NEW PROPOSALS CLARIFY THE JULY 2010 CREDIT CARD REGULATIONS

In the May 5, 2009 publication of the *Federal Register*, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System (Federal Reserve), and the National Credit Union Administration (collectively the Agencies) issued proposals to provide clarifications and additional commentaries (Clarifications) to their December 2008 final rules (Final Rules) regulating credit card practices. These Final Rules prohibit financial institutions from engaging in certain activities in connection with consumer credit card accounts and modified disclosure requirements related to open-end credit plans and overdraft services. The Final Rules, which become effective on July 1, 2010 are described in further detail in our previous advisory: "Federal Bank Regulators Adopt New Rules Curtailing Unfair and Deceptive Credit Card Practices." The Clarifications reportedly were issued in response to concerns and questions related to the implementation of the Final Rules. It is not clear what the effect of these latest Clarifications will have, if any, on the credit card legislation currently being considered by the US Congress, which largely follow the provisions of the Final Rules.

The Agencies have invited public comments on the Clarifications. The deadline for submitting these comments is June 4, 2009.

A summary of the proposed Clarifications follows:

Closed, Acquired, or Transferred Accounts

The Final Rules apply to all credit card accounts provided to a consumer primarily for personal, family, or household purposes under an open-end credit plan. The Clarifications make it clear that any outstanding balances of accounts that have closed, been acquired by another institution, or transferred to another credit account are covered within the scope of the Final Rules. Specifically, citing the aim of eliminating consumer surprise, the Clarifications state the Agencies' intent to apply the protections of the Final Rules to these altered credit accounts, regardless of whether an institution or consumer initiated the change. If an account balance is closed, acquired, or transferred, that account remains subject to the same prohibitions on interest rate increases. The one exception to this clarification applies to situations where the consumer chooses to transfer an account to another institution with a higher interest rate. In those instances, the informed choice of the consumer eliminates the Agencies' concern about surprise rate increases.

APR Adjustments

The Final Rules require institutions to disclose, at account opening, the annual percentage rates (APRs) that will apply to transactions under the account, and

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generally prohibit the increase of the APR unless authorized through a specific exception.

Under the Clarifications, a new account opened by a consumer with the same institution will require new disclosures if the consumer opening the new account can still engage in transactions on the old account. An institution is also prohibited from increasing the rate on the new account within the first year of its opening. This clarification is in effect even if the consumer transfers a balance from the first account to the second. If, however, an institution replaces one consumer account with another credit card account, or consolidates a consumer's multiple accounts, then a new account has not been created under the Final Rules, and, in those circumstances, an institution would not be required to provide new disclosures.

The Final Rules contain several exceptions to the prohibition on increasing the APR on an account during the first year the account is in place. These exceptions include:

1. The expiration of a promotional interest rate period disclosed at account opening;
2. Variable interest rates tied to an external index;
3. Payment delinquencies that exceed 30 days; and
4. The expiration of a workout arrangement.

In addition, after the first year, card issuers can increase the APR upon seven days advance notice.

The Clarifications would create a new exception for servicemembers whose interest rates are decreased through the Servicemembers Civil Relief Act (SCRA). The SCRA prohibits servicemembers and their spouses from being charged interest rates greater than six percent during the period of that person's military service. Once the servicemember's military tenure ends, the Clarifications make it clear that the interest rate on the account may be increased to a rate no higher than the rate on the account before the SCRA applied.

The Clarifications also provided additional guidance on the interest rate increase exceptions. Under the first exception listed above, the Clarifications make it clear that an institution may increase the rate of an account after the expiration of a period disclosed at the opening of the account, often referred to as a "promotional stepped rate offer." If the promotional period expires in the middle of a billing cycle, then the Clarifications note that the bank may delay a rate increase until the start of the next billing cycle without affecting the institution's ability to raise the rate. The Agencies also clarify that the expired period must be based on actual time, and not on the occurrence of a particular event, or at the institution's discretion. This prohibition is aimed at preventing "hair trigger" repricing, in which a late payment would be the trigger for a rate increase. The Agencies will only allow rate increases on delinquencies greater than 30 days, as noted in the fourth exception.

When an institution increases the interest rate on an account after the end of the first year upon seven days advanced notice, the Clarifications make it clear that it may not apply the new rate on any charges made within seven days of disclosure of the rate change. Additionally, the Clarifications make it clear that institutions would be prohibited from accruing any interest at the increased rate until a 45-day period has elapsed from the date of the rate change. Moreover, the Clarifications would prohibit an institution from reaching back to days before the effective date of the rate increase to charge interest at the increased rate. The effect of these Clarifications is to give the card holder a 45-day window to pay off the balance on charges made after the notification of the rate increase and the expiration of the seven day advanced notice period.

Despite the limitations on adjusting the interest rate upward, the Clarifications make it clear that there are no prohibitions against an institution lowering a consumer's APR. If an institution lowers the interest rate on an account, then it must provide advanced notice in order to return the rate back to its original level prior to the decrease. This rule would apply to promotional discount rates, grace periods, workouts, and temporary hardship arrangements. In all of these situations, a temporary decrease in an APR and a subsequent return to the original rate with proper notice would be permitted.

Treatment of Deferred Interest, Waived Interest, and Similar Promotional Programs

The Agencies consider a "deferred interest program" to be a promotional program under which a consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time. Alternatively, a "waived interest program" is a promotional program in which interest is refunded if a balance is paid in full within a specified period of time. The Final Rules considered programs that defer interest rate charges on transactions until after the expiration of a certain date to be in conflict with the Agencies' goal to eliminate unfair consumer surprise. The Agencies stated that programs that waive interest completely if a balance is repaid during a particular period are better alternatives to deferred interest rate programs because they do not raise such concerns about unfair surprise. However, the Clarifications make it clear that the Final Rules do not fully prohibit deferred interest programs, or fully permit waived interest programs. Either program is permitted, but only to the extent that they comply with the Final Rules—in particular, the prohibitions against "hair trigger" and "universal default" repricings of existing balances. Any consumer who participates in one of these promotional programs must have the opportunity to repay a balance and enjoy the waived or deferred interest rate for 30 days after the expiration of the zero percent APR promotional period.

The Clarifications also address current deferred rate interest programs with promotional periods that do not expire until after the enactment of the Final Rules in July 2010. An institution may charge the deferred interest rate after the July 2010 date, provided that the periodic statement mailed after the date provides proper disclosure under 12 C.F.R. § 226.7, and the terms of the rate are also compliant with the newly enacted rules.

Under the Final Rules, if a consumer makes excess payments, the institution must allocate these payments on the accounts in an order from the highest APR balances to the lowest. For deferred or waived interest programs, these accounts are treated as zero percent APR balances for payment allocation purposes. Thus, an institution would allocate a consumer's excess payments to all higher APR accounts before paying the balance of an account that is within a waived or deferred interest payment period. Under the Clarifications, however, all excess consumer payments must go to deferred or waived interest balances first during the last two billing cycles before the expiration of the account's promotional period. The Agencies state that this clarification will provide consumers with a better opportunity to pay off the balance of a deferred or waived interest rate account before the promotional period expires and the interest rate rises.

Deferred and waived interest rate programs remain a major concern of the Agencies, as amendments to Regulation Z have also been proposed by the Federal Reserve, to address these accounts. Deferred and waived interest rate accounts may not disclose their APR as zero percent because the Federal Reserve considers this disclosure misleading. In addition, if a bank uses terms like "no interest," "no payments," "deferred interest," or "same as cash," in an advertisement, then the duration of the deferred or waived interest period, as well as the fact that the entire balance must be paid in full during that period, must be disclosed within immediate proximity to the advertised terms.

Arnold & Porter LLP is available to respond to questions raised by the Clarifications or to provide any assistance in drafting comments to the proposed rules. We also can assist in determining how these rule changes may affect your business and ensuring that your business is compliant with the Final Rules in anticipation of the July 1, 2010 enactment date. For further information, please contact your Arnold & Porter attorney or:

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