

Consumer Lending Update

February 2010

NEW REG Z OPEN-END CREDIT RULES ISSUED

On January 12, 2010 the FRB issued a new final rule amending Regulation Z to deal with the Credit Card Act amendments. While certain provisions become effective February 22, 2010, most of the changes under the final rule will not become effective until July 1, 2010, which was the original effective date for the new open-end (not home secured) credit rules adopted back in January 2009.

New requirements effective February 22, 2010. Some of the changes going into effect February 22, 2010 include:

- Prohibiting the use of the term “fixed” in referring to an APR in a tabular disclosure unless the disclosure specifies a time period that the rate will be fixed or if no such time period is provided, a statement that the rate will not increase while the plan is open.
- Clarifying timing requirements for periodic statements in connection with grace periods. When a grace period is offered and no finance charge is imposed for repaying the outstanding balance by a certain due date, the periodic statement must be delivered at least 21 days prior to the date the grace period will expire. Note that this new rule will apply to all open-end (not home secured) credit, not just credit cards. The 21-day period between mailing the periodic statement and the payment due date currently applies just to credit cards.
- Including on periodic statements issued in connection with credit card accounts the payment due date (which must be the same day of the month for each billing cycle) and the amount of any late payment fee or increased APR that may be imposed as a result of a late payment. The disclosures must appear on the front of the first page of the periodic statement in close proximity to each other.
- Requiring repayment disclosures on credit card statements that basically tell the cardholder how long it would take to pay off the outstanding balance if only the minimum payment is made each month. These disclosures are quite complicated.
- Applying the 45-day advance notice requirement rule that currently applies only to credit card accounts to also apply to other open-end (not home secured) credit accounts, including overdraft protection and other Reg Z-covered lines of credit. The new change-in-terms rules under Section 226.9(c)(2) become effective February 22, 2010, except for the format requirements pertaining to change-in-term notices. The FRB also has revised the information that must be disclosed in change-in-term notices.
- Requiring card issuers to provide disclosures upon renewal of a credit card account at least 30 days or one billing cycle before an annual fee is posted to the account. Renewal disclosures will be required even if the card issuer does not impose an annual fee but has changed any term of a cardholder’s account required to be disclosed under Sections 226.6(b)(1) and (b)(2) (certain account-opening disclosures) that has not been previously disclosed to the cardholder.
- Imposing a number of new rules pertaining to credit card accounts including the new opt-in rule before assessing an overlimit fee (Section 226.56), restrictions on marketing credit cards to college students on campus (Section 226.57) and the new requirement to post credit card agreements on the card issuer’s website and on the Federal Reserve’s website (Section 226.58).

Other provisions effective July 1, 2010. There are other aspects of the Fed’s new final rule that become effective July 1, 2010. Most of these provisions are the

ones adopted by the FRB back in January 2009 including, for example, the new account-opening disclosures required under Section 226.6 (including the new account-opening table) for all open-end (not home secured) credit, the new periodic statement requirements (including grouping fees and interest separately) under Section 226.7, and the rules governing advertising promotional rates on all open-end (not home secured) credit under Section 226.16(g).

AGENCIES ADOPT FINAL RISK-BASED PRICING RULE

The Federal Reserve, together with the FTC, announced on December 22, 2009 the adoption of final risk-based pricing regulations. The final rule is a result of changes made to the Fair Credit Reporting Act (FCRA) by the Fair and Accurate Credit Transactions Act (FACT Act). Commonly referred to as the “risk-based pricing notice,” creditors must provide a notice to a consumer when the creditor uses the consumer’s credit report in extending credit and, based on that report, extends credit to the consumer on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that creditor. The final rule becomes effective January 1, 2011.

Under the final rule, which applies to consumer-purpose credit, certain methods have been provided to assist creditors in determining which consumers should receive the notice. For example, creditors could make a determination on a case-by-case basis, a method whereby the creditor would need to identify an appropriate subset of its current or past consumers to compare to any given consumer. Each consumer would need to be compared to an adequate sample of consumers who have engaged in similar transactions. (For example, the terms offered on 30-year fixed-rate purchase money mortgages cannot be compared to the terms offered on auto loans, credit cards, student loans or adjustable-rate mortgages.)

Two alternative methods to the case-by-case comparison, referred to as the “credit score proxy method” and the “tiered pricing method,” also have been provided. The “credit score proxy method” permits the creditor to set the material terms of credit extended to a consumer based on a credit score whereby a 60/40 credit score cut off is established – that is, where approximately 40 percent of the consumers have higher credit scores and approximately 60 percent of the consumers have lower credit scores. Under the “tiered pricing method” a creditor would set the material terms of credit (in general the APR) by placing the consumer within one of a discrete number of pricing tiers, based in whole or in part on a consumer report. Consumers

identified by either of these two methods are deemed to have been extended credit on materially less favorable material terms and must receive a risk-based pricing notice.

Some exceptions to the notice requirement have been provided to permit creditors to provide consumers with a notice consisting of their credit score and certain additional information. The final rules also include optional model forms that creditors can use to comply with the provisions of the rule.

CHARGING DIFFERENTLY FOR MERGED CREDIT REPORTS MAY RESULT IN FAIR LENDING VIOLATION

The FDIC has begun to scrutinize banks’ practices of charging married applicants for a single, merged credit report but requiring unmarried joint applicants to pay for two separate reports. The issue was brought to light at an industry conference where an FDIC fair lending specialist noted that such practices have the potential for violating the Equal Credit Opportunity Act as marital status discrimination, because the single, merged credit report usually costs less than two separate credit reports. In addition, the FDIC could refer such practices to the Department of Justice for possible legal action.

The FDIC did provide some guidance as to how to avoid the potential for discrimination. According to the FDIC representative, banks should request that their credit report vendors provide merged reports for unmarried joint applications and charge the same fee as those for married couples. If the vendor is unable or unwilling to do so, banks are strongly advised to find a provider that will. A bank examined by the FDIC had requested that its vendor provide merged reports for such joint applicants but was told by the vendor that it could not do so if the applicants did not have a common address. The FDIC noted that the three major credit bureaus have determined that they are able to provide merged reports on unmarried joint applicants. The FDIC also addressed concerns raised about potential privacy issues, noting that the right to privacy diminishes when individuals apply together for joint credit. This is because there is a presumption that there will be disclosure of information that normally is considered protected between the applicants.

The issue, of course, applies only with respect to unmarried applicants that apply for joint credit. Creditors may charge applicants that apply for individual credit for individual credit reports.

FOR ADDITIONAL INFORMATION...

If you have questions, please contact Janet Bonnefin, Robert Olsen or Jill Kovar of Aldrich Bonnefin & Moore.