THE NEWLY ENACTED CREDIT CARD ACT TIGHTENS AGENCY REGULATIONS

On May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act). The legislation amends the Truth in Lending Act (TILA) and the Fair Credit Reporting Act (FCRA) to establish new rules governing credit card accounts. For example, the CARD Act limits the ability of creditors to adjust a card's interest rate, or charge fees based on the actions of consumers. When creditors receive consumer payments, they will be required to apply the funds to balances with the highest interest rates first. Additionally, the CARD Act will require enhanced consumer disclosures, and restrictions on issuing cards to college students.

The CARD Act incorporates many of the rules adopted by federal bank regulators that will become effective in July 2010 (Final Rules)[1], but also contains certain new restrictions designed to protect consumers. Most of the provisions of the new statute, however, will become effective in February 2010, although there are two provisions that will become effective by August 20, 2009:

1. A 45-day advance written notice required to be made to a card holder of any significant changes in the terms of a credit card account, accompanied by a right to cancel the account before the change in terms take effect.
2. A requirement that statements must be delivered to consumers at least 21 days before the end of any grace period, specifying the finance charges that would be assessed once the grace period ends.

A summary of the material provisions of the CARD Act follows, along with the provisions' locations within TILA and the FCRA:

MARKETING AND OPENING CARD ACCOUNTS

- A creditor may not open a credit card account or increase the credit limit on an account without considering the ability of the consumer to repay. (15 U.S.C. §§ 1666 *et seq.*).
- A creditor must maintain websites to post its written credit card agreements with consumers. It must also submit these agreements to the Board of Governors of the Federal Reserve System (Federal Reserve), which will house them in a public repository. (15 U.S.C. § 1632).

1 A summary of the Final Rules (*See* "New Rules Curtailing Unfair and Deceptive Credit Card Practices") and its subsequent clarifications (*See* "New Proposals Clarify July 2010 Credit Card Regulations") have been provided through previous advisories.

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— The Federal Reserve, in consultation with the federal banking agencies and the Federal Trade Commission (FTC), may draft regulations which provide exceptions to this requirement when the administrative burdens of the websites outweigh the increased transparency.

CARD TERMS/CHANGES IN CARD TERMS

- The CARD Act clarifies the use of the term "fixed rate" so that when it appears with a reference to the annual percentage rate (APR) or interest rate applicable to an account, it can only be used to refer to an APR or interest rate that will not change or vary for any reason over the period specified in the account terms. (15 U.S.C. § 1637).
- A creditor may not increase an APR, fee, or finance charge on an outstanding credit card balance unless one of the following exceptions applies: (a) a previously disclosed time period for a promotional rate expires; (b) a variable interest rate increase measured by an external index; (c) a workout or temporary hardship agreement is completed; or (d) payments are delinquent for more than 60 days (which is 30 days longer than in the Final Rules). (15 U.S.C. §§ 1666 *et seq.*).
- Except for these four exceptions to increasing an APR, fee, or finance charge on an outstanding credit card balance, a credit card balance may not experience an increase during its first year. (15 U.S.C. §§ 1666 *et seq.*).
- In the case of a promotional interest rate, the rate cannot expire less than six months after it is introduced. (15 U.S.C. §§ 1666 *et seq.*).
  — The CARD Act provides for the Federal Reserve to define "promotional rate" and develop regulations which provide reasonable exceptions to this rule.
- A creditor must provide a cardholder 45-day advance written notice of any significant change in the terms of an account, including an increase in the interest rate (unless the change is an increase in the APR due to the expiration of a previously disclosed promotional period, a variable increase in the APR, or the completion of a workout or temporary hardship agreement). The advance written notice must provide the cardholder with the right to cancel the account before the change in terms goes into effect, and such cancellation may not constitute default. (15 U.S.C. § 1637(i)).
  — This provision becomes effective August 20, 2009, which is 90 days after the May 22, 2009 date of enactment.
- Creditors must review credit card accounts in which the APR has increased after January 1, 2009 at least once every six months to see if factors such as credit risk and market conditions have changed to support a rate reduction. If the review supports a reduction in the APR, then the rate must be reduced. If the review supports an increase in the APR, then the creditor must provide in a written notice the reasons for the increase. (15 U.S.C. §§ 1661 *et seq.*).
  — The Federal Reserve must issue regulations to clarify the methodology of this review by February 22, 2010, to be effective on August 22, 2010.
- If a creditor amends or changes any term on a credit card account upon renewal, that change must be disclosed at least 30 days prior to the scheduled renewal date. (15 U.S.C. § 1637(d)(1)).

CONSUMER PAYMENTS ON CARD ACCOUNT BALANCES

- If a creditor increases the APR, fee, or finance charge on an account due to a minimum payment not being received within 60 days of the due date, that creditor must terminate the increase if the consumer pays the minimum payments for six months after the increase was imposed. (15 U.S.C. §§ 1666 *et seq.*).
  — The law consequently nullifies the provisions in the Final Rules, which imposed a 30-day period in which a consumer can make a late payment, and did not allow a six month consumer redemption option.
- If a consumer makes a payment in excess of the minimum amount due, the creditor must apply the excess payment to the balance with the highest interest rate first, and then the balance with the next highest rate until the payment

is exhausted. If there are balances with deferred interest rates, then the excess payments must first apply to those balances during the last two billing cycles before the deferred interest rate ends. (15 U.S.C. § 1666c(b)).

- — This provision sets forth the same concepts articulated in the Final Rules, as well as the clarifications on deferred interest rates issued on May 5, 2009.

- A creditor cannot change the repayment terms of an outstanding balance unless the change matches one of the following methods: (a) a minimum amortization period of five years, beginning on the date of the change in terms; or (b) minimum payments which, as a percentage of the outstanding balance, are no greater than twice the percentage required before the change in terms. A creditor may also change the terms to a method that is no less beneficial to the consumer than the suggested methods. (15 U.S.C. §§ 1666 *et seq.*)
- A creditor may not charge a consumer a fee for paying by a certain method (mail, electronic transfer, telephone, etc.) unless the payment involves expedited services by a service representative of the creditor. (15 USC 1637(l)).
- If the creditor makes a material change to its mailing address, office, or procedures for handling payments and the change causes a material delay in crediting a consumer's payment during a 60-day period following the change, then the creditor may not impose a late fee or finance charge on the account for a late payment. (15 U.S.C. § 1666c(c)).
- The payment date on a credit card account must be the same date each month. If the payment date is on a day that the creditor does not receive mail, then a payment received on the next business day may not be considered late. (15 U.S.C. § 1637(o)).
- A creditor may not treat a payment as late for any purpose unless the creditor has adopted reasonable procedures designed to ensure that the periodic statement is mailed or delivered to the consumer at least 21 days before the due date. (15 U.S.C. § 1666b(a)).
- A creditor must disclose that a minimum payment will increase the dollar amount of interest paid, the time it takes to repay the balance, including the number of months it would take to pay the balance if only paying the minimum monthly payments, and the amount that would be required to eliminate the outstanding balance in 36 months. A toll-free number of credit counseling and debt management services must also be prominently displayed on the billing statement. (15 U.S.C. § 1637(b)(11)).
  - — The CARD Act requires the Federal Reserve to promulgate regulations that require these disclosures in the form of a table.
  - — By November 2009, the Federal Reserve must issue guidelines for creditors to establish and maintain toll-free lines for referrals to credit counseling agencies approved by a United States bankruptcy trustee.
- If a consumer payment is made at a local branch of a creditor, then the date the payment is made at the branch must be the date the payment is credited to the account for purposes of determining whether a late fee or charge may be imposed. (15 U.S.C. § 1637(b)(12)).

FEES RELATED TO CARD ACCOUNTS

- A creditor may not impose a finance charge based on prior billing cycles when calculating charges for the current billing cycle (double-cycle billing). A creditor is also prohibited from imposing a finance charge on the balance of a current billing cycle that was repaid during the cycle. There are two exceptions to these prohibitions: finance charge adjustments as a result of a dispute resolution, or the return of a payment for insufficient funds. (15 U.S.C. § 1637(j)).
- A consumer must expressly consent to the imposition of over-the-limit fees, and the creditor must disclose the manner and form of the fee before a consumer can consent. A consumer's consent may be revoked at any time, and a creditor must provide notice of this revocation right in any periodic statement that imposes an over-the-limit fee. Such fees may only be charged once in a billing cycle, and only once in each of the two subsequent billing cycles. (15 U.S.C. § 1637(k)).

- Penalties and fees assessed by a creditor must be reasonable and proportional to the consumer's omission or violation. (15 U.S.C. §§ 1661 *et seq.*).
  - — The Federal Reserve, in consultation with other federal banking agencies must issue regulations by February 2010 to determine standards for assessing whether the amount of any fee or charge is "reasonable and proportional," and such regulations must become effective by August 2010. The regulations must consider the cost incurred to the creditor by the consumer violation, deterrence of the violation, cardholder conduct, and other factors that the Federal Reserve deems necessary and appropriate. The Federal Reserve may also issue a safe harbor rule under which a fee or penalty charged is presumed to be "reasonable and proportional."
- If a credit card (usually subprime cards) requires fees in the first year of an amount exceeding 25% of the credit limit when the account was opened, none of the payment of the fees may come from the credit made available under the account. The fees calculated for this rule do not include charges related to late payments, over-the-limit transactions, or insufficient funds. (15 U.S.C. § 1637(n)).
- During a grace period where no finance charge is imposed, a statement must be delivered to the consumer no less than 21 days before the end of the period specifying the amount upon which the post-grace period finance charge will be assessed. (15 U.S.C. § 1666b(b)).
  - — This provision becomes effective August 20, 2009, 90 days after the May 22, 2009 enactment.
- A creditor must disclose when a credit card balance is eligible for a late fee, as well as when an increase in APR will occur because of a late payment. (15 U.S.C. § 1637(b)(12)).

MARKETING CARDS TO COLLEGE STUDENTS

- Consumers under the age of 21 may not obtain a credit card unless the account is cosigned by a parent, legal guardian, spouse, or an adult above the age of 21 that has the means to repay, and indicates joint liability for the debts incurred by the consumer; or the consumer indicates an independent means of repaying the debt. (15 U.S.C. § 1637(c)(8)).
  - — The Federal Reserve is required to issue standards for determining a consumer's independent means of repaying a credit card debt. Such standards will provide a safe harbor for creditors that adhere to the regulations. Credit reporting agencies cannot issue credit reports on a consumer under 21 if that consumer did not initiate the report. (15 U.S.C. § 1681b(c)(1)(B)).
- Creditors may not offer items in exchange for applying for a credit card anywhere on or near a college campus, or at an event sponsored or affiliated with a college. Colleges must also publicly disclose any marketing contracts with creditors. (15 U.S.C. § 1650(f)).
  - — Creditors must submit an annual report of agreements with colleges, or college-affiliated organizations to the Federal Reserve. The first report is due by February 22, 2010.

CARD ACT INTENTIONS

The new law also contains provisions on gift cards and credit reports. While the intent of the CARD Act is to increase cardholder protections, many of the most widely publicized offensive card-issuer practices (such as double cycle billing and universal default) were already restricted or prohibited in the Final Rule. Many of the APR and other restrictions contained in the CARD Act will make it difficult to raise rates on consumers once a card is issued. Thus, initial interest rates on new cards will likely be set higher than is currently the case. In addition, credit cards may not be offered to certain consumers, in particular those under the age of 21, as the cost to do so will be too high. As noted above, certain portions of the Act are effective in August, with the rest taking effect February 2010, five months before the initial Final Rules' effective date of July 2010.

Strikingly, the CARD Act alludes to a universal default prohibition within its section headings, yet the particular provision is missing from the statute. With the Final Rules already prohibiting the practice, it is doubtful this statutory oversight will affect the legality of universal defaults. The prohibition may simply take effect with the Final Rules in July 2010, instead of February 2010 (unless the Federal Reserve moves up the effective date when it issues rules implementing the CARD Act's provisions).

We would be pleased to assist any financial institutions in adapting their business practices to these significant regulatory changes. We are available to review and modify marketing, disclosure, billing, and servicing practices to ensure compliance with the CARD Act. We have extensive experience in the credit card regulatory area, and can assist in assessing the impact of the CARD Act, its relationship with the Final Rules, and the landscape upon which your business must now operate. If you have any questions about the CARD Act, please contact your Arnold & Porter LLP attorney or:

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