

Financial Institutions

E-ALERT

May 21, 2009

New Credit Card Legislation

The U.S. House of Representatives yesterday passed, by a wide margin (on a vote of 361 to 64), the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Act").¹ The House action followed by just one day the Senate's adoption of the Act with comparably broad bipartisan support (on a vote of 90 to 5). The Act, imposing sweeping new restrictions on the credit card industry, prohibits so-called "double-cycle" billing, limits issuers' ability to levy increased rates and fees, constrains the extension of credit to young adults, and imposes heightened disclosure obligations on issuers. The Act also includes controversial restrictions on the permitted terms for gift cards.

Notably, the bill omits any cap on interest rates, a measure that had been sought by a number of lawmakers. Thus, while issuers generally will be limited in their ability to increase rates on existing balances — at least until the cardholder's payment is substantially overdue — they can still raise them prospectively.

Passage of the Act follows by less than one month President Obama's April 23 meeting with card industry representatives, at which he called for significant changes in the structure and disclosure of credit card rates and fees. The Act delivers the President's wish list, in part by adopting many of the provisions included in credit card regulations promulgated last December by the Board of Governors of the Federal Reserve System (the "Board") and other agencies,² and in part by adding additional measures. President Obama is expected to sign the legislation into law in the next several days. The Act generally will become effective 9 months after enactment, although some provisions will take effect in as little as 90 days, while others will not come into effect for 15 months.

WHAT ARE THE PRACTICAL IMPACTS OF THE ACT FOR THE CARD INDUSTRY?

While it is too early to know with certainty, it would seem probable that issuers will impose higher fees for unrestricted activities, such as balance transfers, cash advances and foreign exchange conversions, as well as higher interest rates at the outset of the cardholder relationship. Lender standards for borrower creditworthiness likely will be heightened as well, resulting in the issuance of fewer cards, and those cards that are approved may feature somewhat lower credit limits.

Passage of the Act also presages an era of lower margins for issuers, with the possibility of even further concentration within an industry that already has seen considerable consolidation in recent years. This same reduction in margins also will mean lower returns for co-branding parties and entities that benefit from credit card affinity agreements.

¹ Credit Card Accountability Responsibility and Disclosure Act of 2009, H.R. 627, 111th Cong. (2009).

² See [Client Advisory on New Federal Credit Card Regulations](#), Covington E-Alert (December 19, 2008).

KEY LIMITATIONS ON RATES AND FEES

The Act imposes a number of new disclosure requirements and a broad array of restrictions on certain credit card industry practices. These provisions, which become effective 9 months after enactment, include:

- **Limits on Interest Rate, Fee, and Finance Charge Increases on Outstanding Balances.** Card issuers may increase the annual percentage rate, fee, or finance charge applicable to outstanding balances only under four circumstances: (i) when the increase occurs after an introductory rate expires, (ii) the cardholder fails to make the required minimum payment within 60 days of the due date, (iii) the rate is based on a variable index not controlled by the issuer, or (iv) the borrower has entered into a workout arrangement with the issuer.
- **Limits on Account Interest Rate Increases within the First Year.** Issuers generally may increase credit card account interest rates within the first year the account is open only under the circumstances permitted for increases on outstanding balances, described above. Promotional rates may not be increased during the first 6 months an account is open, subject to such “reasonable” exceptions as the Board may provide.
- **Single-Cycle Billing Required.** “Double-cycle” billing — a method of calculating finance charges based on the average daily balance owed over the past 2 billing cycles — is prohibited, except for adjustments occurring as part of a dispute resolution or as a result of payments returned for insufficient funds.
- **Application of Payments to Highest-Rate Balances.** Generally, card issuers must first apply amounts in excess of the minimum payment to the card balance bearing the highest rate of interest, and then to successive balances bearing the highest rate of interest.
- **Limits on Fees Tied to Manner of Payment.** Issuers are barred from charging separate fees to cardholders who pay by telephone, mail, electronic transfer or online, except when an issuer representative is providing expedited service to the cardholder.
- **Opt-In Requirement for “Over-the-Limit” Transactions.** Credit card issuers may not charge “over-the-limit” fees unless the credit card holder elects to allow the issuer to complete over-the-limit transactions; and, if the borrower does opt-in for such over-the-limit protection, the Act limits the number of instances in which the applicable fees may be assessed for a single instance of exceeding the limit.

ENHANCED CONSUMER DISCLOSURES

The Act also prescribes heightened disclosures to consumers, which will be required 9 months after enactment, except as otherwise indicated below. These include the following:

- **Advance Notice of Prospective Rate Increases.** Issuers must provide cardholders advance written notice at least 45 days before increasing an interest rate, or before any other change in account terms determined by the Board to be “significant,” unless the rate increase merely continues a permitted rate increase for an outstanding balance, as described above. This disclosure obligation takes effect quickly — just 90 days after enactment of the legislation.
- **Payoff Timing.** Credit card issuers will be required to disclose to account holders a broad array of information relating to the total cost of various repayment strategies — including the amount of time required to pay off balances when making only the minimum payment, as well as the total amount of interest expense that would be incurred — and must provide a toll-free number with information about accessing credit counseling and debt management services.

- **Disclosure of Late Payment Penalties.** Periodic statements provided to consumers must disclose the due date after which a late payment penalty will be imposed, the amount of the penalty that will be imposed, and any resulting rate increase that might occur as a result of the late payment.
- **Internet Posting of Credit Card Agreements.** Pursuant to regulations promulgated by the Board and the Federal Trade Commission, credit card issuers must establish and maintain a website providing the written agreement between the credit card issuer and the consumer for each credit card account, with limited exceptions. The Board will maintain a database compiling all of these agreements, which shall be publicly available.

ISSUANCE AND MARKETING OF CREDIT CARDS TO YOUNG ADULTS

The Act takes aim at the collegiate credit card market, which some have criticized as a trap for unwary and unsophisticated young adults. These provisions will become effective 9 months after enactment, except as otherwise indicated below.

- **Extensions of Credit to Young Adults.** Credit cards may be issued to persons under age 21 only if (i) the application is cosigned by a person older than 21 or (ii) the application demonstrates that the cardholder has independent means to repay any credit extended.³
- **Offering of Credit Cards on College Campuses.** Institutions of higher education must publicly disclose any agreement made with an issuer to market a credit card. Card issuers may not provide students with any “tangible” inducement to apply for a credit card if the offer is made on or near the college campus, or at an event sponsored by the school.
- **College Credit Card Agreements.** Card issuers must provide reports to the Board describing the terms and conditions of all business, marketing, and promotional agreements with institutions of higher education, alumni associations or other affiliates.

OTHER SIGNIFICANT CREDIT CARD PROVISIONS OF THE ACT

These additional provisions will become effective 9 months after enactment, except as otherwise indicated below:

- **Subprime or “Fee Harvester” Card Issuance Limitations.** Credit card issuers issuing subprime cards, under which certain fees owed by the consumer in the first year exceed 25 percent of the amount of credit authorized, may not charge fees to the line of credit available under the terms of the account.
- **Crediting Payments Received on Weekends or Holidays.** When a payment falls due on a weekend or holiday, card issuers may not treat as late payments received the next business day.
- **Credit Card Statement Notice Requirement.** Card issuers may not treat a payment as late unless the issuer has adopted procedures to mail or deliver periodic statements to consumers no later than 21 days prior to the payment due date (the current requirement is 14 days).⁴
- **Alternative Repayment Options.** Credit card issuers may not change the terms governing the repayment of any outstanding balance, but may provide credit card holders with alternative repayment options, as specified in the legislation.

³ This provision will become effective 90 days after enactment of the Act.

⁴ This provision will become effective 90 days after enactment of the Act.

- **Reasonable Penalties for Card Holders.** Penalty fees imposed for violations of a credit card agreement must be “reasonable and proportional” to the violation. This provision will become effective 15 months after enactment of the Act.
- **Periodic Interest Rate Review.** Card issuers that increase interest rates on accounts based on a variety of factors, such as the risk associated with the obligor or market conditions, must review such factors periodically and reduce interest rates when indicated by the review. This provision will become effective 15 months after enactment of the Act.
- **Consideration of Ability to Repay.** Under the new legislation, card issuers may not open a credit card account for any consumer, or increase a credit card holder’s credit limit, without considering the ability of the consumer to make the required payments under the terms of the account.

GIFT CARD RESTRICTIONS

The Act also includes new, separate limitations — effective 15 months after enactment of the legislation — on gift cards which, while not subject to the same criticism as credit cards, have come under scrutiny for their use of service charges and expiration dates that result in the forfeiture of some or all of the card’s value. These include:

- **Limitation on Imposition of Fees or Charges.** Issuers may not impose a dormancy, inactivity or other service fee with respect to a gift certificate, store gift card, or general-use prepaid card, unless the certificate or card has been inactive for the 12-month period ending on the day the charge is imposed. Only one fee may be imposed per month, and then only if the issuer has adequately disclosed the fee arrangement while also meeting any other requirements imposed by the Board.⁵
- **Limitation on Expiration Dates.** Gift certificates, store gift cards, and general-use prepaid cards may not have an expiration date earlier than 5 years after the card or gift certificate was acquired, or the date on which funds were last loaded on a card, and then only if the expiration date is clearly and conspicuously disclosed.

ENHANCED PENALTIES FOR VIOLATIONS

The Act increases the civil penalty for violations of the Truth in Lending Act as applied to credit cards to twice the amount of any finance charge in connection with a transaction, with a minimum of \$500 and a maximum of \$5,000, or even higher amounts in the case of an established pattern or practice of noncompliance.

MANDATORY POLICY ANALYSIS

The Act also includes a number of miscellaneous policy provisions, including:

- requiring the Government Accountability Office to study the impact of interchange fees on consumers and merchants;
- creation of a “Small Business Information Security Task Force” to address the information technology security needs of small businesses and help these businesses prevent the loss of credit card data;
- developing and promoting financial literacy programs;
- requiring the Federal Trade Commission to promulgate rules to prevent deceptive marketing of credit report services to consumers; and

⁵ These restrictions do not apply to gift certificates distributed pursuant to an award, loyalty, or promotional program with respect to which no money or value is exchanged.

- requiring the Federal Reserve Board to review the consumer credit card market, including the terms of credit card agreements, and the practices of credit card issuers and the cost and availability of credit to consumers.

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