



Regulatory Alert

Federal Reserve Board

Notice of Interim Final Rule: Truth in Lending (Regulation Z)

09-EA-13

NAFCU would like to highlight the following:

- The rule requires financial institutions to adopt reasonable procedures to ensure that periodic statements are mailed to consumers at least 21 days before the payment is due. Notably, this 21 day requirement *applies to credit cards and “all open-end consumer credit plans.”*
- In the event that an institution cannot comply with the 21 day requirement, it may remedy the issue by disclosing on the statement that it will not treat a payment as late for any purpose if it is received within 21 days after the statement was mailed.
- The rule requires creditors to provide consumers at least 45 days notice before increasing the annual percentage rate or making any other significant change to the terms of a credit card account.
- Additionally, the 45 day advance notice disclosure must notify consumers of their right to cancel the credit card account before the increase or change in terms goes into effect. If a consumer rejects the changes, the creditor is generally prohibited from applying the increase or change to the account.

Comments due to NAFCU: August 14, 2009

Comments due to the Federal Reserve: September 21, 2009

Effective Date: August 20, 2009



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Summary of the Interim Final Rule Implementing Changes to TILA as Required by the CARD Act

The interim final rule applies only to the three provisions in the Credit Card Accountability Responsibility, and Disclosure Act (CARD Act), which go into effect on August 20, 2009. Specifically, section 106 of the Act requires lenders to adopt reasonable procedures to ensure periodic statements are sent to consumers at least 21 days before the due date. Importantly, this provision applies to all open-end consumer credit plans. Section 101 of the Act requires borrowers to provide 45 days advance notice of a change in interest rate or any other significant changes. Further, section 101 provides consumers the right to reject the proposed change and cancel the account, without any penalty.

The rule is straightforward regarding the new 21 day requirement. Simply put, lenders are required to implement procedures to ensure that periodic statements are mailed out 21 days before the due date. As noted above, this provision applies to all open-end consumer credit plans, not just credit cards. The rule clarifies that treating a payment as late includes increasing the annual percentage rate (APR), assessing a late fee or reporting a late payment to any consumer reporting agency (CRA).

Importantly, the Board provided a short term solution to the 21 day notice requirement. The staff commentary explains that if an institution cannot implement procedures to comply with the 21 day deadline, it must include on the periodic statement a notice that it will not treat the payment as late if it is received within 21 days of the statement being mailed. Consequently, even if a credit union cannot send the periodic statement 21 days before the due date it may still treat the payment as late if it has not been received 21 days after mailing the statement.

The 45 day advance notice rule requires lenders to provide written notice of an increase in the APR, an increase in the required minimum periodic payment, or any "significant change" in terms. The Board defined "significant change" to mean changes in items such as minimum finance charges, grace periods, balance computation methods, etc. More specifically, the list reflects exactly the list of terms that require disclosure in the account opening table under the Board's January 2009 Regulation Z rule. The notice must provide a description of the changes, state the changes being made to the account and state the date the changes will become effective.

Lastly, the rule requires creditors to clearly and conspicuously disclose instructions for how to reject the changes. Where applicable, the lender must disclose that rejecting the changes will result in the account being terminated. In the event the changes are rejected and the account is closed, there are three methods that can be used for repaying the balance. First, the lender may require the same minimum payment as required prior to the consumer rejecting the changes. Second, the borrower may repay on an amortization schedule of not less than five years. Alternatively, the lender can require a minimum periodic payment that is not more than twice the percentage of the prior minimum payment.

Background

The last several months have seen several proposed rules and final rules amending Regulation Z. Additionally, the NCUA, along with other banking regulators, issued final rules on Unfair and Deceptive Acts and Practices (UDAP), which affected a number of issues related to credit cards. Finally, Congress passed the CARD Act this spring, which amended TILA. The Act codified a number of the changes already included in Regulation Z or set to go into effect in the near future, added some new requirements, and also imposed earlier effective dates. As mentioned above, this interim final rule by the Board only addresses three specific provisions of the CARD Act set to go into effect on August 22, 2009. The majority of the provisions in the CARD Act will go into effect on Feb. 22, 2010. Additionally, two final provisions addressing the reasonableness of fees and re-evaluation of rate increases will be effective on August 22, 2010.

The CARD Act, which Congress signed into law on May 22, provided only 90 days before the above mentioned provisions would go into effect. Consequently, the Board had little time to consider the issues raised by the amendments to TILA and issue new regulations. Given the short timeline, the Board issued this interim final rule. While the rule is effective as of August 20, recognizing that consumers and industry were not given an opportunity to express their thoughts on the rule, the Board is accepting comments which it will take into consideration as it continues to address the changes required by the CARD Act.

While the amendments to TILA only provided 90 days before the three provisions covered by this rule went in to effect, the 21 day mailing requirement and the 45 day advance notice requirement were included in the UDAP Rule and the Board's January rule on Regulation Z, respectively. Consequently, credit unions are already familiar with the basics of these changes. However, it is important to note that the 21 day rule now applies to all open-end consumer credit (the UDAP Rule only required periodic statements to be sent out 21 days in advance for credit cards). Further, the CARD Act and this rule provide consumers the right to reject "significant changes" and close the account (the most recent amendment to Regulation Z did not provide the right to reject the change).

Discussion of the Interim Final Rule

Section 226.5 - General Disclosure Requirements

This section details the requirement that creditors establish "reasonable procedures" to ensure that periodic statements are mailed at least 21 days before the due date and the expiration of the grace period, if one exists. Further, a creditor that fails to meet its 21 day obligation may not treat any payment as late. As mentioned above, treating a payment as late includes assessing a fee, increasing the APR or reporting negative information to a CRA.

Additionally, the Board defined "grace period" as "a period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate."

Section 226.9 – Subsequent Disclosure Requirements

The first part of this section makes technical changes to the notice requirements for home-equity plans and other open-end plans that are not credit cards. This merely updates and corrects revisions made to Regulation Z by the Board in the January 2009 rule. The effective date for the notice requirements for home-equity plans has not changed. Further, the Board did not make any substantive changes to the January 2009 rule.

Section 226.9(c)(2) - Rules Affecting Credit Card Accounts that are not Home-Secured

This section details the instances in which the 45 day advance notice requirement is triggered for “significant changes” to the account. Creditors must provide 45 day advance notice of a change to any of the following terms:

- Increase in the required minimum periodic payment.
- Increase in APR.
- Fee for issuance or availability of credit.
- Transaction charges.
- Grace period, which is defined in this section as the “date by which or the period within which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate and any conditions on the availability of the grace period.” Notably, the definition of “grace period” for this section differs from the definition in 226.5 regarding the 21 day notice requirement.
- Balance computation method.
- Cash advance fee.
- Late payment fee.
- Over-the-limit fee.
- Balance transfer fee.
- Returned payment fee.
- Required insurance, debt cancellation or debt suspension coverage.
- Reduction of the credit limit.

The advance notice must include a description of the changes made to the terms, a statement that changes are being made to the account and the date the changes become effective. Additionally, the statement must disclose that the consumer has the right to reject the changes prior to the effective date, instructions on how to reject the changes, including a toll free telephone number the consumer can call to reject the changes, and – if applicable – a statement that the consumer will no longer be able to make charges on the account if the changes are rejected. Notably, if the only change in term is an increase in the periodic minimum payment, the lender need not provide the disclosure detailing the right to reject the changes.

If the APR is increased as a result of delinquency or as a penalty for other events specified in the account agreement, the lender must provide 45 day advance notice *after the events giving rise to the penalty have occurred*. In this case, the disclosure must explain that the penalty rate has been triggered, the date the penalty rate is effective, the circumstances – if applicable – under which the penalty rate will cease to apply, and a statement that the consumer may reject the changes, provided he makes the periodic minimum payment within 60 days after the due date for that payment. Again, the lender must provide instructions on how the consumer may reject the change.

Exceptions to the 45 Day Notice Requirement

There are several exceptions to the 45 day requirement. A lender does not need to satisfy the requirement if the consumer has agreed to a particular change. For example, if a lender offers a credit card with a zero percent introductory rate and discloses at the time of application

that the rate will increase after six months, there is no requirement to send the 45 day advance notice. Next, a lender does not need to provide the notice if the lender has already disclosed that the card is a variable rate and is tied to an index the lender does not control and that is available to the general public.

Advance notice is also not required if the interest rate increases as a result of the consumer completing a workout plan. However, the rate after the plan is completed may not exceed the rate that applied prior to the plan. If, however, the card is a variable rate, the rate after completing the plan may increase, consistent with whatever index to which the variable rate is tied.

Finally, no advance notice is required if there is a reduction in any component of a finance charge or other charge, if the change results from an agreement involving a court proceeding, or if there is a suspension of future credit privileges. The final exception regarding future credit privileges, however, has an exception where the advance notice requirement would still apply. In cases where the credit limit is being decreased, the 45 day advance notice requirement does apply if the lender plans to impose an over-the-limit fee or penalty rate solely as a result of the balance exceeding the newly decreased credit limit. However, generally speaking, a lender does not have to provide a 45 day notice in order to lower a borrower's credit limit. The Board recognized that lenders have a legitimate interest in mitigating the risk of loss if a borrower's creditworthiness begins to rapidly deteriorate.

Section 226.9(g) – Increase in Rates Due to Delinquency or Default or as a Penalty

This section requires lenders to provide 45 day advance notice if a rate is increased as a result of delinquency or as a penalty for failing to comply with one or more specific issues detailed in the credit agreement. The section also specifies that the notice cannot be sent out until after the events giving rise to the penalty. Put another way, the lender may not preemptively send out notices in anticipation of the consumer being delinquent or otherwise violating the credit agreement.

This section also addresses treatment of an account if a consumer fails to complete a workout plan. Where a borrower fails to satisfy the terms of a plan, the lender is not required to give 45 days advance notice of a rate increase. However, the lender cannot increase the APR beyond what the original terms allowed. In short, the regulation treats the successful or unsuccessful completion of a workout plan in the same manner. However, the Board addressed these two related issues in different sections, as treatment of successful workout plans are detailed in section 226.9(c)(2).

Section 226.9(h) - Consumer Rejection of Significant Change in Terms or Increase in APR

The consumer may reject the proposed changes anytime before the change goes into effect. If a consumer rejects a change the lender obviously must not apply the change to the account. Further, the lender cannot impose a fee or treat the account as being in default as a result of the rejection. In short, the lender cannot impose any fee for rejection that would not

have been imposed had the borrower accepted the changed terms. Upon rejection (assuming the account is closed) the lender may require repayment in any one of the following ways:

- The lender may continue the current method of repayment.
- The lender may amortize the balance over a period of five years or more and require payments over that period of time. In the case of a variable interest rate, the lender may adjust the interest charge as necessary to ensure the balance is amortized over five years.
- The lender may increase the minimum periodic payment to an amount equal to twice the percentage required on the date the rejection was received.

Additionally, the lender may implement a repayment method that is “no less beneficial” than any of the methods described above. The staff commentary to the regulation provides that a repayment method satisfies this requirement if the minimum payment is equal to or less than the minimum payment as it would have been calculated prior to the consumer rejecting the changed terms.

While the consumer has the right to reject the changes up until the effective date, the regulation authorizes lenders to apply the changed terms to any transactions made more than 14 days after provision of the notice. The Board determined that 14 days was sufficient time for consumers to review the notice. Consequently, the regulation effectively deems the consumer as having implicitly accepted *certain changed terms* for any transactions made after that 14 day period. There are two important issues that arise in this situation.

First, a consumer may make transactions after the 14 day period and still reject the changes. In this case, the lender would be authorized to apply the changed terms only to those transactions made more than 14 days after provision of the notice. Second, the 14 day exception, where the lender may deem the consumer as having accepted the new terms only applies to terms and rates that can be applied to a transaction. It does not, for example, permit the lender to apply a changed term to an entire account, such as higher late fees, simply because the consumer made a purchase more than 14 days after receiving notice of the changed terms.