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: Proposed rule; request for public comment.

SUMMARY: The Board, OTS, and NCUA (collectively, the Agencies) are proposing to exercise their authority under section 5(a) of the Federal Trade Commission Act to prohibit unfair or deceptive acts or practices. The proposed rule would prohibit institutions from engaging in certain acts or practices in connection with consumer credit cards accounts and overdraft services for deposit accounts. This proposal evolved from the Board's June 2007 Notice of Proposed Rule under the Truth in Lending Act and OTS's August 2007 Advance Notice of Proposed Rulemaking under the Federal Trade Commission Act. The proposed rule relates to other Board proposals under the Truth in Lending Act and the Truth in Savings Act, which are published elsewhere in today's **Federal Register**.

DATES: Comments must be received on or before August 4, 2008.

ADDRESSES: Because paper mail in the Washington DC area and at the Agencies is subject to delay, we encourage commenters to submit comments by e-mail, if possible. We also encourage commenters to use the title ''Unfair or Deceptive Acts or Practices'' to facilitate our organization and distribution of the comments. Comments submitted to one or more of the Agencies will be made available to all of the Agencies. Interested parties are invited to submit comments as follows:

Board: You may submit comments, identified by Docket No. R–1314, by any of the following methods:

- *Agency Web site: http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov.* Include the docket number in the subject line of the message.
- *Facsimile:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP–500 of the Board's Martin Building (20th and C Streets, NW) between 9 a.m. and 5 p.m. on weekdays.

OTS: You may submit comments, identified by OTS–2008–0004, by any of the following methods:

- *Federal eRulemaking Portal-* ''Regulations.gov'': Go to *http://www.regulations.gov*, under the ''more Search Options'' tab click next to the ''Advanced Docket Search'' option where indicated, select ''Office of Thrift Supervision'' from the agency drop-down menu, then click ''Submit.'' In the ''Docket ID'' column, select ''OTS–2008–0004'' to submit or view public comments and to view supporting and related materials for this proposed rulemaking. The ''How to Use This Site'' link on the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- *Mail:* Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: OTS–2008–0004.
- *Facsimile:* (202) 906–6518.
- *Hand Delivery/Courier:* Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9 a.m. to 4 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS–2008–0004.
- *Instructions:* All submissions received must include the agency name and docket number for this rulemaking. All comments received will be entered into the docket and posted on Regulations.gov without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.
- *Viewing Comments Electronically:* Go to *http://www.regulations.gov*, select ''Office of Thrift Supervision'' from the agency drop-down menu, then click ''Submit.'' Select Docket ID ''OTS–2008–0004'' to view public comments for this notice of proposed rulemaking.
- *Viewing Comments On-Site:* You may inspect comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment for access, call (202) 906–5922, send an e-mail to *public.info@ots.treas.gov*, or send a facsimile transmission to (202) 906–6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10 a.m. and 4 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

NCUA: You may submit comments, identified by number RIN 3133–AD47, by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *NCUA Web site: http://www.ncua.gov/news/proposed_regs/proposed_regs.html.* Follow the instructions for submitting comments.
- *E-mail:* Address to *regcomments@ncua.gov.* Include ''[Your name] Comments on Proposed Rule Part 706'' in the e-mail subject line.
- *Facsimile:* (703) 518–6319. Use the subject line described above for e-mail.
- *Mail:* Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.
- *Hand Delivery/Courier:* Same as mail address.

FOR FURTHER INFORMATION CONTACT:

Board: Benjamin K. Olson, Attorney, or Ky Tran-Trong, Counsel, Division of Consumer and Community Affairs, at (202) 452–2412 or (202) 452–3667, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263–4869.

OTS: April Breslaw, Director, Consumer Regulations, (202) 906–6989; Suzanne McQueen, Consumer Regulations Analyst, Compliance and Consumer Protection Division, (202) 906–6459; Glenn Gimble, Senior Project Manager, Compliance and Consumer Protection Division, (202) 906–7158; or Richard Bennett, Senior Compliance Counsel, Regulations and Legislation Division, (202) 906–7409, at Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

NCUA: Matthew J. Biliouris, Program Officer, Office of Examination and Insurance, (703) 518–6360; or Moisette 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 proposing several new provisions intended to protect consumers against unfair or deceptive acts or practices with respect to consumer credit card accounts and overdraft services for deposit accounts. These proposals 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).

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 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. While 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 32948–52.

In response to the June 2007 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 comments, however, urged the Board to take additional action with respect to a number 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 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 the Home Owners' Loan Act (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 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 recognized in its ANPR that the financial services industry and consumers have benefited from consistency in rules and guidance as the federal banking agencies and the NCUA have adopted uniform or very similar rules in many areas. 72 FR at 43571. OTS emphasized in its ANPR that it would be mindful of the goal of consistent interagency standards as it considered issues relating to unfair and deceptive acts or practices. *Id.*

OTS received 29 comment letters on its ANPR, including thirteen from financial institutions and their trade associations, three from consumer advocacy organizations, two from members of Congress, one from the FTC, and ten from others. Generally speaking, the commenters agreed on only one point . . . that OTS should adopt the same principles-based standards for unfairness and deception used by the FTC, the other federal banking agencies, and the NCUA.

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 questioned the need for any new OTS rules. 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. They explained the reasons they use the particular practices listed and how some benefit consumers. Some commenters urged OTS to await the Board's rulemaking under the Home Ownership and Equity Protection Act (HOEPA) on unfair or deceptive acts or practices and then follow the Board's lead.[1] They also opposed using state laws as a model or converting guidance to rules. Further, they opposed OTS expanding its advertising rules.

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

[1] The Board issued its HOEPA proposed in January 2008. *See* 73 FR 1672 (Jan. 9, 2008).

urged OTS to ban numerous practices, including but not limited to those the ANPR indicated OTS might target. One emphasized that whatever OTS does must not preempt state laws on unfair and deceptive acts or practices.

A joint comment from House Financial Services Committee Chairman Barney Frank and Subcommittee on Financial Institutions and Consumer Credit Chairman Carolyn Maloney urged OTS to proceed promptly to adopt comprehensive regulations on unfair and deceptive acts or practices. A comment from Senator Carl Levin urged OTS to move ahead with rulemaking; he focused his comment on unfair or deceptive credit card practices.

A comment from the FTC summarized the FTC's interest and experience with respect to financial services, described how the FTC has used its unfairness and deception authority in rulemaking and law enforcement actions, and recommended that OTS consider the FTC's experience in determining whether to impose rules prohibiting or restricting particular acts and practices.

OTS received comments on several practices relevant to the specific credit card practices addressed in today's proposal:

- OTS received comments on the practice of ''universal default'' or ''adverse action pricing,'' which the OTS ANPR described as imposing an interest rate increase that is triggered by adverse information unrelated to the credit card account. The OTS ANPR contrasted this practice to long-established risk based pricing. Consumer groups supported prohibiting these practices as abusive and unfair to consumers. They cited inaccuracies in the credit reporting system and disparate racial impact as reasons to prohibit using credit reports or credit scores to impose penalty rates. On the other hand, several industry commenters defended these practices. They commented that credit cards should be priced to reflect their current risk. They argued that otherwise, credit card issuers would build a risk premium into all rates to the detriment of other customers.
- OTS received comments on the practice of applying payments first to balances subject to a lower rate of interest before applying payments to balances subject to higher rates of interest, as well as the practice of applying payments first to fees, penalties, or other charges before applying them to principal and interest. Consumer groups supported prohibiting these practices as abusive and unfair to consumers. On the other hand, several industry commenters defended these practices. They commented that if these practices were prohibited fewer products would be available to consumers such as zero or low-cost balance transfers. Some commented that applying payments in this manner was fundamental and would impose significant implementation costs to change.
- OTS received comments on the practice of imposing an over-the-credit-limit fee that is triggered by the imposition of a penalty fee (such as a late fee) and the practice of charging penalty fees in consecutive months based on previous late or over-the-credit-limit transactions, not on new actions. Consumer groups supported prohibiting these practices and prohibiting any over-the-credit-limit fee where the creditor approved the transaction or padded the credit limit, as abusive and unfair to consumers. On the other hand, several industry commenters defended these practices. They commented that the practices deter future defaults and are a way to charge a little more to a customer who has demonstrated higher risk without permanently raising the customer's borrowing costs. They argued that otherwise, these costs would be passed on to borrowers who do not go over their credit limit or pay late.

Consumer groups also commented on additional credit card practices of concern that are relevant to the practices addressed in today's proposal. They urged that payment cut-off times be prohibited and that payments be treated as timely if they are postmarked as of the due date. They also urged that subprime credit cards be prohibited if less than $300 of available credit is left after initial fees are subtracted or initial fees total more than 10% of the overall credit line.

C. Related Action by the Agencies

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. Among the topics discussed were the Board's previously announced plan to issue a proposal under the FTC Act and the Board's June 2007 Proposal. In addition, the Agencies have 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 has also been informed by the results of consumer testing conducted on behalf of the Board in connection with its June 2007 Proposal under Regulation Z. Based on this and other information discussed below, the Agencies have developed proposed rules under the FTC Act prohibiting specific unfair acts or practices regarding consumer credit card accounts.

Finally, the Agencies have also gathered information from a number of recent Congressional hearings on consumer protection issues regarding credit cards.[3] In these hearings, members of Congress heard testimony from individual consumers,

[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 Srvc., *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/borrowing.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).

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 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. Members of Congress have proposed several bills addressing consumer protection issues regarding credit cards.[4]

D. Agency Actions on Overdraft Services

Overdraft services are sometimes offered to transaction account customers as an alternative to traditional ways of covering overdrafts (*e.g.*, overdraft lines of credit or linked accounts). Coverage is generally ''automatically'' provided to consumers that meet a depository institution's criteria, and the service may extend to check as well as other transactions, such as automated teller machine (ATM) withdrawals, debit card transactions and automated clearinghouse (ACH) transactions. Most institutions state that payment of an overdraft is at their discretion. If an overdraft is paid, the consumer will be charged a flat fee for each item. A daily fee also may apply for each day the account remains overdrawn.

In response to the increased availability and customer use of these overdraft protection services, the FDIC, Board, OCC, OTS, and NCUA published guidance on overdraft protection programs in February 2005.[5] The Joint Guidance addresses three primary areas—safety and soundness considerations, legal risks, and best practices—while the OTS guidance focuses on safety and soundness considerations and best practices. The best practices focus on the marketing and communications that accompany the offering of overdraft services, as well as the disclosure and operation of program features, including the provision of a consumer election or opt-out of the overdraft service. The Agencies have also published a consumer brochure on overdraft services.[6]

In May 2005, the Board separately issued revisions to Regulation DD and the staff commentary pursuant to its authority under the Truth in Savings Act (TISA) to address concerns about the uniformity and adequacy of institutions' disclosure of overdraft fees generally, and to address concerns about advertised overdraft services in particular.[7] The goal of the final rule was to improve the uniformity and adequacy of disclosures provided to consumers about overdraft and returned-item fees to assist consumers in better understanding the costs associated with the payment of overdrafts. In addition, the final rule addressed some of the Board's concerns about institutions' marketing practices with respect to overdraft services.

In addition to regulatory actions, there has also been significant Congressional interest in overdraft services, with legislation introduced seeking to curb some of the perceived abusive practices associated with these services. In June 2007, a hearing was held to discuss the proposed legislation with testimony from consumer advocates and industry representatives.[8]

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).[9]

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 Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (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.

B. Standards for Unfairness Under the FTC Act

Congress has codified standards developed by the Federal Trade Commission (FTC) for the FTC to 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 is 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).

[4] *See, e.g.*, The Credit Card Reform Act of 2008, S. 2753, 110th Cong. (Mar. 12, 2008); The Credit Cardholders' Bill of Rights Act of 2008, H.R. 5244, 110th Cong. (Feb. 7, 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] *See* Interagency Guidance on Overdraft Protection Programs (Joint Guidance), 70 FR 9127 (Feb. 24, 2005) and OTS Guidance on Overdraft Protection Programs, 70 FR 8428 (Feb. 18, 2005).

[6] The brochure, entitled ''Protecting Yourself from Overdraft and Bounced-Check Fees,'' can be found at: *http://www.federalreserve.gov/pubs/bounce/default.htm.*

[7] 70 FR 29582 (May 24, 2005). A substantively similar rule applying to credit unions was issued separately by the NCUA. 71 FR 24568 (Apr. 26, 2006). The NCUA issued an interim final rule in 2005. 70 FR 72895 (Dec. 8, 2005).

[8] H.R. 946, ''The Consumer Overdraft Protection Fair Practices Act.'' *See also Overdraft Protection: Fair Practices for Consumers: Hearing Before the House Subcomm. on Financial Institutions and Consumer Credit,* 110th Cong. (2007).

[9] 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.

[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*).

In proposing 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 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 has not taken similar action in generally applicable guidance,[12] the commenters on OTS's ANPR who addressed this issue overwhelmingly urged OTS to 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 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]

First, 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]

Second, 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.[18] 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.[19] Accordingly, the test is not whether the consumer could have made a wiser decision but whether an act or practice unreasonably creates or takes advantage of an obstacle to the consumer's ability to make that decision freely.[20]

Third, 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.[21] 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.[22] 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.[23]

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.[24] *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.[25] Although these standards have not been codified, they have been applied by numerous courts.[26] Accordingly, in proposing rules under section 18(f)(1) of the FTC Act, the Agencies have applied the standards articulated by the FTC for determining whether an act or practice is deceptive.[27]

A representation or omission is deceptive if the overall net impression created is likely to mislead consumers.[28] The FTC conducts its own analysis to determine whether a representation or omission is likely to mislead consumers acting reasonably under the circumstances.[29] 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.[30] 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.[31]

A representation or omission is material if it is likely to affect the consumer's conduct or decision regarding a product or service.[32] Certain types of claims are presumed to be material, including express claims and

[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.

[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 Rules, 49 FR at 7743; FTC Policy Statement on Unfairness at 3 & n.12.

[18] *See* FTC Policy Statement on Unfairness at 3.

[19] *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.

[20] *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.'').

[21] *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.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.'').

[22] *See* FTC Public Comment on OTS–2007–0015, at 6 (Dec. 12, 2007) (available at *http://www.ots.treas.gov/docs/9/963034.pdf*).

[23] *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, 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.'').

[24] FTC Policy Statement on Deception.

[25] *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.*

[26] *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).

[27] 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.

[28] *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).

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

[30] FTC Policy Statement on Deception at 3.

[31] *Id.*

[32] *Id.* at 2, 6–7.

claims regarding the cost of a product or service.[33]

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.[34] Thus, the Agencies are not required to adopt the most restrictive means of preventing the act or practice, nor are they required to adopt the least restrictive means.

III. Summary of Proposed Revisions

In order to best ensure that all entities that offer the products addressed in the proposed rule are treated in a like manner, the Board, OTS, and NCUA have joined together to issue today's 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. In today's proposal, 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 have endeavored to propose rules that are as uniform as possible. The Agencies also consulted with the two other federal banking agencies, OCC and FDIC, as well as with the FTC.

The effort to achieve an even playing field is also furthered by the Agencies' focus 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 recognize 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 these rules. The Agencies believe, however, that FTC-regulated entities represent a small percentage of the market for consumer credit card accounts and overdraft services. For OTS, addressing certain deceptive credit card practices in today's 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 are proposing to make non-substantive, organizational changes to the Credit Practices Rule. Specifically, in order to avoid repetition, the Agencies would 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 have made additional, non-substantive changes to the organization of their versions of the Credit Practices Rule.

Consumer Credit Card Accounts

The Agencies are proposing seven provisions under the FTC Act regarding consumer credit card accounts. These provisions are 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 be prohibited from treating a payment as late for any purpose unless consumers have been provided a reasonable amount of time to make that payment. The proposed rule would create 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. Elsewhere in today's **Federal Register**, the Board has made two additional proposals under Regulation Z that would further ensure that consumers receive a reasonable amount of time to make payment. Specifically, the Board is proposing to revise 12 CFR 226.10(b) to prohibit creditors from setting a cut-off time for mailed payments that is earlier than 5 p.m. at the location specified by the creditor for receipt of such payments. The Board is also proposing to add 12 CFR 226.10(d), which would require 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, when different annual percentage rates apply to different balances, institutions would be 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. The specified methods are applying the entire amount first to the balance with the highest annual percentage rate, splitting the amount equally among the balances, or splitting the amount pro rata among the balances. Furthermore, when an account has a discounted promotional rate balance or a balance on which interest is deferred, institutions would be required to give consumers the full benefit of that discounted rate or deferred interest plan by allocating 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 be 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 be prohibited from increasing the annual percentage rate on an outstanding balance. This prohibition would not apply, however, where a variable rate increases due to the operation of an index, where a promotional rate has expired or is lost (provided the rate is not increased to a penalty rate), or where the minimum payment has not been received within 30 days after the due date.

Fourth, institutions would be 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 may be assessed.

Fifth, institutions would be prohibited from imposing finance charges on balances based on balances for days in billing cycles that precede the most recent billing cycle. The proposed rule would prohibit 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 be 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 utilize the majority of the available credit on the

[33] *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).

[34] *See Am. Fin. Servs. Assoc.* v. *FTC*, 767 F.2d 957, 988–89 (DC Cir. 1985) (*citing Jacob Siegel Co.* v. *FTC*, 327 U.S. 608, 612–13 (1946)).

account. The proposal would also require 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. In addition, elsewhere in today's **Federal Register**, the Board is proposing to revise Regulation Z to provide that a creditor that collects or obtains a consumer's agreement to pay a fee before providing account-opening disclosures must permit that consumer to reject the plan after receiving the disclosures and, if the consumer does so, must refund any fee collected or take any other action necessary to ensure the consumer is not obligated to pay the fee.

Seventh, institutions making firm offers of credit advertising multiple annual percentage rates or credit limits would be 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 are proposing two provisions prohibiting unfair acts or practices related to overdraft services in connection with consumer deposit accounts. The proposed provisions are intended to ensure that consumers understand overdraft services and have the choice to avoid the associated costs where such services do not meet their needs.

The first would provide that it is 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 provides 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 does not opt out. The proposed opt-out right would apply 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 prohibit certain acts or practices associated with assessing overdraft fees in connection with debit holds. Specifically, the proposal would prohibit an institution from assessing an overdraft fee if the overdraft is caused solely by a hold placed on funds that exceeds the actual purchase amount of the transaction, unless this purchase amount would have caused the overdraft.

Elsewhere in today's **Federal Register**, the Board is also proposing to address potentially misleading balance disclosures by generally requiring depository institutions to provide only balances that reflect the consumer's own funds (without funds added by the institution to cover overdrafts) in response to consumer inquiries received through an automated system such as a telephone response system, ATM, or an institution's Web site.

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.[35] 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 and loan institutions, 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 adopted rules substantially similar to the FTC's Credit Practices Rule.[36]

As part of this rulemaking, the Agencies are proposing 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.

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 Scope[37]

The provisions in proposed § ____.1 are largely drawn from the current authority, purpose, and scope provisions in the Agencies' respective Credit Practices Rules.

____.1(a) Authority

Proposed § ____.1(a) provides that the Agencies have issued this part under section 18(f) of the FTC Act. In OTS's proposed rule, this provision further provides that OTS is also exercising its authority under various provisions of HOLA, although the FTC Act is the primary authority for OTS's rule.

____.1(b) Purpose

Proposed § ____.1(b) provides 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 provides that the part contains provisions that define and set forth requirements prescribed for the purpose of preventing specific unfair or deceptive acts or practices. The Agencies note 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, it clarifies 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.

____.1(c) Scope

Proposed § ____.1(c) describes the scope of each agency's rules. The Agencies have each tailored this paragraph to describe those entities to which their part applies. The Board's provision states that its rules would apply to banks and their subsidiaries, except savings associations as defined in 12 U.S.C. 1813(b). The Board's provision further explains that enforcement of its rules is allocated among the Board, OCC, and FDIC, depending on the type of institution. This provision has been updated to reflect intervening changes in law. The Board's Staff Guidelines to the Credit Practices Rule would be revised to remove questions 11(c)–1 and 11(c)–2 and the substance of the Board's answers would be updated and published as commentary under proposed § 227.1(c). *See* proposed Board comments 227.1(c)–1 and –2. The remaining questions and answers in the

[35] *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).

[36] *See* 12 CFR part 227, subpart B (Board); 12 CFR 535 (OTS); 12 CFR 706 (NCUA).

[37] The Board, OTS, and NCUA would place the proposed rules in, respectively, parts 227, 535, and 706 of title 12 of the Code of Federal Regulations. For each of reference, the discussion in this **Supplementary Information** uses the shared numerical suffix of each agency's rule. For example, proposed § ____.1 would be codified at 12 CFR 227.1 by the Board, 12 CFR 535.1 by OTS, and 12 CFR 706.1 by NCUA.

Board's Staff Guidelines would remain in place.

OTS's provision would state 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. The entire OTS part would have the same scope. OTS notes that this scope is somewhat different from the scope of its existing Credit Practices Rule. OTS's Credit Practices Rule currently applies to savings associations and service corporations that are wholly owned by one or more savings associations, which engage in the business of providing credit to consumers. Since the proposed rules would cover more practices than consumer credit, the reference to engaging in the business of providing credit to consumers would be deleted. The reference to wholly owned service corporations would be updated to refer instead to subsidiaries, to reflect the current terminology used in OTS's Subordinate Organizations Rule.[38]

The NCUA's provision would state that its rules apply to federal credit unions.

227.1(d) Definitions

Proposed § ____.1(d) of the Board's rule would clarify that, unless otherwise noted, the 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). OTS and NCUA do not have a need for a comparable subsection so none is included in their proposed rules.

227.2 Consumer-Complaint Procedure

In order to accommodate the revisions discussed above, the Board would consolidate the consumer complaint provisions currently located in 12 CFR 227.1 and 227.2 in proposed § 227.2. OTS and NCUA do not currently have and do not propose to add comparable provisions.

Subpart B—Credit Practices

Each agency would place the substantive provisions of their current Credit Practices Rule in Subpart B. In order to retain the current numbering in its Credit Practices Rule, the Board would reserve 12 CFR 227.11, which currently contains the Board's statement of authority, purpose, and scope. The other provisions of the Board's Credit Practices Rule (§§ 227.12 through 227.16) would not be revised.

OTS is proposing the following notable changes to its version of Subpart B:

Section 535.11 Definitions (Existing Section 535.1)

OTS would delete the definitions of ''Act,'' ''creditor,'' and ''savings association'' as unnecessary. For the convenience of the user, OTS would incorporate 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 would move the definition of ''cosigner'' to the section on unfair or deceptive cosigner practices. OTS would merge the definition of ''debt'' into the definition of ''collecting a debt'' contained in the section on late charges. OTS would move the definition of ''household goods'' to the section on unfair credit contract provisions.

Section 535.12 Unfair Credit Contract Provisions (Existing Section 535.2)

OTS would revise the title of this section to reflect its focus on credit contract provisions. OTS would delete the obsolete reference to extensions of credit after January 1, 1986.

Section 535.13 Unfair or Deceptive Cosigner Practices (Existing Section 535.3)

OTS would delete the obsolete reference to extensions of credit after January 1, 1986. OTS would substitute 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 section on state exemptions. OTS would also clarify that the date that may be stated on the cosigner notice is the date of the transaction. NCUA would make similar amendments to its rule in § 706.13 (existing § 706.3).

Section 535.14 Unfair Late Charges (Existing Section 535.4)

OTS would revise the title of this section to reflect its focus on unfair late charges. OTS would delete the obsolete reference to extensions of credit after January 1, 1986. Similarly, NCUA would propose revisions to § 706.14 (existing § 706.4).

Section 535.15 State Exemptions (Existing Section 535.5)

OTS would revise the subsection on delegated authority to update the current title of the OTS official with delegated authority to make determinations under this section.

Request for Comment

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. In the absence of any legal requirement, however, the Agencies do not propose to extend this provision to the proposed rules for consumer credit card accounts and overdraft services.[39] The Agencies note that only three states have been granted exemptions under the Credit Practices Rule.[40] 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 request 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 greater or substantially similar level of protection.

In addition, OTS also requests comment on whether the state exemption provision in its Credit Practices Rule should be retained.

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 are proposing to adopt rules prohibiting specific unfair acts or practices with respect to consumer credit card accounts. The Agencies would locate these rules in a new Subpart C to their

[38] 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).

[39] The provision of the FTC Act addressing exemptions applies only to the FTC. *See* 12 U.S.C. 57a(g).

[40] 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). OTS has granted an exemption to Wisconsin. 51 FR 45879 (Dec. 23, 1986). The NCUA has not granted any exemptions.

respective regulations under the FTC Act. These proposals should not be construed as a definitive conclusion by the Agencies that a particular act or practice is unfair or deceptive.

Section ____.21—Definitions

Proposed § ____.21 would define certain terms used in new Subpart C.

____.21(a) Annual Percentage Rate

Proposed § ____.21(a) defines ''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 corresponds to the definition of ''annual percentage rate'' in 12 CFR 226.14(b). As discussed in the Board's official staff commentary to § 226.14(b), this computation does not reflect any particular finance charge or periodic balance. *See* comment 14(b)–1. This definition also incorporates the definition of ''periodic rate'' from Regulation Z. *See* 12 CFR 226.2.

____.21(b) Consumer

Proposed § ____.21(b) defines ''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.

____.21(c) Consumer Credit Card Account

Proposed § ____.21(c) defines ''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 incorporates the definitions of ''open-end credit,'' ''credit card,'' and ''charge card'' from Regulation Z. *See* 12 CFR 226.2. Under this definition, a number of accounts would be excluded consistent with exceptions to disclosure requirements for credit and charge card applications and solicitations. *See* proposed 12 CFR 226.5a(a)(5), 72 FR at 33045–46. 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).

____.21(d) Promotional Rate

Proposed § ____.21(d) is similar to the definition of ''promotional rate'' proposed by the Board in 12 CFR 226.16(e)(2) elsewhere in today's **Federal Register**. The first type of ''promotional rate'' covered by this definition is any annual percentage rate applicable to one or more balances or transactions on a consumer credit card account for a specified period of time that is lower than the annual percentage rate that will be in effect at the end of that period. Proposed comment 21(d)(1)–1 clarifies that, for purposes of determining whether a rate is a ''promotional rate'' when the rate that will apply at the end of the specified period is a variable rate, the rate offered by the institution is compared to the variable rate that would have been disclosed at the time of the offer if the promotional rate had not been offered by the institution, subject to applicable accuracy requirements. *See, e.g.*, 12 CFR 226.5a(b)(1)(iii); proposed 12 CFR 226.5a(c)(2)(ii), 72 FR at 33047.

The second type of ''promotional rate'' encompassed by the definition is any annual percentage rate applicable to one or more transactions on a consumer credit card account that is lower than the annual percentage rate that applies to other transactions of the same type. This definition is meant to capture ''life of balance'' offers where a special rate is offered on a particular balance for as long as that balance exists. Proposed comment 21(d)(2)–1 provides an example of a rate that meets this definition.

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

The Agencies are proposing to prohibit 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. Currently, 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 (*i.e.*, the ''grace period''). 15 U.S.C. 1666b(a). Federal law 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); comment 5(b)(2)(ii)–1.

In its June 2007 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.

The Board received comments from individual consumers, consumer groups, and a member of Congress indicating that consumers were not being provided with a reasonable amount of time to pay their credit card bills. Comments 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 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 comments indicated that consumers are unable to accurately predict when their payment will be received by a creditor due to uncertainties in how quickly mail is delivered. Some comments 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.

Comments from industry, 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 comments 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 elsewhere.

The Agencies understand that, although increasing numbers of consumers are receiving periodic statements and making payments electronically, a significant number still utilize mail. In addition, the Agencies recognize that, while first class mail is often delivered within three business days, in some cases it can take significantly longer.[41] Indeed, some large credit card issuers recommend that consumers allow up to seven days for their payments to be received by the issuer via mail. Accordingly, in some cases, a statement sent 14 days before the payment due date may not provide consumers with a reasonable amount of time to pay in order to avoid interest charges, late fees, or other adverse consequences.

The Agencies recognize that, in enacting § 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. At the time of its June 2007 Proposal, the Board believed that consumers might benefit from receiving additional time to make payment. The Board understands that most creditors currently offer grace periods and that they use a single due date, which is both the 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). For that reason, the Board sought comment on whether it should request that Congress increase the 14-day minimum mailing requirement with respect to grace periods. Based on the comments and other information discussed herein, however, the Agencies are concerned that a separate rule may be needed that specifically addresses harms other than loss of the grace period when institutions do not provide a reasonable amount of time for consumers to make payment. This harm includes late fees and rate increases as a penalty for late payment. The Agencies' proposal does not affect the requirements of TILA § 163(a).

Legal Analysis

Treating 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 appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. An institution's failure to provide consumers a reasonable amount of time to make payment appears to cause substantial monetary and other injury. 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.

Injury is not reasonably avoidable. It appears that consumers cannot reasonably avoid this injury unless they have been provided a reasonable amount of time to pay. Although what constitutes a reasonable amount of time may vary based on the circumstances, it may be unreasonable to expect consumers to make payment if they are not given a reasonable amount of time to do so after receiving a periodic statement. TILA and Regulation Z provide consumers with the right to dispute transactions or other items that appear on their periodic statements. 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). Furthermore, in some cases, travel or other circumstances may prevent the consumer from reviewing the statement immediately upon receipt. Finally, as discussed above, consumers cannot control when a mailed payment will be received by the institution. Thus, a payment mailed well in advance of the due date may nevertheless arrive after that date.

Injury is not outweighed by countervailing benefits. The injury does not appear to be outweighed by any countervailing benefits to consumers or competition. The Agencies are not aware of any direct benefit to consumers from receiving too little time to make their payments. 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 are also aware that, as a result of the proposed rule, some institutions may be required to incur costs to alter their systems and will, directly or indirectly, pass those costs on to consumers. It does not appear, however, that these costs would outweigh the benefits to consumers of receiving a reasonable amount of time to make payment.

Proposal

Proposed § ____.22(a) prohibits 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. Proposed comment 22(a)–1 clarifies 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. Although the proposed rule does not mandate a specific amount of time, the commentary to the proposal states that reasonableness would be evaluated from the perspective of the consumer, not the institution. *See* proposed comment 22(a)–2.

Proposed § ____.22(b) provides 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. 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. As noted above, some institutions already recommend that consumers allow seven days for receipt of mailed payments. The Agencies believe 21 days to be reasonable because it allows sufficient time for even delayed mail to be delivered while also allowing most consumers at least a week to review their bill and make payment.

In order to minimize burden and facilitate compliance, proposed comment 22(b)–1 clarifies 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. For example, if an institution had reasonable procedures in place designed to the 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 (*i.e.*, 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 clarifies 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).

[41] *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. Srvs., and Int'l Security (Aug. 2, 2007).

Finally, in order to avoid any potential conflict with section 163(a) of TILA, proposed § ____.22(c) provides that proposed § ____.22(a) does 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 (*i.e.*, a grace period).

Request for Comment

The Agencies request comment on:

- The percentages of consumers who receive periodic statements by mail and electronically.
- The percentages of consumers who make payment by mail, electronically, by telephone, and through other methods.
- The number of days after the closing date of the billing cycle that institutions typically mail or deliver periodic statements.
- Whether the proposed 21-day safe harbor period between mailing or delivery of the periodic statement and the due date would give consumers sufficient time to review their statements and make payment and is otherwise a reasonable amount of time to make payment.
- The cost to institutions of altering their systems to comply with the proposed rule and to mail or deliver periodic statements 21 days in advance of the payment due date.
- Whether the Agencies should adopt a rule that prohibits 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.
- Whether the Agencies should adopt a rule that requires 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 (*e.g.*, a receipt from the U.S. Postal Service or other common carrier) and what time frame would be appropriate (*e.g.*, payment mailed at least five days before the due date, payment received no more than two business days late).
- The impact of the proposed rule on the availability of credit.

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

The Agencies are proposing to prohibit certain unfair acts or practices regarding the allocation of payments on consumer credit card accounts with multiple balances at different interest rates. In its June 2007 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 32982–83. 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 a different allocation method. The Board was particularly concerned that, when the consumer has responded to a promotional rate 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 if the consumer uses the card for other transactions.

For example, assume that a consumer responds to an offer of 5% on transferred balances for six months by opening an account and transferring $3,000. Then, during the same billing cycle, the consumer uses the account for a $300 cash advance (to which an interest rate of 20% applies) and a $500 purchase (to which an interest rate of 15% applies). If the consumer makes an $800 payment, most creditors would apply the entire payment to the promotional rate balance and the consumer would incur interest on the more costly cash advance and purchase balances. Under these circumstances, the consumer is effectively denied the benefit of the 5% promotional rate for six months if the card is used for transactions because the consumer must pay off the entire transferred balance in order to avoid paying a higher rate on the transactions. Indeed, the only way for the consumer to receive the benefit of the 5% promotional rate is to not 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 the same basic concerns. Many creditors offer deferred interest plans where consumers may avoid paying interest on purchases if the balance is paid in full by the end of the deferred interest period. If the balance is not paid in full when the deferred interest period ends, these deferred interest plans often require the consumer to pay interest that has accrued during the deferred interest period. A consumer whose payments are applied to a balance on which interest is deferred instead of a balance on which interest is not deferred incurs additional finance charges and therefore does not receive the benefit of the deferred interest plan.

In addition, creditors typically offer a grace period for purchases if a consumer pays in full each month but do not typically offer a grace period on balance transfers or cash advances. Because payments will be allocated to the transferred balance first, a consumer 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 is to pay off the entire balance, including the transferred balance or cash advance balance subject to the promotional rate.

In preparing its June 2007 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 in 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 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. 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. Nonetheless, testing showed that a significant percentage of participants still did not fully understand how payment allocation can affect their interest charges, even after reading the disclosures tested. In the supplementary information accompanying the June 2007 Proposal, the Board indicated its plans to conduct further testing of the disclosure to determine whether the disclosure could be improved to more effectively communicate to consumers how payment allocation can affect their interest charges. 72 FR at 33047, 33050.

In the June 2007 Proposal, the Board did, however, propose to add § 226.5a(b)(15) to require a creditor to explain payment allocation to consumers. Specifically, the Board proposed that creditors explain how payment allocation would affect consumers, 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 discounted initial 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 32948, 33047.

In response to the June 2007 Proposal, several commenters recommended the Board test a simplified payment allocation disclosure that covers situations other than low rate balance transfers offered with cards. One credit card issuer, however, stated that, because creditors almost uniformly apply payments to the balance with the lowest annual percentage rate, consumers could not shop for a better payment allocation method even if an effective disclosure could be developed. Furthermore, comments from consumers and consumer groups 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 in March 2008, the Board tested a revised payment allocation disclosure.[42] Some 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. For those participants, however, that did not know about payment allocation methods from earlier experience, the disclosure tested was still not effective in communicating payment allocation methods.

Accordingly, the Agencies propose to address the foregoing concerns regarding payment allocation by prohibiting specific unfair acts or practices under the FTC Act. To the extent the Agencies' proposals are ultimately adopted, the Board would withdraw its proposal under Regulation Z to require a creditor to explain payment allocation to consumers.

Legal Analysis

Proposed § ____.23 would prohibit three unfair acts or practices. First, when different annual percentage rates apply to different balances on a consumer credit card account, the Agencies would prohibit allocation among the balances of any amount paid by the consumer in excess of the required minimum periodic payment in a manner that is less beneficial to consumers than one of three listed methods. Second, when a consumer credit card account has one or more promotional rate balances or balances on which interest is deferred, the Agencies would prohibit allocation of amounts paid by the consumer in excess of the minimum payment to such balances before other balances. Third, the Agencies would prohibit institutions from requiring consumers to repay any portion of a promotional rate balance or deferred interest balance in order to receive any grace period offered for purchases. As discussed below, these acts or practices appear to meet the definition of unfairness under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. Each of the three practices described above appear to cause substantial monetary injury to consumers in the form of higher interest charges than would be incurred if institutions did not engage in these practices. Specifically, as discussed above, consumers who do not pay the balance in full and whose payments in excess of the minimum payment are first applied to the balance with the lowest annual percentage rate incur higher interest charges than they would under other payment allocation methods, such as division of the amount among the balances or application of the amount to the balance with the highest rate first. Similarly, consumers who do not receive a grace period offered on a purchase balance solely because they also have a promotional rate balance or deferred interest balance incur higher interest charges than they would if they received the grace period.

Injury is not reasonably avoidable. Several factors appear to prevent consumers from reasonably avoiding these additional interest charges. First, consumers generally have no control over the institution's allocation of payments or provision of grace periods. Second, the Board's consumer testing indicates that disclosures may not enable consumers to understand sufficiently the effects of payment allocation or the loss of the grace period. Even if disclosures were effective, it appears that consumers still could not avoid the injury by selecting a credit card account with more favorable terms because institutions almost uniformly apply payments to the balance with the lowest rate and do not provide a grace period when a consumer has a promotional rate balance or deferred interest balance.[43] 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. Similarly, it may be unreasonable to expect a consumer to avoid the injury by, for example, taking a cash advance or transferring a balance in response to a promotional rate offer and then using a different account for purchases because this would effectively require the consumer to use an open-end credit account as a closed-end installment loan.

Injury is not outweighed by countervailing benefits. The prohibited practices do not appear to create benefits for consumers and competition that outweigh the injury. The Agencies understand that, if implemented, the proposal may reduce the revenue that institutions receive from interest charges, which may in turn lead institutions to increase rates generally or to offer higher promotional rates or fewer deferred interest plans. As a result, consumers who, for example, do not use an account for purchases after transferring a balance would lose the benefit of the lower promotional rate. This effect should be muted, however, because the Agencies' proposal prohibits only the practices that are most harmful to consumers and leaves institutions with considerable flexibility in the allocation of payments, particularly with regard to the minimum payment. Furthermore, the Agencies believe 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. 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, it appears that the Agencies' proposal should 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

[42] This disclosure stated: ''Payments may be applied to balances with lower APRs first. If you have balances at higher APRs, you may pay more in interest because these balances cannot be paid off until all lower-APR balances are paid in full (including balance transfers you make at the introductory rate).''

[43] *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)).

operational expenses) would no longer be forced to compete with institutions that offer artificially reduced rates.

Proposal

Proposed § ____.23(a) would establish a general rule governing payment allocation on accounts that do not have a promotional rate balance or a balance on which interest is deferred. Proposed § ____.23(b) would establish special rules for accounts that do have a promotional rate balance or a deferred interest balance.

Proposed § ____.23 does not limit or otherwise address the institution's ability to determine the amount of the minimum payment or how that payment is allocated. See proposed comment 23–1. Furthermore, an institution may adjust amounts to the nearest dollar when allocating. *See* proposed comment 23–2.

____.23(a) General Rule for Accounts Within Different Annual Percentage Rates on Different Balances

Proposed § ____.23(a) would require the institution 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. Although the proposed rule does not prohibit institutions from using allocation methods other than those listed, the method used must be no less beneficial to consumers than one of the listed methods. A method is no less beneficial to consumers if the method results in the assessment of the same or a lesser amount of interest charges than would be assessed under the listed method. For example, an institution may not reasonably allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to the balance with the lowest annual percentage rate because this method would result in higher interest charges than any of the methods listed in proposed § ____.23(a). *See* proposed comment 23(a)–1. An example of an allocation method that is no less beneficial to consumers than a listed method is provided in proposed comment 23(a)–2.

Proposed § ____.23(a) lists three permissible payment allocation methods. First, proposed § ____.23(a) would allow an institution to apply the entire amount paid in excess of the minimum payment first to the balance with the highest annual percentage rate and any remaining amount to the balance with the next highest annual percentage rate and so forth. Although this method could result in none of the amount being applied to some balances, the Agencies believe that institutions should be able to use this approach because it will generally minimize interest charges. An example of this allocation method is provided in proposed comment 23(a)(1)–1.

Second, proposed § ____.23(a) would allow an institution to allocate equal portions of the amount paid in excess of the minimum payment to each balance. Third, the proposal would allow an institution to allocate the amount among the balances in the same proportion as each balance bears to the total balance (*i.e.*, pro rata). Examples of these allocation methods are provided in proposed comments 23(a)(2)–1 and 23(a)(3)–1.

____.23(b) Special Rules for Accounts With Promotional Rate Balances or Deferred Interest Balances

The Agencies believe that separate requirements may be warranted for accounts with promotional rate balances or balances on which interest is deferred because, in many cases, the consumer will have engaged in transactions based on representations made by the institution regarding a promotional rate or a deferred interest plan. Proposed § ____.23(b) seeks to ensure that consumers receive the benefit of promotional rates and deferred interest plans.

____.23(b)(1)(i) Rule Regarding Payment Allocation

Proposed § ____.23(b)(1)(i) would ensure that consumers receive the benefit of a promotional rate or deferred interest plan by requiring that amounts paid in excess of the minimum payment would be allocated to the promotional rate balance or the deferred interest balance only if other balances have been fully paid. Specifically, the proposal would require that amounts paid by the consumer in excess of the minimum payment be allocated first among balances that are not promotional rate balances or deferred interest balances, consistent with proposed § ____.23(a). If there is any remaining amount, proposed § ____.23(b)(1)(i) would require the institution to allocate the remaining amount to each promotional rate balance or deferred interest balance, consistent with proposed § ____.23(a). Proposed comment 23(b)(1)(i)–1 would provide illustrative examples of how payments must be allocated under proposed § ____.23(b)(1)(i).

____.23(b)(1)(ii) Exception for Balances on Which Interest Is Deferred

Proposed § ____.23(b)(1)(ii) would create an exception to the payment allocation rule in proposed § ____.23(b)(1)(i) during the last two billing cycles of a deferred interest plan. The Agencies understand that currently some institutions begin to apply consumers' payments to the deferred interest balance during the last two billing cycles of a deferred interest plan because doing so will reduce or eliminate that balance and thereby reduce or eliminate the deferred interest that may be charged when the deferred interest plan expires. Because this practice appears to be beneficial to consumers, the Agencies propose to permit institutions to utilize this practice, at their option. Proposed comment 23(b)(1)(ii)–1 provides illustrative examples of how payments may be allocated under this exception. As noted below, the Agencies request comment on whether this exception is appropriate and, if so, whether it should apply during the last two billing cycles of the deferred interest plan or a different period of time.

____.23(b)(2) Rule Regarding Grace Period

Proposed § ____.23(b)(2) would prohibit 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 any grace period on other balances. Under the provision, a consumer would not be denied the benefits of a grace period solely because the consumer carries a balance covered by a promotional rate or deferred interest plan. Proposed comment 23(b)(2)–1 provides an example of when this prohibition would apply.

Request for Comment

The Agencies request comment on:

• Whether other methods of allocation should be listed in proposed § ____.23(a).

• Whether proposed § ____.23(a) should permit institutions to apply amounts in excess of the minimum payment first to balances on which the institution is prohibited from increasing the rate (pursuant to proposed § ____.24).

• Whether the requirement in proposed § ____.23(b)(1)(i) that amounts in excess of the minimum payment be applied to other balances before deferred interest balances may prevent consumers from paying the deferred interest balance in full by the end of the deferred interest period.

• The need for the exception regarding deferred interest balances in proposed § ____.23(b)(1)(ii).

• Whether the exception regarding deferred interest balances in proposed § ____.23(b)(1)(ii) should apply during the last two billing cycles of the deferred interest plan or during a different time period.

• Whether consumers should be permitted to instruct the institution regarding allocation of amounts in excess of the required minimum periodic payment.

• The cost to institutions of the proposed rule and the impact on the availability of credit.

Section ____.24—Unfair Acts and Practices Regarding Application of Increased Rates to Outstanding Balances

The Agencies are proposing to prohibit the application of increased rates to pre-existing balances, except in certain limited circumstances. Currently, § 226.9(c) of Regulation Z requires 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 is not required if an interest rate or other finance charge increases due to a consumer's default or delinquency. *See* 12 CFR 226.9(c)(1); comment 9(c)(1)–3. Furthermore, no change-in-terms notice is required if the creditor set forth the specific change in the account-opening disclosures. *See* 12 CFR 226.9(c), comment 9(c)–1.

In its June 2007 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 33009–13. 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.[44]

Consumer testing conducted for the Board indicated that some consumers do not understand what factors can trigger penalty pricing, such as the fact that one late payment may constitute a ''default.'' In addition, some participants did not appear to understand that penalty rates can apply to all of their balances, including existing 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 his or her 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 his or her account.

The Board's June 2007 Proposal included revisions to Regulation Z 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. *See* proposed 12 CFR 226.9(c), (g), 72 FR at 33056–58.[45] 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. *See* proposed 12 CFR 226.7(b)(11)(i)(C), 72 FR at 33053.

When developing the June 2007 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.

In response to its June 2007 Proposal, the Board received comments from individual consumers, consumer groups, another federal banking agency, and a member of Congress stating that notice alone was not sufficient to protect consumers from the harm caused by rate increases. These comments 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 comments argued that creditors should be prohibited from increasing the rate on an existing balance in all instances. Others argued that consumers should be given the right to reject application of an increased rate to an existing 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 creditors. On the other hand, comments from the majority of creditors stated that the 45-day notice requirement would delay creditors from increasing rates to reflect a consumer's increased risk of default, requiring creditors to account for that risk by, for example, charging higher annual percentage rates at the outset of the account relationship. These comments also noted that, because creditors use rate increases to pass on the costs of funds the creditors themselves pay, delays in the imposition of increased rates could result in higher costs of credit or less available credit.

The Agencies are concerned that disclosure alone may be insufficient to protect consumers from the harm caused by the application of increased rates to pre-existing balances. Accordingly, the Agencies are proposing to prohibit this practice except in certain limited circumstances.

Legal Analysis

The Agencies propose to prohibit institutions from increasing the annual percentage rate applicable to the outstanding balance before the effective date of the rate increase, except in certain circumstances. As discussed below, this practice appears to meet the test for unfairness under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. Application of an increased annual percentage rate to an outstanding balance appears to cause substantial monetary injury by increasing the interest charges assessed to a consumer's credit card account.

Injury is not reasonably avoidable. Although the injury resulting from increases in the annual percentage rate may be avoidable by some consumers under certain circumstances, this injury does not appear to be reasonably avoidable by consumers as a general matter. As discussed above, the Board's consumer testing indicates that many consumers are not aware of the circumstances under which their rates

[44] *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'').

[45] The Board has proposed additional revisions to these provisions elsewhere in today's **Federal Register**.

may increase.[46] Thus, when deciding whether to use a credit card for a particular transaction or whether to pay off a credit card balance versus some other obligation, the consumer is likely to consider only the annual percentage rate in effect at that time. Although the disclosures proposed by the Board under Regulation Z should, if implemented, improve consumers' understanding, disclosures alone may not be sufficient to enable consumers to avoid injury. Consumers may ignore the disclosures because they overestimate their ability to avoid the penalty triggers.[47] Furthermore, although the Board's proposed 45 days advance notice of a rate increase would enable some consumers to transfer the balance to another account with a comparable annual percentage rate and terms, consumers who are not able to do so cannot avoid the resulting injury. For these reasons, disclosures alone may not enable consumers to avoid the injury caused by an increase in rate on an existing balance.

Consumers also lack control over many of the circumstances under which an institution increases an annual percentage rate. First, an institution may increase a rate for reasons that are completely unrelated to any individual consumer. For instance, an institution may increase rates to increase revenues or in response to changes in the cost to the institution of borrowing funds. Consumers lack any control over these increases and therefore cannot reasonably avoid the resulting injury. Furthermore, consumers cannot be reasonably expected to predict when such repricing will occur because many institutions reserve the right to change the terms of the consumer's account at any time for any reason.

Second, an institution may increase an annual percentage rate based on consumer behavior that is unrelated to the consumer's performance on the credit card account with that institution. 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.[48] As noted above, this type of increase is sometimes referred to as ''universal default.'' The consumer may or may not have been aware of or able to control the factor that caused the drop in the consumer's 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 may be unaware that using a certain amount of the available credit on open-end credit accounts can lead to a reduction in credit score. Furthermore, as discussed below, a default may not be reasonably avoidable in some instances. Nor can the consumer control how the institution uses credit scores or other information to set interest rates.

Third, an institution may increase an annual percentage rate based on consumer behavior that is related to the consumer's credit card account with the institution 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 the minimum payment set by the institution for several consecutive months.[49] Although this type of activity may be within the consumer's control, the consumer may not be able to 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, the institution's provision of a specific credit limit or minimum payment, for example, may be reasonably interpreted by the consumer as an implicit representation that the consumer will not be penalized if the credit limit is not exceeded or the minimum payment is made.

Fourth, an institution may increase an annual percentage rate based on consumer behavior that violates the account terms. What violates the account terms can vary from institution to institution and from account to account. The Agencies understand that the most common violations of the account terms that result in an increase in rate are exceeding the credit limit, a payment that is returned for insufficient funds, and a late payment.[50] In some cases, it appears that individual consumers may have been able to avoid these events by taking reasonable precautions. In other cases, however, it appears that the event may not be reasonably avoidable.

For example, consumers who carefully track their transactions may still exceed the credit limit because of charges of which they were not aware (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 how holds will affect the availability of funds and when funds from a deposit or a credit will be made available by the depository institution.[51] Finally, although the Agencies' proposed §____.22 would, if implemented, ensure that consumers' payments will not be treated as late for any reason (including for purposes of triggering an increase in rate) unless they receive a reasonable amount of time to make payment, there may be other reasons why consumers pay late or miss a payment.[52]

[46] *See also* GAO Credit Card Report at 6 (''[O]ur interviews with 112 cardholders indicated that many failed to understand key terms or conditions that could affect their costs, including when they would be charged for late payments or what actions could cause issuers to raise rates.'').

[47] *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.''). This behavior is commonly referred to as ''hyperbolic discounting.'' *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 (2008) (discussing consumers' tendency to underestimate their future credit card usage when they apply for a card and thereby failing to adequately anticipate the costs of the product); Shane Frederick, *et al.*, *Time Discounting and Time Preference: A Critical Review*, 40 J. Econ. Literature 351, 366–67 (2002) (reviewing the literature on hyperbolic discounting); Ted O'Donoghue & Matthew Rabin, *Doing It Now or Later*, 89 Am. Econ. Rev. 103, 103, 111 (1999) (explaining people's preference for delaying unpleasant activities and accepting immediate rewards despite their knowledge that the delay may lessen potential future rewards or increase potential adverse consequences).

[48] *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*).

[49] *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*).

[50] *See* GAO Credit Card Report at 25.

[51] *See* discussion of overdrafts and debit holds in relation to proposed §____.32 below.

[52] *See, e.g.*, 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*

Accordingly, although the injury resulting from the application of increased annual percentage rates to existing balances may be avoidable in some individual cases, it appears that, as a general matter, this injury is not reasonably avoidable. It does not appear, however, that this reasoning extends to the application of increased rates to new transactions. The Board's proposal under Regulation Z would, if implemented, require creditors to provide notice 45 days in advance of an increase in the annual percentage rate. *See* proposed 12 CFR 226.9(c), (g), 72 FR at 33056–58.[53] In addition, as discussed below, proposed ____.24 would not permit the institution to increase the rate on purchases made up to 14 days after provision of the 45-day notice. These proposals would enable consumers to reasonably avoid any injury caused by application of an increased rate to new transactions by providing consumers sufficient time to receive and review the 45-day notice and to decide whether to continue using the card. Finally, as also discussed below, it does not appear that, when a consumer has violated the account terms, application of an increased rate to an existing balance is an unfair practice in all circumstances.

Injury is not outweighed by countervailing benefits. It appears that the proposal will result in a net benefit to consumers because some consumers are likely to benefit substantially while the adverse effects on others are likely to be small. The Agencies are aware that some institutions may offer lower annual percentage rates to consumers at the outset of an account relationship knowing that the rate can be subsequently adjusted to compensate for an increase in the cost of funds or in the risk of default. The Agencies are also aware that, if institutions are prohibited from increasing rates on existing balances, they may charge higher rates or set lower credit limits initially or curtail credit availability to higher risk consumers. As discussed below, however, the Agencies have crafted the proposal to protect consumers from the substantial injury caused by rate increases on existing balances while, to the extent possible, minimizing the impact on institutions' ability to adjust to market conditions and price for risk.

As an initial matter, because the prohibition on applying an increased annual percentage rate to an existing balance does not extend to variable rates, an institution can guard against increases in the cost of funds by utilizing a variable rate that reflects market conditions. Furthermore, the Agencies do not propose to prohibit institutions from increasing the annual percentage rate on an existing balance if a consumer becomes 30 days delinquent. Although the 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 30 days delinquent. A consumer is unlikely, for example, to become 30 days delinquent due to a single returned item or the loss of a payment in the mail. Thus, even when the delinquency was not reasonably avoidable, it appears that the harm in such cases is outweighed by the benefit to consumers as a whole (in the form of lower annual percentage rates and broader access to credit) from allowing institutions to reprice for risk once a consumer has become significantly delinquent.[54]

Accordingly, although the proposal could ultimately result in higher upfront costs and less available credit for some consumers, it appears that consumers and competition may benefit as a whole. Consumers will not only be protected against unexpected increases in the cost of transactions that have already been completed but will also be able to more accurately assess the cost of using their credit card accounts at the time they engage in new transactions. Furthermore, as discussed in regard to payment allocation, 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. Similarly, competition may be enhanced because institutions that offer annual percentage rates that realistically reflect risk and market conditions will no longer be forced to compete with institutions offering artificially reduced rates.

The Agencies considered the suggestion raised in some comments that consumers be permitted to reject (or opt out of) the application of an increased rate to an existing balance by closing the account. As formulated in some of those comments, this proposal would not have addressed the injury to consumers whose rates were increased due to an unavoidable violation of the account terms. Even if consumers were given a right to reject application of an increased rate to an existing balance in all circumstances and were provided timely notice of that right (for example, in the Board's proposed 45-day notice under Regulation Z), it appears that the benefits to consumers of such a right do not outweigh the injury caused by application of an increased rate to an existing balance.

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. Accordingly, assuming consumers understand their right to reject a rate increase, most would rationally exercise that right.[55] As a result, the costs associated with prohibiting application of an increased rate to an existing balance and providing consumers with the right to reject such application should be similar. However, 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 and consumers. Furthermore, a right to reject application of an increased rate to an existing balance would provide fewer benefits to consumers as a whole than the proposed rule because, no matter how well the right is disclosed, a substantial number of consumers might inadvertently forfeit that right by failing to read, understand, or act on the notice. In a 2006 report, the U.S. Government Accountability Office (GAO) noted that, 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.[56] Thus, a right to reject application of an increased rate to an existing balance could create similar

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*).

[53] The Board has proposed additional revisions to these provisions elsewhere in today's **Federal Register**.

[54] The Agencies also note that, although some consumers may not have been able to avoid fees for violating the account terms (for example, late payment fees or fees for exceeding the credit limit), this injury does not appear to outweigh the countervailing benefit to consumers or competition. The application of an increased rate to an existing balance increases consumers' costs until the balance is paid in full or is transferred to an account with more favorable terms. The assessment of a fee, however, is generally an isolated cost that will not be repeated unless the account terms are violated again.

[55] A consumer who cannot obtain a lower rate elsewhere may not reject application of an increased rate to an existing balance. This choice, however, may not enable the consumer to reasonably avoid injury.

[56] GAO Credit Card Report at 26–27.

or greater costs while producing fewer benefits than the proposed rule.

Proposal

____.24(a) General Rule

Proposed § ____.24(a)(1) prohibits 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) defines ''outstanding balance'' as meaning the amount owed on a consumer credit card account at the end of the fourteenth day after the institution provides a notice required by proposed 12 CFR 226.9(c) or (g) as set forth in the Board's June 2007 Proposal.

As discussed above, the Board's June 2007 Proposal would require a creditor to provide consumers with a written notice of a rate increase at least 45 days before the effective date of that increase. *See* proposed 12 CFR 226.9(c) and (g), 72 FR at 33056, 33058. The definition of ''outstanding balance'' in proposed § ____.24(a)(2) is intended to prevent the Board's 45-day notice requirement from creating an extended period following receipt of that notice during which new transactions can be made at the prior rate. Although institutions could address this concern by denying additional extensions of credit after sending the 45-day notice, that outcome may not be beneficial to consumers who have received the notice and wish to use the account for new transactions. Accordingly, under proposed § ____.24(a), the balance to which an institution could not apply an increased rate is the balance 14 days after the institution has provided the 45-day notice. Consistent with the safe harbor in proposed § ____.23(b), 14 days would allow seven days for the notice to reach the consumer and seven days for the consumer to review that notice.

Proposed comment 24(a)–1 provides the following example of the application of proposed § ____.24(a): Assume that on December 30 a consumer credit card account has a balance of $1,000 at an annual percentage rate of 15%. On December 31, the institution mails or delivers a notice required by proposed 12 CFR 226.9(c) informing the consumer that the annual percentage rate will increase to 20% on February 15. The consumer uses the account to make $2,000 in purchases on January 10 and $1,000 in purchases on January 20. Assuming no other transactions, the outstanding balance for purposes of proposed § ____.24 is the $3,000 balance as of the end of the day on January 14. Therefore, under proposed § ____.24(a), the institution cannot increase the annual percentage rate applicable to that balance. The institution can apply the 20% rate to the $1,000 in purchases made on January 20 but, consistent with proposed 12 CFR 226.9(c), it cannot do so until February 15.

Proposed comment 24(a)–2 clarifies that, consistent with the approach in proposed § ____.22(b), an institution is not required to determine the specific date on which a notice required by proposed 12 CFR 226.9(c) or (g) was provided. For purposes of proposed § ____.24(a)(2), if the institution has adopted reasonable procedures designed to ensure that notices required by proposed 12 CFR 226.9(c) or (g) are provided to consumers no later than, for example, three days after the event giving rise to the notice, the outstanding balance is the balance at the end of the seventeenth day after such event.

____.24(b) Exceptions

Proposed § ____.24(b) provides that an institution may apply an increased annual percentage rate to an outstanding balance in three circumstances. First, when the rate is increased due to the operation of an index that is not under the institution's control and is available to the general public, the increased rate may be applied to the outstanding balance. This exception is similar to that in 12 CFR 226.5b(f)(1) and would apply to variable rates. Proposed comment 24(b)(1)–1 clarifies that an institution may not increase the rate on an outstanding 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 would also clarify that an institution may not increase the rate on an outstanding balance by changing the method used to determine the indexed rate. Proposed comment 24(b)(1)–2 clarifies when a rate is considered ''publicly available.''

Second, when a promotional rate expires or is lost for a reason specified in the account agreement (*e.g.*, late payment), an increased rate may be applied to the outstanding balance, provided that the institution increases the rate to the standard rate rather than the penalty rate. For example, as set forth in proposed comment 24(b)(2)–1, assume that a consumer credit card account has a balance of $1,000 at a 5% promotional rate and that the institution also charges an annual percentage rate of 15% for purchases and a penalty rate of 25%. If the consumer does not make payment by the due date and the account agreement specifies that event as a trigger for applying the penalty rate, the institution may increase the annual percentage rate on the $1,000 from the 5% promotional rate to the 15% annual percentage rate for purchases. The institution may not, however, increase the rate on the $1,000 from the 5% promotional rate to the 25% penalty rate, except as otherwise permitted under proposed § ____.24(b)(3).

Third, an institution may apply an increased rate to the outstanding balance if the consumer's minimum payment has not been received within 30 days after the due date. An example is provided in proposed comment 24(b)(3)–1. As discussed above, a consumer will generally have notice and an opportunity to cure the delinquency before becoming 30 days past due.

____.24(c) Treatment of Outstanding Balances Following a Rate Increase

Proposed § ____.24(c) prohibits institutions that have increased the annual percentage rate applicable to a category of transactions on a consumer credit card account with an outstanding balance in that category from requiring payment of that outstanding balance using a method that is less beneficial to the consumer than one of two listed methods and from assessing fees or charges solely on an outstanding balance. Proposed comment 24(c)–1 clarifies that proposed § ____.24(c) does not apply if the account does not have an outstanding balance or if the rate on an outstanding balance is increased pursuant to proposed § ____.24(b). Proposed comment 24(c)–2 clarifies that proposed § ____.24(c) does not apply to balances in categories of transactions other than the category for which an institution has increased the annual percentage rate. For example, if an institution increases the annual percentage rate that applies to purchases but not the rate that applies to cash advances, proposed § ____.24(c) applies to an outstanding balance consisting of purchases but not an outstanding balance consisting of cash advances.

Proposed § ____.24(c)(1) would address the amount of time provided to the consumer in which to pay off the outstanding balance. While there may be circumstances in which institutions would accelerate repayment of the outstanding balance to manage risk, proposed § ____.24(a) 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 require institutions to provide consumers with a method of paying the outstanding balance that is no less beneficial to the consumer than the methods listed in proposed § ____.24(c)(1)(i) and (ii). *See* proposed comment 24(c)(1)–1. Proposed § ____.24(c)(1)(i) would also allow 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.[57] Proposed § ____.24(c)(1)(ii) would allow the percentage of the outstanding balance that was included in the required minimum periodic payment before the rate increase to be doubled. Proposed comment 24(c)(1)(ii)–1 clarifies that this provision does not limit or otherwise address an institution's ability to determine the amount of the minimum payment on other balances. Proposed comment 24(c)(1)(ii)–2 provides an example of how an institution could adjust the minimum payment on the outstanding balance.

The protections of proposed § ____.24(a) could 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 prohibit 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 prohibit, for example, an institution from assessing a monthly maintenance fee on the outstanding balance. The proposal would not, however, prohibit 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.

Request for Comment

The Agencies request comment on:

- The extent to which institutions raise rates on pre-existing card balances.
- The extent to which credit cards are offered pursuant to agreements that do not permit institutions to raise rates on pre-existing card balances.
- The extent to which credit cards are offered pursuant to agreements that permit consumers to reject application of increased rates to pre-existing balances and the extent to which consumers take advantage of this opportunity.
- What consumer behavior with respect to an account institutions consider when determining whether to increase the rate on existing balances (other than late payment, returned payment for insufficient funds, or exceeding the credit limit).
- The reasons institutions currently increase rates on existing balances and, for each reason, what percentage it represents of all rate increases.
- What effect the restrictions in proposed § ____.24(a) would have on outstanding securitizations and institutions' ability to securitize credit card assets in the future.
- Whether the restrictions in proposed § ____.24(a) would limit an institution's ability to effectively manage risk if the default rate on credit cards is greater than anticipated in light of the exceptions in proposed § ____.24(b).
- Whether the 14-day period in proposed § ____.24(a)(2) is an appropriate amount of time to enable consumers to receive and review notice of a rate increase.
- Whether other means of protecting consumers from application of increased rates to existing balances (*e.g.*, an opt-out) are more appropriate.
- Whether the exceptions in proposed § ____.24(b) are appropriate or necessary and whether other exceptions would be appropriate. In particular, the Agencies seek comment on whether: (1) Additional exceptions are needed to address safety and soundness concerns; (2) additional exceptions are needed for a consumer's failure to pay the account as agreed under the account terms, such as conduct that results in imposition of a penalty rate (including late payment, returned payment for insufficient funds, or exceeding the credit limit); and (3) 30 days is the appropriate measure of a serious delinquency.
- Whether additional or different approaches to the repayment of outstanding balances should be considered.
- Whether restrictions similar to those in proposed § ____.24(c) should apply when, rather than increasing the rate on future transactions, an institution declines to extend additional credit to the consumer. For example, the Agencies seek comment on whether, if an institution responds to an increased risk of default by declining to extend additional credit to a consumer, the consumer should receive the protections in proposed § ____.24(c) with respect to any balance on the account.

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

Although the Board's June 2007 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. The Agencies' proposal to prohibit the application of increased rates to existing balances addresses consumer harm resulting from rate increases imposed as a penalty for exceeding the credit limit. The Agencies also have concerns, however, about the imposition of OCL fees in connection with credit holds. This proposal is consistent with a parallel proposal in Subpart D with respect to overdraft fees assessed in connection with debit holds.

As further discussed below in Subpart D, some merchants place a temporary ''hold'' on an account when a consumer uses a credit or debit card 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 (*e.g.*, room service). Therefore, to cover against its risk of loss, 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 does not know the amount of the transaction 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 transaction occurred. During this time between authorization and settlement, the hold remains in place on the consumer's account. The Agencies are concerned that consumers unfamiliar with credit hold practices may inadvertently exceed the credit limit and incur an OCL fee because they assumed that only the actual purchase

[57] This amortization period is consistent with guidance issued by the Board, OCC, FDIC, and OTS, under the auspices of the Federal Financial Institutions Examination Council, noting that credit card workout programs should generally strive to have borrowers repay debt within 60 months. *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*).

amount of the transaction was unavailable for additional transactions.

Legal Analysis

Assessing an OCL fee when the credit limit is exceeded as a result of a credit hold appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC. First, an OCL fee constitutes substantial monetary injury. Second, this injury does not appear to be reasonably avoidable because consumers are generally unaware that a hold has been placed on their account. The Agencies do not believe that enhanced disclosures would enable consumers to avoid the injury because, even if consumers were to receive notice of the amount of the hold at point of sale, they could not know the length of time the hold will remain in place. Third, there do not appear to be countervailing benefits to consumers or competition. The proposal does not prohibit the use of holds, only the assessment of an OCL fee caused by a hold. The Agencies note that there is little risk to the institution from an authorized transaction until the transaction is presented for settlement by the merchant. At that point, the risk of loss is not for the amount of the hold, but rather for the actual purchase amount of the transaction. The Agencies do not, however, propose to prohibit institutions from assessing an OCL fee if there is insufficient available credit to cover the actual purchase amount.

Proposal

Proposed § ____.25 would prohibit institutions from assessing an OCL fee if the credit limit was exceeded due to a hold unless the actual amount of the transaction for which the hold was placed would have resulted in the consumer exceeding the credit limit. Proposed comments 25–2 and 25–3 provide examples of two situations in which this prohibition would apply. The first is where the amount of the hold for an authorized transaction exceeds the credit limit. Assume that a consumer has a credit limit of $2,000 and a balance of $1,500 on a consumer credit card account. The consumer uses the credit card to reserve a hotel room for five days. When the consumer checks in, the hotel obtains authorization from the institution for a $750 ‘‘hold’’ on the account to ensure there is adequate available credit to cover the total cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, § ____.25 prohibits the institution from assessing an OCL fee with respect to the $750 hold. If, however, the total cost of the stay had been more than $500, § ____.25 would not prohibit the institution from assessing an OCL fee.

Another situation in which an institution would be prohibited from assessing an OCL fee is when the hold for a transaction causes a subsequent transaction to exceed the credit limit. Assume that a consumer has a credit limit of $2,000 and a balance of $1,400 on a consumer credit card account. The consumer uses the credit card to reserve a hotel room for five days. When the consumer checks in, the hotel obtains authorization from the institution for a $750 hold on the account to ensure there is adequate available credit to cover the total cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $150 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, § ____.25 would prohibit the institution from assessing an OCL fee with respect to either the $750 hold or the $150 purchase. If, however, the total cost of the stay had been more than $450, § ____.25 would not prohibit the institution from assessing an OCL fee.

Proposed comments 25–4 and 25–5 provide additional examples of the operation of this rule.

Request for Comment

The Agencies are concerned about other potentially unfair practices regarding the assessment of fees for exceeding the credit limit. In order to gather information for purposes of determining whether additional prohibitions are warranted, the Agencies solicit comment on:

- The extent to which institutions assess more than one fee per billing cycle for exceeding the credit limit and, if so, what factors determine whether a fee is assessed (*e.g.*, one fee for each transaction while the account is over the credit limit).
- The extent to which institutions tier or otherwise vary the fee for exceeding the credit limit based on the number or dollar amount of transactions while the account is over the credit limit.
- The extent to which institutions assess fees for exceeding the credit limit when the transaction that exceeded the credit limit occurred in an earlier billing cycle and the consumer has not engaged in subsequent transactions.

Section ____.26—Unfair Balance Computation Method

The Agencies propose to prohibit institutions, as an unfair act or practice, from imposing finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle. Currently, TILA requires creditors to explain as part of the account-opening disclosures the method used to determine the balance to which rates are applied. 15 U.S.C. 1637(a)(2). In its June 2007 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 32991–92. 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 its proposal, the Board received comments from consumers, consumer groups, and members of Congress urging the Board to prohibit the balance computation method sometimes referred to as ‘‘two-cycle’’ or ‘‘double-cycle.’’ This 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 the balance for 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 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.

The following example illustrates how the two-cycle method results in higher costs for these consumers than other balance computation methods. A consumer has a zero balance on a credit card account on January 1, which is the start of the billing cycle. The consumer uses the credit card for a $500 purchase on January 15. The consumer makes no other purchases and the billing cycle closes on January 31. The consumer pays $400 on the due date (February 25), leaving a $100 balance. Under the average daily balance computation method that is used by most credit card issuers, because the consumer did not pay the balance in full on February 25, the periodic statement showing February activity would reflect interest charged on the $500 purchase from the start of the billing cycle (February 1) through February 24 and interest on the remaining $100 from February 25 through the end of the billing cycle (February 28). Under the two-cycle method, however, interest would also be charged on the $500 purchase from the date of purchase (January 15) to the end of the January billing cycle (January 31).

Legal Analysis

Imposing finance charges on consumer credit card accounts based on balances for days in billing cycles that precede the most recent billing cycle appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC.

First, as described above, computing finance charges based on balances preceding the most recent billing cycle appears to cause substantial consumer injury because consumers incur higher interest charges than they would under a balance computation method that focuses only on the most recent billing cycle. Second, it does not appear that consumers can reasonably avoid this injury because, once they use the card, they have no control over the methods used to calculate the finance charges on their accounts. Furthermore, as noted above, the Board's consumer testing indicates that disclosures are not successful in helping consumers understand balance computation methods. Accordingly, a disclosure will not enable the consumer to avoid that method when comparing credit card accounts or to avoid its effects when using a credit card.

Third, there do not appear to be any significant benefits to consumers or competition from computing finance charges based on balances preceding the most recent billing cycle. The Agencies understand that many institutions no longer use the two-cycle computation method. Although prohibition of the two-cycle computation 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 appears that this result would nevertheless benefit consumers because it will result in more transparent pricing.

Proposal

____.26(a) General Rule

Proposed § ____.26(a) would prohibit 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 cites the two-cycle average daily balance computation method as an example of balance computation methods that would be prohibited by the proposed rule and tracks commentary under Regulation Z. *See* 12 CFR 226.5a cmt. 5a(g)–2. Proposed comment 26(a)–2 provides an example of the application of the two-cycle method.

____.26(b) Exceptions

Proposed § ____.26(b) would create two exceptions to the general prohibition in proposed § ____.26(a). First, 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 be permitted to charge the consumer for interest accrued during the period the plan was in effect.

Second, institutions would not be 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 accordingly, even if that requires computing finance charges based on balances in billing cycles preceding the most recent billing cycle.

Section ____.27—Unfair Acts or Practices Regarding Security Deposits and Fees for the Issuance or Availability of Credit

The Agencies propose to prohibit 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. In addition, the proposal would prohibit 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. Finally, 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 would be required to spread that amount equally over the eleven billing cycles following the first billing cycle.

As the Board noted in its June 2007 Proposal, subprime credit cards often have substantial fees related to the issuance or availability of credit. *See* 72 FR at 32980, 32983. 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 statement and substantially reduce the amount of credit that the consumer has available to make purchases or other transactions on the account. For example, after security deposits or fees have been billed to accounts with a minimum credit line of $250, the consumer may have less than $100 of available credit with which to make purchases or other transactions unless the consumer pays the deposits or fees. In addition, consumers will pay interest on security deposits and fees until they are paid in full.

The federal banking agencies have received many complaints from consumers with respect to cards of this type. Consumers often say that they were not aware of how little available credit they would have after the assessment of security deposits and fees. In an effort to address these concerns, the Board's June 2007 Proposal included several proposed amendments to Regulation Z's solicitation and application disclosures for credit and charge cards.

Specifically, the Board proposed to require creditors to disclose both the annualized and the periodic amount of the fee and how often the periodic fee will be imposed. *See* proposed 12 CFR 226.5a(b)(2), 72 FR at 33046; *see also* 72 FR at 32980. The Board also proposed to require creditors to disclose the impact of security deposits and fees for the issuance or availability of credit on consumers' initial available credit. *See* proposed 12 CFR 226.5a(b)(16), 72 FR at 33047. Specifically, the Board proposed that, if the total amount of any security deposit or required fees for the issuance or availability of credit that will be charged against the card at account opening equals 25 percent or more of the minimum credit limit offered for the card, the creditor must disclose an example of the amount of available credit a consumer would have remaining, assuming that the consumer receives the minimum credit limit offered on the account. For example, if the minimum credit limit on an account is $250 and security deposits and covered fees total $150, the creditor would be required to disclose that the consumer may receive only $100 in available credit.

Elsewhere in today's **Federal Register**, the Board is proposing to clarify the circumstances in 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. Under proposed 12 CFR 226.5(b)(1)(iv), the right to reject an open-end (not home-secured) plan would apply when any fee (other than an application fee that is charged to all applicants whether or not they receive the credit) is charged or agreed to be paid before the consumer receives the account-opening disclosures. Similarly, under proposed 12 CFR 226.6(b)(4)(vii), creditors that require substantial fees at account opening and leave consumers with a limited amount of available credit would be required to provide a notice of the consumer's right to reject the plan and not pay fees (other than an application fee, as discussed above) unless the consumer uses the account or pays the fees after receiving a billing statement. As discussed below, however, the Agencies are proposing additional, substantive protections.

Legal Analysis

Charging to a consumer credit card account security deposits and fees for the issuance or availability of the credit during the first year that total a majority of the credit limit appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC. Similarly, charging to the account in 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 also appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. 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 may not be able to pay the charges in full during that grace period. The potential injury from interest charges increases when security deposits and fees for the issuance or availability of credit are charged to the account in the first billing cycle rather than over a longer period of time. In addition, when security deposits and fees for the issuance or availability of credit are charged to the consumer's account, they diminish the value of that account by reducing the credit available to the consumer for purchases or other transactions.[58]

Injury is not reasonably avoidable. It does not appear that consumers are able to avoid the injury caused by the financing of security deposits and fees for the issuance or availability of credit. As an initial matter, disclosures may not be effective in allowing consumers to avoid these charges, particularly where deceptive sales practices mislead consumers about the amount of credit available.[59] For example, in one recent case, the court found 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." [60] In these circumstances, consumers may lack the information necessary to avoid harm.

Furthermore, because cards with high security deposits and fees are typically targeted at subprime consumers whose credit histories or other characteristics may prevent them from obtaining a credit card elsewhere, those consumers may not be able to avoid financing the fees associated with these cards because they lack the funds to pay the charges up front.[61] Furthermore, because the Board's proposals under Regulation Z focus on amounts charged when the account is opened, those disclosures could be evaded by subsequent charges, leaving consumers with less available credit than they anticipated. Thus, consumers may not reasonably be able to avoid the injury caused by the financing of security deposits and fees for the issuance or availability of credit.

Injury is not outweighed by countervailing benefits. The Agencies understand that, in some cases, consumer credit card accounts with financed security deposits and fees can provide benefits to consumers who are unable to obtain a credit card without such charges and who lack the available funds to pay the security deposit and fees at or before account opening. Once, however, security deposits and fees for the issuance or availability of credit consume a majority of the credit limit, it appears that the benefit to consumers from access to available credit is outweighed by the high cost of paying for that credit. The Agencies have sought to narrowly tailor the proposal by allowing 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 no more than 25 percent of the credit limit during the first billing cycle. Security deposits and fees paid from separate funds would not be affected by the proposal.

Finally, although public policy does not serve a primary basis for the Agencies' determination, the established public policy in favor of the safety and soundness of financial institutions appears to support the proposed limitations on the financing of security deposits and fees for the issuance or availability of credit because that practice appears to create a greater risk of default.[62]

---

[58] *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*).

[59] *See, e.g.*, OCC Advisory Letter 2004–4, at 2–3 (finding that "solicitations and other marketing materials used for [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, disclosures problems associated with secured credit cards and related products have constituted *deceptive* practices under the applicable standards of the FTC Act" (emphasis in original)); *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*).

[60] *People* v. *Applied Card Sys., Inc.,* 805 N.Y.S.2d 175, 178 (App. Div. 2005).

[61] *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)).

[62] *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.").

Proposal

____.27(a) Annual Rule

Proposed § ____.27(a) prohibits institutions from financing 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. Proposed § ____.27(a) would not, however, apply to security deposits and fees for the issuance or availability of credit that are not charged to the account. For example, an institution would not be prohibited from providing a credit card account that requires a consumer to pay a security deposit equal to the amount of credit extended if that deposit is not charged to the account. Proposed comment 27–1 clarifies that the ''initial credit limit'' for purposes of this section is the limit in effect when the account is opened. Proposed comment 27(a)–1 clarifies 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. For example, assume that a consumer credit card account has an initial credit limit of $500. Under proposed § ____.27(a), an institution may charge to the account security deposits and fees for the issuance or availability of credit totaling no more than $250 during the twelve months after the date on which the account is opened (consistent with proposed § ____.27(b)).

____.27(b) Monthly Rule

Proposed § .27(b) prohibits 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. Any additional security deposits and fees must be spread equally among the eleven billing cycles following the first billing cycle. Proposed comment 27(b)–1 clarifies that, when dividing amounts pursuant to proposed § ____.27(b)(2), the institution may adjust amounts by one dollar or less. For example, if an institution is dividing $125 over eleven billing cycles, it may charge $12 for four months and $11 for seven months. Proposed comment 27(b)–2 provides the following example of the application of proposed § ____.27(b): Assume that a consumer credit card account opened on January 1 has an initial credit limit of $500 and that an institution charges to the account security deposits and fees for the issuance or availability of credit that total $250 during the twelve months after the date on which the account is opened. 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 proposed § ____.27(b), the institution may charge to the account no more than $250 in security deposits and fees for the issuance or availability of credit. If it charges $250, the institution may charge as much as $125 during the first billing cycle. If it charges $125 during the first billing cycle, it may then charge $12 in any four billing cycles and $11 in any seven billing cycles during the year.

____.27(c) Fees for the Issuance or Availability of Credit

Proposed § ____.27(c) defines ''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 proposed 12 CFR 226.5a(b)(2). *See* 72 FR at 33046. This definition does not include fees such as late fees, fees for exceeding the credit limit, or fees for replacing a card. Proposed comments 27(c)–1, 2, and 3 are based on similar commentary to proposed 12 CFR 226.5a(b)(2) and clarify the meaning of ''fees for the issuance or availability of credit.'' *See* 72 FR at 33108.

Request for Comment

The Agencies seek comment on:

- The dollar amount of security deposits and fees for the issuance or availability of credit typically charged to the account in the first billing cycle.
- The percentage of the initial credit line that is typically made unavailable due to security deposits and fees charged to the account during the first billing cycle.
- The degree to which consumers (including consumers with limited or damaged credit histories) can secure credit cards without high fees for the issuance or availability of credit.
- Whether the proposal would inappropriately curtail consumers' access to credit.
- Whether the final rule should impose additional, specific restrictions on charges on credit card accounts that a creditor can impose without the consumer's advance authorization.
- Whether the twelve-month time period in the proposal is the appropriate time period to consider in determining how much of the credit limit is consumed by security deposits and fees.
- Whether disclosure of security deposits and fees enables consumers to understand the impact of those charges on the availability of credit.
- Whether alternatives to proposed § ____.27(b) are appropriate.

Section ____.28—Deceptive Acts or Practices Regarding Firm Offers of Credit

Proposed § ____.28 applies when institutions make firm offers of credit for consumer credit card accounts that contain a range of or multiple annual percentage rates or credit limits. When the rate or credit limit that a consumer responding to such an offer will receive depends on specific criteria bearing on creditworthiness, § ____.28 requires that the institution disclose the types of eligibility criteria in the solicitation. The disclosure must be provided in a manner that is reasonably understandable to consumers and designed to call attention to the nature and significance of the eligibility criteria for the lowest annual percentage rate or highest credit limit stated in the solicitation. Under the proposal, an institution may use the following disclosure to meet these requirements, if it is presented in a manner that calls attention to the nature and significance of the eligibility information, as applicable: ''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''

Legal Analysis

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.[63] One of the permissible purposes set forth in the FCRA relates to prescreened firm offers of credit or insurance.[64] 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 that will be reflected in the consumer reporting agency's records, such as credit scores in a certain range. 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.

[63] *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).

[64] *See* 15 U.S.C. 1681a(l) (defining ''firm offer of credit or insurance'').

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.[65] The creditor may apply certain additional criteria to evaluate applications from consumers that respond to the offer, such as the consumer's income or debt-to-income ratio.[66] As discussed below, the Agencies are concerned that consumers receiving firm offers of credit may not understand that they are not necessarily eligible for the lowest annual percentage rate and the highest credit limit stated in the offer.

It appears to be a deceptive act or practice under the standards articulated by the FTC to make a firm offer of credit for a consumer credit card account without disclosing that consumers may not receive the lowest annual percentage rate and highest credit limit offered.

Likely to mislead consumers acting reasonably under the circumstances. As discussed above, the FCRA requires that firm offers of credit state that the consumer was selected for the offer based on certain criteria for creditworthiness.[67] Indeed, firm offers of credit often state that consumers have been ''pre-selected'' for credit or make similar statements. Thus, in the absence of an affirmative statement to the contrary, consumers may reasonably believe that they can receive the lowest annual percentage rate and highest credit limit stated in the offer even though that is not the case.[68] For example, assume that an institution obtains from a consumer reporting agency a list of consumers with credit scores of 650 or higher for purposes of sending those consumers a solicitation for a firm offer of credit. The solicitation sent by the institution states that the consumer has been ''pre-selected'' for credit and advertises ''rates from 8.99% to 19.99%'' and ''credit limits from $1,000 to $10,000.'' But under the criteria established by the institution before the selection of the consumers for the offer, the institution will only provide an interest rate of 8.99% and a credit limit of $10,000 to those consumers responding to the solicitation who are verified to have a credit score of 650 or higher, who have a debt-to-income ratio below a certain amount, and who meet other specific criteria bearing on creditworthiness. Because the consumers receiving the offer are not informed of these requirements, consumers who do not meet one or more of the requirements could reasonably interpret the offer as stating that they may receive an interest rate of 8.99% or a credit limit of $10,000 when, in fact, they will not.[69]

As noted above, the FCRA requires that firm offers of credit state, where applicable, that credit may not be extended if the consumer no longer meets the criteria used to select the consumer for the offer or does not meet any other applicable criteria bearing on creditworthiness.[70] This statement, however, only informs the consumer that there may be circumstances in which the consumer will not be eligible to receive *any* credit. This statement does not enable consumers to evaluate whether they will be eligible for the lowest annual percentage rate and highest credit limit if they respond to the firm offer.

Materiality. Statements in firm offers of credit that the consumer has been selected for the offer based on certain criteria for creditworthiness or that the consumer has been ''pre-selected'' for credit are material because they are likely to affect a consumer's decision about whether to respond to the offer of credit.[71] Furthermore, statements in firm offers of credit regarding credit terms are presumptively material because they relate to the cost of a product or service.[72]

Proposal

____.28(a) Disclosure of Criteria Bearing on Creditworthiness

Proposed § ____.28(a) provides that, if an institution offers a range or multiple annual percentage rates or credit limits when making a solicitation for a firm offer of credit for a consumer credit card account, and the annual percentage rate or credit limit that consumers approved for credit will receive depends on specific criteria bearing on creditworthiness, the institution must disclose the types of criteria in the solicitation. The disclosure must be provided in a manner that is reasonably understandable to consumers and designed to call attention to the nature and significance of the information regarding the eligibility criteria for the lowest annual percentage rate or highest credit limit offered.

Under the proposal, an institution may use the following disclosure to meet these requirements, if it is presented in a manner that calls attention to the nature and significance of the eligibility information: ''If you are approved for credit, your annual percentage rate and credit limit will depend on your credit history, income, and debts.'' Proposed comment .28(a)(1)–1 explains that whether a disclosure has been provided in a manner that is designed to call attention to the nature and significance of required information depends on where the disclosure is placed in the solicitation and how it is presented, including whether the disclosure uses a typeface and type size that are easy to read and uses boldface or italics. Placing the disclosure in a footnote would not satisfy this requirement. Proposed comment .28(a)–2 clarifies that, to the extent that disclosures required by proposed § ____.28(a) are provided electronically, the institution must comply with the requirements in 12 CFR 226.5a(a)(2)–8 and –9.

Proposed comment .28(a)–3 clarifies that a firm offer of credit solicitation that states an annual percentage rate or credit limit for a credit card feature and a different annual percentage rate or credit limit for a different credit card feature does not offer multiple annual percentage rates or credit limits. For example, if a firm offer of credit solicitation offers a 15% annual percentage rate for purchases and a 20% annual percentage rate for cash

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

[66] *See, e.g.*, 15 U.S.C. 1681a(l).

[67] *See* 15 U.S.C. 1681m(d)(1)(B).

[68] *See* FTC Policy Statement on Deception at 3 (''To be considered reasonable, the interpretation or reaction does not have to be the only one. When a seller's representation conveys more than one meaning to reasonable consumers, one of which is false, the seller is liable for the misleading interpretation.'' (footnotes omitted)). In consumer testing conducted in relation to the Board's June 2007 Proposal, almost all participants understood that the credit limit for which they would qualify depended on their creditworthiness, such as credit history. *See* 72 FR at 32984. This testing did not, however, specifically focus on firm offers of credit, which, as discussed above, contain statements that the consumer has been selected for the offer.

[69] *See FTC* v. *U.S. Sales Corp.*, 785 F. Supp. 737, 751 (N.D. Ill. 1992) (concluding that express representations that consumers would not be turned down for a secured credit card were misleading because applicants could be denied a card if they had a poor credit history).

[70] *See* 15 U.S.C. 1681m(d)(1)(C).

[71] FTC Policy Statement on Deception at 6–7 (''A 'material' misrepresentation or practice is one which is likely to affect a consumer's choice of or conduct regarding a product. In other words, it is information that is important to consumers.'' (footnotes omitted)).

[72] *See id.* at 6.

advances, the solicitation does not offer multiple annual percentage rates for purposes of proposed § ____.28(a). Proposed comment .28(a)–4 provides an example of the operation of proposed § ____.28(a).

Proposed comment .28(a)–5 clarifies that, when making a disclosure under proposed § ____.28, an institution may only disclose the criteria it uses in evaluating whether consumers who are approved for credit will receive the lowest annual percentage rate or the highest credit limit. For example, if an institution does not consider the consumer's debts when determining whether the consumer should receive the lowest annual percentage rate or highest credit limit, the disclosure must not refer to ''debts.''

.28(b) Firm Offer of Credit Defined

Proposed § ____.28(c) provides that, for purposes of this section, ''firm offer of credit'' has the same meaning as that term has under the definition of ''firm offer of credit or insurance'' in section 603(l) of the Fair Credit Reporting Act (15 U.S.C. 1681a(l)).

Request for Comment

The Agencies are concerned that the disclosure in proposed § ____.28(a) may not be effective unless it is provided in close proximity to the annual percentage rate and/or credit limit in the firm offer of credit. However, the Agencies also recognize that the annual percentage rate and/or credit limit may be stated multiple times in the offer. Accordingly, the Agencies request comment on whether proposed § ____.28 should contain a proximity requirement. If a proximity requirement were to be adopted, the Agencies request comment on whether the disclosure should be proximate to the first statement of the annual percentage rate or credit limit or the most prominent statement of the annual percentage rate or credit limit.

The Agencies also request comment on:

- Whether consumers who receive firm offers of credit offering a range of or multiple annual percentage rates or credit limits understand that there may be no possibility that they will be eligible for the lowest annual percentage rate and the highest credit limit stated in the offer.
- Whether the proposed disclosure would be effective in informing consumers that they may not receive the best terms advertised.

Other Credit Card Practices

The Agencies are also concerned about the potentially deceptive use of the term ''interest free'' in connection with deferred interest plans for credit cards. While consumers may benefit from making payments over a period of time, the Agencies are concerned that some consumers may not be adequately informed that accrued interest charges will be added to the principal owed if they fail to make payment in full by the end of the deferred interest term or otherwise default on the agreement. Because the Board is addressing this concern in a separate proposal under Regulation Z in today's **Federal Register**, the Agencies are not proposing to address the issue in this rulemaking. Under the Board's Regulation Z proposal, creditors that describe deferred interest plans by using ''no interest'' or similar terms in regard to interest during the deferred interest period would be required to disclose in close proximity to the first listing of such terms: (1) A statement that interest will be charged from the date of purchase if the balance is not paid in full by the end of the deferred interest period; and (2) if applicable, a statement that making only the minimum payment will not pay off the balance or transaction in time to avoid interest charges.

VI. Section-By-Section Analysis of Overdraft Services Subpart Introduction

Historically, if a consumer engaged in a transaction that overdrew his or her account, depository institutions used their discretion on an ad hoc basis to pay the overdraft, usually imposing a fee. The Board recognized this longstanding practice when it initially adopted Regulation Z in 1969 to implement TILA. The regulation provided that these transactions are generally not covered under Regulation Z where there is no written agreement between the consumer and institution to pay an overdraft and impose a fee. *See* 12 CFR § 226.4(c)(3). The treatment of overdrafts in Regulation Z was designed to facilitate depository institutions' ability to accommodate consumers' transactions on an ad hoc basis.

Over the years, most institutions have largely automated the overdraft payment process, including setting specific criteria for determining whether to honor overdrafts and limits on the amount of the coverage provided. From the industry's perspective, the benefits of overdraft, or bounced check, services include a reduction in the costs of manually reviewing individual items, as well as the consistent treatment for all customers with respect to overdraft payment decisions. Moreover, industry representatives assert that overdraft services are valued by consumers, particularly for check transactions, as they allow consumers to avoid additional fees that would be charged by the merchant if the item was returned unpaid, and other adverse consequences, such as the furnishing of negative information to a consumer reporting agency.[73]

In contrast, consumer advocates believe overdraft transactions are a high-cost form of lending that traps low- and moderate-income consumers (particularly students and the elderly) into paying high fees. They also note that consumers are enrolled in overdraft services automatically, often with no chance to opt out. In addition, consumer advocates believe that by honoring check and other types of overdrafts, institutions encourage consumers to rely on this service and thereby consumers incur greater costs. Consumer advocates also express concerns about debit card overdrafts where the dollar amount of the fee may far exceed the dollar amount of the overdraft, and multiple fees may be assessed in a single day for a series of small-dollar transactions.[74]

According to a recent report from the GAO, the average cost of overdraft and insufficient funds fees has increased roughly 11 percent between 2000 and 2007 to just over $26 per item.[75] The GAO also reported that large institutions charged between $4 and $5 more for overdraft and insufficient fund fees compared to smaller institutions. In addition, the GAO Bank Fees Report noted that a small number of institutions (primarily large banks) apply tiered fees to overdrafts, charging higher fees as the number of overdrafts in the account increases.[76]

[73] *See, e.g., Overdraft Protection: Fair Practices for Consumers: Hearing before the House Subcomm. on Financial Institutions and Consumer Credit, House Comm. on Financial Services,* 110th Cong. (2007) (*Overdraft Protection Hearing*) (available at *http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr0705072.shtml*).

[74] *See, e.g., Overdraft Protection Hearing* at n.42; Jacqueline Duby, Eric Halperin & Lisa James, *High Cost and Hidden From View: The $10 Billion Overdraft Loan Market,* Ctr. for Responsible Lending (May 26, 2005) (noting that the bulk of overdraft fees are incurred by repeat users) (available at *www.responsiblelending.org*).

[75] *See Bank Fees: Federal Banking Regulators Could Better Insure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts,* GAO Report 08–281 (January 2008) (GAO Bank Fees Report); *see also Bankrate 2007 Checking Account Study,* posted Sep. 26, 2007 (reporting an average overdraft fee of over $28 per item) (available at: *www.bankrate.com/brm/news/chk/chkstudy/20070924_bounced_check_fee_a1.asp?caret=2e*).

[76] According to the GAO, of the financial institutions that applied up to three tiers of fees in 2006, the average overdraft fees were $26.74, $32.53

Continued

Overdraft services vary among institutions but typically share certain characteristics. Coverage is ''automatic'' for consumers who meet the institution's criteria (*e.g.*, the account has been open a certain number of days, the account is in ''good standing,'' deposits are made regularly). While institutions generally do not underwrite on an individual account basis in determining whether to enroll the consumer in the service initially, 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 overdraft program disclosures state that payment of an overdraft is discretionary on the part of the institution, and disclaim any legal obligation of the institution to pay any overdraft. Typically, the service is extended to also cover non-check transactions, including withdrawals at ATMs, automated clearinghouse (ACH) transactions, debit card transactions at point-of-sale, pre-authorized automatic debits from a consumer's account, telephone-initiated funds transfers, and on-line banking transactions. A flat fee is charged each time an overdraft is paid and, commonly, institutions charge the same amount for paying the overdraft as they would if they returned the item unpaid. A daily fee also may apply for each day the account remains overdrawn.

Where institutions vary most in their provision of overdraft services is the extent to which institutions inform consumers about the existence of the service or otherwise promote the use of the service. For those institutions that choose to promote the existence and availability of the service, they may also disclose to consumers, typically in a brochure or welcome letter, the aggregate dollar limit of overdrafts that may be paid under the service.

Notwithstanding the Agencies' issuance in February 2005 of guidance on overdraft protection programs, the Board's May 2005 final rule under Regulation DD, and NCUA's 2006 final rule under part 707,[77] the Agencies remain concerned about certain aspects of the marketing, disclosure, and implementation of some overdraft services. For example, many consumers may be automatically enrolled in their institution's overdraft service, without being given an adequate opportunity to opt out of the service and avoid the costs associated with the service. While the February 2005 overdraft guidance recommended that consumers be given an opportunity to opt out, this practice may not be uniform across institutions and the opt-out right may not be adequately disclosed to consumers. In addition, the Agencies remain concerned about the adequacy of disclosures provided to consumers regarding the costs of overdraft services.

Thus, pursuant to their authority under 15 U.S.C. 57a(f)(1), the Agencies are proposing to adopt rules prohibiting specific unfair acts or practices with respect to overdraft services. The Agencies would locate these rules in a new Subpart D to their respective regulations under the FTC Act. These proposals should not be construed as a definitive conclusion by the Agencies that a particular act or practice is unfair. The Board is also publishing a separate proposal addressing overdraft services in today's **Federal Register** using its authority under TISA and Regulation DD.

Section ____.31—Definitions

Proposed § ____.31 sets forth certain key definitions to clarify the scope and intent of the provisions addressing unfair acts or practices involving overdraft services.

Account

The Agencies would limit the scope of the overdraft services provisions to ''accounts'' as defined in TISA, Regulation DD, and part 707. Thus, the proposal uses a definition of ''account'' that is limited to ''a deposit account at a depository institution that is held by or offered to a consumer.'' *See* proposed § ____.31(a); 12 CFR 230.2(a) and 707.2(a). Although the Agencies are aware that overdraft services are sometimes provided for prepaid cards, such card products are beyond the scope of this rulemaking.

Consumer

The term ''consumer'' refers to a person who holds an account primarily for personal, family, or household purposes.[78] Thus, the proposal would not cover overdraft services that are provided for business accounts, including sole proprietorships. *See* proposed § ____.31(b).

Overdraft Service

Proposed § ____.31(c) defines ''overdraft service'' to mean a service under which an institution charges a fee for paying a transaction (including a check, point-of-sale debit card transaction, ATM withdrawal and other electronic transaction, such as a preauthorized electronic fund transfer or an ACH debit) that overdraws an account. The term covers circumstances when an institution pays an overdraft pursuant to a promoted program or service or under an undisclosed policy or practice and charges a fee for that service. The term does not, however, include services in which an institution pays an overdraft pursuant to a line of credit subject to the Board's Regulation Z, including transfers from a credit card account, a home equity line of credit or an overdraft line of credit. The term also excludes any overdrafts paid through a service that transfers funds from another account of the consumer held at the institution.

Section ____.32—Unfair Acts or Practices Regarding Overdraft Services

____.32(a) Consumer Right To Opt Out

In the February 2005 overdraft guidance, the FDIC, Board, OCC, OTS, and NCUA recommended as a best practice that institutions should obtain a consumer's affirmative consent to receive overdraft protection. Alternatively, where the consumer is automatically enrolled in overdraft protection, these agencies stated that institutions should provide consumers the opportunity to ''opt out'' of the overdraft program and provide a clear consumer disclosure of this option. 70 FR at 9132; 70 FR at 8431.

While many institutions voluntarily provide consumers the right to opt out of overdraft services,[79] this may not be a uniform practice across all institutions. Moreover, institutions vary significantly in the manner in which they provide notice of the opt-out, leading to the Agencies' concern that the opt-out may not be adequately disclosed to consumers. For instance, some institutions may disclose the opt-out in a clause in their deposit agreement, which many consumers are unlikely to read, or the clause may not be written in clearly understandable language. Others may disclose a consumer's right to opt out in a welcome letter or brochure that highlights the potential benefits of the overdraft service, while minimizing or obscuring either the fees associated with the service or that there may be less costly alternatives to the service.

In addition, opt-out notices may not be provided to consumers at a time

and $34.74, respectively. *See* GAO Bank Fees Report at 14.

[77] See **Background** section of the **SUPPLEMENTARY INFORMATION** for discussion of February 2005 Joint Guidance and OTS Guidance, the 2005 final amendments under Regulation DD, and the 2006 final amendments to part 707.

[78] For purposes of this rulemaking, as it relates to federal credit unions, the term ''consumer'' refers to natural person members.

[79] *See, e.g.*, American Bankers Association, ''Overdraft Protection: A Guide for Bankers'' at 18.

when the consumer is most likely to act. For example, institutions may provide notice of a consumer's right to opt out solely at account opening or when the service is initially added to the consumer's account. Subsequently, however, after experiencing an overdraft and incurring the associated fees, the consumer will typically not receive additional notice of the opt-out right, even though it may be the time at which the consumer is most likely to focus on the merits and cost of the service.

In light of these concerns, the Agencies are proposing to create a new substantive right for consumers to opt out of an institution's overdraft service to ensure that they have a meaningful opportunity to decline the service.

Legal Analysis

Assessing overdraft fees before the consumer has been provided with notice and a reasonable opportunity to opt out of the institution's overdraft service appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. Consumers incur substantial monetary injury due to the fees assessed in connection with the payment of overdrafts. These fees may include per item fees as well as additional fees that may be imposed for each day the account remains overdrawn. As noted above, the GAO Bank Fees Report indicates that the cost to consumers resulting from overdraft loans has grown over the past few years to just over $26 per item.[80] While the payment of overdrafts may allow consumers to avoid merchant fees for a returned check or ACH transaction, there are no similar consumer benefits for ACH withdrawals and point-of-sale debit card transactions. Moreover, consumers relying on overdraft services may be more likely to overdraw their accounts, thereby incurring more overdraft fees in the long run.

Injury is not reasonably avoidable. It appears that consumers cannot reasonably avoid this injury if they are automatically enrolled in an institution's overdraft service without having an opportunity to opt out. Although consumers can reduce the risk of overdrawing their accounts by carefully tracking their credits and debits, consumers often lack sufficient information about key aspects of their account. For example, a consumer cannot know with any degree of certainty when funds from a deposit or a credit for a returned purchase will be made available.

Injury is not outweighed by countervailing benefits. The benefits to consumers and competition from not providing an opt-out do not appear to outweigh the injury. This is particularly the case for ATM withdrawals and POS debit card transactions where, but for the overdraft service, the transaction would typically be denied and the consumer would be given the opportunity to provide other forms of payment without incurring any fees.[81]

Moreover, for many POS debit card transactions, the amount of the fee assessed may substantially exceed the amount of the overdraft loan.[82] This injury to consumers is further aggravated when multiple fees are charged in a single day due to multiple small-dollar overdrafts. Even in the case of check and ACH transactions, where payment of the check or ACH overdraft may allow the consumer to avoid a second fee assessed by the merchant for a returned item as well as possible negative reporting consequences, consumers may prefer instead not to have the overdraft paid to avoid additional daily fees. Furthermore, consumers who have overdraft services may be more likely to rely on the existence of the service and overdraw their accounts and thereby incur substantial fees.[83]

Thus, while many consumers may derive some benefit from having overdraft transactions paid, the proposed rule would allow each consumer to decide whether this benefit sufficiently compensates for the cost of the overdraft fees that will be assessed against his or her account.

Proposal

____.32(a)(1) General Rule

Under § ____.32(a)(1), institutions would be prohibited 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 consumer's right to opt out of an institution's overdraft service would apply to all methods of payment, including check, ACH and other electronic methods of payment, such as ATM withdrawals and POS debit card transactions. Institutions would also be required to provide consumers with the option of opting out only of overdrafts at ATMs and for POS debit card transactions under proposed § ____.32(a)(2), discussed below.

The proposal would require notice of the opt-out to be provided both before the institution's assessment of any fee or charge for paying an overdraft to allow consumers to avoid overdraft fees altogether, and subsequently at least once during or for each periodic statement cycle in which any overdraft fee or charge is assessed to the consumer's account. The subsequent notice requirement is intended to ensure that consumers are given notice of their right to opt out at a time that may be most relevant to them, that is, after they have been assessed fees or other charges for the service. The institution would have flexibility with respect to the means by which it provides notice of

[80] *See* GAO Bank Fees Report at 13–14; *see also* Marc Fusaro, *Hidden Consumer Loans: An Analysis of Implicit Interest Rates on Bounced Checks,* J. of Fam. & Econ. Issues (forthcoming June 2008) *(Hidden Consumer Loans)* (citing a Moebs $ervices estimate that 60% of service charge income comes from insufficient funds fees) (available at: *http://personal.ecu.edu/fusarom/fusarobpinterestrates.pdf);* Eric Halperin and Peter Smith, *Out of Balance: Consumers Pay $17.5 Billion Per Year in Fees for Abusive Overdraft Loans,* Center for Responsible Lending (July 11, 2007) (available at: *http://www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf*) (estimating that consumers paid over $17 billion in fees for overdraft loans in 2006); Howard Mason, *The Criminal Risk of Actively-Marketed Bounce Protection Programs,* Bernstein Research Call (Feb. 18, 2005) (suggesting that bounce protection programs account for 2/3 or more of industry NSF fees of an estimated $12–14 billion); Howard Mason, *Impact of Regulatory Best Practices on Bounce Protection Services and NSF Fees,* Bernstein Research Call (Feb. 17, 2005) (estimating that overdraft and NSF fees make up approximately half of service charge income).

[81] According to one consumer group survey, most respondents preferred that their debit card be declined for insufficient funds at the checkout rather than having the overdraft paid and being assessed a fee. Eric Halperin, Lisa James and Peter Smith, *Debit Card Danger,* Center for Responsible Lending at 9 (Jan. 25, 2007) (available at: *http://responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf).*

[82] *See* Eric Halperin, *Testimony on Overdraft Protection: Fair Practices for Consumers Before the House Comm. on Financial Services, Subcomm. on Fin. Instits. & Consumer Credit* at 6 (July 11, 2007) (stating that consumers pay $1.94 in fees for every one dollar borrowed to cover a debit card POS overdraft) (available at: *http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr0705072.shtml*).

[83] Some economic research suggests that when a bank pays overdrafts through an overdraft program, consumers overdraw their accounts more often. *See* Fusaro, *Hidden Consumer Loans* at 6. This finding is consistent with assertions by some third-party vendors of overdraft protection services that implementation of overdraft protection can result in a substantial increase in fee income from overdraft and insufficient funds fees. *See, e.g., http://www.banccommercegroup.com/aarp.html* (''guaranteeing'' that use of overdraft protection can increase revenue from insufficient funds income by at least 50%) (visited Mar. 21, 2008); *http://www.cetoandassociates.com/index.php?option=com_content&task=view&id=147&Itemid=102* (representing that overdraft protection can increase insufficient funds revenue by 200%) (visited Mar. 21, 2008); *http://www.jmfa.com/pageContent.aspx?id=126* (reporting an increase of 50–300% in insufficient funds revenue for clients) (visited Mar. 21, 2008).

the consumer's opt-out right following the payment of the overdraft.

For example, the consumer may be given notice on a periodic statement that reflects the imposition of fees associated with payment of an overdraft. Alternatively, the opt-out right may be disclosed on a notice that the institution may send promptly after the payment of an overdraft to alert the consumer of the overdraft, as is the practice of many institutions. (Under the latter option, institutions need only provide the opt-out notice once during a statement period, even if multiple fees are charged in a single period.) The requirement to provide subsequent notice of the opt-out would terminate if the consumer has exercised this right. *See* proposed § ___.32(a)(1). Of course, if the consumer opts out after having incurred an overdraft fee, the opt-out would apply only to subsequent transactions and the consumer would remain responsible for the fee.

The Agencies are nevertheless aware that an opt-out will not provide a meaningful consumer protection if the notice of the opt-out right is not presented in a clear and conspicuous manner to a consumer, or if the notice does not contain sufficient information for the consumer to make an informed choice. Thus, in a separate proposal under TISA and Regulation DD in today's **Federal Register**, the Board is proposing additional amendments regarding the form, content and timing requirements for the opt-out notice. *See* proposed comment 32(a)(1)–1.[84] As part of the rulemaking process, the Board intends to conduct consumer testing on the proposed opt-out form to ensure that the notice is presented effectively to consumers in a format they can easily understand and use. The Agencies anticipate issuing any final rules simultaneously after reviewing comments received on both proposals.

___.32(a)(2) Partial Opt-Out

Some consumers may want their institution to pay overdrafts by check and ACH, but do not want overdrafts paid in other circumstances, such as for ATM withdrawals and debit card transactions at a point-of-sale.[85] Thus, the proposed rule requires institutions to provide consumers with the option of opting out only of the payment of overdrafts at ATMs and for debit card transactions at the point-of-sale. *See* § ___.32(a)(2). As previously stated, the Agencies note that a consumer that opts out of an overdraft protection service typically also incurs a cost when the check is returned and an insufficient funds fee is charged by the institution (and possibly also by the merchant). Accordingly, the partial opt-out requirement in § ___.32(a)(2) is intended to allow consumers the ability to determine for themselves whether they prefer that their institution deny the payment of all overdrafts, or to have overdrafts paid for check and ACH transactions in order to avoid potential merchant fees for returned items or other adverse consequences. While the Agencies understand that some processors do not currently have systems capable of paying overdrafts for some, but not all, payment channels, it appears that the benefits of providing consumers a choice regarding the transaction types for which they want to have overdrafts paid outweighs the potential programming costs associated with this requirement.

As further discussed below, in light of the potential benefits to consumers if overdrafts for check and ACH transactions are paid, the Agencies seek comment on whether the consumer's right to opt out should be limited to overdrafts caused by ATM withdrawals and debit card transactions at a point-of-sale. Under this alternative approach, institutions would be permitted, but not required, to provide consumers the option of opting out of the payment of overdrafts for check and ACH transactions.

___.32(a)(3) Exceptions

In some cases, an institution may not be able to avoid paying a transaction that overdraws an account. Under the proposal, if the institution does pay an overdraft, the consumer's decision to opt out of the institution's overdraft service would not prohibit institutions from paying overdrafts in all cases. Rather, if the institution does pay an overdraft, the consumer's decision to opt out would generally prohibit the institution from assessing a fee for the service. The Agencies recognize, however, that, in certain narrow circumstances, it may be appropriate to allow institutions to assess a fee or charge for paying an overdraft even where the consumer has elected to opt out.

Section ___.32(a)(3)(i) would permit an institution to charge an overdraft fee for a debit card transaction if the purchase amount presented at settlement by a merchant exceeds the amount that was originally requested for pre-authorization.[86] This exception is intended to cover circumstances in which the settlement amount exceeds the authorization amount because the precise transaction amount is not known to the consumer at the time of the transaction. (This situation is distinct from the circumstances discussed below with respect to the proposed prohibition of assessing an overdraft fee in connection with debit holds in which the authorization amount exceeds the actual purchase amount presented at settlement.)

For example, for some fuel purchases, the consumer may swipe his or her debit card and the merchant may seek a $1 pre-authorization that is primarily intended to verify whether the consumer's account is valid. After the consumer has completed the fuel purchase, the merchant will submit the actual amount of the purchase for settlement, which may cause the consumer to incur an overdraft. Similarly, for restaurant meals, the settlement amount may not match the amount submitted for pre-authorization if the consumer elects to add a tip to the amount of the bill. Proposed comments 32(a)(3)(i)–1 and –2 illustrate this exception for fuel purchases and restaurant transactions.

The second exception is intended to address circumstances in which a merchant or other payee presents a debit card transaction for payment by paper-based means, rather than electronically using a card terminal, and in which the payee does not obtain authorization from the card issuer at the time of the transaction. For example, the merchant may use a card imprinter to take an imprint of the consumer's card and later submit the sales slip with the imprint to its acquirer for payment. In this circumstance, the card issuer does not learn about the transaction, and thus cannot verify whether the consumer has sufficient funds, until it receives the sales slip presenting the transaction for payment. Section ___.32(a)(3)(ii) would permit an institution to assess an overdraft fee or charge if the transaction causes the consumer to overdraw his or her account, despite the consumer's election to opt out. Proposed comment 32(a)(3)(ii)–1 illustrates this exception.

The Agencies considered, but are not proposing, an exception that would

[84] While NCUA is not proposing amendments to its 12 CFR part 707 in today's **Federal Register**, TISA requires NCUA to promulgate regulations substantially similar to Regulation DD. Accordingly, NCUA will issue amendments to part 707 following the Board's adoption of final rules under Regulation DD.

[85] *See* Haperin, *et al.*, *Debit Card Danger* at 3 (concluding that debit card POS overdraft loans are more costly than overdraft loans from other sources, such as overdrafts by check).

[86] Pre-authorization describes the dollar amount of funds that are held on a consumer's account (or against a credit line) when a card is swiped to initiate a transaction. This typically occurs in connection with debit and credit card transactions in which the actual dollar amount of the transaction is not known until the end of the transaction.

allow an institution to impose an overdraft fee despite a consumer's opt-out election as long as the institution did not ''knowingly'' authorize a transaction that resulted in an overdraft. The Agencies are concerned, however, that given the difficulty in determining a consumer's ''real-time'' account balance at any given time, such an exception would undercut the protections provided by a consumer's election to opt out. At the same time, the Agencies recognize that a rule that generally prohibits institutions from imposing an overdraft fee if the consumer has opted out could adversely impact small institutions that use a daily batch balance method for authorizing transactions. Because such institutions do not update the balance during the day to reflect other authorizations or settlements for transactions that occurred before the authorization request, their authorization decisions would be based upon the same dollar amount throughout the day. Accordingly, it would be infeasible for these institutions to determine at any given point in time whether the consumer in fact has a sufficient balance to cover the requested transaction. Similarly, institutions that use a stand-in processor because, for example, the ATM network is temporarily off-line, would also be unable to determine at the time of the transaction whether the consumer's balance is sufficient to cover a requested transaction. In both of these cases, a transaction could result in an overdraft but the institution would not be able to assess a fee for that service. Thus, as discussed below in the request for comment, the Agencies seek comment on whether exceptions are necessary to address these circumstances, and if so, how such exceptions may be narrowly tailored so as not to undermine protections afforded by a consumer's election to opt out. Comment is also requested on whether there are additional circumstances in which an exception may be appropriate to allow an institution to impose a fee in connection with paying an overdraft, notwithstanding a consumer's election to opt out.

____.32(a)(4)–(6)

Section ____.32(a)(4) provides that institutions must comply with a consumer's opt-out request as soon as reasonably practicable after the institution receives it. Proposed § ____.32(a)(5) provides that a consumer may opt out of an institution's overdraft service at any time since consumers may decide later in the account relationship not to have overdrafts paid. Once exercised, the consumer's opt-out remains in effect unless subsequently revoked by the consumer in writing or, if the consumer agrees, electronically. See § ____.32(a)(6).

Request for Comment

The Agencies request comment on:

- Whether the scope of the consumer's opt-out right under § ____.32(a)(1) should be limited to ATM transactions and debit card transactions at the point-of-sale. Under this alternative approach, institutions would be permitted, but not required, to provide consumers the option of opting out of the payment of overdrafts for check and ACH transactions.
- The potential costs and consumer benefits for implementing a partial opt-out that applies only to ATM transactions and debit card transactions at the point-of-sale.
- Whether there are other circumstances in which an exception may be appropriate to allow an institution to impose a fee or charge for paying an overdraft even if the consumer has opted out of the institution's overdraft service, and if so how to narrowly craft such an exception so as not to undermine protections provided by a consumer's opt-out election.

Debit Holds

____.32(b) Debit Holds

Debit holds occur when a consumer uses a debit card for a transaction in which the actual purchase amount is not known at the time the transaction is authorized, causing the merchant (and in some cases the card-issuing bank) to place a hold on the consumer's account for an amount that may be in excess of the actual purchase amount in order to protect against potential risk of loss. For example, this may occur at a pay-at-the pump fuel dispenser, restaurant, or hotel. For example, for fuel purchases, card network rules may allow the merchant to place a pre-authorization hold of up to $75 on the consumer's account in certain types of debit card transactions.[87] Similarly, a hotel may place a hold on the consumer's account in an amount sufficient to cover the length of the stay, plus an additional amount for incidentals, such as anticipated room service charges.

While the merchant generally determines the hold amount based on limits imposed by the card network, it is the card-issuing financial institution that determines how long the hold remains in place, also subject to any limits imposed by the card network rules. Typically, the hold is kept in place until the transaction amount is presented to the financial institution for payment and settled. While PIN-based debit card transactions typically settle on the same day the card is used by the consumer (assuming the transaction takes place before the processing cut-off time that day), settlement for signature-based transactions may take up to three days following authorization. During the time between authorization and settlement, the hold remains in place on the consumer's account. In some cases, where the merchant does not use the same transaction number for both the authorization and the settlement, both the authorization amount and the settlement amount are held on the consumer's account until the institution is able to reconcile the transactions.

The Agencies are concerned that consumers unfamiliar with debit hold practices may inadvertently incur considerable overdraft fees on the assumption that the available funds in their account will only be reduced by the actual purchase amount of the transaction. For example, a consumer who purchases $20 worth of gas, but has a debit hold of $75 placed on the funds in the consumer's account, may not realize that $55 has been made unavailable to the consumer to use until the merchant presents the transaction for payment. During that time, the consumer engaging in a subsequent transaction in the belief that they have only ''spent'' $20, may inadvertently spend more than the available amount in the consumer's account, incurring overdraft fees in the process.

Legal Analysis

Assessing an overdraft fee when the overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount appears to be an unfair act or practice under 15 U.S.C. 45(n) and the standards articulated by the FTC.

Substantial consumer injury. There is substantial injury to consumers from incurring overdraft fees resulting from debit hold amounts that exceed the amount of the transaction. The effect can be compounded if the consumer conducts more than one transaction overdrawing his or her account, as a fee is generally charged each time the consumer overdraws the account.

Injury is not reasonably avoidable. It appears that consumers cannot reasonably avoid this injury as they are generally unaware of the practice of debit holds. Even if the consumer were

[87] Other merchants may instead only place a pre-authorization hold of $1 in order to verify that the consumer's account is valid.

to receive notice at point of sale that a hold, including the amount, will be placed on the consumer's funds, the consumer cannot know the length of time the hold will remain in place. As discussed above, the length of a hold will vary depending on how fast the transaction is processed and the procedures of the consumer's account-holding institution. A consumer cannot reasonably be expected to verify whether a hold remains in place before each and every subsequent transaction.

Injury is not outweighed by countervailing benefits. The benefits to consumers and competition from allowing fees for an overdraft to be charged when the overdraft was caused by a debit hold amount that exceeds the transaction amount do not appear to outweigh the injury. The Agencies understand that financial institutions charge overdraft fees in part to account for the potential risk the institution may assume if the consumer does not have sufficient funds for a requested transaction. Under card network rules generally, institutions guarantee merchants payment for debit card transactions that were properly authorized by the consumer. Accordingly, without the ability to assess overdraft fees to protect against potential losses due to non-payment, account-holding institutions may be reluctant to issue debit cards to consumers.

The Agencies note, however, that the card issuing financial institution is not required to send payment for an authorized transaction until the transaction is presented for settlement by the merchant and is posted to the consumer's account. At this time, any potential loss for the financial institution is not for the amount of the debit hold, but rather for the actual purchase amount for the transaction. The proposed provision would not prohibit institutions from assessing an overdraft fee if the consumer's account has insufficient funds to cover the actual purchase amount when the transaction is presented for settlement (and the consumer has not opted out). Thus, because the provision would allow account-holding institutions to cover their risk of loss in the event consumers overdraw their accounts for the purchase amount of the transaction, it appears that the availability of debit cards for consumers will not be adversely impacted even if this proposal is adopted. The proposed provision, however, would allow consumers to avoid the injury of unwarranted overdraft fees caused by debit holds that exceed the purchase amount of the requested transaction.

Proposal

As discussed above, proposed § ____.32(b) would provide that an institution must not assess a fee or charge on the consumer's account in connection with an overdraft service if an 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 Agencies believe that a substantive ban on assessing fees to address problems with debit holds is appropriate rather than disclosure of the existence of the hold in light of concerns that such disclosures may be ineffective for the reasons discussed above.

Comment 32(b)–1 as proposed clarifies that the prohibition against assessing an overdraft fee in connection with a debit hold applies only if the overdraft is caused solely by the existence of the hold. Thus, if there are other reasons or causes for the consumer's overdraft, the institution may assess an overdraft fee or charge. These reasons may include other transactions that may have been authorized but not yet presented for settlement, a deposited check in the consumer's account that is returned, or if the actual purchase or transaction amount for the transaction for which the hold was placed would have caused the consumer to overdraw his or her account.

Application of the rule is illustrated by four separate examples set forth in proposed commentary provisions. *See* comments 32(b)–2 through –5. The first example describes the circumstance where the amount of the hold for an authorized transaction exceeds the consumer's balance. For example, assume that a consumer with $50 in his deposited account purchases $20 worth of fuel. In authorizing the consumer to begin dispensing fuel after the consumer has swiped his or her debit card at the pump, the gas station imposes a hold for $75 on the consumer's account. The proposal would prohibit the consumer's financial institution from assessing an overdraft fee or charge because the purchase amount for the fuel would not have caused the consumer to overdraw his or her account. See proposed comment 32(b)–2. However, had the consumer purchased $60 of fuel, the institution would be permitted to assess an overdraft fee or charge (assuming the consumer had not opted out of the overdraft service) because the transaction exceeds the consumer's account balance.

The second example illustrates the prohibition when the hold is made in connection with another transaction that has been authorized by the institution but not yet been presented for settlement. To illustrate, assume the same consumer as in the prior example has $100 in his deposit account, and uses his or her debit card to purchase fuel. The gas station puts a hold for $75 on the consumer's account. The consumer purchases $20 worth of fuel. Later that day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Under this example, the consumer's account-holding institution would be prohibited from assessing an overdraft fee or charge in connection with the $75 withdrawal because the overdraft would not have occurred but for the $75 hold. *See* proposed comment 32(b)–3.

The third example illustrates the prohibition when both the authorization amount and the settlement amount are held against the consumer's account, because the merchant did not use the same transaction code for both authorization and settlement, causing the institution to later reconcile the transaction. To illustrate, assume a consumer has $100 in his deposit account, and uses his debit card to purchase $50 worth of fuel. At the time the consumer swipes his debit card at the fuel pump, a hold of $75 is placed on the consumer's account. Because the merchant does not use the same transaction code for both the pre-authorization and for settlement, the consumer's account is temporarily overdrawn. Because the overdraft would not have occurred but for the existence of the $75 hold, the institution may not assess a fee or charge for paying an overdraft. *See* proposed comment 32(b)–4.

The fourth example illustrates a circumstance in which an institution may charge an overdraft fee despite the existence of a hold on funds in the consumer's account because there are other reasons for the overdraft. Using the same facts as in the example in proposed comment 32(b)–3, the consumer makes a $35 purchase of fuel, instead of $20. Under the third example, the institution could permissibly charge an overdraft fee or charge for the subsequent $75 ATM withdrawal because the consumer would have incurred the overdraft even if the hold had been for the actual amount of the fuel purchase. *See* proposed comment 32(b)–5.

Request for Comment

The Agencies seek comment on the operational issues and costs of implementing the proposed prohibition on the imposition of overdraft fees if the overdraft occurs solely because of the existence of a hold.

Other Overdraft Practices

Balance Disclosures

The Agencies are also concerned about balance disclosures that may be deceptive to consumers if they represent that the consumer has more funds in his or her account due to the inclusion of additional funds the institution may provide to cover an overdraft. The Board is addressing this issue in a Regulation DD proposal published contemporaneously with today's proposed rule.

Transaction Clearing Practices

The Agencies are also concerned 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 lists as a best practice explaining the impact of transaction clearing policies to consumers, including 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.[88] 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.[89]

While today's proposal does not address transaction clearing practices, the Agencies solicit 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. Under such an approach, institutions could use an alternative clearing order, provided that it discloses this option to the consumer and the consumer affirmatively opts in. The Agencies solicit comment on how such a rule would impact an institution's ability to process transactions on a real-time basis.

VII. Effective Date

The Agencies solicit comment on when any final rules should be effective and whether a one-year time period is appropriate or whether the period should be longer or shorter.

[88] 70 FR at 8431; 70 FR at 9132.

[89] 70 FR at 8431.

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.

However, 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. Based on its analysis and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

1. *Statement of the need for, and objectives of, the proposed 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 proposing regulations under the FTC Act to protect consumers from specific unfair or deceptive acts or practices regarding consumer credit card accounts and overdraft services. The Board's proposed rule will revise Regulation AA.

Proposals Regarding Consumer Credit Card Accounts

The proposed requirements would provide several substantive protections for consumers against unfair or deceptive acts or practices with respect to consumer credit card accounts. First, proposed § 227.22 ensures that consumers' credit card payments are not treated as late unless they have been provided a reasonable amount of time to make payment. Second, proposed § 227.23 would ensure that, when different annual percentage rates apply to different balances on a credit card account, consumers' payments in excess of the required minimum payment are allocated among the balances, rather than exclusively to the balance with the lowest annual percentage rate. Third, under proposed § 227.24, an increase in the annual percentage rate could not be applied to the outstanding balance on a credit card account, except in certain circumstances. Fourth, proposed § 227.25 would protect consumers from being assessed a fee if the credit limit is exceeded solely due to a hold placed on the available credit. Fifth, proposed § 227.26 would prohibit institutions from reaching back to days in earlier billing cycles when calculating the amount of interest charged in the current cycle. Sixth, proposed § 227.27 would ensure that security deposits and fees for the issuance or availability of credit (such as account-opening fees or membership fees) do not consume the majority of the available credit on a credit card account during the twelve months after the account is opened. In addition, when such amounts exceed 25 percent of the credit limit, they must be spread equally among the eleven billing cycles following the first billing cycle. Seventh and last, proposed § 227.28 would require institutions to disclose in a firm offer of credit the criteria that will determine whether consumers receive the lowest annual percentage rate and highest credit limit.

Proposals Regarding Overdraft Services

The proposed rule would also provide substantive protections against unfair or deceptive acts or practices with respect to overdraft services. Proposed § 227.32 is intended to ensure that consumers understand overdraft services and have the choice to avoid the associated costs where such services do not meet their needs. First, consumers could not be assessed a fee or charge for paying an overdraft unless the consumer is provided with the right to opt out of the payment of overdrafts and a reasonable opportunity to exercise that right but does not do so. Second, the proposal would protect consumers from being assessed an overdraft fee if the overdraft is caused solely by a hold on funds.

2. *Small entities affected by the proposed rule.* The Board's proposed rule would apply to banks and their subsidiaries, except savings associations as defined in 12 U.S.C. 1813(b). Based on 2007 call report data, there are approximately 2,159 banks with assets of $165 million or less that would be required to comply with the Board's proposed rule.

3. *Recordkeeping, reporting, and compliance requirements.* The proposed rule does not impose any new recordkeeping or reporting requirements. The proposed rule would, however, impose new compliance requirements.

Proposals Regarding Consumer Credit Card Accounts

Proposed § 227.22 may require some banks to extend the period of time provided to consumers to make payments on consumer credit card accounts. The Board notes, however, that some 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 proposed rule. Thus, small entities following this practice would not be required to alter their systems or procedures.

Proposed § 227.23 would require small entities that provide consumer credit card accounts with multiple balances at different rates to redesign their systems to allocate payments in excess of the minimum payment among the balances, consistent with the proposed rule. Compliance with this proposal may also reduce interest revenue for small entities that currently allocate payments first to balances with the lowest annual percentage rate. Similarly, compliance with proposed § 227.24 will also reduce interest revenue because such entities would be prohibited from increasing the annual percentage rate on an outstanding balance, except in certain circumstances. However, small entities are likely to adjust other terms (such as increasing the annual percentage rates offered to consumers when the account is opened) to compensate for the loss of revenue. In addition, although proposed § 227.24 will limit the ability of small entities to impose higher rates on pre-existing balances, it would permit small entities to increase the rates applicable to new transactions. Furthermore, the use of variable rates that reflect market conditions could mitigate this effect because proposed § 227.24 does not apply to variable rates. Finally, proposed § 227.24 would also permit small entities to apply an increased rate to an outstanding balance when a promotional rate is lost or expires or when the consumer's payment has not been received within 30 days after the due date.

Proposed § 227.25 would require small entities that provide credit cards to redesign their systems to prevent the assessment of fees for exceeding the credit limit that are caused by holds on the available credit. Similarly, proposed § 227.26 could require some small entities that provide credit cards to change the way finance charges are calculated, although the Board understands that few institutions still use the prohibited method.

Proposed § 227.27 would require small entities that provide credit cards to modify their systems in order to track security deposits and fees for the issuance or availability of credit that are charged to the account during the first year. This proposal could also reduce revenue derived from security deposits and fees. These costs, however, would likely be borne by the few entities offering cards with security deposits and fees that consume a majority of the credit limit.

Proposed § 227.28 would require small entities to disclose that, if the consumer is approved for credit, the annual percentage rate and the credit limit the consumer will receive will depend on specific criteria bearing on creditworthiness. Because similar disclosures are required by the FCRA, this proposal should not result in substantial compliance costs.

Proposals Regarding Overdraft Services

Proposed § 227.32 would convert current Board guidance regarding provision of a notice and opportunity to opt out of overdraft services into a rule. Thus, this proposal should not have a significant impact on small entities if those entities are currently providing opt-out notices. Proposed § 227.32 would also require small entities to redesign their systems to prevent the assessment of overdraft fees that are caused by holds on the available credit.

4. *Other federal rules.* The Board has not identified any federal rules that duplicate, overlap, or conflict with the proposed revisions to Regulation AA.

5. *Significant alternatives to the proposed revisions.* One approach to minimizing the burden on small entities would be to provide a specific exemption for small institutions. However, the FTC Act's prohibition against unfair or deceptive acts or practices makes no provision for exempting small institutions and the Board has no specific authority under the FTC Act to grant an exception that would remove small institutions. Further, in considering rulemaking under the Act, the Board believes an act or practice that is unfair or deceptive remains so despite the size of the institution engaging in such act or practice and, thus, should not be exempt from this rule.

In addition, the Board believes the proposed rule, where appropriate, provides for 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, thus, mitigate any incremental burden that may be created by the proposed rule. For instance, § 227.23, which addresses payment allocation, provides an institution a choice of payment allocation methods.

The Board solicits comment on any significant alternatives that would minimize the impact of the proposed rule on small entities.

OTS: The Regulatory Flexibility Act (5 U.S.C. 601–612) (RFA) requires an agency to either provide an Initial Regulatory Flexibility Analysis with a proposed rule or certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. For purposes of the RFA and OTS-regulated entities, a ''small entity'' is a savings association with assets of $165 million or less (small savings association). Based on its analysis and for the reason stated below, OTS certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities.

1. Reasons for Proposed Rule

This proposed rule is promulgated pursuant to section 18(f)(1) of the FTC Act (15 U.S.C. 57a(f)(1)), which makes OTS responsible for prescribing regulations that prevent savings associations from engaging in unfair or deceptive acts or practices in or affecting commerce within the meaning of section 5(a) of the FTC Act (15 U.S.C. 45(a)). OTS, the Board, and the NCUA are jointly proposing this rule to protect consumers against unfair or deceptive acts or practices with respect to consumer credit card accounts and overdraft services for deposit accounts. The Agencies have identified a number of business practices that present a significant risk of harm to consumers of these products and services. As discussed in the **SUPPLEMENTARY INFORMATION**, the Agencies have acquired information about these practices from several sources, including consumer complaints, supervisory observations, and comments received on OTS's ANPR issued August 6, 2007 and the Board's Reg. Z open-end proposal issued June 14, 2007.

2. Statement of Objectives and Legal Basis

The **SUPPLEMENTARY INFORMATION** above contains this information. The legal basis for OTS's portion of the proposed rule is section 57(a) of the FTC Act and HOLA.

3. Description and Estimate of Small Entities to Which the Rule Applies

OTS's portion of the proposed rule would apply to savings associations and their subsidiaries. There are 407 thrifts with $165 million in assets or less. There are 26 thrifts with $165 million in assets or less that offer credit cards. Many of the thrifts with $165 million in assets or less offer overdraft services.

4. Projected Recordkeeping, Reporting, and Other Compliance Requirements

The proposed rule would not have a significant impact on a substantial number of small entities. It imposes no new recordkeeping requirements or new requirements to report information to the Agencies.

Some of the proposed requirements are not new. Section 535.13, which involves providing disclosures to consumers so that consumers will know their rights and responsibilities as cosigners on consumer loans, is merely a recodification of a long-standing requirement currently codified in section 535.3. Section 535.32, which would require institutions to provide a notice and opportunity to consumers to opt out of overdraft services on deposit accounts, would turn current OTS guidance into a rule. Thus, these provisions of the proposed rule would not have a significant impact on small entities.

The proposal in section 535.28 is new, and would require savings associations that make a solicitation for a firm offer of credit for a consumer credit card account to include certain consumer disclosures in the solicitations. Since savings associations will have developed this information in preparing the firm offer, the burden would be limited to placing an appropriate disclosure in the solicitation and, therefore, would not have a significant impact on small entities.

The professional skills necessary for preparation of the consumer disclosures under sections 535.13 and 535.28 are the same skills needed to prepare disclosures under many other consumer protection laws and regulations, such as the Truth in Lending Act/Reg. Z (12 CFR part 226) and the Truth in Savings Act/Reg. DD (12 CFR part 230). The professional skills necessary for preparation of the notice and opt-out notice under section 535.32 are the same skills needed to prepare opt-out notices under a variety of consumer protection laws and regulations, such as the Privacy Rule (12 CFR part 573) issued under the Gramm-Leach-Bliley Act and the Fair Credit Reporting Act Rule (12 CFR part 571) . These professional skills could include attorneys and compliance specialists, as well as computer programmers.

In addition to disclosures and opt-out notices, the proposed rule would impose some additional compliance requirements. Under section 535.22, a savings association may need to extend the period of time it gives consumers to make credit card account payments. Under section 535.23, a savings association may need to change the way it allocates credit card account payments among multiple account balances. Under section 535.24, a savings association may need to change the circumstances in which it can raise interest rates on outstanding credit card account balances. Under section 535.25, a savings association may need to change the circumstances in which it imposes over limit fees. Under section 535.26, a savings association may need to change the way it computes finance charges on outstanding credit card account balances. Under section 535.27, a savings association may need to change the way it collects security deposits and fees for a credit card's issuance or availability of credit. Each of these provisions could require some adjustments to a savings association's operations and require some additional training of staff as well as computer programming.

Many savings associations already employ the professionals that would be needed to meet the requirements that would be imposed by the rule as proposed rule, since they need these professionals to meet other existing consumer protection requirements. The others have pre-existing arrangements with third party service providers to perform the functions that would be affected by this rulemaking.

In addition, as discussed in the Executive Order 12866 analysis, most of the practices which the proposed provisions would impact are not common among savings associations.

Accordingly, the proposed provisions would not have a significant impact on small entities.

While OTS believes the proposed rule does not have a significant impact on a substantial number of small entities, OTS, nevertheless, requests comment and data on the size and incremental burden on small savings associations that would be created by the proposed rule.

5. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

OTS has not identified any federal statutes or regulations that would duplicate, overlap, or conflict with the proposed rule. As discussed in the **SUPPLEMENTARY INFORMATION**, the laws of only three states have been found by any of the Agencies to provide substantially equivalent rights as the existing Credit Practices rule. OTS seeks comment regarding any statutes or regulations, including state or local statutes or regulations, which would duplicate, overlap, or conflict with the proposed rule.

6. Discussion of Significant Alternatives

One approach to minimizing the burden on small entities would be to provide a specific exemption for small institutions. However, the FTC Act's prohibition against unfair or deceptive acts or practices makes no provision for exempting small institutions and OTS has no specific authority under the FTC Act to grant an exception that would remove small institutions. Further, in contemplating rulemaking under the Act, OTS believes an act or practice that is unfair or deceptive remains so despite the size of the institution engaging in such act or practice and, thus, should not be exempt from this rule.

In addition, OTS believes the proposed rule, where appropriate, provides for sufficient flexibility and choice for institutions, including small entities. As such, any savings association, regardless of size, may tailor its operations to its individual needs and, thus, mitigate any incremental burden that may be created by the proposed rule. For instance, Section 535.23, unfair payment allocations, provides an institution a choice of payment allocation methods.

OTS welcomes comments on any significant alternatives that would minimize the impact of the proposed rule on small entities.

NCUA: Under the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, NCUA must publish an initial regulatory flexibility analysis with its proposed rule, unless NCUA certifies the rule will not have a significant economic impact on a substantial number of small entities. For NCUA, these are federal credit unions with less than $10 million in assets. NCUA certifies this proposed rule would not have a significant economic impact on a substantial number of small entities.

1. Reasons for Proposed Rule

NCUA is exercising authority under section 18(f)(1) of the Federal Trade Commission Act, 15 U.S.C. 57a(f)(1), and proposing to prohibit certain unfair or deceptive acts or practices (UDAPs) that violate section 5(a) of the Federal Trade Commission Act, 15 U.S.C. 45(a). The proposed rule reorganizes and renames NCUA's longstanding Credit Practices Rule, 12 CFR part 706, and addresses UDAPs involving credit cards and overdraft protection services. NCUA, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision are jointly proposing this rule to protect consumers against unfair or deceptive acts or practices with respect to consumer credit card accounts and overdraft services for deposit accounts.

2. Statement of Objectives and Legal Basis

The **SUPPLEMENTARY INFORMATION** above contains this information. The legal basis for the proposed rule is sections 45(a) and 57(a) of the FTC Act.

3. Description and Estimate of Small Entities to Which the Rule Applies

NCUA's portion of the proposed rule would apply to all federal credit unions. As of December 31, 2007, there are 5,036 federal credit unions, of which 2,374 have total assets less than $10 million. NCUA estimates 2,363 small credit unions offer loans to their members. NCUA does not believe the disclosure requirements for co-signors will significantly affect small credit unions because all credit unions have complied with this requirement since 1987, when the credit practices rule was initially promulgated. This proposed rule does not change the co-signor disclosure requirements, but renumbers the applicable sections of the rule.

The proposed rule contains new requirements regarding credit card accounts and overdraft protection services. Approximately 2,461 federal credit unions issue credit cards and have an aggregate portfolio of $18.92 billion. Of these, 425 small federal credit unions issue credit cards and have an aggregate credit card portfolio of approximately $124.73 million. Approximately 2,094 federal credit unions offer overdraft protection service, and 353 of these are small federal credit unions.

4. Projected Recordkeeping, Reporting, and Other Compliance Requirements

The proposed rule does not impose any new recordkeeping or reporting requirements. The proposed rule would, however, impose new compliance requirements.

Some of the proposed requirements are not new. Section 706.13, which involves providing disclosures to cosigners on consumer loans, is a recodification of a long-standing requirement currently in § 706.3. Section 703.32, which would require institutions to provide a notice and opportunity to consumers to opt out of overdraft services on deposit accounts, would turn current interagency guidance into a rule. Thus, these provisions of the proposed rule would not have a significant impact on small entities.

The proposal in § 706.28 is new, and would require federal credit unions that make a solicitation for a firm offer of credit for a consumer credit card account to include certain consumer disclosures in the solicitations. Since federal credit unions will have developed this information in preparing the firm offer, the burden would be limited to placing an appropriate disclosure in the solicitation and, therefore, would not have a significant impact on small entities.

The professional skills necessary for preparation of the consumer disclosures under §§ 706.13 and 706.28 are the same skills needed to prepare disclosures under many other consumer protection laws and regulations, such as the Truth in Lending Act, Regulation Z (12 CFR part 226), and the Truth in Savings Act and part 707 (12 CFR part 707). The professional skills necessary for preparation of the notice and opt-out notice under § 706.32 are the same skills needed to prepare opt-out notices under a variety of consumer protection laws and regulations, such as the Privacy Rule (12 CFR part 716) issued under the Gramm-Leach-Bliley Act and the Fair Credit Reporting Act Rule (12 CFR part 717). These professional skills could include attorneys and compliance specialists, as well as computer programmers.

In addition to disclosures and opt-out notices, the proposed rule would impose some additional compliance requirements. Under § 706.22, a federal credit union may need to extend the period of time it gives consumers to make credit card account payments. Under § 706.23, a federal credit union may need to change the way it allocates credit card account payments among multiple account balances. Under § 706.24, a federal credit union may need to change the circumstances in which it can raise interest rates on outstanding credit card account balances. Under § 706.25, a federal credit union may need to change the circumstances in which it imposes over limit fees. Under § 706.26, a federal credit union may need to change the way it computes finance charges on outstanding credit card account balances. Under § 706.27, a federal credit union may need to change the way it collects security deposits and fees for a credit card's issuance or availability of credit. Each of these provisions could require some adjustments to a federal credit union's operations and require additional computer programming and training of staff.

Many federal credit unions already employ the professionals that would be needed to meet the requirements that would be imposed by the rule as proposed rule, since they need these professionals to meet other existing consumer protection requirements. The others have pre-existing arrangements with third-party service providers to perform the functions that would be affected by this rulemaking.

Additionally, most of the practices that the proposed provisions would impact are not common among federal credit unions. Accordingly, the proposed provisions would not have a significant impact on small entities.

While NCUA believes the proposed rule does not have a significant impact on a substantial number of small entities, it requests comments on the size and incremental burden on small federal credit unions that would be created by the proposed rule.

5. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

NCUA has not identified any federal statutes or regulations that would duplicate, overlap, or conflict with the proposed rule. NCUA seeks comment regarding any statutes or regulations, including state or local statutes or regulations, which would duplicate, overlap, or conflict with the proposed rule.

6. Discussion of Significant Alternatives

NCUA has not identified any significant alternatives to the prohibitions and requirements in the proposed rule. The Agencies explored requiring financial institutions provide disclosures regarding the credit card and overdraft practices to consumers. NCUA does not believe federal credit unions can provide clear or concise disclosures that members could easily understand and use to make an informed decision regarding their credit and saving needs.

Another approach to minimizing the burden on small entities would be to provide a specific exemption to small federal credit unions. However, the Federal Trade Commission Act's prohibition against unfair or deceptive acts or practices makes no provision for exempting small federal credit unions, and NCUA does not have authority to grant an exception. Further, NCUA believes an act or practices that is unfair or deceptive under the Federal Trade Commission Act remains unfair or deceptive despite the size of a federal credit union and should not be exempt from the proposed rule.

NCUA believes the proposed rule provides sufficient flexibility where appropriate for all federal credit unions. NCUA welcomes comments on any significant alternatives that would minimize the impact of the proposed rule on small entities.

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 reviewed the 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 227.28.

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 Federal Reserve is seeking comment on a proposed rule that would prohibit institutions from engaging in certain acts or practices in connection with consumer credit card accounts and overdraft services for deposit accounts. This proposal evolved from the Board's June 2007 Proposal and OTS's August 2007 ANPR. The proposed rule is coordinated with the Board's proposals under the Truth in Lending Act and the Truth in Savings Act published in separate notices in today's **Federal Register**.

Consumer Credit Card Accounts

Under proposed § 227.28 (titled ''Deceptive acts or practices regarding firm offers of credit''), banks would be prohibited from certain marketing practices in relation to prescreened firm offers for consumer credit card accounts unless a disclaimer sufficiently explains the limitations of the offers. The Board anticipates that banks would, with no additional burden, incorporate the proposed disclosure requirement under proposed § 227.28 with an existing disclosure requirement in Regulation Z regarding credit and charge card applications and solicitations. *See* 12 CFR 226.5a. Thus, in order to avoid double-counting, the Board will account for the burden associated with proposed Regulation AA § 227.28 under Regulation Z (OMB No. 7100–0199) § 226.5a. Under Regulation AA § 227.14(b) (titled ''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 these sections of Regulation AA.

Overdraft Services

The proposed rule would also provide substantive protections against unfair and deceptive acts or practices with respect to overdraft services. Proposed § 227.32 is intended to ensure that consumers understand overdraft services and have the choice to avoid the associated costs where such services do not meet their needs. Under this proposal, consumers could not be assessed a fee or charge for paying an overdraft unless the consumer is provided with the right to opt out of the payment of overdrafts and a reasonable opportunity to exercise that right but does not do so.

The burden associated with Regulation AA § 227.28 will be accounted for under Regulation DD (OMB No. 7100–0271) §§ 230.10 (opt-out disclosures for overdraft services), 230.11(a) (disclosure of total fees on periodic statements), and 230.11(c) (disclosure of account balances). The title of the Regulation DD information collection will be updated to account for this section of Regulation AA.

Comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the Board's functions, including whether the information has practical utility; (b) the accuracy of the Board's estimate of the burden of the proposed information collection, including the cost of compliance; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collection of information should be sent to Michelle Shore, Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 151–A, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments sent to the Office of Management and Budget, Paperwork Reduction Project (Regulation AA), Washington, DC 20503.

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 collection requirements contained in this joint notice of proposed rulemaking 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 later in this section along with the Board's burden estimates. The proposed rule contains requirements subject to the PRA. The requirements are found in 12 CFR ____.13, and ____.32. Comments are invited on:

(a) Whether the collection of information is necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record.

Comments should be addressed to:

OTS: Information Collection Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552; send a facsimile transmission to (202) 906–6518; or send an e-mail to *infocollection.comments@ots.treas.gov.* OTS will post comments and the related index on the OTS Internet site at *http://www.ots.treas.gov.* In addition, interested persons may inspect the comments at the Public Reading Room, 1700 G Street, NW., by appointment. To make an appointment, call (202) 906–5922, send an e-mail to *public.info@ots.treas.gov*, or send a facsimile transmission to (202) 906–7755.

NCUA: Jeryl Fish, Paperwork Clearance Officer, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428; send a facsimile to (703) 518–6319; or send an e-mail to *regcomments@ncua.gov.* Please submit information collection comments by one method. NCUA will post comments on its Web site at *http://www.ncua.gov/RegulationsOpinionsLaws/proposedregs/proposedregs.html.* Also, interested persons may inspect the comments at NCUA, 1775 Duke Street, Alexandria, Virginia 22314, by appointment. To make an appointment, call (703) 518–6540, send an e-mail to *OGCmail@ncua.gov*, or send a facsimile transmission to (703) 518–6667.

OTS: Savings associations and their subsidiaries.

NCUA: Federally-chartered 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 this proposed rulemaking, the Agencies would incorporate their existing Credit Practices Rules, which govern unfair or deceptive acts or practices involving consumer credit, into new, more comprehensive rules that would also address unfair or deceptive acts or practices involving credit cards and overdraft protection services.

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

OTS:

Estimated number of respondents: 826.

Estimated time developing opt outs: 10 hours.

Estimated time developing disclaimer: 10 hours.

Estimated time for training: 4 hours.

Total estimated time per respondent: 24 hours.

Total estimated annual burden: 19,824 hours.

NCUA:

Estimated number of respondents: 5,036.

Estimated time developing opt outs: 10 hours.

Estimated time developing disclaimer: 10 hours.

Estimated time for training: 4 hours.

Total estimated time per respondent: 24 hours.

Total estimated annual burden: 120,864 hours.

C. OTS Executive Order 12866 Determination

OTS has determined that its portion of the proposed rulemaking is not a significant regulatory action under Executive Order 12866. However, OTS solicits comment on the economic impact of the rule as proposed.

Summary

The proposed rulemaking is not a significant regulatory action under Executive Order 12866 for a number of reasons. First, the OTS proposal applies only to savings associations and their subsidiaries. As explained in more detail below, these OTS-supervised institutions account for only a small portion of the affected market. Second, these OTS-supervised institutions already refrain from engaging in many of the proposed prohibited practices. 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.

The prohibitions that relate to annual percentage rate (APR) increases on outstanding balances and payment allocation practices will, to some extent, limit fees and interest income currently generated by these practices. However, to the extent income to savings associations is affected, the corresponding offset provided by the limitations is an equally sized consumer benefit of lower fees and interest payments. As a result, most economic effects of the proposed rulemaking would result in small transfers from institutions to consumers, with an overall limited net effect.

Moreover, if such fee and interest income is economically justified in a competitive environment for the allocation of credit, then a likely longer-term outcome would be that institutions would reflect such economic factors in the initial terms of a credit card contract. If that occurs, then consumers will have clearer initial information about potential costs with which to compare credit card offerings than they do currently. Consequently, any shorter term disruptions to institutions caused by the proposed rulemaking will likely be addressed in the longer term by changes in disclosed credit card account APRs and fees, thus making consumer costs and benefits more easily considered and compared.

In-Depth Analysis

1. Limited Economic Effect: Limited Scope of the Proposal

OTS's portion of the proposed rulemaking would apply only to OTS-supervised savings associations and their subsidiaries. OTS is the primary federal regulator for 826 federally- and state-chartered savings associations. The proposed rulemaking primarily addresses certain credit card practices. Of the 826 savings associations, only 124 report any credit card assets. Among those 124 savings associations, only 19 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. In sum, OTS-supervised institutions potentially engaged in the practices prohibited by the proposed rulemaking are not representative of the overall industry that OTS supervises. Most provisions of the proposed rulemaking would have little economic effect on the vast majority of the institutions under OTS jurisdiction.

The Board of Governors of the Federal Reserve System and the National Credit Union Administration are simultaneously proposing a similar set of rules governing credit card practices for other types of federally insured financial institutions. As a consequence, the rulemaking should have little or no intra-industry competitive effects.

2. Limited Economic Effect: Most Affected Practices Are Not Common

Most 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 proposed rule are likely to be minimal.

§ 535.22 Unfair time to make payments. This section would prohibit 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. The proposed rule would create a safe harbor 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. Based on our supervisory observations and experience, OTS-supervised institutions, in general, mail or deliver periodic statements to their customers at least 21 days before the due date. Therefore, a rule that requires institutions to provide a reasonable amount of time to make payment, such as by mailing or delivering periodic statements to customers at least 21 days in advance of the payment due date,

would have insignificant or no economic impact.

§ 535.25 Unfair fees for exceeding the credit limit due to credit holds. This section would prohibit assessing a fee for exceeding the credit limit on a consumer credit card account if the credit limit would not have been exceeded but for a hold on any portion of the available credit on the account that is in excess of the actual purchase or transaction amount. Based on our supervisory observations and experience, OTS-supervised institutions do not, in general, charge overlimit fees in this manner. Therefore, prohibiting this practice would have insignificant or no economic impact.

§ 535.26 Unfair balance computation method. This section would prohibit imposing finance charges on outstanding balances on a consumer credit card account based on balances in billing cycles preceding the most recent billing cycle, subject to certain exceptions.

Very few institutions compute balances using any method other than a single-cycle method. This conclusion was reached by the GAO as part of its recent credit card study.[90] According to the GAO, of the six largest card issuers, only two used the double-cycle billing method between 2003 and 2005.[91] GAO's finding conforms to OTS's own supervisory observations with respect to the prevalence of use of balance computation methods other than single-cycle methods by institutions OTS supervises. Use of a balance computation method other than a single-cycle method is the exception, rather than the norm, for OTS-supervised institutions.

Moreover, the economic impact of this practice arises only in instances where a card holder converts from a convenience user, *i.e.*, one who pays off his/her card balance in full at the end of the billing cycle, to a revolver, *i.e.*, one who carries a balance beyond the end of the billing cycle. Accounts that routinely stay in a ''convenience'' or nonrevolving status would not be impacted by this prohibition. The same would be true of accounts that routinely stay in a revolving status. Only when an account would convert from a nonrevolving status to a revolving status would the prohibition have an impact.

[90] *See* GAO Credit Card Report.

[91] GAO Credit Card Report at 28 (''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.'').

§ 535.27 Unfair charging to the account of security deposits and fees for the issuance or availability of credit. During the period beginning with the date on which a consumer credit card account is opened and ending 12 months from that date, this section would prohibit institutions from charging the account security deposits or fees for the issuance or availability of credit if the total amount of such security deposits and fees constituted a majority of the initial credit limit for the account. During this same period, this rule would require institutions that charge security deposits or fees against the account for the issuance or availability of credit constituting more than 25 percent of the initial credit limit for the account, to apply these charges in the following manner: during the first billing cycle, an institution could charge no more than 25% of the initial credit limit offered for the account; in each of 11 months following the first billing cycle, an institution could charge no more than one eleventh of the total security deposit or fees for the issuance of availability of credit in excess of 25 percent of the initial credit limit for the account.

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. Subprime credit cards represent just 5% of all credit cards issued.[92] Cards of this type are rare among OTS-supervised institutions. Therefore, a rule prohibiting this practice would have insignificant economic impact.

§ 535.28 Deceptive firm offers of credit. This section would prohibit the practice of offering a range of or multiple annual percentage rates or credit limits in a solicitation for a firm offer of credit for a consumer credit card unless it is disclosed to the consumer that, if approved, the consumer's annual percentage rate and the credit limit will depend on specific criteria bearing on creditworthiness.

While the rule would affect how institutions advertise credit, it would not limit the terms of credit offered nor impact any underwriting strategy. Once the rule became effective, institutions would likely adjust their marketing so as not to be misleading under the rule. Operational costs to do so should be minimal and the economic impact, overall, insignificant.

[92] 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/surveilance/asset_backed/credit_card.*

§ 535.32 Unfair overdraft service practices. This section contains two main requirements. First, with certain exceptions, it would prohibit assessing a fee or charge on a consumer's account in connection with an overdraft service, unless an institution provides the consumer with notice and reasonable opportunity to opt out of the payment of all overdrafts and the consumer has not opted out. The consumer would also have to be provided the more limited option of opting out only for the payment of overdrafts for ATM and point-of-sale transactions initiated by a debit card.

OTS Guidance on Overdraft Protection Programs suggests that, as a best practice, institutions that have overdraft protection programs should provide an election or opt-out of the service and obtain affirmative consent from consumers to receive overdraft protection.[93] Therefore, some OTS-supervised institutions may already be carrying out the requirements proposed in this rule. For those institutions, the effect of the opt-out provisions of this notice would be minimal. For the institutions that do not currently offer an opt-out, the rule would trigger some operational costs, but those costs are not likely to materially reduce the revenue generated by overdraft fees. This is because institutions often charge the same fee to pay an overdraft as they do to return it.

Second, this section would prohibit assessing a fee or charge on a consumer's account in connection with an overdraft service if the overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount. Based on our supervisory observations and experience, OTS-supervised institutions do not, in general, charge overdraft fees in this manner. Therefore, prohibiting this practice would have insignificant or no economic impact.

3. Limited Economic Effect: Small Transfers From Institutions to Consumers

The proposed rulemaking contains two other sections. One affects the way in which payments received by the institution are allocated among the customer's outstanding balances. The other specifies the conditions under which the institution could raise the APRs on outstanding balances.

§ 535.23 Unfair payment allocations. A consumer may have multiple balances on a consumer credit card account. Currently, most institutions allocate any

[93] *See* 70 FR 8428 (Feb. 18, 2005).

payment received from a consumer by first covering any fees and finance charges, then allocating any remaining amounts from the lowest APR balance to the highest. This section of the proposed rulemaking would require allocation in a manner that is no less beneficial to the consumer than one of the following methods: (1) Applying the entire amount first to the balance with the highest annual percentage rate, (2) splitting the amount equally among balances, or (3) allocating pro rata among the balances. Any allocation method that would be less beneficial to the consumer than these three methods would be impermissible. For instance, applying the entire amount first to the balance with the lowest annual percentage rate is an example of an allocation method that would be less beneficial to the consumer. The rule leaves open the door to the possibility of other reasonable payment allocation methods.

The costs of the proposed rule are mitigated to some extent by providing institutions with operational flexibility as to which of the allocation methods they choose. To the extent there are economic costs imposed by the payment allocation restrictions included in the proposal, 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.

§ 535.24 Unfair annual percentage rate increases on outstanding balances. This section would generally prohibit institutions from increasing the annual percentage rate on an outstanding balance. This prohibition would not apply, however, where a variable rate increases due to the operation of an index that is not under the institution's control and is available to the general public, where a promotional rate has expired or is lost (provided the APR is not increased to a rate greater than the APR that would have applied after expiration of the promotional rate), or where the minimum payment has not been received within 30 days after the due date.

The proposed rulemaking would not permit the institution to increase the APR on the outstanding balances simply because the consumer pays late or defaults on other debt obligations. This practice is sometimes referred to as ''universal default.'' However, the section would permit APR increases on new purchases or transactions.

Based on our supervisory observations and experience, most larger OTS-supervised institutions do not practice universal default. However, some institutions do raise APR on outstanding balances based on external factors such as a decline in a consumer's credit score. Institutions that make use of this approach would likely adjust to the rule in the longer term by adjusting their initial interest rate pricing schedule.

A potential small negative effect might be that the prohibition on APR increases on outstanding balances would result in higher initial average APRs across all consumers, if the increases on outstanding balances acted as an effective screen for initially weaker credits. However, the fact that most institutions do not use a universal default trigger to increase APRs suggests that this effect may be limited.

D. OTS Executive Order 13132 Determination

OTS has determined that its portion of the proposed rulemaking does not have any federalism implications for purposes of Executive Order 13132.

E. NCUA Executive Order 13132 Determination

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5) voluntarily complies with the Executive Order. The proposed rule apply only to federally chartered credit unions and would not have substantial direct effects on the States, on the connection between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that the proposed rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

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 in any one year. 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 proposed rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more. Accordingly, OTS has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

G. NCUA: The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would 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. Solicitation of 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 specifically invite your comments on how to make this proposal easier to understand. *For example:*

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulations clearly stated? If not, how could the regulations be more clearly stated?
- Do the proposed regulations contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulations easier to understand? If so, what changes to the format would make them easier to understand?
- What else could we do to make the regulations easier to understand?

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, Overdrafts, Unfairness.

12 CFR Part 706

Credit, Credit unions, Deception, Intergovernmental relations, Overdrafts, Trade practices, Unfairness.

Board of Governors of the Federal Reserve System

12 CFR Chapter II

Text of Proposed Revisions

Certain conventions have been used to highlight the proposed revisions. New language is shown inside arrows while language that would be deleted is set off with brackets.

Authority and Issuance

For the reasons discussed in the joint preamble, the Board proposes to amend 12 CFR part 227 as set forth below:

PART 227—UNFAIR OR DECEPTIVE ACTS OR PRACTICES (REGULATION AA)

1. The authority citation for part 227 continues to read as follows:

Authority: 15 U.S.C. 57a(f).

Subpart A—General Provisions

2. The heading for subpart A is revised to read as set forth above.

§ 227.1 [Removed]

§ 227.11 [Redesignated as § 227.1]

3. Section 227.1 is removed and § 227.11 is redesignated as § 227.1 and revised to read as follows:

§ 227.1 Authority, Purpose, and Scope.

(a) *Authority.* This [subpart] ►part◄ is issued by the Board under section 18(f) of the Federal Trade Commission Act, 15 [USC] ►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◄ [Unfair] or deceptive acts or practices ►in violation of◄ [in or affecting commerce are unlawful under] section 5(a)(1) of the Federal Trade Commission Act, 15 [USC] ►U.S.C.◄ 45(a)(1). [This subpart defines] ►Subparts B, C, and D define and contain requirements prescribed for the purpose of preventing specific◄ unfair or deceptive acts or practices of banks [in connection with extensions of credit to consumers]. ►The prohibitions in subparts B, C, and D do not limit the Board's authority to enforce the FTC Act with respect to any other unfair or deceptive acts or practices.◄

(c) *Scope.* [This subpart applies] ►Subparts B, C, and D apply◄ to all banks and their subsidiaries, except [Federal savings banks] ►savings associations as defined in 12 U.S.C. 1813(b).◄ Compliance is to be enforced by:

(1) The Comptroller of the Currency, in the case of national banks[, banks operating under the code of laws for the District of Columbia,] and federal branches and federal agencies of foreign banks;

(2) The Board of Governors of the Federal Reserve System, in the case of banks that are members of the Federal Reserve System (other than banks referred to in paragraph (c)(1) of this section), branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

(3) The Federal Deposit Insurance Corporation, in the case of banks insured by the Federal Deposit Insurance Corporation (other than banks referred to in paragraphs (c)(1) and (c)(2) of this section), and insured state branches of foreign banks.

(d) ►Unless otherwise noted,◄ [T]►t◄he terms used in paragraph (c) of this section that are not defined in the Federal Trade Commission Act or in section 3(s) of the Federal Deposit Insurance Act (12 [USC] ►U.S.C.◄ 1813(s)) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 [USC] ►U.S.C.◄ 3101).

4. Section 227.2 is amended by redesignating paragraphs (a) through (c) as paragraphs (b) through (d), respectively, and republishing them, and adding a new paragraph (a) to read as follows:

§ 227.2 Consumer-Complaint Procedure.

►(a) *Definitions.* For purposes of this section, unless the context indicates otherwise, the following definitions apply:

(1) ''Board'' means the Board of Governors of the Federal Reserve System.

(2) ''Consumer complaint'' means an allegation by or on behalf of an individual, group of individuals, or other entity that a particular act or practice of a State member bank is unfair or deceptive, or in violation of a regulation issued by the Board pursuant to a Federal statute, or in violation of any other act or regulation under which the bank must operate.

(3) ''State member bank'' means a bank that is chartered by a State and is a member of the Federal Reserve System.

(4) Unless the context indicates otherwise, ''bank'' shall be construed to mean a ''State member bank,'' and ''complaint'' to mean a ''consumer complaint.''◄

(b) *Submission of complaints.* (1) Any consumer having a complaint regarding a State member bank is invited to submit it to the Federal Reserve System. The complaint should be submitted in writing, if possible, and should include the following information:

(i) A description of the act or practice that is thought to be unfair or deceptive, or in violation of existing law or regulation, including all relevant facts;

(ii) The name and address of the bank that is the subject of the complaint; and

(iii) The name and address of the complainant.

(2) Consumer complaints should be made to—Federal Reserve Consumer Help Center, P.O. Box 1200, Minneapolis, MN 55480, Toll-free number: (888) 851–1920, Fax number: (877) 888–2520, TDD number: (877) 766–8533.

(c) *Response to complaints.* Within 15 business days of receipt of a written complaint by the Board or a Federal Reserve Bank, a substantive response or an acknowledgment setting a reasonable time for a substantive response will be sent to the individual making the complaint.

(d) *Referrals to other agencies.* Complaints received by the Board or a Federal Reserve Bank regarding an act or practice of an institution other than a State member bank will be forwarded to the Federal agency having jurisdiction over that institution.

§ 227.11 [Reserved]

5. In Subpart B, § 227.11 is added and reserved.

6. A new Subpart C is added to part 227 to read as follows:

Subpart C—Consumer Credit Card Account Practices Rule

Sec.

Subpart C—Consumer Credit Card Account Practices Rule

§ 227.21 Definitions.

For purposes of this subpart, the following definitions apply:

(a) ''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.

(b) ''Consumer'' means 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.

(c) ''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.

(d) ''Promotional rate'' means:

(1) Any annual percentage rate applicable to one or more balances or transactions on a consumer credit card account for a specified period of time that is lower than the annual percentage rate that will be in effect at the end of that period; or

(2) Any annual percentage rate applicable to one or more transactions on a consumer credit card account that is lower than the annual percentage rate that applies to other transactions of the same type.

§ 227.22 Unfair acts or practices regarding time to make payment.

(a) *General rule.* Except as provided in paragraph (c) of this section, a bank 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) *Safe harbor.* A bank satisfies the requirements of 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 provided by the bank within which the consumer may repay any portion of the credit extended without incurring an additional finance charge.

§ 227.23 Unfair acts or practices regarding allocation of payments.

(a) *General rule for accounts with different annual percentage rates on different balances.* Except as provided in paragraph (b) of this section, when different annual percentage rates apply to different balances on a consumer credit card account, the bank must 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 the consumer than one of the following methods:

(1) The amount 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;

(2) Equal portions of the amount are allocated to each balance; or

(3) The amount is allocated among the balances in the same proportion as each balance bears to the total balance.

(b) *Special rules for accounts with promotional rate balances or deferred interest balances.* (1) *Rule regarding payment allocation.* (i) *In general.* When a consumer credit card account has one or more balances at a promotional rate or balances on which interest is deferred, the bank must allocate any amount paid by the consumer in excess of the required minimum periodic payment among the other balances on the account consistent with paragraph (a) of this section. If any amount remains after such allocation, the bank must allocate that amount among the promotional rate balances or the deferred interest balances consistent with paragraph (a) of this section.

(ii) *Exception for deferred interest balances.* Notwithstanding paragraph (b)(1)(i) of this section, the bank may allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to a balance on which interest is deferred during the two billing cycles immediately preceding expiration of the period during which interest is deferred.

(2) *Rule regarding grace periods.* A bank must not require a consumer to repay any portion of a promotional rate balance or deferred interest balance on a consumer credit card account in order to receive any time period offered by the bank in which to repay other credit extended without incurring finance charges, provided that the consumer is otherwise eligible for such a time period.

§ 227.24 Unfair acts or practices regarding application of increased annual percentage rates to outstanding balances.

(a) *Prohibition on increasing annual percentage rates on outstanding balances.* (1) *General rule.* Except as provided in paragraph (b) of this section, a bank must not increase the annual percentage rate applicable to any outstanding balance on a consumer credit card account.

(2) *Outstanding balance.* For purposes of this section, ''outstanding balance'' means the amount owed on a consumer credit card account at the end of the fourteenth day after the bank provides a notice required by 12 CFR 226.9(c) or (g).

(b) *Exceptions.* Paragraph (a) of this section does not apply where the annual percentage rate is increased due to:

(1) The operation of an index that is not under the bank's control and is available to the general public;

(2) The expiration or loss of a promotional rate, provided that, if a promotional rate is lost, the bank does not increase the annual percentage rate to a rate that is greater than the annual percentage rate that would have applied after expiration of the promotional rate; or

(3) The bank not receiving the consumer's required minimum periodic payment within 30 days after the due date for that payment.

(c) *Treatment of outstanding balances following rate increase.* (1) *Payment of outstanding balances.* When a bank increases the annual percentage rate applicable to a category of transactions on a consumer credit card account and the bank is prohibited by this section from applying the increased rate to outstanding balances in that category, the bank must provide the consumer with a method of paying that outstanding balance that is no less beneficial to the consumer than one of the following methods:

(i) An amortization period for the outstanding balance of no less than five years, starting from the date on which the increased annual percentage rate went into effect; or

(ii) A required minimum periodic payment on the outstanding balance that includes a percentage of that balance that is no more than twice the percentage included before the date on which the increased annual percentage rate went into effect.

(2) *Fees and charges on outstanding balance.* When a bank increases the annual percentage rate applicable to a category of transactions on a consumer credit card account and the bank is prohibited by this section from applying the increased rate to outstanding balances in that category, the bank must not assess any fee or charge based solely on the outstanding balance.

§ 227.25 Unfair acts or practices regarding fees for exceeding the credit limit caused by credit holds.

A bank must not assess 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.

§ 227.26 Unfair balance computation method.

(a) *General rule.* Except as provided in paragraph (b) of this section, a bank 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.

(b) *Exceptions.* Paragraph (a) of this section does not apply to:

(1) The assessment of deferred interest; or

(2) Adjustments to finance charges following the resolution of a billing error dispute under 12 CFR 226.12(b) or 12 CFR 226.13.

§ 227.27 Unfair acts or practices regarding security deposits and fees for the issuance or availability of credit.

(a) *Annual rule.* During the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date, a bank must not charge to the account security deposits or fees for the issuance or availability of credit if the total amount of such security deposits and fees constitutes a majority of the initial credit limit for the account.

(b) *Monthly rule.* If the total amount of security deposits and fees for the issuance or availability of credit charged to a consumer credit card account during the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date constitutes more than 25 percent of the initial credit limit for the account:

(1) During the first billing cycle after the account is opened, the bank must not charge to the account security deposits and fees for the issuance or availability of credit that total more than 25 percent of the initial credit limit for the account; and

(2) In each of the eleven billing cycles following the first billing cycle, the bank must not charge to the account more than one eleventh of the total amount of any security deposits and fees for the issuance or availability of credit in excess of 25 percent of the initial credit limit for the account.

(c) *Fees for the issuance or availability of credit.* For purposes of paragraphs (a) and (b) of this section, fees for the issuance or availability of credit include:

(1) 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

(2) Any non-periodic fee that relates to opening an account.

§ 227.28 Deceptive acts or practices regarding firm offers of credit.

(a) *Disclosure of criteria bearing on creditworthiness.* If a bank offers a range or multiple annual percentage rates or credit limits when making a solicitation for a firm offer of credit for a consumer credit card account, and the annual percentage rate or credit limit that consumers approved for credit will receive depends on specific criteria bearing on creditworthiness, the bank must disclose the types of criteria in the solicitation. The disclosure must be provided in a manner that is reasonably understandable to consumers and designed to call attention to the nature and significance of the information regarding the eligibility criteria for the lowest annual percentage rate or highest credit limit stated in the solicitation. If presented in a manner that calls attention to the nature and significance of the information, the following disclosure may be used to satisfy the requirements of this section (as applicable): ''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''

(b) *Firm offer of credit defined.* For purposes of this section, ''firm offer of credit'' has the same meaning as that term has under the definition of ''firm offer of credit or insurance'' in section 603(l) of the Fair Credit Reporting Act (15 U.S.C. 1681a(l)).

7. A new Subpart D is added to part 227 to read as follows:

Subpart D—Overdraft Services Rule

Sec.

Subpart D—Overdraft Services Rule

§ 227.31 Definitions.

For purposes of this subpart, the following definitions apply:

(a) ''Account'' means a deposit account at a bank that is held by or offered to a consumer, and has the same meaning as in § 230.2(a) of the Board's Regulation DD, Truth in Savings (12 CFR part 230).

(b) ''Consumer'' means a person who holds an account primarily for personal, family, or household purposes.

(c) ''Overdraft service'' means a service under which a bank charges a fee for paying a transaction (including a check or other item) that overdraws an account. The term ''overdraft service'' does not include any payment of overdrafts pursuant to—

(1) A line of credit subject to the Federal Reserve Board's Regulation Z (12 CFR part 226), including transfers from a credit card account, home equity line of credit or overdraft line of credit; or

(2) A service that transfers funds from another account of the consumer.

§ 227.32 Unfair acts or practices regarding overdraft services.

(a) *Opt-out requirement.* (1) *General rule.* A bank must not assess a fee or charge on a consumer's account in connection with an overdraft service, unless the bank provides the consumer with the right to opt out of the bank's payment of overdrafts and a reasonable opportunity to exercise that opt-out and the consumer has not opted out. The consumer must be given notice and an opportunity to opt out before the bank's assessment of any fee or charge for an overdraft, and subsequently at least once during or for any periodic statement cycle in which any fee or charge for paying an overdraft is assessed. The notice requirements in paragraphs (a)(1) and (a)(2) do not apply if the consumer has opted out, unless the consumer subsequently revokes the opt-out.

(2) *Partial opt-out.* A bank must provide a consumer the option of opting out only for the payment of overdrafts at automated teller machines and for point-of-sale transactions initiated by a debit card, in addition to the choice of opting out of the payment of overdrafts for all transactions.

(3) *Exceptions.* Notwithstanding a consumer's election to opt out under paragraphs (a)(1) or (a)(2) of this section, a bank may assess a fee or charge on a consumer's account for paying a debit

card transaction that overdraws an account if:

(i) There were sufficient funds in the consumer's account at the time the authorization request was received, but the actual purchase amount for that transaction exceeds the amount that had been authorized; or

(ii) The transaction is presented for payment by paper-based means, rather than electronically through a card terminal, and the bank has not previously authorized the transaction.

(4) *Time to comply with opt-out.* A bank must comply with a consumer's opt-out request as soon as reasonably practicable after the bank receives it.

(5) *Continuing right to opt-out.* A consumer may opt out of the bank's future payment of overdrafts at any time.

(6) *Duration of opt-out.* A consumer's opt-out is effective unless subsequently revoked by the consumer.

(b) *Debit holds.* A bank must not assess a fee or charge on a consumer's account for an overdraft service if the consumer's overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount.

8. A new Supplement I is added to part 227 as follows:

Supplement I to Part 227—Official Staff Commentary

Subpart A—General Provisions for Consumer Protection Rules

Section 227.1—Authority, Purpose, and Scope

1(c) Scope

1. *Penalties for noncompliance.* Administrative enforcement of the rule for banks may involve actions under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), including cease-and-desist orders requiring that actions be taken to remedy violations and civil money penalties.

2. *Industrial loan companies.* Industrial loan companies that are insured by the Federal Deposit Insurance Corporation are covered by the Board's rule.

Subpart C—Consumer Credit Card Account Practices Rule

Section 227.21—Definitions

(d) Promotional Rate

Paragraph (d)(1)

1. *Rate in effect at the end of the promotional period.* If the annual percentage rate that will be in effect at the end of the specified period of time is a variable rate, the rate in effect at the end of that period for purposes of § 227.21(d)(1) is the rate that would otherwise apply if the promotional rate was not offered, consistent with any applicable accuracy requirements under 12 CFR part 226.

Paragraph (d)(2)

1. *Example.* A bank generally offers a 15% annual percentage rate for purchases on a consumer credit card account. For purchases made during a particular month, however, the creditor offers a rate of 5% that will apply until the consumer pays those purchases in full. Under § 227.21(d)(2), the 5% rate is a ''promotional rate'' because it is lower than the 15% rate that applies to other purchases.

Section 227.22—Unfair Acts or Practices Regarding Time To Make Payment

(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 bank. Under § 227.22(b), a bank 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.

(b) Safe Harbor

1. *Reasonable procedures.* A bank is not required to determine the specific date on which periodic statements are mailed or delivered to each individual consumer. A bank 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, for example, three days after the closing date of the billing cycle and the payment due date on the periodic statement is no less than 24 days after the closing date of the billing cycle.

2. *Payment due date.* For purposes of § 227.22(b), ''payment due date'' means the date by which the bank requires the consumer to make payment to avoid being treated as late for any purpose, except as provided in § 227.22(c).

Section 227.23—Unfair Acts or Practices Regarding Allocation of Payments

1. *Minimum periodic payment.* This section addresses the allocation of amounts paid by the consumer in excess of the minimum periodic payment required by the bank. This section does not limit or otherwise address the bank's ability to determine the amount of the minimum periodic payment or how that payment is allocated.

2. *Adjustments of one dollar or less permitted.* When allocating payments, the bank may adjust amounts by one dollar or less. For example, if a bank is allocating $100 equally among three balances, the bank may apply $34 to one balance and $33 to the others. Similarly, if a bank is splitting $100.50 between two balances, the bank may apply $50 to one balance and $50.50 to another.

(a) General Rule for Accounts With Different Annual Percentage Rates on Different Balances

1. *No less beneficial to the consumer.* A bank may allocate payments using a method that is different from the methods listed in § 227.23(a) 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 than a listed method if it results in the assessment of the same or a lesser amount of interest charges than would be assessed under any of the listed methods. For example, a bank may not allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to the balance with the lowest annual percentage rate because this method would result in a higher assessment of interest charges than any of the methods listed in § 227.23(a).

2. *Example of payment allocation method that is no less beneficial to consumers than a method listed in § 227.23(a).* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the required minimum periodic payment. A bank could allocate one-third of this amount ($185) to the cash advance balance and two-thirds ($370) to the purchase balance even though this is not a method listed in § 227.23(a) because the bank is applying more of the amount to the balance with the highest annual percentage rate (with the result that the consumer will be assessed less in interest charges) than would be the case under the pro rata allocation method in § 227.23(a)(3). *See* comment 23(a)(3)–1.

Paragraph (a)(1)

1. *Examples of allocating first to the balance with the highest annual percentage rate.*

(A) Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $800 in excess of the required minimum periodic payment. None of the minimum periodic payment is allocated to the cash advance balance. A bank using this method would allocate $500 to pay off the cash advance balance and then allocate the remaining $300 to the purchase balance.

(B) Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $400 in excess of the required minimum periodic payment. A bank using this method would allocate the entire $400 to the cash advance balance.

Paragraph (a)(2)

1. *Example of equal portion method.* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the required minimum periodic payment. A bank using this method would allocate $278 to the cash advance balance and $277 to the purchase balance (or vice versa).

Paragraph (a)(3)

1. *Example of pro rata method.* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the required minimum periodic payment. A bank 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.

(b) Special Rules for Accounts With Promotional Rate Balances or Deferred Interest Balances

Paragraph (b)(1)(i)

1. *Examples of special rule regarding payment allocation for accounts with promotional rate balances or deferred interest balances.*

(A) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 20%, a purchase balance of $1,500 at an annual percentage rate of 15%, and a transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. The bank must allocate the $800 between the cash advance and purchase balances (consistent with § 227.23(a)) and apply nothing to the transferred balance.

(B) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 20%, a balance of $1,500 on which interest is deferred, and a transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. None of the minimum periodic payment is allocated to the cash advance balance. The bank must allocate $500 to pay off the cash advance balance before allocating the remaining $300 between the deferred interest balance and the transferred balance (consistent with § 227.23(a)).

Paragraph (b)(1)(ii)

1. *Examples of exception for deferred interest balances.* Assume that on January 1 a consumer uses a credit card to make a $1,000 purchase on which interest is deferred until June 30. If this amount is not paid in full by June 30, all interest accrued during the six-month period will be charged to the account. The billing cycle for this credit card begins on the first day of the month and ends on the last day of the month. Each month from January through June the consumer uses the credit card to make $200 in purchases on which interest is not deferred.

(A) The consumer pays $300 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the bank must allocate $200 to the purchase balance and $100 to the deferred interest balance. For the May and June billing cycles, however, the bank has the option of allocating the entire $300 to the deferred interest balance, which will result in that balance being paid in full before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will not be assessed to the consumer's account.

(B) The consumer pays $200 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the bank must allocate the entire $200 to the purchase balance. For the May and June billing cycles, however, the bank has the option to allocate the entire $200 to the deferred interest balance, which will result in that balance being reduced to $600 before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will be assessed to the consumer's account.

Paragraph (b)(2)

1. *Example of special rule regarding grace periods for accounts with promotional rate balances or deferred interest balances.* A bank offers a promotional rate on balance transfers and a higher rate on purchases. The bank also offers a grace period under which consumers who pay their balances in full by the due date are not charged interest on purchases. A consumer who has paid the balance for the prior billing cycle in full by the due date transfers a balance of $2,000 and makes a purchase of $500. Because the bank offers a grace period, it must provide a grace period on the $500 purchase if the consumer pays that amount in full by the due date, even though the $2,000 balance at the promotional rate remains outstanding.

Section 227.24—Unfair Acts or Practices Regarding Application of Increased Annual Percentage Rates to Outstanding Balances

(a) Prohibition Against Increasing Annual Percentage Rates on Outstanding Balances

1. *Example.* Assume that on December 30 a consumer credit card account has a balance of $1,000 at an annual percentage rate of 15%. On December 31, the bank mails or delivers a notice required by 12 CFR 226.9(c) informing the consumer that the annual percentage rate will increase to 20% on February 15. The consumer uses the account to make $2,000 in purchases on January 10 and $1,000 in purchases on January 20. Assuming no other transactions, the outstanding balance for purposes of § 227.24 is the $3,000 balance as of the end of the day on January 14. Therefore, under § 227.24(a), the bank cannot increase the annual percentage rate applicable to that balance. The bank can apply the 20% rate to the $1,000 in purchases made on January 20 but, consistent with 12 CFR 226.9(c), the bank cannot do so until February 15.

2. *Reasonable procedures.* A bank is not required to determine the specific date on which a notice required by 12 CFR 226.9(c) or (g) was provided. For purposes of § 227.24(a)(2), if the bank has adopted reasonable procedures designed to ensure that notices required by 12 CFR 226.9(c) or (g) are provided to consumers no later than, for example, three days after the event giving rise to the notice, the outstanding balance is the balance at the end of the seventeenth day after such event.

(b) Exceptions

Paragraph (b)(1)

1. *External index.* A bank may increase the annual percentage rate on an outstanding balance if the increase is based on an index outside the bank's control. A bank may not increase the rate on an outstanding balance based on its own prime rate or cost of funds and may not reserve a contractual right to change rates on outstanding balances at its discretion. In addition, a bank may not increase the rate on an outstanding balance by changing the method used to determine that rate. A bank is permitted, however, to use a published prime rate, such as that in the *Wall Street Journal*, even if the bank's own prime rate is one of several rates used to establish the published rate.

2. *Publicly available.* The index 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.

Paragraph (b)(2)

1. *Example.* Assume that a consumer credit card account has a balance of $1,000 at a 5% promotional rate and that the bank also charges an annual percentage rate of 15% for purchases and a penalty rate of 25%. If the consumer does not make payment by the due date and the account agreement specifies that event as a trigger for applying the penalty rate, the bank may increase the annual percentage rate on the $1,000 from the 5% promotional rate to the 15% annual percentage rate for purchases. The bank may not, however, increase the rate on the $1,000 from the 5% promotional rate to the 25% penalty rate, except as otherwise permitted under § 227.24(b)(3).

Paragraph (b)(3)

1. *Example.* Assume that the annual percentage rate applicable to purchases on a consumer credit card account is increased from 15% to 20% and that the account has an outstanding balance of $1,000 at the 15% rate. The payment due date on the account is the twenty-fifth of the month. If the bank has not received the required minimum periodic payment due on March 15 on or before April 14, the bank may increase the rate applicable to the $1,000 balance once the bank has complied with the notice requirements in 12 CFR 226.9(g).

(c) Treatment of Outstanding Balances Following Rate Increase

1. *Scope.* This provision does not apply if the consumer credit card account does not have an outstanding balance. This provision also does not apply if a rate is increased pursuant to any of the exceptions in § 227.24(b).

2. *Category of transactions.* This provision does not apply to balances in categories of transactions other than the category for which the bank has increased the annual percentage rate. For example, if a bank increases the annual percentage rate that applies to purchases but not the rate that applies to cash advances, § 227.24(c)(1) and (2) apply to an outstanding balance consisting of purchases but not an outstanding balance consisting of cash advances.

Paragraph (c)(1)

1. *No less beneficial to the consumer.* A bank may provide a method of paying the outstanding balance that is different from the methods listed in § 227.24(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 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 § 227.24(c)(1)(ii). For example, a bank could more than double the percentage of amounts owed included in the minimum payment so long as the minimum payment does not result in amortization of the outstanding balance in less than five years. Alternatively, a bank could require a consumer to make a minimum payment on the outstanding balance that amortizes that balance in less than five years so long as the payment does not include a percentage of the outstanding balance that is more than twice the percentage included in the minimum payment before the effective date of the increased rate.

Paragraph (c)(1)(ii)

1. *Required minimum periodic payment on other balances.* This paragraph addresses the required minimum periodic payment on the outstanding balance. This paragraph does not limit or otherwise address the bank's ability to determine the amount of the minimum periodic payment for other balances.

2. *Example.* Assume that the method used by a bank 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 bank increases the annual percentage rate applicable to purchases on a consumer credit card account from 15% to 20% and that the account has an outstanding balance of $1,000 at the 15% rate. Section 227.24(c)(1)(ii) would permit the bank to calculate the required minimum periodic payment on the outstanding balance by adding fees and interest charges to 2% of the outstanding balance.

Paragraph (c)(2)

1. *Fee or charge based solely on the outstanding balance.* A bank is prohibited from assessing a fee or charge based solely on an outstanding balance. For example, a bank is prohibited from assessing a maintenance or similar fee based on an outstanding balance. A bank 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 an outstanding balance.

Section 227.25—Unfair Acts or Practices Regarding Fees for Exceeding the Credit Limit Caused by Credit Holds

1. *General.* Under § 227.25, a bank may not assess a fee for exceeding the credit limit if the credit limit would not have been exceeded but for a hold placed on the available credit for a consumer credit card account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 227.25 does not limit a bank from charging a fee for exceeding the credit limit in connection with a particular transaction if the consumer would have exceeded the credit limit due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a payment that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to exceed the credit limit.

2. *Example of prohibition in connection with hold placed for same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,500. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the bank for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, the bank is prohibited from assessing a fee for exceeding the credit limit with respect to the $750 hold. If, however, the total cost of the stay charged to the account had been more than $500, the bank would not be prohibited from assessing a fee for exceeding the credit limit.

3. *Example of prohibition in connection with hold placed for another transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the bank for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $150 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, the bank is prohibited from assessing a fee for exceeding the credit limit with respect to either the $750 hold or the $150 purchase. If, however, the total cost of the stay charged to the account had been more than $450, the bank would not be prohibited from assessing a fee for exceeding the credit limit.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the bank for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. When the hotel presents the $450 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $750 hold and the $450 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's balance to exceed the credit limit. Under these circumstances, and assuming no other transactions, the bank is prohibited from assessing a fee for exceeding the credit limit because the credit limit was exceeded solely due to the $750 hold.

5. *Example of permissible fee for exceeding the credit limit in connection with a hold.* Assume that a consumer has a credit limit of $2,000 and a balance of $1,400 on a consumer credit card account. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the bank for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $650 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Notwithstanding the existence of the hold and assuming that there is no other activity on the account, the bank may charge the consumer a fee for exceeding the credit limit with respect to the $650 purchase because the consumer would have exceeded the credit limit even if the hold had been for the actual amount of the hotel transaction.

Section 227.26—Unfair Balance Computation Method

(a) General Rule

1. *Two-cycle method prohibited.* A bank 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. *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. A consumer has a zero balance on March 1. The consumer uses the credit card to make a $500 purchase on March 15. The consumer makes no other purchases and pays $400 on the due date (April 25), leaving a $100 balance. The bank may charge interest on the $500 purchase from the start of the 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 bank 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).

Section 227.27—Unfair Acts or Practices Regarding Security Deposits and Fees for the Issuance or Availability of Credit

1. *Initial credit limit for the account.* For purposes of this section, the initial credit limit is the limit in effect when the account is opened.

(a) Annual Rule

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 § 227.27(a), a bank may only charge to the account security deposits and fees for the issuance or availability of credit totaling no more than $250 during the twelve months after the date on which the account is opened (consistent with § 227.27(b)).

(b) Monthly Rule

1. *Adjustments of one dollar or less permitted.* When dividing amounts pursuant to § 227.27(b)(2), the bank may adjust amounts by one dollar or less. For example, if a bank is dividing $125 over eleven billing cycles, the bank may charge $12 for four months and $11 for the remaining seven months.

2. *Example.* Assume that a consumer credit card account opened on January 1 has an initial credit limit of $500 and that a bank charges to the account security deposits and fees for the issuance or availability of credit that total $250 during the twelve months after the date on which the account is opened. 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 § 227.27(b), the bank may charge to the account no more than $250 in security deposits and fees for the issuance or availability of credit. If it charges $250, the bank may charge as much as $125 during the first billing cycle. If it charges $125 during the first billing cycle, it may then charge $12 in any four billing cycles and $11 in any seven billing cycles during the year.

(c) Fees for the Issuance or Availability of Credit

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.

3. *One-time fees.* Only non-periodic fees related to opening an account (such as one-time membership or participation fees) are fees for the issuance or availability of credit. Fees for reissuing a lost or stolen card and statement reproduction fees are examples of fees that are not fees for the issuance or availability of credit.

Section 227.28—Deceptive Acts or Practices Regarding Firm Offers of Credit

(a) Disclosure of Criteria Bearing on Creditworthiness

1. *Designed to call attention.* Whether a disclosure has been provided in a manner that is designed to call attention to the nature and significance of required information depends on where the disclosure is placed in the solicitation and how it is presented, including whether the disclosure uses a typeface and type size that are easy to read and uses boldface or italics. Placing the disclosure in a footnote would not satisfy this requirement.

2. *Form of electronic disclosures.* Electronic disclosures must be provided consistent with 12 CFR 226.5a(a)(2)–8 and –9.

3. *Multiple annual percentage rates or credit limits.* For purposes of this section, a firm offer of credit solicitation that states an annual percentage rate or credit limit for a credit card feature and a different annual percentage rate or credit limit for a different credit card feature does not offer multiple annual percentage rates or credit limits. For example, if a firm offer of credit solicitation offers a 15% annual percentage rate for purchases and a 20% annual percentage rate for cash advances, the solicitation does not offer multiple annual percentage rates for purposes of this section.

4. *Example.* Assume that a bank requests from a consumer reporting agency a list of consumers with credit scores of 650 or higher so that the bank can send those consumers a firm offer of credit solicitation. The bank sends a solicitation to those consumers for a consumer credit card account advertising ''rates from 8.99% to 19.99%'' and ''credit limits from $1,000 to $10,000.'' Before selection of the consumers for the offer, however, the bank determines that it will provide an interest rate of 8.99% and a credit limit of $10,000 only to those consumers responding to the solicitation who are verified to have a credit score of 650 or higher, who have a debt-to-income ratio below a certain amount, and who meet other specific criteria bearing on creditworthiness. Under § 227.28, this solicitation is deceptive unless the bank discloses, in a manner that is reasonably understandable to the consumer and designed to call attention to the nature and significance of the information, that, if the consumer is approved for credit, the annual percentage rate and credit limit the consumer will receive will depend on specific criteria bearing on the consumer's creditworthiness. The bank may satisfy this requirement by using a typeface and type size that are easy to read and stating in boldface in a manner that otherwise calls attention to the nature and significance of the information: **''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''**

5. *Applicability of criteria in disclosure.* When making a disclosure under this section, a bank may only disclose the criteria it uses in evaluating whether consumers who are approved for credit will receive the lowest annual percentage rate or the highest credit limit. For example, if a bank does not consider the consumer's debts when determining whether the consumer should receive the lowest annual percentage rate or highest credit limit, the disclosure must not refer to ''debts.''

Subpart D—Overdraft Services Rule

Section 227.32—Unfair Acts or Practices Regarding Overdraft Services

(a) Opt-Out Requirement

(a)(1) General Rule

1. *Form, content and timing of disclosure.* The form, content and timing of the opt-out notice required to be provided under paragraph (a) of this section are addressed under § 230.10 of the Board's Regulation DD, Truth in Savings (12 CFR 230).

(a)(3) Exceptions

Paragraph (a)(3)(i)

1. *Example of transaction amount exceeding authorization amount (fuel purchase).* A consumer has $30 in a deposit account. The consumer uses a debit card to purchase fuel. Before permitting the consumer to use the fuel pump, the merchant verifies the validity of the card by obtaining authorization from the bank for a $1 transaction. The consumer purchases $50 of fuel. If the bank pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

2. *Example of transaction amount exceeding authorization amount (restaurant).* A consumer has $50 in a deposit account. The consumer pays for a $45 meal at a restaurant using a debit card. While the restaurant may obtain authorization for the $45 cost of the meal, the consumer may add $10 for a tip. If the bank pays the $55

transaction (including the tip amount), it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

Paragraph (a)(3)(ii)

1. *Example of transaction presented by paper-based means.* A consumer has $50 in a deposit account. The consumer makes a $60 purchase and presents his or her debit card for payment. The merchant takes an imprint of the card. Later that day, the merchant submits a sales slip with the card imprint to its processor for payment. If the consumer's bank pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

(b) Debit Holds

1. *General.* Under § 227.32(b), a bank may not assess an overdraft fee if the overdraft would not have occurred but for a hold placed on funds in the consumer's account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 227.32(b) does not limit a bank from charging an overdraft fee in connection with a particular transaction if the consumer would have incurred an overdraft due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a deposited check that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to overdraw his or her account.

2. *Example of prohibition in connection with hold placed for same transaction.* A consumer has $50 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's bank for a $75 ''hold'' on the account which exceeds the consumer's funds. The consumer purchases $20 of fuel. Under these circumstances, § 227.32(b) prohibits the bank from assessing a fee or charge in connection with the debit hold because the actual amount of the fuel purchase did not exceed the funds in the consumer's account. However, if the consumer had purchased $60 of fuel, the bank could assess a fee or charge for an overdraft because the transaction exceeds the funds in the consumer's account, unless the consumer has opted out of the payment of overdrafts under § 227.32(a).

3. *Example of prohibition in connection with hold placed for another transaction.* A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's bank for a $75 ''hold'' on the account. The consumer purchases $20 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Under these circumstances, § 227.32(b) prohibits the bank from assessing a fee or charge for paying an overdraft with respect to the $75 withdrawal because the overdraft was caused solely by the $75 hold.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction.* A consumer has $100 in his deposit account, and uses his debit card to purchase $50 worth of fuel. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's bank for a $75 ''hold'' on the account. The consumer purchases $50 of fuel. When the merchant presents the $50 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $75 hold and the $50 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's account to be overdrawn. Under these circumstances, and assuming no other transactions, § 227.32(b) prohibits the bank from assessing a fee or charge for paying an overdraft because the overdraft was caused solely by the $75 hold.

5. *Example of permissible overdraft fees in connection with a hold.* A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's bank for a $75 ''hold'' on the account. The consumer purchases $35 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Notwithstanding the existence of the hold, and assuming the consumer has not opted out of the payment of overdrafts under § 227.32(a), the consumer's bank may charge the consumer an overdraft fee for the $75 ATM withdrawal, because the consumer would have incurred the overdraft even if the hold had been for the actual amount of the fuel purchase.

9. The Federal Reserve System Board of Governors' Staff Guidelines on the Credit Practices Rule, published August 3, 1988 at 51 FR 29225, is amended as follows:

Staff Guidelines on the Credit Practices Rule

Effective January 1, 1986; as amended effective [August 1, 1988] ►Insert effective date of new amendments◄

Introduction

*   *   *   *   *

3. *Scope; enforcement.*►As stated in subpart A of Regulation AA,◄ [The Board's] ►this◄ rule applies to all banks and their subsidiaries►, except savings associations as defined in 12 U.S.C. 1813(b).◄ [institutions that are members of the Federal Home Loan Bank System and nonbank subsidiaries of bank holding companies are covered by the rules of the Federal Home Loan Bank Board and the FTC, respectively.] The Board has enforcement responsibility for state-chartered banks that are members of the Federal Reserve System. The Office of the Comptroller of the Currency has enforcement responsibility for national banks. The Federal Deposit Insurance Corporation has enforcement responsibility for insured state-chartered banks that are not members of the Federal Reserve System.

*   *   *   *   *

[Section 227.11 Authority, Purpose, and Scope

Q11(c)–1: *Penalties for noncompliance.* What are the penalties for noncompliance with the rule?

A: Administrative enforcement of the rule for banks may involve actions under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), including cease-and-desist orders requiring that actions be taken to remedy violations. If the terms of the order are violated, the federal supervisory agency may impose penalties of up to $1,000 per day for every day that the bank is in violation of the order.

Q11(c)–2: *Industrial loan companies.* Are industrial loan companies subject to the Board's rule?

A: Industrial loan companies that are insured by the Federal Deposit Insurance Corporation are covered by the Board's rule.]

*   *   *   *   *

Department of the Treasury

Office of Thrift Supervision

12 CFR Chapter V

For the reasons discussed in the joint preamble, the Office of Thrift Supervision proposes to amend chapter V of title 12 of the Code of Federal Regulations by revising 12 CFR part 535 to read as follows:

PART 535—UNFAIR OR DECEPTIVE ACTS OR PRACTICES

Authority: 12 U.S.C. 1462a, 1463, 1464; 15 U.S.C. 57a.

Subpart A—General Provisions

§ 535.1 Authority, purpose and scope.

(a) *Authority.* This part is issued by OTS under section 18(f) of the Federal Trade Commission Act, 15 U.S.C. 57a(f).

(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). This part defines and contains requirements prescribed for the purpose of preventing specific unfair or deceptive acts or practices of savings associations. The prohibitions in this part do not limit OTS's authority to enforce the FTC Act with respect to any other unfair or deceptive acts or practices.

(c) *Scope.* This part applies to savings associations and subsidiaries owned in whole or in part by a savings association.

Subpart B—Consumer Credit Practices

§ 535.11 Definitions.

For purposes of this subpart, the following definitions apply:

(a) *Consumer* means a natural person 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.*

(b) *Consumer credit* means credit extended to a natural person 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 savings association 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.

(c) *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.

(d) *Obligation* means an agreement between a consumer and a creditor.

(e) *Person* means an individual, corporation, or other business organization.

§ 535.12 Unfair credit contract provisions.

It is an unfair act or practice for you, directly or indirectly, to enter into a consumer credit obligation that constitutes or contains, or to enforce in a consumer credit obligation you 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).

§ 535.13 Unfair or deceptive cosigner practices.

(a) *Prohibited deception.* It is a deceptive act or practice for you, 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 you, 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 (d)(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) Your 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.

§ 535.14 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 you, 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.

§ 535.15 State exemptions.

(a) *Applications.* An appropriate state agency may apply to OTS for a determination that:

(1) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of this subpart applies; and

(2) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this subpart.

(b) *Determinations.* If OTS makes a determination under paragraph (a) of this section, then the provision of this subpart will not be in effect in that state to the extent specified by OTS in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively, as determined by OTS.

(c) *Delegated authority.* The Managing Director, Compliance and Consumer Protection in consultation with the Chief Counsel has delegated authority to make such determinations as are required under this subpart.

Subpart C—Consumer Credit Card Account Practices

§ 535.21 Definitions.

For purposes of this subpart, the following definitions apply:

(a) *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 § 226.2 of this title.

(b) *Consumer* means 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.

(c) *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 § 226.2 of this title. The following are not consumer credit card accounts for purposes of this subpart:

(1) Home equity plans subject to the requirements of § 226.5b of this title 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.

(d) *Promotional rate* means:

(1) Any annual percentage rate applicable to one or more balances or transactions on a consumer credit card account for a specified period of time that is lower than the annual percentage rate that will be in effect at the end of that period; or

(2) Any annual percentage rate applicable to one or more transactions on a consumer credit card account that is lower than the annual percentage rate that applies to other transactions of the same type.

§ 535.22 Unfair time to make payment.

(a) *General rule.* Except as provided in paragraph (c) of this section, you must not treat a payment on a consumer credit card account as late for any purpose unless you have provided the consumer a reasonable amount of time to make the payment.

(b) *Safe harbor.* You satisfy the requirements of paragraph (a) of this section if you 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.

(c) *Exception for grace periods.* Paragraph (a) of this section does not apply to any time period you provide within which the consumer may repay any portion of the credit extended without incurring an additional finance charge.

§ 535.23 Unfair payment allocations.

(a) *General rule for accounts with different annual percentage rates on different balances.* Except as provided in paragraph (b) of this section, when different annual percentage rates apply to different balances on a consumer credit card account, you must 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 the consumer than one of the following methods:

(1) You allocate the amount 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;

(2) You allocate equal portions of the amount to each balance; or

(3) You allocate the amount among the balances in the same proportion as each balance bears to the total balance.

(b) *Special rules for accounts with promotional rate balances or deferred interest balances.* (1) *Rule regarding payment allocation.* (i) *In general.* When a consumer credit card account has one or more balances at a promotional rate or balances on which interest is deferred, you must allocate any amount paid by the consumer in excess of the required minimum periodic payment among the other balances on the account consistent with paragraph (a) of this section. If any amount remains after such allocation, you must allocate that amount among the promotional rate balances or the deferred interest balances consistent with paragraph (a) of this section.

(ii) *Exception for deferred interest balances.* Notwithstanding paragraph (b)(1)(i) of this section, you may allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to a balance on which interest is deferred during the two billing cycles immediately preceding expiration of the period during which interest is deferred.

(2) *Rule regarding grace period.* You must not require a consumer to repay any portion of a promotional rate balance or deferred interest balance on a consumer credit card account in order to receive any time period you offer in which to repay other credit extended without incurring finance charges, provided that the consumer is otherwise eligible for such a time period.

§ 535.24 Unfair annual percentage rate increases on outstanding balances.

(a) *Prohibition against increasing annual percentage rates on outstanding balances.* (1) *General rule.* Except as provided in paragraph (b) of this section, you must not increase the annual percentage rate applicable to any outstanding balance on a consumer credit card account.

(2) *Outstanding balance defined.* For purposes of this section, *outstanding balance* means the amount owed on a consumer credit card account at the end of the fourteenth day after you provide a notice required by §§ 226.9(c) or 226.9(g) of this title.

(b) *Exceptions.* Paragraph (a) of this section does not apply where the annual percentage rate is increased due to:

(1) The operation of an index that is not under your control and is available to the general public;

(2) The expiration or loss of a promotional rate provided that, if a promotional rate is lost, you do not increase the annual percentage rate to a rate that is greater than the annual percentage rate that would have applied after expiration of the promotional rate; or

(3) You not receiving the consumer's required minimum payment within 30 days after the due date for that payment.

(c) *Treatment of outstanding balances following rate increase.* (1) *Payment of outstanding balances.* When you increase the annual percentage rate applicable to a category of transaction on a consumer credit card account and this section prohibits you from applying the increased rate to outstanding balances in that category, you must provide the consumer with a method of paying that outstanding balance that is no less beneficial to the consumer than one of the following methods:

(i) An amortization period for the outstanding balance of no less than five years, starting from the date on which the increased annual percentage rate went into effect; or

(ii) A required minimum periodic payment on the outstanding balance that includes a percentage of that balance that is no more than twice the percentage included before the date on which the increased annual percentage rate went into effect.

(2) *Fees and charges on outstanding balance.* When you increase the annual percentage rate applicable to a category of transactions on a consumer credit card account and this section prohibits you from applying the increased rate to outstanding balances in that category, you must not assess any fee or charge based solely on the outstanding balance.

§ 535.25 Unfair fees for exceeding the credit limit due to credit holds.

You must not assess 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.

§ 535.26 Unfair balance computation method.

(a) *General rule.* Except as provided in paragraph (b) of this section, you 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.

(b) *Exceptions.* Paragraph (a) of this section does not apply to:

(1) The assessment of deferred interest; or

(2) Adjustments to finance charges following the resolution of a billing error dispute under §§ 226.12(b) or 226.13 of this title.

§ 535.27 Unfair charging to the account of security deposits and fees for the issuance or availability of credit.

(a) *Annual rule.* During the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date, you must not charge to the account security deposits or fees for the issuance or availability of credit if the total amount of such security deposits and fees constitutes a majority of the initial credit limit for the account.

(b) *Monthly rule.* If the total amount of security deposits and fees for the issuance or availability of credit charged to a consumer credit card account during the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date constitutes more than 25 percent of the initial credit limit for the account:

(1) During the first billing cycle after the account is opened, you must not charge to the account security deposits and fees for the issuance or availability of credit that total more than 25 percent of the initial credit limit for the account; and

(2) In each of the eleven billing cycles following the first billing cycle, you must not charge to the account more than one eleventh of the total amount of any security deposits and fees for the issuance or availability of credit in excess of 25 percent of the initial credit limit for the account.

(c) *Fees for the issuance or availability of credit.* For purposes of paragraphs (a) and (b) of this section, fees for the issuance or availability of credit include:

(1) 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

(2) Any non-periodic fee that relates to opening an account.

§ 535.28 Deceptive firm offers of credit.

(a) *Disclosure of criteria bearing on creditworthiness.* If you offer a range or multiple annual percentage rates or credit limits when you make a solicitation for a firm offer of credit for a consumer credit card account, and the annual percentage rate or credit limit that consumers approved for credit will receive depends on specific criteria bearing on creditworthiness, you must disclose the types of criteria in the solicitation. You must provide the disclosure in a manner that is reasonably understandable to consumers and designed to call attention to the nature and significance of the eligibility criteria for the lowest annual percentage rate or highest credit limit stated in the solicitation. If presented in a manner that calls attention to the nature and significance of the information, the following disclosure may be used to satisfy the requirements of this section (as applicable): ''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''

(b) *Firm offer of credit defined.* For purposes of this section, *firm offer of credit* has the same meaning as that term has under the definition of *firm offer of credit or insurance* in section 603(l) of the Fair Credit Reporting Act (15 U.S.C. 1681a(l)).

Subpart D—Overdraft Service Practices

§ 535.31 Definitions.

For purposes of this subpart, the following definitions apply:

(a) *Account* means a deposit account at a savings association that is held by or offered to a consumer. The term *account* has the same meaning as in § 230.2(a) of this title.

(b) *Consumer* means a person who holds an account primarily for personal, family, or household purposes.

(c) *Overdraft service* means a service under which a savings association charges a fee for paying a transaction (including a check or other item) that overdraws an account. The term *overdraft service* does not include any payment of overdrafts pursuant to:

(1) A line of credit subject to part 226 of this title, including transfers from a credit card account, home equity line of credit, or overdraft line of credit; or

(2) A service that transfers funds from another account of the consumer.

§ 535.32 Unfair overdraft service practices.

(a) *Opt-out requirement.* (1) *General rule.* You must not assess a fee or charge on a consumer's account in connection with an overdraft service, unless you provide the consumer with the right to opt out of your payment of overdrafts and a reasonable opportunity to exercise that opt out and the consumer has not opted out. The consumer must be given notice and an opportunity to opt out before you assess any fee or charge for an overdraft, and subsequently at least once during or for any periodic statement cycle in which any fee or charge for paying an overdraft is assessed. The notice requirements in paragraphs (a)(1) and (a)(2) of this section do not apply if the consumer has opted out, unless the consumer subsequently revokes the opt-out.

(2) *Partial opt-out.* You must provide a consumer the option of opting out only for the payment of overdrafts at automated teller machines and for point-of-sale transactions initiated by a debit card, in addition to the choice of opting out of the payment of overdrafts for all transactions.

(3) *Exceptions.* Notwithstanding a consumer's election to opt out under paragraphs (a)(1) or (a)(2) of this section, you may assess a fee or charge on a consumer's account for paying a debit card transaction that overdraws an account if:

(i) There were sufficient funds in the consumer's account at the time the authorization request was received, but the actual purchase amount for that transaction exceeds the amount that had been authorized; or

(ii) The transaction is presented for payment by paper-based means, rather than electronically through a card terminal, and you have not previously authorized the transaction.

(4) *Time to comply with opt-out.* You must comply with a consumer's opt-out request as soon as reasonably practicable after you receive it.

(5) *Continuing right to opt-out.* A consumer may opt out of your future payment of overdrafts at any time.

(6) *Duration of opt-out.* A consumer's opt-out is effective unless the consumer subsequently revokes it.

(b) *Debit holds.* You must not assess a fee or charge on a consumer's account for an overdraft service if the consumer's overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount.

Appendix to Part 535—Official Staff Commentary

Subpart A—General Provisions

Section 535.1—Authority, Purpose, and Scope

1(c) Scope

1. *Penalties for noncompliance.* Administrative enforcement of the rule for savings associations may involve actions under section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), including cease-and-desist orders requiring that action be taken to remedy violations and civil money penalties.

Subpart C—Consumer Credit Card Account Practices

Section 535.21—Definitions

(d) Promotional Rate

Paragraph (d)(1)

1. *Rate in effect at the end of the promotional period.* If the annual percentage rate that will be in effect at the end of the specified period of time is a variable rate, the rate in effect at the end of that period for purposes of § 535.21(d)(1) is the rate that would otherwise apply if the promotional rate were not offered, consistent with any applicable accuracy requirements under part 226 of this title.

Paragraph (d)(2)

1. *Example.* A savings association generally offers a 15% annual percentage rate for purchases on a consumer credit card account. For purchases made during a particular month, however, the creditor offers a rate of 5% that will apply until the consumer pays those purchases in full. Under § 535.21(d)(2), the 5% rate is a ''promotional rate'' because it is lower than the 15% rate that applies to other purchases.

Section 535.22—Unfair Time To Make Payment

(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 savings association. Under § 535.22(b), a savings association 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.

(b) Safe Harbor

1. *Reasonable procedures.* A savings association is not required to determine the specific date on which periodic statements are mailed or delivered to each individual consumer. A savings association 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, for example, three days after the closing date of the billing cycle and the payment due date on the periodic statement is no less than 24 days after the closing date of the billing cycle.

2. *Payment due date.* For purposes of § 535.22(b), ''payment due date'' means the date by which the savings association requires the consumer to make payment to avoid being treated as late for any purpose, except as provided in § 535.22(c).

Section 535.23—Unfair Payment Allocations

1. *Minimum periodic payment.* This section addresses the allocation of amounts paid by the consumer in excess of the minimum periodic payment required by the savings association. This section does not limit or otherwise address the savings association's ability to determine the amount of the minimum periodic payment or how that payment is allocated.

2. *Adjustments of one dollar or less permitted.* When allocating payments, the savings association may adjust amounts by one dollar or less. For example, if a savings association is allocating $100 equally among three balances, the savings association may apply $34 to one balance and $33 to the others. Similarly, if a savings association is splitting $100.50 between two balances, the savings association may apply $50 to one balance and $50.50 to another.

(a) General Rule for Accounts With Different Annual Percentage Rates on Different Balances

1. *No less beneficial to the consumer.* A savings association may allocate payments using a method that is different from the methods listed in § 535.23(a) 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 than a listed method if it results in the assessment of the same or a lesser amount of interest charges than would be assessed under any of the listed methods. For example, a savings association may not allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to the balance with the lowest annual percentage rate because this method would result in a higher assessment of interest charges than any of the methods listed in § 535.23(a).

2. *Example of payment allocation method that is no less beneficial to consumers than a method listed in § 535.23(a).* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the

required minimum periodic payment. A savings association could allocate one-third of this amount ($185) to the cash advance balance and two-thirds ($370) to the purchase balance even though this is not a method listed in § 535.23(a) because the savings association is applying more of the amount to the balance with the highest annual percentage rate (with the result that the consumer will be assessed less in interest charges) than would be the case under the pro rata allocation method in § 535.23(a)(3). *See* comment 23(a)(3)–1.

Paragraph (a)(1)

1. *Examples of allocating first to the balance with the highest annual percentage rate.*

(A) Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $800 in excess of the required minimum periodic payment. None of the minimum periodic payment is allocated to the cash advance balance. A savings association using this method would allocate $500 to pay off the cash advance balance and then allocate the remaining $300 to the purchase balance.

(B) Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $400 in excess of the required minimum periodic payment. A savings association using this method would allocate the entire $400 to the cash advance balance.

Paragraph (a)(2)

1. *Example of equal portion method.* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the required minimum periodic payment. A savings association using this method would allocate $278 to the cash advance balance and $277 to the purchase balance (or vice versa).

Paragraph (a)(3)

1. *Example of pro rata method.* Assume that a consumer's account has a cash advance balance of $500 at an annual percentage rate of 20% and a purchase balance of $1,500 at an annual percentage rate of 15% and that the consumer pays $555 in excess of the required minimum periodic payment. A savings association 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.

(b) Special Rules for Accounts With Promotional Rate Balances or Deferred Interest Balances

Paragraph (b)(1)(i)

1. *Examples of special rule regarding payment allocation for accounts with promotional rate balances or deferred interest balances.*

(A) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 20%, a purchase balance of $1,500 at an annual percentage rate of 15%, and a transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. The savings association must allocate the $800 between the cash advance and purchase balances (consistent with § 535.23(a)) and apply nothing to the transferred balance.

(B) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 20%, a balance of $1,500 on which interest is deferred, and a transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. None of the minimum periodic payment is allocated to the cash advance balance. The savings association must allocate $500 to pay off the cash advance balance before allocating the remaining $300 between the deferred interest balance and the transferred balance (consistent with § 535.23(a)).

Paragraph (b)(1)(ii)

1. *Examples of exception for deferred interest balances.* Assume that on January 1, a consumer uses a credit card to make a $1,000 purchase on which interest is deferred until June 30. If this amount is not paid in full by June 30, all interest accrued during the six-month period will be charged to the account. The billing cycle for this credit card begins on the first day of the month and ends on the last day of the month. Each month from January through June the consumer uses the credit card to make $200 in purchases on which interest is not deferred.

(A) The consumer pays $300 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the savings association must allocate $200 to the purchase balance and $100 to the deferred interest balance. For the May and June billing cycles, however, the savings association has the option of allocating the entire $300 to the deferred interest balance, which will result in that balance being paid in full before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will not be assessed to the consumer's account.

(B) The consumer pays $200 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the savings association must allocate the entire $200 to the purchase balance. For the May and June billing cycles, however, the savings association has the option to allocate the entire $200 to the deferred interest balance, which will result in that balance being reduced to $600 before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will be assessed to the consumer's account.

Paragraph (b)(2)

1. *Example of special rule regarding grace periods for accounts with promotional rate balances or deferred interest balances.* A savings association offers a promotional rate on balance transfers and a higher rate on purchases. The savings association also offers a grace period under which consumers who pay their balances in full by the due date are not charged interest on purchases. A consumer who has paid the balance for the prior billing cycle in full by the due date transfers a balance of $2,000 and makes a purchase of $500. Because the savings association offers a grace period, it must provide a grace period on the $500 purchase if the consumer pays that amount in full by the due date, even though the $2,000 balance at the promotional rate remains outstanding.

Section 535.24—Unfair Annual Percentage Rate Increases on Outstanding Balances

(a) Prohibition Against Increasing Annual Percentage Rates on Outstanding Balances

1. *Example.* Assume that on December 30, a consumer credit card account has a balance of $1,000 at an annual percentage rate of 15%. On December 31, the savings association mails or delivers a notice required by § 226.9(c) of this title informing the consumer that the annual percentage rate will increase to 20% on February 15. The consumer uses the account to make $2,000 in purchases on January 10 and $1,000 in purchases on January 20. Assuming no other transactions, the outstanding balance for purposes of § 535.24 is the $3,000 balance as of the end of the day on January 14. Therefore, under § 535.24(a), the savings association cannot increase the annual percentage rate applicable to that balance. The savings association can apply the 20% rate to the $1,000 in purchases made on January 20 but, consistent with § 226.9(c) of this title, the savings association cannot do so until February 15.

2. *Reasonable procedures.* A savings association is not required to determine the specific date on which a notice required by §§ 226.9(c) or 226.9(g) of this title was provided. For purposes of § 535.24(a)(2), if the savings association has adopted reasonable procedures designed to ensure that notices required by §§ 226.9(c) or 229.9(g) of this title are provided to consumers no later than, for example, three days after the event giving rise to the notice, the outstanding balance is the balance at the end of the seventeenth day after such event.

(b) Exceptions

Paragraph (b)(1)

1. *External index.* A savings association may increase the annual percentage rate on an outstanding balance if the increase is based on an index outside the savings association's control. A savings association may not increase the rate on an outstanding balance based on its own prime rate or cost of funds and may not reserve a contractual right to change rates on outstanding balances at its discretion. In addition, a savings association may not increase the rate on an outstanding balance by changing the method used to determine that rate. A savings

association is permitted, however, to use a published prime rate, such as that in the *Wall Street Journal,* even if the savings association's own prime rate is one of several rates used to establish the published rate.

2. *Publicly available.* The index 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.

Paragraph (b)(2)

1. *Example.* Assume that a consumer credit card account has a balance of $1,000 at a 5% promotional rate and that the savings association also charges an annual percentage rate of 15% for purchases and a penalty rate of 25%. If the consumer does not make payment by the due date and the account agreement specifies that event as a trigger for applying the penalty rate, the savings association may increase the annual percentage rate on the $1,000 from the 5% promotional rate to the 15% annual percentage rate for purchases. The savings association may not, however, increase the rate on the $1,000 from the 5% promotional rate to the 25% penalty rate, except as otherwise permitted under § 535.24(b)(3).

Paragraph (b)(3)

1. *Example.* Assume that the annual percentage rate applicable to purchases on a consumer credit card account is increased from 15% to 20% and that the account has an outstanding balance of $1,000 at the 15% rate. The payment due date on the account is the twenty-fifth of the month. If the savings association has not received the required minimum periodic payment due on March 15 on or before April 14, the savings association may increase the rate applicable to the $1,000 balance once the savings association has complied with the notice requirements § 226.9(g) of this title.

(c) Treatment of Outstanding Balances Following Rate Increase

1. *Scope.* This provision does not apply if the consumer credit card account does not have an outstanding balance. This provision also does not apply if a rate is increased pursuant to any of the exceptions in § 535.24(b).

2. *Category of transactions.* This provision does not apply to balances in categories of transactions other than the category for which the savings association has increased the annual percentage rate. For example, if a savings association increases the annual percentage rate that applies to purchases but not the rate that applies to cash advances, §§ 535.24(c)(1) and 535.(c)(2) apply to an outstanding balance consisting of purchases but not an outstanding balance consisting of cash advances.

Paragraph (c)(1)

1. *No less beneficial to the consumer.* A savings association may provide a method of paying the outstanding balance that is different from the methods listed in § 535.24(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 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 § 535.24(c)(1)(ii). For example, a savings association could more than double the percentage of amounts owed included in the minimum payment so long as the minimum payment does not result in amortization of the outstanding balance in less than five years. Alternatively, a savings association could require a consumer to make a minimum payment on the outstanding balance that amortizes that balance in less than five years so long as the payment does not include a percentage of the outstanding balance that is more than twice the percentage included in the minimum payment before the effective date of the increased rate.

Paragraph (c)(1)(ii)

1. *Required minimum periodic payment on other balances.* This paragraph addresses the required minimum periodic payment on the outstanding balance. This paragraph does not limit or otherwise address the savings association's ability to determine the amount of the minimum periodic payment for other balances.

2. *Example.* Assume that the method used by a savings association 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 savings association increases the annual percentage rate applicable to purchases on a consumer credit card account from 15% to 20% and that the account has an outstanding balance of $1,000 at the 15% rate. Section 535.24(c)(1)(ii) would permit the savings association to calculate the required minimum periodic payment on the outstanding balance by adding fees and interest charges to 2% of the outstanding balance.

Paragraph (c)(2)

1. *Fee or charge based solely on the outstanding balance.* You are prohibited from assessing a fee or charge based solely on an outstanding balance. For example, a savings association is prohibited from assessing a maintenance or similar fee based on an outstanding balance. A savings association 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 an outstanding balance.

Section 535.25—Unfair Fees for Exceeding the Credit Limit Due to Credit Holds

1. *General.* Under § 535.25, a savings association may not assess a fee for exceeding the credit limit if the credit limit would not have been exceeded but for a hold placed on the available credit for a consumer credit card account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 535.25 does not limit a savings association from charging a fee for exceeding the credit limit in connection with a particular transaction if the consumer would have exceeded the credit limit due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a payment that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to exceed the credit limit.

2. *Example of prohibition in connection with hold placed for same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,500. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the savings association for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, the savings association is prohibited from assessing a fee for exceeding the credit limit with respect to the $750 hold. If, however, the total cost of the stay charged to the account had been more than $500, the savings association would not be prohibited from assessing a fee for exceeding the credit limit.

3. *Example of prohibition in connection with hold placed for another transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the savings association for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $150 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, the savings association is prohibited from assessing a fee for exceeding the credit limit with respect to either the $750 hold or the $150 purchase. If, however, the total cost of the stay charged to the account had been more than $450, the savings association would not be prohibited from assessing a fee for exceeding the credit limit.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the savings association for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. When the hotel presents the

$450 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $750 hold and the $450 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's balance to exceed the credit limit. Under these circumstances, and assuming no other transactions, the savings association is prohibited from assessing a fee for exceeding the credit limit because the credit limit was exceeded solely due to the $750 hold.

5. *Example of permissible fee for exceeding the credit limit in connection with a hold.* Assume that a consumer has a credit limit of $2,000 and a balance of $1,400 on a consumer credit card account. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the savings association for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $650 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Notwithstanding the existence of the hold and assuming that there is no other activity on the account, the savings association may charge the consumer a fee for exceeding the credit limit with respect to the $650 purchase because the consumer would have exceeded the credit limit even if the hold had been for the actual amount of the hotel transaction.

Section 535.26—Unfair Balance Computation Method

(a) General Rule

1. *Two-cycle method prohibited.* A savings association 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. *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. A consumer has a zero balance on March 1. The consumer uses the credit card to make a $500 purchase on March 15. The consumer makes no other purchases and pays $400 on the due date (April 25), leaving a $100 balance. The savings association may charge interest on the $500 purchase from the start of the 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 savings association 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).

Section 535.27—Unfair Charging to the Account of Security Deposits and Fees for the Issuance or Availability of Credit

1. *Initial credit limit for the account.* For purposes of this section, the initial credit limit is the limit in effect when the account is opened.

(a) Annual Rule

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 § 535.27(a), a savings association may charge to the account security deposits and fees for the issuance or availability of credit totaling no more than $250 during the twelve months after the date on which the account is opened (consistent with § 535.27(b)).

(b) Monthly Rule

1. *Adjustments of one dollar or less permitted.* When dividing amounts pursuant to § 535.27(b)(2), the savings association may adjust amounts by one dollar or less. For example, if a savings association is dividing $125 over eleven billing cycles, the savings association may charge $12 for four months and $11 for the remaining seven months.

2. *Example.* Assume that a consumer credit card account opened on January 1 has an initial credit limit of $500 and that a savings association charges to the account security deposits and fees for the issuance or availability of credit that total $250 during the twelve months after the date on which the account is opened. 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 § 535.27(b), the savings association may charge to the account no more than $250 in security deposits and fees for the issuance or availability of credit. If it charges $250, the savings association may charge as much as $125 during the first billing cycle. If it charges $125 during the first billing cycle, it may then charge $12 in any four billing cycles and $11 in any seven billing cycles during the year.

(c) Fees for the Issuance or Availability of Credit

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.

3. *One-time fees.* Only non-periodic fees related to opening an account (such as one-time membership or participation fees) are fees for the issuance or availability of credit. Fees for reissuing a lost or stolen card and statement reproduction fees are examples of fees that are not fees for the issuance or availability of credit.

Section 535.28—Deceptive Firm Offers of Credit

(a) Disclosure of Criteria Bearing on Creditworthiness

1. *Designed to call attention.* Whether a disclosure has been provided in a manner that is designed to call attention to the nature and significance of required information depends on where the disclosure is placed in the solicitation and how it is presented, including whether the disclosure uses a typeface and type size that are easy to read and uses boldface or italics. Placing the disclosure in a footnote would not satisfy this requirement.

2. *Form of electronic disclosures.* Electronic disclosures must be provided consistent with §§ 226.5a(a)(2)–8 and 226.5a(a)(2)–9 of this title.

3. *Multiple annual percentage rates or credit limits.* For purposes of this section, a firm offer of credit solicitation that states an annual percentage rate or credit limit for a credit card feature and a different annual percentage rate or credit limit for a different credit card feature does not offer multiple annual percentage rates or credit limits. For example, if a firm offer of credit solicitation offers a 15% annual percentage rate for purchases and a 20% annual percentage rate for cash advances, the solicitation does not offer multiple annual percentage rates for purposes of this section.

4. *Example.* Assume that a savings association requests from a consumer reporting agency a list of consumers with credit scores of 650 or higher, so that the savings association can send those consumers a firm offer of credit solicitation. The savings association sends a solicitation to those consumers for a consumer credit card account advertising ''rates from 8.99% to 19.99%'' and ''credit limits from $1,000 to $10,000.'' Before selection of the consumers for the offer, however, the savings association determines that it will provide an interest rate of 8.99% and a credit limit of $10,000 only to those consumers responding to the solicitation who are verified to have a credit score of 650 or higher, who have a debt-to-income ratio below a certain amount, and who meet other specific criteria bearing on creditworthiness. Under § 535.28, this solicitation is deceptive unless the savings association discloses, in a manner that is reasonably understandable to the consumer and designed to call attention to the nature and significance of the information, that, if the consumer is approved for credit, the annual percentage rate and credit limit the consumer will receive will depend on specific criteria bearing on the consumer's creditworthiness. The savings association may satisfy this requirement by using a typeface and type size that are easy to read and stating in boldface in a manner that otherwise calls attention to the nature and

significance of the information: **''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''**

5. *Applicability of criteria in disclosure.* When making a disclosure under this section, a savings association may only disclose the criteria it uses in evaluating whether consumers who are approved for credit will receive the lowest annual percentage rate or the highest credit limit. For example, if a savings association does not consider the consumer's debts when determining whether the consumer should receive the lowest annual percentage rate or highest credit limit, the disclosure must not refer to ''debts.''

Subpart D—Overdraft Service Practices

Section 535.32—Unfair Overdraft Service Practices

(a) Opt-Out Requirement

(a)(1) General Rule

1. *Form, content and timing of disclosure.* The form, content and timing of the opt-out notice required to be provided under paragraph (a) of this section are addressed under § 230.10 of this title.

(a)(3) Exceptions

Paragraph (a)(3)(i)

1. *Example of transaction amount exceeding authorization amount (fuel purchase).* A consumer has $30 in a deposit account. The consumer uses a debit card to purchase fuel. Before permitting the consumer to use the fuel pump, the merchant verifies the validity of the card by obtaining authorization from the savings association for a $1 transaction. The consumer purchases $50 of fuel. If the savings association pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

2. *Example of transaction amount exceeding authorization amount (restaurant).* A consumer has $50 in a deposit account. The consumer pays for a $45 meal at a restaurant using a debit card. While the restaurant may obtain authorization for the $45 cost of the meal, the consumer may add $10 for a tip. If the savings association pays the $55 transaction (including the tip amount), it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

Paragraph (a)(3)(ii)

1. *Example of transaction presented by paper-based means.* A consumer has $50 in a deposit account. The consumer makes a $60 purchase and presents his or her debit card for payment. The merchant takes an imprint of the card. Later that day, the merchant submits a sales slip with the card imprint to its processor for payment. If the consumer's savings association pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

(b) Debit Holds

1. *General.* Under § 535.32(b), a savings association may not assess an overdraft fee if the overdraft would not have occurred but for a hold placed on funds in the consumer's account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 535.32(b) does not limit a savings association from charging an overdraft fee in connection with a particular transaction if the consumer would have incurred an overdraft due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a deposited check that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to overdraw his or her account.

2. *Example of prohibition in connection with hold placed for same transaction.* A consumer has $50 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's savings association for a $75 ''hold'' on the account which exceeds the consumer's funds. The consumer purchases $20 of fuel. Under these circumstances, § 535.32(b) prohibits the savings association from assessing a fee or charge in connection with the debit hold because the actual amount of the fuel purchase did not exceed the funds in the consumer's account. However, if the consumer had purchased $60 of fuel, the savings association could assess a fee or charge for an overdraft because the transaction exceeds the funds in the consumer's account, unless the consumer has opted out of the payment of overdrafts under § 535.32(a).

3. *Example of prohibition in connection with hold placed for another transaction.* A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's savings association for a $75 ''hold'' on the account. The consumer purchases $20 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Under these circumstances, § 535.32(b) prohibits the savings association from assessing a fee or charge for paying an overdraft with respect to the $75 withdrawal because the overdraft was caused solely by the $75 hold.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction.* A consumer has $100 in his deposit account, and uses his debit card to purchase $50 worth of fuel. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's savings association for a $75 ''hold'' on the account. The consumer purchases $50 of fuel. When the merchant presents the $50 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $75 hold and the $50 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's account to be overdrawn. Under these circumstances, and assuming no other transactions, § 535.32(b) prohibits the savings association from assessing a fee or charge for paying an overdraft because the overdraft was caused solely by the $75 hold.

5. *Example of permissible overdraft fees in connection with a hold.* A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's savings association for a $75 ''hold'' on the account. The consumer purchases $35 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Notwithstanding the existence of the hold, and assuming the consumer has not opted out of the payment of overdrafts under § 535.32(a), the consumer's savings association may charge the consumer an overdraft fee for the $75 ATM withdrawal, because the consumer would have incurred the overdraft even if the hold had been for the actual amount of the fuel purchase.

National Credit Union Administration

12 CFR Part 706

For the reasons discussed in the joint preamble, the National Credit Union Administration proposes to revise 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

Subpart B—Consumer Credit Practices

Subpart C—Consumer Credit Card Account Practices

Subpart D—Overdraft Service Practices

706.31 Definitions.
706.32 Unfair practices involving overdraft services.
Appendix to Part 706—Official Staff Interpretations

Authority: 15 U.S.C. 57a(f).

Subpart A—General Provisions

§ 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).

(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). This part defines and contains requirements prescribed for the purpose of preventing specific unfair or deceptive acts or practices of federal credit unions. The prohibitions in this part 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 Practices

§ 706.11 Definitions.

For purposes of this subpart, the following definitions apply:

Antique means any item over one hundred years of age, including items that have been repaired or renovated without changing their original form or character.

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.

Cosigner means a natural person who renders himself or herself liable for the obligation of another person without receiving goods, services, or money in return for the credit obligation, or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the obligation. The term 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 whose signature is required on a credit obligation to perfect a security interest pursuant to state law. A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation.

Debt means money that is due or alleged to be due from one person to another.

Earnings mean compensation paid or payable to an individual or for his or her account for personal services rendered or to be rendered by him or her, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

Household goods mean clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects, including wedding rings of the consumer and his or her dependents, provided that the following are not included within the scope of the term ''household goods'':

(1) Works of art;

(2) Electronic entertainment equipment, except one television and one radio;

(3) Items acquired as antiques; and

(4) Jewelry, except wedding rings.

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.

In connection with the extension of credit to consumers, it is an unfair act or practice for a federal credit union, directly or indirectly, to take or receive from a consumer an obligation that:

(a) Constitutes or contains 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.

(b) Constitutes or contains 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) Constitutes or contains an assignment of wages or other earnings unless:

(1) The assignment by its terms is revocable at the will of the debtor, or

(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) Constitutes or contains a nonpossessory security interest in household goods other than a purchase money security interest.

§ 706.13 Unfair or deceptive cosigner practices.

(a) *Prohibited practices.* In connection with the extension of credit to consumers, it is:

(1) A deceptive act or practice for a federal credit union, directly or indirectly, to misrepresent the nature or extent of cosigner liability to any person.

(2) An unfair act or practice for a federal credit union, directly or indirectly, to obligate a cosigner unless the cosigner is informed prior to becoming obligated, which in the case of open-end credit means prior to the time that the agreement creating the cosigner's liability for future charges is executed, of the nature of his or her liability as cosigner.

(b) *Disclosure requirement.* (1) To comply with the cosigner information requirement of paragraph (a)(2), a clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to becoming obligated. The disclosure statement must contain only the following statement, or one which is substantially similar, and shall either be a separate document or included in the documents evidencing the consumer credit obligation.

Notice to 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.

This notice is not the contract that makes you liable for the debt.

(2) If the notice to cosigner is a separate document, nothing other than the following items may appear with the notice. Paragraphs (b)(2)(i) through (v) of this section may not be part of the narrative portion of the notice to cosigner.

(i) The name and address of the federal credit union;

(ii) An identification of the debt to be cosigned, *e.g.*, a loan identification number;

(iii) The amount of the loan;

(iv) The date of the loan;

(v) A signature line for a cosigner to acknowledge receipt of the notice; and

(vi) To the extent permitted by state law, a cosigner notice required by state law may be included in the paragraph (b)(1) notice.

(3) To the extent the notice to cosigner specified in paragraph (b)(1) refers to an action against a cosigner that is not permitted by state law, the notice to cosigner may be modified.

§ 706.14 Unfair late charges.

(a) 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, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s).

(b) For purposes of this section, ''collecting a debt'' means 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 a consumer debt.

§ 706.15 State exemptions.

(a) If, upon application to the NCUA by an appropriate state agency, the NCUA determines that:

(1) There is a state requirement or prohibition in effect that applies to any transaction to which a provision of this rule applies; and

(2) The state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this rule; then that provision of this rule will not be in effect in the state to the extent specified by the NCUA in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

(b) States that received an exemption from the Federal Trade Commission's Credit Practices Rule prior to September 17, 1987, are not required to reapply to NCUA for an exemption under paragraph (a) of this section provided that the state forwards a copy of its exemption determination to the appropriate Regional Office. NCUA will honor the exemption for as long as the state administers and enforces the state requirement or prohibition effectively. Any state seeking a greater exemption than that granted to it by the Federal Trade Commission must apply to NCUA for the exemption.

§§ 706.16–706.20 [Reserved]

Subpart C—Consumer Credit Card Account Practices

§ 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.

Promotional rate means:

(1) Any annual percentage rate applicable to one or more balances or transactions on a consumer credit card account for a specified period of time that is lower than the annual percentage rate that will be in effect at the end of that period; or

(2) Any annual percentage rate applicable to one or more transactions on a consumer credit card account that is lower than the annual percentage rate that applies to other transactions of the same type.

§ 706.22 Unfair time to make payments.

(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) *Safe harbor.* A federal credit union provides a reasonable amount of time to make a payment if it has adopted reasonable procedures to ensure that periodic statements specifying the payment due date are mailed or delivered to consumers at least 21 days prior to the payment due date.

(c) *Exception for grace periods.* Paragraph (a) of this section does not apply to any time period provided by the federal credit union within which the consumer may repay any portion of the credit extended without incurring an additional finance charge.

§ 706.23 Unfair allocation of payments.

(a) *General rule for accounts with different annual percentage rates on different balances.* Except as provided in paragraph (b) of this section, when different annual percentage rates apply to different balances on a consumer credit card account, the federal credit union must 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 the consumer than one of the following methods:

(1) The amount 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;

(2) Equal portions of the amount are allocated to each balance; or

(3) The amount is allocated among the balances in the same proportion as each balance bears to the total outstanding balance.

(b) *Special rules for accounts with promotional rate balances or deferred interest balances.* (1) *Rule regarding payment allocation.* (i) In general, when a consumer credit card account has one or more balances at a promotional rate or balances on which interest is deferred, the federal credit union must allocate any amount paid by the consumer in excess of the required minimum periodic payment among the other balances on the account consistent with paragraph (a) of this section. If any amount remains after such allocation, the federal credit union must allocate that amount among the promotional rate balances or the deferred interest balances consistent with paragraph (a) of this section.

(ii) *Exception for deferred interest balances.* Notwithstanding paragraph (b)(1)(i) of this section, the federal credit union may allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to a balance on which interest is deferred during the two billing cycles immediately preceding expiration of the period during which interest is deferred.

(2) *Rule regarding grace periods.* A federal credit union must not require a consumer to repay any portion of a promotional rate balance or deferred interest balance on a consumer credit card account in order to receive any time period offered by the federal credit union in which to repay other credit extended without incurring finance charges, provided that the consumer is otherwise eligible for such a time period.

§ 706.24 Unfair application of increased annual percentage rates to outstanding balances.

(a) *Prohibition on increasing annual percentage rates on outstanding balances.*

(1) *General rule.* Except as provided in paragraph (b) of this section, a federal credit union must not increase the annual percentage rate applicable to any outstanding balance on a consumer credit card account.

(2) *Outstanding balance.* For purposes of this section, ''outstanding balance'' means the amount owed on a consumer credit card account at the end of the fourteenth day after the federal credit union provides a notice required by 12 CFR 226.9(c) or (g).

(b) *Exceptions.* Paragraph (a) of this section does not apply where the annual percentage rate is increased due to:

(1) The operation of an index or formula that is not under the federal credit union's control and is available to the general public;

(2) The expiration or loss of a promotional rate, provided that, if a promotional rate is lost, the federal credit union does not increase the annual percentage rate to a rate that is greater than the annual percentage rate that would have applied after expiration of the promotional rate; or

(3) The federal credit union not receiving the consumer's required minimum periodic payment within 30 days after the due date for that payment.

(c) *Treatment of outstanding balances following rate increase.* (1) *Payment of outstanding balances.* When a federal credit union increases the annual percentage rate applicable to a category of transactions on a consumer credit card account, and the federal credit union is prohibited by this section from applying the increased rate to outstanding balances in that category, the federal credit union must provide the consumer with a method of paying the outstanding balance that is no less beneficial to the consumer than one of the following methods:

(i) An amortization period for the outstanding balance of no less than five years, starting from the date on which the increased annual percentage rate went into effect; or

(ii) A required minimum periodic payment on the outstanding balance that includes a percentage of that balance that is no more than twice the percentage included before the date on which the increased annual percentage rate went into effect.

(2) *Fees and charges on outstanding balance.* When a federal credit union increases the annual percentage rate applicable to a category of transactions on a consumer credit card account, and the federal credit union is prohibited by this section from applying the increased rate to outstanding balances in that category, the federal credit union must not assess any fee or charge based solely on the outstanding balance.

§ 706.25 Unfair fees for exceeding the credit limit caused by credit holds.

A federal credit union must not assess 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 on any portion of the available credit on the account that is in excess of the actual purchase or transaction amount.

§ 706.26 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 outstanding balances on a consumer credit card account based on balances for days in billing cycles that precede the most recent billing cycle.

(b) *Exceptions.* Paragraph (a) of this section does not apply to:

(1) The assessment of deferred interest; or

(2) Adjustments to finance charges following the resolution of a billing error dispute under 12 CFR 226.12(b) or 12 CFR 226.13.

§ 706.27 Unfair financing of security deposits and fees for the issuance or availability of credit.

(a) *Annual rule.* During the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date, a federal credit union must not charge to the account security deposits or fees for the issuance or availability of credit if the total amount of such security deposits and fees constitutes a majority of the credit limit for the account.

(b) *Monthly rule.* If the total amount of security deposits and fees for the issuance or availability of credit charged to a consumer credit card account during the period beginning with the date on which a consumer credit card account is opened and ending twelve months from that date constitutes more than 25 percent of the initial credit limit for the account:

(1) During the first billing cycle after the account is opened, the federal credit union must not charge security deposits and fees for the issuance or availability of credit that total more than 25 percent of the initial credit limit for the account; and

(2) In each of the eleven billing cycles following the first billing cycle, the federal credit union must not charge to the account more than one eleventh of the total amount of any additional security deposits and fees for the issuance of availability of credit in excess of 25 percent of the initial credit limit for the account.

(c) *Fees for the issuance or availability of credit.* For purposes of paragraphs (a) and (b) of this section, fees for the issuance or availability of credit include:

(1) 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

(2) Any non-periodic fee that relates to opening an account.

§ 706.28 Deceptive firm offers of credit.

(a) *Disclosure of criteria bearing on creditworthiness.* If a federal credit union offers a range or multiple annual percentage rates or credit limits when making a solicitation for a firm offer of credit for a consumer credit card account, and the annual percentage rate or credit limit that consumers approved for credit will receive depends on specific criteria bearing on creditworthiness, the federal credit union must disclose the types of criteria in the solicitation. The disclosure must be provided in a manner that is reasonably understandable to consumers and is designed to call attention to the nature and significance of the information regarding the eligibility criteria for the lowest annual percentage rate or highest credit limit stated in the solicitation. If presented in a manner that calls attention to the nature and significance of the information, the following disclosure may be used to satisfy the requirements of this section, as applicable: ''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income, and debts.''

(b) *Firm offer of credit defined.* For purposes of this section, ''firm offer of credit'' has the same meaning as ''firm offer of credit or insurance'' in section 603(l) of the Fair Credit Reporting Act (15 U.S.C. 1681a(l)).

§§ 706.29–706.30 [Reserved]

Subpart D—Overdraft Services

§ 706.31 Definitions.

For purposes of this subpart, the following definitions apply:

Account means a share account at a federal credit union that is held by or offered to a consumer, and has the same meaning as in § 707.2(a) of this chapter.

Consumer means a member who holds an account primarily for personal, family, or household purposes.

Overdraft service means a service under which a federal credit union charges a fee for paying a transaction, including a check or other item, that overdraws an account. The term ''overdraft service'' does not include any payment of overdrafts pursuant to—

(1) A line of credit subject to the Federal Reserve Board's Regulation Z, 12 CFR part 226, including transfers from a credit card account, home equity line of credit, or overdraft line of credit; or

(2) A service that transfers funds from another account of the consumer.

§ 706.32 Unfair practices involving overdraft services.

(a) *Opt-out requirement.* (1) *General rule.* A federal credit union must not assess a fee or charge on a consumer's account in connection with an overdraft service, unless the federal credit union provides the consumer the right to opt out of the federal credit union's payment of overdrafts and a reasonable opportunity to exercise that opt-out, and the consumer has not opted out. The consumer must be given notice and an opportunity to opt out before the federal credit union's assessment of any fee or charge for an overdraft, and subsequently at least once during or for any periodic statement cycle in which any fee or charge for paying an overdraft is assessed. The notice requirements in this paragraph (a)(1) and (a)(2) do not apply if the consumer has opted out, unless the consumer subsequently revokes the opt-out.

(2) *Partial opt-out.* A federal credit union must provide a consumer the option of opting out only for the payment of overdrafts at automated teller machines and for point-of-sale transactions initiated by a debit card, in addition to the choice of opting out of the payment of overdrafts for all transaction.

(3) *Exceptions.* Notwithstanding a consumer's election to opt out under paragraphs (a)(1) or (a)(2) of this section, a federal credit union may assess a fee or charge on a consumer's account for paying a debit card transaction that overdraws an account if:

(i) There were sufficient funds in the consumer's account at the time the authorization request was received, but the actual purchase amount for that transaction exceeds the amount that had been authorized; or

(ii) The transaction is presented for payment by paper-based means, rather than electronically through a card terminal, and the federal credit union has not previously authorized the transaction.

(4) *Time to comply with opt-out.* A federal credit union must comply with a consumer's opt-out request as soon as reasonably practicable after the federal credit union receives it.

(5) *Continuing right to opt-out.* A consumer may opt out of the federal credit union's future payment of overdrafts at any time.

(6) *Duration of opt-out.* A consumer's opt-out is effective unless subsequently revoked by the consumer.

(b) *Debit holds.* A federal credit union shall not assess a fee or charge on a consumer's account for an overdraft service if the consumer's overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount.

Appendix to Part 706—Official Staff Interpretations

Subpart C—Consumer Credit Card Account Practices

Section 706.21—Definitions

(d) Promotional Rate

Paragraph (d)(1)

1. *Rate in effect at the end of the promotional period.* If the annual percentage rate that will be in effect at the end of the specified period of time is a variable rate, the rate in effect at the end of that period for purposes of § 706.21(d)(1) is the rate that would otherwise apply if the promotional rate was not offered, consistent with any applicable accuracy requirements under 12 CFR part 226.

Paragraph (d)(2)

1. *Example.* A federal credit union generally offers a 15% annual percentage rate for purchases on a consumer credit card account. For purchases made during a particular month, however, the creditor offers a rate of 5% that will apply until the consumer pays those purchases in full. Under § 706.21(d)(2), the 5% rate is a ''promotional rate'' because it is lower than the 15% rate that applies to other purchases.

Section 706.22—Unfair Time To Make Payment

(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 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), 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 prior to the payment due date.

(b) Safe Harbor

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 individual consumer. A federal credit union provides a reasonable amount of time to make a payment if the federal credit union has adopted reasonable procedures designed to ensure that periodic statements are mailed or delivered to consumers no later than, for example, three days after the closing date of the billing cycle and the payment due date on the periodic statement is no less than 24 days after the closing date of the billing cycle.

2. *Payment due date.* For purposes of § 706.22(b), ''payment due date'' means the date by which the federal credit union requires the consumer to make payment to avoid being treated as late for any purpose, except as provided in § 706.22(c).

Section 706.23—Unfair Allocation of Payments

1. *Minimum periodic payment.* This section addresses the allocation of amounts paid by the consumer in excess of the minimum periodic payment required by the federal credit union. This section does not limit or otherwise address the federal credit union's ability to determine the amount of the minimum periodic payment or how that payment is allocated.

2. *Adjustments of one dollar or less permitted.* When allocating payments, the federal credit union may adjust amounts by one dollar or less. For example, if a federal credit union is allocating $100 equally among three balances, the federal credit union may apply $34 to one balance and $33 to the others. Similarly, if a federal credit union is splitting $100.50 between two balances, the federal credit union may apply $50 to one balance and $50.50 to another.

(a) General Rule for Accounts With Different Annual Percentage Rates on Different Balances

1. *No less beneficial to the consumer.* A federal credit union may allocate payments using a method that is different from the methods listed in § 706.23(a) 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 than a listed method if it results in the assessment of the same or a lesser amount of interest charges than would be assessed under any of the listed methods. For example, a federal credit union may not allocate the entire amount paid by the consumer in excess of the required minimum periodic payment to the balance with the lowest annual percentage rate because this method would result in a higher assessment of interest charges than any of the methods listed in § 706.23(a).

2. *Example of payment allocation method that is no less beneficial to consumers than a method listed in § 706.23(a).* Assume that a consumer's account has a cash advance balance of $500 at annual percentage rate of 15% and a purchase balance of $1,500 at an annual percentage rate of 10% and that the consumer pays $555 in excess of the required minimum periodic payment. A federal credit union could allocate one-third of this amount ($185) to the cash advance balance and two-thirds ($370) to the purchase balance even though this is not a method listed in § 706.23(a) because the federal credit union is applying more of the amount to the balance with the highest annual percentage rate, with the result that the consumer will be assessed less in interest charges, than would be the case under the pro rata allocation method in § 706.23(a)(3). *See* comment 23(a)(3)–1.

Paragraph (a)(1)

1. *Examples of allocating first to the balance with the highest annual percentage rate.*

(A) 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. None of the minimum periodic payment is allocated to the cash advance balance. 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.

(B) 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.

Paragraph (a)(2)

1. *Example of equal portion method.* 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 $555 in excess of the required minimum periodic payment. A federal credit union using this method would allocate $278 to the cash advance balance and $277 to the purchase balance, or vice versa.

Paragraph (a)(3)

1. *Example of pro rata method.* 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 $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.

(b) Special Rules for Accounts With Promotional Rate Balances or Deferred Interest Balances

Paragraph (b)(1)(i)

1. *Examples of special rule regarding payment allocation for accounts with promotional rate balances or deferred interest balances.*

(A) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 15%, a purchase balance of $1,500 at an annual percentage rate of 10%, and a transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. The federal credit union must allocate the $800 between the cash advance and purchase balances, consistent with § 706.23(a), and apply nothing to the transferred balance.

(B) A consumer credit card account has a cash advance balance of $500 at an annual percentage rate of 15%, a balance of $1,500 on which interest is deferred, and transferred balance of $3,000 at a promotional rate of 5%. The consumer pays $800 in excess of the required minimum periodic payment. None of the minimum periodic payment is allocated to the cash advance balance. The federal credit union must allocate $500 to pay off the cash advance balance before allocating the remaining $300 among the balance on which interest is deferred and the transferred balance, consistent with § 706.23(a).

Paragraph (b)(1)(ii)

1. *Examples of exception for deferred interest balances.* Assume that on January 1, a consumer uses a credit card to make a $1,000 purchase on which interest is deferred until June 30. If this amount is not paid in full by June 30, all interest accrued during the six-month period will be charged to the account. The billing cycle for this credit card begins on the first day of the month and ends on the last day of the month. Each month from January through June, the consumer uses the credit card to make $200 in purchases on which interest is not deferred.

(A) The consumer pays $300 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the federal credit union must allocate $200 to the purchase balance and $100 to the deferred interest balance. For the May and June billing cycles, however, the federal credit union has the option of allocating the entire $300 to the deferred interest balance, which will result in that balance being paid in full before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will not be assessed to the consumer's account.

(B) The consumer pays $200 in excess of the minimum periodic payment each month from January through June. None of the minimum periodic payment is applied to the deferred interest balance or the purchase balance. For the January, February, March, and April billing cycles, the federal credit union must allocate the entire $200 to the purchase balance. For the May and June billing cycles, however, the federal credit union has the option to allocate the entire $200 to the deferred interest balance, which will result in that balance being reduced to $600 before the deferred interest period expires on June 30. In this example, the interest that accrued between January 1 and June 30 will be assessed to the consumer's account.

Paragraph (b)(2)

1. *Example of special rule regarding grace periods for accounts with promotional rate balances or deferred interest balances.* A federal credit union offers a promotional rate on balance transfers and a higher rate on purchases. The federal credit union also offers a grace period under which consumers who pay their balances in full by the due date are not charged interest on purchases. A consumer who has paid the balance for the prior billing cycle in full by the due date transfers a balance of $2,000 and makes a purchase of $500. Because the federal credit union offers a grace period, the federal credit union must provide a grace period on the $500 purchase if the consumer pays that amount in full by the due date, even though the $2,000 balance at the promotional rate remains outstanding.

Section 706.24—Unfair Application of Increased Annual Percentage Rates to Outstanding Balances

(a) Prohibition Against Increasing Annual Percentage Rates on Outstanding Balances

1. *Example.* Assume that on December 30 a consumer credit card account has a balance of $1,000 at an annual percentage rate of 10%. On December 31, the federal credit union mails or delivers a notice required by 12 CFR 226.9(c) informing the consumer that the annual percentage rate will increase to 15% on February 15. The consumer uses the account to make $2,000 in purchases on January 10 and $1,000 in purchases on January 20. Assuming no other transactions, the outstanding balance for purposes of § 706.24 is the $3,000 balance as of the end of the day on January 14. Therefore, under § 706.24(a), the federal credit union cannot increase the annual percentage rate applicable to that balance. The federal credit union can apply the 15% rate to the $1,000 in purchases made on January 20 but, consistent with 12 CFR 226.9(c), the federal credit union cannot do so until February 15.

2. *Reasonable procedures.* A federal credit union is not required to determine the specific date on which a notice required by 12 CFR 226.9(c) or (g) was provided. For purposes of § 706.24(a)(2), if the federal credit union has adopted reasonable procedures designed to ensure that notices required by 12 CFR 226.9(c) or (g) are provided to consumers no later than, for example, three days after the event giving rise to the notice, the outstanding balance is the balance at the end of the seventeenth day after such event.

(b) Exceptions

Paragraph (b)(1)

1. *External index.* A federal credit union may increase the annual percentage rate on an outstanding balance if the increase is based on an index outside the federal credit union's control. A federal credit union may not increase the rate on an outstanding balance based on its own prime rate or cost of funds and may not reserve a contractual right to change rates on outstanding balances at its discretion. In addition, a federal credit union may not increase the rate on an outstanding balance by changing the method used to determine that rate. 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.

2. *Publicly available.* The index 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.

Paragraph (b)(2)

1. *Example.* Assume that a consumer credit card account has a balance of $1,000 at a 5% promotional rate and that the federal credit union also charges an annual percentage rate of 15% for purchases and a penalty rate of 25%. If the consumer does not make payment by the due date and the account agreement specifies that event as a trigger for applying the penalty rate, the federal credit union may increase the annual percentage rate on the $1,000 from the 5% promotional rate to the 15% annual percentage rate for purchases. The federal credit union may not, however, increase the rate on the $1,000 from the 5% promotional rate to the 25% penalty rate, except as otherwise permitted under § 706.24(b)(3).

Paragraph (b)(3)

1. *Example.* Assume that the annual percentage rate applicable to purchases on a consumer credit card account is increased from 10% to 15% and that the account has an outstanding balance of $1,000 at the 10% rate. The payment due date on the account is the twenty-fifth of the month. If the federal credit union has not received the required minimum periodic payment due on March 15 on or before April 14, the federal credit union may increase the rate applicable to the $1,000 balance once the federal credit union has complied with the notice requirements in 12 CFR 226.9(g).

(c) Treatment of Outstanding Balances Following Rate Increase

1. *Scope.* This provision does not apply if the consumer credit card account does not have an outstanding balance. This provision also does not apply if a rate is increased pursuant to any of the exceptions in § 706.24(b).

2. *Category of transactions.* This provision does not apply to balances in categories of transactions other than the category for which the federal credit union has increased the annual percentage rate. For example, if a federal credit union increases the annual percentage rate that applies to purchases but not the rate that applies to cash advances, § 706.24(c)(1) and (2) apply to an outstanding balance consisting of purchases but not an outstanding balance consisting of cash advances.

Paragraph (c)(1)

1. *No less beneficial to the consumer.* A federal credit union may provide a method of paying the outstanding 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 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 § 706.24(c)(1)(ii). For example, a federal credit union could more than double the percentage of amounts owed included in the minimum payment so long as the minimum payment does not result in amortization of the outstanding balance in less than five years. Alternatively, a federal credit union could require a consumer to make a minimum payment on the outstanding balance that amortizes that balance in less than five years so long as the payment does not include a percentage of the outstanding balance that is more than twice the percentage included in the minimum payment before the effective date of the increased rate.

Paragraph (c)(1)(ii)

1. *Required minimum periodic payment on other balances.* This paragraph addresses the required minimum periodic payment on the outstanding balance. This paragraph does not limit or otherwise address the federal credit union's ability to determine the amount of the 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 federal credit union increases the annual percentage rate applicable to purchases on a consumer credit card account from 10% to 15% and that the account has an outstanding balance of $1,000 at the 10% rate. Section 706.24(c)(1)(ii) would permit the federal credit union to calculate the required minimum periodic payment on the outstanding balance by adding fees and interest charges to 2% of the outstanding balance.

Paragraph (c)(2)

1. *Fee or charge based solely on the outstanding balance.* A federal credit union is prohibited from assessing a fee or charge based solely on an outstanding balance. For example, a federal credit union is prohibited from assessing a maintenance or similar fee based on an outstanding 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 an outstanding balance.

Section 706.25—Unfair Fees for Exceeding the Credit Limit Caused by Credit Holds

1. *General.* Under § 706.25, a federal credit union may not assess a fee for exceeding the credit limit if the credit limit would not have been exceeded but for a hold placed on the available credit for a consumer credit card account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 706.25 does not limit a federal credit union from charging a fee for exceeding the credit limit in connection with a particular transaction if the consumer would have exceeded the credit limit due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a payment that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to exceed the credit limit.

2. *Example of prohibition in connection with hold placed for same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,500. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the federal credit union for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming that there is no other activity on the account, the federal credit union is prohibited from assessing a fee for exceeding the credit limit with respect to the $750 hold. If, however, the total cost of the stay charged to the account had been more than $500, the federal credit union would not be prohibited from assessing a fee for exceeding the credit limit.

3. *Example of prohibition in connection with hold placed for another transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the federal credit union for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $150 purchase. The

consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Assuming there is no other activity on the account, the federal credit union is prohibited from assessing a fee for exceeding the credit limit with respect to either the $750 hold or the $150 purchase. If, however, the total cost of the stay charged to the account had been more than $450, the federal credit union would not be prohibited from assessing a fee for exceeding the credit limit.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the federal credit union for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. When the hotel presents the $450 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $750 hold and the $450 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's balance to exceed the credit limit. Under these circumstances, and assuming no other transactions, the federal credit union is prohibited from assessing a fee for exceeding the credit limit because the credit limit was exceeded solely due to the $750 hold.

5. *Example of permissible fee for exceeding the credit limit in connection with a hold.* Assume that a consumer credit card account has a credit limit of $2,000 and a balance of $1,400. The consumer uses the credit card to check into a hotel for an anticipated stay of five days. When the consumer checks in, the hotel obtains authorization from the federal credit union for a $750 hold on the account to ensure there is adequate available credit to cover the cost of the anticipated stay. While the hold remains in place, the consumer uses the credit card to make a $650 purchase. The consumer checks out of the hotel after three days, and the total cost of the stay is $450, which is charged to the consumer's credit card account. Notwithstanding the existence of the hold and assuming there is no other activity on the account, the federal credit union may charge the consumer a fee for exceeding the credit limit with respect to the $650 purchase because the consumer would have exceeded the credit limit even if the hold had been for the actual amount of the hotel transaction.

Section 706.26—Unfair Balance Computation Method

(a) General Rule

1. *Two-cycle method prohibited.* A 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 outstanding 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. *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. A consumer has a zero balance on March 1. The consumer uses the credit card to make a $500 purchase on March 15. The consumer makes no other purchases and pays $400 on the due date, April 25, leaving a $100 balance. The federal credit union may charge interest on the $500 purchase from the start of the 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.

Section 706.27—Unfair Financing of Security Deposits and Fees for the Issuance or Availability of Credit

1. *Initial credit limit for the account.* For purposes of this section the credit limit is the limit in effect when the account is opened.

(a) Annual Rule

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 credit limit if that total is greater than half of the credit limit. For example, assume that a consumer credit card account has a credit limit of $500. Under § 706.27(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 twelve months after the date on which the account is opened, consistent with § 706.27(b), but may not charge any more than that amount.

(b) Monthly Rule

1. *Adjustments of one dollar or less permitted.* When dividing amounts pursuant to § 706.27(b)(2), the federal credit union may adjust amounts by one dollar or less. For example, if a federal credit union is dividing $125 over eleven billing cycles, the federal credit union may charge $12 for four months and $11 for the remaining seven months.

2. *Example.* Assume that a consumer credit card account opened on January 1 has a credit limit of $500 and that a federal credit union charges to the account security deposits and fees for the issuance or availability of credit that total $250 during the twelve months after the date on which the account is opened. 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 § 706.27(b), 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. If it charges $250, the federal credit union may charge as much as $125 during the first billing cycle. If it charges $125 during the first billing cycle, it may then charge $12 in any four billing cycles and $11 in any seven billing cycles during the year.

(c) Fees for the Issuance or Availability of Credit

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.

3. *One-time fees.* Only non-periodic fees related to opening an account, such as one-time membership or participation fees, are fees for the issuance or availability of credit. Fees for reissuing a lost or stolen card and statement reproduction fees are examples of fees that are not fees for the issuance or availability of credit.

Section 706.28—Deceptive Firm Offers of Credit

(a) Disclosure of Criteria Bearing on Creditworthiness

1. *Designed to call attention.* Whether a disclosure has been provided in a manner that is designed to call attention to the nature and significance of required information depends on where the disclosure is placed in the solicitation and how it is presented, including whether the disclosure uses a typeface and type size that are easy to read and uses boldface or italics. Placing the disclosure in a footnote would not satisfy this requirement.

2. *Form of electronic disclosures.* Electronic disclosures must be provided consistent with 12 CFR 226.5a(a)(2)–8 and –9.

3. *Multiple annual percentage rates or credit limits.* For purposes of this section, a firm offer of credit solicitation that states an annual percentage rate or credit limit for a credit card feature and a different annual percentage rate or credit limit for a different credit card feature does not offer multiple annual percentage rates or credit limits. For example, if a firm offer of credit solicitation offers a 10% annual percentage rate for purchases and a 15% annual percentage rate for cash advances, the solicitation does not offer multiple annual percentage rates for purposes of this section.

4. *Example.* Assume that a federal credit union requests from a consumer reporting agency a list of consumers with credit scores of 650 or higher so that the federal credit union can send those consumers a firm offer of credit solicitation. The federal credit union sends a solicitation to those consumers for a

consumer credit card account advertising ''rates from 8.99% to 14.99%'' and ''credit limits from $1,000 to $10,000.'' Before selection of the consumers for the offer, however, the federal credit union determines that it will offer an interest rate of 8.99% only to those consumers responding to the solicitation who are verified to have a credit score of 650 or higher, who have a debt-to-income ratio below a certain amount, and who meet other specific criteria bearing on creditworthiness. Under § 706.28, this solicitation is deceptive unless the federal credit union discloses, in a manner that is reasonably understandable to the consumer and designed to call attention to the nature and significance of the information, that, if the consumer is approved for credit, the annual percentage rate and credit limit the consumer will receive will depend specific criteria bearing on the consumer's creditworthiness. The federal credit union may satisfy this requirement by using a typeface and type size that are easy to read and stating in boldface in a manner that otherwise calls attention to the nature and significance of the information: **''If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, debt-to-income ratio, and debts.''**

5. *Applicability of criteria in disclosure*. When making a disclosure under this section, a federal credit union may only disclose the criteria it uses in evaluating whether consumers who are approved for credit will receive the lowest annual percentage rate or the highest credit limit. For example, if a federal credit union does not consider the consumer's debts when determining whether the consumer should receive the lowest annual percentage rate or highest credit limit, the disclosure must not refer to ''debts.''

Subpart D—Overdraft Services

Section 706.32—Unfair Practices Involving Overdraft Services

(a) Opt-Out Requirement

(a)(1) General Rule

1. *Form, content, and timing of disclosure*. The form, content, and timing of the opt-out notice required to be provided under paragraph (a) of this section are addressed under § 707.10 of this chapter.

(a)(3) Exceptions

Paragraph (a)(3)(i)

1. *Example of transaction amount exceeding authorization amount (fuel purchase)*. A consumer has $30 in a deposit account. The consumer uses a debit card to purchase fuel. Before permitting the consumer to use the fuel pump, the merchant verifies the validity of the card by obtaining authorization from the federal credit union for a $1 transaction. The consumer purchases $50 of fuel. If the federal credit union pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

2. *Example of transaction amount exceeding authorization amount (restaurant)*. A consumer has $50 in a deposit account. The consumer pays for a $45 meal at a restaurant using a debit card. While the restaurant may obtain authorization for the $45 cost of the meal, the consumer may add $10 for a tip. If the federal credit union pays the $55 transaction, including the tip amount, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

Paragraph (a)(3)(ii)

1. *Example of transaction presented by paper-based means*. A consumer has $50 in a deposit account. The consumer makes a $60 purchase and presents his or her debit card for payment. The merchant takes an imprint of the card. Later that day, the merchant submits a sales slip with the card imprint to its processor for payment. If the consumer's federal credit union pays the transaction, it would be permitted to assess a fee or charge for paying the overdraft, even if the consumer has opted out of the payment of overdrafts.

(b) Debit Holds

1. *General*. Under § 706.32(b), a federal credit union may not assess an overdraft fee if the overdraft would not have occurred but for a hold placed on funds in the consumer's account for a transaction that has been authorized but has not yet been presented for settlement, if the amount of the hold is in excess of the actual purchase or transaction amount when the transaction is settled. Section 706.32(b) does not limit a federal credit union from charging an overdraft fee in connection with a particular transaction if the consumer would have incurred an overdraft due to other reasons, such as other transactions that may have been authorized but not yet presented for settlement, a deposited check that is returned, or if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to overdraw his or her account.

2. *Example of prohibition in connection with hold placed for same transaction*. A consumer has $50 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's federal credit union for a $75 ''hold'' on the account which exceeds the consumer's funds. The consumer purchases $20 of fuel. Under these circumstances, § 706.32(b) prohibits the federal credit union from assessing a fee or charge in connection with the debit hold because the actual amount of the fuel purchase did not exceed the funds in the consumer's account. However, if the consumer had purchased $60 of fuel, the federal credit union could assess a fee or charge for an overdraft because the transaction exceeds the funds in the consumer's account, unless the consumer has opted out of the payment of overdrafts under § 706.32(a).

3. *Example of prohibition in connection with hold placed for another transaction*. A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's federal credit union for a $75 ''hold'' on the account. The consumer purchases $20 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Under these circumstances, § 706.32(b) prohibits the federal credit union from assessing a fee or charge for paying an overdraft with respect to the $75 withdrawal because the overdraft was caused solely by the $75 hold.

4. *Example of prohibition when authorization and settlement amounts are held for the same transaction*. A consumer has $100 in his deposit account, and uses his debit card to purchase $50 worth of fuel. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's federal credit union for a $75 ''hold'' on the account. The consumer purchases $50 of fuel. When the merchant presents the $50 transaction for settlement, it uses a different transaction code to identify the transaction than it had used for the pre-authorization, causing both the $75 hold and the $50 purchase amount to be temporarily posted to the consumer's account at the same time, and the consumer's account to be overdrawn. Under these circumstances, and assuming no other transactions, § 706.32(b) prohibits the federal credit union from assessing a fee or charge for paying an overdraft because the overdraft was caused solely by the $75 hold.

5. *Example of permissible overdraft fees in connection with a hold*. A consumer has $100 in a deposit account. The consumer makes a fuel purchase using his or her debit card. Before permitting the consumer to use the fuel pump, the merchant obtains authorization from the consumer's federal credit union for a $75 ''hold'' on the account. The consumer purchases $35 of fuel, but the transaction is not presented for settlement until the next day. Later on the first day, and assuming no other transactions, the consumer withdraws $75 at an ATM. Notwithstanding the existence of the hold, and assuming the consumer has not opted out of the payment of overdrafts under § 706.32(a), the consumer's federal credit union may charge the consumer an overdraft fee for the $75 ATM withdrawal, because the consumer would have incurred the overdraft even if the hold had been for the actual amount of the fuel purchase.

By order of the Board of Governors of the Federal Reserve System, May 2, 2008.

Jennifer J. Johnson,

Secretary of the Board.

Dated: April 29, 2008.

By the Office of Thrift Supervision.

John M. Reich,

Director.

By the National Credit Union Administration Board, on May 2, 2008.

Mary F. Rupp,

Secretary of the Board.

[FR Doc. E8–10247 Filed 5–16–08; 8:45 am]

BILLING CODE 6210–01– (33%) 6720–01– (33%) 7535–01– (33%) P