

New Rules Add to a Growing Wave of Proposals to Regulate the Credit Card Industry

INTRODUCTION

On May 3, 2008, three federal agencies jointly proposed amended regulations intended to alter the way banks and other institutions provide credit card products and overdraft services. The new rules generally seek, among other things, to categorize certain industry practices as “unfair or deceptive” and limit or halt those practices. The proposed amendments issued by the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration signal a collective regulatory shift from focusing on transparency and disclosure to focusing on certain business practices themselves. Once the final proposed rules are published in the Federal Register, a public comment period will begin. This advisory summarizes the proposed rules, discusses some of the implications of those rules, and briefly outlines actions that potentially affected entities can take.

OVERVIEW OF NEW RULES

The proposed rules will amend Regulation AA (Unfair and Deceptive Practices under the Federal Trade Commission Act), Regulation Z (Truth in Lending Act), and Regulation DD (Truth in Savings Act). Using the authority granted to the agencies under each of those respective statutes, the following rules have been issued:¹

Credit Cards

- **Time to Make Payments** (Reg. AA) – Consumers must be granted a “reasonable amount of time to make payment.” If such time is not provided the card issuer will not be able to charge a late penalty. The rule does not define a “reasonable” timeframe, but does provide a safe harbor to institutions that mail or deliver billing statements at least twenty-one days before the payment due date.
- **Due Dates** (Reg. Z) – Mailed payments received by 5:00 pm on the due date (or the following business day if payments are not accepted on the due date) will have to be considered timely.
- **Two-Cycle Billing** (Reg. AA) – Some institutions employ a billing method that retroactively assesses interest on the balance for days in the preceding billing cycle when the balance is not fully paid within the grace period. The new regulations will prohibit this method of assessing interest which is commonly called “double-cycle” or “two-cycle” billing.
- **Payment Allocation Among Multiple Balances** (Reg. AA) – When a cardholder’s account has different annual percentage rates (APR) that apply to different balances on the card, and the cardholder makes a payment exceeding the minimum payment, the bank will not be allowed to allocate the full amount of the excessive portion of the payment to the balance subject to the lower rate. Instead, the bank will have to allocate the amount over the minimum payment in one of the following ways: split the amount equally between the two balances; allocate the payment first to the balance with the higher APR; or allocate on a pro rata basis. Banks may also allocate

¹ This summary is based on the final proposed rules released by the Federal Reserve and Federal Reserve publications discussing and summarizing the rules. Those materials can be found at <http://www.federalreserve.gov/newsevents/press/bcreg/20080502a.htm>.

under any other method that is “no less beneficial to the consumer.”

- **Rate Increases on Existing Balances** (Reg. AA) – Institutions will be prohibited from increasing the interest rate on existing credit card balances. Similarly, any fee or other charge based only on an outstanding balance (and therefore having the same effect as a rate increase) will also be prohibited. The rule includes three exceptions that will allow for such an increase: if the rate increase is due to the operation of an index; if a promotional rate ends or is otherwise lost; or if minimum payment is not made within thirty days of the due date.
- **Security Deposits and Fees** (Reg. AA) – For any security deposits and fees associated with making credit available (e.g., membership fees), banks will be prohibited from financing such fees if they exceed fifty percent of the initial credit limit. If such fees exceed twenty-five percent (but not more than fifty percent) of the initial credit limit, financing the fees will be allowed, but the financing must be spread over the first year of credit.
- **Charges Due to Credit Card Holds** (Reg. AA) – Banks will be forbidden from charging a fee if a consumer exceeds their credit limit because of pending holds on available credit.
- **Firm Offers of Credit** (Reg. AA) – Any institution that makes a “firm offer” of credit that includes multiple APRs or multiple credit limits will be required to disclose the criteria used to determine which APR or credit limit will be finally offered.

Overdraft Services

- **Opt Out Rights** (Reg. AA) – Banks will be required to provide consumers with an opportunity to opt out of overdraft protection service or otherwise be prohibited from charging fees for overdraft payments. If an institution chooses to provide consumers with the opportunity to opt-out of overdraft services, it will be required to offer a partial opt-out option (*i.e.*, allow consumers to opt out of overdraft protection for ATM and point of sale transactions).
- **Charges Due to Debit Holds** (Reg. AA) – Like the charges described above for exceeding credit limits, the new rules will prohibit banks from charging an overdraft fee if a consumer exceeds their account balance due to a pending hold on the account.
- **Fee Disclosure** (Reg. DD) – Currently banks that advertise overdraft protection must provide statements that indicate monthly and year-to-date overdraft charges. The new rules will extend this obligation to all institutions regardless of their advertising practices.
- **Balance Information** (Reg. DD) – Any institution that provides automated account balance information will be barred from including overdraft protection funds in the consumer’s account balance.

A GROWING WAVE OF REGULATORY ACTION

The proposed regulations outlined above mark the latest attempt to police the consumer credit market. In the wake of the sub-prime mortgage crisis, the Federal Reserve and other regulatory authorities have been accused of failing to act to curb allegedly harmful mortgage industry practices that some maintain contributed to the sub-prime fallout. Now Congress and consumer groups are pressing for change in the credit card industry. Legislative efforts have been initiated in both the House by Rep. Carolyn Maloney (D-NY) and in the Senate by Banking Committee Chairman Christopher Dodd (D-CT) to redress what some perceive to be unfair credit card practices. This credit card legislation foreshadowed many of the provisions now contained in the joint rule. Exactly how the various regulatory efforts will be resolved, and whether the legislation will move forward given the proposed rules is still unclear. What is clear is that some measures will be adopted that will impact the industry, and banking institutions should take steps to influence and prepare for such measures.

WHAT CAN FINANCIAL INSTITUTIONS DO?

All of the proposals discussed above will likely impose additional compliance costs on institutions. Further, the ability for companies to independently assess and price risk using current practices may be hampered. Institutions can take a number of steps in response.

Comment on the Proposed Amendments and Legislation

One step an institution can take is to submit comments regarding the proposed amendments. Comments are now being accepted on the agencies' amendments, and once the rules are published in the Federal Register, the clock will start running on the public comment period. For all changes proposed to Regulation AA, there will be a seventy-five day comment period. For amendments proposed to Regulations Z and DD, there will be a sixty day comment period. Additionally, working through trade groups and with government affairs counsel who can advocate particular issues, companies can and should advise Congress about their concerns with the pending legislation.

Begin Investigating Compliance Steps

While comments may yield changes in the proposed regulations, at least some of the regulations, or all in slightly altered forms, could be finalized and effective by the end of this year. It is important that companies monitor the progress of the proposed rules and legislative efforts. And while it may take some time for the final regulatory picture to become clear, companies should begin taking steps to outline internal policy changes to comply with the new regulations. Outside counsel can be called upon to help monitor legislative and regulatory developments, and find a path through the regulatory fog while providing tips for compliance. Be sure also to consider litigation risks that may surface as a result of these developments.

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