

Please note that the following rule is the version, applicable to federal credit unions only (Part 706), approved by the NCUA Board. The official version of the joint rulemaking will be published in the Federal Register in early 2009. The joint rule will include Parts 227 and 535, and may have some minor numbering or format differences.

FEDERAL RESERVE SYSTEM

12 CFR Part 227

[Regulation AA; Docket No. R-1314]

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 535

[Docket ID. OTS-2008-0004]

RIN 1550-AC17

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 706

RIN 3133-AD47

Unfair or Deceptive Acts or Practices

AGENCIES: Board of Governors of the Federal Reserve System (Board); Office of Thrift Supervision, Treasury (OTS); and National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The Board, OTS, and NCUA (collectively, the Agencies) are exercising their authority under section 5(a) of the Federal Trade Commission Act to prohibit unfair or deceptive acts or practices. The final rule prohibits institutions from engaging in certain acts or practices in connection with consumer credit card accounts. The final rule relates to other Board rules under the Truth in Lending Act, which are published elsewhere in today's **Federal Register**. Because the Board has proposed new rules regarding overdraft services for deposit accounts under the Electronic Fund Transfer Act elsewhere in today's **Federal Register**, the Agencies are not taking action on overdraft services at this time. A secondary basis for OTS's rule is the Home Owners' Loan Act.

EFFECTIVE DATE: The final rule is effective on July 1, 2010.

FOR FURTHER INFORMATION CONTACT:

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NCUA: Matthew J. Biliouris, Program Officer, Office of Examination and Insurance, (703) 518–6360; or Moissette I. Green or Ross P. Kendall, Staff Attorneys, Office of General Counsel, (703) 518–6540, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

SUPPLEMENTARY INFORMATION: The Federal Reserve Board (Board), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (collectively, the Agencies) are adopting several new provisions intended to protect consumers against unfair acts or practices with respect to consumer credit card accounts. These rules are promulgated pursuant to section 18(f)(1) of the Federal Trade Commission Act (FTC Act), which makes the Agencies responsible for prescribing regulations that prevent unfair or deceptive acts or practices in or affecting commerce within the meaning of section 5(a) of the FTC Act. See 15 U.S.C. 57a(f)(1), 45(a). A secondary basis for OTS’s rule is the Home Owners’ Loan Act (HOLA), 12 U.S.C. 1461 et seq.

I. Background

A. The Board’s June 2007 Regulation Z Proposal on Open-End (Non-Home Secured) Credit

On June 14, 2007, the Board requested public comment on proposed amendments to the open-end credit (not home-secured) provisions of Regulation Z, which implements the Truth in Lending Act (TILA), as well as proposed amendments to the corresponding staff commentary to Regulation Z. 72 FR 32948 (June 2007 Regulation Z Proposal). The purpose of TILA is to promote the informed use of consumer credit by providing disclosures about its costs and terms. See 15 U.S.C. 1601 et seq. TILA’s disclosures differ depending on whether the consumer credit is an open-end (revolving) plan or a closed-end (installment) loan. The goal of the proposed amendments was to improve the effectiveness of the disclosures that creditors provide to consumers at application and throughout the life of an open-end (not home-secured) account.

As part of this effort, the Board retained a research and consulting firm (Macro International) to assist the Board in conducting extensive consumer testing in order to develop improved disclosures that consumers would be more likely to pay attention to, understand, and use in their decisions, while at the same time not creating undue burdens for creditors. Although the testing assisted the Board in developing improved disclosures, the testing also identified the limitations of disclosure, in certain circumstances, as a means of enabling consumers to make decisions effectively. See 72 FR at 32948–32952.¹

¹ As discussed below, the Agencies have relied in part on the Board’s consumer testing in determining that certain practices are unfair under the FTC Act. The results of this consumer testing are set forth in the reports prepared by the Board’s testing consultant. The initial report was posted on the Board’s public website along with the June 2007 Regulation Z Proposal. See Design and Testing of Effective Truth in Lending Disclosures (May 16, 2007) (available at <http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf>). Two supplemental

In response to the June 2007 Regulation Z Proposal, the Board received more than 2,500 comments, including approximately 2,100 comments from individual consumers. Comments from consumers, consumer groups, a member of Congress, other government agencies, and some creditors were generally supportive of the proposed revisions to Regulation Z. A number of commenters, however, urged the Board to take additional action with respect to a variety of credit card practices, including late fees and other penalties resulting from perceived reductions in the amount of time consumers are given to make timely payments, allocation of payments first to balances with the lowest annual percentage rate, application of increased annual percentage rates to pre-existing balances, and the so-called two-cycle method of computing interest.

B. The OTS's August 2007 FTC Act Advance Notice of Proposed Rulemaking

On August 6, 2007, OTS issued an ANPR requesting comment on its rules under section 5 of the FTC Act. See 72 FR 43570 (OTS ANPR). The purpose of OTS's ANPR was to determine whether OTS should expand on its current prohibitions against unfair and deceptive acts or practices in its Credit Practices Rule (12 CFR part 535).

OTS's ANPR discussed a very broad array of issues including:

- The legal background on OTS's authority under the FTC Act and HOLA;
- OTS's existing Credit Practices Rule;
- Possible principles OTS could use to define unfair and deceptive acts or practices, including looking to standards the Federal Trade Commission (FTC) and states follow;
- Practices that OTS, individually or on an interagency basis, has addressed through guidance;
- Practices that other federal agencies have addressed through rulemaking;
- Practices that states have addressed statutorily;
- Acts or practices OTS might target involving products such as credit cards, residential mortgages, gift cards, and deposit accounts; and
- OTS's existing Advertising Rule (12 CFR 563.27).

OTS received 29 comment letters on its ANPR. These comments were summarized in the Agencies' May 2008 proposed rule. See 73 FR 28904, 28905-28906 (May 19, 2008) (May 2008 Proposal). In brief, financial industry commenters opposed OTS taking any further action beyond issuing guidance along those lines. They argued that OTS must not create an unlevel playing field for OTS-regulated institutions and that uniformity among the federal banking agencies and the NCUA is essential. They challenged the list of practices OTS had indicated it could consider targeting, arguing that the practices listed were neither unfair nor deceptive under the FTC standards.

In contrast, the consumer group commenters urged OTS to move ahead with a rule that would combine the FTC's principles-based standards with prohibitions on specific practices. They urged OTS to ban numerous practices, including several practices addressed in the final rule (such as "universal default" repricing, applying payments first to balances with the lowest interest rate, and credit cards marketed at subprime consumers that provide little available credit at account opening).

reports have been posted on the Board's public website along with the final rules under Regulation Z, which are published elsewhere in today's **Federal Register**. See Design and Testing of Effective Truth in Lending Disclosures: Findings from Qualitative Consumer Research (Dec. 15, 2008); Design and Testing of Effective Truth in Lending Disclosures: Findings from Experimental Study (Dec. 15, 2008).

C. Related Action by the Agencies Preceding This Rulemaking

In addition to receiving information via comments, the Agencies have conducted outreach regarding credit card practices, including meetings and discussions with consumer group representatives, industry representatives, other federal and state banking agencies, and the FTC. On April 8, 2008, the Board hosted a forum on credit cards in which card issuers and payment network operators, consumer advocates, counseling agencies, and other regulatory agencies met to discuss relevant industry trends and identify areas that may warrant action or further study. In addition, the Agencies reviewed consumer complaints received by each of the federal banking agencies and several studies of the credit card industry.² The Agencies' understanding of credit card practices and consumer behavior was also informed by the results of consumer testing conducted on behalf of the Board in connection with its June 2007 Regulation Z Proposal.

Finally, the Agencies gathered information from a number of Congressional hearings on consumer protection issues regarding credit cards.³ In these hearings, members of Congress heard testimony from individual consumers, representatives of consumer groups, representatives of financial and credit card industry groups, and others. Consumer and community group representatives generally testified that certain credit card practices (including those discussed above) unfairly increase the cost of credit after the consumer has committed to a particular transaction. These witnesses further testified that these practices should be prohibited because

² See, e.g., Am. Bankers Assoc., Likely Impact of Proposed Credit Card Legislation: Survey Results of Credit Card Issuers (Spring 2008); Darryl E. Getter, Cong. Research Srv., The Credit Card Market: Recent Trends, Funding Cost Issues, and Repricing Practices (Feb. 2008); Tim Westrich & Christian E. Weller, Ctr. for Am. Progress, House of Cards: Consumers Turn to Credit Cards Amid the Mortgage Crisis, Delaying Inevitable Defaults (Feb. 2008) (available at http://www.americanprogress.org/issues/2008/02/pdf/house_of_cards.pdf); Jose A. Garcia, Demos, Borrowing to Make Ends Meet: The Rapid Growth of Credit Card Debt in America (Nov. 2007) (available at <http://www.demos.org/pubs/stillborrowing.pdf>); Nat'l Consumer Law Ctr., Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers (Nov. 2007) (available at http://www.consumerlaw.org/issues/credit_cards/content/FEE-HarvesterFinal.pdf); Jonathan M. Orszag & Susan H. Manning, Am. Bankers Assoc., An Economic Assessment of Regulating Credit Card Fees and Interest Rates (Oct. 2007) (available at http://www.aba.com/aba/documents/press/regulating_creditcard_fees_interest_rates92507.pdf); Cindy Zeldin & Mark Rukavia, Demos, Borrowing to Stay Healthy: How Credit Card Debt Is Related to Medical Expenses (Jan. 2007) (available at http://www.demos.org/pubs/healthy_web.pdf); U.S. Gov't Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (Sept. 2006) ("GAO Credit Card Report") (available at <http://www.gao.gov/new.items/d06929.pdf>); Board of Governors of the Federal Reserve System, Report to Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency (June 2006) (available at <http://www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybillstudy200606.pdf>); Demos & Ctr. for Responsible Lending, The Plastic Safety Net: The Reality Behind Debt in America (Oct. 2005) (available at http://www.demos.org/pubs/PSN_low.pdf).

³ See, e.g., The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers: Hearing before the H. Subcomm. on Fin. Instits. & Consumer Credit, 110th Cong. (2007); Credit Card Practices: Unfair Interest Rate Increases: Hearing before the S. Permanent Subcomm. on Investigations, 110th Cong. (2007); Credit Card Practices: Current Consumer and Regulatory Issues: Hearing before H. Comm. on Fin. Servs., 110th Cong. (2007); Credit Card Practices: Fees, Interest Rates, and Grace Periods: Hearing before the S. Permanent Subcomm. on Investigations, 110th Cong. (2007).

they lead consumers to underestimate the costs of using credit cards and that disclosure of these practices under Regulation Z is ineffective. Financial services and credit card industry representatives agreed that consumers need better disclosures of credit card terms but testified that substantive restrictions on specific terms would lead to higher interest rates for all borrowers as well as reduced access to credit for some.⁴

D. The Agencies' May 2008 Proposal

In May 2008, the Agencies proposed rules under the FTC Act addressing unfair or deceptive acts or practices in connection with consumer credit card accounts and overdraft services for deposit accounts. See 73 FR 28904 (May 2008 Proposal). These proposals were accompanied by complementary proposals by the Board under Regulation Z with respect to consumer credit card accounts and Regulation DD with respect to deposit accounts. See 73 FR 28866 (May 19, 2008) (May 2008 Regulation Z Proposal); 73 FR 28739 (May 19, 2008) (May 2008 Regulation DD Proposal).

In order to best ensure that all entities that offer consumer credit card accounts and overdraft services on deposit accounts are treated in a like manner, the Board, OTS, and NCUA joined together to issue the May 2008 Proposal. This interagency approach is consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994. See 12 U.S.C. 4803. Section 303(a)(3), 12 U.S.C. 4803(a)(3), directs the federal banking agencies to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. Two federal banking agencies—the Board and OTS—are primarily implementing the same statutory provision, section 18(f) of the FTC Act, as is the NCUA (although HOLA serves as a secondary basis for OTS's rule). Accordingly, the Agencies endeavored to propose rules that are as uniform as possible. Prior to issuing the proposed rules, the Agencies also consulted with the two other federal banking agencies, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), as well as with the FTC.

In an effort to achieve a level playing field, the May 2008 Proposal focused on unfair and deceptive acts or practices involving credit cards and overdraft services, which are generally provided only by depository institutions such as banks, savings associations, and credit unions. The Agencies recognized that state-chartered credit unions and any entities providing consumer credit card accounts independent of a depository institution fall within the FTC's jurisdiction and therefore would not be subject to the proposed rules. The Agencies noted, however, that FTC-regulated entities appear to represent a small percentage of the market for consumer credit card accounts and overdraft services.⁵ For OTS, addressing certain deceptive credit card practices in

⁴ On September 23, 2008, the U.S. House of Representatives passed the Credit Cardholders' Bill of Rights Act of 2008 (H.R. 5244), which addresses consumer protection issues regarding credit cards. See also The Credit Card Accountability, Responsibility and Disclosure Act, S. 3252, 110th Cong. (July 10, 2008); The Credit Card Reform Act of 2008, S. 2753, 110th Cong. (Mar. 12, 2008); The Stop Unfair Practices in Credit Cards Act of 2007, H.R. 5280, 110th Cong. (Feb. 7, 2008); The Stop Unfair Practices in Credit Cards Act of 2007, S. 1395, 110th Cong. (May 15, 2007); The Universal Default Prohibition Act of 2007, H.R. 2146, 110th Cong. (May 3, 2007); The Credit Card Accountability Responsibility and Disclosure Act of 2007, H.R. 1461, 110th Cong. (Mar. 9, 2007).

⁵ Some commenters on the May 2008 Proposal expressed concern that the proposed rules would place institutions subject to the final rule at a competitive disadvantage in relation to FTC-regulated entities. As discussed in detail below, the Board has published elsewhere in today's **Federal Register** a proposal regarding overdraft services using its authority under the Electronic Fund Transfer Act (EFTA) and Regulation E. These proposed rules would apply to state-chartered credit unions providing overdraft services. Furthermore, because FTC-regulated entities represent

the May 2008 Proposal, rather than through an interpretation or expansion of its Advertising Rule, also fosters consistency because the other Agencies do not have comparable advertising regulations.

Credit Practices Rule

The Agencies proposed to make non-substantive, organizational changes to the Credit Practices Rule. Specifically, in order to avoid repetition, the Agencies proposed to move the statement of authority, purpose, and scope out of the Credit Practices Rule and revise it to apply not only to the Credit Practices Rule but also to the proposed rules regarding consumer credit card accounts and overdraft services. OTS and NCUA proposed additional, non-substantive changes to the organization of their versions of the Credit Practices Rule. OTS also solicited comment on whether to retain the state exemption provision in its Credit Practices Rule.

Consumer Credit Card Accounts

The Agencies proposed seven provisions under the FTC Act regarding consumer credit card accounts. These provisions were intended to ensure that consumers have the ability to make informed decisions about the use of credit card accounts without being subjected to unfair or deceptive acts or practices.

First, institutions would have been prohibited from treating a payment as late for any purpose unless consumers had been provided a reasonable amount of time to make that payment. The proposed rule would have created a safe harbor for institutions that adopt reasonable procedures designed to ensure that periodic statements (which provide payment information) are mailed or delivered at least 21 days before the payment due date.

Second, when different annual percentage rates apply to different balances, institutions would have been required to allocate amounts paid in excess of the minimum payment using one of three specified methods or a method that is no less beneficial to consumers. Furthermore, when an account has a discounted promotional rate balance or a balance on which interest is deferred, institutions would have been required to allocate amounts in excess of the minimum payment first to balances on which the rate is not discounted or interest is not deferred (except, in the case of a deferred interest plan, for the last two billing cycles during which interest is deferred). Institutions would also have been prohibited from denying consumers a grace period on purchases (if one is offered) solely because they have not paid off a balance at a promotional rate or a balance on which interest is deferred.

Third, institutions would have been prohibited from increasing the annual percentage rate on an outstanding balance. This prohibition would not have applied, however, where a variable rate increases due to the operation of an index, where a promotional rate expired or was lost (provided the rate was not increased to a penalty rate), or where the minimum payment was not received within 30 days after the due date.

Fourth, institutions would have been prohibited from assessing a fee if a consumer exceeds the credit limit on an account solely due to a hold placed on the available credit. If, however, the actual amount of the transaction would have exceeded the credit limit, then a fee could have been assessed.

a small percentage of the market for consumer credit card accounts, the Agencies believe that any competitive disadvantage is unlikely to be significant. In addition, although the final rule does not apply to FTC-regulated entities, those entities are still subject to the FTC Act.

Fifth, institutions would have been prohibited from imposing finance charges based on balances for days in billing cycles that precede the most recent billing cycle. The proposed rule would have prohibited institutions from reaching back to earlier billing cycles when calculating the amount of interest charged in the current cycle, a practice that is sometimes referred to as two- or double-cycle billing.

Sixth, institutions would have been prohibited from financing security deposits or fees for the issuance or availability of credit (such as account-opening fees or membership fees) if those deposits or fees utilized the majority of the available credit on the account. The proposal would also have required security deposits and fees exceeding 25 percent of the credit limit to be spread over the first year, rather than charged as a lump sum during the first billing cycle.

Seventh, institutions making firm offers of credit advertising multiple annual percentage rates or credit limits would have been required to disclose in the solicitation the factors that determine whether a consumer will qualify for the lowest annual percentage rate and highest credit limit advertised.

Overdraft Services

The Agencies also proposed two provisions prohibiting unfair acts or practices related to overdraft services in connection with consumer deposit accounts. The proposed provisions were intended to ensure that consumers understand the terms of overdraft services and have the choice to avoid the associated costs where such services do not meet their needs.

The first provision provided that it would be an unfair act or practice for an institution to assess a fee or charge on a consumer's account for paying an overdraft unless the institution provided the consumer with the right to opt out of the institution's payment of overdrafts and a reasonable opportunity to exercise the opt out, and the consumer did not opt out. The proposed opt-out right would have applied to all transactions that overdraw an account regardless of whether the transaction is, for example, a check, an ACH transaction, an ATM withdrawal, a recurring payment, or a debit card purchase at a point of sale.

The second proposal would have prohibited certain acts or practices associated with assessing overdraft fees in connection with debit holds. Specifically, the proposal would have prohibited an institution from assessing an overdraft fee if the overdraft was caused solely by a hold placed on funds that exceeded the actual purchase amount of the transaction, unless this purchase amount would have caused the overdraft.

Comments on the May 2008 Proposal

The comment period for this proposal closed on August 4, 2008. The Board received more than 60,000 comments on the May 2008 Proposal, more than for any other regulatory proposal in its history. OTS received approximately 5,200 comments. NCUA received approximately 1,000 comments. The overwhelming majority of these comments came from individual consumers. A substantial majority of individual consumers expressed support for the proposed rules, and many urged the Agencies to go further in protecting consumers. The remaining comments came from credit card issuers, banks, savings associations, credit unions, trade associations, consumer groups, members of Congress, other federal banking agencies, state and local governments, and others. These commenters expressed varying views on the May 2008 Proposal. In preparing this final rule, the Agencies considered the comments and the accompanying information. To the extent that commenters addressed specific aspects of the proposal, those comments are discussed below.

II. Statutory Authority Under the Federal Trade Commission Act To Address Unfair or Deceptive Acts or Practices

A. Rulemaking and Enforcement Authority Under the FTC Act

Section 18(f)(1) of the FTC Act provides that the Board (with respect to banks), OTS (with respect to savings associations), and the NCUA (with respect to federal credit unions) are responsible for prescribing “regulations defining with specificity * * * unfair or deceptive acts or practices, and containing requirements prescribed for the purpose of preventing such acts or practices.” 15 U.S.C. 57a(f)(1).⁶

The FTC Act allocates responsibility for enforcing compliance with regulations prescribed under section 18 with respect to banks, savings associations, and federal credit unions among the Board, OTS, and NCUA, as well as the OCC and the FDIC. See 15 U.S.C. 57a(f)(2)–(4). The FTC Act grants the FTC rulemaking and enforcement authority with respect to other persons and entities, subject to certain exceptions and limitations. See 15 U.S.C. 45(a)(2); 15 U.S.C. 57a(a). The FTC Act, however, sets forth specific rulemaking procedures for the FTC that do not apply to the Agencies. See 15 U.S.C. 57a(b)–(e), (g)–(j); 15 U.S.C. 57a–3.⁷

In response to the May 2008 Proposal, industry commenters and the OCC noted that the Board has stated in the past that enforcement of the FTC Act’s prohibition on unfair and deceptive practices is best handled on a case-by-case basis because determinations of unfairness and deception depend heavily on individual facts and circumstances.⁸ These commenters urged that the Agencies withdraw the proposed rules and that the Board instead use its authority under TILA, the Electronic Fund Transfer Act (EFTA), 15 U.S.C. 1693 et seq., or other statutes to promulgate rules regarding consumer credit card accounts and overdraft services on deposit accounts, respectively. One commenter suggested that OTS instead use its authority under HOLA.

⁶ The FTC Act refers to OTS’s predecessor agency, the Federal Home Loan Bank Board (FHLBB), rather than to OTS. However, in section 3(e) of HOLA, Congress transferred this rulemaking power of the FHLBB, among others, to the Director of OTS. 12 U.S.C. 1462a(e). The FTC Act refers to “savings and loan institutions” in some provisions and “savings associations” in other provisions. Although “savings associations” is the term currently used in the HOLA, see, e.g., 12 U.S.C. 1462(4), the terms “savings and loan institutions” and “savings associations” can be and are used interchangeably. OTS has determined that the outdated language does not affect OTS’s rulemaking authority under the FTC Act.

⁷ Some commenters suggested that the proposed rules were not supported by sufficient evidence and that the Agencies should follow the rulemaking procedures for the FTC under the FTC Act, which include the requirement to hold informal hearings at which interested parties may submit their positions and rebut the positions of others. 15 U.S.C. 57a(c). As the commenters acknowledge, this process applies only to the FTC. The Agencies believe that the comment process provides a robust opportunity for interested parties to express their views and provide relevant information. This is confirmed by the unprecedented number of comment letters received by the Agencies in response to the proposed rules. In many cases, the data and other information necessary to make informed judgments regarding the proposed rules is in the possession of the institutions to which the rules would apply. Although institutions generally consider this data proprietary, some have chosen to submit certain information to the Agencies for consideration as part of the public record. The Agencies have carefully considered all public information in issuing the final rule.

⁸ See, e.g., Testimony of Randall S. Kroszner, Governor, Board of Governors of the Federal Reserve System, before the H. Comm. on Financial Services (June 13, 2007); Testimony of Sandra F. Braunstein before the H. Subcomm. on Fin. Insts. & Consumer Credit (Mar. 27, 2007); Letter from Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to the Hon. Barney Frank (Mar. 21, 2006); Letter from Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, to the Hon. John J. LaFalce (May 30, 2002).

As discussed in greater detail below in § VI of this **SUPPLEMENTARY INFORMATION**, the Agencies agree that concerns about overdraft services can be appropriately addressed using the Board’s authority under the EFTA. With respect to consumer credit card accounts, however, the Agencies believe that use of their FTC Act authority is appropriate. Although the Agencies continue to believe that case-by-case enforcement is often the most effective means of addressing unfair and deceptive practices, the practices addressed by the final rule are or have been engaged in by a substantial number of the institutions offering credit cards without significant material variation in the facts and circumstances. As a result, case-by-case enforcement by the banking agencies would not only be an inefficient means of addressing these practices but could also lead to inconsistent outcomes. Accordingly, the Agencies have determined that, in this instance, promulgating regulations under the FTC Act is the most effective way to address the practices at issue.⁹

B. Standards for Unfairness Under the FTC Act

Congress has codified standards developed by the FTC for its use in determining whether acts or practices are unfair under section 5(a) of the FTC Act.¹⁰ Specifically, the FTC Act provides that the FTC has no authority to declare an act or practice unfair unless: (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition. In addition, the FTC may consider established public policy, but public policy may not serve as the primary basis for its determination that an act or practice is unfair. See 15 U.S.C. 45(n).

In proposing and finalizing rules under section 18(f)(1) of the FTC Act, the Agencies have applied the statutory elements consistent with the standards articulated by the FTC. The Board, FDIC, and OCC have previously issued guidance generally adopting these standards for purposes of enforcing the FTC Act’s prohibition on unfair or deceptive acts or practices.¹¹ Although the OTS had not taken similar action in generally applicable guidance prior to the May 2008 Proposal,¹² the commenters on OTS’s ANPR who addressed this issue overwhelmingly urged that any OTS action be consistent with the FTC’s standards for unfairness.

According to the FTC, an unfair act or practice will almost always represent a market failure or imperfection that prevents the forces of supply and demand from maximizing benefits

⁹ Industry commenters and the OCC raised concerns that, because many of the practices prohibited by the proposed rules are widely used, determinations by the Agencies that those practices are unfair or deceptive under the FTC Act could lead to litigation under similar state laws. As discussed below in § VII of this **SUPPLEMENTARY INFORMATION**, the Agencies do not intend these rules to apply to acts or practices preceding the effective date and have determined that, prior to the effective date, the prohibited practices are not unfair under the FTC Act.

¹⁰ See 15 U.S.C. 45(n); FTC Policy Statement on Unfairness, Letter from the FTC to the Hon. Wendell H. Ford and the Hon. John C. Danforth, S. Comm. on Commerce, Science & Transp. (Dec. 17, 1980) (FTC Policy Statement on Unfairness) (available at <http://www.ftc.gov/bcp/policystmt/ad-unfair.htm>).

¹¹ See Board and FDIC, Unfair or Deceptive Acts or Practices by State-Chartered Banks (Mar. 11, 2004) (available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf>); OCC Advisory Letter 2002–3, Guidance on Unfair or Deceptive Acts or Practices (Mar. 22, 2002) (available at <http://www.occ.treas.gov/ftp/advisory/2002–3.doc>).

¹² See OTS ANPR, 72 FR at 43573.

and minimizing costs.¹³ Not all market failures or imperfections constitute unfair acts or practices, however. Instead, the central focus of the FTC's unfairness analysis is whether the act or practice causes substantial consumer injury.¹⁴

Substantial consumer injury. The FTC has stated that a substantial consumer injury generally consists of monetary, economic, or other tangible harm.¹⁵ Trivial or speculative harms do not constitute substantial consumer injury.¹⁶ Consumer injury may be substantial, however, if it imposes a small harm on a large number of consumers or if it raises a significant risk of concrete harm.¹⁷

In response to the May 2008 Proposal, several commenters expressed concern that the FTC's interpretation of substantial consumer injury is overbroad and requested that the Agencies introduce a variety of limitations. As noted above, the Agencies have adopted the FTC's standards for determining whether an act or practice is unfair. Accordingly, in the interest of uniform application of the FTC Act, the Agencies decline to read in such limitations where the FTC has not done so.¹⁸ Furthermore, the Agencies emphasize that a finding of consumer injury does not, by itself, establish an unfair practice. Instead, as discussed below and with respect to each of the prohibited practices, the injury also must not be reasonably avoidable and must not be outweighed by countervailing benefits to consumers or to competition. Thus, while many practices that result in imposition of a fee or assessment of interest may cause a substantial consumer injury, few may satisfy the other elements of unfairness.

Injury is not reasonably avoidable. The FTC has stated that an injury is not reasonably avoidable when consumers are prevented from effectively making their own decisions about whether to incur that injury.¹⁹ The marketplace is normally expected to be self-correcting because consumers are relied upon to survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory.²⁰ Accordingly, the test is not whether the consumer could have made a wiser decision but whether an act or practice

¹³ Statement of Basis and Purpose and Regulatory Analysis for Federal Trade Commission Credit Practices Rule (Statement for FTC Credit Practices Rule), 49 FR 7740, 7744 (Mar. 1, 1984).

¹⁴ Id. at 7743.

¹⁵ See id.; FTC Policy Statement on Unfairness at 3.

¹⁶ See Statement for FTC Credit Practices Rule, 49 FR at 7743 (“[E]xcept in aggravated cases where tangible injury can be clearly demonstrated, subjective types of harm—embarrassment, emotional distress, etc.—will not be enough to warrant a finding of unfairness.”); FTC Unfairness Policy Statement at 3 (“Emotional impact and other more subjective types of harm * * * will not ordinarily make a practice unfair.”).

¹⁷ See Statement for FTC Credit Practices Rule, 49 FR at 7743; FTC Policy Statement on Unfairness at 3 & n.12.

¹⁸ See Am. Fin. Servs. Assoc. v. FTC, 767 F.2d 957, 978-83 (DC Cir. 1985) (“In essence, petitioners ask the court to limit the FTC's exercise of its unfairness authority to situations involving deception, coercion, or withholding of material information. * * * [D]espite considerable controversy over the bounds of the FTC's authority, neither Congress nor the FTC has seen fit to delineate the specific ‘kinds’ of practices which will be deemed unfair within the meaning of section 5.”).

¹⁹ See FTC Policy Statement on Unfairness at 3.

²⁰ See Statement for FTC Credit Practices Rule, 49 FR at 7744 (“Normally, we can rely on consumer choice to govern the market.”); FTC Policy Statement on Unfairness at 3.

unreasonably creates or takes advantage of an obstacle to the consumer's ability to make that decision freely.²¹

In response to the May 2008 Proposal, several industry commenters argued that an injury resulting from the operation of a contractual provision is always reasonably avoidable because the consumer could read the contract and decide not to enter into it. These commenters further argued that institutions could not be held responsible for consumers' failure to read or understand the contract or the disclosures provided by the institution. These arguments, however, are inconsistent with the FTC's application of the unfairness analysis in support of its Credit Practices Rule, where the FTC determined that consumers could not reasonably avoid injuries caused by otherwise valid contractual provisions.²² Furthermore, as discussed below, many of the practices at issue either create the complexity that acts as an obstacle to consumers' ability to make free and informed decisions or take advantage of that complexity by assessing interest or fees when a consumer fails to understand the practice.²³

Injury is not outweighed by countervailing benefits. The FTC has stated that the act or practice causing the injury must not also produce benefits to consumers or competition that outweigh the injury.²⁴ Generally, it is important to consider both the costs of imposing a remedy and any benefits that consumers enjoy as a result of the practice.²⁵ The FTC has stated that both consumers and competition benefit from prohibitions on unfair or deceptive acts or practices because prices may better reflect actual transaction costs and merchants who do not rely on unfair or deceptive acts or practices are no longer required to compete with those who do.²⁶

²¹ See Statement for FTC Credit Practices Rule, 49 FR at 7744 ("In considering whether an act or practice is unfair, we look to whether free market decisions are unjustifiably hindered."); FTC Policy Statement on Unfairness at 3 & n.19 ("In some senses any injury can be avoided—for example, by hiring independent experts to test all products in advance, or by private legal actions for damages—but these courses may be too expensive to be practicable for individual consumers to pursue.").

²² See Statement for FTC Credit Practices Rule, 49 FR 7740 *et seq.*; see also *Am. Fin. Servs. Assoc.*, 767 F.2d at 978-83 (upholding the FTC's analysis).

²³ One commenter stated that the following language from the FTC Policy Statement on Unfairness suggested that complexity alone is not sufficient to make injury unavoidable: "A seller's failure to present complex technical data on his product may lessen a consumer's ability to choose . . . but may also reduce the initial price he must pay for the article." FTC Policy Statement on Unfairness at 3. The Agencies note that the FTC included this example in its discussion of whether injury is outweighed by countervailing benefits, not whether the injury is reasonably avoidable.

²⁴ See Statement for FTC Credit Practices Rule, 49 FR at 7744; FTC Policy Statement on Unfairness at 3; see also S. Rep. 103-130, at 13 (1994), *reprinted in* 1994 U.S.C.A.N. 1776, 1788 ("In determining whether a substantial consumer injury is outweighed by the countervailing benefits of a practice, the Committee does not intend that the FTC quantify the detrimental and beneficial effects of the practice in every case. In many instances, such a numerical benefit-cost analysis would be unnecessary; in other cases, it may be impossible. This section would require, however, that the FTC carefully evaluate the benefits and costs of each exercise of its unfairness authority, gathering and considering reasonably available evidence.").

²⁵ See FTC Public Comment on OTS-2007-0015, at 6 (Dec. 12, 2007) (available at <http://www.ots.treas.gov/docs/9/963034.pdf>).

²⁶ See FTC Public Comment on OTS-2007-0015, at 8 (citing Preservation of Consumers' Claims and Defenses, Statement of Basis and Purpose, 40 FR 53506, 53523 (Nov. 18, 1975) (codified at 16 CFR 433)); see also FTC Policy Statement on Deception,

Public policy. As noted above, the FTC may consider established public policy in making an unfairness determination, but public policy may not serve as the primary basis for such a determination.²⁷ For purposes of the unfairness analysis, public policy is generally embodied in a statute, regulation, or judicial decision.²⁸ As discussed below, the Agencies have considered various authorities cited by commenters as evidence of public policy.²⁹ At no point, however, have the Agencies used public policy as the primary basis for a determination that a practice was unfair.

Some commenters argued that section 18(f)(1) of the FTC Act prevents the Board from issuing final rules that would seriously conflict with the Board's essential monetary and payments systems policies. The language cited by the commenters, however, does not apply to this rulemaking. Instead, this language creates an exception to the general requirement that the Board promulgate regulations substantially similar to those issued by the FTC if the Board "finds that implementation of similar regulations with respect to banks, savings and loan institutions or Federal credit unions would seriously conflict with essential monetary and payments systems policies of such Board, and publishes any such finding, and the reasons therefore, in the Federal Register."³⁰ Nevertheless, to the extent a commenter has cited a specific monetary or payments systems policy that may conflict with one of these rules, the Agencies have considered that potential conflict below.

C. Standards for Deception Under the FTC Act

The FTC has also adopted standards for determining whether an act or practice is deceptive under the FTC Act.³¹ Under the FTC's standards, an act or practice is deceptive where: (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that information is material to consumers.³² Although these standards have not been codified, they have been applied by

Letter from the FTC to the Hon. John H. Dingell, H. Comm. on Energy & Commerce (Oct. 14, 1983) (FTC Policy Statement on Deception) (available at <http://www.ftc.gov/bcp/policystmt/ad-decept.htm>) ("Deceptive practices injure both competitors and consumers because consumers who preferred the competitor's product are wrongly diverted.").

²⁷ See 15 U.S.C. 45(n); Board and FDIC, Unfair or Deceptive Acts or Practices by State-Chartered Banks at 3-4 ("Public policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair.").

²⁸ See, e.g., FTC Policy Statement on Unfairness at 5 (stating that public policy "should be clear and well-established" and "should be declared or embodied in formal sources such as statutes, judicial decisions, or the Constitution as interpreted by the court * * *").

²⁹ Several commenters urged the Agencies to consider the safety and soundness of financial institutions either under the countervailing benefits prong or as public policy. To the extent that these commenters raised specific safety and soundness concerns, those concerns are addressed below.

³⁰ 15 U.S.C. 57a(f)(1) (third sentence).

³¹ FTC Policy Statement on Deception.

³² Id. at 1-2. The FTC views deception as a subset of unfairness but does not apply the full unfairness analysis because deception is very unlikely to benefit consumers or competition and consumers cannot reasonably avoid being harmed by deception. Id.

numerous courts.³³ Accordingly, in proposing rules under section 18(f)(1) of the FTC Act, the Agencies applied the standards articulated by the FTC for determining whether an act or practice is deceptive.³⁴

A representation or omission is deceptive if the overall net impression created is likely to mislead consumers.³⁵ The FTC conducts its own analysis to determine whether a representation or omission is likely to mislead consumers acting reasonably under the circumstances.³⁶ When evaluating the reasonableness of an interpretation, the FTC considers the sophistication and understanding of consumers in the group to whom the act or practice is targeted.³⁷ If a representation is susceptible to more than one reasonable interpretation, and if one such interpretation is misleading, then the representation is deceptive even if other, non-deceptive interpretations are possible.³⁸

A representation or omission is material if it is likely to affect the consumer's conduct or decision regarding a product or service.³⁹ Certain types of claims are presumed to be material, including express claims and claims regarding the cost of a product or service.⁴⁰

D. Choice of Remedy

The Agencies have wide latitude to determine what remedy is necessary to prevent an unfair or deceptive act or practice so long as that remedy has a reasonable relation to the act or practice.⁴¹ The Agencies have carefully considered the potential remedies for addressing each practice and have adopted the remedy that, in the Agencies' judgment, is effective in preventing that practice while minimizing the burden on institutions.

³³ See, e.g., FTC v. Tashman, 318 F.3d 1273, 1277 (11th Cir. 2003); FTC v. Gill, 265 F.3d 944, 950 (9th Cir. 2001); FTC v. QT, Inc., 448 F. Supp. 2d 908, 957 (N.D. Ill. 2006); FTC v. Think Achievement, 144 F. Supp. 2d 993, 1009 (N.D. Ind. 2000); FTC v. Minuteman Press, 53 F. Supp. 2d 248, 258 (E.D.N.Y. 1998).

³⁴ As noted above, the Board, FDIC, and OCC have issued guidance generally adopting these standards for purposes of enforcing the FTC Act's prohibition on unfair or deceptive acts or practices. As with the unfairness standard, comments on OTS's ANPR addressing this issue overwhelmingly urged the OTS to adopt the same deception standard as the FTC.

³⁵ See, e.g., FTC v. Cyberspace.com, 453 F.3d 1196, 1200 (9th Cir. 2006); Gill, 265 F.3d at 956; Removatron Int'l Corp. v. FTC, 884 F.2d 1489, 1497 (1st Cir. 1989).

³⁶ See FTC v. Kraft, Inc., 970 F.2d 311, 319 (7th Cir. 1992); QT, Inc., 448 F. Supp. 2d at 958.

³⁷ FTC Policy Statement on Deception at 3.

³⁸ Id.

³⁹ Id. at 2, 6–7.

⁴⁰ See FTC Public Comment on OTS–2007–0015, at 21; FTC Policy Statement on Deception at 6; see also FTC v. Pantron I Corp., 33 F.3d 1088, 1095–96 (9th Cir. 1994); In re Peacock Buick, 86 F.T.C. 1532, 1562 (1975), aff'd 553 F.2d 97 (4th Cir. 1977).

⁴¹ See Am. Fin. Servs. Assoc., 767 F.2d at 988–89 (citing Jacob Siegel Co. v. FTC, 327 U.S. 608, 612–13 (1946)).

III. Summary of Final Rule

Based on the comments and further analysis, the Agencies have revised the proposed rules substantially. As discussed in greater detail below, the Agencies are not taking action on some aspects of the proposed rule at this time. However, the Agencies note that this rule is not intended to identify all unfair or deceptive acts or practices, even with regard to consumer credit card accounts. Accordingly, the fact that a particular act or practice is not addressed by today's final rule does not limit the ability of the Agencies to make a determination that it is unfair or deceptive. As noted elsewhere, to the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to continue to address those practices on a case-by-case basis through supervisory and enforcement actions.

Credit Practices Rule

The Agencies proposed to make certain non-substantive, organizational changes to their respective versions of the Credit Practices Rule. These changes are adopted as proposed except for one additional nonsubstantive clarification to the scope paragraph of OTS's rule.

OTS also solicited comment on eliminating the section of its rule on state exemptions. 73 FR at 28911. OTS is eliminating that section as discussed in § IV of this **SUPPLEMENTARY INFORMATION**.

Consumer Credit Card Accounts

In May 2008, the Agencies proposed several provisions under the FTC Act related to consumer credit card accounts. As discussed below, based on the comments and further analysis, the Agencies have adopted five provisions designed to protect consumers who use credit cards from unfair acts or practices.

First, the Agencies have adopted the proposed rule prohibiting institutions from treating a payment as late for any purpose unless consumers have been provided a reasonable amount of time to make that payment. The Agencies have also adopted the proposed safe harbor providing that institutions may comply with this requirement by adopting reasonable procedures designed to ensure that periodic statements are mailed or delivered at least 21 days before the payment due date. Elsewhere in today's **Federal Register**, the Board has adopted two additional proposals under Regulation Z that further ensure that consumers receive a reasonable amount of time to make payment. Specifically, the Board has revised 12 CFR 226.10(b) to seek to ensure that creditors do not set cut-off times for mailed payments earlier than 5 p.m. at the location specified by the creditor for receipt of such payments. The Board has also adopted 12 CFR 226.10(d), which requires that, if the due date for payment is a day on which the U.S. Postal Service does not deliver mail or the creditor does not accept payment by mail, the creditor may not treat a payment received by mail the next business day as late for any purpose.

Second, the Agencies have adopted a revised version of the proposed rule regarding allocation of payments when different annual percentage rates apply to different balances on a consumer credit card account. The final rule requires institutions to allocate amounts paid in excess of the minimum payment either by applying the entire amount first to the balance with the highest annual percentage rate or by splitting the amount pro rata among the balances.

Third, the Agencies have revised the proposed rule regarding increases in annual percentage rates to require institutions to disclose at account opening the rates that will apply to the account and to prohibit institutions from increasing annual percentage rates unless expressly

permitted. Institutions are permitted to increase a rate disclosed at account opening at the expiration of a specified period, provided that the increased rate was also disclosed at account opening. After the first year following opening of the account, institutions are also permitted to increase rates for new transactions so long as the institution complies with the 45-day advance notice requirement in Regulation Z (adopted by the Board elsewhere in today's **Federal Register**). In addition, institutions may increase a variable rate due to the operation of an index and an increase a rate when the consumer is more than 30 days' delinquent.

Fourth, the Agencies have adopted the proposed rule prohibiting institutions from imposing finance charges based on balances for days in billing cycles that precede the most recent billing cycle as a result of the loss of a grace period. This rule generally prohibits institutions from reaching back to earlier billing cycles when calculating the amount of interest charged in the current cycle, a practice that is sometimes referred to as two- or double-cycle billing.

Fifth, the Agencies have adopted a revised version of the proposed rule regarding the financing of security deposits or fees for the issuance or availability of credit (such as account-opening fees or membership fees). The final rule prohibits institutions from financing security deposits or fees for the issuance or availability of credit if, during the first year after account opening, those deposits or fees consume the majority of the available credit on the account. In addition, the Agencies have adopted a requirement that security deposits and fees exceeding 25 percent of the credit limit to be spread over no less than the first six months, rather than charged as a lump sum during the first billing cycle. Furthermore, elsewhere in today's **Federal Register**, the Board has adopted revisions to Regulation Z requiring creditors that collect or obtain a consumer's agreement to pay a fee before providing account-opening disclosures to permit that consumer to reject the plan after receiving the disclosures and, if the consumer does so, to refund any fee collected or to take any other action necessary to ensure the consumer is not obligated to pay the fee.

Finally, the Agencies are not taking action at this time on the proposed rule addressing holds placed on available credit. As discussed below, the Board is proposing to address holds placed on available funds in a deposit account using its authority under Regulation E. In addition, the Agencies are not taking action at this time on the proposed rule regarding firm offers of credit advertising multiple annual percentage rates or credit limits. Concerns about this practice are addressed by amendments to Regulation Z adopted by the Board elsewhere in today's **Federal Register**. The Agencies plan to rely on case-by-case supervisory and enforcement actions in appropriate circumstances where practices regarding credit holds or firm offers of credit raise unfairness or deception concerns.

Overdraft Services

The Agencies are not taking action on overdraft services on deposit accounts or debit holds at this time. As discussed below, the Board has published a separate proposal addressing these issues under Regulation E elsewhere in today's **Federal Register**. The Agencies will review information obtained through that rulemaking to determine whether to take further action.

IV. Section-by-Section Analysis of the Credit Practices Subpart

On March 1, 1984, the FTC adopted its Credit Practices Rule pursuant to its authority under the FTC Act to promulgate rules that define and prevent unfair or deceptive acts or

practices in or affecting commerce.⁴² The FTC Act provides that, whenever the FTC promulgates a rule prohibiting specific unfair or deceptive practices, the Board, OTS (as the successor to the Federal Home Loan Bank Board), and NCUA must adopt substantially similar regulations imposing substantially similar requirements with respect to banks, savings associations, and federal credit unions within 60 days of the effective date of the FTC's rule unless the agency finds that such acts or practices by banks, savings associations, or federal credit unions are not unfair or deceptive or the Board finds that the adoption of similar regulations for banks, savings associations, or federal credit unions would seriously conflict with essential monetary and payment-systems policies of the Board. The Agencies have previously adopted rules substantially similar to the FTC's Credit Practices Rule.⁴³

As part of this rulemaking, the Agencies proposed to reorganize aspects of their respective Credit Practices Rules. Although the Agencies have approached these revisions differently in some respects, the Agencies do not intend to create any substantive difference among their respective rules and believe that these rules remain substantially similar to the FTC's Credit Practices Rule. Except as otherwise stated below, the Agencies did not receive comments on this portion of the proposal.

Subpart A—General Provisions

Subpart A contains general provisions that apply to the entire part. As discussed below, there are some differences among the Agencies' proposals.

.1 Authority, purpose, and scope⁴⁴

The provisions in proposed § __.1 were largely drawn from the current authority, purpose, and scope provisions in the Agencies' respective Credit Practices Rules. As discussed below, § __.1 is generally adopted as proposed.

.1(a) Authority

Proposed § __.1(a) provided that the Agencies issued this part under section 18(f) of the FTC Act. Section __.1(a) is adopted largely as proposed.

One commenter urged that OTS should use safety and soundness authority as the legal basis for this rule, including its authority under HOLA. While OTS disagrees with this commenter to the extent that it argued that OTS should use its safety and soundness authority instead of its FTC Act authority, OTS agrees that HOLA serves as an appropriate secondary basis for OTS's portion of the rule. Accordingly, OTS is inserting express references to HOLA in its rule (including § 535.1(a)) to reflect that HOLA serves as an independent secondary basis for OTS's final rule.

HOLA provides authority for both safety and soundness and consumer protection regulations. Consequently, HOLA serves as a secondary, independent basis for OTS's rule. Using HOLA as a basis for this rulemaking was discussed in the **SUPPLEMENTARY INFORMATION** that accompanied the OTS's August 6, 2007 ANPR (72 FR at 43572-43573), was reflected in the preamble to the proposed rule and proposed rule text (73 FR at 28910 and

⁴² See 42 FR 7740 (Mar. 1, 1984) (codified at 16 CFR part 444); see also 15 U.S.C. 57a(a)(1)(B), 45(a)(1).

⁴³ See 12 CFR part 227, subpart B (Board); 12 CFR 535 (OTS); 12 CFR 706 (NCUA).

⁴⁴ The Board, OTS, and NCUA have placed these rules in, respectively, parts 227, 535, and 706 of title 12 of the Code of Federal Regulations. For each reference, the discussion in this **SUPPLEMENTARY INFORMATION** uses the shared numerical suffix of each agency's rule. For example, § __.1 will be codified at 12 CFR 227.1 by the Board, 12 CFR 535.1 by OTS, and 12 CFR 706.1 by NCUA.

28948), and is also discussed further in the section-by-section analysis of § 535.26 in this **SUPPLEMENTARY INFORMATION**.

With regard to safety and soundness, HOLA section 4(a) (12 U.S.C. 1463(a)) authorizes the Director of OTS to issue regulations governing savings associations that the Director determines to be appropriate to carry out his responsibilities, including providing for the examination, safe and sound operation, and regulation of savings associations. The Director of OTS has used HOLA authority to issue regulations requiring savings associations to operate safely and soundly.⁴⁵ Existing OTS rules also allow the agency to impose limits on credit card lending, if a savings association's concentration in such lending presents a safety and soundness concern.⁴⁶ All of the practices addressed in the rule will advance the safety and soundness of consumer credit card lending by savings associations such as by reducing reputation risk, as well as the risk of litigation under state contract laws and, where applicable, state laws prohibiting unfair or deceptive acts or practices.

With regard to consumer protection, HOLA section 5(a) (12 U.S.C. 1464(a)) authorizes the Director of OTS to regulate federal savings associations giving primary consideration to the best practices of thrift institution in the United States. As courts have consistently and repeatedly recognized for decades, HOLA empowered OTS and its predecessor agency, the Federal Home Loan Bank Board (FHLBB), to adopt comprehensive rules and regulations governing the operations of federal savings associations.⁴⁷ Consequently, OTS has a history of using HOLA as the legal basis for consumer protection regulations. Examples include the OTS Advertising Rule,⁴⁸ OTS rules that limit home loan late charges, prepayment penalties, and adjustments to the interest rate, payment, balance, or term to maturity,⁴⁹ as well as the portions of the OTS Nondiscrimination Rule that exceed Equal Credit Opportunity Act and Fair Housing Act requirements.⁵⁰ All of the practices addressed in the rule will help protect consumers.

.1(b) Purpose

⁴⁵ See, e.g., 12 CFR 563.161(a) (OTS management and financial policies rule).

⁴⁶ See 12 CFR 560.30 and Endnote 6.

⁴⁷ As stated in Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 144-45 (1982):

The [FHLBB], an independent federal regulatory agency, was formed in 1932 and thereafter was vested with plenary authority to administer [HOLA].... Section 5(a) of the HOLA ...empowers the Board, "under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations.'" Pursuant to this authorization, the [FHLBB] has promulgated regulations governing "the powers and operations of every Federal savings and loan association from its cradle to its corporate grave." People v. Coast Federal Savings and Loan Ass'n, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

Accord Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256, 1260 (9th Cir. 1979), aff'd mem., 445 U.S. 921 (1980) (recognizing the "pervasive" and "broad" regulatory control of the FHLBB over federal savings associations granted by HOLA).

⁴⁸ 12 CFR 563.27.

⁴⁹ 12 CFR 560.33, 12 CFR 560.34, and 12 CFR 560.35.

⁵⁰ 12 CFR part 528.

Proposed § __.1(b) provided that the purpose of the part is to prohibit unfair or deceptive acts or practices in violation of section 5(a)(1) of the FTC Act, 15 U.S.C. 45(a)(1). It further provided that the part contains provisions that define and set forth requirements prescribed for the purpose of preventing specific unfair or deceptive acts or practices. In May 2008, the Agencies noted that these provisions define and prohibit specific unfair or deceptive acts or practices within a single provision, rather than setting forth the definitions and remedies separately. Finally, proposed § __.1(b) clarified that the prohibitions in subparts B, C, and D do not limit the Agencies' authority to enforce the FTC Act with respect to other unfair or deceptive acts or practices.

The Agencies have revised proposed § __.1(b) to reflect their decision not to take action on proposed subpart D at this time. Also, OTS has added an express reference to HOLA in § 535.1(b). Otherwise, this provision is adopted as proposed.

__.1(c) Scope

Proposed § __.1(c) described the scope of each agency's rules. The Agencies each tailored this paragraph to describe those entities to which their part applies.

The Board's proposed provision stated that the Board's rules would apply to banks and their subsidiaries, except savings associations as defined in 12 U.S.C. 1813(b). It further explained that enforcement of the Board's rules is allocated among the Board, the OCC, and the FDIC, depending on the type of institution. This provision was updated to reflect intervening changes in law. The Board also proposed to revise its Staff Guidelines to the Credit Practices Rule to remove questions 11(c)–1 and 11(c)–2, to update the substance of its answers to those questions, and to publish those answers as commentary to proposed § 227.1(c). See proposed Board comments 227.1(c)–1 and –2. As proposed, the remaining questions and answers in the Board's Staff Guidelines would remain in place. The Board has adopted these proposals without alteration.

OTS's proposed provision stated that its rules apply to savings associations and subsidiaries owned in whole or in part by a savings association. OTS also enforces compliance with respect to these institutions. As proposed, the entire OTS part would have the same scope. In May 2008, OTS noted that this scope is somewhat different from the scope of its existing Credit Practices Rule. Prior to today's revisions, OTS's Credit Practices Rule applied to savings associations and service corporations that were wholly owned by one or more savings associations, which engaged in the business of providing credit to consumers. Since the proposed rules would cover more practices than consumer credit, the proposal deleted the reference to engaging in the business of providing credit to consumers. The proposal also updated the reference to wholly owned service corporations to refer instead to subsidiaries in order to reflect the current terminology used in OTS's Subordinate Organizations Rule.⁵¹

Only one commenter addressed the scope of OTS's proposed rule. It supported applying the rule to savings associations and subsidiaries as proposed. Another commenter requested clarification of which entities the rule refers to as "you." OTS is finalizing the scope as proposed but clarifying through a parenthetical in section 535.1(c) that the term "you" refers to savings associations and subsidiaries owned in whole or in part by a savings association.

The NCUA's proposed provision stated that its rules would apply to federal credit unions. This provision is adopted as proposed.

⁵¹ 12 CFR part 559. OTS has substantially revised this rule since promulgating its Credit Practices Rule. See, e.g., Subsidiaries and Equity Investments: Final Rule, 61 FR 66561 (Dec. 18, 1996).

227.1(d) Definitions

Proposed § __.1(d) of the Board's rule would have clarified that, unless otherwise noted, terms used in the Board's proposed § __.1(c) that are not defined in the FTC Act or in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101). This provision is adopted as proposed.

OTS and NCUA did not have a need for a comparable subsection so none was included in their proposed rules.

227.2 Consumer-Complaint Procedure

In order to accommodate the revisions discussed above, the Board proposed to consolidate the consumer complaint provisions previously located in 12 CFR 227.1 and 227.2 in proposed § 227.2. The Board has revised the proposal for clarity and to include an e-mail address and website where consumers can submit complaints. Otherwise, this provision is adopted as proposed.

OTS and NCUA do not have and did not propose to add comparable provisions.⁵²

Subpart B—Credit Practices

Each agency has placed the substantive provisions of their Credit Practices Rule in Subpart B. In order to retain the current numbering in its Credit Practices Rule, the Board has reserved 12 CFR 227.11, which previously contained the Board's statement of authority, purpose, and scope. The other provisions of the Board's Credit Practices Rule (§§ 227.12 through 227.16) have not been revised.

As discussed below, OTS proposed several notable changes to its version of Subpart B. Except as otherwise stated, these sections have been adopted as proposed.

Section 535.11 Definitions (previously section 535.1)

OTS received no comments on its proposed changes to this section and is finalizing it as proposed. OTS has deleted the definitions of "Act," "creditor," and "savings association" as unnecessary. It has substituted the term "you" for "savings association" or "creditor" in the definitions of "consumer credit" and "obligation" as applicable. For the convenience of the user, OTS has also incorporated the definition of "consumer credit" into this section, instead of using a cross-reference to a definition contained in a different part of OTS's rules. OTS has moved the definition of "cosigner" to the section on unfair or deceptive cosigner practices. OTS has also merged the definition of "debt" into the definition of "collecting a debt" contained in the section on late charges. Finally, OTS has moved the definition of "household goods" to the section on unfair credit contract provisions.

Section 535.12 Unfair Credit Contract Provisions (previously section 535.2)

OTS received no comments on its proposed changes to this section and is finalizing it as proposed. OTS has revised the title of this section to reflect its focus on credit contract provisions. OTS has also deleted the obsolete reference to extensions of credit after January 1, 1986.

⁵² Longstanding OTS and NCUA complaint procedures are available to consumers and the public at www.ots.treas.gov and www.ncua.gov.

Section 535.13 Unfair or Deceptive Cosigner Practices (previously section 535.3)

OTS received no comments on its proposed changes to this section and is finalizing it as proposed. OTS has deleted the obsolete reference to extensions of credit after January 1, 1986. OTS has substituted the term “substantially similar” for the term “substantially equivalent” in referencing a document that equates to the cosigner notice for consistency with the Board’s rule and to avoid confusion with the term of art “substantial equivalency” used in the Board’s section on state exemptions. OTS has also clarified that the date that may be stated on the cosigner notice is the date of the transaction. NCUA has made similar amendments to its rule in § 706.13 (previously § 706.3).

Section 535.14 Unfair Late Charges (previously section 535.4)

OTS received no comments on its proposed changes to this section and is finalizing it as proposed. OTS has revised the title of this section to reflect its focus on unfair late charges. OTS has deleted the obsolete reference to extensions of credit after January 1, 1986. Similarly, NCUA has made similar revisions to § 706.14 (previously § 706.4).

Section 535.15 State Exemptions (previously section 535.5)

OTS proposed to revise the subsection on delegated authority to update the current title of the OTS official with delegated authority to make determinations under this section. As discussed below, however, OTS has removed § 535.5 from codification and has not replaced it with proposed § 535.15.

The FTC’s Credit Practices Rule included a provision allowing states to seek exemptions from the rule if state law affords a greater or substantially similar level of protection. See 16 CFR 444.5. The Agencies adopted similar provisions in their respective Credit Practices Rules. See 12 CFR 227.16; 12 CFR 535.5; 12 CFR 706.5. The May 2008 Proposal did not extend this provision to the proposed rules for consumer credit card accounts and overdraft services because there was no legal requirement to do so.⁵³ The Agencies noted that only three states have been granted exemptions under the Credit Practices Rule.⁵⁴ The Agencies stated that, because the exemption is available when state law is “substantially equivalent” to the federal rule, an exemption may provide little relief from regulatory burden while undermining the uniform application of federal standards. Accordingly, the Agencies requested comment on whether states should be permitted to seek exemption from the proposed rules on consumer credit card accounts and overdraft services if state law affords a greater or substantially similar level of protection. In addition, OTS requested comment on whether the state exemption provision in its Credit Practices Rule should be retained.

The Agencies received only a few comments on state exemptions. One consumer advocacy organization urged the Agencies to expand the opportunity for state exemptions to the final rule as a way to ensure a consumer private right of action under state law and to enable

⁵³ The provision requiring consideration of requests for exemption from rules promulgated under the FTC Act applies only to the FTC. See 12 U.S.C. 57a(g).

⁵⁴ The Board and the FTC have granted exemptions to Wisconsin, New York, and California. 51 FR 24304 (July 3, 1986) (FTC exemption for Wisconsin); 51 FR 28238 (Aug. 7, 1986) (FTC exemption for New York); 51 FR 41763 (Nov. 19, 1986) (Board exemption for Wisconsin); 52 FR 2398 (Jan. 22, 1987) (Board exemption for New York); 53 FR 19893 (June 1, 1988) (FTC exemption for California); 53 FR 29233 (Aug. 3, 1988) (Board exemption for California). The Federal Home Loan Bank Board (“FHLBB”), OTS’s predecessor agency, granted an exemption to Wisconsin. 51 FR 45879 (Dec. 23, 1986). The NCUA has not granted any exemptions.

states to develop new protections. In contrast, several financial institutions opposed allowing states to seek exemption from practices addressed in the final rule. They argued that allowing such exemptions would provide no meaningful regulatory burden relief and would interfere with consistent implementation of the final rule.

The Agencies have decided not to extend the opportunity for state exemptions to the final rule. First, as noted above, the FTC Act does not require the Agencies to provide such an opportunity. Second, requiring all institutions under the Agencies' jurisdiction to comply with the final rule will enhance consumer protections nationwide and facilitate uniformity in examinations.

OTS received a few comments on whether it should retain the existing state exemption provision in its Credit Practices Rule. The comments on this issue largely tracked those discussed above concerning whether to expand the availability of state exemptions to new practices addressed in the final rule. In addition, one organization representing state banking interests supported preserving state laws that afford more protection to consumers than the federal rule.

A few comments reflect confusion about how the availability or unavailability of state exemptions would affect federal savings associations. Eliminating the availability of exemptions under the OTS Credit Practices Rule will have no direct effect on federal savings associations. Apparently, the only state exemption granted by OTS or its predecessor is to the State of Wisconsin for substantially equivalent provisions of the Wisconsin Consumer Act. That exemption only applied to state-chartered savings associations; it specifically did not extend to federal savings associations.⁵⁵

For the same reasons the Agencies are not extending the opportunity for state exemptions to apply to new practices addressed in the final rule, OTS is removing § 535.5 and eliminating the existing state exemption authority under its rule. Accordingly, the exemption granted to Wisconsin and any other exemptions which may have been granted by OTS or its predecessor with respect to its Credit Practices Rule will cease to be in effect as of this rule's effective date.

V. Section-by-Section Analysis of the Consumer Credit Card Practices Subpart

Pursuant to their authority under 15 U.S.C. 57a(f)(1), the Agencies adopt rules prohibiting specific unfair acts or practices with respect to consumer credit card accounts. A secondary basis for OTS's rule is HOLA. These rules are located in a new Subpart C to the Agencies' respective regulations under the FTC Act.

Section __.21—Definitions

Section __.21 defines certain terms used in Subpart C.

__.21(a) Annual Percentage Rate

Proposed § __.21(a) defined "annual percentage rate" as the product of multiplying each periodic rate for a balance or transaction on a consumer credit card account by the number of periods in a year. This definition corresponded to the definition of "annual percentage rate" in 12 CFR 226.14(b). As discussed in the Board's official staff commentary to 12 CFR 226.14(b),

⁵⁵ See Prohibited Consumer Credit Practices; Request for Exemption by State of Wisconsin, 51 FR 45879 (Dec. 23, 1986) ("It is well established that the [FHLBB] has exclusive authority to regulate all aspects of the operations of federally chartered associations under section 5 of [HOLA]. See, e.g., 12 CFR 545.2. Federally chartered associations will therefore continue to be subject to the rule rather than the Wisconsin Act, and the [FHLBB] will continue to examine them for compliance with the Rule.").

this computation does not reflect any particular finance charge or periodic balance. See 12 CFR 226.14 comment 226.14(b)–1. This definition also incorporated the definition of “periodic rate” from Regulation Z. See 12 CFR 226.2.

The Agencies did not receive any significant comments on this definition. Accordingly, it is adopted as proposed.

.21(b) Consumer

Proposed § __.21(b) defined “consumer” as a natural person to whom credit is extended under a consumer credit card account or a natural person who is a co-obligor or guarantor of a consumer credit card account. The Agencies did not receive any significant comments on this definition. Accordingly, it is adopted as proposed.

.21(c) Consumer Credit Card Account

Proposed § __.21(c) defined “consumer credit card account” as an account provided to a consumer primarily for personal, family, or household purposes under an open-end credit plan that is accessed by a credit or charge card. This definition incorporated the definitions of “open-end credit,” “credit card,” and “charge card” from Regulation Z. See 12 CFR 226.2. Under the proposed definition, a number of accounts would have been excluded consistent with exceptions to disclosure requirements for credit and charge card applications and solicitations. See 12 CFR 226.5a(a)(5). For example, home-equity plans accessible by a credit card and lines of credit accessible by a debit card are not covered by proposed § __.21(c).

One consumer group requested that this definition be expanded to cover debit cards with a linked credit card feature. The Agencies do not believe any change is necessary because, to the extent such cards meet the definition of “credit card” under 12 CFR 226.2, they are covered. Accordingly, this definition is adopted as proposed.

Proposed __.21(d) Promotional rate

Proposed § __.21(d) defined “promotional rate.” This definition was similar to the definition of “promotional rate” proposed by the Board in 12 CFR 226.16(e)(2) in the May 2008 Regulation Z Proposal. See 73 FR at 28892. As discussed in greater detail below, the provisions in proposed §§ __.23 and __.24 utilizing this definition have been revised such that a definition of “promotional rate” is no longer necessary for purposes of this subpart. Accordingly, this definition and its accompanying commentary have not been included in the final rule.

Section __.22—Unfair Acts or Practices Regarding Time To Make Payment

Summary. In May 2008, the Agencies proposed § __.22(a), which would have prohibited institutions from treating payments on a consumer credit card account as late for any purpose unless the institution has provided a reasonable amount of time for consumers to make payment. See 73 FR at 28912-28914. The Agencies also proposed a safe harbor in § __.22(b) for institutions that adopt reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date. Finally, to avoid any potential conflict with section 163(a) of TILA (15 U.S.C. 1666b(a)), the Agencies expressly stated in proposed § __.22(c) that the rule would not apply to any time period provided by an institution within which the consumer may repay any portion of the credit extended without incurring an additional finance charge. As discussed below, based on the comments and further analysis, the Agencies have adopted § __.22 as proposed except that proposed § __.22(b) has been revised to clarify that institutions must be able to establish that they have complied with § __.22(a).

Background. Section 163(a) of TILA requires creditors to send periodic statements at least 14 days before expiration of any period during which consumers can avoid finance charges on purchases by paying the balance in full (in other words, the “grace period”). 15 U.S.C. 1666b(a). TILA does not, however, mandate a grace period, and grace periods generally do not apply when consumers carry a balance from month to month. Regulation Z requires that creditors mail or deliver periodic statements 14 days before the date by which payment is due for purposes of avoiding additional finance charges or other charges, such as late fees. See 12 CFR 226.5(b)(2)(ii); 12 CFR 226.5 comment 5(b)(2)(ii)–1.

In its June 2007 Regulation Z Proposal, the Board noted anecdotal evidence of consumers receiving statements relatively close to the payment due date, with little time remaining to mail their payments in order to avoid having those payments treated as late. The Board observed that it may take several days for a consumer to receive a statement after the close of a billing cycle. The Board also observed that consumers who pay by mail may need to mail their payments several days before the due date to ensure that the payment is received on or before that date. Accordingly, the Board requested comment on whether it should recommend to Congress that the 14-day requirement in section 163(a) of TILA be increased. See 72 FR at 32973.

In response to the June 2007 Regulation Z Proposal, individual consumers, consumer groups, and a member of Congress stated that consumers were not being provided with a reasonable amount of time to pay their credit card bills. These commenters indicated that, because of the time required for periodic statements to reach consumers by mail and for consumers’ payments to reach creditors by mail, consumers had little time in between to review their statements for accuracy before making payment. This situation can be exacerbated if the consumer is traveling unexpectedly or otherwise unable to give the statement immediate attention when it is delivered or if the consumer needs to compare the statement to receipts or other records. In addition, some commenters indicated that consumers are unable to accurately predict when their payment will be received by a creditor due to uncertainties about how quickly mail is delivered. Some commenters argued that, because of these difficulties, consumers’ payments were received after the due date, leading to finance charges as a result of loss of the grace period, late fees, rate increases, and other adverse consequences.

Industry commenters, however, generally stated that consumers currently receive ample time to make payments, particularly in light of the increasing number of consumers who receive periodic statements electronically and make payments electronically or by telephone. These commenters also stated that providing additional time for consumers to make payments would be operationally difficult and would reduce interest revenue, which would have to be recovered by raising the cost of credit for all consumers.

Comments on the Agencies’ May 2008 Proposal were generally consistent with those on the Board’s June 2007 Regulation Z Proposal. Individual consumers, consumer groups, members of Congress, the FDIC, and state attorneys general largely supported the proposed rule. Some of these commenters stated that institutions have reduced the amount of time for consumers to make payment while increasing the late payment fees, penalty rates, and other costs imposed on consumers as a result of late payment.⁵⁶ In contrast, although some industry groups and credit card issuers supported the proposal, most industry commenters opposed the proposed rule, stating that consumers have more time to make payment than ever before because of alternative means for receiving statements and making payments. Some industry commenters

⁵⁶ See Testimony of Adam J. Levitin, Assoc. Prof. of Law, Georgetown Univ. Law Ctr. before the H. Subcomm. on Fin. Instits. & Consumer Credit at 13-14 (Mar. 13, 2008) (cited by several commenters).

also stated that complying with the proposed safe harbor would be impossible without making costly operational changes. To the extent that commenters addressed specific aspects of the proposal or its supporting legal analysis, those comments are discussed below.

Legal Analysis

The Agencies conclude that, based on the comments received and their own analysis, it is an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC to treat a payment on a consumer credit card account as late for any purpose (other than expiration of a grace period) unless the consumer has been provided a reasonable amount of time to make that payment.

Substantial consumer injury. In the May 2008 Proposal, the Agencies stated that an institution's failure to provide consumers a reasonable amount of time to make payment appeared to cause substantial monetary and other injury. The Agencies noted that, when a payment is received after the due date, institutions may impose late fees, increase the annual percentage rate on the account as a penalty, or report the consumer as delinquent to a credit reporting agency.

Several industry commenters stated that consumers are not harmed by the lack of a reasonable amount of time to pay because a significant majority of consumers pay on or before the due date, indicating that they currently receive sufficient time to make payment. Other commenters, however, noted that the GAO Report found that, in 2005, 35 percent of active accounts were assessed at least one late fee and that the average late fee assessment per active account was \$30.92.⁵⁷ In addition, the Chairman of the Senate Permanent Subcommittee on Investigations cited case histories of consumers who received periodic statements shortly before the due date, making it difficult for them to avoid a late fee and, in some cases, a rate increase. This comment also cited instances in which consumers submitted payments 10 to 14 days in advance of the due date, only to have the payment treated as late. Individual consumers described similar experiences in their comments. Thus, the Agencies conclude that the failure to provide a reasonable amount of time to make payment causes or is likely to cause substantial monetary injury to a significant number of consumers.

Injury is not reasonably avoidable. The Agencies stated in the May 2008 Proposal that it appeared consumers could not reasonably avoid the injuries caused by late payment unless they were provided a reasonable amount of time to pay. The Agencies observed that it could be unreasonable to expect consumers to make a timely payment if they are not given a reasonable amount of time to do so after receiving a periodic statement, although what constitutes a reasonable amount of time may vary based on the circumstances. The Agencies noted that TILA and Regulation Z provide consumers with the right to dispute transactions or other items that appear on their periodic statements. Accordingly, the Agencies reasoned that, in order to exercise certain of these rights, consumers must have a reasonable opportunity to review their statements. See 15 U.S.C. 1666i; 12 CFR 226.12(c).

The Agencies further stated that, in some cases, travel or other circumstances may prevent the consumer from reviewing the statement immediately upon receipt. Finally, as discussed above, the Agencies recognized that, because consumers cannot control when a mailed payment will be received by the institution, a payment mailed well in advance of the due date may nevertheless arrive after that date.

⁵⁷ See GAO Report at 32-33.

Some industry commenters stated that consumers should know the due date and minimum payment before receiving a periodic statement and should therefore be prepared to make payment immediately. As an initial matter, however, the consumer's due date and minimum payment may vary from month to month depending on the institution's practices. For example, some institutions use a 30-day billing cycle, which results in due dates that vary with the length of the month. Similarly, a consumer would not necessarily know how much to pay without the periodic statement because the amount of the required minimum payment may vary depending on the percentage of the total balance included and whether interest charges and fees are included. Furthermore, a consumer who pays the balance in full each month may not know how much to pay until receiving a periodic statement stating the total amount owed.

Furthermore, this argument fails to recognize, as discussed above, that consumers must have a reasonable opportunity to review their statement in order to exercise their dispute rights under TILA and Regulation Z. Finally, travel or other circumstances may prevent the consumer from reviewing the statement immediately. Accordingly, the Agencies conclude the injuries caused by late payment are not reasonably avoidable unless the consumer is provided a reasonable amount of time to make payment.

Injury is not outweighed by countervailing benefits. The May 2008 Proposal stated that the injury does not appear to be outweighed by any countervailing benefits to consumers or competition. At the proposal stage, the Agencies were not aware of any direct benefit to consumers from receiving too little time to make their payments. The Agencies observed that, although a longer time to make payment could result in additional finance charges for consumers who do not receive a grace period, the consumer would have the choice whether to wait until the due date to make payment. The Agencies also acknowledged that, as a result of the proposed rule, some institutions could be required to incur costs to alter their systems and would, directly or indirectly, pass those costs on to consumers. The Agencies stated, however, that it did not appear that these costs would outweigh the benefits to consumers of receiving a reasonable amount of time to make payment.

Some industry commenters stated that, because their practices are already consistent with the proposed safe harbor in § __.22(b), the costs of complying with the proposed rule would be minimal. Other industry commenters indicated that complying with the proposed safe harbor would require significant changes to their processes for generating and delivering periodic statements. As discussed below, the Agencies have adopted the safe harbor as proposed. See § __.22(b)(2). Assuming that the cost of altering practices to comply with a 21-day safe harbor will be passed on to consumers, this cost will be spread among thousands or hundreds of thousands of consumers and will not outweigh the benefits to consumers of avoiding late fees and increased annual percentage rates. Thus, the Agencies conclude that the injury to consumers is not outweighed by any countervailing benefits to consumers or competition.

Public policy. Some industry commenters stated that the proposed 21-day safe harbor was contrary to public policy and the Board's established payment systems policy as set forth in section 163(a) of TILA and section 226.5(b)(2)(ii) of Regulation Z, which, as discussed above, provide that periodic statements must be mailed at least 14 days in advance of the expiration of the grace period. The Agencies, however, have expressly provided that § __.22 does not apply to the mailing or delivery of periodic statements with respect to the expiration of grace periods. See § __.22(c). In the May 2008 Proposal, the Agencies recognized that, in enacting section 163(a) of TILA, Congress set the minimum amount of time between sending the periodic statement and expiration of any grace period offered by the creditor at 14 days. Because most

creditors currently offer grace periods and use a single due date for expiration of the grace period and the date after which a payment will be considered late for other purposes (such as the assessment of late fees), the Board requested comment in its June 2007 Regulation Z Proposal on whether it should request that Congress increase the mailing requirement with respect to grace periods.

Based on the comments received, the Agencies concluded in May 2008 that, because many consumers carry a balance from month to month and therefore do not receive a grace period, a separate rule might be needed to specifically address harms other than loss of the grace period when institutions do not provide a reasonable amount of time for consumers to make payment (such as late fees and rate increases as a penalty for late payment). However, in order to avoid any conflict with the statutory requirement regarding grace periods, proposed § __.22(c) specifically provided that the rule would not affect the requirements of section 163(a) of TILA. Accordingly, because § __.22(c) has been adopted as proposed, the Agencies conclude that § __.22 is not contrary to public policy generally or any established payment systems policy of the Board.

Final Rule

§ __.22(a) General rule

Proposed § __.22(a) would have prohibited institutions from treating a payment as late for any purpose unless the consumer has been provided a reasonable amount of time to make that payment. For the reasons discussed above, the Agencies have adopted § __.22(a) as proposed.

Proposed comment 22(a)-1 clarified that treating a payment as late for any purpose includes increasing the annual percentage rate as a penalty, reporting the consumer as delinquent to a credit reporting agency, or assessing a late fee or any other fee based on the consumer's failure to make a payment within the amount of time provided under this section. One industry commenter stated that the failure to provide a reasonable amount of time to pay is unlikely to cause a consumer to be reported as delinquent to a credit reporting agency, citing the policy of credit reporting agencies to consider an account delinquent only when it is 30 days past due.⁵⁸ Although the Agencies agree that the failure to provide a reasonable amount of time to pay is unlikely to cause injury in the form of a delinquency notation on a credit report, allowing institutions that fail to provide a reasonable amount of time to pay to treat payments as late for purposes of credit reporting but not for other purposes would be anomalous. Accordingly, comment 22(a)-1 is adopted as proposed.

Proposed comment 22(a)-2 stated that whether an institution had provided a reasonable amount of time to pay would be evaluated from the perspective of the consumer, not the institution. Some industry commenters requested that the Agencies establish standards for determining whether a particular amount of time is reasonable. The Agencies, however, have adopted a flexible reasonableness analysis rather than a set of fixed standards because whether a particular amount of time is sufficient for consumers to make payment will depend on the facts and circumstances. In addition, in order to remove uncertainty and facilitate compliance, the Agencies have, as discussed below, provided a means for complying with § __.22(a) in § __.22(b) and its accompanying commentary. Accordingly, comment 22(a)-2 is adopted as proposed.

__.22(b) Compliance with general rule

⁵⁸ See Consumer Data Industry Ass'n, Credit Reporting Resource Guide 6-6 (2006).

As proposed, § __.22(b) provided a safe harbor for institutions that have adopted reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date. As explained in the May 2008 Proposal, the 21-day safe harbor was intended to ensure that consumers received at least a week to review their statement and make payment. Compliance with this safe harbor would allow seven days for the periodic statement to reach the consumer by mail, seven days for the consumer to review the statement and make payment, and seven days for that payment to reach the institution by mail. The Agencies noted that, although increasing numbers of consumers are receiving periodic statements and making payments electronically, a significant number still utilize mail. The Agencies further noted that, while first class mail is often delivered within three business days, in some cases it can take significantly longer.⁵⁹ Furthermore, some large credit card issuers already recommend that consumers allow up to seven days for their payments to be received by the issuer via mail.

The Agencies requested comment on whether the proposed 21-day safe harbor provided a reasonable amount of time for consumers to review their periodic statements and make payment. Consumer groups and others stated that a longer period of 28 or 30 days was needed. Some industry commenters stated that they currently mail or deliver periodic statements 21 days in advance of the due date. Most industry commenters, however, raised the following objections to the proposed 21-day safe harbor.

First, many industry commenters stated that allowing seven days for receipt of mailed periodic statements was excessive because, in most cases, statements are generally delivered two to four days after mailing. These commenters, however, provided only the average delivery time or the delivery time for the great majority of consumers, not the outer range of delivery times. For example, as one consumer group noted, mailing times are often significantly longer for consumers in sparsely populated rural areas. Thus, while the Agencies agree that seven days may be more time than is needed for most consumers to receive a periodic statement by mail, a safe harbor based solely on average mailing times would not adequately protect the small but significant number of consumers whose delivery times are longer than average. Furthermore, because many institutions use practices that reduce delivery times for periodic statements (such as pre-sorting statements by ZIP code prior to delivery to the U.S. Postal Service), delivery times for periodic statements mailed by institutions to consumers likely are not representative of delivery times for payments mailed by consumers to institutions.

Second, several industry commenters stated that allowing seven days for mailing time was excessive for the additional reason that many consumers receive their statements electronically and make payment electronically or by telephone. These commenters, however, also confirmed that a significant number of consumers receive statements and make payments by mail. While many consumers at larger institutions have the ability to review statements online, it is unclear how many actually do so since most also receive statements by mail. Furthermore, the percentage of consumers paying by mail varied significantly by the type of institution. For example, some larger institutions reported that less than half of their consumers use mail to submit payments, while an industry group reported that 70 to 80 percent of community bank consumers mail their payments. In addition, one consumer group cited a study indicating that

⁵⁹ See, e.g., Testimony of Jody Berenblatt, Senior Vice President—Postal Strategy, Bank of America, before the S. Subcomm. on Fed. Fin. Mgmt., Gov't Info., Fed. Svcs., and Int'l Security (Aug. 2, 2007).

internet usage is not evenly distributed among the population.⁶⁰ Thus, a safe harbor based on the assumption that consumers use alternative means to receive statements or make payments would not protect a significant number of consumers.⁶¹

Third, many industry commenters stated that complying with the 21-day safe harbor would require significant and costly changes to institutions' practices for generating and mailing periodic statements. As discussed above, however, the Agencies have concluded that these costs are outweighed by the benefits to consumers of receiving a reasonable amount of time to pay.

Finally, some commenters stated that adjusting to the 21-day safe harbor could lead to consumer confusion because the institution would not have sufficient time to reflect timely payments on the subsequent periodic statement. This concern, however, depends on a number of variables, including the number of days in the month, whether the institution uses billing cycles that vary with the length of the month (as opposed to a fixed 30-day billing cycle), and whether the institution processes payments on weekends or holidays. Although it is possible that, in some narrow set of circumstances, an institution may not be able to reflect a timely payment on the periodic statement, the Agencies conclude that any resulting confusion does not warrant a reduction in the proposed safe harbor. Accordingly, the 21-day safe harbor is adopted as proposed except that, for the reasons discussed below, this provision has been retitled and, for reasons discussed below, moved to § __.22(b)(2).

In order to minimize burden and facilitate compliance, proposed comment 22(b)-1 clarified that an institution with reasonable procedures in place designed to ensure that statements are mailed or delivered within a certain number of days from the closing date of the billing cycle may utilize the safe harbor by adding that number to the 21-day safe harbor for purposes of determining the payment due date on the periodic statement. Proposed comment 22(b)-1 is adopted as proposed. Accordingly, if, for example, an institution had reasonable procedures in place designed to ensure that statements are mailed or delivered within three days of the closing date of the billing cycle, the institution could comply with the safe harbor by stating a payment due date on its periodic statements that is 24 days from the close of the billing cycle (in other words, 21 days plus three days). Similarly, if an institution's procedures reasonably ensured that payments would be sent within five days of the close of the billing cycle, the institution could comply with the safe harbor by setting the due date 26 days from the close of the billing cycle.

Proposed comment 22(b)-2 further clarified that the payment due date is the date by which the institution requires the consumer to make payment in order to avoid being treated as late for any purpose (except with respect to expiration of a grace period). Comment 22(b)-2 is adopted as proposed.

The Agencies also received requests from industry for clarification that compliance with the safe harbor is not the only means of complying with the requirement that consumers be provided a reasonable amount of time to make the payment. Accordingly, the Agencies have

⁶⁰ See Public Policy Institute of Cal., California's Digital Divide (June 2008) ("Whites, blacks, and Asians currently have similarly high rates of computer and Internet use. Latinos have the lowest rates by far (computers 58%, Internet 48%).") (available at http://www.ppic.org/content/pubs/jtf/JTF_DigitalDivideJTF.pdf).

⁶¹ In addition, multiple safe harbors providing longer or shorter periods of time depending on how the consumer receives periodic statements or makes payments would not be operationally feasible because an institution will not know in advance what method a consumer will use. For example, a consumer might review their periodic statement online one month but wait for the statement to arrive by mail the next. Similarly, a consumer might pay electronically one month and by mail the next.

restructured § __.22(b) to provide additional clarity regarding compliance with § __.22(a). The Agencies have added a new § __.22(b)(1), which clarifies that institutions are responsible for establishing that they have complied with § __.22(a). The 21-day safe harbor, which the Agencies have moved to § __.22(b)(2), provides one method of compliance. Finally, the Agencies have added comment 22(b)-3, which provides an example of an alternative compliance method. In this example, because an institution only provides periodic statements and accepts payments electronically, the institution could deliver statements for those accounts less than 21 days before the payment due date and still satisfy the general rule in § __.22(a) because those consumers would need less time to receive their statements or make their payments by mail.

__.22(c) Exception for grace periods

In order to avoid any potential conflict with section 163(a) of TILA, proposed § __.22(c) provided that proposed § __.22(a) would not apply to any time period provided by the institution within which the consumer may repay the new balance or any portion of the new balance without incurring finance charges (in other words, a grace period).

Several industry commenters argued that, notwithstanding proposed § __.22(c), institutions would essentially be required to use a single date for the payment due date and for expiration of the grace period because consumers would be confused by different dates. Consumer groups also raised concerns about the potential for consumer confusion. One consumer group requested that the Board use its authority under section 1604(a) of TILA to require that the expiration of the grace period coincide with the payment due date. Because the mailing or delivery of periodic statements in relation to expiration of the grace period is specifically addressed by section 163(a) of TILA, the Agencies believe that deviating from the statutory requirement would be inappropriate and unnecessary in this case, particularly because Regulation Z would require an institution that elected to use separate dates to disclose both dates on the periodic statement. See 12 CFR 226.6(b), adopted elsewhere in today's **Federal Register**. An institution that chooses to use separate dates, however, must ensure that consumers understand the implications if payment is not received on or before each date.

Other Issues

Implementation. As discussed in § VII of this **SUPPLEMENTARY INFORMATION**, the effective date for § __.22 is July 1, 2010. As of that date, this provision applies to existing as well as new consumer credit card accounts. Thus, institutions must provide consumers with a reasonable amount of time to make any payment due on or after the effective date.

Alternatives to proposed rule. The Agencies requested comment on two potential alternatives to the proposed rule. First, the Agencies asked for comment on whether to adopt a rule that would prohibit institutions from treating a payment as late if received within a certain number of days after the due date and, if so, the number of days that would be appropriate. Consumer groups and some institutions that currently provide such a period of time were supportive, but most industry commenters stated that this requirement would be operationally burdensome. The Agencies have concluded that requiring institutions to provide a period of time after the due date during which payments must be treated as timely could create consumer confusion regarding when payment is actually due and undermine the Board's efforts elsewhere in today's **Federal Register** to ensure that consumers' due dates are meaningful.⁶²

⁶² See 12 CFR 226.10(b)(2)(ii) (providing that a reasonable cut-off time for payments received by mail would be 5 p.m. on the payment due date at the location specified by the creditor for the receipt of such payments); 12 CFR 226.10(d) (providing that, if the due date for payments is a day on which the creditor does not receive or accept

Second, the Agencies sought comment on whether to adopt a rule that would require institutions, upon the request of a consumer, to reverse a decision to treat a payment mailed before the due date as late and, if so, what evidence the institution could require the consumer to provide (for example, a receipt from the U.S. Postal Service or other common carrier) and what time frame would be appropriate (for example, payment mailed at least five days before the due date, payment received no more than two business days' late). Although some commenters supported such a requirement, the Agencies also received comments from both industry and a consumer group opposing the requirement on the grounds that it would be burdensome for consumers to obtain proof of mailing and for institutions to establish systems for accepting such proof. Furthermore, the Agencies note that some institutions stated that they will generally waive any late payment fee when a consumer produces proof that a payment was mailed sufficiently in advance of the due date.

Supplemental Legal Basis for This Section of the OTS Final Rule

As discussed above, HOLA provides authority for both safety and soundness and consumer protection regulations. Section 535.22 supports safety and soundness by reducing reputational risk that would result from providing consumers an unreasonably short period of time to make payment. Section 535.22 also protects consumers by providing sufficient time to make payment. It is somewhat akin to OTS's late charge provision for home loans, which prohibits federal savings associations from imposing a late charge as to any payment received within 15 days of the due date.⁶³ Further, mailing or delivery of periodic statements at least 21 days before the payment due date is consistent with best industry practices. Consequently, HOLA serves as an independent basis for § 535.22.

Section __.23—Unfair Acts or Practices Regarding Allocation of Payments

Summary. In May 2008, the Agencies proposed § __.23 in response to concerns that institutions were applying consumers' payments in a manner that inappropriately maximized interest charges on consumer credit card accounts with balances at different annual percentage rates. Specifically, most institutions allocate consumers' payments first to the balance with the lowest annual percentage rate, resulting in the accrual of interest at higher rates on other balances (unless all balances are paid in full). See 73 FR at 28914-28917. Proposed § __.23(a) would have addressed this practice by requiring institutions to allocate payments in excess of the required minimum periodic payment ("excess payments") using one of three permitted methods or a method equally beneficial to consumers. The permitted methods were allocating the excess payment first to the balance with the highest annual percentage rate, allocating equal portions of the excess payment to each balance, and allocating the excess payment pro rata among the balances.

In addition, because the Agencies were concerned that existing payment allocation practices were especially harmful when an account had a balance at a discounted promotional rate or a balance on which interest was deferred, proposed § __.23(b) would have placed more stringent requirements on those accounts. Proposed § __.23(b)(1)(i) would have prohibited institutions from allocating excess payments to promotional rate and deferred interest balances unless all other balances had been paid in full. Proposed § __.23(b)(1)(ii), however, created an

payments by mail, the creditor may not treat a payment received by mail the next business day as late for any purpose).

⁶³ 12 CFR 560.33.

exception for the existing practice by some institutions of allocating excess payments first to a deferred interest balance during the last two billing cycles of the deferred interest period so that consumers could pay off that balance and avoid assessment of deferred interest. Finally, proposed § __.23(b)(2) would have prohibited institutions from denying consumers a grace period solely because an account had a promotional rate or deferred interest balance.

Based on the comments received and further analysis, the Agencies have revised the general payment allocation rule in proposed § __.23(a) to require institutions either to apply excess payments first to the balance with the highest annual percentage rate or to allocate excess payments pro rata among the balances. The final version of § __.23 prohibits the current practice of applying payments to the lowest rate balance first while also responding to concerns raised by commenters that the number of allocation methods permitted by the proposed rule would have increased the complexity of payment allocation, making the practice and its effects on interest charges even less transparent for consumers.

In addition, the Agencies have not included proposed § __.23(b) in the final rule. First, because current practices regarding assessment of deferred interest are not permitted under the final version of § __.24, the provisions regarding deferred interest plans are no longer necessary. Second, due to concerns that proposed § __.23(b) could significantly reduce or eliminate promotional rate offers that provide substantial benefits to consumers, the Agencies have not included the provisions regarding promotional rate balances. Instead, the Agencies believe that applying the general allocation rule in § __.23 in all circumstances strikes the appropriate balance by preserving promotional rate offers that provide substantial benefits to consumers while prohibiting the most harmful payment allocation practices.

Background. In its June 2007 Regulation Z Proposal, the Board discussed the practice among some creditors of allocating payments first to balances that are subject to the lowest interest rate. 72 FR at 32982–32983. Because many creditors offer different rates for purchases, cash advances, and balance transfers, this practice can result in consumers who do not pay the balance in full each month incurring higher finance charges than they would under any other allocation method. The Agencies were also concerned that, when the consumer has responded to a promotional rate or deferred interest offer, the allocation of payments to balances with the lowest interest rate often prevents the consumer from receiving the full benefit of the promotional rate or deferred interest plan if the consumer uses the credit card account for other transactions.

For example, assume that a consumer credit card account charges annual percentage rates of 12% on purchases and 20% on cash advances. Assume also that, in the same billing cycle, the consumer uses the account for purchases totaling \$3,000 and cash advances totaling \$300. If the consumer makes an \$800 excess payment, most creditors would apply the entire payment to the purchase balance and the consumer would incur interest charges on the more costly cash advance balance. Under these circumstances, the consumer is effectively prevented from paying off the balance with the higher interest rate (cash advances) unless the consumer pays the total balance (purchases and cash advances) in full.

This outcome is exacerbated if the consumer uses the card in reliance on a promotional rate or deferred interest offer. For example, assume the same facts as above but that, during the same billing cycle, the consumer also transfers to the account a balance of \$3,000 in response to a promotional rate offer of 5% for six months. In this case, most creditors would apply the consumer's \$800 excess payment to the promotional rate balance and the consumer would incur interest charges on the more costly purchase and cash advance balances. Under these

circumstances, the consumer would effectively be denied the benefit of the 5% promotional rate for six months if the card is used for purchase or cash advance transactions because the consumer must pay off the entire transferred balance in order to avoid paying a higher rate on other transactions. Indeed, the only way for the consumer to receive the full benefit of the 5% promotional rate is not to use the card for purchases, which would effectively require the consumer to use an open-end credit account as a closed-end installment loan.

Deferred interest plans raise similar – but not identical – concerns. Currently, some creditors offer deferred interest plans under which interest accrues on purchases at a specified rate but is not charged to the account for a period of time. If the balance is paid in full by the end of the period, the consumer generally will not be charged any interest. If, however, the balance is not paid in full by the end of the period, all interest accrued during that period will be charged to the account. With respect to payment allocation, a consumer whose payments are applied to a deferred interest balance instead of balances on which interest is not deferred will incur additional finance charges during the deferred interest period.

In addition, creditors typically provide consumers who pay their balance in full each month a grace period for purchases but not for balance transfers or cash advances. Because payments generally will be allocated to the transferred balance first, a consumer typically cannot take advantage of both a promotional rate on balance transfers or cash advances and a grace period on purchases. Under these circumstances, the only way for a consumer to avoid paying interest on purchases would be to pay off the entire balance, including the transferred balance or cash advance balance subject to the promotional rate.

In preparing its June 2007 Regulation Z Proposal, the Board sought to address issues regarding payment allocation by developing disclosures explaining payment allocation methods on accounts with multiple balances at different annual percentage rates so that consumers could make informed decisions about card usage, particularly with regard to promotional rates. For example, if consumers knew that they would not receive the full benefit of a promotional rate on a particular credit card account if they used that account for purchases during the promotional period, they might use a different account for purchases and pay that second account in full every month to take advantage of the grace period. The Board conducted extensive consumer testing in an effort to develop disclosures that would enable consumers to understand typical payment allocation practices and make informed decisions regarding the use of credit cards for different types of transactions. In this testing, many participants did not understand that they could not take advantage of the grace period on purchases and the discounted rate on balance transfers at the same time. Model forms were tested that included a disclosure notice attempting to explain this to consumers. Testing, however, showed that a significant percentage of participants still did not fully understand how payment allocation can affect their interest charges, even after reading the model disclosures.

In the June 2007 Regulation Z Proposal, the Board acknowledged these results and stated that it would conduct further testing to determine whether the disclosure could be improved to communicate more effectively to consumers how payment allocation can affect their interest charges. The Board also solicited comment on a proposed amendment to Regulation Z that would have required creditors to explain payment allocation to consumers. Specifically, the Board proposed that creditors explain how payment allocation would affect consumers' interest charges if an initial discounted rate was offered on balance transfers or cash advances but not purchases. The Board proposed that creditors must disclose to consumers that: (1) the initial discounted rate applies only to balance transfers or cash advances, as applicable, and not to

purchases; (2) that payments will be allocated to the balance transfer or cash advance balance, as applicable, before being allocated to any purchase balance during the time the initial discounted rate is in effect; and (3) that the consumer will incur interest on the purchase balance until the entire balance is paid, including the transferred balance or cash advance balance, as applicable. 72 FR at 33047-33050.

In response to the June 2007 Regulation Z Proposal, several commenters recommended that the Board test a simplified payment allocation disclosure that covered situations other than low rate balance transfers. One credit card issuer, however, stated that, even if an effective disclosure could be developed, consumers could not shop for a better payment allocation method because creditors almost uniformly apply payments to the balance with the lowest annual percentage rate. Furthermore, consumer and consumer group commenters urged the Board to go further and prohibit payment allocation methods that applied payments to the lowest rate balance before other balances.

In consumer testing conducted for the Board prior to the May 2008 Proposal, the Board tested a revised payment allocation disclosure. This disclosure was not effective in improving consumers' understanding. The majority of participants understood from earlier experience that creditors typically will apply payments to lower rate balances first and that this method causes them to incur higher interest charges. However, for those participants that did not know about payment allocation methods from earlier experience, the disclosure tested was not effective in communicating payment allocation methods.⁶⁴

Accordingly, because the Board's testing indicated that disclosure was not effective in allowing consumers to avoid the common practice of allocating payments first to the balance with the lowest rate, the Agencies proposed in May 2008 to address concerns regarding payment allocation in proposed § __.23 by placing limitations on allocation of excess payments.⁶⁵ The Agencies also solicited comment on whether the exception regarding deferred interest balances was needed. 73 FR 28916.

The Agencies received comments in support of proposed § __.23 from individual consumers, consumer groups, members of Congress, the FDIC, state attorneys general, a state consumer protection agency, and others. Nevertheless, many of these commenters criticized the proposed rule as overly complex, arguing that – if consumers cannot understand the effects of the current low-to-high allocation method on interest charges – increasing the number and complexity of allocation methods would only make the cost of credit less transparent. These commenters urged the Agencies to revise the proposed rule to require that excess payments be applied first to the balance with the highest rate in all circumstances. Some consumer advocates urged the Agencies to ban deferred interest balances rather than create an exception for them.

In contrast, credit card issuers and industry groups strongly opposed the proposal, particularly the special requirements regarding accounts with promotional rate and deferred interest balances. These commenters generally argued that disclosure would enable consumers to avoid any harm caused by payment allocation, that the proposed restrictions regarding promotional rate and deferred interest balances would ultimately harm consumers by reducing or

⁶⁴ The Board also tested whether, given the opportunity, consumers could select how amounts paid in excess of the minimum would be allocated using a payment coupon. Most participants, however, were not able to understand the effects of payment allocation sufficiently to apply payments in a manner that minimized interest charges.

⁶⁵ After the May 2008 Proposal, the Board conducted additional testing of consumers' ability to understand payment allocation disclosures and select how excess payments would be allocated. This testing, however, produced similar results to those discussed above.

eliminating promotional rate and deferred interest offers, and that complying with the proposed rule would require burdensome systems changes.

To the extent that commenters addressed specific aspects of the proposal or its supporting legal analysis, those comments are discussed below.

Legal Analysis

When different annual percentage rates apply to different balances on a consumer credit card account, the Agencies conclude that, based on the comments received and their own analysis, it is an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC to allocate amounts paid by the consumer in excess of the required minimum periodic payment in a manner that does not apply a significant portion of the amount to the balance with the highest annual percentage rate.⁶⁶

Substantial consumer injury. In the May 2008 Proposal, the Agencies stated that allocating excess payments first to the balance with the lowest rate appeared to cause substantial monetary injury to consumers in the form of higher interest charges than would be incurred if some or all of the excess payment were applied to balances with higher rates.

In response, the Agencies received an analysis of credit card data purporting to represent approximately 70 percent of outstanding consumer credit card balances (the Argus Analysis). Although the Agencies are not able to verify the accuracy of the Argus Analysis or the data supporting it, the Agencies note that this analysis estimated that consumers are charged an additional \$930 million annually as a result of the practices addressed by proposed § __.23.⁶⁷ In addition, a state consumer protection agency stated that the practice of allocating payments first to the balance with the lowest rate is particularly harmful to low-income consumers, citing its own study finding that a quarter of low-income cardholders surveyed used a credit card for a cash advance (which generally accrues interest at a higher rate than other transactions) every few months.⁶⁸

One industry commenter asserted that allocating payments first to the balance with the lowest interest rate could not cause an injury for purposes of the FTC Act merely because other, less costly allocation methods exist. It is well established, however, that monetary harm constitutes an injury under the FTC Act.⁶⁹ This comment did not provide any legal authority

⁶⁶ In the May 2008 Proposal, the Agencies considered whether other practices specifically related to promotional rate and deferred interest balances were unfair. As discussed below, based on the comments and further analysis, § __.23 does not include the provisions specifically addressing those practices. To the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

⁶⁷ See Exhibit 1, Table 1 to Comment from Oliver I. Ireland, Morrison Foerster LLP (Aug. 7, 2008) (“Argus Analysis”) (presenting results of analysis by Argus Information & Advisory Services, LLC of historical data for consumer credit card accounts believed to represent approximately 70 percent of all outstanding consumer credit card balances).

⁶⁸ See N.Y. City Dept. of Consumer Affairs, Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two N.Y. City Neighborhoods at 6 (June 2008) (available at http://www.nyc.gov/html/ofe/downloads/pdf/NFS_ExecSumm.pdf).

⁶⁹ See Statement for FTC Credit Practices Rule, 49 FR at 7743; FTC Policy Statement on Unfairness at 3.

distinguishing interest charges assessed as a result of current payment allocation practices from other monetary harms, nor are the Agencies aware of any such authority.

Another industry commenter stated that assessing interest consistent with a contractual provision to which the consumer has agreed cannot constitute an injury under the FTC Act. This argument, however, is inconsistent with the FTC's application of the unfairness analysis in support of its Credit Practices Rule, where the FTC determined that otherwise valid contractual provisions injured consumers.⁷⁰

Accordingly, the Agencies conclude that the failure to allocate a significant portion of an excess payment to the balance with the highest rate causes or is likely to cause substantial monetary injury to consumers.

Injury is not reasonably avoidable. In May 2008, the Agencies cited several factors that appeared to prevent consumers from reasonably avoiding the injury. First, consumers generally have no control over the institution's allocation of payments. Second, the Board's consumer testing indicated that disclosures do not enable consumers to understand sufficiently the effects of payment allocation. Furthermore, the Agencies stated that, even if disclosures were effective, it appeared consumers still could not avoid the injury by selecting a credit card account with more favorable terms because institutions almost uniformly apply payments first to the balance with the lowest rate.⁷¹ Third, although a consumer could avoid the injury by paying the balance in full each month, this may not be a reasonable expectation as many consumers are unable to do so.

The Agencies conclude that these factors support a determination that the injury caused by the failure to allocate a significant portion of an excess payment to the highest rate balance is not reasonably avoidable. In particular, the Agencies note that additional consumer testing has further confirmed that disclosure is not an effective alternative to the proposed rule.⁷²

Furthermore, although one industry commenter argued that consumers could reasonably avoid the injury by paying their balance in full each month, one of the intended purposes of a credit card (as opposed to a charge card) is to finance purchases over multiple billing cycles. Thus, it is unreasonable to expect consumers to avoid the harm caused by current payment allocation practices by paying their balances in full each month.

Injury is not outweighed by countervailing benefits. In the May 2008 Proposal, the Agencies stated that the prohibited practices did not appear to create benefits for consumers or competition that outweighed the injury. The Agencies noted that, if implemented, the proposal could reduce the revenue that institutions receive from interest charges, which could in turn lead institutions to increase rates generally. The Agencies stated, however, that this effect should be muted because the proposal prohibited only the practices that are most harmful to consumers and

⁷⁰ See Statement for FTC Credit Practices Rule, 49 FR 7740 *et seq.*; see also *Am. Fin. Servs. Assoc.*, 767 F.2d at 978-83 (upholding the FTC's analysis).

⁷¹ See Statement for FTC Credit Practices Rule, 48 FR at 7746 ("If 80 percent of creditors include a certain clause in their contracts, for example, even the consumer who examines contract[s] from three different sellers has a less than even chance of finding a contract without the clause. In such circumstances relatively few consumers are likely to find the effort worthwhile, particularly given the difficulties of searching for contract terms * * *" (footnotes omitted)).

⁷² For this reason, the Board has removed the proposed disclosure regarding payment allocation under Regulation Z, as discussed elsewhere in today's **Federal Register**.

leaves institutions with considerable flexibility. Specifically, the proposed rule permitted institutions to choose between three specified allocation methods or any other method that was no less beneficial to the consumer. In addition, the proposed rule did not apply to the allocation of minimum payments.

Furthermore, the Agencies stated that the proposal would enhance transparency and enable consumers to better assess the costs associated with using their credit card accounts at the time they engage in transactions. The Agencies noted that, to the extent that upfront costs have been artificially reduced because many consumers cannot reasonably avoid paying higher interest charges later, the reduction does not represent a true benefit to consumers as a whole. Finally, the Agencies stated that it appeared the proposal would enhance rather than harm competition because institutions offering rates that reflect the institution's costs (including the cost to the institution of borrowing funds and operational expenses) would no longer be forced to compete with institutions offering rates that are artificially reduced based on the expectation that interest will accrue on higher rate balances until the promotional rate balance is paid in full.

Based on the comments and further analysis, the Agencies conclude that these rationales support a determination that the injury to consumers when institutions do not allocate a significant portion of the excess payment to the balance with the highest annual percentage rate outweighs any benefits of this practice for consumers and competition. Industry commenters generally argued that the restrictions in proposed § __.23 would reduce interest revenue and force institutions to compensate by increasing the interest rates or fees charged to consumers, decreasing the amount of available credit, or using some combination of the two. For example, the Argus Analysis stated that, as a result of proposed § __.23, institutions could lose 0.125 percent of their annual interest revenue on revolving credit card accounts (in other words, accounts where interest is charged because the balance is not paid in full each billing cycle).⁷³ Again, as noted above, the Agencies are unable to verify the accuracy of the conclusions reached by the Argus Analysis or its supporting data. Furthermore, the Argus Analysis did not estimate the potential impact of proposed § __.23 on the cost and availability of credit.⁷⁴ Nevertheless, assuming for the sake of discussion that the data and assumptions underlying the Argus Analysis are accurate, it appears that institutions might respond by increasing interest rates approximately 0.15 percentage points or by decreasing credit limits approximately \$155.⁷⁵ Accordingly, if, for

⁷³ See Exhibit 1, Table 1 to Argus Analysis (combining the predictions for “Revolvers” in the rows labeled “Change in Payment Allocation” and “Grace Period Requirement for Retail Transactions”).

⁷⁴ As discussed in greater detail below, the Argus Analysis assumes that institutions will adjust to the restrictions in the proposed rules by increasing interest rates, decreasing credit limits, eliminating credit for consumers with low credit scores, or some combination of the three. This analysis ignores other potential adjustments, such as increasing fee revenue (including the assessment of annual fees) and developing improved underwriting techniques that will reduce losses and the need to engage in repricing when a consumer violates the account terms.

⁷⁵ The Argus Analysis estimated that proposed § __.23 will reduce interest revenue by 0.125 percent. Accordingly, for purposes of this discussion, the Agencies assumed that, consistent with the Argus Analysis, the increase in interest rates attributable to proposed § __.23 would be 120 percent of the reduction in interest revenue ($0.125 \times 1.2 = 0.15$). The Agencies also assumed that the reduction in credit limits attributable to proposed § __.23 would be proportionate to the overall reduction predicted by the Argus Analysis. Thus, because the estimated revenue loss attributable to proposed § __.23 (0.125) is 7.6% of the overall estimated revenue loss predicted by the Argus Analysis (1.637), the Agencies assumed that the reduction in credit limits attributable to proposed § __.23 would be 7.6% of the overall reduction of \$2,029 predicted by the Argus Analysis ($\$2,029 \times 0.076 = \155). The Agencies were not able to estimate the potential impact on credit availability for consumers with FICO scores below 620 but,

example, an institution charges its consumers an interest rate of 15% on a credit line of \$9,000, the Argus Analysis appears to indicate that the institution might respond to proposed § __.23 by increasing the rate to 15.15% or by decreasing the credit limit to \$8,850.⁷⁶

The Argus Analysis also stated that more than three quarters of revolving accounts do not carry multiple balances, meaning that the estimated \$930 million in interest revenue is currently generated from only one quarter of all revolving accounts.⁷⁷ Thus, even if the Agencies were to accept the Argus Analysis and its underlying data at face value, it appears that the restrictions in proposed § __.23 will result in significantly reduced interest charges for one quarter of consumer credit card accounts, while potentially resulting in a smaller increase in interest charges for all other accounts or a small reduction in available credit for all accounts. Furthermore, the Argus Analysis was based on the proposed rule. Although the final rule permits only two allocation methods, the Agencies' decision to omit from the final rule the more restrictive rules for accounts with promotional rate balances in proposed § __.23(b) should significantly reduce the estimated impact.⁷⁸ The Agencies therefore conclude that, based on the available information, the injury to consumers as a result of the current practice of applying excess payments in a manner that maximizes interest charges outweighs the potential increase in interest rates or reduction in available credit as a result of prohibiting that practice. Even if the shifting of costs from one group of consumers to another, much larger group is viewed as neutral from a cost-benefit perspective, the less quantifiable benefits to consumers and competition of more transparent upfront pricing weigh in favor of the proposed rule.

Some industry commenters also argued that compliance with proposed § __.23 would require extensive changes to payment allocation systems, the cost of which would be passed on to consumers. One systems provider estimated the cost of developing systems to allocate payments among different balances at tens of thousands of dollars per institution. Another systems provider, however, stated that these systems currently exist. Again, because the Agencies have simplified the payment allocation rule by permitting only two payment allocation methods and by omitting the special allocation requirements for promotional rate balances, the burden associated with systems changes should be reduced. Furthermore, if the cost of altering practices to comply with § __.23 is passed on to consumers, that cost will be spread among

given the limited estimated impact of proposed § __.23 on rates and credit limits, it appears this impact would not be substantial.

⁷⁶ As discussed in greater detail in § VII of this **SUPPLEMENTARY INFORMATION**, the Agencies anticipate that, prior to the effective date, some institutions may respond to the restrictions in § __.23 by, for example, adjusting interest rates on existing balances or reducing credit limits.

⁷⁷ See Exhibit 4a, Table 3b to Argus Analysis.

⁷⁸ As noted above, the Argus Analysis stated that, as a result of proposed § __.23, institutions could lose 0.125 percent of their annual interest revenue on revolving credit card accounts. See Exhibit 1, Table 1 to Argus Analysis. This figure appears to be based on the equal share method, which – according to the Argus Analysis – would have the least impact of any of the proposed methods on interest revenue. See Exhibit 1, Table 3a to Argus Analysis (column labeled “New Payment Allocation Method,” row labeled “Equal”). Although the final rule does not permit use of the equal share method, the Argus Analysis estimates that the impact of the pro rata method (which is permitted) would only be two one-hundredths of a percent (0.002) higher. See *id.* (column labeled “New Payment Allocation Method,” row labeled “Proportional”). Furthermore, the 0.125 figure also includes an estimated 0.014 loss in interest revenue attributable to proposed § __.23(b)(2), which the Agencies have not adopted. See Exhibit 1, Table 1 to Argus Analysis. Thus, assuming the Argus Analysis is accurate, the overall impact of the final rule on interest revenue should be less than the proposal.

thousands, hundreds of thousands, or millions of consumers and will not outweigh the benefits to consumers of avoiding additional interest charges and more transparent upfront pricing.⁷⁹

Public policy. Some industry commenters argued that the proposed rule was contrary to public policy as set forth in statements by another federal banking agency. Specifically, these commenters pointed to statements in Congressional testimony and an advisory letter by the OCC suggesting that concerns regarding payment allocation should be addressed through disclosure rather than substantive regulation.⁸⁰

While public policy may be considered as part of the unfairness analysis under the FTC Act, it is not a required element of that analysis and cannot serve as the primary basis for determining that an act or practice is unfair.⁸¹ For purposes of the unfairness analysis, public policy is generally embodied in a statute, regulation, or judicial decision.⁸² Nevertheless, to the extent that the OCC's statements constitute public policy, the Agencies find that those statements (which the Agencies have not adopted) do not preclude a determination that allocating excess payments in a manner that does not apply a significant portion to the balance with the highest rate is an unfair practice. The May 2008 Proposal explained that extensive consumer testing conducted by the Board indicated that disclosure was not effective in enabling consumers to avoid the harm caused by current payment allocation practices. The Agencies also note that the OCC statements cited by the commenters were made prior to the May 2008 Proposal and were not repeated in the OCC's comment on that proposal.

Final Rule

As proposed, § __.23(a) would have established a general rule governing payment allocation on accounts that have balances with different annual percentage rates but do not have a promotional rate or deferred interest balance. Proposed § __.23(b) would have established special rules for accounts with balances at different rates that do have a promotional rate or deferred interest balance. As discussed below, however, the final rule eliminates the special rules in proposed § __.23(b) and applies a revised version of the general rule in proposed § __.23(a) to all types of balances.

As an initial matter, industry commenters and a member of Congress criticized proposed § __.23 as overly complex. They stated that, rather than making payment allocation practices easier for consumers to understand, the proposed rule would make payment allocation harder to disclose and increase consumer confusion. The Agencies reemphasize that the Board's

⁷⁹ As discussed below, the Agencies have revised the proposed remedy for this unfair practice by allowing only two allocation methods for excess payments: high-to-low and pro rata allocation. Unlike the proposal, the final rule would not permit institutions to split excess payments equally among the balances or to allocate using a method that is no less beneficial to consumers than one of the listed methods because the Agencies have determined that these methods would not provide benefits to consumers that outweigh the injury addressed by this final rule.

⁸⁰ See Testimony of Julie L. Williams, Chief Counsel & First Senior Deputy Controller, OCC before H. Subcomm. on Fin. Instits. & Consumer Credit at 10-11 (Apr. 17, 2008) (available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/williams041708.pdf); see also OCC Advisory Letter 2004-10 (Sept. 14, 2004) (available at <http://www.occ.treas.gov/ftp/advisory/2004-10.doc>).

⁸¹ 15 U.S.C. 45(n).

⁸² See, e.g., FTC Policy Statement on Unfairness at 5 (stating that public policy "should be clear and well-established" and "should be declared or embodied in formal sources such as statutes, judicial decisions, or the Constitution as interpreted by the court * * *").

consumer testing indicates that, regardless of the complexity of the method, payment allocation methods cannot be effectively disclosed. The proposed restrictions on payment allocation were not intended to ease disclosure but instead to protect consumers from unfair practices that cannot be effectively addressed by disclosure. Nevertheless, as discussed below, the Agencies have greatly simplified the final rule.

.23 Allocation of excess payments

When an account has balances with different annual percentage rates, proposed § __.23(a) would have required institutions to allocate any amount paid by the consumer in excess of the required minimum periodic payment among the balances in a manner that is no less beneficial to consumers than one of three listed methods. First, proposed § __.23(a)(1) would have allowed an institution to apply the excess payment first to the balance with the highest annual percentage rate and any remaining portion to the balance with the next highest annual percentage rate and so forth. Second, proposed § __.23(a)(2) would have allowed an institution to allocate equal portions of the excess payment to each balance. Third, proposed § __.23(a)(3) would have allowed an institution to allocate the excess payment among the balances in the same proportion as each balance bears to the total balance (in other words, pro rata).

As discussed above, some consumer group commenters argued that – because the Board’s consumer testing indicates that disclosure does not enable consumers to understand the effects of payment allocation on interest charges – providing institutions with the ability to choose between different allocation methods would only make payment allocation more complex and the associated costs less transparent. Because this result would be contrary to the intended purpose of proposed § __.23, the final rule allows only two allocation methods for excess payments: applying the excess payment first to the balance with the highest annual percentage rate and any remaining amount to the other balances in descending order based on the applicable annual percentage rate; and allocating the excess payment pro rata.

Although consumer groups and others argued that the Agencies should require allocation to the highest rate balance first in all circumstances because this method would minimize interest charges, the Agencies believe that the final version of § __.23 strikes the appropriate balance between institutions and consumers. It prohibits institutions from using the allocation method that maximizes interest charges but does not require use of the method that minimizes interest charges. The Agencies expect that most institutions will use the pro rata method, which will standardize payment allocation practices and focus competition on more transparent costs of credit (such as interest rates). Although permitting a second allocation method creates the potential for increased complexity, the Agencies believe that the allocation of excess payments first to the highest rate balance should be permitted because, even if few institutions will do so, this method minimizes interest charges for consumers.

The Agencies have not included the proposed methods allowing allocation of equal portions of the excess payment to each balance and allowing institutions to allocate excess payments in a manner that is no less beneficial to the consumer than one of the listed methods in order to reduce complexity and promote transparency. In addition, because information received during the comment period indicates that, as a general matter, consumers have approximately 25 percent of their total balance at a discounted promotional rate,⁸³ it appears that the equal share method would generally be less beneficial to consumers than the pro rata method because – unless the account has four or more balances – the equal share method would apply more of the

⁸³ See Exhibit 7, Table 1c to Argus Analysis (column labeled “Overall”).

excess payment to the discounted promotional rate balance (and therefore less to balances with higher interest rates) than the pro rata method.⁸⁴ Finally, because an allocation method would have been no less beneficial to a consumer than a listed method only if it resulted in the same or lesser interest charges,⁸⁵ institutions were unlikely to take advantage of this option because it would require individualized determinations based on each consumer's balances and rates.

The Agencies note that several industry commenters argued that institutions should be permitted to allocate payments first to the oldest transactions on the account, which would often be transactions on which the institution is prohibited from increasing the annual percentage rate pursuant to proposed § __.24. These commenters stated that this method (which is sometimes referred to as "first in, first out" or "FIFO") would pay down those transactions faster, thereby reducing the burden to institutions of carrying balances at rates that no longer reflect market rates or the consumer's risk. However, the Agencies believe that concerns related to proposed § __.24 are better addressed through revisions to that proposal (as discussed below), rather than through payment allocation. In addition, permitting FIFO allocation would, in some circumstances, allow institutions to allocate excess payments first to the balance with the lowest rate. For example, if a consumer opened an account by transferring a balance in reliance on a discounted promotional rate, that balance would be the oldest balance on the account. Consequently, FIFO allocation could perpetuate the current practice of using payment allocation to maximize interest charges.

Although some industry commenters stated that their payment allocation systems could allocate excess payments pro rata or in equal portions, others stated that their systems could not and that they would be forced instead to allocate payments first to the balance with the highest interest rate. The Agencies note that neither the proposal nor the final rule require institutions to allocate first to the balance with the highest interest rate. Accordingly, if an institution's payment allocation system cannot currently allocate excess payments pro rata, the institution must make the determination whether to adjust that system or allocate to the highest rate balance first and forego the additional interest charges. As discussed below in § VII of this **SUPPLEMENTARY INFORMATION**, institutions will be provided with 18 months in which to adjust their systems.

The Agencies proposed commentary to clarify how proposed § __.23 would be applied. Proposed comment 23-1 clarified that § __.23 would not limit or otherwise address the institution's ability to determine the amount of the required minimum periodic payment or how that payment is allocated. Consumer groups urged the Agencies to apply proposed § __.23 to the entire payment. In contrast, one industry commenter stated that excluding the minimum payment was not helpful because such payments are kept small for competitive reasons. Another industry commenter urged the Agencies to remove the distinction between minimum and excess payments in order to reduce the rule's complexity.

The Agencies, however, believe that proposed § __.23 strikes the appropriate balance by providing institutions flexibility regarding the minimum amount consumers must pay while ensuring that, when consumers voluntarily pay more than the minimum, those payments are not

⁸⁴ The Agencies note that, according to the Argus Analysis, the pro rata method will result in a greater loss in annual interest revenue than the equal share method. See Exhibit 1, Table 3a to Argus Analysis (column labeled "New Payment Allocation Method," rows labeled "Proportional" and "Equal"). Thus, assuming this data is accurate, the pro rata method will result in lower interest charges for consumers than the equal share method.

⁸⁵ See proposed comment 23(a)-1, 73 FR at 28944.

allocated in a manner that maximizes interest charges.⁸⁶ In response to comments from institutions whose systems cannot distinguish between minimum and excess payments when allocating and comments objecting to the complexity created by the distinction, the Agencies clarify in comment 23-1 that institutions may apply the entire payment consistent with § __.23 (unless doing so would be inconsistent with applicable law and regulatory guidance). The Agencies have also clarified that the amount and allocation of the required minimum periodic payment must be determined consistent with applicable law and regulatory guidance. Otherwise, proposed comment 23-1 is adopted as proposed.

In order to simplify the allocation process and reduce the operational burden on institutions, proposed comment 23-2 permitted institutions to make small adjustments of one dollar or less when allocating payments. One industry commenter requested that institutions also be permitted to make adjustments equal to or less than one percent of the total balance. This is not, however, the type of small adjustment envisioned by the Agencies. For example, one percent of a \$5,000 balance would be \$50. Accordingly, comment 23-2 adopted as proposed.

Because proposed § __.23 would have required institutions to allocate payments based on the balances and annual percentage rates on the account, some industry commenters requested guidance regarding the point in time at which the various determinations required by proposed § __.23 would be made. For example, because transactions are commonly made between the close of a billing cycle and the date on which payment for that billing cycle is received, the balances on the account on the day the payment is applied will often be different than the balances on the periodic statement for the billing cycle. Similarly, the annual percentage rates may have changed in the interim. One industry commenter stated that payment allocation should be based on the balances and rates on the preceding periodic statement, while two other industry commenters stated that the balances and rates at the time the payment is credited should be used. The Agencies believe that, because the benefit to consumers of one approach or the other will depend on the consumer's individual circumstances, there is no need to require a particular approach. Accordingly, the Agencies adopt comment 23-3, which clarifies that an institution may allocate based on the balances and annual percentage rates on the date the preceding billing cycle ends (which will typically be the balances and rates reflected on the periodic statement), on the date the payment is credited to the account, or on any day in between those two dates.

Some commenters requested that the Agencies prohibit institutions from varying the allocation method on an account from billing cycle to billing cycle or from account to account, while others requested that this be expressly permitted. The Agencies are not prohibiting institutions from moving from one permissible allocation method to another or from using one permissible method on some accounts and a different permissible method on other accounts. Because, under the final rule, the only alternative to allocating pro rata is allocating to the highest rate balance first, the Agencies do not believe there is a significant danger that institutions will be able to manipulate the payment allocation process to their advantage by switching from one method to another. Accordingly, the Agencies adopt comment 23-4, which acknowledges that § __.23 does not restrict an institution's ability to shift between permissible allocation methods or to use different permissible allocation methods for different accounts.

⁸⁶ One commenter requested that proposed § __.23 be revised to permit excess payments to be allocated first to interest and fees. The Agencies do not believe such a change is necessary because, to the extent that an institution wishes to recover interest and fees, those amounts can (and often are) included in the required minimum periodic payment.

One industry commenter noted that the commentary to Regulation Z, 12 CFR 226.12(c) sets forth specific payment allocation requirements when a consumer asserts a claim or defense under that section that could be inconsistent with those in proposed § __.23. Because the payment allocation requirements in the commentary to § 226.12(c) are intended to prevent extinguishment of claims or defenses, the Agencies adopt comment 23-5, which clarifies that, when a consumer has made a claim or defense pursuant to 12 CFR 226.12(c), an institution must allocate payments consistent with 12 CFR 226.12 comment 226.12(c)-4, as adopted elsewhere in today's **Federal Register**.

An industry commenter requested clarification regarding allocation of payments when an account has multiple balances with the same annual percentage rate. As an initial matter, because § __.23 applies only "when different annual percentage rates apply to different balances on a consumer credit card account," this section does not apply if all balances in the account have the same rate. If, however, an account has multiple balances with the same annual percentage rate and another balance with a different rate, the benefit to the consumer of allocating between the balances with the same rate in a particular manner will depend on the circumstances and the allocation method chosen by the institution. Accordingly, the Agencies have adopted comment 23-6, which clarifies that, in these circumstances, the institution may allocate between balances with the same rate in the manner that the institution determines is appropriate. This comment also clarifies that institutions may treat balances with the same annual percentage rate as separate balances or as a single balance.

The Agencies have also revised the proposed commentary and adopted new commentary in response to comments regarding specific allocation methods.⁸⁷ Proposed comment 23(a)(1)-1 provided examples of allocating excess payments to the highest rate balance first. In response to requests from commenters, the Agencies have added examples illustrating application of this method to accounts with balances on which the annual percentage rate cannot be increased pursuant to § __.24 and accounts with multiple balances at the same rate and at least one balance at a different rate. Otherwise, this comment is redesignated as comment 23(a)-1 and adopted as proposed.

With respect to pro rata allocation, some industry commenters requested guidance on how the total balance should be determined. They suggested that amounts paid by the required minimum periodic payment should be included in the total balance because excluding such amounts would be operationally burdensome insofar as it would require institutions to allocate the minimum payment and then recalculate each balance for purposes of allocating pro rata. The Agencies agree that the suggested clarification will reduce burden and assist institutions in allocating payments consistent with § __.23(b). Accordingly, the Agencies have adopted comment 23(b)-1 clarifying that an institution may, but is not required to, deduct amounts paid by the consumer's required minimum periodic payment when calculating the total balance for purposes of § __.23(b). An illustrative example is provided in comment 23(b)-2.iii.

In the May 2008 Proposal, proposed comment 23(a)(3)-1 provided an example of allocating excess payments pro rata among the balances. This comment is redesignated as

⁸⁷ Because the final rule does not permit institutions to use a payment allocation method that is no less beneficial to consumers than one of the listed methods, the Agencies have omitted proposed comments 23(a)-1 and -2, which clarified the meaning of this aspect of the proposal. Similarly, because the final rule does not permit institutions to allocate equal portions of the excess payment to each balance, the Agencies have omitted proposed comment 23(a)(2)-1, which provided examples of that allocation method.

comment 23(b)-2 for organizational reasons and generally adopted as proposed. In response to requests from commenters, however, the Agencies have added examples illustrating application of this method to accounts with balances on which the annual percentage rate cannot be increased pursuant to § __.24 and, as noted above, the different methods of calculating the total balance consistent with comment 23(b)-1.

Proposed __.23(b) Special rules for accounts with promotional rate balances or deferred interest balances

As proposed, § __.23(b) contained special rules for accounts with promotional rate and deferred interest balances that were intended to ensure that consumers received the full benefit of the promotional rate or deferred interest plan. Proposed § __.23(b)(1)(i) would have required that excess payments be allocated to promotional rate balances or deferred interest balances only after all other balances had been paid in full. Because, however, the Agencies were concerned that consumers may want to pay off deferred interest balances shortly before the deferred interest period expired, proposed § __.23(b)(1)(ii) would have permitted the existing practice by some institutions of allocating the entire payment first to the deferred interest balance in the last two months of the deferred interest period. Finally, proposed § __.23(b)(2) would have prohibited institutions from requiring consumers who are otherwise eligible for a grace period to repay any portion of a promotional rate balance or deferred interest balance in order to receive the benefit of a grace period on other balances (such as purchases).

Proposed § __.23(b) was strongly opposed by industry commenters on the grounds that, if implemented, it would significantly diminish interest revenue, leading institutions to significantly reduce or eliminate promotional rate and deferred interest offers that provide substantial benefits to consumers. Many of these commenters requested that proposed § __.23(b) be withdrawn and that institutions instead be permitted to apply excess payments first to promotional rate and deferred interest balances. Some industry commenters, however, requested that the general rule in proposed § __.23(a) be applied to all balances. In contrast, some consumer advocates urged the Agencies to ban deferred interest balances rather than create an exception for them.

As an initial matter, the Agencies have not included the special rules regarding deferred interest balances. As discussed below with respect to the § __.24, the final rule does not permit institutions to charge interest retroactively and thus does not permit deferred interest plans.

With respect to promotional rates, the Argus Analysis indicates that 16-19 percent of active accounts have one or more promotional rate balances and that the average promotional rate on those balances is between two and three percent, which is approximately 13 percentage points lower than the average non-promotional rate.⁸⁸ Furthermore, when the rates were weighted to account for the proportion of the total balance that was at a promotional rate, the effective annual percentage rate for these accounts was approximately 5.5 percent or roughly ten percentage points lower than the average rate for non-promotional balances.⁸⁹ Assuming this information is accurate, it appears that discounted promotional rates offer significant benefits to many consumers.

⁸⁸ See Exhibit 7, Tables 1b and 2 to Argus Analysis.

⁸⁹ See *id.*

Notwithstanding these benefits, the Agencies continue to believe that, as suggested by other commenters, allocating payments to promotional rate balances before other balances with higher interest rates significantly diminishes the value of promotional rate offers. Furthermore, although the Agencies believe that proposed § __.23 would have had a negative impact on the availability of promotional rates, the commenters provided little data regarding the extent of that impact. Thus, the Agencies believe that application of the general payment allocation rule in § __.23 to promotional rate balances is appropriate. Application of this rule to all balances will limit the extent to which institutions may reduce promotional rate offers while ensuring that payment allocation is not used to significantly undercut the benefits to consumers who act in reliance on such offers. Accordingly, the Agencies have not included proposed § __.23(b)(1)(i) in the final rule. To the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

The Agencies have also omitted proposed § __.23(b)(2), which would have prohibited institutions from denying a grace period solely because a consumer did not repay a promotional rate or deferred interest balance. This proposal was strongly criticized by industry as operationally burdensome and punitive for institutions that voluntarily provide a grace period on purchases. Proposed § __.23(b)(2) was intended to act in combination with proposed § __.23(b)(1)(i) to ensure that consumers receive the full benefit of promotional rate and deferred interest offers. Because the Agencies have concluded that a different approach is appropriate, the Agencies have not included proposed § __.23(b)(2) in the final rule. To the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

Other Issues

Implementation. As discussed in § VII of this **SUPPLEMENTARY INFORMATION**, the effective date for § __.23 is July 1, 2010. As of that date, this provision applies to existing as well as new consumer credit card accounts and balances. Thus, institutions must apply amounts paid by the consumer in excess of the required minimum periodic payment that the institution receives after the effective date consistent with § __.23.

Alternative to proposed rule. The Agencies requested comment on whether consumers should be permitted to instruct the institution regarding allocation of amounts in excess of the required minimum periodic payment. The response was mixed. Some consumer groups supported creating an exception to proposed § __.23 allowing consumers to select how their excess payments would be allocated, while others expressed concern that such an exception would be ineffective and subject to abuse because disclosures do not enable consumers to understand payment allocation. Similarly, institutions that currently allow consumers to select how their payments are allocated requested that they be permitted to continue doing so, while most industry commenters opposed any provision that would require them to allocate consistent with consumer choice as operationally burdensome.

In consumer testing prior to the May 2008 Proposal, the Board tested whether, given the opportunity, consumers could select how amounts paid in excess of the minimum would be allocated using the payment coupon. Most participants, however, were not able to understand the effects of payment allocation sufficiently to apply payments in a manner that minimized interest charges. Additional testing conducted by the Board after the May 2008 Proposal

produced similar results. Accordingly, because it does not appear that consumer choice would be effective, the Agencies have not included such an exception in the final rule.

Supplemental Legal Basis for This Section of the OTS Final Rule

As discussed above, HOLA provides authority for both safety and soundness and consumer protection regulations. Section 535.23 supports safety and soundness by reducing reputational risk that would result from allocating consumers' payments in an unfair manner. Section 535.23 also protects consumers by providing them with fair allocations of their payments. When a creditor treats a consumer credit card account as having separate balances with separate interest rates and terms, it is essentially treating the card as having separate debts even though the consumer makes only one payment. Were the separate balances actually separate debts being collected by a debt collector, the consumer would have the right under section 810 of the Fair Debt Collection Practices Act (15 U.S.C. 1692h) to have payments applied in accordance with the consumer's directions. As discussed above, that approach did not test well for consumer credit card accounts with multiple balances, and the Agencies are not imposing the same requirement under § __.23. However, ensuring that the consumer's payment will be applied to the highest rate balance first or pro rata will be an important protection for consumers. Consequently, HOLA serves as an independent basis for § 535.23.

Section __.24—Unfair Acts or Practices Regarding Increases in Annual Percentage Rates

Summary. In May 2008, the Agencies proposed to prohibit the application of increased rates to outstanding balances, except in certain limited circumstances. See 73 FR 28917-28921. Specifically, proposed § __.24(a)(1) would have prohibited the application of an increased annual percentage rate to an outstanding balance on a consumer credit card account, except as provided in proposed § __.24(b). Proposed § __.24(a)(2) would have defined "outstanding balance" as the amount owed on an account at the end of the fourteenth day after the institution provides the notice required by Regulation Z, 12 CFR 226.9(c) or (g). Proposed § __.24(b) would have permitted institutions to increase the rate on an outstanding balance due to an increase in an index, when a promotional rate expired or was lost, or when the account became more than 30 days' delinquent. Finally, proposed § __.24(c) would have prohibited institutions from engaging in certain practices that would undercut the protections in proposed § __.24(a). Under proposed § __.24(c)(1), institutions would have been prohibited from requiring consumers to repay the outstanding balance over a period of less than 5 years or from more than doubling the repayment rate on the outstanding balance. Proposed § __.24(c)(2) would also have prohibited institutions from assessing fees or charges based solely on the outstanding balance (for example, assessing a maintenance fee in lieu of increased interest charges).

Based on the comments received and further analysis, the Agencies have revised proposed § __.24(a) to prohibit institutions from increasing the annual percentage rate for a category of transactions on any consumer credit card account unless specifically permitted by one of the exceptions in § __.24(b). The final rule also requires institutions to disclose at account opening all rates that will apply to each category of transactions on the account. Because consumers rely on the rates stated by the institution when deciding whether to open a credit card account and whether to use the account for transactions, these requirements are intended to ensure that consumers are protected from unfair surprise.

The Agencies have also revised the exceptions in proposed § __.24(b). First, the Agencies have adopted a new § __.24(b)(1), which permits an institution that has disclosed at

account opening that an annual percentage rate will increase at a specified time to a specified amount to increase that rate accordingly. Second, the Agencies have adopted the proposed exception for variable rates as § __.24(b)(2). Third, the Agencies have adopted a new § __.24(b)(3), which permits institutions to increase rates for new transactions pursuant to the 45-day advance notice requirement in 12 CFR 226.9 (adopted by the Board elsewhere in today's **Federal Register**), although this exception does not apply during the first year after account opening. Fourth, to allow institutions to adjust rates in response to serious delinquencies, the Agencies have adopted the proposed exception allowing repricing when an account becomes more than 30 days' delinquent as § __.24(b)(4). Fifth, to avoid discouraging workout arrangements that decrease rates for consumers in default if the consumer abides by certain conditions (for example, making payment on time each month), § __.24(b)(5) has been added allowing a decreased rate to be returned to the pre-existing rate if the consumer fails to abide by the conditions of the workout arrangement. Finally, the Agencies have adopted the repayment provisions in proposed § __.24(c) with some stylistic changes.

Background. Prior to the Regulation Z amendments published elsewhere in today's **Federal Register**, 12 CFR 226.9(c) required 15 days' advance notice of certain changes to the terms of an open-end plan as well as increases in the minimum payment. However, advance notice was not required if an interest rate or other finance charge increased due to a consumer's default or delinquency.⁹⁰ Furthermore, no change-in-terms notice was required if the creditor set forth the specific change in the account-opening disclosures.⁹¹

In its June 2007 Regulation Z Proposal, the Board expressed concern that the imposition of penalty pricing can come as a costly surprise to consumers who are not aware of, or do not understand, what behavior is considered a "default" under their agreement. See 72 FR at 33009–33013. The Board noted that penalty rates can be more than twice as much as the consumer's normal rate on purchases and may apply to all of the balances on the consumer's account for several months or longer.⁹²

Consumer testing conducted for the Board indicated that interest rates are a primary consideration for consumers when shopping for credit card accounts but that some consumers do not understand that events such as one late payment can cause them to lose the advertised rate and incur penalty pricing. In addition, some testing participants did not appear to understand that penalty rates can apply to all of their balances, including outstanding balances. Some participants also did not appear to understand how long a penalty rate could remain in effect. The Board observed that account-opening disclosures may be provided to the consumer too far in advance for the consumer to recall the circumstances that may cause rates to increase. In addition, the consumer may not have retained a copy of the account-opening disclosures and may not be able to effectively link the information disclosed at account opening to the current repricing of the account.

⁹⁰ See prior versions of 12 CFR 226.9(c)(1); 12 CFR 226.9 comment 226.9(c)(1)–3.

⁹¹ See prior version of 12 CFR 226.9 comment 226.9(c)–1.

⁹² See also GAO Credit Card Report at 24 (noting that, for the 28 credit cards it reviewed, "[t]he default rates were generally much higher than rates that otherwise applied to purchases, cash advances, or balance transfers. For example, the average default rate across the 28 cards was 27.3 percent in 2005—up from the average of 23.8 in 2003—with as many as 7 cards charging rates over 30 percent").

The Board's June 2007 Regulation Z Proposal included revisions to the regulation and its commentary designed to improve consumers' awareness about changes in their account terms and increased rates, including rate increases imposed as a penalty for delinquency or other acts or omissions constituting default under the account agreement. These revisions were also intended to enhance consumers' ability to shop for alternative financing before such changes in terms or increased rates become effective. Specifically, the Board proposed to give consumers 45 days' advance notice of a change in terms or an increased rate imposed as a penalty and to make the disclosures about changes in terms and increased rates more effective.⁹³ The Board also proposed to require that periodic statements for credit card accounts disclose the annual percentage rate or rates that may be imposed as a result of late payment.⁹⁴

When developing the June 2007 Regulation Z Proposal, the Board considered, but did not propose, a prohibition on so-called "universal default clauses" or similar practices under which a creditor raises a consumer's interest rate to the penalty rate if, for example, the consumer makes a late payment on an account with a different creditor. The Board also considered but did not propose a requirement similar to that in some state laws providing consumers with the right to reject a change in terms if the consumer agrees to close the account.

In response to its June 2007 Regulation Z Proposal, individual consumers, consumer groups, another federal banking agency, and a member of Congress stated that notice alone was not sufficient to protect consumers from the harm caused by rate increases. These commenters argued that many consumers would not read or understand the proposed disclosures and, even if they did, many would be unable to transfer the balance to a new credit card account with comparable terms before the increased rate went into effect. Some of these commenters argued that creditors should be prohibited from increasing the rate on an outstanding balance in all instances. Others argued that consumers should be given the right to reject application of an increased rate to an outstanding balance by closing the account, but only if the increase was not triggered by a late payment or other violation of the terms of that account. This approach was also endorsed by some credit card issuers. On the other hand, most industry commenters stated that the 45-day notice requirement would delay issuers from increasing rates to reflect a consumer's increased risk of default, requiring them to account for that risk by, for example, charging higher annual percentage rates at the outset of the account relationship. These commenters also noted that, because rate increases are also used to pass on the cost of funds issuers themselves pay, delays in the imposition of increased rates could result in higher costs of credit or less available credit.

In the May 2008 Proposal, the Agencies expressed concern that disclosure alone may be insufficient to protect consumers from the harm caused by the application of increased rates to outstanding balances. Accordingly, the Agencies proposed § __.24, which would have prohibited this practice except in certain limited circumstances. This aspect of the proposal received strong support from individual consumers, consumer groups, members of Congress, the FDIC, two state attorneys general, and a state consumer protection agency. Many of these commenters urged the Agencies to go further, by eliminating all but the exception for variable rates and by applying the prohibition to rate increases on future transactions. In contrast,

⁹³ See proposed 12 CFR 226.9(c), (g), 72 FR at 33056–33058, 73 FR at 28891. Elsewhere in today's **Federal Register**, the Board has adopted a revised version of this proposal.

⁹⁴ See proposed 12 CFR 226.7(b)(11)(i)(C), 72 FR at 33053. Elsewhere in today's **Federal Register**, the Board has adopted a revised version of this proposal.

however, the proposal received strong opposition from credit card issuers, industry groups, and the OCC. These commenters generally argued that the proposed restrictions undermined institutions' ability to price according to current market conditions and the risk presented by the consumer and would therefore result in higher costs of credit or reduced credit availability for all consumers. They requested that the Agencies adopt additional exceptions to the proposed rule, take a different approach (such as requiring consumers to opt out of rate increases), or withdraw the proposal entirely. To the extent that commenters addressed specific aspects of the proposal or its supporting legal analysis, those comments are discussed below.

Legal Analysis

The Agencies conclude that, except in certain limited circumstances, increasing the annual percentage rate applicable to an outstanding balance on a consumer credit card account is an unfair practice under 15 U.S.C. 45(n) and the standards articulated by the FTC. In addition, based on these standards, the Agencies conclude that it is also an unfair practice to increase an annual percentage rate that applies to a consumer credit card account during the first year after account opening (except in certain limited circumstances).

Substantial consumer injury. In May 2008, the Agencies stated that application of an increased annual percentage rate to an outstanding balance appeared to cause substantial monetary injury by increasing the interest charges assessed to a consumer's credit card account. Commenters who opposed the proposed rule did not dispute that such increases result in additional interest charges. Indeed, the Argus Analysis indicated that consumers are charged more than \$11 billion in interest annually as a result of the practices addressed by proposed § __.24.⁹⁵

Some industry commenters stated that only a minority of accounts are repriced each year and that even consumers who have violated the account terms by, for example, paying late are, as a general matter, not repriced. This does not, however, alter the fact that consumers who are repriced incur substantial monetary injury.

Some industry commenters argued that, to the extent the increased rate reflects the prevailing market rate for consumers with the same risk profile and other relevant characteristics, it cannot constitute an injury under the FTC Act. These commenters did not provide – nor are the Agencies aware of – any legal authority supporting the proposition that increasing the cost of credit is not an injury under the FTC Act so long as the increased rate does not exceed the market rate.

For all of these reasons, the Agencies conclude that applying an increased annual percentage rate to an outstanding balance causes substantial consumer injury. The Agencies further conclude that consumers who rely on advertised interest rates when deciding to open and use a credit card account experience substantial injury in the form of the increased cost of new transactions when rates are increased during the first year after account opening.⁹⁶ In addition, the account loses some of its value because the cost of financing transactions is higher than anticipated when the consumer decided to open the account.

⁹⁵ See Exhibit 1, Table 1 to Argus Analysis (estimated annualized interest lost for rows labeled “30+DPD Penalty Trigger,” “CIT Repricing,” and “Non 30+ DPD Penalty Triggers”). The Argus Analysis indicates that some portion of this total is attributable to the requirement in Regulation Z, 12 CFR 226.9, that creditors provide 45 days' advance notice of most rate increases.

⁹⁶ For this reason, consumers must be informed at account opening of the rates that will apply to each category of transactions on the account.

Injury is not reasonably avoidable. In May 2008, the Agencies stated that, although the injury resulting from increases in the annual percentage rate may be avoidable by some consumers under certain circumstances, this injury did not appear to be reasonably avoidable as a general matter because consumers appeared to lack control over many of the circumstances in which institutions increase rates. The Agencies grouped these circumstances into four categories: circumstances that are completely unrelated to the consumer's behavior (for example, changes in market conditions); consumer behavior that is unrelated to the account on which the rate is increased (for example, so-called "universal defaults"); consumer behavior that is related to the account in question but does not violate the terms of that account (for example, using most but not all of the credit limit); and consumer behavior that violates the terms of the account (for example, late payment or exceeding the credit limit). As discussed below, based on the comments and further analysis, the Agencies conclude that consumers cannot, as a general matter, reasonably avoid rate increases on outstanding balances.

First, an institution may increase a rate for reasons that are completely unrelated to the consumer's behavior. For instance, an institution may increase rates to increase revenues or to respond to changes in the cost to the institution of borrowing funds. In May 2008, the Agencies observed that consumers lack any control over these increases and cannot be reasonably expected to predict when such repricings will occur because many institutions reserve the right to change the terms of the consumer's account at any time and for any reason. Accordingly, the Agencies concluded that consumers appeared to be unable to reasonably avoid injury in these circumstances.

Some industry commenters responded that consumers can reasonably avoid injury by transferring the balance to another credit card account, particularly if the consumer receives the 45 days' advance notice required by proposed 12 CFR 226.9. These commenters acknowledged, however, that many consumers will be unable to find another credit card account with a rate comparable to the pre-increase rate. Furthermore, even if a comparable rate could be found, the transfer may carry a cost because many institutions charge a flat fee for transferring a balance or a fee equal to a percentage of the transferred balance. Accordingly, the Agencies conclude that consumers cannot reasonably avoid the injury caused by rate increases on outstanding balances for reasons that are unrelated to their behavior.

Second, an institution may increase an annual percentage rate on a consumer credit card account based on behavior that is unrelated to the consumer's performance on that account. This is sometimes referred to as "off-account" behavior or "universal default." For example, an institution may increase a rate due to a drop in a consumer's credit score or a default on an account with a different creditor even though the consumer has paid the credit card account with the institution according to the terms of the cardholder agreement.⁹⁷ The consumer may or may not have been aware of or able to control the factor that caused the drop in credit score, and the consumer cannot control what factors are considered or how those factors are weighted in creating the credit score. For example, a consumer is not likely to be aware that using a certain amount of the available credit on open-end credit accounts can lead to a reduction in credit score. Moreover, even if a consumer were aware that the utilization of available credit can affect a credit score, the consumer could not control how the institution uses credit scores or other

⁹⁷ See, e.g., Statement of Janet Hard before S. Perm. Subcomm. on Investigations, Hearing on Credit Card Practices: Unfair Interest Rate Increases (Dec. 4, 2007) (available at <http://www.senate.gov/~govt-aff/index.cfm?Fuseaction=Hearings.Detail&HearingID=509>).

information to set interest rates.⁹⁸ Furthermore, as discussed below, a late payment or default on a different account (or the account in question) will not be reasonably avoidable in some instances.

One industry commenter stated that a consumer has a right under the Fair Credit Reporting Act (FCRA) to dispute any inaccurate information that causes a drop in credit score.⁹⁹ This right, however, does not assist consumers whose credit scores decrease due to information that accurately reflects events that were nevertheless unavoidable by the consumer. Furthermore, even when the drop in credit score was caused by inaccurate information, the right to dispute that information comes too late to enable the consumer to avoid the harm caused by an increase in rate on an outstanding balance. Accordingly, the Agencies conclude that, as a general matter, consumers cannot reasonably avoid the injury caused by rate increases on outstanding balances that are based on a drop in credit score or on behavior that is unrelated to the consumer's performance on the account in question.

Third, some institutions increase annual percentage rates on consumer credit card accounts based on consumer behavior that is related to the account but does not violate the account terms. For example, an institution may increase the annual percentage rates of consumers who are close to (but not over) the credit limit on the account or who make only the required minimum periodic payment set by the institution for several consecutive months.¹⁰⁰ Although in some cases this type of activity may be within the consumer's control, the consumer cannot reasonably avoid the resulting injury because the consumer is not aware that this behavior may be used by the institution's internal risk models as a basis for increasing the rate on the account. Indeed, a consumer could reasonably interpret an institution's provision of a specific credit limit, minimum payment, or other account term as an implicit representation that the consumer will not be penalized if the credit limit is not exceeded, the minimum payment is made, or the consumer otherwise complies with the terms of the account. Accordingly, the Agencies conclude that consumers cannot reasonably avoid the injury caused rate increases based on behavior that does not violate the account terms.

Fourth, institutions increase annual percentage rates based on consumer behavior that violates the account terms. Although what violates the account terms can vary from institution to institution and from account to account, the most common violations that result in an increase in rate are exceeding the credit limit, a payment that is returned for insufficient funds, and a late payment.¹⁰¹ In the May 2008 Proposal, the Agencies stated that, in some cases, it appeared that individual consumers could avoid these events by taking reasonable precautions. In other cases, however, it appeared that the event was not reasonably avoidable. For example, consumers who carefully track their transactions are less likely to exceed their credit limit than those who do not,

⁹⁸ Indeed, several credit card issuers stated in their comments that, rather than relying solely on credit scores to increase rates, they use proprietary underwriting systems that examine a wide range of criteria. Because those criteria are not available to the public, consumers cannot be reasonably expected to know what behavior will cause their issuer to increase the rate on their account.

⁹⁹ See 15 U.S.C. 1681i.

¹⁰⁰ See, e.g., Statement of Bruce Hammonds, President, Bank of America Card Services before S. Perm. Subcomm. on Investigations, Hearing on Credit Card Practices: Unfair Interest Rate Increases at 5 (Dec. 4, 2007) (available at http://hsgac.senate.gov/public/_files/STMTHammondsBOA.pdf).

¹⁰¹ See GAO Credit Card Report at 25.

but these consumers may still exceed the limit due to charges of which they were unaware (such as the institution's imposition of interest or fees) or because of the institution's delay in replenishing the credit limit following payment. Similarly, although consumers can reduce the risk of making a payment that will be returned for insufficient funds by carefully tracking the credits and debits on their deposit account, consumers still lack sufficient information about key aspects on their accounts, including when funds from a deposit or a credit will be made available by the depository institution.¹⁰² Finally, the Agencies noted that, although proposed § __.22 would ensure that a consumer's payment would not be treated as late for any reason (including for purposes of triggering an increase in rate) unless the consumer received a reasonable amount of time to make that payment, consumers may nevertheless pay late for reasons that are not reasonably avoidable. As support, the Agencies cited the FTC's conclusion with respect to its Credit Practices Rule that the majority of defaults are not reasonably avoidable by consumers as well as studies, reports, and other evidence indicating that involuntary factors such as unemployment play a large role in delinquency.¹⁰³

In response, some industry commenters asserted that, because most consumers pay on time and do not otherwise violate the account terms, these behaviors must be reasonably avoidable. As an initial matter, although the information available is limited, it appears that a significant number of consumers are penalized for violating the account terms.¹⁰⁴ Furthermore, the fact that a particular behavior may be relatively infrequent does not necessarily make it reasonably avoidable.¹⁰⁵

Another commenter cited as evidence that late payment is reasonably avoidable a study finding that a consumer is 44 percent less likely to pay a late fee in the current month if that

¹⁰² See also 73 FR at 28927-28933 (discussing unfairness concerns regarding overdraft services and debit holds).

¹⁰³ See Statement for FTC Credit Practices Rule, 49 FR at 7747-48 (finding that "the majority [of defaults] are not reasonably avoidable by consumers" because of factors such as loss of income or illness); Testimony of Gregory Baer, Deputy General Counsel, Bank of America before the H. Fin. Servs. Subcomm. on Fin. Instit. & Consumer Credit at 4 (Mar. 13, 2008) ("If a customer falls behind on an account, our experience tells us it is likely due to circumstances outside his or her control."); Sumit Agarwal & Chunlin Liu, Determinants of Credit Card Delinquency and Bankruptcy: Macroeconomic Factors, 27 J. of Econ. & Finance 75, 83 (2003) (finding "conclusive evidence that unemployment is critical in determining delinquency"); Fitch: U.S. Credit Card & Auto ABS Would Withstand Sizeable Unemployment Stress, Reuters (Mar. 24, 2008) ("According to analysis performed by Fitch, increases in the unemployment rate are expected to cause auto loan and credit card loss rates to increase proportionally with subprime assets experiencing the highest proportional rate.") (available at <http://www.reuters.com/article/pressRelease/idUS94254+24-Mar-2008+BW20080324>).

¹⁰⁴ See GAO Report at 32-33 (finding that, in 2005, 11% of active accounts were being assessed a penalty interest rate, 35% had been assessed a late fee, and 13% had been assessed a fee for exceeding the credit limit); Exhibit 6, Tables 1a to Argus Analysis (stating that a total of 15.6% of accounts were repriced as a penalty from March 2007 through February 2008). One credit card issuer cited data showing that its consumers tend to make payments close to the due date, which – it argued – indicates that consumers are able to reasonably avoid late payment. This same data, however, indicated that a significant number of payments are received after the due date.

¹⁰⁵ Some industry commenters noted that the Board's consumer testing indicated that consumers have a general understanding that their rate would change if they violated the account terms by, for example, paying late. This does not, however, mean that consumers can, as a general matter, reasonably avoid such violations.

consumer paid a late fee the prior month.¹⁰⁶ While this study indicates that consecutive late payments are less likely to be accidental, it does not indicate that the initial late payment (which currently may trigger a rate increase) is reasonably avoidable.

Accordingly, the Agencies conclude that, as a general matter, the injury caused by rate increases on outstanding balances due to a violation of the account terms is not reasonably avoidable. For all of the reasons discussed above, the Agencies further conclude that, although the injury resulting from the application of increased annual percentage rates to outstanding balances is avoidable in some individual cases, this injury is not reasonably avoidable by consumers as a general matter.¹⁰⁷

For these same reasons, the Agencies also conclude that the injury caused by rate increases during the first year after account opening is not, as a general matter, reasonably avoidable, particularly if consumers are not informed at account opening of the rates that will apply to the account. A consumer will receive 45 days' advance notice of such increases pursuant to the Board's revisions to 12 CFR 226.9 (adopted elsewhere in today's **Federal Register**) but, as discussed above, many consumers will be unable to find another credit card account with a rate comparable to the pre-increase rate. Thus, although some consumers may be able to avoid injury by using a different credit card account for transactions or ceasing to use credit cards entirely, consumers who open an account to finance important purchases (such as medical services or home or automotive repairs) and cannot obtain credit at the same or a better rate elsewhere cannot reasonably avoid injury. Furthermore, to the extent that consumers are injured because the rate increase caused the account to lose value as a means of financing transactions, this injury is not reasonably avoidable because, as discussed above, rate increases are not, as a general matter, reasonably avoidable.

Injury is not outweighed by countervailing benefits. In May 2008, the Agencies stated that, although proposed § __.24 could result in increased costs or reduced credit availability for consumers generally, these costs did not appear to outweigh the substantial benefits to consumers of avoiding significant unanticipated increases in the cost of completed transactions. As discussed below, based on the comments received and further analysis, the Agencies have revised aspects of proposed § __.24 in order to ensure that the final rule creates benefits for consumers that exceed any associated costs. In light of these revisions, the Agencies conclude that, to the extent prohibited by § __.24, increases in the annual percentage rate do not produce benefits for consumers or competition that outweigh the injury.

¹⁰⁶ See Sumit Agarwal *et al.*, Stimulus and Response: The Path from Naivete to Sophistication in the Credit Card Market (Aug. 20, 2006) (available at <http://www.iue.it/FinConsEU/ResearchActivities/BehavioralApproachesMay2007/Driscoll.pdf>).

¹⁰⁷ Some commenters argued that the Board's existing or proposed Regulation Z disclosures or state laws allowing consumers to opt out of rate increases by closing the account enable consumers to reasonably avoid injury. These arguments are addressed below in the Agencies' discussion of public policy. In particular, the Agencies note that disclosure will not enable consumers to select a credit card that does not reprice because institutions almost uniformly reserve the right to increase rates at any time and for any reason. See Statement for FTC Credit Practices Rule, 48 FR at 7746. In addition, some commenters criticized the May 2008 Proposal for failing to explain why injury was reasonably avoidable for each of the proposed exceptions in proposed § __.24(b). As discussed below, the exceptions in § __.24(b) are not based on a conclusion that the injury is reasonably avoidable as a general matter but instead on a determination that allowing repricing in those circumstances ensures that the costs of prohibiting rate increases on outstanding balances do not outweigh the benefits.

In response to the May 2008 Proposal, individual consumers, consumer groups, and some members of Congress argued that repricing is inherently unfair and should be prohibited in most if not all circumstances. In contrast, industry commenters generally argued that flexible pricing models that respond to changes in the consumer's risk of default have produced substantial benefits for consumers and competition that outweigh any injury. These commenters noted that, whereas institutions once charged a single rate of around 20 percent on all credit card accounts regardless of the risk presented by the consumer, institutions now vary the interest rate based on the consumer's risk profile with the result that the great majority of consumers receive rates below 20 percent.¹⁰⁸

The exceptions in proposed § __.24(b) permitted three types of repricing that appeared to produce benefits for consumers and competition that outweighed the injury. These exceptions were designed to provide institutions with flexibility in the repricing of outstanding balances while protecting consumers from unfair surprise. Based on the comments and further analysis, the Agencies have modified these exceptions as well as the general rule. As discussed below, the Agencies believe that the final rule achieves the appropriate balance between providing consumers with increased certainty and transparency regarding the cost of credit and providing institutions with sufficient flexibility to adjust to market conditions and allocate risk efficiently.

1. Increases in the rate that applies to new transactions

Individual consumers, consumer groups, members of Congress, and the FDIC urged the Agencies to apply the proposed restrictions on the repricing of outstanding balances to increases in the rates that apply to future transactions. Some argued that consumers who have opened an account in reliance on the rates stated by the institution should be protected from unexpected increases in those rates for a specified period of time.

As discussed above, the Agencies agree that rate increases during the first year after account opening can cause substantial injury that is not, as a general matter, reasonably avoidable by consumers. In addition, because the Board's consumer testing indicates that interest rates are a primary focus for consumers when reviewing credit card applications and solicitations, the Agencies believe that allowing unlimited rate increases during the first year would be contrary to the purpose of § __.24, which is to prevent surprise increases in the cost of credit. Indeed, as noted below with respect to promotional rates, allowing this type of repricing while restricting others would create an incentive for institutions to offer artificially low interest rates to attract new customers based on the expectation that future repricings will generate sufficient revenues, a practice which distorts competition and undermines consumers' ability to evaluate the true cost of using credit. Accordingly, because consumers who open an account should be able to rely on the interest rate (or rates) stated by the institution, the Agencies have revised § __.24 to prohibit, as a general matter, rate increases during the first year after account opening.

This prohibition, however, is not absolute. The exception in § __.24(b)(1) permits an institution to increase any annual percentage rate disclosed at account opening so long as the institution also disclosed a period of time after which the rate will increase and the increased rate that will apply. In addition, a variable rate may be increased due to an increase in the index pursuant to § __.24(b)(2). Furthermore, after the first year, § __.24(b)(3) permits an institution

¹⁰⁸ Many of these commenters relied on the GAO Credit Card Report, which states that data reported by six top issuers indicated that, in 2005, about 80% of active accounts were assessed rates of less than 20% (with more than 40% receiving rates of 15% or less). See GAO Credit Card Report at 5. However, as noted by consumer groups, this data also indicated that approximately 11% of active accounts were charged rates over 25%. See *id.* at 32.

to increase the rates that apply to new transactions, provided the institution complies with Regulation Z's 45-day advance notice requirement. Finally, § __.24(b)(4) permits an institution to increase rates when the account becomes more than 30 days' delinquent.

The Agencies acknowledge that these additional restrictions will reduce interest revenue and therefore have some effect on the cost and availability of credit. Industry commenters, however, generally stated that the amount of interest revenue generated from raising rates on future transactions was relatively small in comparison to the revenue generated from applying increased rates to outstanding balances. Therefore, the Agencies believe that the effect of restricting rate increases during the first year after account opening will be significantly less than that for restricting rate increases on outstanding balances. Accordingly, the Agencies conclude that repricing during the first year after account opening does not produce benefits for consumers or competition that outweigh the injury to consumers.

By requiring institutions to commit in advance to the rates that will ultimately apply to transactions and to disclose those rates to consumers, the final rule will also prevent institutions from relying on the ability to reprice outstanding balances when setting upfront rates, thereby creating additional incentives for institutions to ensure that the rates offered to consumers at the outset fully reflect the risk presented by the consumer as well as current and anticipated market conditions.

2. Variable rates

The proposed rule provided that the prohibition on applying an increased annual percentage rate to an outstanding balance would not extend to variable rates. This exception was intended to allow institutions to adjust to increases in the cost of funds by utilizing a variable rate that reflects market conditions because, if institutions were not permitted to do so, they would be less willing to extend open-end credit. The Agencies reasoned that, although the injury caused by application of an increased variable rate to an outstanding balance is not reasonably avoidable insofar as the increase is due to market conditions that are beyond the consumer's ability to predict or control, the proposed exception would protect consumers from arbitrary rate increases by requiring that the index for the variable rate be outside the institution's control and available to the general public. This exception was supported by most commenters. Accordingly, because allowing institutions to utilize variable rates provides countervailing benefits sufficient to outweigh the increased interest charges, the Agencies have adopted the proposed exception for variable rates as § __.24(b)(2) with some stylistic changes.

3. Non-variable rates

Industry commenters urged the Agencies to revise proposed § __.24 to provide greater flexibility to offer rates that do not vary with an index. Without such an exception, they argued, concerns regarding increases in the cost of funds would force institutions to offer only variable rates, depriving consumers of the reliability of rates that do not fluctuate with the market. Some of these commenters requested that proposed § __.24 be revised to allow repricing of outstanding balances at the end of a specified period (such as six months, one year, or two years).

The Agencies agree that non-variable rates can provide significant benefits to consumers but only if consumers are informed before opening an account or engaging in transactions how long the rate will apply and what rate will be applied thereafter. Accordingly, the final rule provides two ways for institutions to offer non-variable rates. First, at account opening, § __.24(b)(1) permits institutions to offer non-variable rates that apply for a specified period of time and to reprice at the end of that period so long as the institution discloses at account opening the increased rate that will apply. For example, an institution could offer a consumer credit card

account with a non-variable rate of 10% for six months after which a variable rate based on a disclosed index and margin will apply to outstanding balances and new transactions. Similarly, following the first year after account opening, § __.24(b)(3) permits institutions to provide non-variable rates that apply for a specified period of time, although these rates can only be applied to new transactions. For example, consistent with the notice requirements in 12 CFR 226.9(c), an institution could apply a non-variable rate of 15% to purchases for one year after which a variable rate will apply.

In either case, a consumer who receives a non-variable rate would be subject to repricing. However, the consumer will know at the time of each purchase not only how long the current rate will apply to that purchase but also the specific rate that will apply thereafter. Thus, the final rule provides institutions with the ability to increase rates to reflect anticipated changes in market conditions while enabling consumers to make informed decisions about the cost of using credit. Accordingly, the Agencies conclude that the benefits of allowing repricing under these circumstances outweigh the injury.

4. Promotional rates

The proposed rule would have allowed institutions to apply an increased rate to an outstanding balance upon expiration or loss of a promotional rate, except that, when a promotional rate was lost, the increased rate could not exceed the rate that would have applied after expiration. Consumer groups opposed this exception, stating that, because it did not limit the circumstances in which a promotional rate could be lost, it would leave in place abusive repricing practices. These commenters argued that this exception would allow institutions to continue to engage in “hair trigger” repricing by, for example, increasing the rate on an outstanding balance from a 0% promotional rate to a 15% standard rate when the consumer’s payment was received one day after the due date. They also stated that some institutions impose conditions on retention of a promotional rate that are unrelated to the consumer’s risk of default and are instead intended to trap unwary consumers into losing the discounted rate (for example, requiring consumers to make a certain number or dollar amount of purchases each billing cycle). Accordingly, they argued that, because discounted promotional rate offers are used to encourage consumers to engage in transactions they would not otherwise make (such as large purchases or balance transfers), consumers who rely on promotional rate offers need the same protections as consumers who rely on non-promotional rates.

Based on the comments and further analysis, the Agencies agree that this aspect of the proposed rule could allow the very practices that the Agencies intended to prevent. For example, an institution seeking to attract new consumers by offering a promotional rate that is lower than its competitors’ rates could offer a rate that would be unprofitable if the institution did not place conditions on retention of the rate that, based on past consumer behavior, it anticipates will result in a sufficient number of repricings to generate sufficient revenues. This type of practice distorts competition and undermines consumers’ ability to evaluate the true cost of using credit.

Although the Agencies understand that discounted promotional rates can provide substantial benefits to consumers¹⁰⁹ and that institutions may reduce promotional rate offers if their ability to reprice is restricted, practices that cause consumers to lose a promotional rate before the previously-disclosed expiration date deprive those consumers of the benefit of a rate on which they have relied. Accordingly, because proposed § __.24 was intended to improve transparency and prevent surprise increases in the cost of completed transactions, the Agencies conclude that the injury caused by the repricing of promotional rate balances prior to expiration

¹⁰⁹ See above discussion regarding the benefits of promotional rates in relation to § __.23 (payment allocation).

is not outweighed by the benefits of the promotional rate itself. Absent a serious default, a consumer should be able to rely on a rate for the period specified in advance by the institution. Therefore, the final rule does not permit repricing of outstanding balances prior to the end of the specified period (except in the case of a delinquency of more than 30 days as provided in § __.24(b)(4)). As discussed above, however, the final rule (like the proposal) permits repricing at the end of a specified period so long as the increased rate was disclosed in advance.

5. Violations of the account terms

The proposed rule would have permitted institutions to increase the annual percentage rate on an outstanding balance if the consumer became more than 30 days' delinquent. The Agencies observed that, although this delinquency may not have been reasonably avoidable in certain individual cases, the consumer will have received notice of the delinquency (in the periodic statement and likely in other notices as well) and had an opportunity to cure before becoming more than 30 days' delinquent. The Agencies noted that a consumer is unlikely, for example, to become more than 30 days' delinquent due to a single returned item or the loss of a payment in the mail. Thus, the harm in individual cases where a delinquency of more than 30 days is not reasonably avoidable appeared to be outweighed by the benefits to all consumers (in the form of lower annual percentage rates and broader access to credit) of allowing institutions to reprice for risk once a consumer has become significantly delinquent. For these reasons and for the additional reasons discussed below, the Agencies conclude that the benefits of allowing repricing in these circumstances outweigh the costs. The Agencies further conclude, however, that the same is not true for repricing based on other violations of the account terms.

In response to the May 2008 Proposal, consumer groups argued that repricing outstanding balances based on violations of the account terms is fundamentally unfair and should be prohibited entirely or, failing that, a delinquency of more than 30 days should be the only circumstance in which institutions are permitted to reprice based on a violation of the account terms. A consumer group explained that a delinquency of more than 30 days was the appropriate period because, under industry guidelines governing credit reporting, an account is not reported as delinquent until it is at least 30 days late, suggesting that paying less than 30 days late is not considered to affect creditworthiness significantly.¹¹⁰ In contrast, industry commenters and the OCC argued that the proposed rule provided insufficient flexibility because accounts that become more than 30 days' delinquent have such a high rate of loss that repricing is ineffective. The Argus Analysis stated that 32.4 percent of accounts that are more than 30 days past due and 49.8 percent of the balances on those accounts will become losses within the next twelve months.¹¹¹ Industry commenters argued that, given these rates, institutions would be unable to compensate for the losses through rate increases on all accounts that become more than 30 days' delinquent. Instead, they argued, these losses would have to be spread over a larger population of accounts, potentially raising rates and reducing credit availability for many or all consumers.

The Argus Analysis stated that – as a result of the restrictions in proposed § __.23 (payment allocation), proposed § __.24 (repricing), and proposed 12 CFR 226.9 (45 days' advance notice of most rate increases) – institutions could lose 1.639 percent of their annual

¹¹⁰ See Consumer Data Industry Ass'n, Credit Reporting Resource Guide 6-6 (2006).

¹¹¹ See Exhibit 5, Tables 1a and 1b to Argus Analysis (row labeled "Mar-07" containing twelve-month outcome duration). The Argus Analysis categorized an account as a loss if it became 90 or more days' delinquent, charged off, or bankrupt. Id.

interest revenue on revolving credit card accounts.¹¹² This analysis estimated that, in order to offset this loss, institutions might increase interest rates by approximately 120 percent of the loss (1.937 percentage points), decrease the average credit line of \$9,561 by approximately 22 percent (\$2,029), cease lending to consumers with Fair Isaac Corporation (“FICO”) scores below 620, or engage in some combination of these responses.¹¹³

Although the Argus Analysis did not estimate the potential impact on interest rates and credit availability specifically attributable to proposed § __.24, it did state that annual interest revenue on revolving accounts would be reduced by approximately 1.514 percent as a result of proposed § __.24 and proposed 12 CFR 226.9.¹¹⁴ Therefore, assuming for the sake of discussion that the data and assumptions underlying the Argus Analysis are accurate, that analysis predicts that institutions might respond by increasing interest rates approximately 1.817 percentage points, by decreasing credit limits approximately \$1,874, or by substantially reducing lending to consumers with FICO scores below 620.¹¹⁵ Accordingly, if, for example, an institution currently charges a consumer an interest rate of 15% on a credit line of \$9,000, the institution could respond to proposed § __.24 and proposed 12 CFR 226.9 by increasing the rate to 16.82% or by decreasing the credit limit to \$7,126.

As noted above, however, the Agencies are unable to verify the accuracy of the conclusions reached by the Argus Analysis or its supporting data. Furthermore, this analysis assumed that institutions could only respond to the proposed rules by increasing rates, reducing credit limits, or eliminating credit to consumers with FICO scores below 620, ignoring other potential responses such as offsetting lost interest revenue by increasing revenue from fees (including annual fees) or developing improved underwriting techniques in order to reduce losses on accounts that eventually default.¹¹⁶

In addition, even if the Agencies were to accept the Argus Analysis and its underlying data at face value, that analysis also indicates that the typical rate increase is approximately eight

¹¹² See Argus Analysis at 3; Exhibit 1, Table 1 to Argus Analysis.

¹¹³ See Argus Analysis at 4; Exhibit 1, Tables 7 – 11 to Argus Analysis.

¹¹⁴ See Exhibit 1, Table 1 to Argus Analysis (combining the predictions for “Revolvers” in the rows labeled “30+DPD Penalty Trigger,” “CIT Repricing,” and “Non 30+DPD Penalty Triggers”).

¹¹⁵ As noted above, the Argus Analysis estimated that proposed § __.24 and proposed 12 CFR 226.9 would reduce interest revenue by 1.514 percent. Accordingly, the Agencies assumed that, consistent with the Argus Analysis, the increase in interest rates attributable to proposed § __.24 and proposed 12 CFR 226.9 would be 120 percent of the reduction in interest revenue ($1.514 \times 1.2 = 1.817$). The Agencies also assumed that the reduction in credit limits attributable to proposed § __.24 and proposed 12 CFR 226.9 would be proportionate to the overall reduction predicted by the Argus Analysis. Thus, because the estimated revenue loss attributable to proposed § __.24 and proposed 12 CFR 226.9 (1.514) is 92.4% of the overall estimated revenue loss (1.637), the Agencies assumed that the reduction in credit limits attributable to proposed § __.24 and proposed 12 CFR 226.9 would be 92.4% of the overall reduction of \$2,029 predicted by the Argus Analysis ($\$2,029 \times 0.924 = \$1,874.26$). The Agencies were not able to estimate the potential impact on credit availability for consumers with FICO scores below 620 but, because proposed § __.24 and proposed 12 CFR 226.9 accounted for 92.4% of the estimated revenue loss, the Agencies assumed the reduction in available credit for these consumers would be substantial.

¹¹⁶ As discussed above with respect to § __.23 and in greater detail below in § VII of this **SUPPLEMENTARY INFORMATION**, the Agencies anticipate that, prior to the effective date, some institutions may respond to the restrictions in proposed § __.24 and proposed 12 CFR 226.9 by, for example, adjusting interest rates on existing balances, increasing fees, or reducing credit limits.

percentage points and that approximately 22 percent of accounts are repriced over the course of a year.¹¹⁷ Thus, with respect to interest rates, the Argus Analysis indicates that the impact of the proposed rule would be relatively neutral because the rule would prevent a six percentage point net increase on roughly a quarter of accounts while the other three-quarters may experience an increase of less than two percentage points.¹¹⁸ Although the Argus Analysis also predicted that – instead of increasing interest rates – institutions might reduce credit limits or lending to consumers with lower FICO scores, those responses would reduce or eliminate the need for a rate increase, thereby retaining roughly the same relationship between the costs and benefits of the rule.¹¹⁹

As with § __.23, even if the shifting of costs from one group of consumers to another, much larger group is viewed as neutral from a cost-benefit perspective, the less quantifiable benefits to consumers and competition of more transparent upfront pricing weigh in favor of § __.24. Upfront annual percentage rates that are artificially reduced based on the expectation of future increases do not represent a true benefit to consumers as a whole. In addition to protecting consumers from unexpected increases in the cost of transactions that have already been completed, § __.24 will enable consumers to more accurately assess the cost of using their credit card accounts at the time they engage in new transactions. Finally, competition will be enhanced because institutions that offer annual percentage rates that more accurately reflect risk and market conditions will no longer be forced to compete with institutions offering artificially reduced rates. Accordingly, the Agencies conclude that limiting rate increases on outstanding balances and during the first year to circumstances where the account is more than 30 days' delinquent produces benefits that outweigh the associated costs.

Industry commenters and the OCC urged the Agencies to adopt additional exceptions to proposed § __.24 based on violations of the account terms other than a single late payment (specifically, exceeding the credit limit, making payment with a check that is returned for insufficient funds, and paying late twice in a twelve month period). Many of these commenters provided data indicating that these behaviors are associated with loss rates that are significantly higher than those for consumers who do not violate the account terms (although all of these loss rates were significantly lower than the loss rates associated with delinquencies of more than 30 days). As an initial matter, the Agencies note that the impact on the cost and availability of credit of prohibiting repricing based on these behaviors is subsumed within the impact of prohibiting repricing based on any violation of the account terms other than a delinquency of more than 30 days. Accordingly, for the reasons already stated above, repricing outstanding

¹¹⁷ See Argus Analysis at 7; Exhibit 6, Tables 1a and 3a to Argus Analysis (totaling the percentage of accounts repriced as a penalty and as a change-in-terms from March 2007 through February 2008).

¹¹⁸ In other words, if, according to the Argus Analysis, roughly 22% of consumers currently experience a rate increase averaging 8 percentage points each year and all consumers will experience a 1.817-point increase in interest rate as a result of the proposed rules, then the proposed rules will prevent 22% of consumers from incurring a net increase of 6.183 points (8 minus 1.817) while the other 78% may experience an increase of 1.817. Although some portion of the 22 percent are presumably accounts that become 30 days' delinquent and thus would still be repriced, the comments indicate that this portion is relatively small.

¹¹⁹ The Agencies also note that, while the estimated impact on interest rates and credit availability is a prediction regarding potential future events, the average eight percentage point increase appears to reflect the harm that is currently imposed on consumers. Accordingly, the Agencies believe that the latter figure is entitled to greater weight.

balances based on these behaviors does not provide benefits to consumers or competition that outweigh the injury to consumers.

Furthermore, with respect to repricing outstanding balances when the credit limit is exceeded or when a payment is returned for insufficient funds, the Agencies have already concluded that these violations of the account terms are not, as a general matter, reasonably avoidable by consumers. Accordingly, allowing repricing in those circumstances would undermine the purpose of § __.24, which is to protect consumers from being unfairly surprised by increases in the cost of completed transactions.

Similarly, the Agencies conclude that allowing repricing based on two late payments in twelve months would not sufficiently protect consumers from unfair surprise. As discussed above, the Agencies have already concluded that consumers cannot, as a general matter, reasonably avoid repricing based on late payments. Furthermore, making a payment that is received one day after the due date twice in a period of twelve months is precisely the type of “hair trigger” repricing that § __.24 is intended to prevent. Even if repricing were allowed only when the late payments were received two, three, or even five days after the due date (as some commenters suggested), these periods would not provide consumers with sufficient time to learn of the delinquency and cure it (unlike a delinquency of 30 days or more).¹²⁰ Furthermore, as discussed above with respect to § __.22, the Agencies have already concluded that providing a short period of time after the due date during which payments must be treated as timely could create consumer confusion regarding when payment is actually due and undermine the Board’s efforts elsewhere in today’s **Federal Register** to ensure that consumers’ due dates are meaningful. Finally, the Agencies note that the exception in § __.24(b)(4) permitting repricing for delinquencies of more than 30 days is similar to an exception allowing repricing based on consecutive delinquencies because a consumer who is more than 30 days’ delinquent will, in most cases, have missed two due dates.

6. Assessment of deferred interest

As noted above, consumer groups stated that the assessment of deferred interest raises many of the same concerns as the repricing of outstanding balances. Deferred interest plans are typically marketed as being “interest free” for a specified period (such as a year) and are often offered to promote large purchases such as furniture or appliances. However, although interest is not charged to the account during that period, interest accrues at a specified rate. If the consumer violates the account terms (which could include a “hair trigger” violation such as paying one day late) or fails to pay the purchase balance in full before expiration of the period, the institution retroactively charges all interest accrued from the date of purchase.

Consumer groups stated that, like discounted promotional rates, deferred interest plans are used to encourage consumers to engage in transactions they would not otherwise make. They argued that, because of “hair trigger” repricing, many consumers lose the benefit of the deferred interest plan earlier than expected and that many other consumers incur deferred interest charges by failing to pay the balance in full prior to expiration either inadvertently or because they lack the resources to do so. In addition, they noted that the injury to the consumer in such cases may

¹²⁰ One commenter suggested that the second late payment would be reasonably avoidable if the first late payment was followed by a notice warning the consumer that a second delinquency would result in repricing. Because, however, this notice could precede the second late payment by as much as eleven months, the Agencies do not believe it would be effective to enable consumers to avoid repricing. See Agarwal, Stimulus and Response (finding that a consumer is 44 percent less likely to pay a late fee in the current month if that consumer paid a late fee the prior month but that this effect decreases with each additional month).

be far greater than when a promotional rate is lost because interest is charged retroactively on the outstanding balance. Finally, they stated that deferred interest plans cannot be adequately disclosed to consumers because of their complexity.

Based on the comments and further analysis, the Agencies believe that the assessment of deferred interest under these circumstances is effectively a repricing of an outstanding balance. For example, assume that an institution offers a consumer credit card account that accrues interest on purchases at an annual percentage rate of 15% but interest will not be charged on purchases for one year unless the consumer violates the account terms or the purchase balance is not paid in full by the end of the year. The account is marketed as “no interest on purchases for one year.” On January 1 of year one, a consumer opens an account in order to make a \$3,000 purchase. Although interest technically accrues on the \$3,000 purchase at 15% from January 1 through December 31, this interest is not charged to the account, making the rate that applies to the purchase effectively zero during that period. If, however, the consumer violates the account terms during year one by paying late or fails to pay the \$3,000 in full by January 1 of year two, all of the interest that has accrued at 15% since January 1 of year one will be charged retroactively to the account. In addition, the 15% rate (or a higher penalty rate) will apply to the \$3,000 balance thereafter.

The Agencies believe that this is precisely the type of surprise increase in the cost of completed transactions that § __.24 is intended to prevent. As noted by the commenters, the assessment of accrued interest causes substantial injury to consumers. In addition, for the same reasons that consumers cannot, as a general matter, reasonably avoid rate increases as a result of a violation of the account terms, consumers cannot, as a general matter, reasonably avoid assessment of deferred interest as a result of a violation of the account terms or the failure to pay the balance in full prior to expiration of the deferred interest period. For example, just as illness or unemployment may reasonably prevent some consumers from paying on time, these conditions may reasonably prevent some consumers from paying the deferred interest balance in full prior to expiration. In addition, as noted by the commenters, disclosure may not provide an effective means for consumers to avoid the harm caused by these plans.

Finally, although deferred interest plans provide some consumers with substantial benefits in the form of an interest-free advance if the balance is paid in full prior to expiration, the Agencies conclude that these benefits do not outweigh the substantial injury to consumers. As discussed above, deferred interest plans are typically marketed as “interest free” products but many consumers fail to receive that benefit and are instead charged interest retroactively. Accordingly, as with the prohibitions on other repricing practices discussed above, prohibiting the assessment of deferred interest will improve transparency and enable consumers to make more informed decisions regarding the cost of using credit. Accordingly, the Agencies conclude that an exception to the general prohibition on rate increases is not warranted for the assessment of deferred interest.

The Agencies note, however, that the final rule does not preclude institutions from offering consumers interest-free promotional plans. As discussed above, institutions can still offer 0% promotional rates for specified periods so long as they disclose the rate that will apply thereafter. Furthermore, an institution could offer a plan where interest is assessed on purchases at a disclosed rate for a period of time but the interest charges are waived or refunded if the principal is paid in full by the end of the period. For example, assume that an institution offers an account that charges interest on purchases at a 15% non-variable rate but only requires the consumer to repay a portion of the outstanding principal balance each month during the first year

after the account is opened. If the principal is paid in full by the end of that year, the institution waives all interest accrued during that year. At account opening on January 1 of year one, the institution discloses these terms (including the 15% rate at which interest will accrue). The consumer uses the account for a \$3,000 purchase on January 1. The consumer makes no other purchases and makes no payments. At the end of each billing cycle, the institution charges to the account interest accrued on the \$3,000 balance at the 15% rate. On December 15 of year one, the consumer pays \$3,000 and the institution waives all accrued interest. This type of product would comply with the final rule.

Public policy. Industry commenters and the OCC argued that proposed § __.24 conflicted with established public policy, citing a variety of sources. The Agencies note that public policy is not a required element of the unfairness analysis.¹²¹ Nevertheless, after carefully considering the materials cited by the comments, the Agencies conclude that any inconsistency is necessary to protect consumers from practices that satisfy the required statutory elements of unfairness.

First, industry commenters and the OCC cited testimony, guidance, reports, and advisory letters from federal banking regulators (including the Board and OTS) stating or suggesting that institutions should actively manage risk on credit card accounts, that one method of managing risk is adjusting interest rates on outstanding balances and new transactions to reflect the consumer's risk of default, and that doing so can be beneficial for consumers insofar as it reduces rates overall.¹²² The Agencies agree that, to the extent that these materials constitute public policy for purposes of the FTC Act unfairness analysis, many contain statements that could be deemed inconsistent with the restrictions in § __.24. As discussed above, however, the Agencies have already taken the benefits of adjusting rates to reflect changes in a consumer's risk of default into account and concluded that these benefits do not outweigh the injury to consumers caused by this practice. Accordingly, the Agencies find that the regulatory materials cited do not preclude a determination that, to the extent prohibited by § __.24, application of increased annual percentage rates is an unfair practice.

Second, some industry commenters and the OCC stated that proposed § __.24 conflicts with previous Board policy regarding rate increases. Specifically, these commenters noted that, prior to the revisions to Regulation Z in today's **Federal Register**, 12 CFR 226.9 placed no restrictions on rate increases resulting from a violation of the account terms and required only 15 days' advance notice of rate increases resulting from a change in the terms of the contract. These commenters further noted that, rather than proposing to prohibit repricing of outstanding balances in the June 2007 Regulation Z Proposal, the Board instead proposed to improve disclosures regarding the rate increases. According to these commenters, the improved

¹²¹ See 15 U.S.C. 45(n).

¹²² See, e.g., Testimony of Julie L. Williams, Chief Counsel & First Senior Deputy Controller, OCC before H. Subcomm. on Fin. Instits. & Consumer Credit at 5 (Apr. 17, 2008); Board of Governors of the Federal Reserve System, Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit at O5 (Aug. 2007) (available at <http://www.federalreserve.gov/boarddocs/RptCongress/creditscore/creditscore.pdf>); Testimony of John C. Dugan, Comptroller of the Currency, OCC, before the H. Subcomm. on Fin. Instits. & Consumer Credit at 21-24 (June 7, 2007) (available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htdugan060707.pdf); OTS Handbook on Credit Card Lending § 218 (2006) (available at <http://files.ots.treas.gov/422064.pdf>); OCC Advisory Letter 2004-10, at 3 (Sept. 14, 2004); OCC Handbook, Rating Credit Risk (Apr. 2001) (available at <http://www.occ.treas.gov/handbook/RCR.pdf>).

Regulation Z disclosures are sufficient, by themselves, to address any concerns regarding application of increased rates to outstanding balances.

These commenters first argued that disclosure in solicitations and at account opening of the circumstances in which a penalty rate will be applied to a consumer credit card account will enable consumers to avoid those circumstances and therefore any injury. Although these disclosures are necessary and appropriate for the informed use of credit, the Agencies do not believe that, by themselves, they would be effective in preventing the harm caused by application of increased rates. Disclosure will not enable consumers to select a credit card that does not reprice outstanding balances because institutions almost uniformly reserve the right to increase rates at any time and for any reason and to apply those increased rates to prior transactions.¹²³ Nor, as discussed above, would disclosure enable consumers to avoid rate increases resulting from circumstances outside their control, such as late payments due to delays in the delivery of mail. Furthermore, as noted in the May 2008 Proposal, there is evidence that disclosure at solicitation and account opening has limited effectiveness in preventing subsequent defaults because consumers do not focus on the consequences of default when deciding whether to open a credit card account and whether to use the account for a particular transaction.¹²⁴

Industry commenters also argued that disclosure of the rate increase 45 days before that increase goes into effect allows consumers to avoid injury by paying the balance in full or transferring that balance to another credit card account.¹²⁵ It would be unreasonable, however, to expect consumers who have chosen to use a credit card to finance purchases in reliance on the rate in effect at that time to pay those purchases in full in order to avoid injury. Furthermore, as discussed above, alternative financing (such as a balance transfer) only enables the consumer to avoid injury if the consumer can obtain a comparable annual percentage rate and terms elsewhere, which often will not be the case. Accordingly, because disclosure alone would not be

¹²³ The GAO's 2005 analysis of 28 popular credit cards, for example, identified only one that did not reprice outstanding balances to a default rate. See GAO Report at 24. Furthermore, the comments from industry on the May 2008 Proposal generally stated that all or almost all credit card issuers reprice outstanding balances. Thus, as the FTC concluded with respect to its Credit Practices Rule, the prevalence of a contractual provision indicates that harm caused by that provision is not reasonably avoidable. See Statement for FTC Credit Practices Rule, 48 FR at 7746.

¹²⁴ See Statement for FTC Credit Practices Rule, 49 FR at 7744 (“Because remedies are relevant only in the event of default, and default is relatively infrequent, consumers reasonably concentrate their search on such factors as interest rates and payment terms.”); see, e.g., Angela Littwin, Beyond Usury: A Study of Credit-Card Use and Preference Among Low-Income Consumers, 80 Tex. L. Rev. 451, 467–478, 494 (2008) (“Issuers currently compete on the basis of interest rates, but because this competition focuses on initial interest rates and not on the total amount that consumers will pay, it fails to give sufficient decision-making information either to consumers who literally do not understand the events that trigger higher interest rates and fees or to consumers who underestimate the likelihood that they will be faced with these rates and fees.”); Shane Frederick, et al., Time Discounting and Time Preference: A Critical Review, 40 J. Econ. Literature 351, 366–67 (2002); Ted O’Donoghue & Matthew Rabin, Doing It Now or Later, 89 Am. Econ. Rev. 103, 103, 111 (1999). Some industry commenters argued that, under the FTC Policy Statement on Unfairness, a finding of unfairness is not appropriate when the institutions did not create an obstacle to the free exercise of consumer decision-making. In fact, the FTC Policy Statement on Unfairness states (at 3) that the proper analysis is whether the institution “unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.” (Emphasis added.)

¹²⁵ See 12 CFR 226.9(c)(2) and (g).

effective in preventing the harm caused by application of increased rates to outstanding balances, the Agencies conclude that § __.24 does not conflict with the Board's Regulation Z.

Third, industry commenters and the OCC argued that proposed § __.24 conflicts with state laws that, rather than prohibiting repricing of outstanding balances, require consumers to affirmatively reject (or opt out of) such increases by closing the account.¹²⁶ These commenters urged the Agencies to adopt this approach as a less restrictive alternative to proposed § __.24.

In the May 2008 Proposal, the Agencies considered a similar suggestion raised by some commenters in response to the Board's June 2007 Regulation Z Proposal and concluded that this remedy would not effectively protect consumers.¹²⁷ The Agencies noted that, in most cases, it would not be economically rational for a consumer to choose to pay more for credit that has already been extended, particularly when the increased rate is significantly higher than the prior rate. If consumers understand their right to reject a rate increase, most would rationally exercise that right.¹²⁸ Thus, the Agencies conclude that providing consumers with a right to opt out of rate increases on outstanding balances would be less restrictive than prohibiting such increases only if a significant number of consumers inadvertently forfeited that right by failing to read, understand, or act on the notice.¹²⁹ According to the GAO Report, however, although state laws applying to four of the six largest credit card issuers require an opt-out, representatives of those issuers stated that few consumers exercise that right.¹³⁰ Although several institutions asserted that providing an opt-out would allow consumers to reasonably avoid injury, none provided the percentage of consumers that currently opt out under applicable state statutes.¹³¹

Finally, some industry commenters argued that the failure to provide an opt-out for rate increases was inconsistent with the provision of an opt-out for payment of overdrafts in proposed § __.32(a). As discussed below, the Agencies are not taking action on proposed § __.32(a) at this time. The Board has proposed a revised opt-out right with respect to overdraft services under Regulation E elsewhere in today's **Federal Register**. The Board is also proposing an alternative approach that would require consumer opt-in to overdraft services. Furthermore, the

¹²⁶ See, e.g., Ala. Code § 5-20-5; 5 Del. Code § 952; Off. Code of Ga. § 7-5-4; Nev. Rev. Stat. § 97A.140; S.D. Codified Laws § 54-11-10; Utah Code § 70C-4-102.

¹²⁷ At that time, commenters urged that the opt-out right not apply when the rate increase was due to a violation of the account terms. As the Agencies noted in May 2008, such a right would not address the injury to consumers whose rates were increased due to a violation of the account terms that was not reasonably avoidable. The Agencies understand the commenters on this proposal to urge that the opt-out right be given in all circumstances. This suggestion, however, does not alter the Agencies' conclusion that an opt-out right would not effectively address the injury to consumers.

¹²⁸ As some commenters noted, a consumer who cannot obtain a lower rate elsewhere and wants continued access to a credit card account could rationally choose not to reject application of an increased rate to an outstanding balance if rejection meant closing the account. In the scenario, however, the consumer cannot reasonably avoid injury.

¹²⁹ The Agencies also noted in May 2008 that providing consumers with notice and a means to exercise an opt-out right (e.g., a toll-free telephone number) would create additional costs and burdens for institutions.

¹³⁰ GAO Credit Card Report at 26–27.

¹³¹ One institution stated that half of the consumers who called its customer service with questions regarding an opt-out notice exercised that right, although it is unclear what percentage of all affected consumers this subset comprised.

Agencies' decision to propose an opt-out with respect to payment of overdrafts but not with respect to rate increases was based on an evaluation of the consumers' incentives in each situation. A consumer could rationally prefer assessment of an overdraft fee to rejection of the transaction because of the costs associated with rejection (for example, a merchant fee for a check that is not honored), whereas – for the reasons discussed above – few if any consumers would willingly choose to pay more for credit already extended.

Accordingly, although § __.24 is broader than the law in some states, the Agencies conclude that provision of a right to opt out of rate increases would not be effective in preventing the harm caused by application of increased rates to outstanding balances.

Applicability of unfairness analysis to other practices. Industry and consumer group commenters questioned why the Agencies' unfairness analysis with respect to rate increases as a result of a violation of the account terms could not be applied to other consequences of such violations, such as increases in the rate for new transactions or fees. As discussed above, the Agencies have concluded that the unfairness analysis does, in fact, preclude rate increases during the first year after account opening. After the first year, however, the Agencies believe that the consumer has less of a reasonable expectation that the rate promised at account opening will continue to apply to new transactions. At that point, even if the reason for the rate increase was not reasonably avoidable, other provisions should enable consumers to reasonably avoid the harm caused by an increase in the rate for new transactions. Specifically, consumers will receive notice of most rate increases 45 days before the increase goes into effect.¹³² Furthermore, as discussed below, § __.24(b)(3) prevents surprise by prohibiting application of the increased rate to transactions made up to seven days after provision of the 45-day notice. After the first year, these provisions will enable consumers to reasonably avoid any injury caused by application of an increased rate to new transactions by providing them sufficient time to receive the 45-day notice and to decide whether to continue using the card.

Similarly, although there will be circumstances in which some consumers cannot reasonably avoid fees for violating the account terms (for example, a late payment fee when a delay in mail delivery caused the late payment), this injury is not sufficient to outweigh the countervailing benefits to consumers and competition of discouraging violations of the account terms. The application of an increased rate to an outstanding balance increases consumers' costs until the rate is reduced or the balance is paid in full or transferred to an account with more favorable terms. Similarly, an increase in the rate applicable to new transactions increases the costs of using the account indefinitely. The assessment of a fee, however, is generally an isolated cost that will not be repeated unless the account terms are violated again.

Final Rule

As discussed below, § __.24 imposes certain disclosure requirements on institutions. Comment 24-1 clarifies that an institution that complies with the applicable disclosure requirements in Regulation Z, 12 CFR part 226, has complied with the disclosure requirements in § 227.24. This comment further clarifies that nothing in § __.24 alters the 45-day advance notice requirements in 12 CFR 226.9(c) and (g). However, nothing in § __.24, its commentary, or this **SUPPLEMENTARY INFORMATION** should be construed to suggest that, by itself, a failure to comply with the notice requirements in 12 CFR 226.9 constitutes a violation of § __.24.

¹³² See 12 CFR 226.9(c)(2) and (g).

__.24(a) General rule

Proposed § __.24(a)(1) would have prohibited institutions from increasing the annual percentage rate applicable to any outstanding balance on a consumer credit card account, except in the circumstances set forth in proposed § __.24(b). Proposed § __.24(a)(2) defined “outstanding balance.”

As discussed above, the Agencies have adopted a new § __.24(a), which requires institutions to disclose at account opening the annual percentage rates that will apply to each category of transactions on the consumer credit card account. Section __.24(a) further provides that an institution must not increase the annual percentage rate for a category of transactions on any consumer credit card account except as provided in § __.24(b). As discussed below, the general prohibition on increasing rates in § __.24(b) applies to existing accounts and balances as of the July 1, 2010 effective date.

Comment 24(a)-1 clarifies that an institution cannot satisfy the disclosure requirement in § __.24(a) by disclosing at account opening only a range of rates or that a rate will be “up to” a particular amount. Comment 24(a)-2 provides illustrative examples of the application of the prohibition on increasing rates.

__.24(b) Exceptions

Proposed § __.24(b) set forth exceptions to the general prohibition in proposed § __.24(a) on applying increased rates to outstanding balances. As discussed above, the Agencies have revised § __.24(b) to reflect the changes to § __.24(a) and to ensure that consumers are protected from unfair surprise regarding the cost of credit.

__.24(b)(1) Account opening disclosure exception

Section __.24(b)(1) permits an increase in the annual percentage rate for a category of transactions to a rate that was disclosed at account opening upon expiration of a period of time that was also disclosed at account opening. For example, an institution could offer a consumer credit card account that applies a 5% non-variable rate during the first six months after account opening, a 15% non-variable rate for an additional six months, and a variable rate thereafter. So long as the institution discloses these terms to the consumer at account opening, § __.24(b)(1) permits the institution to apply the 15% rate to the purchase balance and to new purchases after six months and the variable rate to the purchase balance and new purchases after the first year. However, the institution could not subsequently increase that variable rate unless specifically permitted by one of the other exceptions in § __.24(b).

Comment 24(b)(1)-1 clarifies that § __.24(b)(1) does not permit application of increased rates that are disclosed at account opening but are contingent on a particular event or occurrence or may be applied at the institution’s discretion (unless one of the exceptions in § __.24(b) applies). The comment provides several examples, including the retroactive assessment of deferred interest. However, comment 24(b)(1)-2 clarifies that nothing in § __.24 prohibits an institution from assessing interest due to the loss of a grace period as provided in § __.25. In addition, comment 24(b)(1)-3 clarifies that nothing in § __.24 prohibits an institution from applying a rate that is lower than the disclosed rate upon expiration of the period. However, if the lower rate is applied to an existing balance, the institution cannot subsequently increase the rate with respect to that balance unless it has provided the consumer with advance notice pursuant to 12 CFR 226.9(c). An illustrative example is provided.

__.24(b)(2) Variable rate exception

Proposed § __.24(b)(1) would have permitted an increase in the annual percentage rate due to an increase in an index that is not under the institution's control and is available to the general public. This exception was designed to be similar to the exception for variable rates in 12 CFR 226.5b(f)(1). This aspect of the proposal was supported by comments from both industry and consumer groups. Accordingly, proposed § __.24(b)(1) is adopted as § __.24(b)(2) with stylistic revisions. This provision cannot be used to increase the annual percentage rate based on an index except to the extent disclosed.

The Agencies have adopted a new comment 24(b)(2)-1, which clarifies that § __.24(b)(2) does not permit an institution to increase an annual percentage rate by changing the method used to determine a variable (such as by increasing the margin), even if that change will not result in an immediate increase.

Proposed comment 24(b)(1)-1 clarified that an institution may not increase a variable rate balance based on its own prime rate but may use a published prime rate, such as that in the Wall Street Journal, even if the institution's prime rate is one of several rates used to establish the published rate. This comment also clarified that an institution may not increase a variable rate by changing the method used to determine the indexed rate. Proposed comment 24(b)(1)-2 clarified when a rate is considered "publicly available."

One industry commenter requested clarification that institutions were not limited to basing variable rates on prime rates and could also use one or more other publicly available indices, such as the Consumer Price Index. Because the method for determining the variable rate must be disclosed consistent with 12 CFR 226.6, the Agencies believe that the use of multiple indices is appropriate so long as those indices are publicly available. The Agencies have revised proposed comments 24(b)(1)-1 and -2 accordingly and adopted those comments as 24(b)(2)-2 and -3.

Some industry commenters requested that institutions be permitted to change a non-variable rate to a variable rate or to change the method used to determine a variable rate so long as, at the time of the change, the rate would not increase. Because such changes could lead to future increases in a rate during the first year or a rate applicable to an outstanding balance, comment 24(b)(2)-4 clarifies that a non-variable rate may be converted to a variable rate only when specifically permitted by § __.24. For example, under § __.24(b)(1), an institution may convert a non-variable rate to a variable rate if this change was disclosed at account opening.

Because § __.24 applies only to increases in annual percentage rates, the Agencies have adopted comment 24(b)(2)-5, which clarifies that nothing in § __.24 prohibits an institution from changing a variable rate to an equal or lower non-variable rate. Whether the non-variable rate is equal to or lower than the variable rate is determined at the time the institution provides the notice required by 12 CFR 226.9(c). For example, assume that on March 1 a variable rate that is currently 15% applies to a balance of \$2,000 and the institution sends a notice pursuant to 12 CFR 226.9(c) informing the consumer that the variable rate will be converted to a non-variable rate of 14% effective April 16. On April 16, the institution may apply the 15% non-variable rate to the \$2,000 balance and to new transactions even if the variable rate on April 16 was less than 14%.

Comment 24(b)(2)-6 clarifies that an institution may change the index and margin used to determine a variable rate if the original index becomes unavailable, so long as historical fluctuations in the original and replacement indices were substantially similar and the replacement index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. This comment further clarifies that, if the replacement

index is newly established and therefore does not have any rate history, it may be used if it produces a rate substantially similar to the rate in effect when the original index became unavailable. This comment is modeled on comment 226.5b(f)(3)(ii)-1 to 12 CFR 226.5b.

__.24(b)(3) Advance notice exception

The Agencies have adopted a new § __.24(b)(3), which provides that an annual percentage rate for a category of transactions may be increased pursuant to a notice under 12 CFR 226.9(c) or (g) for transactions that occur more than seven days after provision of the notice. An institution cannot, however, utilize this exception during the first year after account opening.

The prohibition in § __.24(b)(3) on applying an increased rate to transactions that occur more than seven days after provision of the 12 CFR 226.9 notice is modeled on the definition of “outstanding balance” in proposed § __.24(a)(2). Proposed § __.24(a)(2) defined “outstanding balance” as the amount owed on a consumer credit card account at the end of the fourteenth day after the institution provides the notice required by proposed 12 CFR 226.9(c) or (g). This definition was intended to prevent the requirement in proposed 12 CFR 226.9 that creditors provide 45 days’ advance notice of rate increases from creating an extended period following receipt of that notice during which new transactions could be made at the prior rate. Although institutions could address this concern by denying additional extensions of credit after sending the 45-day notice, the Agencies believe that this outcome would not be beneficial to consumers who have received the notice and wish to use the account for new transactions. The 14-day period was intended to be consistent with the 21-day safe harbor in proposed § __.22(b) insofar as it would allow seven days for the notice to reach the consumer and seven days for the consumer to review that notice and take appropriate action.

Some industry commenters opposed proposed § __.24(a)(2) entirely, arguing that – because rates are often increased as a result of increases in the consumer’s risk of default – delaying imposition of the new rate only increases the risk borne by the institution. Other industry commenters acknowledged that it is reasonable to provide some period of time for consumers to receive and review the notice but that fourteen days is excessive because average mail times are much less than seven days and because a consumer who does not wish to engage in transactions at the new rate need only cease to use the card.

As discussed above with respect to § __.22, while the Agencies believe that seven days will be more than sufficient for the great majority of consumers to receive a periodic statement or notice by mail, relying on average mailing times would not adequately protect the significant number of consumers whose delivery times are longer than average. The Agencies agree, however, that consumers do not require seven days to review the notice and take appropriate action. Indeed, many consumers will not be required to take any action to reasonably avoid transactions to which the increased rate will apply. In addition, because in most cases the notice will be delivered in less than seven days, most consumers will have time to cancel recurring charges to their account (if necessary). The Agencies conclude that, in order to protect consumers from inadvertently engaging in transactions to which an increased rate will apply while minimizing the period during which credit extended by the institution must remain at the pre-increase rate, a rate that is increased pursuant to § __.24(b)(3) should apply only to transactions that occur after the seventh day following provision of the 12 CFR 226.9 notice.

Comment 24(b)(3)-1 clarifies that the limitation in § __.24(b)(3) regarding rate increases during the first year after an account is opened does not apply to accounts opened prior to July 1, 2010.

One industry commenter expressed concern that the “outstanding balance” under proposed § __.24(a)(2) could be construed to include transactions that were authorized before the end of the relevant date but were settled until after that date. The Agencies agree that an institution should not be required to include such transactions in the balance to which the increased rate cannot be applied. Accordingly, comment 24(b)(3)-2 clarifies that an institution may apply a rate increased pursuant to § __.24(b)(3) to transactions that occur within seven days after provision of the notice but are settled more than seven days after that notice was provided. An illustrative example is provided in comment 24(b)(3)-3.

__.24(b)(4) Delinquency exception

Proposed § __.24(b)(3) provided that an institution could apply an increased rate if the consumer’s minimum payment had not been received within 30 days after the due date. This exception was intended to ensure that consumers would generally have notice and an opportunity to cure the delinquency before becoming more than 30 days’ past due. As discussed above, the Agencies have adopted proposed § __.24(b)(3) as § __.24(b)(4) with stylistic changes.¹³³

Some commenters requested that, in addition to restricting the circumstances in which institutions could apply high penalty rates to existing balances based on a violation of the account terms, the Agencies also restrict the length of time a penalty rate can be applied to an account. They suggested that, for example, institutions be prohibited from applying a penalty rate to an account for more than six months if the consumer does not violate the account terms during that period. The Agencies, however, are not imposing a substantive prohibition at this time. As discussed above, the Agencies have placed significant limitations on institutions’ ability to reprice outstanding balances based on violations of the account terms. Furthermore, because the amendments to Regulation Z adopted by the Board elsewhere in today’s **Federal Register** require creditors to provide 45 days’ advance notice of the imposition of a penalty rate, a consumer will have the opportunity to decide whether to engage in transactions at the penalty rate.¹³⁴ Finally, the Board has also improved the disclosures under Regulation Z to require creditors to disclose how long a penalty rate will remain in effect or, if the creditor reserves the right to apply the penalty rate indefinitely, to affirmatively state that fact.¹³⁵ Although the Agencies are not requiring such practices as part of today’s final rule, they believe that limiting the duration of a penalty rate and periodically reevaluating a consumer’s creditworthiness to determine eligibility to return to the non-penalty rate are policies that can be both beneficial for the consumer and safe and sound policy for the institution. Some industry commenters indicated that they already follow such a practice.

__.24(b)(5) Workout arrangement exception

One commenter noted that, as proposed, § __.24 would prohibit institutions that reduced the annual percentage rate on an account pursuant to a workout arrangement from increasing the rate if the consumer failed to comply with the terms of the arrangement. Because workout arrangements can provide important benefits to consumers in serious default, the Agencies have adopted § __.24(b)(5), which provides that, when a consumer fails to comply with the terms of a workout arrangement, the institution may increase the annual percentage rate to a rate that does

¹³³ The example provided in proposed comment 24(b)(3)–1 has been removed. Instead, examples of the application of this exception are provided in comment 24(a)-1.

¹³⁴ See 12 CFR 226.9(g).

¹³⁵ See 12 CFR 226.5a(b)(1)(iv); comment 5a(b)(1)-5; App. G-10(B) and G-10(C).

not exceed the rate that applied prior to the arrangement. For example, assume that, consistent with § __.24(b)(4), the annual percentage rate on a \$5,000 balance is increased from 15% to 25%. Assume also that the institution and the consumer subsequently agree to a workout arrangement that reduces the rate to 15% on the condition that the consumer pay a specified amount by the payment due date each month. If the consumer does not pay the agreed-upon amount by the payment due date, § __.24(b)(5) permits the institution to increase the rate on the \$5,000 balance to no more than 25%. See comment 24(b)(5)-3.

Comment 24(b)(5)-1 clarifies that, except as expressly provided, § __.24(b)(5) does not permit an institution to alter any of the requirements in § __.24 pursuant to a workout arrangement between a consumer and the institution. For example, an institution cannot increase a rate pursuant to a workout arrangement unless otherwise permitted by § __.24. In addition, an institution cannot require the consumer to make payments with respect to a protected balance that exceed the payments permitted under § __.24(c).

Comment 24(b)(5)-2 clarifies that, if the rate that applied prior to the workout arrangement was a variable rate, the rate that can be applied if the consumer fails to comply with the terms of the arrangement must be calculated using the same formula as before the arrangement.

__.24(c) Treatment of protected balances

Proposed § __.24(c) was intended to ensure that the protections in § __.24 were not undercut. Accordingly, it would have provided that, when an institution increases the annual percentage rate applicable to a category of transactions (for example, purchases), the institution was prohibited from requiring repayment of an outstanding balance in that category using a method that is less beneficial to the consumer than one of the methods listed in § __.24(c)(1) and from assessing fees or charges solely on an outstanding balance. In order to clarify the application of § __.24(c), the Agencies have revised this paragraph to state that it applies only to “protected balances,” which are defined as amounts owed for a category of transactions to which an increased annual percentage rate cannot be applied after the rate for that category of transactions has been increased pursuant to § __.24(b)(3). This definition is similar to the definition of “outstanding balance” in proposed § __.24. In addition, proposed § __.24(c) has been revised for consistency with the revisions to § __.24(b) and for stylistic reasons. Otherwise, it has been adopted as proposed.

The Agencies have replaced proposed comments 23(c)-1 and -2 with a new comment 24(c)-1, which clarifies that, because rates cannot be increased pursuant to § __.24(b)(3) during the first year after account opening, the requirements of § __.24(c) do not apply to balances during the first year. Instead, § __.24(c) applies only to “protected balances.” For example, assume that, on March 15 of year two, an account has a purchase balance of \$1,000 at a non-variable rate of 12% and that, on March 16, the bank sends a notice pursuant to 12 CFR 226.9(c) informing the consumer that the rate for new purchases will increase to a non-variable rate of 15% on May 2. On March 20, the consumer makes a \$100 purchase. On March 24, the consumer makes a \$150 purchase. On May 2, § __.24(b)(3) permits the bank to start charging interest at 15% on the \$150 purchase made on March 24 but does not permit the bank to apply that 15% rate to the \$1,100 purchase balance as of March 23. Accordingly, § __.24(c) applies to the \$1,100 purchase balance as of March 23 but not the \$150 purchase made on March 24.

__.24(c)(1) Repayment

In the May 2008 Proposal, the Agencies stated that, while there may be circumstances in which institutions would accelerate repayment of the outstanding balance to manage risk,

proposed § __.24 would provide little effective protection if consumers did not receive a reasonable amount of time to pay off the outstanding balance. Accordingly, proposed § __.24(c)(1) would have required institutions to provide consumers with a method of paying the outstanding balance that is no less beneficial to the consumer than one of the methods listed in proposed § __.24(c)(1)(i) and (ii).

Proposed § __.24(c)(1)(i) would have allowed an institution to amortize the outstanding balance over a period of no less than five years, starting from the date on which the increased rate went into effect for new transactions. Although some industry commenters criticized the five-year period as excessive and requested that it be reduced or eliminated, the OCC and consumer groups generally supported this repayment period as reasonable. One consumer group argued that, if the amount owed is large, five years may be insufficient.

In May 2008, the Agencies cited as support for the proposed five-year amortization period guidance issued by the Board, OCC, FDIC, and OTS (under the auspices of the Federal Financial Institutions Examination Council) stating that credit card workout arrangements should generally strive to have borrowers repay debt within 60 months.¹³⁶ One commenter argued that the Agencies' reliance on this guidance was misplaced because it applies to workout arrangements and uses 60 months as a maximum repayment period, rather than a minimum. The Agencies note, however, that the guidance set 60 months as the repayment period preferred in most cases for consumers who had become sufficiently delinquent to be placed in workout arrangements. Section __.24(c), however, will generally apply to a less risky population of consumers because accounts that have paid more than 30 days' late are excluded. See § __.24(b)(4). Accordingly, based on the comments and the Agencies' own analysis, the Agencies conclude that a five-year minimum amortization period is appropriate. Therefore, proposed § __.24(c)(1)(i) has been revised for stylistic reasons and adopted as proposed.

An industry commenter requested clarification regarding the relationship between § __.24(c)(1) and the payment allocation rules in proposed § __.23. Section __.23 addresses only payments in excess of the required minimum periodic payment. Thus, nothing in § __.23 limits an institution's ability to set a required minimum periodic payment consistent with § __.24(c). By the same token, nothing in § __.24(c)(1) alters the requirement regarding allocation of excess payments in § __.23. Thus, if an institution has elected to set a required minimum periodic payment on a protected balance that will amortize that balance over a five-year period consistent with § __.24(c)(1)(i), the institution must apply excess payments consistent with § __.23 even if doing so will cause the protected balance to pay off in less than five years. In order to eliminate any ambiguity, the Agencies have added examples to the commentary to § __.23 illustrating how an excess payment could be applied in this situation. See comment 23(a)-1.iii; comment 23(b)-2.ii. In addition, the Agencies have added comment 24(c)(1)(i)-1, which clarifies that an institution is not required to recalculate the amortization period even if, during the course of that period, allocation of excess payments to the protected balance means the balance will be paid off in less than 5 years.

An industry commenter requested clarification on whether an institution that chose to provide an amortization period of five years for the outstanding balance consistent with proposed § __.24(c)(1)(i) was prohibited from applying some or all of the required minimum periodic

¹³⁶ See, e.g., Board Supervisory Letter SR 03–1 on Account Management and Loss Allowance Methodology for Credit Card Lending (Jan. 8, 2003) (available at <http://www.federalreserve.gov/boarddocs/srletters/2003/sr0301.htm>).

payment to the outstanding balance before the effective date of the rate increase if doing so would result in a shorter amortization period. Section __.24(c)(1)(i) provides for “[a]n amortization period for the outstanding balance of no less than five years, starting from the date on which the increased annual percentage rate becomes effective.” (Emphasis added.) Accordingly, § __.24(c)(1)(i) does not affect an institution’s ability to apply some or all of the required minimum periodic payment to the protected balance prior to the effective date of the rate increase.

An industry commenter requested clarification regarding how an amortization period would be calculated if the annual percentage rate was variable. Comment 24(c)(1)(i)-2 clarifies that, if the annual percentage rate that applies to the protected balance varies with an index as provided in § __.24(b)(2), the institution may vary the interest charges included in the required minimum periodic payment for that balance accordingly in order to ensure that the protected balance is amortized in five years.

As an alternative to the five-year amortization period, proposed § __.24(c)(1)(ii) would have allowed the percentage of the total balance that was included in the required minimum periodic payment before the rate increase to be doubled with respect to the outstanding balance. For example, if the required minimum periodic payment prior to the rate increase was one percent of the total amount owed plus accrued interest and fees, an institution would be permitted to increase the minimum payment for the outstanding balance up to two percent of that balance plus accrued interest and fees. The Agencies did not receive any significant comment on this aspect of the proposal. Accordingly, § __.24(c)(1)(ii) has been revised for stylistic reasons and adopted as proposed.

Proposed comment 24(c)(1)(ii)–1 clarified that proposed § __.24(c)(1)(ii) did not limit or otherwise address an institution’s ability to determine the amount of the minimum payment on other balances (in other words, balances that are not outstanding balances under § __.24(a)(2)). This comment has been revised for stylistic reasons and adopted as proposed.

Proposed comment 24(c)(1)(ii)–2 provided an example of how an institution could adjust the minimum payment on the outstanding balance. This comment has been revised for clarity.

Proposed comment 24(c)(1)–1 clarified that an institution may provide a method of paying the outstanding balance that is different from the methods listed in § __.24(c)(1) so long as the method used is no less beneficial to the consumer than one of the listed methods. It further stated that a method is no less beneficial to the consumer if the method amortizes the outstanding balance in five years or longer or if the method results in a required minimum periodic payment on the outstanding balance that is equal to or less than a minimum payment calculated consistent with § __.24(c)(1)(ii). As requested by the commenters, the Agencies have clarified and expanded the examples provided in the proposed comment. Otherwise, the comment has been revised for stylistic reasons and adopted as proposed.

An industry commenter asked whether, if amortization of the outstanding balance over a five-year period would result in a required minimum periodic payment below the lower limit or “floor” used by the institution for such payments,¹³⁷ the institution could require the consumer to pay the floor minimum payment. The Agencies believe this should be permitted, so long as the lower limit for the required minimum periodic payment on the protected balance is the same limit used by the institution before the increased rate went into effect. Similarly, an institution is

¹³⁷ For example, an institution might require a minimum periodic payment that is the greater of \$20 or the total of 1% of the amount owed plus interest and fees.

permitted to require the consumer to make a pre-existing floor minimum payment that exceeds the amount permitted under § __.24(c)(1)(ii). Accordingly, the Agencies have adopted comment 24(c)-2.

__.24(c)(2) Fees and charges

The protections of proposed § __.24(a) would also be undercut if institutions were permitted to assess fees or other charges as a substitute for an increase in the annual percentage rate. Accordingly, proposed § __.24(c)(2) would have prohibited institutions from assessing any fee or charge based solely on the outstanding balance. As explained in proposed comment 24(c)(2)-1, this proposal would have prohibited, for example, an institution from assessing a monthly maintenance fee on the outstanding balance. The proposal would not, however, have prohibited an institution from assessing fees such as late payment fees or fees for exceeding the credit limit that are based in part on the outstanding balance. Similarly, proposed § __.24(c)(2) would not have prohibited assessment of fees that are unrelated to the outstanding balance, such as fees for providing account documents.

The Agencies did not receive any significant comment on this aspect of the proposal. Accordingly, proposed § __.24(c)(2) and the accompanying commentary have been revised for stylistic reasons and adopted as proposed.

Other Issues

Implementation. As discussed in § VII of this **SUPPLEMENTARY INFORMATION**, the effective date for § __.24 is July 1, 2010. As of that date, this provision applies to existing as well as new consumer credit card accounts and balances (except as expressly stated below). The Agencies provide the following guidance:

- Account opening disclosures. The disclosure requirements in § __.24(a) apply only to accounts opened on or after the effective date. Thus, if a consumer credit card account is opened on or after July 1, 2010, the institution must disclose the annual percentage rates that will apply to each category of transactions on that account.
- Rates that expire after a specified period of time. If a rate that will expire after a specified period of time applies to a balance on the effective date, the institution can apply an increased rate to that balance at expiration so long as the institution previously disclosed the increased rate. For example, if on January 1, 2010 an account is opened with a non-variable promotional rate of 5% on purchases that applies for one year (after which a variable rate will apply) and, on July 1, 2010, the 5% rate applies to a balance of \$2,000, the institution can apply the previously-disclosed variable rate to any remaining portion of the \$2,000 balance on January 1, 2011 pursuant to § __.24(b)(1).
- Variable rates that do not expire. If a variable rate that does not expire applies to a balance on the effective date, the institution may continue to adjust that rate due to increases in an index consistent with § __.24(b)(2).
- Non-variable rates that do not expire. If a non-variable rate that does not expire applies to a balance on the effective date, the institution cannot increase the rate that applies to that balance unless the account becomes more than 30 days' delinquent (in which case an increase is permitted by § __.24(b)(4)). For example, if an account has a \$3,000 purchase balance at a non-variable rate of 15% on July 1, 2010, the institution cannot subsequently increase the rate that applies to the \$3,000 (unless the account becomes more than 30 days' delinquent, in which case § __.24(b)(4) applies).

- Rate increases pursuant to advance notice under 12 CFR 226.9(c) or (g). Section __.24(b)(3) applies to any rate increase for new transactions that will take effect on or after the July 1, 2010 effective date. For example, assume that an account has a \$3,000 purchase balance at a non-variable rate of 15%. In order to increase the rate that applies to purchases made on or after July 1, 2010 to a non-variable rate of 18%, the institution must comply with 12 CFR 226.9(c) by providing notice of the increase at least 45 days in advance (in this case, on or before May 17, 2010). Assuming the institution provides the notice on May 17, the requirements in § __.24(c) will apply to the \$3,000 balance beginning on May 24, 2010.
- First year after the account is opened. An institution may not increase in an annual percentage rate pursuant to § __.24(b)(3) during the first year after the account is opened. However, this limitation does not apply to accounts opened prior to July 1, 2010. For example, if an account is opened on June 1, 2010, the institution may increase a rate for new transactions pursuant to § __.24(b)(3).
- Delinquencies of more than 30 days. An institution may increase a rate pursuant to § __.24(b)(4) when an account becomes more than 30 days' delinquent even if the delinquency began prior to the effective date. For example, if the required minimum periodic payment due on June 15, 2010 is not received until July 20, § __.24(b)(4) permits the institution to increase the rates on that account.
- Workout arrangements. If a workout arrangement applies to an account on the effective date and the consumer fails to comply with the terms of arrangement after the effective date, § __.24(b)(5) only permits the institution to apply an increased rate that does not exceed the rate that applied prior to commencement of the workout arrangement. For example, assume that, on June 1, 2010, an institution decreases the rate that applies to a \$5,000 balance from a non-variable penalty rate of 30% to a non-variable rate of 15% pursuant to a workout arrangement between the institution and the consumer. Under this arrangement, the consumer must pay by the fifteenth of each month in order to retain the 15% rate. The institution does not receive the payment due on July 15 until July 20. In these circumstances, § __.24(b)(5) does not permit the institution to apply a rate to the \$5,000 balance that exceeds the 30% penalty rate.

Effect of § __.24 on securitization. In the May 2008 Proposal, the Agencies requested comment on what effect the restrictions in proposed § __.24 would have on outstanding securitizations and institutions' ability to securitize credit card assets in the future. In response, industry commenters raised general concerns that a reduction in interest revenue as a result of proposed § __.24 could require institutions to alter the structure of existing securities and could reduce investor interest in future offerings. As discussed below, however, the Agencies are providing institutions and the markets for credit card securities with 18 months in which to adjust interest rates and other account terms to compensate for the restrictions in the final rules. Accordingly, the Agencies do not believe that any additional revisions are necessary to accommodate securitization of credit card assets.

Supplemental Legal Basis for This Section of the OTS Final Rule

As discussed above, HOLA provides authority for both safety and soundness and consumer protection regulations. For example, § 535.24 supports safety and soundness by reducing reputation risk that would occur from repricing consumer credit card accounts in an

unfair manner. Section 535.24 also protects consumers by providing them with fair terms on which their accounts may be repriced. Consequently, HOLA serves as an independent basis for § 535.24.

Section __.25—Unfair Balance Computation Method

Summary. In the May 2008 Proposal, the Agencies proposed § __.26, which would have prohibited institutions from imposing finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle. 73 FR at 28922-28923. This proposal was intended to prohibit the balance computation method sometimes referred to as “two-cycle billing” or “double-cycle billing.” As discussed below, based on the comments and further analysis, the Agencies have revised the proposed rule and its commentary to clarify that the final rule prohibits the assessment of interest charges on balances for days in prior billing cycles when such charges are imposed as a result of the loss of a grace period. The Agencies have also removed the exception for assessment of deferred interest and added an exception permitting adjustments to finance charges following the return of a payment for insufficient funds. Finally, because the Agencies are not taking action on proposed § __.25 at this time (as discussed below), proposed § __.26 has been designated in the final rule as § __.25.

Background. TILA requires creditors to explain as part of the account-opening disclosures the method used to determine the balance to which interest rates are applied. 15 U.S.C. 1637(a)(2). In its June 2007 Regulation Z Proposal, the Board proposed that the balance computation method be disclosed outside the account-opening table because explaining lengthy and complex methods may not benefit consumers. 72 FR at 32991–32992. That proposal was based on the Board’s consumer testing, which indicated that consumers did not understand explanations of balance computation methods. Nevertheless, the Board observed that, because some balance computation methods are more favorable to consumers than others, it was appropriate to highlight the method used, if not the technical computation details.

In response to the June 2007 Regulation Z Proposal, consumers, consumer groups, and a member of Congress urged the Board to prohibit two-cycle billing. The two-cycle balance computation method has several permutations but, generally speaking, an institution using the two-cycle method assesses interest not only on the balance for the current billing cycle but also on balances on days in the preceding billing cycle. This method generally does not result in additional finance charges for a consumer who consistently carries a balance from month to month (and therefore does not receive a grace period) because interest is always accruing on the balance. Nor does the two-cycle method affect consumers who pay their balance in full within the grace period every month because interest is not imposed on their balances. The two-cycle method does, however, result in greater interest charges for consumers who pay their balance in full one month but not the next month (and therefore lose the grace period).

The following example illustrates how the two-cycle method results in higher costs for these consumers than other balance computation methods: Assume that the billing cycle on a consumer credit card account starts on the first day of the month and ends on the last day of the month. The payment due date for the account is the twenty-fifth day of the month. Under the terms of the account, the consumer will not be charged interest on purchases if the balance at the end of a billing cycle is paid in full by the following payment due date (in other words, if the consumer receives a grace period). The consumer uses the credit card to make a \$500 purchase on March 15. The consumer pays the balance for the February billing cycle in full on March 25. At the end of the March billing cycle (March 31), the consumer’s balance consists only of the

\$500 purchase and the consumer will not be charged interest on that balance if it is paid in full by the following due date (April 25). The consumer pays \$400 on April 25, leaving a \$100 balance. Because the consumer did not pay the balance for the March billing cycle in full on April 25, the consumer would lose the grace period and most institutions would charge interest on the \$500 purchase from the start of the April billing cycle (April 1) through April 24 and interest on the remaining \$100 from April 25 through the end of the April billing cycle (April 30). Institutions using the two-cycle method, however, would also charge interest on the \$500 purchase from the date of purchase (March 15) to the end of the March billing cycle (March 31).

The proposed ban on two-cycle billing was generally supported by individual consumers, consumer groups, members of Congress, other federal banking regulators, state consumer protection agencies, state attorneys general, and some industry groups and credit card issuers. On the other hand, some credit card issuers and one industry group opposed the proposal on the grounds that two-cycle billing was not sufficiently prevalent to warrant a ban. As discussed below, the Agencies are including a prohibition on the two-cycle method because that method continues to be used by a number of large credit card issuers. To the extent that the commenters addressed specific aspects of the proposal or the supporting legal analysis, those comments are discussed below.

Legal Analysis

The Agencies conclude that, based on the comments received and their own analysis, it is an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC to impose finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle as a result of the loss of any time period provided by the institution within which the consumer may repay any portion of the credit extended without incurring a finance charge (in other words, a grace period).

Substantial consumer injury. In the May 2008 Proposal, the Agencies stated that computing finance charges based on balances preceding the most recent billing cycle appeared to cause substantial consumer injury because consumers who lose the grace period incur higher interest charges than they would under a balance computation method that calculates interest based only on the most recent billing cycle.

One industry commenter asserted that use of the two-cycle method could not cause an injury for purposes of the FTC Act simply because other, less costly methods exist. As discussed above, however, it is well established that monetary harm constitutes an injury under the FTC Act.¹³⁸ As with similar arguments raised regarding § __.23, this commenter did not provide any legal authority distinguishing interest charges assessed as a result of the two-cycle method from other monetary harms, nor are the Agencies aware of any such authority.

Another industry commenter stated that assessing interest consistent with a contractual provision to which the consumer agreed cannot constitute an injury under the FTC Act. As discussed above, however, this argument is inconsistent with the FTC's application of the unfairness analysis in support of the Credit Practices Rule, where the FTC determined that otherwise valid contractual provisions injured consumers.¹³⁹

¹³⁸ See Statement for FTC Credit Practices Rule, 49 FR at 7743; FTC Policy Statement on Unfairness at 3.

¹³⁹ See Statement for FTC Credit Practices Rule, 49 FR 7740 *et seq.*; see also *Am. Fin. Servs. Assoc.*, 767 F.2d at 978-83 (upholding the FTC's analysis).

Finally, an industry commenter argued that the two-cycle method was not unfair because it only injures consumers who lose the grace period. A practice need not, however, injure all consumers in order to be unfair.

Accordingly, the Agencies conclude that the two-cycle balance computation method causes substantial consumer injury.

Injury is not reasonably avoidable. The Agencies' May 2008 Proposal stated that it did not appear that consumers can reasonably avoid injury because, once they use the card, they have no control over the methods used to calculate the finance charges on their accounts. The proposal further noted that, because the Board's consumer testing indicates that disclosures are not successful in helping consumers understand balance computation methods, a disclosure would not enable consumers to avoid the two-cycle method when comparing credit card accounts or to avoid the effects of the two-cycle method when using a credit card.¹⁴⁰

One industry commenter argued that consumers could reasonably avoid the injury by paying their balance in full each month. As discussed above, however, because one of the intended purposes of a credit card (as opposed to a charge card) is to finance purchases over multiple billing cycles, it would not be reasonable to expect consumers to avoid the two-cycle method by paying their balance in full each month.

Accordingly, the Agencies conclude that consumers cannot reasonably avoid the injury caused by the two-cycle balance computation method.

Injury is not outweighed by countervailing benefits. The May 2008 Proposal stated that there did not appear to be any significant benefits to consumers or competition from computing finance charges based on balances for days in billing cycles preceding the most recent billing cycle. The Agencies also noted that many institutions no longer use the two-cycle balance computation method. In addition, the Agencies noted that, although prohibition of the two-cycle method may reduce revenue for the institutions that currently use it and those institutions may replace that revenue by charging consumers higher annual percentage rates or fees, it appeared that this result would nevertheless benefit consumers because it will result in more transparent pricing.

One industry commenter stated that, given a preference, consumers would choose lower prices and other purported benefits of the two-cycle method (such as the provision of a grace period) over transparency. As an initial matter, the commenter did not cite any evidence that institutions that use the two-cycle method are more likely to offer lower prices and grace periods than institutions that do not, nor are the Agencies aware of any such evidence. Furthermore, individual consumers overwhelmingly supported the proposed prohibition on the two-cycle method. Finally, the Agencies believe that transparent pricing provides substantial benefits to consumer by enabling them to make informed decisions about the use of credit.

Accordingly, the Agencies conclude that the two-cycle method does not produce benefits that outweigh the injury to consumers.

Public policy. Several industry commenters stated that the proposed rule was contrary to established public policy because, as noted above, TILA requires creditors to disclose the balance computation method at account opening (15 U.S.C. 1637(a)(2)) and Regulation Z includes the two-cycle method in the list of methods that may be described by name (12 CFR

¹⁴⁰ Although several industry commenters on the May 2008 Proposal argued that disclosure would enable consumers to choose a credit card with a different balance computation method, those commenters did not provide any evidence that refutes the Board's consumer testing.

226.5a(g)).¹⁴¹ Regulation Z's acknowledgement that the two-cycle method has been a commonly-used balance computation method does not, however, constitute an endorsement of that method. Furthermore, nothing in TILA or Regulation Z requires use of the two-cycle method.

One industry commenter noted that, more than twenty years ago, a member of the Board expressed concern that the costs of regulating balance computation methods could outweigh the benefits for consumers.¹⁴² As discussed above, however, the Agencies have concluded that, in today's marketplace, the costs associated with prohibiting this particular balance computation method do not outweigh the benefits to consumers.

Final Rule

As discussed below, the Agencies are not taking action on credit holds at this time. Accordingly, subject to the revisions discussed below, proposed § __.26 is adopted as § __.25. The proposed commentary has been redesignated to reflect this change.

__.25(a) General rule

The proposed rule prohibited institutions from imposing finance charges on balances on consumer credit card accounts based on balances for days in billing cycles preceding the most recent billing cycle. Proposed comment 26(a)–1 cited the two-cycle average daily balance computation method as an example of balance computation methods that would be prohibited by the proposed rule, tracking commentary under Regulation Z. *See* 12 CFR 226.5a(g)(2). Proposed comment 26(a)–2 provided an example of the circumstances in which the proposed rule prohibited the assessment of interest.

Industry commenters stated that, as drafted, the proposed rule went further than necessary to protect consumers from the injury caused by the two-cycle balance computation method. Specifically, because the proposed rule was not limited to circumstances in which the two-cycle method results in greater interest charges than other balance computation methods (that is, when a consumer who has been eligible for a grace period does not pay the balance in full on the due date), it would prohibit the assessment of interest from the date of the transaction even when the consumer was not eligible for a grace period. Because the Agencies did not intend this result, § __.25(a) and its commentary have been revised to clarify that an institution is prohibited from imposing finance charges based on balances for days in billing cycles that precede the most recent billing cycle as a result of the loss of the grace period. Otherwise, the Agencies adopt the proposed rule and commentary.

__.25(b) Exceptions

As proposed, § __.26(b) contained two exceptions to the general prohibition in § __.26(a). First, under proposed § __.26(b)(1), institutions would not be prohibited from charging consumers for deferred interest even though that interest may have accrued over multiple billing cycles. Thus, if a consumer did not pay a balance or transaction in full by the specified date under a deferred interest plan, the institution would have been permitted to charge the consumer for interest accrued during the period the plan was in effect. As discussed above,

¹⁴¹ As discussed elsewhere in today's **Federal Register**, the Board has not deleted the two-cycle method from the list in 12 CFR 226.5a(g) because the prohibition in § __.25 does not apply to all credit card issuers.

¹⁴² *See* Statement of Emmett J. Rice, Member, Board of Governors of the Federal Reserve System before the S. Subcomm. on Fin. Instits. (May 21, 1986).

because current practices regarding the assessment of deferred interest are prohibited by § __.24, this exception has not been adopted.

Second, under proposed § __.26(b)(2), institutions would not have been prohibited from adjusting finance charges following resolution of a billing error dispute. For example, if after complying with the requirements of 12 CFR 226.13 an institution determines that a consumer owes all or part of a disputed amount, the institution would be permitted to adjust the finance charge consistent with 12 CFR 226.13, even if that requires computing finance charges based on balances in billing cycles preceding the most recent billing cycle. The Agencies did not receive any significant comment on this exception. Accordingly, the Agencies have revised this exception for clarity and adopted it as § __.25(b)(1).

Industry commenters requested two additional exceptions to the proposed rule. First, they requested an exception when the date of a transaction for which the consumer does not receive a grace period is in a different billing cycle than the date on which that transaction is posted to the account – for example, if a consumer uses a convenience check for a cash advance transaction (which is not typically subject to a grace period) on the last day of a billing cycle, the check may not reach the institution for posting to the account until the first day of the next billing cycle or later. These commenters stated that the proposed rule should not apply in this situation because the institution is entitled to assess interest from the transaction date. Rather than creating an additional exception, the Agencies have addressed this concern by clarifying, as discussed above, that § __.25(a) only applies to interest charges imposed as a result of the consumer losing the grace period. Accordingly, when a consumer is not eligible for a grace period at the time of a transaction, the final rule does not prohibit the institution from assessing interest from the date of the transaction.

Second, industry commenters requested an exception allowing adjustments to finance charges when a consumer's payment is credited to the account in one billing cycle but is returned for insufficient funds in the subsequent billing cycle. This could occur, for example, when a consumer's check is received and credited by the institution near the end of a billing cycle but is returned to the institution for insufficient funds early in the next billing cycle. The Agencies view this situation as analogous to adjusting finance charges following resolution of a billing error or other dispute, which is permitted under § __.25(b)(1). Accordingly, the final rule adopts, in § __.25(b)(2), an exception permitting adjustments to finance charges as a result of the return of a payment for insufficient funds.

Other Issues

Implementation. As discussed in § VII of this **SUPPLEMENTARY INFORMATION**, the effective date for § __.25 is July 1, 2010. As of the effective date, this provision applies to existing as well as new consumer credit card accounts and balances.

Additional prohibitions considered. Consumer groups and a member of Congress requested that the proposed rule be expanded to cover two additional practices. First, they urged that, when a consumer who is eligible for a grace period pays some but not all of the relevant balance by the due date, the institution be prohibited from assessing interest on the amount paid. For example, assume that the billing cycle on a consumer credit card account starts on the first day of the month and ends on the last day of the month and that the payment due date is the twenty-fifth day of the month. Under the terms of the account, the consumer will receive a grace period on purchases if the balance at the end of a billing cycle is paid in full by the following payment due date. The consumer is eligible for a grace period on a \$500 purchase made on

March 15. At the end of the March billing cycle (March 31), the consumer's balance consists only of the \$500 purchase. The consumer pays \$400 on the following due date (April 25), leaving a \$100 balance. Because the consumer did not pay the balance for the March billing cycle in full on April 25, § __.25(a) prohibits the institution from charging interest on the \$500 purchase from the date of purchase (March 15) to the end of the March billing cycle (March 31). The commenters would also prohibit the institution from assessing any interest on \$400 of the \$500 purchase during the April billing cycle because the consumer paid that amount by the due date.

The Agencies, however, are not taking action on this issue at this time. As an initial matter, elsewhere in today's **Federal Register**, the Board has improved the disclosures under Regulation Z to assist consumers in understanding that they must pay the entire balance by the due date to receive the grace period.¹⁴³ Furthermore, because TILA does not require institutions to provide a grace period, the requested prohibition could reduce the availability of such periods, which provide substantial benefits to consumers. To the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

Second, many of the same commenters requested that, when a consumer who has been carrying a balance from month to month – and therefore has not been receiving a grace period – pays the balance stated on the most recent periodic statement by the applicable due date, the institution be prohibited from assessing interest on that balance in the period between mailing or delivery of the statement and receipt of the consumer's payment. This type of interest is sometimes referred to as "trailing interest." For example, assume that a consumer who is not eligible for a grace period receives a periodic statement reflecting a balance of \$1,000 as of March 31 and a due date of April 25. The consumer mails a payment of \$1,000, which is credited by the institution on April 25. Ordinarily, because the consumer was not eligible for a grace period, this payment will not be sufficient to pay off the balance in full because interest will have accrued on the \$1,000 balance from April 1 through April 24. The commenters, however, would prohibit the assessment of interest on the \$1,000 balance after March 31. The Agencies note that, because an institution will not know at the time it sends a periodic statement whether the consumer will pay the balance in full, the requested prohibition would essentially require institutions to waive subsequent interest charges for the subset of consumers who do so. To the extent that specific practices raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

Supplemental Legal Basis for This Section of the OTS Final Rule

As discussed above, HOLA provides authority for both safety and soundness and consumer protection regulations. Section 535.25 supports safety and soundness by reducing reputation risk that would occur from using unfair balance computation methods. Section 535.25

¹⁴³ See 12 CFR 226.5a(b)(5) comment 5a(b)(5)-1 ("The card issuer must state any conditions on the applicability of the grace period. An issuer that offers a grace period on all purchases and conditions the grace period on the consumer paying his or her outstanding balance in full by the due date each billing cycle, or on the consumer paying the outstanding balance in full by the due date in the previous and/or the current billing cycle(s) will be deemed to meet these requirements by providing the following disclosure, as applicable: 'Your due date is [at least] ___ days after the close of each billing cycle. We will not charge you interest on purchases if you pay your entire balance by the due date each month.'").

also protects consumers by providing them with fair balance computation methods on their account so that they do not pay additional interest due to the application of this balance computation method that testing shows few understand. Consequently, HOLA serves as an independent basis for § 535.25.

Section __.26—Unfair Charging of Security Deposits and Fees for the Issuance or Availability of Credit to Consumer Credit Card Accounts

Summary. In the May 2008 Proposal, the Agencies proposed § __.27(a), which would have prohibited institutions from charging to a consumer credit card account security deposits and fees for the issuance or availability of credit during the twelve months after the account is opened that, in the aggregate, constitute the majority of the credit limit for that account. The Agencies also proposed § __.27(b), which would have prohibited institutions from charging to the account during the first billing cycle security deposits and fees for the issuance or availability of credit that total more than 25 percent of the credit limit and would have required that if security deposits and fees for the issuance or availability of credit total more than 25 percent but less than the majority of the credit limit during the first year, the institution must spread that amount equally over the eleven billing cycles following the first billing cycle. Further, the Agencies proposed § __.27(c), which would have defined “fees for the issuance or availability of credit.” See 73 FR at 28925-28926.

Based on the comments received and further analysis, the Agencies have revised proposed § __.27(a) for clarity and adopted that provision as § __.26(a).¹⁴⁴ The Agencies have revised proposed § __.27(b) to permit security deposits and fees to be spread over no fewer than the first six months, rather than the first year (as proposed). This provision has been adopted as § __.26(b).¹⁴⁵

In § __.26(c), the Agencies have adopted a new provision prohibiting institutions from evading § __.26(a) and (b) by providing the consumer with additional credit to fund the payment of security deposits and fees for the issuance or availability of credit in excess of the amounts permitted by §§ __.26(a) and (b). The Agencies have also added definitions to proposed § __.27(c) and adopted that provision as § __.26(d).

Background. Subprime credit cards often have substantial fees related to the issuance or availability of credit. For example, these cards may impose an annual fee and a monthly maintenance fee for the card. In other cases, a security deposit may be charged to the account. These cards may also impose multiple one-time fees when the consumer opens the card account, such as an application fee and a program fee. Those amounts are often billed to the consumer as part of the first periodic statement and substantially reduce the amount of credit that the consumer has available to make purchases or other transactions on the account. For example, some subprime credit card issuers assess \$250 in fees at account opening on accounts with credit limits of \$300, leaving the consumer with only \$50 of available credit with which to make purchases or other transactions. In addition, the consumer will pay interest on the \$250 in fees until they are paid in full.

¹⁴⁴ As discussed above, the Agencies are not taking action on proposed § __.25 at this time. Accordingly, proposed § __.26 and § __.27 have been adopted as § __.25 and § __.26, respectively.

¹⁴⁵ For purposes of this discussion, products that currently charge security deposits and fees for the issuance or availability of credit that exceed the amounts permitted by the final rule are referred to as “high-fee subprime credit cards.”

The federal banking agencies have received many complaints from consumers with respect to subprime credit cards. Consumers often stated that they were not aware of how the high upfront fees would affect their ability to use the card for its intended purpose of engaging in transactions. In an effort to address these concerns, the Board's June 2007 and May 2008 Regulation Z Proposals included several proposed amendments to the disclosure requirements for credit and charge cards (which have been adopted in a revised form elsewhere in today's **Federal Register**). Because, however, the Agencies were concerned that disclosure alone was insufficient to protect consumers from unfair practices regarding high-fee subprime credit cards, the May 2008 Proposal contained additional, substantive protections.

The Agencies received comments on the proposed rule from a wide range of interested parties. The proposal received strong support from consumer groups, several members of Congress, the FDIC, the OCC, two state attorneys general, and a state consumer protection agency. These commenters generally argued that high-fee subprime credit cards trap consumers with low incomes or poor credit histories, causing those consumers either to pay off the upfront fees by depleting their limited resources or to default and further damage their credit records. In particular, one consumer group stated that high-fee subprime credit cards are unfair because: (1) the upfront fees impose an overly high price for access to credit and significantly reduce available credit, leading consumers to exceed their credit limit and incur additional fees; (2) disclosures are insufficient because subprime consumers are particularly vulnerable to predatory marketing practices and may have limited educational or literacy skills; and (3) subprime consumers generally have limited incomes and therefore cannot pay the upfront fees within the grace period for the initial billing cycle, causing them to incur interest charges. Many of these commenters urged the Agencies to strengthen the proposed rule by, for example, lowering the thresholds for security deposits and fees, applying those thresholds to all security deposits and fees regardless of whether they are charged to the account, and prohibiting the marketing of subprime credit cards as credit repair products.

Some industry commenters also expressed support for the proposed rule, stating that it was an appropriate use of the Agencies' rulemaking authority under the FTC Act. In contrast, other issuers who specialize in subprime credit cards strongly opposed the proposed rule. According to these commenters, the large upfront fees and limited initial credit availability that characterize high-fee subprime credit cards are necessitated by the risk and expense of extending credit to consumers who pose a greater risk of default than prime consumers. They asserted that subprime credit card accounts have higher delinquencies, losses, reserve requirements, and servicing costs than prime credit card accounts.¹⁴⁶ They further argued that, to the extent the proposal would prevent issuers from protecting themselves against the risk of loss, it would ultimately harm consumers because issuers would be forced to reduce credit access and increase the price of credit. They also asserted that high-fee subprime credit cards offer important benefits by providing credit cards to consumers who could not otherwise obtain them and by enabling consumers with limited or damaged credit records to build positive credit histories and qualify for prime credit. Finally, these commenters argued that any concerns regarding high-fee

¹⁴⁶ One subprime credit card issuer stated that approximately 30% of its consumers charge off without paying all or part of the balance due. The same issuer stated that the delinquency rate for subprime credit card accounts is approximately 20% (versus 4-5% for prime accounts) and that reserve requirements for such accounts can be up to 56% of outstanding balances (versus as little as 8% for prime credit card issuers). Finally, this issuer stated that subprime consumers contact their issuers an average of once or twice a month (versus once per year for prime consumers).

subprime credit cards should be addressed through improved disclosures, such as those proposed by the Board under Regulation Z.

Subprime credit card issuers received support from some state and Congressional representatives. The Agencies also received comments from thousands of individual consumers, who explained that high-fee subprime credit cards were the only option available to them because of their credit problems. These consumers expressed concern that they might have fewer credit alternatives if the proposal were finalized. Finally, two advocacy organizations expressed concern that the proposed rule would result in reduced credit availability for low-income minority consumers.

Legal Analysis

The Agencies conclude that, based on the comments received and their own analysis, it is an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC to charge to a consumer credit card account security deposits or fees for the issuance or availability of credit that exceed the limits in the final rule.

Substantial consumer injury. The Agencies conclude that consumers incur substantial monetary injury when security deposits and fees for the issuance or availability of credit are charged to a consumer credit card account, both in the form of the charges themselves and in the form of interest on those charges. Even in cases where the institution provides a grace period, many consumers will be unable to pay the charges in full during that grace period and will incur interest. Indeed, many consumers who use high fee subprime cards submitted comments explaining that they have very limited incomes. Moreover, a large issuer of subprime cards commented that, while it offers consumers the option of paying fees up front, most new cardholders do not do so. Thus, as consumer advocates noted in their comments, consumers who open a high-fee subprime credit card account are unlikely to be able to pay down the upfront charges quickly. In addition, when security deposits and fees for the issuance or availability of credit are charged to the consumer's account, they substantially diminish the value of that account by reducing the credit available to the consumer for purchases or other transactions.¹⁴⁷

Injury is not reasonably avoidable. In May 2008, the Agencies stated that the Board's proposed disclosures under Regulation Z did not appear to be sufficient, by themselves, to allow consumers to reasonably avoid the injury caused by security deposits and fees that consume most of the available credit at account opening. Specifically, the Agencies expressed concern that high-fee subprime credit cards are typically marketed to financially vulnerable consumers with limited credit options and that these products have in the past been associated with deceptive sales practices. Although several industry commenters asserted that the disclosures in Regulation Z were sufficient to enable consumers to avoid any injury, the Agencies conclude, for the reasons discussed below, that consumers cannot, as a general matter, reasonably avoid the injury caused by high-fee subprime credit cards.

In the May 2008 Proposal, the Agencies noted that high-fee subprime credit cards are typically marketed to vulnerable consumers whose credit histories or other characteristics

¹⁴⁷ See OCC Advisory Letter 2004-4, at 3 (Apr. 28, 2004) (stating that a finding of unfairness with respect to subprime cards with financed security deposits could be based on the fact that "because charges to the card by the issuer utilize all or substantially all of the nominal credit line assigned by the issuer, they eliminate the card utility and credit availability applied and paid for by the cardholder") (available at <http://www.occ.treas.gov/ftp/advisory/2004-4.txt>).

prevent them from obtaining less expensive credit card products.¹⁴⁸ In support of its Credit Practices Rule, the FTC suggested that, when most or all credit offers received by a consumer contain particular terms, those terms may not be reasonably avoidable.¹⁴⁹ In addition, when evaluating whether a practice violates the FTC Act, the FTC has considered whether that practice targets consumers who are particularly vulnerable to unfair or deceptive practices.¹⁵⁰ Similarly, states have used statutes and regulations prohibiting unfairness and deception to ensure that lenders do not “exploit the lack of access of low-income individuals, the elderly, and communities of color to mainstream banking institutions.”¹⁵¹

In response to the proposed rule, the Agencies received thousands of comments from individual consumers who have used high-fee subprime credit cards. These consumers frequently stated that, due to their credit problems and limited incomes, high-fee subprime credit cards were the only type of credit card that they could obtain. Many of these consumers described themselves as elderly, living on limited incomes, and/or having serious health problems. Accordingly, because high-fee subprime credit cards are marketed to financially vulnerable consumers who generally cannot obtain credit card products with less onerous terms, the Agencies conclude that – even with improved disclosures – those consumers cannot, as a general matter, reasonably avoid the injury caused by high upfront fees and low initial credit availability.

As discussed in the May 2008 Proposal, this conclusion is further supported by the Agencies’ concern that the Regulation Z disclosures could be undermined by deceptive sales practices. In addition to taking enforcement actions against issuers of high-fee subprime credit cards, the OCC has found as a general matter that “solicitations and other marketing materials

¹⁴⁸ For a consumer who has sufficient funds, a secured credit card account is generally a more beneficial product than a high-fee subprime credit card. Secured credit cards generally require the consumer to provide a cash collateral deposit that is equal to the credit line for the account. For example, in order to obtain a credit line of \$300, a consumer would be required to deposit \$300 with the lender. Generally, the consumer can receive the deposit back if the account is closed with no outstanding balance. In some cases, these deposits earn interest. See OTS Examination Handbook, Asset Quality, Section 218 Credit Card Lending at § 218.3 (May 2006). The final rule does not limit issuers’ ability to offer secured credit cards. Indeed, by restricting the financing of security deposits and fees, the final rule may encourage issuers to expand secured credit card offerings.

¹⁴⁹ See Statement for FTC Credit Practices Rule, 48 FR at 7746 (“If 80 percent of creditors include a certain clause in their contracts, for example, even the consumer who examines contract[s] from three different sellers has a less than even chance of finding a contract without the clause. In such circumstances relatively few consumers are likely to find the effort worthwhile, particularly given the difficulties of searching for contract terms. . . .” (footnotes omitted)).

¹⁵⁰ See FTC Trade Regulation Rule; Funeral Industry Practices, 47 FR 42260, 42262 (Sept. 24, 1982) (stating finding by the FTC’s Presiding Officer “that the funeral transaction has several characteristics which place the consumer in a disadvantaged bargaining position . . . , leave the consumer vulnerable to unfair and deceptive practices, and cause consumers to have little knowledge of legal requirements [and] available alternatives”); In the Matter of Travel King, Inc., 86 F.T.C. 715 (Sept. 30, 1975), paragraphs 7 and 8 (alleging that “[p]eople who are seriously ill, and their families, are vulnerable to the influence of respondents’ promotions [regarding ‘psychic surgery’] which held out tantalizing hope which the medical profession, by contrast, cannot offer”).

¹⁵¹ United Companies Lending Corp. v. Sargeant, 20 F. Supp. 2d 192, 203 (D. Mass. 1998) (upholding a state regulation that limited the rates and other terms of certain subprime mortgage loans in order to “prevent[] lenders from exploiting the financial vacuum created by redlining”).

used for [high-fee subprime] credit card programs have not adequately informed consumers of the costs and other terms, risks, and limitations of the product being offered” and that, “[i]n a number of cases, disclosure problems associated with secured credit cards and related products have constituted deceptive practices under the applicable standards of the FTC Act.”¹⁵² The Agencies believe that the amendments to Regulation Z published elsewhere in today’s **Federal Register** will reduce the risk of deception in written solicitations. However, because of the vulnerable nature of subprime consumers and the history of deceptive practices by some subprime credit card issuers, the Agencies remain concerned that the required disclosures could be undermined by, for example, deceptive telemarketing practices.¹⁵³

Injury is not outweighed by countervailing benefits. In May 2008, the Agencies recognized that, in some cases, high-fee subprime credit cards can provide access to credit to consumers who are unable to obtain other credit card products. Nevertheless, the Agencies stated that, once security deposits and fees for the issuance or availability of credit consume a majority of the initial credit limit, the benefit to consumers from access to credit appeared to be outweighed by the high cost of paying for that credit. In order to minimize the impact on access to credit, the Agencies tailored the proposed rule to allow institutions to charge to the account security deposits and fees that total less than a majority of the credit limit during the first year and by allowing institutions to charge amounts totaling up to 25 percent of the initial credit limit in the first billing cycle. In addition, the Agencies clarified that security deposits and fees paid from separate funds would not be affected by the proposal.

In response, industry commenters who opposed the rule primarily relied on two arguments. First, they contended that, rather than increasing access to credit, the restrictions in the proposed rule would reduce or eliminate the availability of credit cards for subprime consumers. Specifically, they argued that the cost of extending credit to subprime consumers is substantially higher than the cost of extending credit to prime consumers and that the proposed rule would limit subprime issuers’ ability to pass those higher costs on to consumers. In addition, they argued that the proposed restrictions on the amount of security deposits and fees that may be charged to the account in the first billing cycle will actually increase issuer costs because subprime issuers will be forced to make more credit available to consumers, which will increase their cost of funds, their reserve requirements, and their losses. As a result, they argued, subprime credit card issuers will be forced to reduce costs by substantially reducing the amount of credit extended to subprime consumers.

The Agencies have carefully considered the arguments presented by these commenters but have concluded that, while the final rule may result in some subprime consumers who are currently eligible for high-fee subprime credit cards not having access to a credit card, this outcome does not outweigh the benefits to subprime consumers generally of receiving credit cards that provide a meaningful amount of available credit. The Agencies recognize that credit cards enable consumers to engage in certain types of transactions, such as making purchases by

¹⁵² OCC Advisory Letter 2004-4, at 2-3 (emphasis in original); see also In re First Nat’l Bank in Brookings, No. 2003-1 (Dept. of the Treasury, OCC) (Jan. 17, 2003) (available at www.occ.treas.gov/ftp/eas/ea2003-1.pdf); In re First Nat’l Bank of Marin, No. 2001-97 (Dept. of the Treasury, OCC Dec. 3, 2001) (available at www.occ.treas.gov/ftp/eas/ea2001-97.pdf).

¹⁵³ See, e.g., People v. Applied Card Sys., Inc., 805 N.Y.S.2d 175, 178 (App. Div. 2005) (finding that credit card marketing materials sent to consumers who were otherwise unable to qualify for credit “did not represent an accurate estimation of a consumer’s credit limit” and that, “at all times, it appeared that the confusion was purposely fostered by [the defendant’s] telemarketers.”).

telephone or online or renting a car or hotel room. As noted above, however, credit lines for subprime credit card accounts are typically very low, meaning that, once security deposits and fees have been charged to the account, consumers receive little available credit with which to make purchases until they pay off the deposits or fees. Currently, many subprime credit card issuers assess fees that consume 75 percent or more of the credit line at account opening. Thus, on an account with a \$400 credit limit, a consumer may pay \$300 (plus interest charges) to obtain \$100 of available credit. The benefit of receiving this relatively small amount of available credit does not outweigh its high cost.

Some industry commenters suggested that, rather than focusing on the amount of available credit at account opening, the Agencies should consider the benefits to consumers who pay the upfront charges and then have access to the entire credit line. As an initial matter, these commenters did not provide information regarding how many consumers are able to obtain access to the entire credit line or how long it takes them to do so. Furthermore, as noted above, a large issuer of subprime cards indicated that few new cardholders choose not to finance the upfront fees, and many consumer commenters who use high fee subprime cards explained that they have limited incomes. Therefore, it is unlikely that consumers who open a high-fee subprime credit card account will be able to pay down the upfront charges quickly. Moreover, as noted above, consumers who have the resources to pay upfront charges may receive more economic benefit from using those resources to obtain secured credit card accounts instead of high-fee subprime credit cards.

Accordingly, the Agencies conclude that, when security deposits and fees charged to a credit card account in the first year exceed the amount of credit extended at account opening, the injury caused by the charges outweighs the benefit to the consumer of receiving available credit. Similarly, the Agencies conclude that, in order to ensure that consumers receive a meaningful amount of available credit at account opening that outweighs the injury, security deposits and fees can consume no more than 25 percent of the available credit at account opening.¹⁵⁴

Although these restrictions will require issuers of high-fee subprime credit cards to adjust their lending practices, the Agencies believe that the final rule provides sufficient flexibility for these issuers to continue offering credit cards to subprime consumers. Specifically, subprime issuers may charge to the account in the first year security deposits and fees totaling 50 percent

¹⁵⁴ Some issuers and members of Congress recommended that the Agencies endorse a “Code of Fair Practices” instead of finalizing the rule. These practices include enhanced disclosure, offering consumers the option to pay fees up front, not assessing interest on fees posted to the account, a commitment to report account payment experience to credit reporting agencies, and offering consumers the opportunity to cancel the card after receiving disclosures. Several of these “best practices” have essentially been codified by the Board’s amendments to Regulation Z elsewhere in today’s **Federal Register**. For example, creditors will be required to disclose the impact of security deposits and fees for the issuance or availability of credit on the amount of available credit the consumer will receive at account opening. See 12 CFR 226.5a(b)(14). In addition, the Board has clarified the circumstances under which a consumer who has received account-opening disclosures (but has not yet used the account or paid a fee) may reject the plan and not be obligated to pay upfront fees. See 12 CFR 226.5(b)(1)(iv). As discussed above, few consumers considering high fee subprime cards are likely to have the resources to pay the amount of fees currently assessed “up front.” Moreover, while the Agencies support accurate credit reporting, the rulemaking record discussed below indicates that the majority of high fee subprime cardholders do not improve their credit scores. Finally, while forbearance from charging interest on fees would provide some benefit to consumers, that benefit is outweighed by the harm that consumers experience from the high fees themselves.

of the initial credit limit and may charge half of that total at account opening.¹⁵⁵ In addition, the Agencies have modified the proposal to permit issuers to spread deposits and fees that constitute more than 25 percent of the initial credit limit over the first six months rather than the first year. This change is intended to better enable issuers to limit the risk from the early default of new cardholders, but still ensure that consumers who obtain these cards have meaningful access to credit. Furthermore, although issuers are prohibited from evading the final rule by providing the consumer with additional credit to finance additional fees, the final rule does not limit issuers' ability to collect additional amounts if the consumer can obtain those funds independently.

The second argument raised by industry commenters was that high-fee subprime credit cards offer an opportunity for consumers with damaged or limited credit histories to build or repair their credit records and qualify for credit at prime rates. However, the data supplied by these commenters indicates that most users of high-fee subprime credit cards do not experience an increase in credit score. Specifically, a study of subprime accounts performed by TransUnion (one of the three nationwide consumer reporting agencies) indicates that, while approximately 37 percent of consumers experienced an increase in credit score during the twelve months following the opening of a subprime credit card, the other 63 percent experienced a drop or no change in credit score.¹⁵⁶ Similarly, a subprime credit card issuer stated that only 35 percent of consumers who receive its low limit credit cards improve their credit score within 24 months of account opening.¹⁵⁷ The Agencies cannot verify the accuracy of this data, nor can the Agencies verify that the subset of consumers who did experience an increase in credit score did so as a result of the use of a subprime credit card and not due to other factors. Furthermore, even assuming for purposes of this discussion that the data are accurate, they indicate that most consumers who use subprime credit cards do not experience an increase in credit score. In fact, it appears that the majority of the consumers in the sample studied by TransUnion actually experienced a decrease in credit score within twelve months of opening a subprime credit card account.¹⁵⁸

Accordingly, for the reasons discussed above, the Agencies conclude that high-fee subprime credit cards do not produce benefits that outweigh the injury to consumers.

Public policy. For purposes of the unfairness analysis, public policy is generally embodied in a statute, regulation, or judicial decision.¹⁵⁹ In the May 2008 Proposal, however, the Agencies noted that the OCC has concluded in regulatory guidance that high-fee subprime credit card accounts increase the risk of default and therefore present concerns regarding the

¹⁵⁵ Notably, the final rule does not place any limit on the dollar amount of security deposits and fees that may be charged to the account. Instead, the amount of deposits and fees that an issuer may charge to the account is tied to the credit limit, which the issuer determines.

¹⁵⁶ See TransUnion Summary of Results for CEAC Coalition ("TransUnion Summary") at 4 (dated July 2008) (attached to comment letter from the Political and Economic Research Council (PERC) (dated Aug. 4, 2008)).

¹⁵⁷ This same issuer also stated that, on average, only 22.5% of these consumers receive a higher limit card within 24 months, which – it asserted – is higher than the industry average of 20%.

¹⁵⁸ See TransUnion Summary at 6.

¹⁵⁹ See, e.g., FTC Policy Statement on Unfairness at 5.

safety and soundness of financial institutions.¹⁶⁰ To the extent that this guidance constitutes public policy, that policy weighs in favor of the restrictions in the final rule. The OCC's guidance does not, however, serve as a primary basis for the Agencies' unfairness determination.

Supplemental Legal Basis for This Section of the OTS Final Rule

As discussed above, HOLA provides authority for both safety and soundness and consumer protection regulations. Section 535.26 supports safety and soundness. The commenters described very high credit risks associated with high-fee subprime credit cards. One estimated that at least one-third of new high fee cardholders default and over 75 percent of them default immediately, upon using 97 percent of their available credit, paying no fees, and repaying no principal. The TransUnion study also found that about 60 percent of subprime cardholders experience a drop in their VantageScore, which suggests a continuing inability to pay these obligations. Section 535.26 provides issuers with an incentive to employ better underwriting in order to target customers who are less likely to default. Consequently, it fosters the safe and sound operation of the institutions that offer these products.

In this vein, it should be noted that the federal banking agencies have agreed that subprime lending that is appropriately underwritten, priced and administered can serve the goals of enhancing credit access for borrowers with blemished credit histories.¹⁶¹ However, OTS has made it clear that credit card issuers under its jurisdiction must have well-defined credit approval criteria to ensure that underwriting standards are appropriately and uniformly followed.¹⁶² OTS advises all of its institutions that whether they use a judgmental process, an automated scoring system, or a combination of both to make the credit decision, it is important to have well-defined credit approval criteria to ensure that underwriting standards are appropriately and uniformly followed.¹⁶³ Appropriate underwriting should reduce the costs of default for issuers and consumers with subprime credit histories.

Moreover, as noted above, subprime cardholders now receive little usable credit due to the current market practice of charging fees for the issuance of credit in amounts that substantially exhaust the line. Section 535.26 should alleviate some of the negative consequences associated with this practice, including the creation of unmanageable debt that consumers cannot repay. In particular, requiring issuers to spread the payment of a portion of account opening fees over a number of billing cycles should increase the likelihood that borrowers can repay them. It is therefore consistent with guidance issued by the federal banking

¹⁶⁰ See OCC Advisory Letter 2004-4, at 4 (“[P]roducts carrying fee structures that are significantly higher than the norm pose a greater risk of default. . . . This is particularly true when the security deposit and fees deplete the credit line so as to provide little or no card utility or credit availability upon issuance. In such circumstances, when the consumer has no separate funds at stake, and little or no consideration has been provided in exchange for the fees and other amounts charged to the consumer, the product may provide a disincentive for responsible credit behavior and adversely affect the consumer's credit standing.”)

¹⁶¹ Interagency Expanded Guidance for Subprime Lending Programs (Feb. 2, 2001).

¹⁶² OTS Examination Handbook, Asset Quality, Section 218 Credit Card Lending, at § 218.5 (May 2006).

¹⁶³ *Id.*

agencies on the management of credit card lending.¹⁶⁴ It is also consistent with guidance issued by the OTS.¹⁶⁵

Given the high default rate and the unsecured nature of credit card lending, OTS concludes that it is not a safe and sound practice for savings associations to offer consumer credit cards that charge security deposits and fees that do not comply with § 535.26.

With regard to consumer protection, § 535.26 is consistent with regulating savings associations in a manner that protects consumers and gives due consideration to best practices of thrift institutions nationwide. As a result of this provision, consumers will be protected from excessive security deposits and fees for the issuance or availability of credit that diminish the value of the account by reducing the credit available to the consumer for purchases or other transactions. They will also be protected from incurring excessive cost for credit cards that provide access to a very small amount of credit. Issuers will have less incentive to make unsubstantiated claims that these products facilitate credit repair. These benefits are particularly important when it is recognized that the consumers most likely to receive the protections provided by § 535.26 are those who are the most vulnerable, including people who are elderly, live on limited incomes, have serious health problems, or live with a combination of these circumstances.

Consequently, HOLA serves as an independent basis for § 535.26.

Final Rule

As discussed above, the Agencies have redesignated proposed § __.27 as § __.26. The proposed commentary has been revised accordingly. In addition, the title of this section has been revised for clarity.

__.26(a) Limitation for first year

Proposed § __.27(a) would have prohibited institutions from charging to the account security deposits and fees for the issuance or availability of credit during the twelve months following account opening if, in the aggregate, those fees constitute a majority of the initial credit limit. The Agencies have revised this paragraph of the proposed rule for clarity and adopted it as § __.26(a).

Proposed comment 27(a)-1 clarified that the total amount of security deposits and fees for the issuance or availability of credit constitutes a majority of the initial credit limit if that total is greater than half of the limit and provided an example. The Agencies adopt this comment as comment 26(a)-1.

Proposed § __.27(b) would have prohibited institutions from charging to the account during the first billing cycle security deposits and fees for the issuance or availability of credit that, in the aggregate, constitute more than 25 percent of the initial credit limit. It would have further required that any additional security deposits and fees be spread equally among the

¹⁶⁴ See Interagency Guidance, Credit Card Lending, Account Management and Loss Allowance Guidance, OTS, Examination Handbook, Asset Quality, Credit Card Lending, Appendix A.

¹⁶⁵ OTS Examination Handbook, Asset Quality, Section 218 Credit Card Lending, p. 218.10 (May 2006). Notably, OTS has recognized the risks to safety and soundness of subprime lending by requiring more intensive risk management and capital for institutions that engage in subprime lending. *Id.* at § 218.4. These risks are particularly pronounced in the current economic environment, in which credit card charge-offs have increased. See Federal Reserve Board Statistical Release, Charge-off and Delinquency Rates, 3rd Q 2008 (available at: <http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm>).

eleven billing cycles following the first billing cycle. Proposed comment 27(b)-1 clarified that, when dividing amounts pursuant to § __.27(b)(2), the institution may adjust amounts by one dollar or less. Proposed comment 27(b)-2 provided an example of the application of the rule.

As discussed above, the Agencies have adopted § __.27(b) as § __.26(b) with modifications. The final rule provides that security deposits and fees that constitute more than 25 percent of the initial credit limit be charged to the account in equal portions in no fewer than the five billing cycles immediately following the first billing cycle. Institutions that wish to spread these deposits and fees over a longer period may do so. This change is intended to better enable issuers to limit the risk of early default by new cardholders, but still ensure that consumers who obtain these cards have meaningful access to credit. The Agencies have revised proposed comments 27(b)-1 and 27(b)-2 for consistency with the final rule and adopted those comments as 26(b)-1 and 26(b)-2, respectively.

__.26(c) Evasion prohibited

As discussed above, some consumer groups expressed concern that institutions could evade the proposed rule by requiring consumers to pay security deposits and fees for the issuance or availability of credit from separate funds. Although the Agencies generally do not intend the final rule to apply to amounts that are not charged to the account (such as deposits for secured credit cards), the Agencies conclude that § __.26 would provide little effective protection against the unfair assessment of security deposits and fees if institutions could evade its requirements by providing the consumer with additional credit to fund the payment of security deposits and fees for the issuance or availability of credit that exceed the total amounts permitted by §§ __.26(a) and (b). Accordingly, the Agencies have adopted § __.26(c), which prohibits this practice. The Agencies have also adopted comment 26(c)-1 (which provides an example of the application of the rule) and comment 26(c)-2 (which clarifies that an institution does not violate § __.26(c) if it requires the consumer to pay security deposits or fees for the issuance or availability of credit using funds that are not obtained, directly or indirectly, from the institution).

__.26(d) Definitions

Proposed § __.27(c) would have defined “fees for the issuance or availability of credit” as including any annual or other periodic fee, any fee based on account activity or inactivity, and any non-periodic fee that relates to opening an account. This definition is based on the definition of “fees for the issuance or availability of credit” in 12 CFR 226.5a(b)(2), published by the Board elsewhere in today’s **Federal Register**. This definition does not include fees such as late fees or fees for exceeding the credit limit. In order to provide additional clarity, the Agencies have added definitions of other terms used in the rule and have adopted those definitions in § __.26(d). Specifically, the Agencies have moved the definition of “initial credit limit” in proposed comment 27-1 into the text of the regulation and added definitions clarifying the meaning of the terms “first billing cycle” and “first year.”

Proposed comments 27(c)-1, -2, and -3 clarified the meaning of “fees for the issuance or availability of credit.” These comments were based on similar commentary to 12 CFR 226.5a(b)(2), which was proposed by the Board with its June 2007 Regulation Z Proposal. The Agencies have revised the proposed commentary to § __.26(d) for consistency with the final Regulation Z commentary published by the Board elsewhere in today’s **Federal Register**. Specifically, proposed comment 27(c)-2 has been revised to clarify that fees for providing additional cards to primary cardholders (as opposed to authorized users) are fees for the issuance or availability of credit. Otherwise, these comments are redesignated as comments 26(d)-1, -2, and -3 and adopted as proposed.

Other Issues

Implementation. As discussed in § VII of this **SUPPLEMENTARY INFORMATION**, the effective date for § __.26 is July 1, 2010. Although the Agencies particularly encourage institutions to use their best efforts to conform their practices to this section of the final rule sooner, institutions are not prohibited from charging security deposits and fees for the issuance or availability that do not comply with § __.26 until the effective date. These provisions do not affect security deposits and fees charged to consumer credit card accounts prior to that date, even if some or all of the security deposits and fees have not been paid in full as of the effective date.

Advertising. Based on the record in this rulemaking, the Agencies are not persuaded that, as a general matter, high-fee subprime credit cards provide meaningful benefits to consumers as credit repair tools. Notably, institutions that make marketing claims regarding the use of subprime credit cards as a means to improve credit scores risk violating the FTC Act's prohibition on deception if they cannot substantiate their claims.¹⁶⁶ Savings associations that cannot do so are also at risk of violating the OTS rule against making inaccurate representations in advertising.¹⁶⁷

Other Proposals

Proposed § __.25—Unfair Acts or Practices Regarding Fees for Exceeding the Credit Limit Caused by Credit Holds

Summary. In May 2008, the Agencies proposed § __.25, which would have prohibited institutions from assessing a fee or charge for exceeding the credit limit on a consumer credit card account if the credit limit would not have been exceeded but for a hold placed on any portion of the available credit on the account that is in excess of the actual purchase or transaction amount. See 73 FR 28921-28922. The Agencies intended this provision to parallel proposed § __.32(b), which would have imposed identical restrictions with respect to holds placed on available funds in a deposit account as a result of a debit card transaction. See id. at 28931-32892. As discussed below, the Agencies are not taking action on debit holds or credit holds at this time.

Background. Although the Board's June 2007 Regulation Z Proposal did not directly address over-the-credit-limit (OCL) fees, the Board received comments from consumers, consumer groups, and members of Congress expressing concern about the penalties imposed by creditors for exceeding the credit limit. Specifically, commenters were concerned that consumers may unknowingly exceed their credit limit and incur significant rate increases and fees as a result.

As discussed in the May 2008 Proposal, the Agencies believed these concerns were addressed by proposed § __.24 to the extent that it prohibited institutions from applying increased rates to outstanding balances as a penalty for exceeding the credit limit. The Agencies were concerned, however, about the imposition of OCL fees in connection with credit holds. As further discussed below in § VI of this **SUPPLEMENTARY INFORMATION**, some merchants place a temporary "hold" on an account when a consumer uses a credit or debit card

¹⁶⁶ See FTC Policy Statement Regarding Advertising Substantiation, 49 FR 30999 (Aug. 2, 1984); see also FTC v. QT, Inc., 448 F. Supp. 2d. 908, 959-960 (N.D. Ill. 2006) (substantiation policy used in federal litigation as guidance for the court), aff'd, 512 F.3d 858 (7th Cir. 2008).

¹⁶⁷ See 12 CFR 563.27.

for a transaction in which the actual purchase amount is not known at the time the transaction is authorized. For example, when a consumer uses a credit card to obtain a hotel room, the hotel often will not know the total amount of the transaction at the time because that amount may depend on, for example, the number of days the consumer stays at the hotel or the charges for incidental services the hotel may provide to the consumer during the stay (such as room service). Therefore, the hotel may place a hold on the available credit on the consumer's account in an amount sufficient to cover the expected length of the stay plus an additional amount for potential purchases of incidentals. In these circumstances, the institution may authorize the hold but the final amount of the transaction will not be known until the hotel submits the actual purchase amount for settlement.

Typically, the hold is kept in place until the transaction amount is presented to the institution for payment and settled, which may take place a few days after the original authorization. During this time between authorization and settlement, the hold may remain in place on the consumer's account. As discussed in the May 2008 Proposal, the Agencies were concerned that consumers who were unfamiliar with credit hold practices might inadvertently exceed the credit limit and incur an OCL fee because they assumed that the available credit was reduced only by the actual amount of the purchase.

Comments received. Industry commenters stated that credit holds do not typically reduce the amount of available credit on a consumer credit card account (in contrast to debit holds, which do reduce the amount of available funds in a deposit account). Some stated that, for this reason, they did not object to the proposed rule, while others argued that – to the extent the provision would require any changes to issuers' systems – it would be unnecessarily burdensome because credit holds are very unlikely to result in OCL fees.

The proposed rule was supported by consumer groups, members of Congress, the FDIC, state attorneys general, and state consumer protection agencies, although these commenters generally argued that the final rule should go further in addressing the harm caused by OCL fees. Some of these commenters argued that exceeding the credit limit should not be a basis for loss of a promotional rate under proposed § __.24(b)(2). As discussed above with respect to § __.24, the Agencies agree and the final version of § __.24(b)(2) does not permit this practice.

In addition, some of these commenters argued that institutions that reduce the credit limit on a consumer credit card account should be prohibited from penalizing consumers for exceeding that reduced limit. The Agencies believe that these concerns are addressed by the Board's revisions to Regulation Z, published elsewhere in today's **Federal Register**. Specifically, 12 CFR 226.9(c)(2)(v) provides that, if a creditor decreases the credit limit on an account, notice of the decrease must be provided at least 45 days before an OCL fee or a penalty rate can be imposed solely as a result of the consumer exceeding the newly-decreased limit.

These commenters also urged the Agencies to take a variety of other actions with respect to OCL fees, including prohibiting OCL fees unless the account is over the credit limit at the end of the billing cycle, prohibiting OCL fees when the institution approved the transaction that put the account over the credit limit (or allowing consumers to direct institutions not to honor such transactions), prohibiting OCL fees when interest charges or other fees placed the account over the credit limit, prohibiting multiple OCL fees based on a single transaction, and prohibiting OCL fees that are not reasonably related to the institution's cost. The Agencies, however, believe that the protections provided elsewhere in Regulation Z and in this final rule – particularly the prohibition on repricing existing balances as a penalty for exceeding the credit limit – provide substantial protections for consumers who exceed their credit limit.

Conclusion. The Agencies are not taking action on credit holds or debit holds at this time. As discussed below in § VI of this **SUPPLEMENTARY INFORMATION**, the Board has published proposed amendments to Regulation E addressing debit holds elsewhere in today’s **Federal Register**. The Agencies will review information obtained through that rulemaking to determine whether to take further action. In addition, to the extent that specific practices involving debit or credit holds raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions.

Proposed § __.28—Deceptive Acts or Practices Regarding Firm Offers of Credit

Summary. In May 2008, the Agencies proposed § __.28 to address circumstances in which institutions make firm offers of credit for consumer credit card accounts that contain a range of or multiple annual percentage rates or credit limits because such offers appeared to be deceptive. *See* 72 FR at 28925-28927. When the rate or credit limit that a consumer responding to such an offer will receive depends on specific criteria bearing on creditworthiness, proposed § __.28 would have required that the institution disclose the types of eligibility criteria in the solicitation. An institution would have been permitted to use the following disclosure to meet these requirements: “If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.” Based on the comments and further analysis, the Agencies have concluded that concerns regarding firm offers of credit containing a range of or multiple annual percentage rates are adequately addressed by provisions of Regulation Z published by the Board elsewhere in today’s **Federal Register**. Accordingly, as discussed below, the Agencies are not taking action on this issue at this time.

Background. The Fair Credit Reporting Act (FCRA) limits the purposes for which consumer reports can be obtained. It permits consumer reporting agencies to furnish consumer reports only for one of the “permissible purposes” enumerated in the statute.¹⁶⁸ One of the permissible purposes set forth in the FCRA relates to prescreened firm offers of credit or insurance.¹⁶⁹ In a typical use of prescreening for firm offers of credit, a creditor submits a request to a consumer reporting agency for the contact information of consumers meeting certain pre-established criteria, such as credit scores or a lack of serious delinquencies. The creditor then sends offers of credit targeted to those consumers, which state certain terms under which credit may be provided. For example, a firm offer of credit may contain statements regarding the annual percentage rate or credit limit that may be provided.

The FCRA requires that a firm offer of credit state, among other things, that (1) information contained in the consumer’s credit report was used in connection with the transaction; (2) the consumer received the firm offer because the consumer satisfied the criteria for creditworthiness under which the consumer was selected for the offer; and (3) if applicable, the credit may not be extended if, after the consumer responds to the offer, the consumer does not meet the criteria used to select the consumer for the offer or any other applicable criteria bearing on creditworthiness or does not furnish any required collateral.¹⁷⁰ The creditor may

¹⁶⁸ *See* 15 U.S.C. 1681b. Similarly, persons obtaining consumer reports may do so only with a permissible purpose. *See* 15 U.S.C. 1681b(f).

¹⁶⁹ *See* 15 U.S.C. 1681b(c); *see also* 15 U.S.C. 1681a(l) (defining “firm offer of credit or insurance”).

¹⁷⁰ *See* 15 U.S.C. 1681m(d)(1); *see also* 16 CFR 642.1–642.4 (Prescreen Opt-Out Notice Rule).

apply certain additional criteria to evaluate applications from consumers that respond to the offer, such as the consumer's income.¹⁷¹

As discussed in the May 2008 Proposal, the Agencies were concerned that, because firm offers of credit often state that consumers have been "pre-selected" for credit or make similar statements, consumers receiving such offers may not understand that they are not necessarily eligible for the lowest annual percentage rate and the highest credit limit stated in the offer. Thus, in the absence of an affirmative statement to the contrary, consumers could reasonably believe that they could receive the lowest annual percentage rate and highest credit limit stated in the offer even though that is not the case. Accordingly, the Agencies proposed § __.28.

Comments received. Proposed § __.28 was supported by some industry commenters as well as some members of Congress, the FDIC, and state attorneys general. Other industry commenters argued that the Agencies' concerns regarding firm offers of credit were more appropriately addressed under Regulation Z or the FCRA. Consumer groups, some members of Congress, and a state consumer protection agency criticized the proposed disclosure as ineffective and requested that the Agencies take more substantive action, such as prohibiting institutions from making firm offers of credit that do not state a specific annual percentage rate or credit limit or making firm offers of credit to consumers who are not eligible for the best terms stated in the offer.

Conclusion. The Agencies believe that the Board's final rules under Regulation Z (published elsewhere in today's **Federal Register**) adequately address their concerns regarding firm offers of credit that contain a range of or multiple annual percentage rates. Specifically, the Board has adopted 12 CFR 226.5a(b)(1)(v) to address circumstances in which a creditor is unable to state in a solicitation the exact rate all consumers who respond to the solicitation will receive because that rate depends on a subsequent evaluation of the consumer's creditworthiness. This provision generally requires the creditor to disclose in the Schumer Box provided with credit card solicitations (including firm offers of credit) the specific rates or the range of rates that could apply and to state that the rate for which the consumer may qualify at account opening will depend on the consumer's creditworthiness and other factors (if applicable).

After conducting consumer testing, the Board has also provided model forms that can be used to disclose multiple rates or a range of rates. See App. G to 12 CFR 226, Samples G-10(B) and G-10(C). In this testing, almost all participants understood that, when multiple rates or a range of rates were provided in the Schumer Box, it meant that the consumer's initial annual percentage rate would be determined among those rates or within that range based on the consumer's credit history and credit score. Accordingly, the Agencies believe that 12 CFR 226.5a(b)(1)(v) adequately addresses concerns that consumers will be misled when firm offers state multiple or a range of annual percentage rates.

Similarly, although Regulation Z does not require disclosure of the credit limit in the Schumer Box, the Board's consumer testing indicates that consumers are not misled by solicitations stating multiple credit limits or a range of credit limits. Specifically, when a solicitation did not state a specific credit limit, almost all participants understood that the credit limit for which they would qualify depended on their creditworthiness. In addition, when

¹⁷¹ See, e.g., 15 U.S.C. 1681a(l).

looking at statements that the initial credit limit would be “up to \$2,500,” most participants understood that the limit they would receive might be lower than \$2,500.¹⁷²

Accordingly, the Agencies are not taking action regarding firm offers of credit at this time. To the extent that specific practices regarding firm offers of credit raise concerns regarding unfairness or deception under the FTC Act, the Agencies plan to address those practices on a case-by-case basis through supervisory and enforcement actions. Further, to the extent that individual consumers do not wish to receive firm offers of credit, they can elect to be excluded from firm offer lists.¹⁷³

VI. Proposed Subpart Regarding Overdraft Services Background

Historically, if a consumer attempted to engage in a transaction that would overdraw his or her deposit account, the consumer’s depository institution used its discretion on an ad hoc basis to determine whether to pay the overdraft. If an overdraft was paid, the institution usually imposed a fee on the consumer’s account. In recent years, many institutions have largely automated the overdraft payment process. Automation is used to apply specific criteria for determining whether to honor overdrafts and set limits on the amount of the coverage provided.

Overdraft services vary among institutions but often share certain common characteristics. In general, consumers who meet the institution’s criteria are automatically enrolled in overdraft services.¹⁷⁴ While institutions generally do not underwrite on an individual account basis when enrolling the consumer in the service, most institutions will review individual accounts periodically to determine whether the consumer continues to qualify for the service, and the amounts that may be covered. Most institutions disclose to consumers that the payment of overdrafts is discretionary, and that the institution has no legal obligation to pay any overdraft.

In the past, institutions generally provided overdraft coverage only for check transactions. In recent years, however, the service has been extended to cover overdrafts resulting from non-check transactions, including withdrawals at ATMs, automated clearinghouse (ACH) transactions, debit card transactions at point-of-sale (POS), pre-authorized automatic debits from a consumer’s account, telephone-initiated funds transfers, and online banking transactions.¹⁷⁵

¹⁷² In the May 2008 Proposal, the Agencies noted that prior consumer testing by the Board indicated that consumers who read solicitations that did not state a specific credit limit generally understood that the limit they would receive depended on their creditworthiness. This testing did not, however, specifically focus on firm offers of credit that contain statements that the consumer has been selected for the offer. Accordingly, after the May 2008 Proposal, the Board conducted additional testing using such an offer, which produced similar results.

¹⁷³ 12 U.S.C. 1681b(e).

¹⁷⁴ These criteria may include whether the account has been open a certain number of days, whether the account is in “good standing,” and whether deposits are regularly made to the account.

¹⁷⁵ According to the FDIC’s Study of Bank Overdraft Programs (FDIC Study), nearly 70 percent of banks surveyed implemented their automated overdraft program after 2001. In addition, 81 percent of banks surveyed that operate automated programs allow overdrafts to be paid at ATMs and POS debit card terminals. See FDIC Study of Bank Overdraft Programs 8, 10 (Nov. 2008) (hereinafter, FDIC Study) (available at: http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_FinalTOC.pdf). See also Overdraft Protection: Fair Practices for Consumers: Hearing before the House Subcomm. on Financial Institutions and Consumer Credit, House Comm. on Financial Services, 110th Cong., at 72 (2007) (hereinafter, Overdraft Protection Hearing) (available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr0705072.shtml) (stating that as recently as

Institutions charge a flat fee each time an overdraft is paid, regardless of the amount of the overdraft. Institutions commonly charge the same amount for paying the overdraft as they would if they returned the item unpaid.¹⁷⁶ A daily fee also may apply for each day the account remains overdrawn.

In the May 2008 Proposal, the Agencies proposed to establish a new Subpart D to their respective FTC Act regulations which would adopt rules prohibiting specific unfair acts or practices with respect to overdraft services. One provision (discussed in more detail below) would have prohibited institutions from assessing any fees on a consumer's account in connection with an overdraft service, unless the consumer is given notice and a reasonable opportunity to opt out of the service, and the consumer does not opt out.¹⁷⁷ The Agencies also proposed to prohibit institutions from assessing an overdraft fee where the overdraft would not have occurred but for a hold placed on funds that exceeds the actual purchase or transaction amount.

Based on the comments received and further analysis, the Agencies are not taking action regarding overdraft services or debit holds at this time. As noted above, the Board has proposed rules regarding overdraft services under Regulation E elsewhere in today's **Federal Register**.¹⁷⁸ The Agencies will review information obtained during that rulemaking to determine whether to take further action.

A. Proposed Section __.32(a) – Consumer Right to Opt Out

The Agencies proposed in § __.32(a) to prohibit institutions from assessing any fees on a consumer's account in connection with an overdraft service, unless the consumer is given notice and a reasonable opportunity to opt out of the service, and the consumer does not opt out. The proposed opt-out right would have applied to overdrafts resulting from all methods of payment, including check, ACH transactions, ATM withdrawals and debit card transactions (full opt-out). In addition, the proposal would have required institutions to provide consumers with the option of opting out of only those overdrafts resulting from ATM withdrawals and debit card transactions at POS (partial opt-out). In a separate proposal under TISA and Regulation DD, the Board proposed additional amendments regarding the form, content, and timing requirements for the opt-out notice.

2004, 80 percent of banks still declined ATM and debit card transactions without charging a fee when account holders did not have sufficient funds in their account).

¹⁷⁶ See Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts, GAO Report 08-281, at 14 (Jan. 2008) (reporting that the average cost of overdraft and insufficient funds fees was just over \$26 per item in 2007). See also Bankrate 2008 Checking Account Study, posted October 27, 2008 (available at: <http://www.bankrate.com/brm/news/chk/chkstudy/20081027-bounced-check-fees-a1.asp?caret=2>) (reporting an average overdraft fee of approximately \$29 per item).

¹⁷⁷ As noted above, the Board also separately published a proposal under its authority under TISA and Regulation DD setting forth requirements regarding the form, content and timing for the opt-out notice. 73 FR 28739 (May 19, 2008).

¹⁷⁸ The proposed provisions under Regulation DD regarding the form, content and timing of delivery for the opt-out notice are not included in that final rule, but instead are included with certain revisions in the Regulation E proposal. Both rulemakings are published elsewhere in today's **Federal Register**.

Comments received. The Agencies received approximately 1,500 comment letters on the overdraft services portion of the May 2008 Proposal. Banks, savings associations, credit unions, and industry trade associations, generally, but not uniformly, opposed the proposed requirement to provide consumers with the right to opt out of an institution's payment of overdrafts. Industry commenters stated that the cost of complying with the rule would far exceed any consumer benefits. Rather than causing consumer harm, industry commenters asserted that overdraft services provide consumers substantial benefits, particularly with respect to check transactions. These industry commenters observed that the payment of overdrafts for checks enables consumers to avoid more significant injuries, such as merchant fees, negative credit reports, and violations of bad check laws. Industry commenters and the OCC stated that if the opt-out right applied to check transactions, more checks would be returned unpaid. Industry commenters and the OCC also noted a potential unintended consequence of the rule could be that institutions would lengthen their availability schedules to the extent permitted by the Board's Regulation CC, 12 CFR Part 229, to ensure that a deposited check was written on good funds. As a result, consumers would have to wait longer than they do today before gaining access to deposited funds.

Industry commenters also raised a number of operational concerns regarding the proposed partial opt-out for ATM and POS transactions. These commenters noted that most systems may not be able to differentiate POS debit card transactions from other types of debit card transactions. Some industry commenters, however, argued that the opt-out should be limited to ATM withdrawals and debit card transactions. These commenters stated that the majority of consumer complaints about overdraft fees arise in connection with debit card purchases in which the amount of the overdraft fee is significantly higher than the amount of the overdraft.

Finally, industry commenters believed that it was inappropriate to address overdraft practices under the Agencies' FTC Act authority. In particular, industry commenters disputed the suggestion that overdraft services were unfair in light of the consumer benefits when overdrafts are paid, such as the avoidance of merchant fees. Industry commenters also argued that consumers could reasonably avoid overdraft fees even without being given an opportunity to opt out by properly managing their accounts. Lastly, industry commenters noted that the federal banking agencies have not previously indicated that institutions' payment of overdrafts pursuant to non-promoted overdraft services raise significant supervisory concerns, and asserted that the Agencies' proposal would subject institutions to potential litigation risks. Accordingly, many industry commenters recommended that the Board address any concerns about overdraft services under other regulatory authority, such as Regulation E and Regulation DD.

Consumer groups, members of Congress, the FDIC, individual consumers, and others supported the Agencies' proposal to prohibit institutions from assessing fees for overdraft services, unless the consumer is given notice and the opportunity to opt out. However, most of these commenters argued that the rule should instead require institutions to obtain the consumer's affirmative consent (that is, opt-in) before overdrafts could be paid and fees assessed. These commenters also stated that overdrafts are extensions of credit and should be subject to Regulation Z. Specifically, they asserted that institutions should be required to disclose the cost of an overdraft service as an annual percentage rate to allow consumers to compare those costs with other forms of credit.

Consumer testing. The Agencies noted in the May 2008 Proposal that, as part of the rulemaking process, the Board would conduct consumer testing on a proposed opt-out form (set

forth in the accompanying May 2008 Regulation DD Proposal) to ensure that the notice can be easily understood by consumers. After considering the comments received in response to both proposals, Board staff worked with a testing consultant, Macro International (Macro), to revise the proposed model form and to create a short-form opt-out notice that would appear on the periodic statement. In September 2008, Macro conducted two rounds of one-on-one interviews with a diverse group of consumers.

In general, after reviewing the model disclosures, testing participants generally understood the concept of overdraft coverage, and that they would be charged fees if their institution paid their overdrafts. Participants also appeared to understand that if they opted out of overdraft coverage, this meant their checks would not be paid and they could be charged fees by both their institution and by the merchant.¹⁷⁹

During the first round of testing, Macro tested an opt-out form that allowed consumers to opt out of the payment of overdrafts for all transaction types, including checks and recurring debits. During both rounds, virtually all of the participants indicated that they would not opt out if their checks would be returned unpaid. However, when asked if they would opt out if the choice was limited to opting out of overdrafts in connection with ATM withdrawals and debit card purchases, half of the participants indicated that they would consider doing so.

Conclusion. Based on the comments received and further analysis, the Board is publishing a proposal elsewhere in today's **Federal Register** under Regulation E that would require that an institution provide its consumers the right to opt out of the institution's payment of ATM withdrawals and one-time debit card transactions pursuant to the institution's overdraft service. The Board is also proposing an alternative approach that would require an institution to obtain a consumer's affirmative consent (that is, opt-in) before the institution could pay overdrafts for ATM withdrawals and one-time debit card transactions and assess a fee. Additional comments received in response to the Agencies' May 2008 Proposal and the Board's Regulation DD Proposal regarding the content, timing, and format of the opt-out notice are further discussed in the Board's Regulation E proposal. The Board also anticipates conducting further consumer testing following its review of the comments received on the Regulation E proposal.

Accordingly, the Agencies are not taking action regarding overdraft services at this time. The Agencies will review information obtained from the Board's rulemaking to determine whether to take further action.

B. Proposed Section __.32(b) – Debit Holds

When a consumer uses a debit card to make a purchase, a hold may be placed on funds in the consumer's account to ensure that the consumer has sufficient funds in the account when the transaction is presented for settlement. This is commonly referred to as a "debit hold." During the time the debit hold remains in place, which may be up to three days after authorization, those funds may be unavailable for the consumer's use for other transactions.

In some cases, the actual purchase amount is not known at the time the transaction is authorized, such as when a consumer uses a debit card to pay for gas at the pump or pay for a meal at a restaurant. Consequently, a debit hold may be placed for an estimated amount which may exceed the actual transaction amount. The consumer may engage in subsequent transactions reasonably assuming that the account has only been debited for the actual transaction amount.

¹⁷⁹ See Review and Testing of Overdraft Notices, Macro International (Dec. 8, 2008).

Because of the excess hold, however, the consumer may incur overdraft fees for those subsequent transactions.

In May 2008, the Agencies proposed in § __.32(b) to prohibit institutions from assessing an overdraft fee where the overdraft would not have occurred but for a hold placed on funds in the consumer's account that exceeds the actual purchase or transaction amount. The proposed prohibition was intended to enable consumers to avoid the assessment of fees when the consumer would not have overdrawn his or her account had the actual transaction amount been presented for payment in a timely manner.

Consumer groups supported the proposed prohibition. However, they recommended that the Agencies also address check holds and prohibit the assessment of overdraft fees if a consumer has deposited funds that have not yet cleared, but where the deposit would have been sufficient to cover the overdraft. Alternatively, consumer groups urged the Board to use its authority under the Expedited Funds Availability Act (EFAA) to shorten the funds availability schedule for deposited items.

Industry commenters, however, opposed the debit hold proposal, stating that it would present significant operational difficulties. For example, industry commenters noted that institutions authorize transactions in real time, taking into account transactions subject to a debit hold. Because the actual purchase amount for certain transactions subject to a debit hold will not be known until the transaction is presented for payment, some industry commenters expressed concern that the rule would require institutions to monitor accounts retroactively and manually adjust transactions and fees that have posted to the account to determine whether an overdraft was caused by an excess hold. Otherwise, institutions would have to stop placing holds altogether which, industry commenters argued, raised potential safety and soundness concerns. Nonetheless, a few financial institution commenters stated that for fuel purchases, they do not place holds beyond the \$1 pre-authorization amount, and one large financial institution commenter stated that it does not currently place holds of any amount on authorizations coming from gas stations, hotels, or rental car companies.

Rather than using their FTC Act authority, industry commenters urged the Agencies to use other existing regulatory authority. For example, industry commenters recommended that the Board exercise its authority under Regulation E to require merchants to disclose at the point-of-sale when holds may be placed on debit card transactions.

As discussed above, the Board is proposing to address concerns about debit holds pursuant to the Board's authority under the EFTA and Regulation E in a separate proposal published elsewhere in today's **Federal Register**. Accordingly, the Agencies are not taking action regarding overdraft services at this time. The Agencies will review information obtained from the Board's rulemaking to determine whether to take further action.¹⁸⁰

Other Overdraft Practices

Balance disclosures. The Agencies also noted their concerns in the proposal regarding how consumer balances are disclosed. In particular, the Agencies observed that consumers could be misled by balance disclosures that include additional funds that the institution may provide to cover an overdraft. The Board is addressing this issue in the final rule under Regulation DD published contemporaneously in today's **Federal Register**.

¹⁸⁰ Additional comments received on the proposed FTC Act debit hold provision are discussed in more detail in the Board's Regulation E proposal where relevant.

Transaction clearing practices. The May 2008 Proposal also noted the Agencies' concerns about the impact of transaction clearing practices on the amount of overdraft fees that may be incurred by the consumer. The February 2005 overdraft guidance recommends as a best practice that institutions explain the impact of transaction clearing policies to consumers. For example, institutions could disclose that transactions may not be processed in the order in which they occurred and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumer.¹⁸¹ In its Guidance on Overdraft Protection Programs, the OTS also recommended as best practices: (1) clearly disclosing rules for processing and clearing transactions; and (2) having transaction clearing rules that are not administered unfairly or manipulated to inflate fees.¹⁸²

The May 2008 Proposal did not propose any rules addressing transaction clearing practices. Instead, the Agencies solicited comment on the impact of requiring institutions to pay smaller-dollar items before larger-dollar items when received on the same day for purposes of assessing overdraft fees on a consumer's account. The Agencies also solicited comment on how such a rule would impact an institution's ability to process transactions on a real-time basis.

Industry commenters urged the Agencies not to engage in a rulemaking relating to transaction clearing practices. First, they argued that state law under the Uniform Commercial Code¹⁸³ specifically provides institutions flexibility in determining posting order.¹⁸⁴ Second, industry commenters stated that each transaction clearing method has inherent flaws, and that most customers prefer high-to-low posting order because it results in consumers' largest bills—typically their higher priority payments—being paid first. Third, these commenters argued that transaction clearing processes are more complex than high-to-low or low-to-high decisions. Industry commenters stated, for example, that institutions use a variety of other clearing methods based on different processing capabilities, such as real-time processing or processing in check number order. In addition, an institution may use a combination of posting order methods based on the capabilities of its processing system and the transaction type. For example, an institution may clear some items in real-time and others on a high-to-low basis during batch processing, depending on how the item is presented and depending on applicable funds availability and payment decision requirements. Industry commenters also expressed concern that requiring a particular processing order would create significant litigation risk given the complexity of items processing. Finally, industry commenters stated that it would be technologically impracticable to permit a small subset of consumers to opt in to a particular processing order and to treat their transactions differently than other consumers' transactions.

Consumer groups and some members of Congress urged the Agencies to ban institutions from engaging in manipulative clearing practices. In particular, they asserted that institutions use transaction processing order to maximize revenue from overdrafts because more overdraft fees can be levied if largest debits are processed first and cause other small debits to overdraw the account multiple times. They also argued that the justification favoring high-to-low payment

¹⁸¹ 70 FR at 8431; 70 FR at 9132.

¹⁸² 70 FR at 8431.

¹⁸³ U.C.C. § 4-303. The commentary to § 4-303 states that any posting order is permitted because (1) it is impossible to state a rule that would be fair in all circumstances, and (2) a drawer should have sufficient funds on deposit at all times, he or she should thus be indifferent as to posting order.

¹⁸⁴ See also OCC Interp. Letter No. 916 (May 22, 2001).

order because higher-priority items are paid first is undermined by the fact that all items are paid via the institution's overdraft protection program.

The Agencies are not addressing transaction processing order at this time. The Agencies believe that it would be difficult to set forth a bright-line rule that would clearly result in the best outcome for all or most consumers. For example, requiring institutions to pay smaller dollar items first may cause an institution to return unpaid a large dollar nondiscretionary item, such as a mortgage payment, if there is an insufficient amount of overdraft coverage remaining to cover the large dollar item after the smaller items have been paid. The Agencies also acknowledge the inherent complexity of payments processing and recognize that mandating a particular posting order could create complications for institutions seeking to move toward real-time transaction processing.

VII. Effective Date

The May 2008 Proposal solicited comment on whether the rules should become effective one year after issuance or whether a different period was appropriate. Although some industry commenters agreed that a one-year period was appropriate, most urged the Agencies to allow 18 or 24 months due to the difficulty of redesigning systems and procedures to comply with the rules. In contrast, some consumer advocates requested a shorter period.

The final rule is effective on July 1, 2010. Compliance with the provisions of the final rule is not required before the effective date. Accordingly, the final rule and the Agencies' accompanying analysis should have no bearing on whether or not acts or practices restricted or prohibited under this rule are unfair or deceptive before the effective date of this rule.

Unfair acts or practices can be addressed through case-by-case enforcement actions against specific institutions, through regulations applying to all institutions, or both. An enforcement action concerns a specific institution's conduct and is based on all of the facts and circumstances surrounding that conduct. By contrast, a regulation is prospective and applies to the market as a whole, drawing bright lines that distinguish broad categories of conduct.

Because broad regulations, such as those in the final rule, can require large numbers of institutions to make major adjustments to their practices, there could be more harm to consumers than benefit if the regulations were effective earlier than the effective date. If institutions were not provided a reasonable time to make changes to their operations and systems to comply with the final rule, they would either incur excessively large expenses, which would be passed on to consumers, or cease engaging in the regulated activity altogether, to the detriment of consumers. And because the Agencies find an act or practice unfair only when the harm outweighs the benefits to consumers or to competition, the implementation period preceding the effective date set forth in the final rule is integral to the Agencies' decision to restrict or prohibit certain acts or practices by regulation.

For these reasons, acts or practices occurring before the effective date of the final rule will be judged on the totality of the circumstances under applicable laws or regulations. Similarly, acts or practices occurring after the rule's effective date that are not governed by these rules will continue to be judged on the totality of the circumstances under applicable laws or regulations.

Some industry commenters requested that, because existing accounts were established with the expectation that institutions could engage in the practices prohibited by the final rule, those accounts (or existing balances on those accounts) be exempted from the final rule. The Agencies recognize that, as discussed above with respect to specific prohibitions, the final rule

prohibits some long-standing practices that have been expressly or implicitly permitted under state or federal law or the guidance of the federal banking agencies. As noted above, the final rule is not intended to suggest that these practices are unfair or deceptive prior to the effective date. However, the Agencies do not believe the requested exemption is necessary because institutions will have sufficient time prior to the effective date to adjust their pricing and other practices with respect to existing accounts and balances. Indeed, prior to the effective date, institutions may change interest rates on existing balances and take other actions that will be prohibited once the final rule is effective. However, in light of the significant nature of the changes required by the final rule (including training staff), the Agencies anticipate that institutions will need to begin the compliance process long before the effective date. Although institutions are not required to comply with the final rule before the effective date, the Agencies strongly encourage institutions to use their best efforts to conform their practices to the final rule before July 1, 2010.

VIII. Regulatory Analysis

A. Regulatory Flexibility Act

Board: The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) generally requires an agency to perform an assessment of the impact a rule is expected to have on small entities. Under section 605(b) of the RFA, 5 U.S.C. 605(b), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies, along with a statement providing the factual basis for such certification, that the rule will not have a significant economic impact on a substantial number of small entities. The Board prepared an initial regulatory flexibility analysis in connection with the May 2008 Proposal, which reached the preliminary conclusion that the proposed rule would not have a significant economic impact on a substantial number of small entities. *See* 73 FR 28933-28934 (May 19, 2008). The Board received no comments specifically addressing its initial regulatory flexibility analysis. However, industry commenters generally stated that the overall proposal would impose significant implementation costs and result in a loss of revenue from interest charges and overdraft fees.

Based on the comments and further analysis, the Board has concluded that the final rule will have a significant economic impact on a substantial number of small entities. Accordingly, the Board has prepared the following final regulatory flexibility analysis pursuant to section 604 of the RFA.

1. **Succinct statement of the need for, and objectives of, the rule.** The Federal Trade Commission Act (15 U.S.C. 41 *et seq.*) (FTC Act) prohibits unfair or deceptive acts or practices in or affecting commerce. 15 U.S.C. 45(a)(1). The FTC Act provides that the Board (with respect to banks), OTS (with respect to savings associations), and the NCUA (with respect to federal credit unions) are responsible for prescribing regulations prohibiting such acts or practices. 15 U.S.C. 57a(f)(1). The Board, OTS, and NCUA are jointly issuing regulations under the FTC Act to protect consumers from specific unfair or deceptive acts or practices regarding consumer credit card accounts. The Board's final rule will amend Regulation AA.

The **SUPPLEMENTARY INFORMATION** above describes in detail the need for, and objectives of, the final rule.

2. **Summary of the significant issues raised by public comments in response to the Board's initial analysis, the Board's assessment of such issues, and a statement of any changes made as a result of such comments.** As discussed above, the Board's initial regulatory flexibility

analysis reached the preliminary conclusion that the proposed rule would not have a significant economic impact on a substantial number of small entities. See 73 FR 28933-28934 (May 19, 2008). The Board received no comments specifically addressing this analysis.

3. Description and estimate of the number of small entities to which the final rule applies. The Board's final rule applies to banks and their subsidiaries, except savings associations as defined in 12 U.S.C. 1813(b). Based on 2008 call report data, there are approximately 709 banks with assets of \$175 million or less that offer credit cards and are therefore required to comply with the Board's final rule.

4. Description of the recordkeeping, reporting, and other compliance requirements of the final rule. The final rule does not impose any new recordkeeping or reporting requirements. The final rule does, however, impose new compliance requirements.

Section 227.22 will require some small entities to extend the period of time provided to consumers to make payments on consumer credit card accounts. One commenter estimated that the cost of compliance at \$30,000 per institution, although this cost will vary depending on the size of the institution. Based on the comments, however, many credit card issuers already send periodic statements 21 days in advance of the payment due date, which constitutes a reasonable amount of time under the rule. Indeed, a trade association representing community banks (many of which are small entities under the RFA) stated in its comment that 90 percent of its members currently mail or deliver periodic statement more than 21 days before the payment due date.

Section 227.23 will require small entities that provide consumer credit card accounts with multiple balances at different rates to alter their payment allocation systems and, in some cases, develop new systems for allocating payments among different balances. The cost of such changes will depend on the size of the institution and the composition of its portfolio. Compliance with this provision will also reduce interest revenue for small entities that currently allocate payments first to balances with the lowest annual percentage rate. The economic impact, however, will be mitigated to the extent that small entities adjust other terms to compensate for the loss of revenue (such as by increasing the dollar amount of fees and the annual percentage rates offered to consumers when an account is opened).

Section 227.24 generally prohibits small entities from increasing annual percentage rates, except in certain circumstances. This provision will reduce interest revenue, although – as noted above – small entities can mitigate the economic impact by increasing the dollar amount of fees, increasing the annual percentage rates offered to consumers when an account is opened, or otherwise adjusting account terms. In addition, § 227.24 permits small entities to increase the rates applicable to new transactions after the first year and to increase the rates on outstanding balances pursuant to an increase in an index and when the consumer's payment has not been received within 30 days after the due date.

Section 227.25 may require some small entities to change the way finance charges are calculated. The Board understands, however, that few institutions still use the prohibited method.

Section 227.26 will reduce the revenue that some small entities derive from security deposits and fees. These costs, however, will be borne only by those entities offering cards with security deposits and fees that currently consume a majority of the credit limit.

Accordingly, the Board believes that, in the aggregate, the provisions in its final rule will have a significant economic impact on a substantial number of small entities.

5. Description of the steps the Board has taken to minimize the significant economic impact on small entities consistent with the stated objectives of the FTC Act. As discussed

above in this **SUPPLEMENTARY INFORMATION**, the Board has considered a wide variety of alternatives and has concluded that the restrictions in the final rule achieve the appropriate balance between providing effective protections for consumers against unfair or deceptive acts or practices (which are prohibited by the FTC Act) and minimizing the burden on institutions that offer credit cards (including small entities). In the May 2008 Proposal, the Board considered whether small entities should be exempted from the proposed rules. The Board indicated, however, that such an exemption would not be appropriate because the FTC Act neither exempts small entities from the prohibition against engaging in unfair or deceptive acts or practices nor provides the Board with authority to create such an exemption. Furthermore, the Board noted that whether an act or practice is unfair or deceptive should not depend on the size of the institution. See 73 FR at 28934. The Board did not receive any comments regarding this preliminary conclusion. Accordingly, the Board has not exempted small entities from the final rule.

The Board also believes that the final rule, where appropriate, provides sufficient flexibility and choice for institutions, including small entities. As such, any institution, regardless of size, may tailor its operations to its individual needs and thereby mitigate to some degree any burdens created by the final rule. For instance, although § 227.23 prohibits institutions from applying payments in excess of the minimum payment first to the balance with the lowest interest rate, it allows institutions to choose between two permissible allocation methods and does not place any limitations on institutions' ability to allocate the minimum payment. In addition, although § 227.24 generally prohibits institutions from increasing the annual percentage rates on outstanding balances, it provides reasonable exceptions and does not restrict the ability of institutions to increase rates on future transactions after the first year.

OTS: The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) generally requires an agency to perform an assessment of the impact a rule is expected to have on small entities. For purposes of the RFA and OTS-regulated entities, a "small entity" is a savings association with assets of \$175 million or less. Under section 605(b) of the RFA, 5 U.S.C. 605(b), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies, along with a statement providing the factual basis for such certification, that the rule will not have a significant economic impact on a substantial number of small entities. OTS certified that the proposed rule would not have a significant economic impact on a substantial number of small entities but prepared an initial regulatory flexibility analysis in connection with the May 2008 Proposal anyway. See 73 FR 28934-28935 (May 19, 2008). OTS received no comments specifically addressing its initial regulatory flexibility analysis.

OTS certifies that this final rule will not have a significant economic impact on a substantial number of small entities. OTS is the primary federal regulator for 817 federally- and state-chartered savings associations. Of these 817 savings associations, only 116 report any credit card assets. Of these 116, only 22 have assets of \$175 million or less.

NCUA: The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) generally requires an agency to perform an assessment of the impact a rule is expected to have on small entities. For purposes of the RFA and NCUA, a "small entity" is a credit union with assets of \$10 million or less. Under section 605(b) of the RFA, 5 U.S.C. 605(b), the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies, along with a statement providing the factual basis for such certification, that the rule will not have a significant economic impact on a substantial number of small entities. NCUA certified that the proposed rule would not have a significant economic impact on a substantial number of small

entities, but prepared an initial regulatory flexibility analysis in connection with the May 2008 Proposal anyway. See 73 FR 28904, 28935 (May 19, 2008). NCUA received no comments specifically addressing its initial regulatory flexibility analysis.

Accordingly, NCUA certifies that this final rule will not have a significant economic impact on a substantial number of small entities. NCUA regulates approximately 5036 federal credit unions. Only 2427 federal credit unions report credit card assets. Of those federal credit unions offering loan products, 2363 small federal credit unions offer loans, and 425 small federal credit unions offer credit cards to members.

B. Paperwork Reduction Act

Board: In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Board has reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The collections of information that are required by this proposed rule are found in 12 CFR 227.14 and 227.24(b)(2).

This information collection is required to provide benefits for consumers and is mandatory (15 U.S.C. 4301 *et seq.*). The respondents/recordkeepers are for-profit financial institutions, including small businesses. Regulation AA establishes consumer complaint procedures and defines unfair or deceptive acts or practices in extending credit to consumers. As discussed above, the final rule amends Regulation AA to prohibit institutions from engaging in certain acts or practices in connection with consumer credit card accounts. This proposal evolved from the Board's June 2007 Regulation Z Proposal. This final rule is coordinated with the Board's final rule under the Truth in Lending Act and Regulation Z, which is published elsewhere in today's **Federal Register**.

Under § 227.24(a) (Unfair acts or practices regarding increases in annual percentage rates), banks are generally required to disclose at account opening the annual percentage rates that will apply to the account. In addition, under § 227.24(b)(3), banks must disclose in advance any increase in the rate that applies to new transactions pursuant to 12 CFR 226.9. The Board anticipates that banks will, with no additional burden, incorporate the disclosure requirements under § 227.24(a) with the disclosure requirements regarding credit and charge cards in Regulation Z, 12 CFR 226.5a and 226.6. Thus, in order to avoid double-counting, the Board will account for the burden associated with proposed Regulation AA § 227.24(a) under Regulation Z (OMB No. 7100-0199) §§ 226.5a and 226.6. Similarly, because the Board anticipates that banks will, with no additional burden, incorporate the disclosure requirement under § 227.24(b)(3) with the disclosure requirements in Regulation Z, 12 CFR 226.9, the Board will account for the burden associated with proposed Regulation AA § 227.24(b)(2) under Regulation Z (OMB No. 7100-0199) § 226.9.

Under Regulation AA § 227.14(b) (Unfair and deceptive practices involving cosigners), a clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to being obligated. The disclosure statement must be substantively similar to the example provided in § 227.14(b). The Board will also account for the burden associated with Regulation AA § 227.14(b) under Regulation Z. The title of the Regulation Z information collection will be updated to account for this section of Regulation AA.

In May 2008, the Board proposed § 227.28, which would have prohibited banks from engaging in certain marketing practices in relation to prescreened firm offers of credit for consumer credit card accounts unless a disclaimer sufficiently explained the limitations of the offer. As discussed elsewhere in the **SUPPLEMENTARY INFORMATION**, the Board has not taken action on proposed § 227.28 at this time because, among other reasons, the disclosures

required by Regulation Z will address the Board's concerns. The burden increase of 1,808 hours associated with proposed § 227.28 would have been accounted for under Regulation Z (OMB No. 7100-0199) § 226.5a; however, it has been removed from the Regulation Z burden estimate.

In May 2008, the Board proposed § 227.32, which would have provided that a consumer could not be assessed a fee or charge for paying an overdraft unless the consumer was provided with the right to opt out of the payment of overdrafts and a reasonable opportunity to exercise that right but did not do so. The Board stated that the burden associated with proposed § 227.32 would be accounted for under Regulation DD (OMB No. 7100-0271). However, as discussed elsewhere in the **SUPPLEMENTARY INFORMATION**, the Board is not taking action on proposed § 227.32 at this time.

OTS and NCUA: In accordance with section 3512 of the Paperwork Reduction Act of 1995, 44 U.S.C. 3501-3521 ("PRA"), the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget ("OMB") control number. The information requirements contained in this joint final rule have been submitted by the OTS and NCUA to OMB for review and approval under section 3507 of the PRA and section 1320.11 of OMB's implementing regulations (5 CFR part 1320). The review and authorization information for the Board is provided earlier in this section along with the Board's burden estimates. The collections of information that are required by this final rule are found in 12 CFR __.13 and __.24. Collections of information that were required by the proposed rule in § __.28 and § __.32 are not included in the final rule.

OTS: Savings associations and their subsidiaries.

NCUA: Federal credit unions.

Abstract: Under section 18(f) of the FTC Act, the Agencies are responsible for prescribing rules to prevent unfair or deceptive acts or practices in or affecting commerce, including acts or practices that are unfair or deceptive to consumers. Under the final rule, the Agencies are incorporating their existing Credit Practices Rules, which govern unfair or deceptive acts or practices involving consumer credit, into new, more comprehensive rules that also address unfair or deceptive acts or practices involving credit cards.

Under § __.24(a) (Unfair acts or practices regarding increases in annual percentage rates), institutions are generally required to disclose at account opening the annual percentage rates that will apply to the account. In addition, under § __.24(b)(3), institutions must disclose in advance any increase in the rate that applies to new transactions pursuant to 12 CFR 226.9 in Regulation Z. The OTS and NCUA anticipate that institutions would, with little additional burden, incorporate the proposed disclosure requirement under § __.24(a) with the existing disclosure requirements regarding credit and charge cards in Regulation Z, 12 CFR 226.5a, and 226.6. Similarly, the OTS and NCUA anticipate that institutions will, with little additional burden, incorporate the disclosure requirement under § __.24(b)(3) with the disclosure requirements in Regulation Z, 12 CFR 226.9.

Under the existing Credit Practices Rule, 12 CFR 535.3 (to be recodified at 12 CFR 535.13) and 12 CFR 706.3, (to be recodified at 12 CFR 706.13) both entitled "Unfair or deceptive cosigner practices," a clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to being obligated. The disclosure statement must be substantively similar to the example provided in the section of the rule. Since this is not a new requirement, the OTS and NCUA, anticipate little additional burden associated with this section of the rule.

In May 2008, the OTS, NCUA and the Board proposed § __.28, which would have prohibited financial institutions from engaging in certain marketing practices in relation to prescreened firm offers of credit for consumer credit card accounts unless a disclaimer sufficiently explained the limitations of the offer. As discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the Agencies are not taking action on proposed § __.28 at this time. The burden increases of 8,260 for OTS and 50,360 for NCUA have been removed from the burden estimate.

In May 2008, the Agencies' proposed § __.32, which would have provided that a consumer could not be assessed a fee or charge for paying an overdraft unless the consumer was provided with the right to opt out of the payment of overdrafts and a reasonable opportunity to exercise that right but did not do so. The OTS stated that the burden associated with proposed § 535.32 would be 8,260 hours. OTS's burden estimate was based on the effect of this rule on all of its institutions because they are all depository institutions, most of which offer overdraft services. By not including provisions on overdrafts, OTS's rule affects only the 116 OTS-supervised institutions that issue credit cards. The NCUA stated that the burden associated with proposed § 706.32 would be 50,360 hours. As discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the Agencies are not taking action on proposed § __.32 at this time. Accordingly, the OTS and NCUA remove their respective burden increase.

Estimated Burden: The burden associated with this collection of information may be summarized as follows.

OTS:

Estimated number of respondents: 817
Estimated time for developing disclosures: 4 hours
Estimated time for training: 4 hours
Total estimated time per respondent: 8 hours
Total estimated annual burden: 6536 hours

NCUA:

Estimated number of respondents: 5,036
Estimated time for developing disclosures: 4 hours
Estimated time for training: 4 hours
Total estimated time per respondent: 8 hours
Total estimated annual burden: 40,288 hours

C. OTS Executive Order 12866 Determination

Executive Order 12866 requires federal agencies to prepare a regulatory impact analysis for agency actions that are found to be "significant regulatory actions." "Significant regulatory actions" include, among other things, rulemakings that "have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities."¹⁸⁵

Based on the prediction of industry commenters, OTS anticipates that the final rule will exceed the \$100 million threshold. However, OTS believes that these estimates may overstate the actual costs borne by institutions under OTS jurisdiction for a number of reasons. First,

¹⁸⁵ See 58 FR 51735 (October 4, 1993), as amended.

OTS-supervised institutions account for only a small portion of the entire credit card market. Second, several provisions included in the proposed rulemaking are not being finalized at this time, which reduces the overall economic impact of the final rule. Third, OTS-supervised institutions already refrain from engaging in many of the practices prohibited by this final rule. Issuing a rule to prevent institutions from taking up these practices will help ensure that market conduct standards remain high, but it will not cause significant economic impact on these institutions.

OTS acknowledges that several provisions of the rules may carry operational costs, although the general information provided by commenters on this point does not permit the OTS to quantify such costs with any precision. Moreover, commenter suggestions about the effect that two provisions of the rule may have on the fee and interest income may be overestimated. Notably, these suggestions blend the effects of this rulemaking with those of a related Board rulemaking on Regulation Z.

Further, given the continuing contraction in the economy since the May 2008 proposal and the close of the August 2008 comment period, OTS anticipates that the economic effect on credit card issuers will be lower than projected by commenters as the industry itself shrinks.¹⁸⁶

OTS has provided the Administrator of the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) an economic analysis. As required by Executive Order 12866, it addresses: (1) the need for the regulatory action and how the rule meets that need, (2) the costs and benefits of the rule and its consistency with a statutory mandate that avoids interference with State, local and tribal governments, (3) the benefits anticipated from the regulation, (4) the costs anticipated from the regulation, and (5) alternatives to the regulation.

1. The need for the regulatory action and how the rule meets that need.

The OTS final rule, like the rules issued by the Board and NCUA, consists of five provisions intended to protect consumers from unfair acts or practices with respect to consumer credit card accounts. The identified unfair acts or practices inhibit or prevent a consumer from accurately assessing the costs and benefits of their actions and thus produce a market failure. The rule should permit cardholders to better predict how their actions will affect their costs and benefits. Presently, they cannot do so effectively.¹⁸⁷ The final rule should also promote the safe and sound operation of institutions that issue credit cards by better aligning the interests of the financial markets and consumers to ensure that credit card loans will be repaid.

Regulatory Background

OTS issued an Advance Notice of Proposed Rulemaking on August 6, 2007, requesting comment on possible changes to its rules under section 5 of the FTC Act. See 72 FR 43570 (OTS ANPR). OTS received comments from consumers, the industry and Congress. Industry

¹⁸⁶ See National Bureau of Economic Research, Determination of the December 2007 Peak in Economic Activity (Dec.1, 2008) (available at: <http://wwwdev.nber.org/dec2008.html>).

¹⁸⁷ “Although they work well for many consumers, credit card plans have become more complex. The greater complexity has reduced transparency in credit card pricing and increased the risk that consumers will not understand key terms that affect the cost of using the account. The Federal Reserve has used consumer testing to make great strides in developing improved disclosures under the Truth in Lending Act. However, based on our review of consumers' response to the Board's recent regulatory initiative, it seems clear that improved disclosures alone cannot solve all of the problems consumers face in trying to manage their credit card accounts.” Statement by Federal Reserve Board Chairman Ben S. Bernanke (May 2, 2008) (available at: <http://www.federalreserve.gov/newsevents/press/bcreg/bernankecredit20080502.htm>).

commenters suggested that OTS should use guidance rather than rules, arguing OTS would create an unlevel playing field for OTS-regulated institutions and that uniformity among the federal banking agencies and the NCUA is essential, and that the possible practices listed in the ANPR were neither unfair nor deceptive under the FTC standards.

In contrast, the consumer commenters urged OTS to move ahead with a rule that would combine the FTC's principles-based standards with prohibitions on specific practices. They urged OTS to ban numerous practices, including several practices addressed in the final rule, such as "universal default" repricing, applying payments first to balances with the lowest interest rate, and credit cards marketed at subprime consumers that provide little available credit at account opening.

The May 2008 Proposal

To address the issue of lack of uniformity if only OTS issued a rule, and to best ensure that all entities that offer consumer credit card accounts and overdraft services on deposit accounts are treated in a like manner, the OTS, Board, and NCUA joined together to issue the May 2008 Proposal.¹⁸⁸ This proposal was based on outreach conducted by the Agencies, consumer testing and Congressional hearings.¹⁸⁹ It was accompanied by complementary proposals by the Board under Regulation Z with respect to consumer credit card accounts and Regulation DD with respect to deposit accounts.¹⁹⁰

The Final Rule

A description of the five provisions in this final rule follows. It includes observations about how each provision responds to a specific unfair practice.

First, § 535.22 prohibits savings associations from treating a payment as late for any purpose unless consumers have been provided a reasonable amount of time to make that payment. The rule provides that 21 days is a safe harbor. Consumers have complained that they encountered situations where they did not have enough time to make payments and that this was an unfair practice. This provision will prevent card issuers from providing an insufficient time for consumers to make payments, and then charging fees or increasing interest rates because the payment was late. The largest issuers under OTS supervision already provide at least a 20 day period to pay.

Second, when an account has balances with different annual percentage rates, § 535.23 requires savings associations to allocate amounts paid in excess of the minimum payment using one of two specified methods: either allocating the excess payment to the highest interest balance or proportionately to all balances. This provision addresses the unfairness that consumers experience when they accept low-rate promotional offers, but do not appreciate that card issuers now allocate their payments to minimize the benefits of the offer and maximize interest charges.

Third, § 535.24 prohibits savings associations from increasing the APR during the first year unless the planned increase has been disclosed at account opening, the APR varies with an index, the card holder fails to pay within 30 days of the due date, or the card holder fails to comply with a workout arrangement. After the first year, the rule also allows savings

¹⁸⁸ See 73 FR 28904 (May 19, 2008) (May 2008 Proposal).

¹⁸⁹ See 73 FR at 28905-07.

¹⁹⁰ See 73 FR 28866 (May 19, 2008) (May 2008 Regulation Z Proposal); 73 FR 28739 (May 19, 2008) (May 2008 Regulation DD Proposal).

associations to increase the annual percentage rate on transactions that occur more than seven days after the institution provides a notice of the APR increase under Regulation Z. This section addresses the unfairness consumers experience when a creditor increases interest rates at any time and for any reason, and where a creditor applies a new rate to purchases that have already been made. The rule will allow consumers to more accurately estimate their costs and to predict the consequences of their decisions and actions.

Fourth, § 535.25 prohibits savings associations from using the practice sometimes referred to as two-cycle billing, in which, as a result of the loss of a grace period, a savings association imposes finance charges based on balances associated with previous billing cycles. Research conducted by the Board showed that consumers do not understand disclosures that attempt to explain this billing practice. As a result, consumers could not avoid cards that feature this practice. However, this practice is now rare, especially for OTS-supervised issuers.

Fifth, to address concerns regarding subprime credit cards with high fees and low credit limits, § 535.26 prohibits savings associations from charging to the account security deposits and fees for the issuance or availability of credit that constitute a majority of the initial credit limit in the first year or more than 25 percent of the initial credit limit in the first month. In addition the rule requires that if the fees and security deposit charges exceed 25% of the available credit, repayment would be spread over at least the first six months. These cards impose multiple fees when the consumer opens the card account and those amounts are billed to the consumer in the first statement. These large initial billings substantially reduce the amount of credit that the consumer has available on the card. For example, a card with a credit line of \$250 may have only \$100 available after security deposits or fees have been billed and consumers will pay interest on these billings until they are paid in full. Consumers have complained that they were not aware of how little available credit they would have after the assessment of security deposits and fees. This rule prevents this practice and provides that consumers will have a sizeable percentage of the initial credit on the card available for use.

2. **The costs and benefits of the rule, consistency with statutory mandate and non-interference with State, local and tribal governments.**

Costs and Benefits

Both the costs and the benefits of the rule are difficult to measure with precision. As noted above, OTS has relied on cost projections submitted by industry commenters, but has reduced these estimates where they appear to be overstated. Benefits, such as protecting consumers from unfairness, are more intangible and more difficult to quantify. Moreover, the monetary costs and benefits of this rule have a net effect in some important ways. The approach taken by the OTS with respect to these issues is explained in subsequent sections of this statement.

Consistency with Statutory Mandate and Non-interference with State, Local and Tribal Governments

Section 18(f)(1) of the FTC Act provides that OTS (with respect to savings associations), as well as the Board (with respect to banks) and the NCUA (with respect to federal credit unions) are responsible for prescribing “regulations defining with specificity * * * unfair or deceptive acts or practices, and containing requirements prescribed for the purpose of preventing such acts or practices.”¹⁹¹ The FTC Act allocates responsibility for enforcing compliance with regulations prescribed under section 18 with respect to savings associations,

¹⁹¹ 15 U.S.C. 57a(f)(1).

banks, and federal credit unions among OTS, the Board, and NCUA, as well as the OCC and FDIC.¹⁹² Consistent with the FTC Act, this final rule is intended to prevent the unfair practices discussed more fully elsewhere in the **SUPPLEMENTARY INFORMATION**.

Also, as discussed in the **SUPPLEMENTARY INFORMATION** that accompanied the OTS August 6, 2007 ANPR,¹⁹³ reflected in the proposed rule,¹⁹⁴ and explained in detail in the **SUPPLEMENTARY INFORMATION** to today's issuance, HOLA serves as an independent basis for the final OTS final rule. HOLA provides authority for both safety and soundness and consumer protection regulations. Consistent with HOLA, this final rule is intended to prevent unsafe and unsound practices and to protect consumers as discussed more fully elsewhere in the **SUPPLEMENTARY INFORMATION**.

Issuing the rule on an interagency basis is consistent with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994.¹⁹⁵ Section 303(a)(3)¹⁹⁶ directs the federal banking agencies to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. Two federal banking agencies—the Board and OTS—are primarily implementing the same statutory provision, section 18(f) of the FTC Act, as is the NCUA. Accordingly, the Agencies endeavored to finalize rules that are as uniform as possible. This rule will have no undue not interference with State, local, or tribal governments in the exercise of their governmental functions.

3. Benefits of the regulation

The most important benefit of the rule is that it will protect consumers from certain practices that meet well established standards for unfairness. In so doing, the rule will increase consumer confidence in the financial system.

Since the rule was proposed in May 2008, exigent market circumstances have arisen which necessitate immediate liquidity in consumer credit cards. These circumstances are reflected in the announcement on November 25, 2008 of the Treasury Department and Federal Reserve Board Term Asset-Backed Securities Loan Facility (TALF) program.¹⁹⁷ This final rule furthers liquidity in the consumer credit card market by providing certainty to the industry, consumers, and other members of the public as to rules governing such transactions in the future. In addition, OTS anticipates that provisions of the final rule that are designed to ensure greater safety and soundness for financial institutions may also yield a beneficial economic result for the

¹⁹² See 15 U.S.C. 57a(f)(2)–(4). The FTC Act grants the FTC rulemaking and enforcement authority with respect to other persons and entities, subject to certain exceptions and limitations. See 15 U.S.C. 45(a)(2); 15 U.S.C. 57a(a). The FTC Act, however, sets forth specific rulemaking procedures for the FTC that do not apply to OTS, the Board, or the NCUA. See 15 U.S.C. 57a(b)–(e), (g)–(j); 15 U.S.C. 57a–3.

¹⁹³ 72 FR at 43572-73.

¹⁹⁴ See 73 FR at 28910 and 28948.

¹⁹⁵ See 12 U.S.C. 4803.

¹⁹⁶ 12 U.S.C. 4803(a)(3).

¹⁹⁷ See November 25, 2008 announcements by the Department of Treasury and Board of the TALF under the authority in the Emergency Economic Stabilization Act of 2008, Pub. L. 110-343 and section 13(3) of the Federal Reserve Act (12 U.S.C. 343) (available at <http://www.treas.gov/press/releases/hp1292.htm> and <http://www.federalreserve.gov/newsevents/press/monetary/monetary20081125a1.pdf>).

taxpayers who ultimately bear the cost of a program such as the TALF, which will make and insure loans backed by credit card securities.

However, because this rule provides more rationality and integrity to the credit card system, its broader benefits are more qualitative than quantitative. For example, the rule will promote more efficient functioning of the economy by creating more transparency for consumers as they make credit card agreements. Consumers currently are confused by the complexity of credit card agreements, and are surprised by unexpected terms. In several of the areas addressed by the rule, disclosures have been inadequate to make the terms understandable.¹⁹⁸ Consequently, the clear standards set by this rule will promote more efficient credit decisions by consumers.

The monetary costs and benefits of this rule have a net effect. Particularly as a result of the payment allocation and retroactive rate increase provisions, some card issuers will experience reduced revenues and additional expenses, but the cost of credit will be substantially reduced for many consumers. Moreover, the rule will create stability, predictability, and standardization in the credit card market and its receivables, and will help foster steady sources of funding that would otherwise avoid some risk and uncertainty.

Another benefit of the rule is that it will create a uniform playing field for credit card issuers, not only because the federal financial regulators are issuing consistent rules, but also because of its clarity. As the Board and the NCUA are simultaneously issuing virtually identical rules governing credit card practices for other types of federally insured financial institutions, the OTS final rule will ensure that consistent rules apply among banks, federal credit unions, and savings associations.

Significantly, issuers that have tried to provide better and clearer terms for consumers will no longer face a competitive disadvantage for doing so. Consumers will have more confidence in the credit card system because of the uniform protections.¹⁹⁹

By substantially limiting behavioral risk pricing, the rule will foster more efficient risk-based pricing by credit card issuers at the initial underwriting stage. Consequently, this rule will improve credit risk management. Issuer interest in assessing the cost of risk will be more closely aligned with the consumer interest in taking on more credit and being able to repay it.

Finally, because the rule clearly defines several examples of unfair practices, the federal financial institution regulatory agencies will be able to monitor and supervise the credit card market more efficiently. Similarly, the reduced uncertainty will simplify issuer efforts to act in compliance with the law.

4. Anticipated costs of the regulation.

It is helpful to put the share of OTS supervised issuers in context. OTS is the primary federal regulator for 817 federally- and state-chartered savings associations. Of these 817 savings associations, only 116 report any credit card assets. Among the 116 savings associations that offer credit cards, only 18 have more than 1% of their total assets in credit card receivables. Moreover, credit card assets comprise only 3% of all assets held by savings associations. With

¹⁹⁸ See “Design and Testing of Effective Truth in Lending Disclosures” (available at: <http://www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf>).

¹⁹⁹ See Furletti, Mark, Payment System Regulation and How It Causes Consumer Confusion, Discussion Paper, Payment Cards Center, Philadelphia Federal Reserve, Nov 2004, at 7, quoting Professor Mark Budnitz of Georgia State University School of Law (available at: http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2004/PaymentSystemRegulation_112004.pdf).

respect to the share of the overall credit card market held by OTS supervised institutions, it is notable that savings associations hold only 3.5% of credit card receivables.²⁰⁰ In part, this figure is attributable to the fact that two large savings associations, one with \$10.6 billion in credit card receivables, have failed since OTS proposed these rules in May 2008 and do not currently operate under OTS supervision.²⁰¹ In sum, most provisions of the rulemaking would have no economic effect on the vast majority of the institutions under OTS jurisdiction, since the vast majority simply does not issue credit cards.

Limited economic effect: several affected practices are uncommon

The majority of the practices covered by this rulemaking have been included as a prophylactic measure to ensure that institutions do not begin to use or expand the use of activities deemed unfair or deceptive. Since most OTS-supervised institutions do not currently engage in these practices, the costs of complying with the provisions of the final rules are likely to be minimal.

Unfair time to make payments. This section prohibits treating a payment on a consumer credit card account as late for any purpose unless consumers have been provided a reasonable amount of time to make payment with 21 days serving as a safe harbor.

Although some commenters indicated that implementing this provision would entail operational costs, OTS supervisory observations and experience indicates that most savings associations generally mail or deliver periodic statements to their customers at least 20 days before the due date, including the ten largest.²⁰² Therefore, a rule that requires institutions to provide a reasonable amount of time to make payment, such as by complying with the safe harbor for mailing or delivering periodic statements to customers at least 21 days in advance of the payment due date, should have insignificant or no economic impact on institutions under OTS jurisdiction.

Unfair balance computation method. OTS has adopted this section substantially as proposed in May 2008. It prohibits institutions from imposing finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle. This rule is intended to prohibit the balance computation method sometimes referred to as “two-cycle billing” or “double-cycle billing.” The final rule contains an added

²⁰⁰ Federal Reserve Board, Statistical Supplement to the November Federal Reserve Bulletin, Nov. 7, 2008, G.19, Consumer Credit (available at: <http://www.federalreserve.gov/releases/g19/Current/>).

²⁰¹ IndyMac Bank was closed on July 11, 2008. The Federal Deposit Insurance Corporation is running the successor institution that holds IndyMac’s assets. See OTS Release OTS 08-029 (available at: http://www.ots.treas.gov/index.cfm?p=PressReleases&ContentRecord_id=37f10b00-1e0b-8562-ebdd-d5d38f67934c&ContentType_id=4c12f337-b5b6-4c87-b45c-838958422bf3&MonthDisplay=7&YearDisplay=2008).

After Washington Mutual Bank was closed on Sept. 25, 2008, JPMorganChase, a national bank regulated by the Office of the Comptroller of the Currency, acquired its assets. OTS Release 08-046 (available at: http://www.ots.treas.gov/index.cfm?p=PressReleases&ContentRecord_id=9c306c81-1e0b-8562-eb0c-fed5429a3a56&ContentType_id=4c12f337-b5b6-4c87-b45c-838958422bf3&MonthDisplay=9&YearDisplay=2008).

²⁰² One commenter noted that some institutions could incur up to \$30,000 in operational costs if procedural changes are needed to comply with the final rules. It is unclear whether this is an accurate estimate of the cost of those changes and whether the size of the bank would affect the actual cost. Furthermore, as a mitigating economic factor, consumers should incur fewer fees and interest charges as a result of receiving a reasonable amount of time to pay.

exception permitting adjustments to finance charges following the return of a payment for insufficient funds.

OTS notes that many institutions no longer use the two-cycle balance computation method and very few institutions compute balances using any method other than a single-cycle method and according to the Government Accountability Office, of the six largest card issuers, only two used the double-cycle billing method between 2003 and 2005.²⁰³ Because few other institutions still use this practice,²⁰⁴ the prohibition on two-cycle billing should not have a significant impact on institutions under OTS jurisdiction.

Unfair charging to the account of security deposits and fees for the issuance or availability of credit. This section prohibits institutions from charging high security deposits and fees for issuing a credit card to the account's credit limit if those fees amounted to more than half of the credit available over the first year. Further, those fees cannot exceed 25% of the available credit in the first month; fees above that limit would have to be spread out over at least the first 6 months.

This section does not apply to security deposits and fees for the issuance or availability of credit that are not charged to the account, *i.e.*, not financed through the credit card, except to the extent such an arrangement is a mere evasion of the prohibition. Further, this provision does not set any ceiling on the amount of security deposits and fees that may be charged to the account. Rather, any limit is calculated as a percentage of the credit line (a majority or 25%) and changes with the credit line. Since the rule does not limit the credit line that a creditor may offer on high fee accounts, it necessarily does not set a ceiling on the security deposits or fees, either. The final rule contains a new paragraph (d) prohibiting evasions of the section. The paragraph is modeled after the anti-evasion provisions in Regulation Z.²⁰⁵

Credit cards to which security deposits and high account opening related fees are charged against the credit line are found predominately in the subprime credit card market, *i.e.*, the market that targets borrowers with lower credit scores. Many of these consumers will incur significantly lower fees as a result of this provision.

As noted above, savings associations have only a 3.5% share of the credit card market generally.²⁰⁶ Subprime credit cards represent just 5% of all credit cards issued,²⁰⁷ and high fee

²⁰³ "In our review of 28 popular cards from the six largest issuers, we found that two of the six issuers used the double-cycle billing method on one or more popular cards between 2003 and 2005. The other four issuers indicated they would only go back one cycle to impose finance charges." "Credit Cards, Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," Government Accountability Office, Sept. 2006 at 28. Neither of the two issuers referred to is supervised by OTS.

²⁰⁴ Based on OTS supervisory observations and experience, only one large savings association engaged in this practice at the time that this provision was proposed. That institution was closed in September 2008 and is no longer subject to rules issued by the OTS, as noted above.

²⁰⁵ See 12 C.F.R. §§ 226.34(a)(3) and 226.35(b)(4).

²⁰⁶ See Federal Reserve Board, Statistical Supplement to the November Federal Reserve Bulletin, Nov. 7, 2008, G.19, Consumer Credit (available at: <http://www.federalreserve.gov/releases/g19/Current/>).

²⁰⁷ Outstanding credit card balances as of February 2008 as reported by Fitch Ratings, Know Your Risk; Asset Backed Securities Prime Credit Card Index and Subprime Credit Card Index (available at: http://www.fitchresearch.com/creditdesk/sectors/surveillance/asset_backed/credit_card).

cards represent only a portion of the subprime market. Among OTS-supervised institutions, cards of this type are rare. In fact, based on OTS supervisory observations and experience, only two savings associations currently offer such cards and those product lines are a small part of their business.

Based on one commenter's estimate, this provision of the rule would mean these OTS-supervised subprime issuers would receive as much as \$10,948,000 less revenue.²⁰⁸ This estimate is based on the rule as it was proposed, with a repayment schedule spread over 12 months. The final rule allows the repayment period to be shortened to six months. This shorter time would mitigate some of the estimated lost revenue. The commenter's estimate assumes that the issuers will experience higher losses from making more credit available to consumers with blemished credit histories, and it assumes that the issuers will make no changes in the way that they acquire new accounts as a result of the rule. However, with better underwriting, issuers should be able to target customers who are less likely to default and thereby limit their losses. Another strategy to limit loss would be to offer consumers smaller lines of credit. In sum, the limited economic impact noted above may be overstated.

Economic effect that appears to trigger the requirements of Executive Order 12866

This final rule contains two other sections with a greater economic impact. One affects the way in which an institution allocates customer payments among the customer's outstanding balances. The other specifies the conditions under which an institution can raise the APR on outstanding balances.

Unfair payment allocations. A consumer may have multiple balances on a consumer credit card account, each with a different interest rate. Currently, most institutions allocate payments they receive from a consumer by first covering fees and finance charges, then allocating any remaining amount from the lowest APR balance to the highest. In May 2008, OTS proposed this section in response to concerns that, by following this practice, institutions were applying consumers' payments in a way that inappropriately maximized interest charges on consumer credit card accounts by not allocating payments to balances that accrue interest at higher rates unless all balances are paid in full. Commenters noted that some institutions would have to alter their systems and in some cases develop new systems for allocating payments among different balances, although the cost of such changes is not known and will depend on the size of the institution and the composition of its portfolio. Commenters further noted that this provision would discourage promotional rate offers to consumers and would affect the institutions' interest revenue. Finally, commenters predicted that issuers would compensate by increasing costs or decreasing credit available to consumers.

Based on the comments received and OTS's analysis, the final rule adopts the general payment allocation rule as proposed with a few important changes to reduce burden and cost to the industry. This section will prohibit institutions from allocating payments above the minimum required to the balance with the lowest rate first. It will allow institutions to split such payments pro rata among the balances or to allocate them to the balance with the highest rate first. The costs of this rule are mitigated somewhat by providing institutions with flexibility as to which of the allocation methods they choose. In addition, by allowing institutions to have a general rule for allocating payments to all balances, including promotional balances, the costs to institutions have been reduced.

²⁰⁸ The commenter estimated that this provision of the rule could reduce revenue to subprime issuers by as much as \$119 per account. OTS estimates that the institutions under its jurisdiction hold approximately 92,000 affected high fee accounts.

Due to concerns that this section as proposed could significantly reduce or eliminate promotional rate offers, OTS has modified this provision. For the most part, this is because commenters supplied data that indicates that promotional rates provide an overall benefit to consumers in addition to the marketing benefits that such rates provide to institutions. Consequently, OTS believes that applying the general allocation rule to promotional rate balances strikes the appropriate balance by preserving promotional rate offers that provide substantial benefits to consumers while prohibiting the most harmful payment allocation practices. Accordingly, the final rule, unlike the proposal, does not require payments above the minimum payment to be applied to promotional rate balances last, after other balances are paid.

Commenters indicated that this provision may affect institutions' interest revenue. Based on a projection for the total industry by a group of credit card issuers representing 70% of outstanding balances, the Board has estimated that this rule could result in an annual loss in interest revenue of \$415 million.²⁰⁹ Savings associations currently account for a 3.5 percent share of total credit card receivables.²¹⁰ The estimated loss of revenue for savings associations under this provision could be as high as \$14,525,000.²¹¹ However, neither the OTS nor the Board has the data necessary to quantify the economic impact of this provision with specificity. Notably, the commenter did not provide adequate information to validate its assertions.

It should also be noted that while this provision will significantly reduce interest charges that consumers will pay, removing requirements in the proposed rule regarding promotional rate balances will mitigate this effect by reducing the estimated impact on interest revenue. Moreover, to the extent that the payment allocation restrictions included in the rule impose costs, institutions are likely to adjust initial credit card terms to reflect those costs. If this occurs, consumers will likely have a clearer initial disclosure of potential costs with which to compare credit card offerings than they do now. Their actual cost of credit will not be increased by low-to-high balance payment allocation strategies implemented by institutions after charges have been incurred.

Unfair annual percentage rate increases. This section generally prohibits institutions from increasing the annual percentage rate on any balance the first year and on outstanding balances thereafter. For new accounts, institutions would be prohibited from increasing the APR during the first year unless the APR varies with an index, the card holder fails to pay within 30 days of the due date, or the card holder fails to comply with a workout arrangement. After the first year, the rule also allows savings associations to increase the annual percentage rate on transactions that occur more than seven days after the institution provides a notice of the APR

²⁰⁹ The commenter projected a loss of interest revenue of up to \$930 million, based on a drop of 0.098 percent in income. Board and OTS staff estimate that the removal of requirements in the proposed rule regarding grace periods reduced the projected loss by \$100 million, and the removal of requirements in the proposed rule regarding promotional rate balances further decrease the impact on interest revenue by at least 55 percent, to approximately \$415 million.

²¹⁰ Outstanding revolving credit for September 2008 was \$970.5 billion. Of this, savings institutions accounted for \$34.4 billion, a 3.5 % share. Federal Reserve Board, Statistical Supplement to November 2008 Federal Reserve Bulletin, G.19 (Nov. 7, 2008) (available at <http://www.federalreserve.gov/releases/g19/Current/>).

²¹¹ This estimate may be excessive because the OTS estimate of overall credit card receivables may inappropriately include charge cards, which do not carry balances and do not have different interest rates. To the extent that outstanding balances on charge cards are included, the economic effect of the rule is overstated.

increase under Regulation Z. Nothing in the final rule prohibits issuers from imposing late charges or other sanctions short of increasing the APR.

The rule will not permit the institution to increase the APR on the outstanding balances if the consumer defaults on other debt obligations. This practice is sometimes referred to as “universal default.” Based on OTS supervisory observations and experience, none of the larger savings associations practice universal default. The final rule will also require issuers to adjust the manner in which they offer deferred interest rate balances to ensure that consumers are not unfairly surprised by the assessment of deferred interest.

A group of credit card issuers representing 70% of outstanding balances submitted a comment which projected that the overall cost to the industry of this provision of the rule as proposed would result in an annual loss in interest revenue of 0.872 percent, or \$7.40 billion. This analysis stated that banks will compensate for a loss in interest revenue by increasing rates and/or decreasing available credit for consumers. Even assuming this analysis is accurate, the OTS, Board, and NCUA believe that the revisions to the proposed rule may decrease the estimated impact on interest revenue by more than 70 percent (to an annual loss of interest revenue of 0.242 percent, or approximately \$2.05 billion) and, therefore, result in a proportionately lower impact on consumers.²¹² However this lower projection may still be overstated because some of the impact asserted by the commenter is attributable to disclosure requirements of Regulation Z. These Regulation Z requirements, implemented by the Board, require advance notice to consumers of increased rates and delay implementation of increased rates for 45 days.

Applying these estimates to institutions under OTS jurisdiction, this provision of the final rule appears to have an economic impact on savings associations that ranges from \$71.75 million (based on a potential \$2.05 billion in loss of industry revenue)²¹³ to \$259 million (based on loss of industry revenue of \$7.4 billion).²¹⁴

However, if such revenue is economically justified in a competitive environment for the allocation of credit, then a likely longer-term outcome will be that institutions will incorporate such economic factors in the initial terms of credit card contracts. If that occurs, then consumers will have clearer initial information than they currently have on the comparative costs of credit card offerings. Consequently, the short term disruptions to institutions caused by this rulemaking will likely be addressed in the longer term by changes in disclosed credit card account interest rates and fees, thus making it easier for consumers to more easily compare and consider the costs and benefits of different credit cards.

²¹² The issuers’ analysis does not consider the effect of prohibiting APR changes in the first year on new balances or the adjustments that they will likely make to the way deferred interest rate balances are offered.

²¹³ Applying 3.5 percent to the \$2.05 billion loss of revenue gives an estimated revenue loss of \$71,750,000 for this provision. See Federal Reserve Board, Statistical Supplement to November 2008 Federal Reserve Bulletin, G.19 (Nov. 7, 2008) (available at <http://www.federalreserve.gov/releases/g19/Current/>). As with the payment allocation estimate, this estimate may be excessive since it may inappropriately include charge cards, which do not carry balances and do not have different interest rates. To the extent that charge card outstanding balances are included, the effect of the rule has been overstated.

²¹⁴ Applying 3.5 percent to the \$7.4 billion estimate gives an estimated revenue loss for OTS-supervised institutions of \$259 million for this provision.

Costs to consumers

Commenters have suggested that institutions will compensate for potential losses in interest revenue by increasing credit card rates and/or decreasing credit available to consumers. Even assuming this assertion is accurate, OTS believes that the differences between the proposed and final rules will lead to both a smaller loss of revenue for issuers and decreased incentives for raising rates or limiting credit offered to consumers. To the extent income to savings associations is affected, the corresponding offset is an equally sized consumer benefit of lower fees and interest payments. Although OTS is unable to estimate its precise impact, OTS believes that many consumers will incur significantly reduced interest charges as a result of the rule. As a result, the economic effects of this rulemaking may result in transfers from institutions to consumers, with an overall limited net effect.

Costs to the Government

The costs to OTS from this rule are insignificant. OTS, like the other federal financial regulators, conducts examinations of institutions on a regular basis for safety, soundness and compliance with laws and regulations. This rule will not add to that supervisory burden. To the contrary, OTS anticipates that this rule, by clarifying some of the prohibitions against unfair acts and practices in credit card lending with bright line rules, will make the supervision of savings associations more efficient, less time consuming, and less burdensome.

Conclusion

Some predict that because of this rule, issuers will raise credit card rates for consumers and lower credit limits. However, OTS believes that many consumers will incur significantly reduced interest charges as a result of the rule.

The costs to OTS from this rule are insignificant. In fact, this rule will make supervision and enforcement more efficient, less time consuming, and less burdensome.

The cost to savings associations is limited because of the small size of the credit card market held by savings associations, the reduced impact of this rule caused by the Agencies' decision not to finalize several provisions, and the small number of institutions that presently employ the practices prohibited in this rule. Although the revenue loss data submitted by commenters has not been verified, the OTS has used it to provide the most generous estimate of the costs of this rule. Based on that data, the costs of this rule range between \$97,223,000 and \$284,473,000.²¹⁵

5. Why the final regulation is preferable to alternatives.

Alternative A: OTS issues rule alone

In proposing this rule, OTS considered different approaches. As suggested in the ANPR, one approach was for OTS to issue a rule under either the FTC Act or as an expansion of OTS's Advertising rule that would cover only OTS-supervised institutions.²¹⁶ Industry commenters responded that such an approach would create an unlevel playing field, and put OTS-supervised institutions at a possible competitive disadvantage. They argued that uniformity among the federal banking agencies and the NCUA is essential for the efficient functioning of the market.

²¹⁵ The range is based on \$10,948,000 (high fee cards) + \$14,525,000 (payment allocation) + \$71,750,000 (restriction on rate increases - with reduced impact) = \$97,223,000. The higher figure is based on \$10,948,000 (high fee cards) + \$14,525,000 (payment allocation) + \$259,000,000 (restriction on rate increases - higher estimated impact) = \$284,473,000.

²¹⁶ 72 FR 43573.

Consequently, the OTS has joined with the Board and NCUA to issue rules applicable to all banks, federal credit unions, and savings associations.²¹⁷

Alternative B: Agencies issue rules that address a range of issues in a variety of markets

In its ANPR, the OTS sought comment on whether it should attempt to address a broad range of potentially unfair or deceptive practices including those relating credit cards, residential mortgage lending, gift cards, and deposit accounts.²¹⁸ However, the May 2008 Proposal focused on unfair and deceptive acts or practices involving credit cards and overdraft services, which are generally provided only by depository institutions such as banks, savings associations, and credit unions. Targeting such practices fosters a level playing field and the efficient functioning of the market.

Alternative C: Agencies issue rules addressing all practices covered in the May 2008 proposal

In the May 2008 Proposal, the Agencies proposed seven provisions under the FTC Act regarding consumer credit card accounts and two provisions regarding checking account overdraft services. These provisions were intended to ensure that consumers were protected from harmful practices that they could not reasonably avoid and have the ability to make informed decisions about the use of credit card accounts and checking accounts without being subjected to unfair or deceptive acts or practices.

However, after considering the comments received, OTS has decided not to address the practices covered by four of the proposed provisions in a final rule at this time. These provisions concerned overdraft and overlimit fees caused by holds, deceptive firm offers of credit, and a provision that would have provided a mechanism for a consumer to opt out of overdraft protection services.

The Board is issuing a proposal under Regulation E published elsewhere in today's **Federal Register** to address overdraft and overlimit fees caused by holds and a mechanism for a consumer to opt out of overdraft protection services. OTS will determine whether to address these matters in the future in light of further information that may be obtained through the Board's Regulation E rulemaking. The Board is also publishing a final rule under Regulation Z that will address firm offers of credit containing a range of or multiple annual percentage rates. OTS will also address unfair or deceptive acts or practices that are not specifically included in today's final rule on a case-by-case basis.

Alternative D: Agencies issue rules that address five unfair credit card practices

There were more than 65,000 comments on the May 2008 Proposal, and the overwhelming majority of these were from consumers. There were also comments from the industry, members of Congress²¹⁹ and other governmental organizations. Based on the

²¹⁷ The Agencies recognized that state-chartered credit unions and any entities providing consumer credit card accounts independent of a depository institution fall within the FTC's jurisdiction and therefore would not be subject to the proposed rules. However, FTC-regulated entities appear to represent a small percentage of the market for consumer credit card accounts and overdraft services. See, Federal Reserve Board, Statistical Supplement to November 2008 Federal Reserve Bulletin, G.19 (Nov. 7, 2008) (available at <http://www.federalreserve.gov/releases/g19/Current/>).

²¹⁸ 72 FR 43575.

²¹⁹ Members of Congress have proposed several bills addressing consumer protection issues regarding credit cards. See, e.g., H.R. 5244 and S. 3255. See also The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers: Hearing before the H. Subcomm. on Fin. Instits. & Consumer Credit, 110th Cong. (2007); Credit Card Practices: Unfair Interest Rate Increases: Hearing before the S. Permanent Subcomm. on Investigations, 110th Cong.

comments, outreach and Congressional testimony, the Agencies concluded that the final rule should contain five provisions.

Time to make payments. Based on the comments of consumers and on Congressional testimony, there were many instances of consumers who received their statements just before the due date, and that the consequence of late fees and higher interest was not avoidable. The Agencies agreed that a consumer should have a reasonable time to pay. A reasonable amount of time to pay may vary depending on the circumstances, but if a consumer is to have the possibility of disputing errors on the statement, that amount of time needs to be approximately three weeks. That allows a week to receive the statement, a week to review it, and a week for the payment to travel by mail. Shorter amounts of time for mailing would cover the majority of consumers, but would not adequately protect the small but significant number of consumers whose delivery times are longer than average.

Unfair payment allocation. This rule requires issuers to allocate a consumer's payment over the required minimum to balances with the highest interest first or proportionately to all balances. This provision was a response to concerns that institutions applied consumers' payments in a manner that inappropriately maximized interest charges on consumer credit card accounts with balances at different interest rates. Interest charges were maximized by applying payments to balances with the lowest interest rate. The Agencies considered an exception for promotional rate balances, so that they would not be paid down and thereby lose the benefit of the promotional rate. However, the Agencies decided not to pursue that alternative because it would discourage promotional balance offers, and such offers are a significant benefit to consumers. The Agencies also considered an exception for deferred interest balances, but the need for this exception is negated by the final rule's restriction on the manner in which deferred interest rate balances are offered. The Agencies also considered using consumer disclosures as an alternative to this rule. After extensive testing by the Board, it became clear that consumers did not understand payment allocation practices and could not make informed decisions on using credit cards for different types of transactions.

Unfair annual percentage rate increases. The rule will prohibit credit card issuers from increasing interest rates during the first year unless the planned increase has been disclosed at account opening, the annual percentage rate varies with an index, the card holder fails to pay within 30 days of the due date, or the card holder fails to comply with a workout arrangement. After the first year, the rule also allows card issuers to increase the annual percentage rate on transactions that occur more than seven days after the institution provides a notice of the annual percentage rate increase under Regulation Z. This rule was a response to changes in credit card terms that consumers either did not expect or could not avoid. Some changes in terms were a response to a consumer's lowered credit score – caused by actions unrelated to the credit card account (universal default). Some changes were a response to a payment that was late by a day (hair trigger penalty repricing). Some changes in terms were based on a credit card issuer's changed business circumstances (any time any reason repricing). Consumer testing showed that many consumers did not understand what factors, such as one late payment, can trigger penalty pricing.

Many consumer commenters, as well as consumer groups, members of Congress, the FDIC, two state attorneys general and a state consumer protection agency supported the proposal

(2007); Credit Card Practices: Current Consumer and Regulatory Issues: Hearing before H. Comm. on Fin. Servs., 110th Cong. (2007); Credit Card Practices: Fees, Interest Rates, and Grace Periods: Hearing before the S. Permanent Subcomm. on Investigations, 110th Cong. (2007).

to limit repricing except in very limited situations. Some advocated providing the consumer with a right to opt-out of interest rate increases.

The injury to consumers of having their interest rate increased substantially is difficult for most consumers to avoid. There are several circumstances that give rise to interest rate changes: market conditions (unrelated to consumer behavior), consumer default on an unrelated account, using a large proportion of the available credit, or late payment or overlimit charges. It is only the last two that are violations of the card agreement. Most consumers would not avoid the rate increase because they would not expect it in the circumstances described.

The Agencies considered, and rejected the alternative proposed by some commenters to allow a consumer to “opt out” of the card relationship by closing it and transferring the balance. This was not a good alternative because it may not be possible for a consumer to close the card and transfer the balance to a comparable rate card without paying a transfer fee. The Agencies considered the impact on credit card issuers by limiting this rule to apply to outstanding balances, not to new purchases, except for the first year an account is open.

The Agencies considered requiring the use of disclosures to inform consumers about the triggers for repricing. However, it was clear, based on consumer testing, that consumers did not understand how the triggers work, and consumers do not focus on the possibility of default at the time they open accounts. More importantly, disclosures would not allow consumers to avoid credit cards with this feature, since institutions almost uniformly apply increased rates to prior transactions.

Unfair balance computation method. The final rule prohibits “double-cycle” billing – charging interest on credit card balances for the days preceding the most recent billing cycle. The effect on a consumer is to lose the grace period for paying the full balance when a consumer who normally pays in full pays less than the full balance one month. This rule prohibits this practice because it is so difficult for consumers to understand. The Agencies considered the alternative of disclosures. However, after extensive consumer testing by the Board, it became clear that it was not possible to disclose this practice so that consumers could understand it.

Unfair charging to the account of security deposits and fees for the issuance or availability of credit. This rule prohibits a credit card issuer from charging fees or security deposits to an account that use up more than the majority of the available credit. If the fees amount to more than 25% of the initial available credit, their repayment must be spread out over at least six months. These cards are called high fee accounts, or derogatorily, “fee-harvester cards.”

The Agencies have received many complaints from consumers about these cards from consumers who say they were not aware of how little available credit they would have after the security deposit and fees were charged to the card. Over 70 members of Congress, several states, the Federal Deposit insurance Corporation and the Office of the Comptroller of the Currency supported this provision. Many commenters wanted to add more prohibitions to this rule, by lowering fee thresholds, prohibiting the charging of security deposits to the cards, enhancing disclosure and prohibiting the marketing of these cards and credit repair products. Many industry commenters supported this rule.

However, some commenters who are in this business asserted that they provide credit to consumers who would otherwise be unable to obtain it. In an effort to balance the concerns of consumers and the subprime credit card industry, the Agencies have limited the percentage of the fees and security deposits that can be charged to the card. This limit is no more than the majority. In addition, the rule will require issuers to spread repayment over the first six months

if the fees and security deposits amount to more than 25 percent of the available credit. OTS believes that its issuers will change their underwriting, or reduce initial credit available, in response to this rule.

D. OTS Executive Order 13132 Determination

OTS has determined that its portion of the rulemaking does not have any federalism implications for purposes of Executive Order 13132. As discussed in § IV of this **SUPPLEMENTARY INFORMATION**, OTS is removing from codification 12 CFR 535.5. This section had allowed OTS to grant state exemptions from OTS's Credit Practices Rule if state law affords a greater or substantially similar level of protection. The FHLBB, OTS's predecessor agency, had granted an exemption to the State of Wisconsin for substantially equivalent provisions of the Wisconsin Consumer Act. By removing this section, the exemption will cease to exist on July 1, 2010, the rule's effective date. As a result, state chartered savings associations that had previously been exempt from complying with OTS's Credit Practices Rule with regard to their Wisconsin operations but were required to comply with equivalent provisions of the Wisconsin Consumer Act, will now be required to comply with both OTS's Credit Practices Rule and the equivalent provisions of the Wisconsin Consumer Act.

E. NCUA Executive Order 13132 Determination

The NCUA has determined that its portion of the rulemaking does not have any federalism implications for purposes of Executive Order 13132.

F. OTS Unfunded Mandates Reform Act of 1995 Determinations

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year. (The inflation adjusted threshold is \$133 million or more.) If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

OTS has determined that this rule will not result in expenditures by State, local, and tribal governments in excess of the threshold but may result in expenditures by the private sector in excess of the threshold. Accordingly, OTS has prepared a budgetary impact statement and addressed the regulatory alternatives considered. This is discussed further in § VIII.C. of this **SUPPLEMENTARY INFORMATION** ("OTS Executive Order 12866 Analysis").

G. NCUA: The Treasury and General Government Appropriations Act, 1999—
Assessment of Federal Regulations and Policies on Families

NCUA has determined that this final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

IX. Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Board and OTS to use plain language in all proposed and final rules published after January 1, 2000. Additionally, NCUA's goal is to promulgate clear and understandable regulations that impose minimal regulatory burdens. Therefore, the Agencies invited comment on how to make the May 2008 Proposal easier to understand.

The Agencies received only one comment in response. A credit card issuer suggested that the proposed rules prohibiting unfair or deceptive acts or practices with respect to consumer credit card accounts would be easier to understand if placed with the rules governing credit cards in the Board's Regulation Z. As discussed above, however, the Agencies have determined that the FTC Act is the appropriate authority for issuance of the final rule.

List of Subjects

12 CFR Part 227

Banks, Banking, Credit, Intergovernmental relations, Trade practices.

12 CFR Part 535

Consumer credit, Consumer protection, Credit, Credit cards, Deception, Intergovernmental relations, Savings associations, Trade practices, Unfairness.

12 CFR Part 706

Credit, Credit unions, Deception, Intergovernmental relations, Trade practices, Unfairness.

For the reasons discussed in the joint preamble, NCUA revises part 706 of Title 12 of the Code of Federal Regulations to read as follows:

PART 706—UNFAIR OR DECEPTIVE ACTS OR PRACTICES

Subpart A—General Provisions

Sec.

706.1 Authority, purpose, and scope.

706.2-706.10 [Reserved]

Subpart B—Consumer Credit Practices

706.11 Definitions.

706.12 Unfair credit contract provisions.

706.13 Unfair or deceptive cosigner practices.

706.14 Unfair late charges.

706.15-706.20 [Reserved]

Subpart C—Consumer Credit Card Account Practices Rule

706.21 Definitions.

706.22 Unfair time to make payment.

706.23 Unfair allocation of payments.

706.24 Unfair increases in annual percentage rates.

706.25 Unfair balance computation method.

706.26 Unfair charging of security deposits and fees for the issuance or availability of credit to consumer credit card accounts.

Appendix to Part 706 – Official Staff Commentary

Authority: 15 U.S.C. 57a.

§ 706.1 Authority, Purpose, and Scope.

(a) Authority. This part is issued by NCUA under section 18(f) of the Federal Trade Commission Act, 15 U.S.C. 57a(f) (§ 202(a) of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Pub. L. 93–637).

(b) Purpose. The purpose of this part is to prohibit unfair or deceptive acts or practices in violation of section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. 45(a)(1). Subparts B and C define and contain requirements prescribed for the purpose of preventing specific unfair or deceptive acts or practices of federal credit unions. The prohibitions in subparts B and C do not limit NCUA’s authority to enforce the FTC Act with respect to any other unfair or deceptive acts or practices.

(c) Scope. This part applies to federal credit unions.

§§ 706.2 – 706.10 [Reserved]

Subpart B—Consumer Credit Card Account Practices Rule

§ 706.11 Definitions.

For purposes of this subpart, the following definitions apply:

Consumer means a natural person member who seeks or acquires goods, services, or money for personal, family, or household purposes, other than for the purchase of real property, and who applies for or is extended consumer credit.

Consumer credit means credit extended to a natural person member for personal, family, or household purposes. It includes consumer loans; educational loans; unsecured loans for real property alteration, repair or improvement, or for the equipping of real property; overdraft loans; and credit cards. It also includes loans secured by liens on real estate and chattel liens secured by mobile homes and leases of personal property to consumers that may be considered the functional equivalent of loans on personal security but only if the federal credit union relies substantially upon other factors, such as the general credit standing of the borrower, guaranties, or security other than the real estate or mobile home, as the primary security for the loan.

Earnings means compensation paid or payable to an individual or for the individual's account for personal services rendered or to be rendered by the individual, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

Obligation means an agreement between a consumer and a federal credit union.

Person means an individual, corporation, or other business organization.

§ 706.12 Unfair credit contract provisions.

It is an unfair act or practice for a federal credit union, directly or indirectly, to enter into a consumer credit obligation that constitutes or contains, or to enforce in a consumer credit obligation the federal credit union purchased, any of the following provisions:

(a) Confession of judgment. A cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

(b) Waiver of exemption. An executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(c) Assignment of wages. An assignment of wages or other earnings unless:

(1) The assignment by its terms is revocable at the will of the debtor;

(2) The assignment is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment; or

(3) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(d) Security interest in household goods. A nonpossessory security interest in household goods other than a purchase-money security interest. For purposes of this paragraph, household goods:

(1) Means clothing, furniture, appliances, linens, china, crockery, kitchenware, and personal effects of the consumer and the consumer's dependents.

(2) Does not include:

- (i) Works of art;
- (ii) Electronic entertainment equipment (except one television and one radio);
- (iii) Antiques (any item over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character); or
- (iv) Jewelry (other than wedding rings).

§ 706.13 Unfair or deceptive cosigner practices.

(a) Prohibited deception. It is a deceptive act or practice for a federal credit union, directly or indirectly in connection with the extension of credit to consumers, to misrepresent the nature or extent of cosigner liability to any person.

(b) Prohibited unfairness. It is an unfair act or practice for a federal credit union, directly or indirectly in connection with the extension of credit to consumers, to obligate a cosigner unless the cosigner is informed, before becoming obligated, of the nature of the cosigner's liability.

(c) Disclosure requirement. (1) Disclosure statement. A clear and conspicuous statement must be given in writing to the cosigner before becoming obligated. In the case of open-end credit, the disclosure statement must be given to the cosigner before the time that the cosigner becomes obligated for any fees or transactions on the account. The disclosure statement must contain the following statement or one that is substantially similar:

NOTICE OF COSIGNER

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.

(2) Compliance. Compliance with paragraph (c)(1) of this section constitutes compliance with the consumer disclosure requirement in paragraph (b) of this section.

(3) Additional content limitations. If the notice is a separate document, nothing other than the following items may appear with the notice:

- (i) The federal credit union's name and address;
- (ii) An identification of the debt to be cosigned (e.g., a loan identification number);
- (iii) The date (of the transaction); and
- (iv) The statement, "This notice is not the contract that makes you liable for the debt."

(d) Cosigner defined. (1) Cosigner means a natural person who assumes liability for the obligation of a consumer without receiving goods, services, or money in return for the obligation, or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the account.

(2) Cosigner includes any person whose signature is requested as a condition to granting credit to a consumer, or as a condition for forbearance on collection of a consumer's obligation

that is in default. The term does not include a spouse or other person whose signature is required on a credit obligation to perfect a security interest pursuant to state law.

(3) A person who meets the definition in this paragraph is a cosigner, whether or not the person is designated as such on a credit obligation.

§ 706.14 Unfair late charges.

(a) Prohibition. In connection with collecting a debt arising out of an extension of credit to a consumer, it is an unfair act or practice for a federal credit union, directly or indirectly, to levy or collect any delinquency charge on a payment, when the only delinquency is attributable to late fees or delinquency charges assessed on earlier installments and the payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period.

(b) Collecting a debt defined. Collecting a debt means, for the purposes of this section, any activity, other than the use of judicial process, that is intended to bring about or does bring about repayment of all or part of money due (or alleged to be due) from a consumer.

§§ 706.15 – 706.20 [Reserved]

Subpart C—Consumer Credit Card Account Practices Rule

§ 706.21 Definitions.

For purposes of this subpart, the following definitions apply:

Annual percentage rate means the product of multiplying each periodic rate for a balance or transaction on a consumer credit card account by the number of periods in a year. The term “periodic rate” has the same meaning as in 12 CFR 226.2.

Consumer means a natural person member to whom credit is extended under a consumer credit card account or a natural person who is a co-obligor or guarantor of a consumer credit card account.

Consumer credit card account means an account provided to a consumer primarily for personal, family, or household purposes under an open-end credit plan that is accessed by a credit card or charge card. The terms “open-end credit,” “credit card,” and “charge card” have the same meanings as in 12 CFR 226.2. The following are not consumer credit card accounts for purposes of this subpart:

- (1) Home equity plans subject to the requirements of 12 CFR 226.5b that are accessible by a credit or charge card;
- (2) Overdraft lines of credit tied to asset accounts accessed by check-guarantee cards or by debit cards;
- (3) Lines of credit accessed by check-guarantee cards or by debit cards that can be used only at automated teller machines; and
- (4) Lines of credit accessed solely by account numbers.

§ 706.22 Unfair time to make payment.

(a) General rule. Except as provided in paragraph (c) of this section, a federal credit union must not treat a payment on a consumer credit card account as late for any purpose unless the consumer has been provided a reasonable amount of time to make the payment.

(b) Compliance with general rule. (1) Establishing compliance. A federal credit union must be able to establish that it has complied with paragraph (a) of this section.

(2) Safe harbor. A federal credit union complies with paragraph (a) of this section if it has adopted reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date.

(c) Exception for grace periods. Paragraph (a) of this section does not apply to any time period a federal credit union provides within which the consumer may repay any portion of the credit extended without incurring an additional finance charge.

§ 706.23 Unfair allocation of payments.

When different annual percentage rates apply to different balances on a consumer credit card account, a federal credit union must allocate any amount paid by the consumer in excess of the required minimum periodic payment among the balances using one of the following methods:

(a) High-to-low method. The amount paid by the consumer in excess of the required minimum periodic payment is allocated first to the balance with the highest annual percentage rate and any remaining portion to the other balances in descending order based on the applicable annual percentage rate.

(b) Pro rata method. The amount paid by the consumer in excess of the required minimum periodic payment is allocated among the balances in the same proportion as each balance bears to the total balance.

§ 706.24 Unfair increases in annual percentage rates.

(a) General rule. At account opening, a federal credit union must disclose the annual percentage rates that will apply to each category of transactions on the consumer credit card account. A federal credit union must not increase the annual percentage rate for a category of transactions on any consumer credit card account except as provided in paragraph (b) of this section.

(b) Exceptions. The prohibition in paragraph (a) of this section on increasing annual percentage rates does not apply where an annual percentage rate may be increased pursuant to one of the exceptions in this paragraph.

(1) Account opening disclosure exception. An annual percentage rate for a category of transactions may be increased to a rate disclosed at account opening upon expiration of a period of time disclosed at account opening.

(2) Variable rate exception. An annual percentage rate for a category of transactions that varies according to an index that is not under the federal credit union's control and is available to the general public may be increased due to an increase in the index.

(3) Advance notice exception. An annual percentage rate for a category of transactions may be increased pursuant to a notice under 12 CFR 226.9(c) or (g) for transactions that occur more than seven days after provision of the notice. This exception does not permit an increase in any annual percentage rate during the first year after the account is opened.

(4) Delinquency exception. An annual percentage rate may be increased due to the federal credit union not receiving the consumer's required minimum periodic payment within 30 days after the due date for that payment.

(5) Workout arrangement exception. An annual percentage rate may be increased due to the consumer's failure to comply with the terms of a workout arrangement between the federal credit union and the consumer, provided that the annual percentage rate applicable to a category of transactions following any such increase does not exceed the rate that applied to that category of transactions prior to commencement of the workout arrangement.

(c) Treatment of protected balances. For purposes of this paragraph, "protected balance" means the amount owed for a category of transactions to which an increased annual percentage rate cannot be applied after the rate for that category of transactions has been increased pursuant to paragraph (b)(3) of this section.

(1) Repayment. A federal credit union must provide the consumer with one of the following methods of repaying a protected balance or a method that is no less beneficial to the consumer than one of the following methods:

(i) An amortization period of no less than five years, starting from the date on which the increased rate becomes effective for the category of transactions; or

(ii) A required minimum periodic payment that includes a percentage of the protected balance that is no more than twice the percentage required before the date on which the increased rate became effective for the category of transactions.

(2) Fees and charges. A federal credit union must not assess any fee or charge based solely on a protected balance.

§ 706.25 Unfair balance computation method.

(a) General rule. Except as provided in paragraph (b) of this section, a federal credit union must not impose finance charges on balances on a consumer credit card account based on balances for days in billing cycles that precede the most recent billing cycle as a result of the loss of any time period provided by the federal credit union within which the consumer may repay any portion of the credit extended without incurring a finance charge.

(b) Exceptions. Paragraph (a) of this section does not apply to:

(1) Adjustments to finance charges as a result of the resolution of a dispute under 12 CFR 226.12 or 12 CFR 226.13; or

(2) Adjustments to finance charges as a result of the return of a payment for insufficient funds.

§ 706.26 Unfair charging of security deposits and fees for the issuance or availability of credit to consumer credit card accounts.

(a) Limitation for first year. During the first year, a federal credit union must not charge to a consumer credit card account security deposits and fees for the issuance or availability of credit that in total constitute a majority of the initial credit limit for the account.

(b) Limitations for first billing cycle and subsequent billing cycles. (1) First billing cycle. During the first billing cycle, the federal credit union must not charge to a consumer credit card account security deposits and fees for the issuance or availability of credit that in total constitute more than 25 percent of the initial credit limit for the account.

(2) Subsequent billing cycles. Any additional security deposits and fees for the issuance or availability of credit permitted by paragraph (a) of this section must be charged to the account in equal portions in no fewer than the five billing cycles immediately following the first billing cycle.

(c) Evasion prohibited. A federal credit union must not evade the requirements of this section by providing the consumer additional credit to fund the payment of security deposits and fees for the issuance or availability of credit that exceed the total amounts permitted by paragraphs (a) and (b) of this section.

(d) Definitions. For purposes of this section, the following definitions apply:

(1) Fees for the issuance or availability of credit means:

(i) Any annual or other periodic fee that may be imposed for the issuance or availability of a consumer credit card account, including any fee based on account activity or inactivity; and

(ii) Any non-periodic fee that relates to opening an account.

(2) First billing cycle means the first billing cycle after a consumer credit card account is opened.

(3) First year means the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date.

(4) Initial credit limit means the credit limit in effect when a consumer credit card account is opened.

Appendix to Part 706—Official Staff Commentary

Subpart A—General Provisions for Consumer Protection Rules

Section 706.1—Authority, Purpose, and Scope

1(c) Scope

1. Penalties for noncompliance. Administrative enforcement of the rule for federal credit unions may involve actions under section 206 of the Federal Credit Union Act (12 U.S.C. 1786), including cease-and-desist orders requiring that actions be taken to remedy violations and civil money penalties.

Subpart C—Consumer Credit Card Account Practices Rule

Section 706.22—Unfair Time To Make Payment

22(a) General Rule

1. Treating a payment as late for any purpose. Treating a payment as late for any purpose includes increasing the annual percentage rate as a penalty, reporting the consumer as delinquent to a credit reporting agency, or assessing a late fee or any other fee based on the consumer's

failure to make a payment within the amount of time provided to make that payment under this section.

2. Reasonable amount of time to make payment. Whether an amount of time is reasonable for purposes of making a payment is determined from the perspective of the consumer, not the federal credit union. Under § 706.22(b)(2), a federal credit union provides a reasonable amount of time to make a payment if it has adopted reasonable procedures designed to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days before the payment due date.

22(b) Compliance with General Rule

1. Reasonable procedures. A federal credit union is not required to determine the specific date on which periodic statements are mailed or delivered to each consumer. A federal credit union provides a reasonable amount of time to make a payment if it has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than a certain number of days after the closing date of the billing cycle and adds that number of days to the 21-day period in § 706.24(b)(2) when determining the payment due date. For example, if a federal credit union has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than three days after the closing date of the billing cycle, the payment due date on the periodic statement must be no less than 24 days after the closing date of the billing cycle.

2. Payment due date. For purposes of § 706.22(b)(2), “payment due date” means the date by which a federal credit union requires the consumer to make the required minimum periodic payment in order to avoid being treated as late for any purpose, except as provided in § 706.22(c).

3. Example of alternative method of compliance. Assume that, for a particular type of consumer credit card account, a federal credit union only provides periodic statements electronically and only accepts payments electronically, consistent with applicable law and regulatory guidance. Under these circumstances, the federal credit union could comply with § 706.22(a) even if it does not provide periodic statements 21 days before the payment due date consistent with § 706.22(b)(2).

Section 706.23—Unfair Allocation of Payments

1. Minimum periodic payment. Section 706.23 addresses the allocation of amounts paid by a consumer in excess of the minimum periodic payment required by a federal credit union. Section 706.23 does not limit or otherwise address a federal credit union’s ability to determine, consistent with applicable law and regulatory guidance, the amount of the required minimum periodic payment or how that payment is allocated. A federal credit union may, but is not required to, allocate the required minimum periodic payment consistent with the requirements in § 706.23 to the extent consistent with other applicable law or regulatory guidance.

2. Adjustments of one dollar or less permitted. When allocating payments, a federal credit union may adjust amounts by one dollar or less. For example, if a federal credit union is allocating \$100 pursuant to § 706.23(b) among balances of \$1,000, \$2,000, and \$4,000, the federal credit union may apply \$14 to the \$1,000 balance, \$29 to the \$2,000 balance, and \$57 to the \$4,000 balance.

3. Applicable balances and annual percentage rates. Section 706.23 permits a federal credit union to allocate an amount paid by the consumer in excess of the required minimum periodic payment based on the balances and annual percentage rates on the date the preceding billing cycle ends, on the date the payment is credited to the account, or on any day between

those two dates. For example, assume that the billing cycles for a consumer credit card account start on the first day of the month and end on the last day of the month. On the date the March billing cycle ends, March 31, the account has a purchase balance of \$500 at a variable annual percentage rate of 10% and a cash advance balance of \$200 at a variable annual percentage rate of 13%. On April 1, the rate for purchases increases to 13% and the rate for cash advances increases to 15% consistent with § 706.24(b)(2). On April 15, the purchase balance increases to \$700. On April 25, the federal credit union credits to the account \$400 paid by the consumer in excess of the required minimum periodic payment. Under § 706.23, the federal credit union may allocate the \$400 based on the balances in existence and rates in effect on any day from March 31 through April 25.

4. Use of permissible allocation methods. A federal credit union is not prohibited from changing the allocation method for a consumer credit card account or from using different allocation methods for different consumer credit card accounts, so long as the methods used are consistent with § 706.23. For example, a federal credit union may change from allocating to the highest rate balance first pursuant to § 706.23(a) to allocating pro rata pursuant to § 706.23(b) or vice versa. Similarly, a federal credit union may allocate to the highest rate balance first pursuant to § 706.23(a) on some of its accounts and allocate pro rata pursuant to § 706.23(b) on other accounts.

5. Claims or defenses under Regulation Z, 12 CFR 226.12(c). When a consumer has asserted a claim or defense against the card issuer pursuant to 12 CFR 226.12(c), a federal credit union must allocate consistent with 12 CFR 226.12 comment 226.12(c)-4.

6. Balances with the same annual percentage rate. When the same annual percentage rate applies to more than one balance on an account and a different annual percentage rate applies to at least one other balance on that account, § 706.23 does not require that a federal credit union use any particular method when allocating among the balances with the same annual percentage rate. Under these circumstances, a federal credit union may treat the balances with the same rate as a single balance or separate balances. See comments 23(a)-1.iv and 23(b)-2.iv.

23(a) High-to-Low Method

1. Examples. For purposes of the following examples, assume that none of the required minimum periodic payment is allocated to the balances discussed, unless otherwise stated.

i. Assume that a consumer's account has a cash advance balance of \$500 at an annual percentage rate of 15% and a purchase balance of \$1,500 at an annual percentage rate of 10% and that the consumer pays \$800 in excess of the required minimum periodic payment. A federal credit union using this method would allocate \$500 to pay off the cash advance balance and then allocate the remaining \$300 to the purchase balance.

ii. Assume that a consumer's account has a cash advance balance of \$500 at an annual percentage rate of 15% and a purchase balance of \$1,500 at an annual percentage rate of 10% and that the consumer pays \$400 in excess of the required minimum periodic payment. A federal credit union using this method would allocate the entire \$400 to the cash advance balance.

iii. Assume that a consumer's account has a cash advance balance of \$100 at an annual percentage rate of 15%, a purchase balance of \$300 at an annual percentage rate of 13%, and a \$600 protected balance on which the 10% annual percentage rate cannot be increased pursuant to § 706.24. If the consumer pays \$500 in excess of the required minimum periodic payment, a federal credit union using this method would allocate \$100 to pay off the cash advance balance, \$300 to pay off the purchase balance, and \$100 to the protected balance.

iv. Assume that a consumer's account has a cash advance balance of \$500 at an annual percentage rate of 15%, a purchase balance of \$1,000 at an annual percentage rate of 12%, and a transferred balance of \$2,000 that was previously at a discounted annual percentage rate of 5% but is now at an annual percentage rate of 12%. Assume also that the consumer pays \$800 in excess of the required minimum periodic payment. A federal credit union using this method would allocate \$500 to pay off the cash advance balance and allocate the remaining \$300 among the purchase balance and the transferred balance in the manner the federal credit union deems appropriate.

23(b) Pro Rata Method

1. Total balance. A federal credit union may, but is not required to, deduct amounts paid by the consumer's required minimum periodic payment when calculating the total balance for purposes of § 706.23(b)(3). See comment 23(b)-2.iii.

2. Examples. For purposes of the following examples, assume that none of the required minimum periodic payment is allocated to the balances discussed, unless otherwise stated, and that the amounts allocated to each balance are rounded to the nearest dollar.

i. Assume that a consumer's account has a cash advance balance of \$500 at an annual percentage rate of 15% and a purchase balance of \$1,500 at an annual percentage rate of 12% and that the consumer pays \$555 in excess of the required minimum periodic payment. A federal credit union using this method would allocate 25% of the amount (\$139) to the cash advance balance and 75% of the amount (\$416) to the purchase balance.

ii. Assume that a consumer's account has a cash advance balance of \$100 at an annual percentage rate of 15%, a purchase balance of \$300 at an annual percentage rate of 13%, and a \$600 protected balance on which the 10% annual percentage rate cannot be increased pursuant to § 706.24. If the consumer pays \$130 in excess of the required minimum periodic payment, a federal credit union using this method would allocate 10% of the amount (\$13) to the cash advance balance, 30% of the amount (\$39) to the purchase balance, and 60% of the amount (\$78) to the protected balance.

iii. Assume that a consumer's account has a cash advance balance of \$300 at an annual percentage rate of 15% and a purchase balance of \$600 at an annual percentage rate of 13%. Assume also that the required minimum periodic payment is \$50 and that the federal credit union allocates this payment first to the balance with the lowest annual percentage rate, the \$600 purchase balance. If the consumer pays \$300 in excess of the \$50 minimum payment, a federal credit union using this method could allocate based on a total balance of \$850, consisting of the \$300 cash advance balance plus the \$550 purchase balance after application of the \$50 minimum payment. In this case, the federal credit union would apply 35% of the \$300 (\$105) to the cash advance balance and 65% of that amount (\$195) to the purchase balance. In the alternative, the federal credit union could allocate based on a total balance of \$900, which does not reflect the \$50 minimum payment. In that case, the federal credit union would apply one-third of the \$300 excess payment (\$100) to the cash advance balance and two-thirds (\$200) to the purchase balance.

iv. Assume that a consumer's account has a cash advance balance of \$500 at an annual percentage rate of 15%, a purchase balance of \$1,000 at an annual percentage rate of 12%, and a transferred balance of \$2,000 that was previously at a discounted annual percentage rate of 5%, but is now at an annual percentage rate of 12%. Assume also that the consumer pays \$800 in excess of the required minimum periodic payment. A federal credit union using this method would allocate 14% of the excess payment (\$112) to the cash advance balance and allocate the

remaining 86% (\$688) among the purchase balance and the transferred balance in the manner the federal credit union deems appropriate.

Section 706.24—Unfair Increases in Annual Percentage Rates

1. Relationship to Regulation Z, 12 CFR part 226. A federal credit union that complies with the applicable disclosure requirements in Regulation Z, 12 CFR part 226, has complied with the disclosure requirements in § 706.24. See 12 CFR 226.5a, 226.6, 226.9. For example, a federal credit union may comply with the requirement in § 706.24(a) to disclose at account opening the annual percentage rates that will apply to each category of transactions by complying with the disclosure requirements in 12 CFR 226.5a regarding applications and solicitations and the requirements in 12 CFR 226.6 regarding account-opening disclosures. Similarly, in order to increase an annual percentage rate on new transactions pursuant to § 706.24(b)(3), a federal credit union must comply with the disclosure requirements in 12 CFR 226.9(c) or (g). However, nothing in § 706.24 alters the requirements in 12 CFR 226.9(c) and (g) that creditors provide consumers with written notice at least 45 days prior to the effective date of certain increases in the annual percentage rates on open-end (not home-secured) credit plans.

24(a) General Rule

1. Rates that will apply to each category of transactions. Section 706.24(a) requires federal credit unions to disclose, at account opening, the annual percentage rates that will apply to each category of transactions on the account. A federal credit union cannot satisfy this requirement by disclosing at account opening only a range of rates or that a rate will be “up to” a particular amount.

2. Application of prohibition on increasing rates. Section 706.24(a) prohibits federal credit unions from increasing the annual percentage rate for a category of transactions on any consumer credit card account unless specifically permitted by one of the exceptions in § 706.24(b). The following examples illustrate the application of the rule:

i. Assume that, at account opening on January 1 of year one, a federal credit union discloses that the annual percentage rate for purchases is a non-variable rate of 1% and will apply for six months. The federal credit union also discloses that, after six months, the annual percentage rate for purchases will be a variable rate that is currently 9% and will be adjusted quarterly by adding a margin of 8 percentage points to a publicly-available index not under the federal credit union’s control. Finally, the federal credit union discloses that the annual percentage rate for cash advances is the same variable rate that will apply to purchases after six months. The payment due date for the account is the twenty-fifth day of the month and the required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase and cash advance balances.

A. On January 15, the consumer uses the account to make a \$2,000 purchase and a \$500 cash advance. No other transactions are made on the account. At the start of each quarter, the federal credit union adjusts the variable rate that applies to the \$500 cash advance consistent with changes in the index, pursuant to § 706.24(b)(2). All required minimum periodic payments are received on or before the payment due date until May of year one, when the payment due on May 25 is received by the federal credit union on May 28. The federal credit union is prohibited by § 706.24 from increasing the rates that apply to the \$2,000 purchase, the \$500 cash advance, or future purchases and cash advances. Six months after account opening, July 1, the federal credit union applies the previously-disclosed variable rate determined using an 8-point margin pursuant to § 706.24(b)(1). Because no other increases in rate were disclosed at account

opening, the federal credit union may not subsequently increase the variable rate that applies to the \$2,000 purchase and the \$500 cash advance, except due to increases in the index pursuant to § 706.24(b)(2). On November 16, the federal credit union provides a notice pursuant to 12 CFR 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two, calculated using the same index and an increased margin of 12 percentage points. On January 1 of year two, the federal credit union increases the margin used to determine the variable rate that applies to new purchases to 12 percentage points pursuant to § 706.24(b)(3). On January 15 of year two, the consumer makes a \$300 purchase. The federal credit union applies the variable rate determined using the 12-point margin to the \$300 purchase but not the \$2,000 purchase.

B. Same facts as above, except that the required minimum periodic payment due on May 25 of year one is not received by the federal credit union until June 30 of year one. Because the federal credit union received the required minimum periodic payment more than 30 days after the payment due date, § 706.24(b)(4) permits the federal credit union to increase the annual percentage rate applicable to the \$2,000 purchase, the \$500 cash advance, and future purchases and cash advances. However, the federal credit union must first comply with the notice requirements in 12 CFR 226.9(g). Thus, if the federal credit union provided a 12 CFR 226.9(g) notice on June 25 stating that all rates on the account would be increased to a non-variable penalty rate of 15%, the federal credit union could apply that 15% rate beginning on August 9, to all balances and future transactions.

ii. Assume that, at account opening on January 1 of year one, a federal credit union discloses that the annual percentage rate for purchases will increase as follows: a non-variable rate of 3% for six months; a non-variable rate of 8% for an additional six months; and thereafter a variable rate that is currently 13% and will be adjusted monthly by adding a margin of 5 percentage points to a publicly-available index not under the federal credit union's control. The payment due date for the account is the fifteenth day of the month and the required minimum periodic payments are applied to accrued interest and fees but do not reduce the purchase balance. On January 15, the consumer uses the account to make a \$1,500 purchase. Six months after account opening, July 1, the federal credit union begins accruing interest on the \$1,500 purchase at the previously-disclosed 8% non-variable rate pursuant to § 706.24(b)(1). On September 15, the consumer uses the account for a \$700 purchase. On November 16, the federal credit union provides a notice pursuant to 12 CFR 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two, calculated using the same index and an increased margin of 8 percentage points. One year after account opening, January 1 of year two, the federal credit union begins accruing interest on the \$2,200 purchase balance at the previously-disclosed variable rate determined using a 5-point margin pursuant to § 706.24(b)(1). Because the variable rate determined using the 8-point margin was not disclosed at account opening, the federal credit union may not apply that rate to the \$2,200 purchase balance. Furthermore, because no other increases in rate were disclosed at account opening, the federal credit union may not subsequently increase the variable rate that applies to the \$2,200 purchase balance, (except due to increases in the index pursuant to § 706.24(b)(2)). The federal credit union may, however, apply the variable rate determined using the 8-point margin to purchases made on or after January 1 of year two pursuant to § 706.24(b)(3).

iii. Assume that, at account opening on January 1 of year one, a federal credit union discloses that the annual percentage rate for purchases is a variable rate determined by adding a margin of 6 percentage points to a publicly-available index outside of the federal credit union's control. The federal credit union also discloses that, to the extent consistent with § 706.24 and

other applicable law, a non-variable penalty rate of 15% may apply if the consumer makes a late payment. The due date for the account is the fifteenth of the month. On May 30 of year two, the account has a purchase balance of \$1,000. On May 31, the creditor provides a notice pursuant to 12 CFR 226.9(c) informing the consumer of a new variable rate that will apply on July 16 for all purchases made on or after June 8, calculated by using the same index and an increased margin of 8 percentage points. On June 7, the consumer makes a \$500 purchase. On June 8, the consumer makes a \$200 purchase. On June 25, the federal credit union has not received the payment due on June 15, and provides the consumer with a notice pursuant to 12 CFR 226.9(g) stating that the penalty rate of 15% will apply as of August 9, to all transactions made on or after July 2. On July 4, the consumer makes a \$300 purchase.

A. The payment due on June 15 of year two is received on June 25. On July 17, § 706.24(b)(3) permits the federal credit union to apply the variable rate determined using the 8-point margin to the \$200 purchase made on June 8 but does not permit the federal credit union to apply this rate to the \$1,500 purchase balance. On August 9, § 706.24(b)(3) permits the federal credit union to apply the 15% penalty rate to the \$300 purchase made on July 4, but does not permit the federal credit union to apply this rate to the \$1,500 purchase balance, which remains at the variable rate determined using the 6-point margin, or the \$200 purchase, which remains at the variable rate determined using the 8-point margin.

B. Same facts as above, except the payment due on September 15 of year two is received on October 20. Section 706.24(b)(4) permits the federal credit union to apply the 15% penalty rate to all balances on the account and to future transactions because it has not received payment within 30 days after the due date. However, in order to apply the 15% penalty rate to the entire \$2,000 purchase balance, the federal credit union must provide an additional notice pursuant to 12 CFR 226.9(g). This notice must be sent no earlier than October 16, which is the first day the account became more than 30 days' delinquent.

C. Same facts as paragraph A above, except the payment due on June 15 of year two is received on July 20. Section 706.24(b)(4) permits the federal credit union to apply the 15% penalty rate to all balances on the account and to future transactions because it has not received payment within 30 days after the due date. Because the federal credit union provided a 12 CFR 226.9(g) notice on June 24 stating the 15% penalty rate, the federal credit union may apply the 15% penalty rate to all balances on the account as well as any future transactions on August 9, without providing an additional notice pursuant to 12 CFR 226.9(g).

24(b) Exceptions

24(b)(1) Account Opening Disclosure Exception

1. Prohibited increases in rate. Section § 706.24(b)(1) permits an increase in the annual percentage rate for a category of transactions to a rate disclosed at account opening upon expiration of a period of time that was also disclosed at account opening. Section 706.24(b)(1) does not permit application of increased rates that are disclosed at account opening but are contingent on a particular event or occurrence or may be applied at the federal credit union's discretion. The following examples illustrate rate increases that are not permitted by § 706.24(a):

i. Assume that a federal credit union discloses at account opening on January 1 of year one that a non-variable rate of 8% applies to purchases, but that all rates on an account may be increased to a non-variable penalty rate of 15% if a consumer's required minimum periodic payment is received after the payment due date, which is the fifteenth of the month. On March 1, the account has a \$2,000 purchase balance. The payment due on March 15 is not received

until March 20. Section 706.24 does not permit the federal credit union to apply the 15% penalty rate to the \$2,000 purchase balance. However, pursuant to § 706.24(b)(3), the federal credit union could provide a 12 CFR 226.9(c) or (g) notice on November 16, informing the consumer that, on January 1 of year two, the 15% rate (or a different rate) will apply to new transactions.

ii. Assume that a federal credit union discloses at account opening on January 1 of year one that a non-variable rate of 5% applies to transferred balances but that this rate will increase to a non-variable rate of 15% if the consumer does not use the account for at least \$200 in purchases each billing cycle. On July 1, the consumer transfers a balance of \$4,000 to the account. During the October billing cycle, the consumer uses the account for \$150 in purchases. Section 706.24 does not permit the federal credit union to apply the 15% rate to the \$4,000 transferred balance. However, pursuant to § 706.24(b)(3), the federal credit union could provide a 12 CFR 226.9(c) or (g) notice on November 16 informing the consumer that, on January 1 of year two, the 15% rate, or a different rate, will apply to new transactions.

iii. Assume that a federal credit union discloses at account opening on January 1 of year one that interest on purchases will be deferred for one year, although interest will accrue on purchases during that year at a non-variable rate of 15%. The federal credit union further discloses that, if all purchases made during year one are not paid in full by the end of that year, the federal credit union will begin charging interest on the purchase balance and new purchases at 15% and will retroactively charge interest on the purchase balance at a rate of 15% starting on the date of each purchase made during year one. On January 1 of year one, the consumer makes a purchase of \$1,500. No other transactions are made on the account. On January 1 of year two, \$500 of the \$1,500 purchase remains unpaid. Section 706.24 does not permit the federal credit union to reach back to charge interest on the \$1,500 purchase from January 1 through December 31 of year one. However, the federal credit union may apply the previously-disclosed 15% rate to the \$500 purchase balance beginning on January 1 of year two pursuant to § 706.24(b)(1).

2. Loss of grace period. Nothing in § 706.24 prohibits a federal credit union from assessing interest due to the loss of a grace period to the extent consistent with § 706.25.

3. Application of rate that is lower than disclosed rate. Section 706.24(b)(1) permits an increase in the annual percentage rate for a category of transactions to a rate disclosed at account opening upon expiration of a period of time that was also disclosed at account opening. Nothing in § 706.24 prohibits a federal credit union from applying a rate that is lower than the disclosed rate upon expiration of the period. However, if a lower rate is applied to an existing balance, the federal credit union cannot subsequently increase the rate on that balance unless it has provided the consumer with advance notice of the increase pursuant to 12 CFR 226.9(c). Furthermore, the federal credit union cannot increase the rate on that existing balance to a rate that is higher than the increased rate disclosed at account opening. The following example illustrates the application of this rule:

i. Assume that, at account opening on January 1 of year one, a federal credit union discloses that a non-variable annual percentage rate of 5% will apply to purchases for one year and discloses that, after the first year, the federal credit union will apply a variable rate that is currently 15% and is determined by adding a margin of 10 percentage points to a publicly-available index not under the federal credit union's control. On December 31 of year one, the account has a purchase balance of \$3,000.

A. On November 16 of year one, the federal credit union provides a notice pursuant to 12 CFR 226.9(c) informing the consumer of a new variable rate that will apply on January 1 of year two, calculated using the same index and a reduced margin of 8 percentage points. The

notice further states that, on July 1 of year two, the margin will increase to the margin disclosed at account opening, 5 percentage points. On July 1 of year two, the federal credit union increases the margin used to determine the variable rate that applies to new purchases to 10 percentage points and applies that rate to any remaining portion of the \$3,000 purchase balance pursuant to § 706.24(b)(1).

B. Same facts as above, except that the federal credit union does not send a notice on November 16 of year one. Instead, on January 1 of year two, the federal credit union lowers the margin used to determine the variable rate to 8 percentage points and applies that rate to the \$3,000 purchase balance and to new purchases. 12 CFR 226.9 does not require advance notice in these circumstances. However, unless the account becomes more than 30 days' delinquent, the federal credit union may not subsequently increase the rate that applies to the \$3,000 purchase balance except due to increases in the index pursuant to § 706.24(b)(2).

24(b)(2) Variable Rate Exception

1. Increases due to increase in index. Section 706.24(b)(2) provides that an annual percentage rate for a category of transactions that varies according to an index that is not under the federal credit union's control and is available to the general public may be increased due to an increase in the index. This section does not permit a federal credit union to increase the annual percentage rate by changing the method used to determine a rate that varies with an index, such as by increasing the margin, even if that change will not result in an immediate increase.

2. External index. A federal credit union may increase the annual percentage rate if the increase is based on an index or indices outside the federal credit union's control. A federal credit union may not increase the rate based on its own prime rate or cost of funds. A federal credit union is permitted, however, to use a published prime rate, such as that in the Wall Street Journal, even if the federal credit union's own prime rate is one of several rates used to establish the published rate.

3. Publicly available. The index or indices must be available to the public. A publicly-available index need not be published in a newspaper, but it must be one the consumer can independently obtain, by telephone, for example, and use to verify the rate applied to the outstanding balance.

4. Changing a non-variable rate to a variable rate. Section 706.24 generally prohibits a federal credit union from changing a non-variable annual percentage rate to a variable rate because such a change can result in an increase in rate. However, § 706.24(b)(1) permits a federal credit union to change a non-variable rate to a variable rate if the change was disclosed at account opening. Furthermore, following the first year after the account is opened, § 706.24(b)(3) permits a federal credit union to change a non-variable rate to a variable rate with respect to new transactions, after complying with the notice requirements in 12 CFR 226.9(c) or (g). Finally, § 706.24(b)(4) permits a federal credit union to change a non-variable rate to a variable rate if the required minimum periodic payment is not received within 30 days of the payment due date, after complying with the notice requirements in 12 CFR 226.9(g).

5. Changing a variable annual percentage rate to a non-variable annual percentage rate. Nothing in § 706.24 prohibits a federal credit union from changing a variable annual percentage rate to an equal or lower non-variable rate. Whether the non-variable rate is equal to or lower than the variable rate is determined at the time the federal credit union provides the notice required by 12 CFR 226.9(c). For example, assume that on March 1 a variable rate that is currently 15% applies to a balance of \$2,000 and the federal credit union sends a notice pursuant

to 12 CFR 226.9(c) informing the consumer that the variable rate will be converted to a non-variable rate of 14% effective April 17. On April 17, the federal credit union may apply the 14% non-variable rate to the \$2,000 balance and to new transactions even if the variable rate on March 2 or a later date was less than 14%.

6. Substitution of index. A federal credit union may change the index and margin used to determine the annual percentage rate under § 706.24(b)(2) if the original index becomes unavailable, as long as historical fluctuations in the original and replacement indices were substantially similar, and as long as the replacement index and margin will produce a rate similar to the rate that was in effect at the time the original index became unavailable. If the replacement index is newly established and therefore does not have any rate history, it may be used if it produces a rate substantially similar to the rate in effect when the original index became unavailable.

24(b)(3) Advance Notice Exception

1. First year after the account is opened. A federal credit union may not increase an annual percentage rate pursuant to § 706.24(b)(3) during the first year after the account is opened. This limitation does not apply to accounts opened prior to July 1, 2010.

2. Transactions that occur more than seven days after notice provided. Section 706.24(b)(3) generally prohibits a federal credit union from applying an increased rate to transactions that occur within seven days after provision of the 12 CFR 226.9(c) or (g) notice. This prohibition does not, however, apply to transactions that are authorized within seven days after provision of the 12 CFR 226.9(c) or (g) notice but are settled more than seven days after the notice was provided.

3. Examples.

i. Assume that a consumer credit card account is opened on January 1 of year one. On March 14 of year two, the account has a purchase balance of \$2,000 at a non-variable annual percentage rate of 5%. On March 15, the federal credit union provides a notice pursuant to 12 CFR 226.9(c) informing the consumer that the rate for new purchases will increase to a non-variable rate of 15% on May 1. The notice further states that the 5% rate will apply for six months until November 1, and states that thereafter the federal credit union will apply a variable rate that is currently 15% and is determined by adding a margin of 10 percentage points to a publicly-available index that is not under the federal credit union's control. The seventh day after provision of the notice is March 22 and, on that date, the consumer makes a \$200 purchase. On March 24, the consumer makes a \$1,000 purchase. On May 1, § 706.24(b)(3) permits the federal credit union to begin accruing interest at 15% on the \$1,000 purchase made on March 24. The federal credit union is not permitted to apply the 15% rate to the \$2,200 purchase balance as of March 22. After six months, November 2, the federal credit union may begin accruing interest on any remaining portion of the \$1,000 purchase at the previously-disclosed variable rate determined using the 10-point margin.

ii. Same facts as above except that the \$200 purchase is authorized by the federal credit union on March 22 but is not settled until March 23. On May 1, § 706.24(b)(3) permits the federal credit union to start charging interest at 15% on both the \$200 purchase and the \$1,000 purchase. The federal credit union is not permitted to apply the 15% rate to the \$2,000 purchase balance as of March 22.

iii. Same facts as in paragraph i above, except that on September 17 of year two, which is 45 days before expiration of the 18% non-variable rate, the federal credit union provides a notice pursuant to 12 CFR 226.9(c) informing the consumer that, on November 2, a new variable rate will apply to new purchases and any remaining portion of the \$1,000 balance, calculated by using the same index and a reduced margin of 10 percentage points. The notice further states that, on May 1 of year three, the margin will increase to the margin disclosed at account opening, 12 percentage points. On May 1 of year three, § 706.24(b)(3) permits the federal credit union to increase the margin used to determine the variable rate that applies to new purchases to 12 percentage points and to apply that rate to any remaining portion of the \$1,000 purchase as well as to new purchases. See comment 24(b)(1)-3. The federal credit union is not permitted to apply this rate to any remaining portion of the \$2,200 purchase balance as of March 22.

24(b)(5) Workout Arrangement Exception

1. Scope of exception. Nothing in § 706.24(b)(5) permits a federal credit union to alter the requirements of § 706.24 pursuant to a workout arrangement between a consumer and the federal credit union. For example, a federal credit union cannot increase an annual percentage

rate pursuant to a workout arrangement unless otherwise permitted by § 706.24. In addition, a federal credit union cannot require the consumer to make payments with respect to a protected balance that exceed the payments permitted under § 706.24(c).

2. Variable annual percentage rates. If the annual percentage rate that applied to a category of transactions prior to commencement of the workout arrangement varied with an index consistent with § 706.24(b)(2), the rate applied to that category of transactions following an increase pursuant to § 706.24(b)(5) must be determined using the same formula, index and margin.

3. Example. Assume that, consistent with § 706.24(b)(4), the margin used to determine a variable annual percentage rate that applies to a \$5,000 balance is increased from 5 percentage points to 15 percentage points. Assume also that the federal credit union and the consumer subsequently agree to a workout arrangement that reduces the margin back to 5 points on the condition that the consumer pay a specified amount by the payment due date each month. If the consumer does not pay the agreed-upon amount by the payment due date, the federal credit union may increase the margin for the variable rate that applies to the \$5,000 balance up to 15 percentage points. 12 CFR 226.9 does not require advance notice of this type of increase.

24(c) Treatment of Protected Balances

1. Protected balances. Because rates cannot be increased pursuant to § 706.24(b)(3) during the first year after account opening, § 706.24(c) does not apply to balances during the first year. Instead, the requirements in § 706.24(c) apply only to “protected balances,” which are amounts owed for a category of transactions to which an increased annual percentage rate cannot be applied after the rate for that category of transactions has been increased pursuant to § 706.24(b)(3). For example, assume that, on March 15 of year two, an account has a purchase balance of \$1,000 at a non-variable rate of 12% and that, on March 16, the federal credit union sends a notice pursuant to 12 CFR 226.9(c) informing the consumer that the rate for new purchases will increase to a non-variable rate of 15% on May 2. On March 20, the consumer makes a \$100 purchase. On March 24, the consumer makes a \$150 purchase. On May 2, § 706.24(b)(3) permits the federal credit union to start charging interest at 15% on the \$150 purchase made on March 24 but does not permit the federal credit union to apply that 15% rate to the \$1,100 purchase balance as of March 23. Accordingly, § 706.24(c) applies to the \$1,100 purchase balance as of March 23 but not the \$150 purchase made on March 24.

24(c)(1) Repayment

1. No less beneficial to the consumer. A federal credit union may provide a method of repaying the protected balance that is different from the methods listed in § 706.24(c)(1) so long as the method used is no less beneficial to the consumer than one of the listed methods. A method is no less beneficial to the consumer if the method amortizes the protected balance in five years or longer or if the method results in a required minimum periodic payment that is equal to or less than a minimum payment calculated consistent with § 706.24(c)(1)(ii). For example, a federal credit union could increase the percentage of the protected balance included in the required minimum periodic payment from 2% to 5% so long as doing so would not result in amortization of the protected balance in less than five years. Alternatively, a federal credit union could require a consumer to make a minimum payment that amortizes the protected balance in less than five years so long as the payment does not include a percentage of the balance that is more than twice the percentage included in the minimum payment before the effective date of the increased rate. For example, a federal credit union could require the consumer to make a minimum payment that amortizes the protected balance in four years so long

as doing so would not more than double the percentage of the balance included in the minimum payment prior to the effective date of the increased rate.

2. Lower limit for required minimum periodic payment. If the required minimum periodic payment under § 706.24(c)(1)(i) or (ii) is less than the lower dollar limit for minimum payments established in the cardholder agreement before the effective date of the rate increase, the federal credit union may set the minimum payment consistent with that limit. For example, if at account opening the cardholder agreement stated that the required minimum periodic payment would be either the total of fees and interest charges plus 1% of the total amount owed or \$20, whichever is greater, the federal credit union may require the consumer to make a minimum payment of \$20 even if doing so would pay off the protected balance in less than five years or constitute more than 2% of the protected balance plus fees and interest charges.

Paragraph 24(c)(1)(i)

1. Amortization period starting from date on which increased rate becomes effective. Section 706.24(c)(1)(i) provides for an amortization period for the protected balance of no less than five years, starting from the date on which the increased annual percentage rate becomes effective. A federal credit union is not required to recalculate the required minimum periodic payment for the protected balance if, during the amortization period, that balance is reduced as a result of the allocation of amounts paid by the consumer in excess of the minimum payment consistent with § 706.23 or any other practice permitted by these rules and other applicable law.

2. Amortization when applicable annual percentage rate is variable. If the annual percentage rate that applies to the protected balance varies with an index consistent with § 706.24(b)(2), the federal credit union may adjust the interest charges included in the required minimum periodic payment for that balance accordingly in order to ensure that the outstanding balance is amortized in five years. For example, assume that a variable rate that is currently 10% applies to a protected balance and that, in order to amortize that balance in five years, the required minimum periodic payment must include a specific amount of principal plus all accrued interest charges. If the 10% variable rate increases due to an increase in the index, the federal credit union may increase the required minimum periodic payment to include the additional interest charges.

Paragraph 24(c)(1)(ii)

1. Required minimum periodic payment on other balances. Section 706.24(c)(1)(ii) addresses the required minimum periodic payment on the protected balance. Section 706.24(c)(1)(ii) does not limit or otherwise address the federal credit union's ability to determine the amount of the required minimum periodic payment for other balances.

2. Example. Assume that the method used by a federal credit union to calculate the required minimum periodic payment for a consumer credit card account requires the consumer to pay either the total of fees and interest charges plus 1% of the total amount owed or \$20, whichever is greater. Assume also that the account has a purchase balance of \$2,000 at an annual percentage rate of 10% and a cash advance balance of \$500 at an annual percentage rate of 15% and that the federal credit union increases the rate for purchases to 15%, but does not increase the rate for cash advances. Under § 706.24(c)(1)(ii), the federal credit union may require the consumer to pay fees and interest plus 2% of the \$2,000 purchase balance. Section 706.24(c)(1)(ii) does not prohibit the federal credit union from increasing the required minimum periodic payment for the cash advance balance.

24(c)(2) Fees and Charges

1. Fee or charge based solely on the protected balance. A federal credit union is prohibited from assessing a fee or charge based solely on balances to which § 706.24(c) applies. For example, a federal credit union is prohibited from assessing a monthly maintenance fee that would not be charged if the account did not have a protected balance. A federal credit union is not, however, prohibited from assessing fees such as late payment fees or fees for exceeding the credit limit even if such fees are based in part on the protected balance.

Section 706.25—Unfair Balance Computation Method

25(a) General Rule

1. Two-cycle method prohibited. When a consumer ceases to be eligible for a time period provided by the federal credit union within which the consumer may repay any portion of the credit extended without incurring a finance charge, a grace period, the federal credit union is prohibited from computing the finance charge using the so-called two-cycle average daily balance computation method. This method calculates the finance charge using a balance that is the sum of the average daily balances for two billing cycles. The first balance is for the current billing cycle, and is calculated by adding the total balance, including or excluding new purchases and deducting payments and credits, for each day in the billing cycle, and then dividing by the number of days in the billing cycle. The second balance is for the preceding billing cycle.

2. Examples.

i. Assume that the billing cycle on a consumer credit card account starts on the first day of the month and ends on the last day of the month. The payment due date for the account is the twenty-fifth day of the month. Under the terms of the account, the consumer will not be charged interest on purchases if the balance at the end of a billing cycle is paid in full by the following payment due date. The consumer uses the credit card to make a \$500 purchase on March 15. The consumer pays the balance for the February billing cycle in full on March 25. At the end of the March billing cycle, March 31, the consumer's balance consists only of the \$500 purchase and the consumer will not be charged interest on that balance if it is paid in full by the following due date, April 25. The consumer pays \$400 on April 25, leaving a \$100 balance. The federal credit union may charge interest on the \$500 purchase from the start of the April billing cycle, April 1, through April 24 and interest on the remaining \$100 from April 25 through the end of the April billing cycle, April 30. The federal credit union is prohibited, however, from reaching back and charging interest on the \$500 purchase from the date of purchase, March 15 to the end of the March billing cycle, March 31.

ii. Assume the same circumstances as in the previous example except that the consumer does not pay the balance for the February billing cycle in full on March 25 and therefore, under the terms of the account, is not eligible for a time period within which to repay the \$500 purchase without incurring a finance charge. With respect to the \$500 purchase, the federal credit union may charge interest from the date of purchase, March 15, through April 24 and interest on the remaining \$100 from April 25 through the end of the April billing cycle, April 25.

Section 706.26 – Unfair Charging of Security Deposits and Fees for the Issuance or Availability of Credit to Consumer Credit Card Accounts

26(a) Limitation for First Year

1. Majority of the credit limit. The total amount of security deposits and fees for the issuance or availability of credit constitutes a majority of the initial credit limit if that total is greater than half of the limit. For example, assume that a consumer credit card account has an initial credit limit of \$500. Under § 706.26(a), a federal credit union may charge to the account

security deposits and fees for the issuance or availability of credit totaling no more than \$250 during the first year (consistent with § 706.26(b)).

26(b) Limitations for First Billing Cycle and Subsequent Billing Cycles

1. Adjustments of one dollar or less permitted. When dividing amounts pursuant to § 706.26(b)(2), a federal credit union may adjust amounts by one dollar or less. For example, if a federal credit union is dividing \$87 over five billing cycles, the federal credit union may charge \$18 for two months and \$17 for the remaining three months.

2. Examples.

i. Assume that a consumer credit card account opened on January 1 has an initial credit limit of \$500. Assume also that the billing cycles for this account begin on the first day of the month and end on the last day of the month. Under § 706.26(a), the federal credit union may charge to the account no more than \$250 in security deposits and fees for the issuance or availability of credit during the first year after the account is opened. If it charges \$250, the federal credit union may charge up to \$125 during the first billing cycle. If it charges \$125 during the first billing cycle, it may then charge no more than \$25 in each of the next five billing cycles. If it chooses, the federal credit union may spread the additional security deposits and fees over a longer period, such as by charging \$12.50 in each of the ten billing cycles following the first billing cycle.

ii. Same facts as above except that on July 1 the federal credit union increases the credit limit on the account from \$500 to \$750. Because the prohibition in § 706.26(a) is based on the initial credit limit of \$500, the increase in credit limit does not permit the federal credit union to charge to the account additional security deposits and fees for the issuance or availability of credit, such as a fee for increasing the credit limit.

26(c) Evasion Prohibited

1. Evasion. Section 706.26(c) prohibits a federal credit union from evading the requirements of this section by providing the consumer with additional credit to fund the consumer's payment of security deposits and fees that exceed the total amounts permitted by §§ 706.26(a) and (b). For example, assume that on January 1 a consumer opens a consumer credit card account with an initial credit limit of \$400 and the federal credit union charges to that account \$100 in fees for the issuance or availability of credit. Assume also that the billing cycles for the account coincide with the days of the month and that the federal credit union will charge \$20 in fees for the issuance or availability of credit in the February, March, April, May, and June billing cycles. The federal credit union violates § 706.26(c) if it provides the consumer with a separate credit product to fund additional security deposits or fees for the issuance or availability of credit.

2. Payment with funds not obtained from the federal credit union. A federal credit union does not violate § 706.26(c) if it requires the consumer to pay security deposits or fees for the issuance or availability of credit using funds that are not obtained, directly or indirectly, from the federal credit union. For example, a federal credit union does not violate § 706.26(c) if a \$400 security deposit paid by a consumer to obtain a consumer credit card account with a credit line of \$400 is not charged to a credit account provided by the federal credit union or its affiliate.

26(d) Definitions

1. Membership fees. Membership fees for opening an account are fees for the issuance or availability of credit. A membership fee to join an organization that provides a credit or charge card as a privilege of membership is a fee for the issuance or availability of credit only if the card

is issued automatically upon membership. If membership results merely in eligibility to apply for an account, then such a fee is not a fee for the issuance or availability of credit.

2. Enhancements. Fees for optional services in addition to basic membership privileges in a credit or charge card account, for example, travel insurance or card-registration services, are not fees for the issuance or availability of credit if the basic account may be opened without paying such fees. Issuing a card to each primary cardholder, not authorized users, is considered a basic membership privilege and fees for additional cards, beyond the first card on the account, are fees for the issuance or availability of credit. Thus, a fee to obtain an additional card on the account beyond the first card, so that each cardholder would have his or her own card, is a fee for the issuance or availability of credit even if the fee is optional; that is, if the fee is charged only if the cardholder requests one or more additional cards.

3. One-time fees. Non-periodic fees related to opening an account, such as application fees or one-time membership or participation fees, are fees for the issuance or availability of credit. Fees for reissuing a lost or stolen card, statement reproduction fees, and fees for late payment or other violations of the account terms are examples of fees that are not fees for the issuance or availability of credit.

[THIS SIGNATURE PAGE RELATES TO THE NOTICE OF PROPOSED RULEMAKING
TITLED "UNFAIR OR DECEPTIVE ACTS OR PRACTICES."]

By the National Credit Union Administration Board, on December 18, 2008.

Mary F. Rupp
Secretary of the Board

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