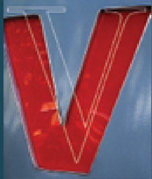
VENABLE LLP



financial services alert

www.Venable.com
JUNE 2009

For more information, please contact:

FINANCIAL SERVICES

Emilio W. Cividanes
202.344.4414
ecividanes@Venable.com

William J. Donovan
202.344.4939
wjdonovan@Venable.com

Joseph T. Lynyak III
202.344.4597
310.229.9660
jtlynyak@Venable.com

Suzanne F. Garwood
202.344.8046
sgarwood@Venable.com

Brenna V. Greenwald
202.344.4013
bvgreenwald@Venable.com

LEGISLATIVE AND GOVERNMENT AFFAIRS

Stuart P. Ingis
202.344.4613
singis@Venable.com

John J. O'Neill, Jr.
202.344.4548
jjoneill@Venable.com

Robert L. Smith, II
202.344.4077
rlsmith@Venable.com

ADVERTISING AND MARKETING

Melissa Landau Steinman
202.344.4972
mlsteinman@Venable.com

Historic Credit Card Crackdown Law Affects Creditors, Credit Card Issuers, Gift Card Sellers, Colleges and More

Even though the ink is not yet dry on the Federal Reserve Board's (the "Board") newly adopted credit card regulations, on May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Act"). Similar to the Board's recent amendments to Regulation Z that preceded it, the Act is intended to crackdown on certain credit card practices perceived as abusive – such as retroactive interest rate increases, "double cycle" billing and the offering of "fee harvester" cards. Despite the many similarities the Act shares with the Board's regulations, the Act is notably broader in two primary ways. First, the Act amends the Electronic Funds Transfer Act ("EFTA") by adding new provisions relating to certain gift cards and other prepaid cards. Second, the Act mandates numerous studies on a variety of consumer credit-related issues – from interchange fees to financial literacy.

In this Alert we highlight three main parts of the Act:

- **TILA Credit Card Provisions.** The Act amends the federal Truth-in-Lending Act's ("TILA") provisions relating to credit card accounts by adding numerous substantive and procedural restrictions on the charging of account-related fees and increasing APRs;
- **EFTA Gift Card Provisions.** The Act amends the EFTA to limit the fees imposed upon, and requires expiration dates for, electronic gift cards, gift certificates and store cards; and
- **Studies and Reports.** The Act requires that the GAO and the Board conduct a number of studies and reports regarding the effect of the Act's new substantive provisions and other issues affecting the consumer credit market.

1. Summary of the Credit Card Provisions

Historically, TILA has been primarily a disclosure statute that also included a few provisions that substantively regulated the terms of credit for credit cards. These substantive provisions, however, mostly focused on practices related to the issuance of unsolicited cards, consumer claims and prohibitions on adding credit features to an existing account.

The focus of the Act's new substantive credit card provisions is a sharp departure from the existing law by imposing specific APR, finance charge and fee limitations on creditors and card issuers. In addition to these substantive limitations, the Act also imposes new disclosure and transparency requirements, including a mandate on the Board to publish creditors' credit card agreements on-line.

A. *Interest Rate and Finance Charge Limitations*

Although TILA expressly states that it does not otherwise "annul, alter or affect in any manner" "laws relating to the types, amounts or rates of charges or any element or elements of charges permissible" under state law, the Act does just that. Specifically, it imposes a number of federal fee and APR caps and other limitations on credit cards covered under the TILA. (The Act does not attempt to resolve this inconsistency with existing provisions under TILA.)

A summary of these limitations follows.

- **Expiration of Specified Time.** A creditor may increase the APR after a specified period of time provided: (i) prior to the commencement of the time period, the creditor clearly and conspicuously discloses to the consumer the length of the time period prior to the date the change is effective and the APR that would apply after the expiration of that time period; (ii) the APR actually imposed does not exceed the amount of the increase disclosed; and (iii) the increased APR is not retroactively applied to transactions that occurred prior to the commencement of that time period.
- **Outside Index.** Similar to TILA's restrictions on variable rate loans for home equity lines of credit, creditors will be permitted to increase APRs on credit card accounts if the increase is consistent with an index that is not under the control of the creditor and is available to the general public.
- **Completion of Workout.** Assuming that a creditor lowers a consumer's APR for purposes of assisting the consumer with a workout arrangement, the creditor is permitted to increase the APR, fee or finance charge to the level that the rate or fee was at for the category of transaction prior to

commencement of the workout and this arrangement is clearly and conspicuously disclosed to the consumer prior to commencement of the workout.

- **Default.** The creditor may increase the interest rate due solely to the fact that the creditor has not received a minimum payment within 60 days of the payment due date. The creditor must provide notice of this increase (as discussed in greater detail, below) and the increase is imposed for not more than six months, during which the consumer makes timely minimum payments.

The above broad restrictions apply to increases in APRs and fees relating to "outstanding balances," which refers to the amount owed on a credit card account as of the 14th day after the date on which the creditor provides notice of an increase in the APR, rate, fee or finance charge as required by TILA.

In addition to the restrictions on creditors related to outstanding balances, the Act also limits a creditor's ability to charge fees and to increase APRs in three other circumstances. First, creditors are prohibited from increasing APRs (except as discussed above for outstanding balances) before the end of a one-year period commencing with the date the account was opened. Second, "promotional rates," which term the Board must define, must be in effect for six months. Third, the Act provides that, if a creditor increases the APR based on factors related to the credit risk of the obligor, including market conditions and other factors, the creditor must also contemplate reductions to the APR not less frequently than once every six months. This final requirement has a delayed effective date of 15 months following the effective date of the Act.

In addition to the above general restrictions on increasing APRs, the Act also provides for specific limitations on three categories of fees: (i) finance charges charged under "double cycle billing;" (ii) fees for overlimit payments; and (iii) fees for method of payments.

"Double cycle billing" is an industry shorthand term for the practice whereby creditors calculate the finance charge based on the average daily balance for a consumer's current and previous billing cycles. The Act prohibits double cycle billing in those instances where consumers are permitted to repay without incurring a finance charge.

Overdraft fees are prohibited except where the consumer opts-in to the overdraft line of credit after receiving required disclosures. The consumer may revoke this opt-in election at any time consistent with regulations issued by the Board. If a consumer does not opt in to the overdraft credit, a creditor may still extend the credit, provided it does not impose a fee.

Finally, the Act prohibits a creditor from imposing a fee for the method of payment unless it involves an expedited service by the creditor's service representative. Stated another way, if a consumer elects to pay via the telephone, the creditor cannot impose a fee unless the creditor's service representative handles the payment in an expedited manner.

Importantly, the Act limits fees for late payments, over the limit or other penalties to amounts that are reasonable and proportional to the contractual violation or harm. The Board, in conjunction with the other federal banking agencies (Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, and National Credit Union Administration) must issue regulations determining what constitutes a "reasonable" and "proportional" fee. (This provision has a delayed effective date of 15 months following the effective date of the Act, and the regulatory drafting process promises to be participated-in by industry and consumer groups.)

B. *45-Day Notice Requirements*

To limit the practice of retroactive changes to credit card terms, the Act imposes two new 45-day notice requirements prior to the effective date of any rate increases or the imposition of "significant changes," a term left to the discretion of the Board to define, on outstanding balances.

- **Rate Increase Notice.** Except as otherwise provided, a creditor must provide consumers with a clear and conspicuous notice of an increase in an APR and the consumer's right to cancel the account not later than 45 days prior to the effective date of the change. Notice is not required in the following instances: (i) where the rate expired after a specified period of time and the consumer was advised of this expiration date; (ii) the rate increases in accordance with an index outside of the creditor's control; or (iii) the increase is imposed following the completion of a workout arrangement (discussed in greater detail, above).

  Any creditor that provides for an increase in the rate as permitted by the Act, and that provides notice as required, above, also may provide the obligor with the option of changing the repayment terms by either amortizing the loan over at least five years beginning on the effective date of the increase, requiring a minimum payment that is equal to not more than twice the percentage of the outstanding balance before the effective date of the increase, or pursuant to a repayment plan that is no less beneficial to the consumer than those two options.

- **Significant Change Notice.** A creditor also must provide consumers with clear and conspicuous notice of "any significant change" (other than increases in finance charges subject to the notice requirement, above) and the consumer's right to cancel the account not later than 45 days prior to the effective date of the change. The Act does not define what constitutes "any significant change," instead leaving it to the Board to fill in the details when drafting the implementing regulations.

It is important to note that these 45-day notice requirements reflect a new concept - a consumer now has a right to cancel an existing credit card account *without accelerating the debt*. Prior to the adoption of the Act, under TILA a consumer's right to cancel a credit transaction was limited to rescission of certain real estate secured loans. The Board is to provide further guidance on the right by regulation. The Board's authority is limited by the Act which provides that (i) any closure or cancellation of an account by the obligor on the account does not constitute a default; (ii) the creditor may not upon cancellation accelerate the debt to be paid in full; and (iii) cancellation may not trigger the payment of a fee. The creditor may upon closure of the account by the consumer require repayment as amortized over not less than five years or allow repayment by minimum payments equal to not more than twice the percentage of the minimum payment required on the outstanding balance prior to the APR increase.

C. *Enhanced Consumer Disclosure*s

In addition to the new 45-day notice requirements discussed above, the Act requires creditors to make the following new clear and conspicuous disclosures in the periodic statements provided to consumers in a format to be included by the Board in Regulation Z:

- **Minimum Payment Warning.** The warning advises: "Making only the minimum payment will increase the amount of interest you pay and the time it takes to repay your balance"
- **Repayment Information.** This information includes the number of months required to pay the whole balance, the total cost to the consumer, the monthly payment required to pay off the debt in 36 months, and a toll-free number to call to receive information on credit counseling and debt management services.
- **Late Payment.** Consumers must be advised of the date on which a late payment fee will be charged as well as the amount of the fee or charge and any increase in interest rate that results from late payment, including the amount of the penalty APR.

D. *Ability to Repay*

A "card issuer,"—which in the card context essentially means the same as a creditor for purposes of TILA—may not open any credit card account or increase an existing credit limit without first considering whether the consumer has the ability to make the payments. The Act does not provide meaningful guidance on how creditors may comply with the requirement. The existing standard measuring ability to repay already found in Regulation Z relates to high cost mortgage loans and requires creditors to verify and document income. If the Board imposes similar restrictions on the issuances of credit cards, concerns have been raised by industry commentators that the availability of credit may be adversely impacted for low- to moderate- income households.

E. *Protection of Young Consumers*

In keeping with the theme that persons who obtain credit cards must have an ability to repay the credit made available, the Act makes a point of providing additional protections for persons who are under 21 or attending college.

Specifically, creditors may not issue a credit card to or on behalf of, an individual under the age of 21, unless the individual has an application co-signed by a parent, guardian or other individual with the means to repay the debt or the individual can provide financial information proving his or her own ability to repay the debt. For those cards issued to persons under 21 where a parent or guardian is jointly liable on the debt, parental approval is required in writing to increase the credit line and the parent or guardian must agree to be liable on the additional credit.

With respect to students (irrespective of age), creditors and card issuers are prohibited from offering anything tangible to a student at an institution of higher education to apply for a credit card if such offer is made on or near a campus, or at a campus-sponsored event. Creditors also must submit an annual report to the Board containing information related to all business, marketing, and promotional agreements and college affinity card agreements with institutions of higher education, alumni organizations, and foundations associated with such institutions as well as the amount of payments from the creditor to the institution, organization or foundation, and the number of credit card accounts opened during, and still outstanding at the end of, the period.

F. *Public Availability of Contracts*

Except for those contracts that are individually negotiated, creditors are required to establish and maintain an Internet Web site where they will post all written credit card agreements that they enter into with consumers. The Board must also publish these agreements on a publicly available Internet site in a format that the Board, in consultation with the Federal Trade Commission, establishes.

In addition to creditors, colleges are required to publicly disclose any contract or other agreement made with a card issuer or creditor for the purpose of marketing a credit card.

G. *Prompt and Fair Crediting of Payments*

TILA already requires that creditors promptly apply payments to existing balances. The Act takes this requirement one step further by mandating the manner in which the creditor must apply the payment – first to the card balance bearing the highest rate of interest, and then to each successive balance bearing the next highest rate of interest – until the payment is exhausted.

The Act also requires that consumers be given sufficient time to make payments. As such, a creditor cannot treat a payment as late unless the creditor has adopted reasonable procedures to ensure that periodic statements are mailed or delivered at least 21 days before the payment due date.

H. *"Fee Harvester" Cards*

A "fee harvester" card generally refers to a credit card issued to a subprime borrower, which has a very low credit limit, but with very high fees. For example, the credit card may offer $250 in credit, but charges an up-front administration fee of $100 which fee is deducted from the credit available under the card. To limit these "fee harvester" cards, the Act prohibits any fee other than a late or over limit fee that is more than 25 percent of the total amount of credit authorized under the account to be made from the line of credit. This prohibition is effective for one year from the date of account opening.

I. *Credit Counseling*

Not later than six months following enactment, the Board, in consultation with the Secretary of the Treasury, must issue guidelines for the establishment and maintenance by creditors of a toll-free number for purposes of providing information about credit counseling and debt management services. These guidelines may only refer to those counseling agencies that are approved by the United States bankruptcy trustee pursuant to Section 111(a) of Title 11 of the United States Code.

J. *Penalties*

The Act imposes a five-fold increase in the amount of the statutory damages available for violations of the disclosures or rescission provisions related to credit cards from a minimum of $100 and maximum of $1,000 in individual actions to $500 and $5,000, respectively. The Act also provides the courts with the authority to award amounts higher than the statutory maximum if the creditor was engaging in a "pattern or practice" of violations. This concept does not otherwise exist in TILA except for certain high cost mortgages.

2. Summary of the Gift Card Provisions

While the majority of the Act amends TILA provisions related to credit cards, the Act also makes notable change to the Electronic Funds Transfer Act ("EFTA") by making that law expressly applicable to electronic "general-use prepaid cards," "gift certificates," and "store gift cards." For purposes of these new provisions, the following definitions apply:

- **General-Use Prepaid Cards:** a card or other payment code or device, issued by a person, that is: (i) redeemable at multiple, unaffiliated merchants/service providers or ATMs; (ii) issued in a requested amount that may be increased; (iii) purchased or loaded on a prepaid basis; and (iv) honored by merchants for goods or at ATMs.

- **Gift Certificate:** an electronic promise that is: (i) redeemable at a single merchant or affiliated merchants that share the same mark or logo; (ii) issued in a specified amount that may not be reloaded; (iii) prepaid and purchased in return for payment; and (iv) honored upon presentation by the single/affiliated merchants.

- **Store Gift Card:** an electronic promise, plastic card or other payment code or device that is: (i) redeemable at a single merchant or affiliated merchants that share the same mark or logo; (ii) issued in a specified amount that may be increased; (iii) prepaid and purchased in return for payment; and (iv) honored upon presentation by the single/affiliated merchants.

Notwithstanding these rather broad definitions, the Act ***excludes*** any electronic promise, plastic card, code or device that may otherwise meet the definition under the law that is: (i) used solely for telephone services; (ii) reloadable and not marketed or labeled as a gift card or gift certificate; (iii) a loyalty, award, or promotional gift card as defined by the Board; (iv) not marketed to the general public, ***or*** (v) issued in paper form only (including tickets to events).

For those electronic promises codes or cards that constitute general use prepaid cards, gift certificates or store cards, the following restrictions apply:

- **Fee Limitations.** Dormancy fees, inactivity charges or service fees on such cards or certificates are unlawful under the Act unless there has been no activity on the card or certificate for 12 months, the terms of the fees or charges are conspicuously disclosed. Under no circumstance may more than one fee be charged in any given month.

- **Expiration Dates.** A card or certificate may not expire earlier than five years after the date on which it was issued. The terms of the expiration must be clearly and conspicuously stated.

The new law will ***not*** preempt existing state laws regulating gift cards, including more restrictive laws regarding expiration dates and dormancy and other fees. Instead, the provisions provide a floor, or minimum standard, for gift cards. Thus, marketers selling gift cards on a national platform must continue to comply with state laws.

The gift card provisions of the new law are scheduled to take effect on August 21, 2010. In the interim, the law authorizes the Board, in consultation with the Federal Trade Commission to: (i) develop requirements relating to the amount of dormancy fees, inactivity charge fees or service fees that may be assessed; and (ii) determine the extent to which the individual definitions and provisions of the EFTA or Regulation E apply to general-use pre-paid cards, gift certificates and store gift cards. These regulations will provide important additional details to marketers as to precisely how the new provisions will apply to their activities.

3. Identification of Key Studies and Reports

As significant as the Act may be viewed in regard to reforming abusive credit card practices, the numerous studies required under the Act suggest that Congress is not yet done with its reforms. For example, within 180 days of the effective date of the Act, the Comptroller General of the United States is required to conduct a study of interchange fees and their cost to consumers in terms of merchant pricing. The Act also requires two studies on financial literacy be conducted by the Secretary of Education and the GAO, as well as two studies be conducted analyzing the effect of the Act's changes to TILA on the availability of credit.

4. Conclusions

In the next several months, the Board and other federal agencies will be promulgating voluminous proposed regulation to implement provisions of the Act. Among other things, the Board must issue guidance to homogenize is recent credit card amendments to Regulation Z, as well as to address effective dates for the same in order to minimize expense to creditors and other effected parties.

Whether you are a creditor, a retailer, a gift card seller or a college, the Act will have an effect on your business. Venable is ready to assist you in navigating this new and changing landscape to ensure that you and your business fully comply with the new requirements of the Act.

CALIFORNIA   MARYLAND   NEW YORK   VIRGINIA   WASHINGTON, DC

1.888.VENABLE | www.Venable.com

© 2009 Venable LLP. This alert is published by the law firm Venable LLP. This alert is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to specific fact situations.