (EFTA)	Proposed rules on gift-card fees and expiration dates
10/1/2010	Reg. Z (TILA)	HOEPA escrow requirements for manufactured homes
12/31/2010	Reg. P (GLBA)	Elimination of safe harbor for sample clauses in privacy rules
1/1/2011	Reg. V (FACTA)	Risk-based pricing notices

## CALENDAR OF EVENTS

May 7-10	Annual Conference on Bank Structure and Competition Federal Reserve Bank of Chicago InterContinental Hotel Chicago, IL	June 6-11	Compliance Institute Independent Community Bankers of America Kansas City, MO
May 12-14	Reinventing Older Communities Federal Reserve Bank of Philadelphia Hyatt Regency at Penn's Landing Philadelphia, PA	June 13-16	Regulatory Compliance Conference American Bankers Association Manchester Grand Hyatt San Diego, CA
June 6-8	CBA Live 2010 Consumer Bankers Association Westin Diplomat Hotel Hollywood, FL	July 8-10	Interagency Minority Depository Institutions National Conference Federal Financial Institution Regulatory Agencies Westin Michigan Avenue Chicago, IL