

CREDIT UNION EXECUTIVE NEWS

November 4, 2010

SPECIAL EDITION CREDIT CARD COMPLIANCE UPDATE

REASONABLE CARD PENALTY FEES AND RATE REEVALUATIONS

The third phase of the Federal Reserve Board's (FRB) Regulation Z rules to implement the Credit CARD Act became effective August 22, 2010. The August 22 rules made key changes in certain card penalty fees and risk based rate changes. The FRB's changes will further impair credit unions' abilities to generate fee income on card programs. These restrictions do not apply to home equity lines of credit or open-end signature lines of credit that do not include a credit card.

Reasonable Card Penalty Fees. The FRB added a number of fee restrictions to ensure that card penalty fees are reasonable. Card penalty fees must be "reasonable and proportionate" to the costs that the credit union incurs for the penalty event. There are two standards by which a penalty fee will be considered reasonable and proportional. First, is a "cost evaluation" method where the penalty fee must represent a reasonable proportion of the credit union's total costs for the type of violation. The credit union's losses are not considered as a cost factor in this calculation. Also, the credit union must reevaluate its cost analysis every 12 months. Alternatively, there is a safe harbor method under which the FRB has established a reasonable safe harbor late fee amount of \$25 (\$35 if a member already had one late payment in the last six months).

There are three additional rules that impact how the credit union can impose penalty fees:

Excessive Penalties. Penalty fees cannot exceed the dollar amount associated with the violation. The dollar amount associated with late fees and returned payments is the minimum payment due immediately prior to the assessment of the fee. The dollar amount associated with an over limit fee is the total amount of credit extended in excess of the credit limit as of the date the over limit fee is assessed. The credit union cannot charge a late payment fee or returned check fee if the fee is greater than the amount of the associated minimum payment or returned item. So if the minimum payment is \$20, the applicable late payment or returned check fee cannot be more than \$20. Similarly, if a member exceeds a credit limit by \$5, the over limit fee cannot exceed \$5. These limitations may require some programming and program changes, such as making the minimum payment amount at least as much as the late fee.

Inactivity Fee Prohibition. Reg Z now prohibits fees for violations not associated with a dollar amount (e.g., declined transactions, inactivity and closure, etc.). Accordingly, credit unions can no longer charge inactivity fees for not using a card or account closure fees.

Inside this issue:

Card Penalty Fees	1
College Credit Cards	2
Changing Card Terms	3
Cleanup Card Rules	6
Welcome Jeff Martin	7

The August 22 rules made key changes in certain card penalty fees and risk based rate changes. The FRB's changes will further impair credit unions' abilities to generate fee income on card programs.

Cont. p 2

CARD PENALTY FEES AND RATE REEVALUATIONS (CONT.)

Multiple Fee Prohibitions. The credit union can no longer charge more than one fee for a single transaction or event that breaches the terms of the agreement. For example, when the minimum payment is not timely made because the member's payment check is returned for insufficient funds, the credit union may charge a late fee or a returned check fee but not both. Multiple late fees (e.g., a fee for continued late payments) arising from the same billing cycle are prohibited and only one over limit fee is permitted per billing cycle.

Reevaluation of Rate Increases. If the credit union has increased the interest rate on a member's card account, such as unilateral change due to a risk based pricing strategy, the credit union is now obligated to reevaluate the rate every six (6) months. If the factor that was the impetus for the increase no longer justifies the increase, the credit union must reduce the member's rate within 45 days following the reevaluation.

The factors the credit union is to consider in the reevaluation include: factors on which the rate increase was originally based or factors currently used in determining APRs for similar accounts. If the credit union's review indicates a rate reduction is justified, the credit union must lower the APR within 45 days of the evaluation. The rate reevaluation obligation does not apply to card programs where the rate varies according to an independent index (e.g., prime rate), provided that variable rate cards with an interest rate floor do not qualify for the independent index exception.

We do not see many credit unions that have continued the practice of making risk based pricing changes after an initial risk based rate setting at card opening. Under such programs, Reg Z requires a 45-day notice of rate change, a freeze on the balance under the old rate and now the reevaluation of the account every six months to readjust previous rate increases. Did we mention risk based pricing notices yet?

Brian Witt

REPORTING COLLEGE CREDIT CARD PROGRAMS

Are there only three credit unions in the country who have a college related credit card program? Either credit unions' marketing departments have abandoned their marketing relationships with colleges (which is possible given the new restrictions on opening accounts for persons under 21 years old) or some credit unions have overlooked this obscure but necessary Credit CARD Act reporting duty.

REPORTING COLLEGE CREDIT CARD PROGRAMS (CONT.)

Under the CARD Act, credit card issuers who have marketing agreements with an institution of high education or related organization (e.g., alumni associations) are required to submit a copy of their college credit card marketing agreement to the Federal Reserve Board (FRB) along with program data including the payment amounts paid to the college and number of accounts opened under such programs. In turn, the CARD Act requires the FRB to compile information on college credit card programs and submit a report to Congress.

On October 25, 2010, the FRB submitted its first annual "Report on College Credit Card Agreements." The FRB reported a total of 1,044 college credit card agreements from 17 card issuers, including 3 credit unions. The larger nationwide card issuers (FIA Card Services, US Bank, Chase Bank) accounted for 96% of all college credit card programs. Those figures are not surprising, but what is shocking—the amount of payments made to issuers and total accounts opened in 2009: \$83,462,712 for 53,164 accounts, or \$1,569.91 per account. Maybe that's why credit unions have stayed out of the college credit card program arena.

If your credit union has a college credit card marketing relationship, you should review the reporting requirements and marketing prohibitions under Reg Z 226.57. A "college credit card agreement" includes any business, marketing, or promotional agreement between the credit union and a college, university, or affiliated organization, if the agreement provides for the issuance of credit cards to full- or part-time students.

The business, marketing, or promotional agreements may include a broad range of arrangements, including donations, discounted card terms or marketing of logos, under an arrangement that contemplates the issuance of college student credit cards. Both the college and the card issuer have public disclosure requirements on their agreements: The college, on its website or upon request; and the card issuer, a submission to the FRB of the agreement or even a memorandum of understanding, along with data on payments and cards issued. The public can access the complete agreement text in PDF format and see the credit union's program information at: www.federalreserve.gov/CollegeCreditCardAgreements. The first report by card issuers was due February 22, 2010. In the future, it is March 31 of each year. There is no de minimis credit card level or credit union asset threshold for this reporting, if you have an agreement with a college, university, or alumni association, you should do the required reporting—before you get schooled by an examiner or the new Bureau of Consumer Financial Protection.

Brian Witt

CHANGING CREDIT CARD TERMS– A RECAP OF THE LIMITATIONS AND NOTICE REQUIREMENTS

The Credit CARD Act was much more onerous than anyone predicted. The numerous restrictions on unfair and deceptive practices were not the problem. However, the various limitations on fees, the new consumer rights on changed terms and increased notice requirements were far more complex than most observers imagined. In fact, that complexity alone has inhibited credit unions from moving forward with necessary program changes and fee increases. The following is an overview of the various requirements for credit unions to implement credit card (open-end credit plan) changes in terms and the required notices to members. Except as otherwise noted below, these requirements apply to both credit cards and open-end (not home-secured) plans (i.e., signature lines of credit).

Changes in Terms Requiring Written Notice	
Change	Action
1. Significant changes in account terms 226.9(c)(2)(ii): <ul style="list-style-type: none"> • APRs <ul style="list-style-type: none"> - Each APR - Variable rate information - Penalty APRs - Discount APRs - Introductory APRs • Annual Fee • Transaction Charges for Purchases • Grace Period • Balance Computation Method • Cash Advance Fees • Overdraft Advance Fees • Late Payment Fees • Overlimit Fees • Foreign Transaction Fees • Balance Transfer Fees • Returned Payment Fees • Security Interest • Other Fees and Charges 226.6(b)(3) <ul style="list-style-type: none"> - Finance Charges - Default Fees/Charges (not collection costs) - Charges for Plan Termination • Voluntary Credit Insurance and Debt Cancellation • Increase Required Minimum Periodic Payment 	45 day written notice prior to the effective date of change.
2. Changes agreed to by the member (changes unique to member, not credit union unilateral changes). 226.9(c)(2)(i)(B)	Written notice before effective date of change (45 days <u>not</u> required).
3. Increase in any component of any charge not covered above; new change that is not a “significant change.”	Written or oral notice of amount of charge before member becomes obligated.
4. Change from failure to make minimum periodic payment within 60 days of due date. 226.9(c)(2)(iv)(c)	45 day written notice prior to the effective date of change.
5. Penalty Rate Increases – delinquency and default. 226.9(g)	45 day written notice prior to the effective date of change.

Changes in Terms Requiring Written Notice (CONT.)

6. Decrease in credit limit. 226.9(c)(2)(vi)	45 day advance notice written or oral before overlimit fee or penalty rate applies for exceeding decrease credit limit.
--	---

Changes in Terms Not Requiring Written Notice

Significant changes in account terms 226.9(c)(2)(v):

- Charges for documentary evidence
- Reduction in a component of finance or other charge
- Suspension of future credit privileges
- Termination of account (except member adverse action)
- Agreement from court proceeding
- Extension of grace period
- Change to credit card checks
- Increase in promotional APR at specified time
- Increase in variable rate according to index terms
- Increase in APR, fee or charge or minimum periodic payment due to completion of workout

Changes in Terms Providing Member Rejection Rights

Change	Action
Significant changes in account terms. 226.9(c)(2)(iv)(B) EXCEPT: <ul style="list-style-type: none"> • Change in APR • Increase in minimum periodic payment • Change in balance computation method • Change from not receiving timely minimum periodic 	Triggers member's right to reject changes to the account term with notice to credit union and right to pay off balance under beneficial method. 226.9(h)

Content of Notice of Change in Terms

Notice	Content
1. Significant changes in terms (45 day written notice). 226.9(c)(2)(iv)	<ul style="list-style-type: none"> • Summary of changes in terms • Description of any increase in required minimum periodic payment • Description of any security interest being acquired by the credit union • Statement that changes are being made to the account • Date the changes will become effective • For rate changes (other than penalty rate) statement that if penalty rate currently applies, new rate change will not apply until penalty rate expires

Content of Notice of Change in Terms (CONT.)	
Notice	Content
	<ul style="list-style-type: none"> For APR increases, <ul style="list-style-type: none"> Balance to which increased APR will be applied Statement identifying balances to which current rate will continue to apply as of effective date of change
2. Rejection rights	<ul style="list-style-type: none"> Statement that member has right to reject change prior to effective date of change (unless member fails to make a timely minimum payment) Instructions for rejecting the change and toll-free telephone number for member to notify credit union of rejection Statement that impact of rejected change is member's inability to use card
3. Failure to make minimum periodic payment within 60 days of due date	<ul style="list-style-type: none"> Increase will cease to apply to transactions that occurred prior to or within 14 days of the notice if credit union receives 6 consecutive payments Statement of the reason for increase in APR or fee

Format of Notice Requirements
<p>Summary of changes in terms must be in a tabular format with headings and format substantially similar to account opening tables in FRB Model Form G-17.</p> <ul style="list-style-type: none"> Disclose changed terms Information relevant to change New terms described in same level of detail as initial disclosures <p>For notices included with periodic statements: <i>Note:</i> the brief summary/notice must be included on the periodic statement as described below even if the actual notice is included separately (i.e. as a statement stuffer). The only way to avoid showing the notice/summary on the statement is to send the notice of change in a <u>separate mailing</u> from the statements.</p> <ul style="list-style-type: none"> Notice of change in terms must be disclosed on the front of any page of statement The statement notice must include a summary of changes in terms in tabular format as shown in FRB Model Forms G-20 or G-21

We have assisted many of our credit union clients in implementing credit card terms changes in the last few months as credit unions search for income enhancements and replacements. This is a tricky area and it demands getting your change in terms notices correct the first time. There is nothing worse than having to inform your members of a change in a change in terms notice.

FRB'S LATEST PROPOSAL— CLEANUP CARD RULES

It's been a year since the Credit CARD Rules became effective and during this last year, the Federal Reserve Board (FRB) rolled out three sets of Reg Z rules to implement the CARD Act provisions, the latest - the August 22 rules discussed above. On November 2, 2010, the FRB proposed additional rules to clarify certain aspects of the Reg Z credit card rules. While most of the FRB's proposed clarifications are true cleanup changes, the FRB took the opportunity to close a number of loopholes card issuers have discovered over the last year. In any event, consumers win again with enhanced protections.

1. Promotional Programs. Some card issuers use promotional programs that "waive" interest charges for a specified period of time as a means to avoid recognizing rate changes and the required disclosures and protected balances. Such program features will be subject to the same protections as promotional programs that apply a reduced, promotional rate or tease rate for a specified period.

For example, if a card issuer charges a consumer 17% APR, but agrees to "waive" 3% so long as payments are timely made. Such an arrangement is a promotional program no different than a discount rate which requires:

- i. fixed promotional period of not less than six months;
- ii. disclosure of the rate after the promotional period;
- iii. the inability to revoke the waiver during the period except if the account became 60 days delinquent; and
- iv. existing balances are protected from increased rates after the period.

2. Application and Account Opening Fee Protections. Card application fees and similar account opening fees that a member is required to pay *before* the card account is opened are covered by the same limitations as fees charged during the first year after the account is opened. According to the FRB, the total amount of these fees cannot exceed 25% of the initial credit limit for the account, so if a member is charged a \$75 application fee for a card with a \$400 credit limit, the credit union could not charge more than \$25 in additional fees during the first year of the account.

3. Member's Ability to Pay. The credit union is required to evaluate a member's ability to make the required periodic payments before a new card is issued or the member's credit limit can be increased on an existing account.

The FRB is clarifying that the credit union will need to consider the member's independent individual income, rather than his or her household income in the evaluation. This will require greater scrutiny in setting initial credit limits and will likely result in fewer cards being issued.

4. Employee Preferential Rates. In the earlier Reg Z rules, the FRB did not really effectively address the disclosures for employee preferential rate programs. The FRB is now proposing to deal with them, treating such rates as penalty rates rather than a form of introductory rate.

Under these credit union programs, eligibility for the preferential or reduced rate is conditioned upon the consumer's continued employment with the credit union. Upon employment termination, the card agreement provides that the rate will increase to a higher rate, generally the standard rate offered to all members.

Similar to a penalty rate increase the loss of a preferred employee rate requires a 45-day notice prior to the increase and triggers the 6-month rate reevaluation rate under 226.59(a)(i).

The FRB is proposing changes to both the credit card application and account opening tabular disclosures when preferred employee rates are listed in the table.

Disclosures regarding the loss of an employee preferred rate must be added directly below the table. The description of the circumstances under which an employee preferred rate could be revoked should be brief, such as "if your employment with the credit union ends."

The FRB's proposed Reg Z changes were published November 2, 2010 and the comment period expires on January 3, 2011.

On November 2, 2010, the FRB proposed additional rules to clarify certain aspects of the Reg Z credit card rules... the FRB took the opportunity to close a number of loopholes card issuers have discovered over the last year. In any event, consumers win again...

FARLEIGH WADA WITT WELCOMES JEFF MARTIN

We are pleased to announce a new addition to Farleigh Wada Witt's credit union practice. Earlier this year Jeff Martin joined the firm as an associate with an emphasis on federal and state regulatory compliance.

Prior to joining the firm, Jeff managed compliance and other legal matters as Division Counsel for a Fortune 200 company.

With more than fifteen years advising financial institutions on a variety of consumer and commercial lending matters, Jeff adds depth to the firm's strong capabilities in the financial services area.

Jeff Martin
503.228.6044
jmartin@fwwlaw.com



Jeff Martin

FARLEIGH WADA WITT

CREDIT UNION ATTORNEYS:

- Brian Wittbwitt@fwwlaw.com*
- Hal Scogginshscoggins@fwwlaw.com*
- Jeff Martin jmartin@fwwlaw.com*
- Karen Saulksaul@fwwlaw.com*
- Dean Sandowdsandow@fwwlaw.com*
- Valerie Tomasivtomasi@fwwlaw.com*
- Dave Ludwigdludwig@fwwlaw.com*
- Kathy Salyerksalyer@fwwlaw.com*
- Michelle Bertolinombertolino@fwwlaw.com*
- Kimberley McGairkmcgair@fwwlaw.com*
- Kelly Tildenktilden@fwwlaw.com*
- Chris Parnellcparnell@fwwlaw.com*

We have assisted many of our credit union clients with credit card program planning, compliance changes and disclosures.

If you need assistance, please call Brian Witt, Hal Scoggins, or Jeff Martin at 503.228.6044.



Brian Witt



Hal Scoggins

Portland Office:

121 SW Morrison Street, Suite 600
Portland, OR 97204
Phone: 503.228.6044
Fax: 503.228.1741

Central Oregon Office:

750 Buckaroo Trail, #203
Sisters, OR 97759
Phone: 541.549.4958
Fax: 541.549.4959

www.fwwlaw.com