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Inside

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An Overview of the Risk-Based Pricing Implementing Regulations

By Rebecca Reagan, Supervisory Examiner, Federal Reserve Bank of Richmond

January 1, 2011 is the mandatory compliance deadline for the risk-based pricing notice requirements under implementing regulations jointly written by the Board of Governors of the Federal Reserve System (Board) and the Federal Trade Commission (FTC) (the agencies).[1] The rules require creditors to provide a notice to consumers when, based in whole or in part on information in a consumer report, a creditor grants credit to the consumer on material terms that are materially less favorable than the most favorable terms available from the creditor to a substantial proportion of other consumers. The rules contain model notice forms and provide several methods for compliance. This article provides an overview of the risk-based pricing rules.

SCOPE OF RULES

Section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act)[2] amended the Fair Credit Reporting Act (FCRA) to add the risk-based pricing notice requirement in §615(h)(15 U.S.C. §1681m(h)), and directed the Board and the FTC to issue implementing regulations. The Board codified its implementing regulations in subpart H of Regulation V, 12 C.F.R. §§222.70-75.[3] Risk-based pricing refers to a creditor's practice of setting the price or other credit terms based on a consumer's risk of nonpayment. Creditors generally offer consumers with poor credit histories less favorable credit terms than consumers with strong credit histories to compensate for the higher risk of default.

Creditors currently are required by §615(a) of the FCRA (15 U.S.C. §1681m(a)) to provide adverse action notices when they deny a consumer's credit application, based in whole or in part on information in a consumer report. However, when a creditor does not reject an applicant with impaired credit, but instead offers credit on less favorable terms, the creditor generally is not required to

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[1] The December 22, 2009 joint announcement and the *Federal Register* notice are available on the Board's website at: http://www.federalreserve.gov/newsevents/press/bcreg/20091222b.htm.

[2] Public Law 108-159, 117 Stat. 1952, which is available at: http://www.gpo.gov/fdsys/pkg/PLAW-108publ159/pdf/PLAW-108publ159.pdf

[3] The FTC placed its substantially similar regulations in 16 C.F.R. part 640.

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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). 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

Regulation Z's Payment Crediting Rules for Open-End Credit, Credit Cards, and Closed-End Mortgage Payments

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

The Board of Governors of the Federal Reserve System (Board) adopted amendments to Regulation Z in 2008 and 2010 that impose new compliance requirements on loan servicers for crediting mortgage payments and on creditors for crediting open-end credit payments. The rules for mortgage payments appeared in the Board's July 2008 final rule issued under the Truth in Lending Act and the Home Ownership and Equity Protection Act of 1994,[1] while the rules for open-end credit payments appeared in the Board's February 2010 final rule implementing the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act).[2] To facilitate compliance, this article provides an overview of the Board's Regulation Z rules under §226.36(c) for mortgage loan servicers and §226.10 for open-end credit payments, including special rules for credit card payments required by the Credit CARD Act.

RULES FOR MORTGAGE LOANS

The Board's 2008 final rule added §226.36(c) to Regulation Z concerning mortgage loan servicing practices. This section applies to closed-end credit secured by a consumer's principal dwelling and contains several new compliance requirements for "servicers," as defined in §3500.2(b) of Regulation X, the implementing regulation for the Real Estate Settlement Procedures Act.[3] Home equity lines of credit are specifically excluded from coverage.[4]

Crediting Payments as of the Date of Receipt

Section 226.36(c) requires loan servicers to credit a payment to a consumer's loan account as of the date it is received. However, this does not mean that servicers must physically post a payment on the date received, provided the consumer is not penalized by the delay in posting. In other words, a servicer can have a delay between the time it receives a payment and posts it to the

[1] 73 Fed. Reg. 44521 (July 30, 2008), available at: http://edocket.access.gpo.gov/2008/pdf/E8-16500.pdf

[2] 75 Fed. Reg. 7657 (Feb. 22, 2010), available at: http://edocket.access.gpo.gov/2010/pdf/2010-624.pdf

[3] 24 C.F.R. §3500.2(b). "Servicer means the person responsible for the servicing of a mortgage loan (including the person who makes or holds a mortgage loan if such person also services the mortgage loan)." The definition excludes certain federal agencies and government-sponsored enterprises.

[4] Section 1464 of the Dodd-Frank Wall Street Reform and Consumer Protection Act amends TILA to add §129F, which requires loan servicers to promptly credit home loan payments. The requirements of §129F are similar to the ones in §226.36(c), except §129F applies to all consumer credit transactions secured by the consumer's principal dwelling, while §226.36(c) applies only to closed-end credit transactions. Under §1400(c) of Dodd-Frank, final rules must be issued within 18 months of the designated transfer date and the rules become effective 12 months after the issuance of the final rules.

consumer's account, as long as the payment reflects the date of receipt when it is credited. The distinction is important because it may not be operationally feasible for a servicer to post a payment on the date it is received. Comment 226.36(c)(1)(i)-1 of the Official Staff Commentary (OSC) for Regulation Z clarifies this point: "A servicer that receives a payment on or before its due date (or within any grace period), and does not enter the payment on its books or in its system until after the payment's due date (or expiration of any grace period), does not violate this rule *as long as the entry does not result in the imposition of a late charge, additional interest, or similar penalty to the consumer, or in the reporting of negative information to a consumer reporting agency"* (emphasis added).

This requirement has raised questions for loan servicers. If a consumer pays electronically through a third-party service, when is a payment considered received? If a payment is made at the bank branch ATM of a servicer on the due date after the branch closes, does the payment have to be credited as of the due date? If the mortgage payment includes an amount to be placed into escrow for taxes and/or homeowners' insurance, and the consumer sends in a payment that covers the mortgage interest and principal, but not the escrow portion, must the payment be fully credited?

The OSC provides guidance on these complex issues. For the "date of receipt," comment 226.36(c)(1)(i)-3 states that "payment by check is received when the mortgage servicer receives it, *not when the funds are collected*. If the consumer elects to have payment made by a third-party payor such as a financial institution, through a preauthorized payment or telephone bill-payment arrangement, payment is received when the mortgage servicer receives the third-party payor's check or other transfer medium, such as an electronic fund transfer" (emphasis added).

The OSC[5] also states that loan servicers can establish reasonable requirements in writing for the consumer's payment, including the following:

- requiring that payments be accompanied by the account number or payment coupon;
- setting a cut-off hour for payment to be received, or setting different hours for payment by mail and payments made in person;
- specifying that only checks or money orders should be sent by mail;
- specifying that payment is to be made in U.S. dollars; or
- specifying one particular address for receiving payments, such as a post office box.[6]

The OSC further clarifies that a servicer's payment requirements must be "reasonable," meaning that it should not be difficult for most consumers to make conforming payments. To facilitate compliance, the OSC includes a safe harbor for reasonable payment requirements: "It would be reasonable to require a cut-off time of 5 p.m. for receipt of a mailed check at the location specified by the servicer for receipt of such check."[7]

DEFAULT CREDITING RULE WHEN SERVICER DOES NOT SPECIFY PAYMENT REQUIREMENTS

If servicers do not specify payment requirements, the OSC includes an omnibus payment crediting rule to address the myriad circumstances that can arise:

> "Implied guidelines for payments. In the absence of specified requirements for making payments, *payments may be made at any location where the servicer conducts business; any time during the servicer's normal business hours; and by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the servicer and consumer have so agreed"* (emphasis added).[8]

For servicers without payment requirements, this section of the OSC addresses the situations discussed earlier. For example, if a consumer makes a cash payment at a bank branch ATM while the branch is open, or makes a check payment at a bank's supermarket

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[5] Comment 226.36(c)(2)-1

[6] The OSC also notes that the servicer cannot specify that only electronic payments are permitted.

[7] Comment 226.36(c)(2)-1

[8] Comment 226.36(c)(2)-3

Understanding Regulation DD's Advertising Requirements

Amy Armstrong, Assistant Examiner, Federal Reserve Bank of Philadelphia

Depository institutions spend large sums on advertising to attract potential deposit customers and increase revenues. Many institutions rely on third-party vendors and internal marketing departments to ensure compliance with advertising laws and regulations. However, it is important that bank personnel and particularly compliance officers understand that depository institutions are ultimately responsible for ensuring that advertisements comply with federal law and are free from misleading statements or omissions. To facilitate compliance with these requirements, this article discusses the advertising provisions in Regulation DD, the implementing regulation for the Truth in Savings Act (TISA) issued by the Board of Governors of the Federal Reserve System (Board). It also briefly discusses the compliance requirements of §5(a) of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices (UDAP) and which applies to a depository institution's advertising and marketing campaigns.

SCOPE OF THE REGULATION

Regulation DD applies to all depository institutions except credit unions, so references to depository institutions do not include credit unions.[1] While Regulation DD is primarily focused on depository institutions, its advertising provisions in §230.8 "apply to any person who advertises an account offered by a depository institution, including deposit brokers."[2] Regulation DD broadly defines an advertisement as a commercial message in any medium that promotes directly or indirectly (1) "the availability or terms of, or a deposit in, a new account"; and (2) for purposes of §230.8(a) and §230.11, "the terms of, or a deposit in, a new or existing account."

MISLEADING ADVERTISEMENTS

Regulation DD generally prohibits advertisements that are misleading or inaccurate or that misrepresent an institution's deposit contract.[3] To aid compliance, comment 230.8(a)-10 of the Official Staff Commentary (OSC) provides these examples of violations:

- representing an overdraft service as a "line of credit" (unless the service is subject to Regulation Z);
- representing that an institution will honor all checks or pay all transactions that overdraw an account, with or without a specified dollar limit, when the institution retains discretion not to honor checks or authorize transactions;
- representing that an overdrawn account can maintain a negative balance when the overdraft service agreement requires that the deposit account maintain a positive balance;
- describing an overdraft service as protecting solely against bounced checks when the overdraft service also applies to an account overdrawn by other means, such as ATM withdrawals, debit card transactions, or other electronic fund transfers.

Regulation DD generally prohibits advertisements that are misleading or inaccurate or that misrepresent an institution's deposit contract.

"FREE" OR "NO COST"

In addition to the general prohibition against misleading or inaccurate advertisements, Regulation DD imposes specific restrictions on advertisements. In

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[1] Section 272 (12 U.S.C. §4311) of TISA excludes credit unions from the scope of Regulation DD's coverage, but they are subject to the National Credit Union Administration's implementing regulation for TISA, 12 C.F.R. §707, which is substantially similar to the Board's Regulation DD.

[2] 12 C.F.R. §230.1(c)

[3] §230.8(a)

particular, some depository institutions advertise free checking or no cost accounts. To ensure that consumers are not misled by the use of these terms, §230.8(a)(2) prohibits depository institutions from describing an account as "free" or "no cost" (or similar terminology) if any maintenance or activity fee can be imposed. These charges include:

- fees imposed for exceeding transaction limitations;
- fees for failing to maintain a minimum balance;
- monthly service fees;
- transaction and service fees that consumers reasonably expect to be imposed on a regular basis; or
- fees imposed to deposit, withdraw, or transfer funds.

However, comment 230.8(a)-4 of Regulation DD's OSC identifies five fees that are not considered maintenance or activity fees: check-printing fees, balance-inquiry fees, dormant account fees, stop-payment fees, and ATM or electronic transfer fees not required to obtain an account. In addition, the restriction under §230.8(a)(2) for free or no cost accounts applies only to maintenance or activity fees and not to *incidental* fees such as fees associated with state escheat laws, garnishment and attorney's fees, or photocopying fees. Thus, institutions imposing these incidental fees on a free checking or no cost account do not violate §230.8(a)(2).

Some institutions offer free or no cost accounts for a limited period of time. For example, a checking account might be free for the first year. Regulation DD permits an institution to advertise this type of account as free or no cost as long as the period during which it is free is stated in the advertisement.[4]

The OSC also clarifies that institutions may advertise free or no cost accounts for consumers meeting conditions not related to the deposit account. Comment 230.8(a)-8 includes this example: "Institutions may advertise a NOW account as 'free for persons over 65 years old,' even though a maintenance or activity fee is assessed on accounts held by consumers 65 or younger."

Finally, institutions may advertise a particular account service as free (such as an account free of withdrawal fees), provided "the advertisement does not mislead consumers by implying that the account is free and that no other fee (a monthly service fee, for example) may be charged."[5]

RATES AND YIELDS

Section 230.8(b) restricts the use of rates in advertisements. First, if an advertisement states a rate of return, the rate must be identified as an "annual percentage yield" (using that term). No other term can be used except for "interest rate," provided it is stated in conjunction with the annual percentage yield. The abbreviation "APY" may be used if the term "annual percentage yield" is stated at least once in the advertisement. Often, advertisements will use the abbreviation in the text of the advertisement and direct the consumer to the bottom of the advertisement for the expansion of the abbreviation. Second, if the annual percentage yield is stated in an advertisement, §230.8(c) requires that the following additional disclosures be made clearly and conspicuously:

(1) *Variable rates.* For variable-rate accounts, a statement that the rate may change after the account is opened.
(2) *Time annual percentage yield is offered.* The period of time the annual percentage yield will be offered or a statement that the annual percentage yield is accurate as of a specified date.
(3) *Minimum balance.* The minimum balance required to obtain the advertised annual percentage yield. For tiered-rate accounts, the minimum balance required for each tier shall be stated in close proximity and with equal prominence to the applicable annual percentage yield.
(4) *Minimum opening deposit.* The minimum deposit required to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield.

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[4] Comment 230.8(a)-7

[5] Comment 230.8(a)-6

Compliance Alert

INTERAGENCY GUIDANCE ON REVERSE MORTGAGE PRODUCTS

On August 17, 2010, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Office of Thrift Supervision, and the National Credit Union Administration (the agencies) issued final guidance on reverse mortgages for the institutions they supervise to assist them in addressing the compliance and reputation risks for this complex product.* Americans aged 65 or older are projected to make up 19 percent of the U.S. population in 2030, an increase from 12.4 percent in 2000. As a result, reverse mortgages have the potential to become an increasingly important credit product for this aging population if they are prudently underwritten and used appropriately. However, because of the risk that consumers will not understand the costs, terms, and consequences of this complex product, lenders must provide consumers with adequate information and other protections. To facilitate this, the reverse mortgage guidance discusses the following issues: legal considerations, consumer communications and counseling, conflicts of interest, abusive practices, and third-party relationships.

Legal Considerations

The guidance discusses the laws and regulations most relevant to reverse mortgages, including:

- the Federal Trade Commission Act
- the Truth in Lending Act/Regulation Z
- the Real Estate Settlement Procedures Act/Regulation X
- the Equal Credit Opportunity Act/Regulation B
- the Fair Housing Act
- the National Flood Insurance Act
- HUD's regulation for HECM mortgages, 24 C.F.R. §206, and
- state laws that may apply, including specific laws for reverse mortgages.

Consumer Communications and Counseling

The guidance emphasizes the importance of ensuring that marketing materials and communications with consumers are balanced and refrain from providing misleading information about product features, loan terms, product risks, or a borrower's obligations. The guidance also discusses providing independent counseling to consumers, similar to the counseling provided for HECMs.

Conflicts of Interest, Abusive Practices, and Third-Party Relationships

The guidance recommends that institutions adopt policies designed to ensure that loan originators and brokers do not have an inappropriate incentive to sell other products that appear to be linked to the granting of a reverse mortgage and to guard against tying the purchase of certain nonbanking products from an affiliate to the granting or pricing of credit. The guidance also recommends that institutions monitor compliance by third parties and implement appropriate corrective actions against third parties for compliance violations.

The agencies' announcement and the guidance are available on the Federal Financial Institutions Examination Council's website at: http://www.ffiec.gov/press/pr081610.htm. In connection with the guidance, the Board has issued CA Letter 10-11 (Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks), which is available at http://www.federalreserve.gov/boarddocs/caletters/2010/1011/caltr1011.htm.

* Reverse mortgages generally fall into two categories: lenders' proprietary products and the home equity conversion mortgage (HECM) insured by the Federal Housing Administration (FHA). The guidance applies to both categories.

Public Hearings on the Community Reinvestment Act (CRA) and Home Mortgage Disclosure Act (HMDA)

Congress enacted the CRA to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The Board of Governors (Board) of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Office of Thrift Supervision (the agencies) have rulemaking authority under the CRA to issue implementing regulations for the institutions they supervise. The agencies are working together to update their regulations to reflect changes in the financial services industry, changes in how banking services are delivered to consumers today, and current housing and community development needs. To inform their revision of the CRA's implementing regulations, the agencies held four public hearings earlier this year in Arlington, VA; Atlanta; Chicago; and Los Angeles. The Board also invited members of the public to submit written comment on the hearing issues.

Each agency hosted a hearing. The hearing in Chicago, which the Board coordinated, focused on geographic coverage, CRA performance tests, asset thresholds, designations, and affiliate activities. The agencies also discussed and solicited written comment on the following topics: small business and consumer lending evaluations and data; access to banking services; community development; ratings and incentives; the effect of evidence of discriminatory or other illegal credit practices on CRA performance evaluations; and CRA disclosures and performance evaluations. The comment period closed on August 31, 2010. Information about the hearing, including comments, agendas, transcripts, and/or audio or video recordings, is available on the Board's website at: http://www.federalreserve.gov/communitydev/cra_hearings.htm.

In addition to the CRA hearings, the Board conducted four public hearings in Atlanta, San Francisco, Chicago, and Washington, D.C., to gather information for its comprehensive review of Regulation C, which implements the HMDA. HMDA requires mortgage lenders to collect information about their mortgage lending activity and report it to their supervisory agency and the public.

Consumers, community and consumer advocacy organizations, mortgage lenders, and other interested parties were invited to participate in the hearings. HMDA discussion topics included data elements, including the new elements required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, coverage, scope, and compliance and technical issues as well as emerging issues. In addition, panelists were asked to identify ways to improve the quality and usefulness of HMDA data, including whether any data elements should be added, modified, or deleted, and their views on the burdens and possible privacy risks associated with collecting and reporting that information.

The HMDA comment period closed August 20, 2010; however, information about the hearings and public comments can be accessed on the Board's HMDA web page at: http://www.federalreserve.gov/communitydev/hmda_hearings.htm.

News From Washington: Regulatory Updates

The Board of Governors of the Federal Reserve System (Board) releases report on agreements between credit card issuers and institutions of higher education concerning credit cards issued to students during 2009. The Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) requires card issuers to submit to the Board annually their agreements with educational institutions or affiliated organizations, such as alumni associations, including payments made to institutions or organizations and the number of accounts opened under the agreement. The Board's report covers 1,044 agreements in effect during 2009. A new online database, http://www.FederalReserve.gov/CollegeCreditCardAgreements, provides additional information about the agreements and allows users to access them in PDF format. The Board's announcement and the report are available at: http://www.federalreserve.gov/newsevents/press/bcreg/20101025b.htm.

The Board announces a final rule implementing recent legislation modifying the effective date of certain disclosure requirements for gift cards under the Credit CARD Act. The rule finalizes an interim final rule published in the *Federal Register* on August 17, 2010. For gift certificates, store gift cards, and general-use prepaid cards produced prior to April 1, 2010, the legislation and interim final rule delay the August 22, 2010 effective date of these disclosures until January 31, 2011, provided the issuers disclose through in-store signage, messages during customer service calls, websites, and general advertising that: (i) the underlying funds of the card or certificate do not expire; (ii) consumers have a right to a free replacement certificate or card, which must be accompanied by the packaging and materials typically associated with the certificate or card; and (iii) any dormancy, inactivity, or service fee that might otherwise be charged will not be charged if such fees do not comply with Section 915 of the Electronic Fund Transfer Act. The Board's announcement and the *Federal Register* notice are available at: http://www.federalreserve.gov/newsevents/press/bcreg/20101019b.htm.

The Board proposes a rule amending Regulation Z to clarify aspects of the Board's rules under the Credit CARD Act. The proposal is intended to enhance protections for consumers and to resolve areas of uncertainty so that card issuers fully understand their compliance obligations. The proposal would clarify three issues:

- Promotional programs that waive interest charges for a specified period of time are subject to the same protections as promotional programs that apply a reduced rate for a specified period. For example, a card issuer that offers to waive interest charges for six months would be prohibited from revoking the waiver and charging interest during the six-month period unless the account becomes more than 60 days delinquent.
- Application and similar fees that a consumer is required to pay before a credit card account is opened are covered by the same limitations as fees charged during the first year after the account is opened. Because the total amount of these fees cannot exceed 25 percent of the account's initial credit limit, a card issuer that, for example, charges a $75 fee to apply for a credit card with a $400 credit limit generally would not be permitted to charge more than $25 in additional fees during the first year after the account is opened.
- When evaluating a consumer's ability to make the required payments before opening a new credit card account or increasing the credit limit on an existing account, card issuers must consider information regarding the consumer's independent income, rather than his or her household income.

The comment period closes on January 3, 2011. The Board's announcement and the *Federal Register* notice are available at: http://www.federalreserve.gov/newsevents/press/bcreg/20101019a.htm.

Banking agencies issue final Community Reinvestment Act (CRA) rule to implement provision of Higher Education Opportunity Act (HEOA). On September 29, 2010, the Board, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision

(OTS) (the agencies) issued a joint final rule under the CRA to implement a provision of HEOA that requires the agencies to consider low-cost higher education loans to low-income borrowers as a positive factor when assessing a financial institution's record of meeting community credit needs under the CRA. The rule also incorporates a CRA statutory provision that allows the agencies to consider a financial institution's capital investment, loan participation, and other ventures with minority-owned financial institutions, women-owned institutions, and low-income credit unions as factors in assessing the institution's CRA record. The effective date for the rule was November 3, 2010. The agencies' joint press release and the *Federal Register* notice are available at: http://www.federalreserve.gov/newsevents/press/bcreg/20100929a.htm.

HUD announces new reverse mortgage option. On September 22, 2010, the United States Department of Housing and Urban Development (HUD) announced a new modified version of its home equity conversion mortgage (HECM). Like HECM, the new product is a reverse mortgage that is insured by the federal government and allows older homeowners to tap into the equity of their home to pay expenses without having to make mortgage payments. The Federal Housing Administration (FHA) designed this second reverse mortgage option, called HECM Saver, for homeowners who want to borrow a smaller amount than what would be available with a HECM standard loan. HUD's announcement is available at: http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-205.

FTC proposes to ban deceptive mortgage ads. On August 16, 2010, the Federal Trade Commission (FTC) proposed a rule that would ban material misrepresentations in mortgage advertising and would allow the FTC to seek civil penalties and injunctions against violators. The proposed rule would apply to mortgage lenders, brokers, and servicers; real estate agents and brokers; advertising agencies; home builders; lead generators; rate aggregators; and other entities under the FTC's jurisdiction. The proposed rule lists 19 examples of misrepresentations about fees, costs, obligations, and other aspects of credit that would violate the proposed rule. The deadline for comments was November 15, 2010. The FTC's announcement is available at: http://www.ftc.gov/opa/2010/09/nprm.shtm.

FTC proposes changes to update and improve credit reporting notices. On August 16, 2010, the FTC proposed changes to the notices that consumer reporting agencies provide to consumers and to users and furnishers of credit report information under the Fair Credit Reporting Act (FCRA). The deadline for comment was September 21, 2010. The FTC's announcement is available at: http://www.ftc.gov/opa/2010/08/fcra.shtm.

FHA begins offering short refinancing options for underwater borrowers. On September 7, 2010, HUD began providing an additional refinancing option to borrowers who owe more on their mortgage than their home is worth. The program is known as the FHA Short Refinance option and has a number of requirements: all lien holders must consent, the value of the home must be less than the value of the existing mortgage, the homeowner must qualify for a new loan under standard FHA underwriting requirements, the property must be the homeowner's primary residence, the borrower's existing first lien holder must agree to write off at least 10 percent of the unpaid principal balance, the existing loan must not be an FHA-insured loan, and the refinanced FHA-insured mortgage must have a loan-to-value ratio of no more than 97.75 percent and a combined loan-to-value ratio no greater than 115 percent. The U.S. Department of the Treasury will provide incentives to existing second lien holders who agree to a full or partial extinguishment of the liens. HUD's announcement is available at: http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-190.

On the Docket: Recent Federal Court Opinions*

REGULATION Z - TRUTH IN LENDING ACT (TILA)

Circumstances justifying HELOC suspension. *Schulken v. Washington Mutual Bank, Henderson, NV,* 2010 WL 3987680 (N.D. Cal. Oct. 12, 2010). Plaintiffs obtained a home equity line of credit (HELOC) from Washington Mutual Bank (WaMu) in 2005 for $250,000. (WaMu was later acquired by JP Morgan Chase (Chase), which was also named as a defendant in the lawsuit.) On March 13, 2009, WaMu asked plaintiffs to provide a copy of a recent paystub and an authorization form so that WaMu could obtain their tax returns for income verification purposes. Plaintiffs provided financial information several days later but did not provide paystubs because they are self-employed. On March 18, 2009, WaMu notified plaintiffs that their account had been suspended because WaMu could not verify that their income was sufficient to support the HELOC. Plaintiffs' class action lawsuit alleged several violations of TILA and Regulation Z, and Chase filed a motion to dismiss. First, Chase argued that TILA and Regulation Z permit a suspension for a material change in a consumer's financial circumstances. The court rejected this argument because a creditor's inability to verify a borrower's income is not a recognized basis under §226.5b(f)(3)(vi) for suspending a HELOC. Chase also argued that Regulation Z permits a suspension for a breach of material obligations and that a creditor can specify the material obligations in the HELOC agreement. The court rejected this argument because although the HELOC agreement stated that failure to provide a current financial statement would constitute a material breach, it did not specify that failing to provide paystubs or a form authorizing release of tax returns would do so. Additionally, the plaintiffs provided many pages of financial information in response to WaMU's request. The court also rejected Chase's attempt to dismiss plaintiffs' claim that the March 18th change-in-terms notice was deficient. The court found that a HELOC suspension notice that relies on an impermissible basis for the suspension was a potential violation of Regulation Z. The court did grant Chase's motion to dismiss a claim arguing that the March 13, 2009 letter violated Regulation Z's change-in-terms notice requirements. The court held that this letter was not a change-in-terms notice.

FAIR CREDIT REPORTING ACT (FCRA)

Duties of consumer reporting agency for information in consumer report. *Cortez v. TransUnion, LLC,* 617 F.3d 688 (3d Cir. 2010). In a case of first impression, the Third Circuit held that an alert in a consumer reporting agency's (CRA) records indicating that a consumer's name matched a name on the Treasury Department's Specially Designated Nationals (SDN) list is subject to the FCRA's reporting requirements. Before shopping for a car loan, the plaintiff obtained her TransUnion credit report, which showed a high credit score and did not reveal an alert on her file for the SDN list. The Treasury Department maintains the list to identify individuals and businesses whose assets are blocked (such as terrorists) and whom individuals and organizations are prohibited from dealing with under the PATRIOT Act and its implementing regulations. When the plaintiff applied for a car loan, the car dealership notified her of the SDN alert on her TransUnion report, causing her to wait several hours while the dealership investigated and contacted the FBI. The dealership later approved her loan after determining that she was not the person on the list because the plaintiff's name (Sandra Jean Cortez) and birth date were different from the name (Sandra Cortez Quintero) and birth date of the person on the SDN list. The plaintiff subsequently contacted TransUnion four times to dispute the SDN listing and was assured that it did not appear on her file. However, when she later attempted to rent an apartment, she learned that TransUnion had not removed the alert, and she sued TransUnion for violating the FCRA. A jury awarded $50,000 in compensatory damages and $750,000 in punitive damages, but the trial court reduced the punitive damages to $100,000. On appeal, the Third Circuit affirmed the $150,000 verdict, finding that TransUnion: 1) violated §1681e(b) by failing to have reasonable procedures in place to recognize the birth date and name discrepancies; 2) violated §1681g by failing to list the SDN alert on the credit report TransUnion provided to the plaintiff; 3) violated §1681i by failing to reinvestigate the SDN alert after the consumer disputed it; and 4) violated §1681i(b) by failing to note in the consumer's file that she continued to dispute the SDN alert after receiving TransUnion's response. TransUnion argued that it was not required to include the information in the plaintiff's credit report because a third party provided it, and the SDN alert was not subject to the FCRA's reporting requirements. The court rejected this argument, finding that a CRA must report information in its files that affects a consumer's eligibility for credit. Because a match on the SDN list renders a consumer ineligible for credit under the PATRIOT Act, and the information was in TransUnion's files, the court held it was subject to FCRA reporting requirements. The court found further that the use of a third party to obtain the SDN information did not negate TransUnion's reporting obligations.

Furnisher's duty to investigate disputed information. *Chiang v. MBNA,* 620 F.3d 30 (1st Cir. 2010). The plaintiff alleged that MBNA erroneously reported to the consumer reporting agencies (CRAs) that he was delinquent on his credit card account and that MBNA violated §1681s-2(b)(1) of the FCRA because it failed to investigate when he disputed the delinquency report. The court noted that under §1681s-2(b)(1), a furnisher is required to investigate disputed information only when it receives notice of the dispute from a CRA and is not required to investigate a dispute filed directly by the consumer. The plaintiff was unable to submit any credible evidence at trial that the CRAs had notified MBNA of a dispute. The First Circuit therefore affirmed the dismissal of the case. It should be noted that Congress amended §1681s-2(b)(1) to require the federal banking agencies to issue regulations allowing consumers to file direct disputes with furnishers. In July 2009, the agencies issued those regulations, which became effective July 1, 2010. The Third Quarter 2010 issue of *Outlook* discussed the obligations of furnishers under the new direct dispute rules. http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2010/third-quarter/furnisher-requirements.cfm

FAIR HOUSING ACT (FHA)

Discrimination case standards to survive a motion to dismiss. *Swanson v. Citibank, N.A.,* 614 F.3d 400 (7th Cir. 2010). A divided panel of the Seventh Circuit held that a discrimination case under the Fair Housing Act (FHA) survives a motion to dismiss and proceeds to discovery as long as the plaintiff states a claim that is "plausible on its face" to satisfy the legal requirements for an FHA claim. The plaintiff, an African-American, applied for a home equity loan with Citibank, which conditionally approved a $50,000 loan based on the plaintiff's estimate that her house was worth $270,000. But when the bank's appraiser later valued the property at only $170,000, Citibank denied the loan. Two months later, the plaintiff had an appraisal done that valued her home at $240,000. The plaintiff sued Citibank and the appraisal company for violating the FHA, alleging that they disfavored making loans to African-Americans and deliberately lowered the appraisal value of her home to provide a pretext for denying the loan. The Seventh Circuit reversed the trial court's dismissal of the case, holding that the plaintiff's complaint identified the type of discrimination (racial), by whom (Citibank and the appraiser), and when (in connection with her application for a home equity loan), which was sufficient to allow the case to proceed to the next phase, in which the plaintiff could obtain discovery to further support her claims. The court emphasized, however, that while the plaintiff alleged sufficient facts to survive a motion to dismiss, she would need more evidence of discrimination than a mere discrepancy in two appraisals to ultimately prevail on her claims.

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

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An Overview of the Risk-Based Pricing Implementing Regulations

provide an adverse action notice. The risk-based pricing notice requirements are designed to address such circumstances not covered by §615(a), where a consumer receives less favorable credit terms based on his or her consumer report, rather than being denied credit.[4]

The final rule clarifies that the risk-based pricing notice requirements apply only to consumer credit, i.e., credit primarily for personal, household, or family purposes.[5] Business credit is excluded. This is consistent with the purpose of the notices to alert consumers that their consumer reports may contain negative information and allow them to check the reports for accuracy.[6] To facilitate this review, consumers receiving a risk-based pricing notice are entitled to a free consumer report for 60 days after receipt of the notice in addition to the free annual reports to which they are entitled under the FACT Act.

GENERAL REQUIREMENTS

When a creditor engages in risk-based pricing and uses consumer reports for this purpose, the requirement to provide a risk-based pricing notice to a consumer depends on what "material terms" are extended to the consumer and how those terms compare to the material terms extended to other consumers. Under the final rule, "material terms" generally is defined as the annual percentage rate (APR) for credit products that have an APR.[7] For credit products without an APR, material terms means the financial term that the creditor varies based on the consumer report and that has the most significant financial impact on consumers, such as an annual membership fee.[8]

The agencies state in the final rule that focusing on the APR is appropriate because most consumer credit products have an APR, and it has historically been a significant factor in the pricing of credit.[9] The APR used to determine the applicability of the rule varies, depending on the type of credit product:

- For open-end plans, the APR is the rate required to be disclosed under §226.6(a)(1)(ii) or §226.6(b)(2)(i), excluding any temporary initial rate that is lower than the rate that will apply after the temporary rate expires, any penalty rate, and any fixed APR option for a home equity line of credit.
- For credit cards (other than a credit card used to access a home equity line of credit or a charge card), the APR is the rate for purchases described under §226.6(b)(2)(i). If the credit card has no purchase APR, the material term is defined as the APR that varies based on information in a consumer report and that has the most significant impact on the consumer.
- For closed-end credit, the APR is the rate required to be disclosed under §226.17(c) and §226.18(e).[10]

The risk-based pricing rules generally require a creditor to determine whether a consumer receives materi-

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[4] The Senate Committee on Banking, Housing, and Urban Affairs cited concerns that the adverse action notification construct had been made obsolete in certain circumstances and found this problematic because the adverse action notice is the "primary tool the FCRA contains to ensure that mistakes in credit reports are discovered." See S. Rep. No. 108-166, at 20 (Oct. 17, 2003) Available at: http://www.glin.gov/download.action?fulltextId=97194&documentId=176079&glinID=176079

[5] 12 C.F.R. §222.70(a)(1)(i)

[6] 75 Fed. Reg. at 2724

[7] §222.71(n)(1) and (2)

[8] §222.71(n)(3)

[9] 75 Fed. Reg. at 2728

[10] §222.71(n)

[11] Section 222.72(b) defines "specific type of credit product" as one or more credit products with similar features that are designed for similar purposes. Examples of a specific type of credit product include student loans, unsecured credit cards, secured credit cards, new automobile loans, used automobile loans, fixed-rate mortgage loans, and variable-rate mortgage loans.

ally less favorable material terms for a specific type of credit product[11] and to provide a risk-based pricing notice to a consumer when this occurs. The agencies state that it would not be operationally feasible in many cases for creditors to compare terms offered to each consumer with the credit terms offered to other consumers to determine if the material terms are materially less favorable. As a result, the agencies provide tests that serve as proxies for comparing the terms offered to different consumers to determine which consumers must receive a risk-based pricing notice, although creditors retain the option to determine which consumers must receive a risk-based pricing notice on a case-by-case basis.

Credit Score Proxy Method

A creditor that sets the material terms of credit granted, extended, or otherwise provided to a consumer, based in whole or in part on a credit score, may use the credit score proxy method. This method uses a cutoff score at which approximately 40 percent of the consumers to whom the creditor grants, extends, or provides credit have higher scores and approximately 60 percent have lower scores. Any consumer whose credit score is lower than the cutoff score must be given a risk-based pricing notice. When a creditor has granted the most favorable credit terms to more than 40 percent of consumers, it has the option to set the cutoff score at an alternative point based on its historical data.

Creditors can use a representative sample for each specific type of credit product to determine the cutoff score. For creditors who are new to the market, secondary source information derived from appropriate market research or third-party sources for a specific type of credit product, such as market research or data from companies that develop credit scores, can be used. If a creditor acquires a credit portfolio as a result of a merger or acquisition, it may rely on information from the entity it acquired, with which it merged, or from which it acquired the portfolio.

Creditors that use the credit score proxy method must recalculate their cutoff score(s) no less than every two years. If market research, third-party data, or information from an entity it acquired, with which it merged, or from which it acquired the portfolio was used, the creditor must calculate a cutoff score using its own consumers within one year. Creditors with insufficient origination activity to calculate a score may continue to use secondary sources for an additional time frame not to exceed two years.

When a creditor uses multiple credit scores in setting the material terms of credit, the method used to determine the cutoff score must be the same method used to evaluate multiple scores for credit decisions. For example, a creditor may select the low, median, high, most recent, or average credit score of each consumer. If the creditor does not use a consistent method, a cutoff score should be calculated using reasonable means. The agencies deem as "reasonable means" either using a method that is regularly used or calculating the average credit score of each consumer.

THE AGENCIES STATE IN THE FINAL RULE THAT FOCUSING ON THE APR IS APPROPRIATE BECAUSE MOST CONSUMER CREDIT PRODUCTS HAVE AN APR, AND IT HAS HISTORICALLY BEEN A SIGNIFICANT FACTOR IN THE PRICING OF CREDIT.

Creditors using the credit score proxy method when no credit score is available must assume that the consumer receives credit on terms materially less favorable than the most favorable credit terms offered to a substantial proportion of consumers. The creditor must provide a risk-based pricing notice to the consumer.

Tiered Pricing Method

The tiered pricing method is available to creditors that set the material terms of credit by assigning each consumer to a discrete number of pricing tiers for a specific type of credit product. Creditors that use four or fewer tiers must provide notices to all consumers who do not qualify for the top tier. For example, if a credit card issuer has three pricing tiers (10 percent, 14 percent, and 18 percent) for the purchase APR, the issuer must provide a risk-based pricing notice to each consumer who did not qualify for the 10 percent purchase APR. When the creditor uses five or more pricing tiers, it must provide notices to any consumer who does not qualify for the top two tiers and any other tier that, together with the top two tiers, comprise no less than the top 30 percent but no more than the top 40 percent of the total number of tiers. For example, if a creditor has nine pricing tiers, the top three tiers comprise no less than the top 30 percent but no more than the top 40 percent of the tiers. Therefore, a creditor using this method would provide a risk-based pricing notice to each consumer who is placed in the bottom six tiers.[12]

Application to Credit Card Issuers

Section 222.72(c) addresses how credit card issuers can comply with the risk-based pricing rule. Issuers have the option of using any of the methods described above. If the issuer uses the credit score proxy or tiered pricing method, it must determine which consumers receive a notice through an analysis of the issuer's entire portfolio, rather than on an offer-by-offer basis. Alternatively, in connection with an application program, such as a direct-mail offer or a take-one application, or in response to a solicitation under §226.5a of Regulation Z, if the creditor offers multiple purchase APRs, the creditor may satisfy its obligations by sending risk-based pricing notices to any consumer who does not receive the lowest APR under that particular offer. When using this special method for credit cards, the issuer determines which consumers must receive a notice on an offer-by-offer basis with no requirement to compare different offers. Issuers are not required to provide notices when the consumer applies for a credit card and the issuer provides a single APR (excluding teaser or penalty rates) or when the issuer provides the consumer the lowest APR under the specific offer, even if there are lower rates available under different credit card programs issued by the card issuer.

Account Review

Under §222.72(d), a creditor is required to provide risk-based pricing notices if it performs an account review using information in a consumer report and a consumer's APR is increased as a result. Section 222.72(d)(2) contains an example to clarify: "A credit card issuer periodically obtains consumer reports for the purpose of reviewing the terms of credit it has extended to consumers in connection with credit cards. As a result of this review, the credit card issuer increases the purchase APR applicable to a consumer's credit card based in whole or in part on information in a consumer report. The credit card issuer is subject to the requirements of paragraph (a) of this section and must provide a risk-based pricing notice to the consumer."

CONTENT AND TIMING

Section 222.73 establishes the requirements for the content, form, and timing of the risk-based pricing notices.

Content

The content of the notices is prescribed in §222.73(a)(1) and (a)(2). Generally, the notice conveys what type of information is contained in a consumer report and that the terms of credit offered to the consumer are based on such information and may be less favorable than those for other borrowers with better credit histories. The notice encourages the consumer to verify the accuracy of the information in his or her report and notes the consumer's right to dispute inaccurate information. The notice must also inform the consumer of his or her right to receive a free credit report, provide information about how to obtain the report, disclose the identity of the consumer reporting agency or agencies that issued the report, and the fact that the consumer has 60 days after receipt of the notice to request a credit report.

To facilitate compliance with the content provisions, model disclosure forms H-1 and H-2 are provided. Model form H-1 may be used (as applicable) when a creditor extends credit to a consumer on materially less favorable terms, while model form H-2 may be used when an APR is increased as a result of an account review. Creditors' appropriate use of the model forms provides a safe harbor.[13]

Timing

Timing requirements for the risk-based pricing notice vary based on the type of credit extended. For closed-end credit, notices must be given before consummation of the transaction but not earlier than when the decision to approve the application is communicated to the consumer. For open-end credit, notices must be provided before the first transaction is made under the plan. When periodic account reviews are

[12] §222.72(b)(2)

[13] The model forms are available at: http://tinyurl.com/model-forms.

performed, the notice must be given at the time the decision to increase the APR is communicated to the consumer. If no notice is provided prior to the effective date of the change in the APR, the risk-based pricing notice must be given no later than five days after the effective date of the change.

The rules for providing the notice vary when credit is extended in conjunction with the purchase of an automobile from an auto dealer. First, when an auto dealer is the original creditor, pursuant to §222.75(b)(1), the auto dealer must provide the risk-based pricing (or alternative) notice, even if the dealer immediately assigns the credit agreement to a third party that serves as the source of funding for the credit. Conversely, when a creditor grants credit for the purpose of financing the purchase of an automobile from an unaffiliated auto dealer, the risk-based pricing notice can be provided either by the creditor or the dealer pursuant to the timing requirements discussed previously. If the notice is provided by the dealer, the creditor must maintain reasonable policies and procedures to verify that the auto dealer provides the notice within applicable time periods. Furthermore, if the consumer receives a notice containing a credit score (under the exception notice provisions of §222.74(e) or (f), discussed below) obtained by the dealer (or other party) and that score differs from the score obtained by the creditor, the creditor's obligations under the regulation are considered satisfied.

Under open-end plans, if credit is granted contemporaneously with a purchase of goods or services, the risk-based pricing notice may be provided at the earlier of the time of the first mailing by the creditor to the consumer after credit is granted or within 30 days after the decision to approve credit. For example, a consumer may apply for and be approved for a credit card when making a purchase at a department store. If a notice is required to be given to the consumer, the creditor may provide the notice in a mailing containing the account agreement or the credit card or within 30 days after the decision to approve credit, whichever is earlier.

EXCEPTIONS

Section 222.74 contains six exceptions to the risk-based pricing notice requirements. No notice is required when:

- A consumer applies for specific material terms (for example, a 10 percent APR) and is granted those terms, unless those terms were specified by the person using a consumer report after the consumer applied for or requested credit and after the person obtained the consumer report.
- A creditor uses consumer reports to prepare a prescreened credit solicitation under the "firm offer of credit" provision of §604(c)(2) of the FCRA (15 U.S.C. §1681b(c)(2)).[14] However, if a consumer receives a solicitation, applies for credit, and a risk-based pricing notice is triggered under §222.72, the creditor must provide the notice.[15]
- A creditor provides an adverse action notice to the consumer under §615(a) of the FCRA (15 U.S.C. §1681m(a)).

More important, the agencies provide a set of exceptions that apply if a creditor provides to all consumers who request credit a credit score disclosure notice in lieu of a risk-based pricing notice. The exception notices are:

- For loans secured by residential real property, creditors must disclose the consumer's credit score and certain additional information required by §222.74(d)(1)(ii) clearly and conspicuously and in writing. Appendix H contains model form H-3, which creditors can use to comply. This notice contains all of the information required to be disclosed pursuant to section 609(g) of the FCRA (15 U.S.C. §1681g), and the agencies intend that model form H-3 also be compliant with the disclosure required under 609(g). This credit score exception notice must be provided before consummation of the transaction in the case of closed-end credit or before the first transaction is made under an open-end plan.

  For credit not secured by one to four units of residential real property, creditors must provide a credit score notice similar to the credit score exception notice for residential real estate. Creditors must disclose the consumer's credit score

[14] §222.74(c)

[15] 75 Fed. Reg. at 2739

and certain additional information required by §222.74(e)(1)(ii). Appendix H contains model form H-4, which creditors may use to comply.

These credit score exception notices explain that credit scores are affected by a consumer's credit history and can affect the availability and cost of credit. Both notices disclose the consumer's credit score and compare it with a distribution of credit scores among consumers in graphical form or through a clear and readily understandable statement informing the consumer how his or her credit score compares with the scores of other consumers. Since the credit score is provided with these exception notices, the consumer does not have the right to a free consumer report, other than a free annual report. A statement encouraging the consumer to verify the accuracy of the information contained in the consumer report and noting the consumer's right to dispute any inaccurate information in the report is required. The creditor must also disclose how the consumer can obtain a consumer report.

For either of the credit score exception notices described above, if the creditor obtains two or more credit scores for a consumer and uses one of those scores as the basis for setting the material terms, that score must be disclosed. If the creditor instead uses multiple scores to set the material terms (such as by averaging the scores), the creditor may disclose one of the scores obtained or may disclose more than one score. Regardless of which method the creditor uses, the information specified in §222.74(d)(1)(ii) or (e)(1)(ii), as applicable, must be provided for each credit score disclosed.

- If a creditor regularly obtains credit scores from a consumer reporting agency and is unable to obtain a score for a particular consumer from that consumer reporting agency, an exception notice may be given stating that a credit score was unavailable, which may indicate a lack of credit history. Other disclosures in the notice describe what credit scores are, why they are important, and how to obtain a copy of the consumer's credit report. Model form H-5 affords a safe harbor.

MULTIPLE CONSUMERS

In the case of risk-based pricing notices for transactions involving two or more consumers who are granted, extended, or otherwise provided credit, a creditor must provide a notice to each consumer to satisfy the requirements of §222.72(a) or (c). If the consumers have the same address, a creditor may satisfy the requirements by providing a single notice addressed to both consumers. If the consumers do not have the same address, a creditor must provide a separate notice to each consumer.

Credit score exception notices have different requirements. When a transaction involves two or more consumers, the creditor providing such notices must provide a separate notice to each consumer to satisfy the exceptions in §§222.74(d), (e), or (f), regardless of whether the consumers have the same address. Each separate notice must contain only the credit score(s) of the consumer to whom the notice is provided and not the credit score(s) of the other consumer.

Section 222.75 also provides other rules of construction. Section 222.75(a) generally provides that a consumer is entitled to only one risk-based pricing notice per credit extension, unless the creditor must provide an account review notice(s) to the consumer. Section 222.75(b) provides that the original creditor has the obligation to provide a notice, even if it immediately assigns the credit agreement to a third party and is not the source of funding for the credit. A purchaser or assignee of a credit contract is not required to provide a notice.

CONCLUSION

The risk-based pricing and credit score exception notices provide consumers with an additional opportunity to review the accuracy of their credit reports or to receive their current credit score. The disclosure is further intended to educate consumers about the connection between the information in their credit reports and the cost of credit. Creditors need to evaluate which method(s) for compliance with the risk-based pricing rules works best for their credit products. 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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Regulation Z's Payment Crediting Rules for Open-End Credit, Credit Cards, and Closed-End Mortgage Payments

branch while the branch is open, the payment must be credited as of that day, even if it is entered into the system at a later date. But if a consumer makes a check payment at the bank branch ATM when the branch is closed, that payment does not have to be credited as of that day.

Partial Payments

During the comment period, some servicers expressed concern that problems could arise if they were required to credit partial payments. Comment 226.36(c)(1)(i)-2 addresses this, stating that "payments should be credited based on the legal obligation between the creditor and consumer. The legal obligation is determined by applicable state or other law." The preamble to the final rule provided this example to clarify: "If under the terms of the legal obligations governing the loan, the required monthly payment includes principal, interest, and escrow, then consistent with those terms, servicers would not be required to credit payments that include only principal and interest payments."[9] Thus, in the event of a partial payment, a servicer would have to review the consumer's legal obligation with the creditor to determine how to credit the payment.[10]

Finally, the regulation addresses a circumstance many servicers are likely to encounter: If reasonable payment requirements *are* specified, how should a servicer credit a nonconforming payment that the servicer accepts? Section 226.33(c)(2) provides the answer: "If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, *the servicer shall credit the payment as of 5 days after receipt"* (emphasis added).

Pyramiding Late Fees

Pyramiding late fees refers to a creditor's practice of imposing a late fee when a consumer sends a timely payment in an amount sufficient to cover the regularly scheduled payment but insufficient to cover a prior unpaid late or delinquency fee. If the creditor allocates payments first to late fees, the consumer's payment only partially covers the currently scheduled payment, resulting in a new late fee. If the consumer continues to pay only the scheduled payment, late fees will continually be assessed (hence, the phrase pyramiding of late fees). Section 226.36(c)(1)(ii) requires that if a consumer sends a timely payment sufficient to cover the currently scheduled payment, the creditor cannot assess late fees.

Most financial institutions are familiar with this rule because pyramiding late fees is already prohibited by the credit practices rule issued by the Federal Trade Commission (FTC) and the federal banking agencies under the FTC Act.[11] During the rulemaking, commenters questioned the need for this rule in light of these existing regulations. But the Board explained in the final rule that by "bringing the fee pyramiding rule under TILA Section 129(l)(2), state attorneys general would be able to enforce the rule through TILA, where currently they may be limited to enforcing the rule solely through state statutes (which statutes may not be uniform)."[12]

RULES FOR OPEN-END CREDIT, INCLUDING CREDIT CARDS

The payment crediting rules for open-end consumer credit in §226.10 are generally similar to the rules in §226.36(c) for loan servicers. In addition, §226.10 includes several requirements that apply only to credit

[9] 73 Fed. Reg. at 44572

[10] In addressing partial payments, creditors should also be aware of the prohibition on pyramiding late fees, which is discussed below.

[11] 12 C.F.R. §227.15 (commercial banks); 16 C.F.R. §444.4 (nondepository creditors); 12 C.F.R. §535.4 (savings and loan associations); and 12 C.F.R. §706.4 (federal credit unions)

[12] 73 Fed. Reg. at 44572

card accounts that implement specific requirements of the Credit CARD Act.

In general, §226.10(a) applies to all open-end consumer credit and provides that a consumer's payment must be credited on the date of receipt. The OSC[13] provides additional guidance on this requirement:

- The "received" date for a check payment is based on the date the check reaches the creditor, not when it clears.
- In a payroll deduction plan in which funds are deposited to an asset account held by the creditor and from which payments are made periodically to an open-end credit account, payment is received on the date debited to the asset account (rather than the date of the deposit), provided the payroll deduction method is voluntary and the consumer retains use of the funds until the contractual payment date.
- If the consumer uses a third-party payment service through preauthorized electronic payment or through telephone payment, payment is received when the creditor receives the third-party payor's check or other transfer medium, such as an electronic fund transfer.
- Payment through a creditor's website is received on the date on which the consumer authorizes the creditor to effect the payment, even if the consumer gives the instruction authorizing payment in advance of the date on which the creditor is authorized to effect payment. If the consumer authorizes the creditor to effect the payment immediately, but the consumer's instruction is received after 5 p.m. or any later cut-off time specified by the creditor, the date on which the consumer authorizes the creditor to effect the payment is deemed to be the next business day. (See additional discussion of payment crediting requirements for website payments below.)

Similar to closed-end credit, creditors may impose reasonable payment requirements that enable most consumers to make conforming payments. Section 226.10(b)(2) provides several examples:

- requiring that payments be accompanied by the account number or payment stub;
- setting a reasonable cut-off time for payments to be received by mail, by electronic means, by telephone, and in person (except as provided in §226.10(b)(3)), except the cut-off time cannot be earlier than 5 p.m. on the payment due date at the location specified by the creditor for the receipt of such payments;
- specifying that only checks or money orders should be sent by mail;
- specifying that payment is to be made in U.S. dollars; or
- specifying one particular address for receiving payments, such as a post office box.

Section 226.10(b) and the accompanying commentary provide additional guidance on creditor payment requirements by specifying the following restrictions:[14]

- *Payment by electronic fund transfer.* Pursuant to §913 of the Electronic Fund Transfer Act, creditors cannot condition an extension of credit on the requirement that a consumer use pre-authorized electronic fund transfers for repayment.[15]
- *Payment via creditor's website.* When a creditor promotes electronic payment via its website (for example, by stating on the website that payments can be made electronically through the website), a payment made on the website prior to any cut-off time specified by the creditor is considered a conforming payment.[16]
- *Acceptance of nonconforming payments.* If a creditor accepts a nonconforming payment (for example, mailing to a branch office when the creditor specified a different location for mailed payments), the creditor must credit the payment within five days of receipt and can impose finance charges for the period between receipt and crediting of the payment.[17]

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[13] Comment 226.10(a)-2

[14] Some restrictions apply only to card issuers and are so noted; otherwise, the restrictions apply to all payment requirements for open-end consumer credit.

[15] Comment 226.10(b)-1

[16] Comment 226.10(b)-2

- *Payments made at point of sale.* If a card issuer is a financial institution and has a card that can be used only with a particular merchant or merchants or is cobranded with the name of a particular merchant or merchants, and a consumer can pay the card account at a retail location maintained by such a merchant, the retail location is not considered to be a branch or office of the card issuer for purposes of §226.10(b)(3).[18]
- *In-person payments on credit card accounts.* When a consumer makes a credit card payment at a branch or office of a financial institution before the close of business of the branch or office, the payment is considered received on the date on which the consumer made the payment. A financial institution card issuer cannot impose a cut-off time earlier than the close of business for any such payments made in person at any branch or office of the card issuer at which such payments are accepted. But a card issuer may impose a cut-off time earlier than 5 p.m. for such payments if the branch or office closes earlier than 5 p.m. In addition, if a consumer makes a credit card payment at a branch or office with the direct assistance of a branch or office employee, that payment constitutes an "in-person payment" and is considered received on the date of payment. But a card payment made at the bank branch or office *without* the direct assistance of a branch or office employee, *for example, a payment placed in a branch or office mail slot,* is not an in-person payment for purposes of §226.10(b)(3)[19] (emphasis added).
- *In-person payments at an affiliate of a financial institution card issuer.* If a financial institution card issuer (such as "ABC Bank") shares a name with an affiliate (such as "ABC Mortgage"), and the affiliate accepts in-person payments on the card issuer's credit card accounts, those payments are subject to the requirements of §226.10(b)(3) and are considered received on the date of payment.[20]

The discussion above addressed the payment crediting rules when a creditor specifies payment requirements. However, if the creditor does not impose specific payment requirements, comment 226.10(b)-4 of the OSC establishes three payment crediting rules that apply by default:

- Payments may be made at any location where the creditor conducts business.
- Payments may be made any time during the creditor's normal business hours.
- Payments may be made by cash, money order, draft, or other similar instrument in properly negotiable form, or by electronic fund transfer if the creditor and consumer have so agreed.

These bright-line rules provide clarity for creditors and consumers in circumstances when the creditor did not specify payment requirements.

If a creditor fails to credit a payment in accordance with the rules in §226.10 in time to avoid imposing finance charges, the creditor is required under §226.10(c) to provide an adjustment to the consumer's account during the next billing cycle.

Payment Due Date When Creditor Cannot Receive Payment

Section 226.10 also addresses the circumstances when a payment due date is a day on which the creditor does not receive or accept payments by mail. For example, the creditor may specify that payment is due on a Sunday, and the creditor does not receive mailed payments on Sundays. Section 226.10(d) provides that the creditor cannot treat a payment received the next business day by any method as late for any purpose (late fee, finance charge, reporting to consumer reporting agencies, etc.). However, if the creditor accepts or receives payments by a method other than mail, such as electronic or telephone payments, on a due date on which the creditor did not receive or accept payments by mail, it is not required to treat a payment made by that method on the next business day as timely.

Card Issuer's Change of Address for Receiving Payment

Another important rule addresses material changes in the address or procedures for receiving credit card payments, which are defined as "any change in the address for receiving payment or procedures for handling cardholder payments which causes a material de-

[17] Comment 226.10(b)-3

[18] Comment 226.10(b)-5

[19] Comment 226.10(b)-6

[20] Comment 226.10(b)-7

lay in the crediting of a payment."[21] When this occurs, and it causes a material delay in crediting payments during the 60-day period following the change, the card issuer cannot impose late fees or finance charges for a late payment during the 60-day period following the date on which the change took effect.[22] For this purpose, "material delay" means a delay in crediting a payment that results in a late payment and imposition of a late fee or finance charge. A delay that does not result in a late fee or finance charge is not material.[23]

One additional requirement of the regulation concerns fees imposed by card issuers to make a payment (for example, a fee to pay by telephone). The Credit CARD Act generally prohibits card issuers from imposing a separate fee to allow a consumer to repay an extension of credit or pay a finance charge, unless the payment involves an expedited service by a customer service representative. Section 226.10(e) implements this requirement and defines "expedited payment" as crediting a payment to the account on the same day or, if the payment is received after the creditor's cut-off time, the next business day.

CONCLUSION

Financial institutions should establish controls and have appropriate policies and procedures in place to reflect the new payment crediting requirements. Specific issues and questions should be raised with the consumer compliance contact at your Reserve Bank or with your primary regulator.

[21] Comment 226.10(f)-2

[22] § 226.10(f)

[23] Comment 226.10(f)-2

CONTINUED FROM PAGE 5...

Understanding Regulation DD's Advertising Requirements

(5) *Effect of fees.* A statement that fees could reduce the earnings on the account.

(6) *Features of time accounts.* For time accounts:

   (i) Time requirements. The term of the account.
   (ii) Early withdrawal penalties. A statement that a penalty will or may be imposed for early withdrawal.
   (iii) Required interest payouts. For noncompounding time accounts with a stated maturity greater than one year that do not compound interest on an annual or more frequent basis, that require interest payouts at least annually, and that disclose an APY determined in accordance with section E of Appendix A of the regulation, a statement that interest cannot remain on deposit and that payout of interest is mandatory.

OVERDRAFT SERVICES

Many depository institutions have been heavily advertising their overdraft services to encourage customers to opt in for the service to comply with recent regulatory changes under Regulation E (Electronic Fund Transfers). Section 230.11(b)(1) requires, subject to certain exceptions discussed below, that institutions promoting overdraft services in advertisements include the following disclosures in a clear and conspicuous manner:

- the fee for each overdraft;
- the categories of transactions for which an overdraft fee can be imposed;
- the time period to repay an overdraft; and
- the circumstances under which the institution will not pay an overdraft.

To facilitate compliance, the OSC provides three examples of promoting overdraft services in advertisements that trigger these disclosure requirements:

- promoting the institution's policy or practice of paying overdrafts through print media advertisements such as newspapers or brochures, telephone solicitations, electronic mail, or messages posted on an Internet site;
- including a message on a periodic statement informing the consumer of an overdraft limit or

funds available for overdrafts (stating, for example, that the consumer has a $500 overdraft limit or that $300 remains on the overdraft limit); or

- disclosing an overdraft limit or including the dollar amount of an overdraft limit in a balance disclosed on an automated system, such as a telephone-response machine, ATM screen, or the institution's Internet site.[6]

Section 230.11(b)(2) exempts certain overdraft communications and advertisements from these disclosure requirements. For communications, the exemptions apply to:

- an advertisement promoting overdraft services subject to Regulation Z and a written agreement (such as an overdraft line of credit);
- a communication by an institution about the payment of overdrafts in response to a consumer-initiated inquiry about deposit accounts or overdrafts;[7]
- an advertisement made through broadcast or electronic media, such as television or radio. However, this exception does not apply to advertisements on an institution's Internet site, on an ATM screen, on telephone-response machines, or sent by electronic mail.
- an advertisement made on outdoor media, such as billboards;
- an ATM receipt;
- an in-person discussion with a consumer;
- disclosures required by federal or other law;
- information on a periodic statement or notice about a specific overdrawn item or the amount by which an account is overdrawn;
- a notice to consumers, such as at an ATM, that completing a requested transaction may trigger a fee for overdrawing an account, or a general notice that items overdrawing an account may trigger a fee;
- informational or educational materials about overdrafts that do not specifically describe the institution's overdraft service; or
- an opt-out or opt-in notice regarding the institution's payment of overdrafts or provision of discretionary overdraft services.

For advertisements, the regulation exempts indoor sign advertisements for overdrafts from the disclosure requirements, provided the sign clearly and conspicuously discloses that fees may apply and that consumers should contact an employee for further information.[8]

UNFAIR AND DECEPTIVE ACTS AND PRACTICES (UDAP)

While this article has focused on the advertising requirements of Regulation DD, it is not the only law regulating deposit product advertising. Section 5(a) of the Federal Trade Commission Act (15 U.S.C. §45(a)) prohibits unfair or deceptive acts or practices. This law applies to all aspects of a depository institution's consumer products and services, including advertisements.[9] Under §5(n), an act or practice is "unfair" if it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consum-

> To facilitate compliance, the OSC provides three examples of promoting overdraft services in advertisements that trigger these disclosure requirements.

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[6] For the last example of promoting overdraft services on an ATM screen or telephone-response machine, §230.11(b)(3) specifies that only two of the four disclosures in §230.11(b)(1) must be made, namely, the fee(s) for paying each overdraft and the period by which the overdraft must be repaid.

[7] Providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as an ATM or an institution's Internet site, is not a response to a consumer-initiated inquiry for purposes of this exemption.

[8] §230.11(b)(4)

[9] Section 1031 of the Dodd-Frank Wall Street Reform and Consumer Protection Act expands the UDAP lexicon by also prohibiting "abusive" practices. This term is defined in §1031(d), and its meaning will likely be fleshed out in a future rulemaking by the new Bureau of Consumer Financial Protection. The bureau can also issue regulations identifying specific unfair, deceptive, or abusive acts or practices. Section 1031 becomes effective on the bureau's designated transfer date, which is currently July 21, 2011, but could be extended by six months. Section 1031 will be codified in the U.S. Code as 12 U.S.C. §5531.

ers themselves and not outweighed by countervailing benefits to consumers or to competition."[10]

A three-pronged test is used to determine if an act or practice is "deceptive." First, the representation, omission, or practice must be misleading or likely to be misleading to the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Finally, the misleading representation, omission, or practice must be material. A complete discussion of UDAP is beyond the scope of this article. For further information, readers should consult the joint guidance on UDAP for state-chartered institutions published by the Board and the Federal Deposit Insurance Corporation.[11]

To avoid unfair or deceptive advertisements, institutions should ensure that appropriate policies and procedures are in place; that communication is open and effective among all departments of the institution, including contact with third-party vendors; and that advertisements are reviewed for UDAP compliance before publication. Institutions should always:

- Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend or is not able to provide the service to account holders;
- Avoid advertising terms that are not available to most customers and the use of unrepresentative examples in advertising, marketing, and promotional materials;
- Implement and maintain effective risk and supervisory controls to select and manage third-party servicers; and
- Ensure that employees and third parties who market or promote bank products are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.

CONCLUSION

Advertising compliance begins and ends with a strong compliance program and includes effective policies and procedures, awareness, education, and communication between all areas. 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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[10] 15 U.S.C. §45(n)

[11] Unfair or Deceptive Acts or Practices by State-Chartered Banks, March 11, 2004; available at: http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf

Setting the Record Straight

CLARIFICATION

An article in the Third Quarter 2009 issue of *Outlook,* "An Overview of the Home Affordable Modification Program," stated that "HAMP requires that all banks and lending institutions accepting funding from the Troubled Asset Relief Program (TARP), after the announcement of HAMP in March 2009, must implement loan modifications for eligible loans under HAMP's guidelines."

For clarification, HAMP was announced in February 2009, after the majority of the support for banks and lending institutions had already been made under the Capital Purchase Program of the Troubled Asset Relief Program's (TARP). In February 2009, the Treasury Department proposed another TARP program: the Capital Assistance Program (CAP). It was originally expected that financial institutions participating in CAP would be required to participate in HAMP and modify eligible loans, but the CAP program was never used. However, because additional TARP support was provided to AIG, Citibank, and GMAC after the announcement of HAMP, these three institutions were required to participate in HAMP.

CORRECTION

An article in the Third Quarter 2010 issue of *Outlook,* "Mortgage Disclosure Improvement Act (MDIA): Examples and Explanations," acknowledged Jeff Paul and Gary Louis of the Federal Reserve Bank of Atlanta for their work in developing a MDIA training tool on which the author of the MDIA article relied. We should have acknowledged Jeff Paul and Bill Beall of the Federal Reserve Bank of Atlanta.

Regulatory Calendar*

EFFECTIVE DATE	IMPLEMENTING REGULATION	REGULATORY CHANGE
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)	New rules for HPMLs and all residential mortgages
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. 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
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)	HPML escrow requirements for nonmanufactured homes
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)	Revisions to open-end credit disclosures
7/6/2010	Reg. E (EFTA) and Reg. DD (TISA)	Clarification of overdraft rules
8/16/2010	Reg. Z (TILA)	Proposal for higher trigger for first-lien jumbo HPML escrows
8/16/2010	Reg. Z (TILA)	Significant proposed amendments affecting residential mortgage loans
8/22/2010	Reg. E (EFTA)	Phase 3 CARD Act rules for gift cards
8/22/2010	Reg. Z (TILA)	Phase 3 CARD Act rules for penalty fees and rate-increase review
10/1/2010	Reg. Z (TILA)	HPML escrow requirements for manufactured homes
10/1/2010	S.A.F.E. Act	Registration requirement for mortgage loan originators
10/19/2010	Reg. Z (TILA)	Rulemaking proposal to clarify 3 issues in Credit CARD Act implementing regulations
11/3/2010	Reg. BB (CRA)	CRA credit for making low-cost education loans to low-income borrowers
11/29/2010	Reg. E (EFTA)	Final rule modifying effective date of certain disclosure requirements for gift cards
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
1/1/2011	Reg. Z (TILA)	Required notice to borrower when mortgage is sold or transferred
1/1/2011	Reg. Z (TILA)	HOEPA Trigger Amounts Revised for 2010
1/1/2011	Reg. BB (CRA)	CRA asset-size threshold adjustments
1/1/2011	Reg. C (HMDA)	HMDA asset-size exemption threshold adjustment
1/30/2011	Reg. Z (TILA)	MDIA interim final rule for mortgage loans with variable rates or payments
4/1/2011	Reg. Z (TILA)	Restrictions on loan steering and loan originator compensation
4/1/2011	Reg. Z (TILA)	Interim final rule for appraisal independence for consumer credit transactions

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

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Calendar of Events

February 3, 2011	Consumer Protection Law Conference American Bar Association George Washington University Washington, D.C.
February 20-23, 2011	ABA National Conference for Community Bankers Manchester Grand Hyatt San Diego, CA
March 20-24, 2011	Independent Community Bankers Association National Convention San Diego Convention Center San Diego, CA
March 25-27, 2011	ABA Intermediate Compliance School Dolce Hayes Conference Center San Jose, CA
March 25-31, 2011	ABA National Compliance School Dolce Hayes Conference Center San Jose, CA