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Compliance Corner

FEDERAL RESERVE BANK OF PHILADELPHIA

The Board of Governors' Proposed Amendments to Regulation Z's Open-End Disclosure Rules

by Kenneth J. Benton, Consumer Regulations Specialist

On June 14, 2007, the Board of Governors of the Federal Reserve System (the Board) published a notice of proposed rulemaking for its long-awaited amendments to the open-end credit sections of Regulation Z, the Board's implementing regulation for the Truth in Lending Act (TILA).[1] TILA is the federal law requiring creditors to disclose the terms and conditions of consumer credit plans and transactions, such as credit cards, car loans, and mortgages. TILA applies at all stages of consumer credit, including advertising, application, account opening, and consummation.

The proposed amendments are the first phase of the Board's comprehensive review of Regulation Z. The Board's goal is to improve the effectiveness of the disclosures creditors must provide to con-

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[1] The notice in the Federal Register is available at <edocket.access.gpo.gov/2007/pdf/07-2656.pdf>. The Board also simultaneously issued a press release that discusses the background of the changes and contains links to various materials in the rulemaking, including model forms: <www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm>. The Board also issued an internal memo summarizing the proposed changes: <www.federalreserve.gov/DCCA/RegulationZ/20070523/memo.pdf>.

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FEDERAL RESERVE BANK OF PHILADELPHIA

The Scope of Regulation E Now Covers Payroll Cards

by Eddie L. Valentine, Supervising Examiner

The Board of Governors of the Federal Reserve System (the Board) recently amended Regulation E, the Board's implementing regulation for the Electronic Funds Transfer Act, to expand its coverage to include consumer payroll cards. This article reviews the regulatory requirements for financial institutions offering payroll cards on behalf of employers.

The final rule, which became effective on July 1, 2007, amends the definition of "account" to include payroll card accounts established directly or indirectly by an employer on behalf of a consumer with which electronic fund transfers of the consumer's salary, wages, or other employee compensation are made on a recurring basis. In addition, the final rule adds a new section, 205.18, which imposes specific requirements on financial institutions offering payroll cards.[2]

Background

Payroll cards permit employees to access their wages or other recurring compensation payments using a payment card comparable to a debit card. Typically, an employer, working with a financial institution, provides the employee with a plastic card with a magnetic stripe. This card accesses an account assigned to the individual employee. Each payday, the employer credits the employee's account for the amount of their compensation instead of providing a paper check or making a direct deposit to a checking account. Employees have access to the funds by using the payroll card to make withdrawals from an ATM and to make point-of-sale (POS) purchases. In 2001, Visa and MasterCard began programs to encourage banks to offer Visa and MasterCard payroll cards so employees could use them anywhere those cards are accepted. These programs resulted in a significant increase in the growth of payroll cards.

Payroll cards are often marketed to employers as an effective means of providing wages to employees who lack a traditional banking relationship. Employers benefit because they save money by reducing the

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[1] The Board conducted the rulemaking in two steps. An interim final rule was in effect from January 1, 2007, through June 30, 2007. The final rule, which is slightly different from the interim rule, became effective on July 1, 2007. A copy of the Board's notice of the final rulemaking is available at <www.federalreserve.gov/boardDocs/press/bcreg/2006/20060824/attachment.pdf>.

costs associated with delivering paper paychecks or pay stubs. Financial institutions benefit because payroll cards are a revenue source and serve as another valuable service offered to business customers and can also lead to expanded banking relationships with unbanked consumers. Unbanked consumers benefit because payroll cards provide a convenient way to access their wages, without incurring check-cashing fees, and can serve as substitutes for traditional transaction accounts at financial institutions. Some payroll cards offer additional features for consumers, such as convenience checks, overdrafts, and electronic bill payment.

Definition of Account

Under the final rule, the definition of "account" in section 205.2(b)(2) is expanded to include payroll cards: "The term includes a 'payroll card account' which is an account directly or indirectly established through an employer and to which transfers of the consumer's wages or other compensation are made on a recurring basis, whether the account is operated or managed by the employer, a third-party payroll processor, a depository institution or any other person."

Payroll cards are often marketed to employers as an effective means of providing wages to employees who lack a traditional banking relationship.

Because the definition specifies recurring payments such as a consumer's wages or other compensation, the rule does not cover a one-time payment on a payroll card, such as a final payment or emergency payment. The rule also does not cover expense reimbursement if the card were solely used for that purpose since expense reimbursement does not constitute "wages or other compensation." However, the rule does cover seasonal employees since they are paid on a recurring basis.

New Rules

The amendment adds a new section to the regulation specific to payroll cards: Section 205.18, *Requirements for Financial Institutions Offering Payroll Card Accounts*. This section provides that financial institutions offering payroll cards must comply with all other applicable requirements of Regulation E and includes modifications of those requirements, which are discussed below.

Alternative to periodic statements. This section allows financial institutions some flexibility in complying with the section 205.9 requirement to provide periodic statements regularly. As an alternative to providing paper periodic statements, financial institutions can instead elect to offer payroll card customers any of the following options to access their account transaction information:

1. Make balance information available to the consumer through a readily available telephone line
2. Make an account history available electronically (e.g., through the Internet) of the consumer's account transactions covering at least a period of 60 days prior to the consumer's oral or written request
3. Promptly provide, upon the consumer's request, a written history of the consumer's account transactions covering at least a period of 60 days prior to the request

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Compliance Alert: Adverse Action Notices and Willful Violations of the Fair Credit Reporting Act

The United States Supreme Court (the Court) recently issued its long-awaited decision in *Safeco Ins. Co. of America v. Burr* concerning two important issues under section 615(a) of the Fair Credit Reporting Act (FCRA).[1] This section requires users of consumer credit reports to notify consumers when they take adverse action based in whole or in part on information in the report. It is designed to alert consumers about negative information in their credit reports and encourage them to obtain a free copy of the report to address the negative issues, especially if the report contains incorrect information the consumer can easily correct by filing a dispute with the consumer reporting agency.

The Court consolidated for review two class-action decisions from the United States Court of Appeals for the Ninth Circuit against GEICO Insurance and against Safeco Insurance.[2] The Ninth Circuit held in both cases that insurance companies using consumer reports are required to send adverse action notices to applicants if they are not offered the lowest premium available to consumers with the highest credit ratings. Since few applicants have credit ratings eligible to qualify for the lowest rates, the Ninth Circuit's ruling created headlines in business journals because it would have required insurance companies to send out a large number of adverse action notices. The Court also reviewed the legal standard for establishing a willful violation of the FCRA, an issue of concern to financial institutions because a damage award for willful violations can include actual damages, statutory damages, and punitive damages. While the case arose in the context of insurance, the Supreme Court's interpretation of section 615(a) applies to all users of consumer credit reports.

The Court reviewed GEICO's and Safeco's notice procedures to determine whether they violated section 615(a). In GEICO's case, when pricing an insurance application, it first calculated the hypothetical premium it would have charged if the applicant's credit report were not considered (the neutral premium) and compared it to the premium actually charged. If the actual premium exceeded the neutral premium, GEICO sent out an adverse action notice.

For Safeco, the issue was its notice procedures for applicants applying for the first time. Safeco did not send these applicants notices because it believed that section 615(a) only applied to insurance renewals, when the premium is increased because of negative information in the credit report. The Ninth Circuit held that both companies' procedures violated section 615(a) because it interpreted adverse action to include not offering a consumer the lowest premiums available to applicants with the highest credit ratings.

The Court reversed the Ninth Circuit's ruling. It held that section 615(a) requires an adverse action notice only when a creditor is charging a higher rate (or otherwise acting adversely to the consumer) *based on* information in the consumer's credit report. If the user of a consumer report examines it but does not take adverse action because of it, section 615(a) has not been violated. The Court illustrated this point with an example: "if a consumer's driving record is so poor that no insurer would give him anything but the highest possible rate regardless of his credit report, whether or not an insurer happened to look at

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[1] The case is available on the Supreme Court's website at <www.supremecourtus.gov/opinions/06pdf/06-84.pdf>.

[2] The Ninth Circuit, located in San Francisco, is one of 13 federal appeals courts. It hears appeals from federal courts and agencies in the states of Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington, as well as Guam and the Mariana Territorial Islands.

his credit report should have no bearing on whether the consumer must receive notice, since he has not been treated differently as a result of it."

The Court found that GEICO's procedure complies with section 615(a). Sending out notices only when the actual premium exceeds the neutral premium that would have been charged if the credit report were not considered ensures that consumers are notified when information in their credit report negatively impacted a transaction.

The Court rejected the interpretation advanced by the plaintiffs that users of credit reports must send out an adverse action notice if consumers were not offered the lowest rate offered to those with the highest credit ratings. This interpretation would require creditors to inundate consumers with adverse action notices because only a small percentage of applicants have the highest credit ratings. In practice, consumers would learn to ignore adverse action notices, thus defeating the primary purpose of section 615(a) of alerting consumers to negative information in their credit report.

With respect to Safeco, the Court rejected the argument that section 615(a) did not apply to first-time applicants. However, because Safeco was charged with willfully violating the FCRA (as opposed to negligently violating it), the Court still had to determine whether Safeco's violation was willful. Safeco argued that a willful violation requires evidence that a creditor knowingly violated the FCRA, while the plaintiffs argued that a reckless violation would also qualify. The Court affirmed the Ninth Circuit's ruling that a company can be liable for a willful violation if it recklessly disregards the risk of violating the FCRA, framing the test as follows: "a company does not act in reckless disregard of the FCRA unless the action is not only a violation under a reasonable reading of the statute, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless."

Significantly, the Court held that Safeco was not reckless because its belief that the FCRA did not apply to initial insurance policies, while erroneous, was a plausible reading of the statute. The Court noted that neither the Federal Trade Commission, which enforces the FCRA, nor the federal courts of appeals had addressed the issue, and that the FCRA is not a model of clarity. Under these circumstances, Safeco's violation was not willful.

The standard for a willful violation is important. For a negligent violation, a consumer is entitled to the actual damages sustained as a result of the violation along with court costs and attorney's fees. But proving actual damages is difficult because the consumer would have to demonstrate that if the creditor had provided the adverse action notice, the consumer would have obtained his credit report, taken steps to improve his credit score, and reduced the cost of credit.

Willful violations expose financial institutions and other users of credit reports to greater liability. For a willful violation, a consumer is entitled to actual or statutory damages (a minimum of $100 but not greater than $1,000), punitive damages as the court may award, court costs, and attorney's fees. The availability of statutory damages is a particular concern because it is likely to attract class actions, since every class member would be entitled to statutory damages ranging from a minimum of $100 up to $1,000. Those damages could be substantial for a willful violation in which a creditor failed to send adverse action notices to a large number of consumers. A court could also award punitive damages, which are not available for a negligent violation. By ruling that a plaintiff can establish a willful violation by showing that a company acted recklessly, the Court has made it somewhat easier to prove a willful violation.

The lesson for financial institutions from the *Safeco* decision is to ensure they have established procedures for sending out adverse action notices under section 615(a) of the FCRA whenever they take adverse action against consumers based on their credit report or score. By establishing such procedures, financial institutions can prevent costly lawsuits for violations, particularly willful violations. □

FRS Alert:
The Board's Rulemaking Hearing Under HOEPA to Address Unfair or Deceptive Practices in the Home Mortgage Market

The Board of Governors of the Federal Reserve System (Board) held a hearing on June 14, 2007, under the Home Ownership and Equity Protection Act of 1994 (HOEPA), a federal anti-predatory lending law, to explore how to exercise its rulemaking authority under HOEPA to address abusive practices in the mortgage market, particularly the subprime sector.[1] This alert details the rulemaking hearing and the background of HOEPA.

HOEPA amended the Truth in Lending Act (TILA) by adding section 129, which imposes restrictions on non-purchase mortgage loans that meet the HOEPA definition of a high-rate or high-fee loan. In addition, section 129(l)(2) of TILA contains a rulemaking provision that provides the Board with broad authority to place restrictions on mortgage loan practices that are unfair or deceptive and on mortgage refinancing practices that are abusive:

> *The Board, by regulation or order, shall prohibit acts or practices in connection with—*
> *(A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and*
> *(B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.*

HOEPA amended the Truth in Lending Act (TILA) by adding section 129, which imposes restrictions on non-purchase mortgage loans that meet the HOEPA definition of a high-rate or high-fee loan.

It is important to note that while the existing HOEPA provisions only apply to high-rate or high-fee non-purchase loans, the Board's HOEPA rulemaking authority applies to *all* mortgage loans. HOEPA authorizes the Board to prohibit any mortgage act or practice if the Board finds it is unfair or deceptive and to prohibit any mortgage refinancing practice if the Board finds it is abusive or not in the interest of the borrower.

The broad scope of the Board's HOEPA authority is important because many regulated financial institutions have complained that the consumer mortgage market is not a level playing field. While banks, thrifts, and credit unions are accountable to the federal banking agencies, which regularly conduct consumer compliance examinations and issue supervisory guidance to the institutions they regulate, many nonbank lenders, like finance companies and mortgage brokers, are regulated lightly (if at all).[2] A HOEPA rule would address this issue.

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[1] The transcript of the Board's June 14, 2007, HOEPA hearing is available at <www.federalreserve.gov/events/publichearings/hoepa/2007/20070614/transcript.pdf>. The Board's announcement, which includes a link to the notice in the Federal Register, is available at <www.federalreserve.gov/boarddocs/press/bcreg/2007/20070529/default.htm>.

[2] In the last year, for example, the federal banking agencies have issued guidance on nontradional mortgages (www.federalreserve.gov/BoardDocs/Press/bcreg/2006/20060929/default.htm) and on subprime mortgage lending (www.federalreserve.gov/boardDocs/press/bcreg/2007/20070629/default.htm).

Section 158 of HOEPA directs the Board to hold public hearings periodically to determine the adequacy of the existing regulatory framework in protecting consumers. The Board scheduled the 2007 hearing to respond to the recent turmoil in the home mortgage market, where defaults and foreclosures have been rising precipitously, especially in the subprime sector. The hearing focused on the Board's use of its section 129 rulemaking authority to address questions related to the following four mortgage practices:

Prepayment Penalties
- Should prepayment penalties be restricted?
- Would enhanced disclosures help address concerns about abuses?

Escrow for taxes and insurance on subprime loans
- Should escrow for taxes and insurance be required for subprime mortgage loans?
- Should lenders be required to disclose the absence of escrows to consumers?

"Stated income" or "low doc" loans
- Should lenders be prohibited from using "stated income" or "low doc" loans in certain cases like subprime loans?
- How would a restriction on "stated income" or "low doc" loans affect consumers and the type and terms of credit offered?

Unaffordable Loans
- Should lenders be required to underwrite all loans based on the fully indexed rate and fully amortizing payments?
- Should there be a rebuttable presumption that a loan is unaffordable if the borrower's debt-to-income ratio exceeds 50 percent (at loan origination)?

These issues were debated for nearly eight hours by consumer groups, lenders, state regulators, community groups, and researchers. The Board will consider the testimony from this hearing in determining how to enact rules prohibiting abusive mortgage practices. The Board will also consider the following: the testimony at the four HOEPA hearings conducted in 2006;[3] the comments received at the June 21, 2007, Consumer Advisory Council meeting, at which the HOEPA rulemaking was an agenda topic;[4] as well as any public comments.[5]

During his recent appearance before Congress presenting the semiannual monetary policy report, Chairman Bernanke stated that he expected the Board to publish proposed HOEPA rules by the end of the year:

> "We are certainly aware, however, that disclosure alone may not be sufficient to protect consumers. Accordingly, we plan to exercise our authority under the Home Ownership and Equity Protection Act (HOEPA) to address specific practices that are unfair or deceptive. We held a public hearing on June 14 to discuss industry practices, including those pertaining to pre-payment penalties, the use of escrow accounts for taxes and insurance, stated-income and low-documentation lending, and the evaluation of a borrower's ability to repay. The discussion and ideas we heard were extremely useful, and we look forward to receiving additional public comments in coming weeks. Based on the information we are gathering, I expect that the Board will propose additional rules under HOEPA later this year."

The Board is aware, however, as Governor Kroszner stated at the beginning of the hearing, of the need to "walk a fine line" between restricting unfair and deceptive acts while maintaining access to credit. ☐

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[3] Transcripts of the four hearings conducted last year are available at <www.federalreserve.gov/events/publichearings/hoepa/2006/default.htm>.

[4] The transcript for this meeting is available at <www.federalreserve.gov/generalinfo/adviscoun/cac/default.htm>.

[5] Public comments submitted to the Board can be viewed at: <www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=OP%2D1288&doc_ver=1&ShowAll=Yes>.

The Board of Governors' Proposed Amendments to Regulation Z's Open-End Disclosure Rules

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sumers. Because of the regulation's complexity, the review was scheduled in two phases. The Board first examined the regulation's open-end credit sections (except credit secured by a consumer's home) and is now reviewing the closed-end sections. The Board last conducted a comprehensive review in 1981.

The proposed amendments focus on five areas of open-end credit: (1) application and solicitation disclosures, (2) account-opening disclosures, (3) periodic statement disclosures, (4) change-in-terms notices, and (5) advertising provisions. To enhance the effectiveness of the disclosures, the Board retained a third-party consumer testing firm, Macro International, Inc., to conduct extensive consumer testing of existing open-end credit disclosures as well as the Board's proposed changes. The results of the testing influenced the changes to the disclosures, and the Board has indicated that all future amendments will undergo testing. For interested readers, Macro prepared a detailed memo discussing the testing.[2] This article highlights the proposed amendments.

The proposed amendment requires card issuers to use the specific term "penalty APR" to identify a penalty APR and to identify the circumstance triggering it inside the Schumer Box.

Credit and Charge Card Application and Solicitation Disclosures

The proposed amendments contain significant changes for credit card solicitations and applications. Regulation Z requires card issuers to disclose key costs and terms in a prominent table known as the Schumer Box (named after New York Senator Charles Schumer, who introduced the bill in Congress with that requirement). The proposed amendments would modify the requirements for the Schumer Box disclosures with respect to disclosures for penalty pricing, penalty fees, balance computation method, variable-rate information, payment allocation, subprime credit cards, and new required reference to the board's consumer credit education website. The changes are discussed below.

Penalty pricing. Under the current version of Regulation Z, card issuers must disclose all interest rates that can be used to compute finance charges in the Schumer Box. Most credit cards specify different annual percentage rates (APRs) for different card transactions, such as a purchase APR, a cash advance APR, and a high-rate penalty APR that is triggered when a cardholder defaults on the cardholder agreement. The current regulation does not specify how to identify a penalty APR. Most issuers use the term "default APR." The current regulation also requires that the circumstance triggering a penalty APR be disclosed *outside* the Schumer Box.

The proposed amendment requires card issuers to use the specific term "penalty APR" to identify a penalty APR and to identify the circumstance triggering it inside the Schumer Box. Consumer testing inspired these changes because it revealed that many consumers did not understand the concept of a penalty APR when it was identified as a "default APR," but they were able to comprehend it when the term penalty APR was used. Testing also revealed that many consumers do not read information outside the Schumer Box.

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[2] Macro's memo is available at <www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf>.

Penalty fees. Section 5a of the current version of Regulation Z requires credit card issuers to disclose cash advance fees, late payment fees, over-the-limit fees, and balance transfer fees in solicitations and advertisements either in the Schumer Box or clearly and conspicuously elsewhere in the application or solicitation. The amendments would require that these fees appear inside the Schumer Box because testing again revealed that consumers did not notice fees disclosed outside the box. The amendment also requires a new disclosure for a returned payment fee.

In addition, if the circumstances triggering a penalty fee will also trigger a penalty APR (e.g., for paying late), the penalty fee must cross-reference the penalty APR disclosure. The model form shows this example alongside the disclosure for a late payment fee: “Your APRs may also increase; see Penalty APR section.” The interested reader can view the disclosures in the revised Schumer Box in a model form that the Board published in the rulemaking notice.[3]

Balance computation method. The balance computation method disclosure is no longer required to be disclosed inside the Schumer Box and can instead appear outside it. Testing revealed that that the different balance computation methods were not meaningful to consumers who do not consider such information when shopping for a card.

Variable-rate information. Currently, Regulation Z requires card issuers with variable APRs to disclose inside the Schumer Box the index or formula used to make adjustments to the APR and the amount of any margin that is added. Other details are disclosed outside the box, such as how often the rate can change. Under the proposed amendment, information about variable APRs would be reduced to a single phrase indicating the APR varies “with the market,” along with a reference to the type of index used to compute the APR, such as the prime rate. Testing revealed that few consumers focused on variable-rate information when shopping for a card, and many were confused by details about margin values.

Payment allocation. When a consumer submits a payment on an account with multiple balances subject to different APRs, most card issuers will allocate the payment to the balance with the lowest APR first. This practice has created confusion for consumers when they accept balance transfer solicitations for credit cards that offer a zero percent APR for a specified period on the transferred balance, but not on new purchases. Many consumers do not understand that if they make new purchases and remit payment for the new purchases by the due date to avoid finance charges, but pay nothing toward the transferred balance because it has a zero percent APR, the payment may not be allocated to the purchase balance but instead be first allocated to the transferred balance because it has the lowest APR. As a result, finance charges will accrue on all new purchases until the transferred balance is paid off in full.

The proposed amendment addresses this issue. It would add a new disclosure to the Schumer Box about the effect of card issuers’ payment allocation methods when payments are applied entirely to transferred balances at low introductory APRs. It would alert consumers that they will incur finance charges on any new purchases until the transferred balance is paid in full. The Board’s model form for the proposed credit card amendments shows one method

[3] The model form is available at <www.federalreserve.gov/dcca/regulationz/20070523/g10c.pdf>.

of making this disclosure: "Notice Regarding Interest Charges: Your introductory APR applies only to balance transfers, not to purchases. During the introductory period we will apply your payments to transferred balances before we apply them to any purchases you make. You will be charged interest on all purchases until your entire balance has been paid off completely, including transferred balances."[4]

Subprime credit cards. Federal banking agencies frequently receive consumer complaints about subprime credit card offers. Consumers state that when they applied for subprime credit cards, they did not understand that substantial fees are required to open the account, which are billed to their first periodic statement, and that the amount of available credit is often small, especially after it is reduced by the required fees. The Board cited an example of a subprime card with a $250 credit limit and $100 in required fees that left a remaining credit limit of $150 when the account was opened.

Consumers state that when they applied for subprime credit cards, they did not understand that substantial fees are required to open the account.

To address this issue, the proposed amendments require that when mandatory fees are equal to or greater than 25 percent of the minimum credit limit offered on the account, the card issuer must include an example in the Schumer Box of the amount of available credit after paying fees or a security deposit. The Board included a proposed model form with this example: "NOTICE: Some of these set-up and maintenance fees will be assessed before you begin using your card and will reduce the amount of credit you initially have available. For example, if you are assigned the minimum credit limit of $250, your initial available credit will be only $68 (or $53 if you choose to have an additional card)."

Another important change is the treatment of a fee to apply for a card that is imposed regardless of whether the application is approved. Under the existing regulation, the fee would not have to be disclosed in the Schumer Box because it is not imposed for the issuance or availability of credit. The proposed amendment would eliminate this exception and require disclosure of the fee in the box because the Board believes consumers should be aware of it when shopping for credit.

Reference to the Board's website. All card issuers would also have to include a reference to the Board's website in credit card applications and solicitations. The website provides information on comparing credit cards and the factors to consider. During the rulemaking, commenters suggested that the Board consider nonregulatory approaches to educate consumers about credit. The Board's current website for credit card shopping will be expanded to provide additional information on helping consumers shop for credit cards.[5]

Open-End Credit Initial Disclosures

Under the current version of Regulation Z, the Schumer Box is only used for credit card solicitations and applications. The proposed amendment requires the use of the Schumer Box to disclose key terms for all initial account disclosures for open-end credit products as well. Consumer testing revealed that many consumers do not read initial account disclosures because they are long, complex documents. Testing further revealed that consumers reacted favorably to a separate insert of key disclosures of account terms and conditions in a tabular format. The key terms are: interest, minimum charges, transaction fees, annual fees, and penalty fees (e.g., late payment).

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[4] All of the proposed Regulation Z model forms are available on the Board of Governors' website at <www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm>.

[5] The Board's current website for credit card information is available at <www.federalreserve.gov/pubs/shop/default.htm>.

Another important change is that card issuers would not have to include fees and costs other than the ones listed above in the initial account disclosures. The Board received comments indicating that some charges are not incurred until years after the account has been opened and that disclosing them initially does not benefit consumers. The creditor would only be required to disclose other charges prior to the time the consumer becomes obligated to pay them. For example, if a creditor charges a fee to retrieve an old account statement, the creditor would have to disclose the related fee when the customer called to request the statement and before the charge is imposed. While Regulation Z has always required written disclosures in a form the customer can keep, the proposal would allow creditors to disclose the charges orally. This change was permitted because consumers often contact creditors by telephone when a written disclosure is not feasible.

To help consumers understand the cost of credit, the proposed amendments would require disclosure on the periodic statement of the total fees incurred during the billing cycle.

Periodic Statement

To help consumers understand the cost of credit, the proposed amendments would require disclosure on the periodic statement of the total fees incurred during the billing cycle separate from the total interest charges incurred during the cycle. In addition, the interest charges would have to be itemized (e.g., interest charges resulting from purchases and interest charges resulting from cash advances). The proposal would also require year-to-date totals for both interest and fees. Testing revealed that consumers understand the cost of credit better when it is expressed in dollar amounts.

The Board is also soliciting comments on whether to eliminate the effective APR disclosure on periodic statements or to take steps to improve consumers' understanding of it. The effective APR refers to the consumer's actual cost of credit during the billing cycle, including interest charges and fees that are considered finance charges under Regulation Z, such as a fee for a cash advance or balance transfer. Testing revealed that many consumers do not understand it. Creditors complain that the effective APR disclosure confuses consumers who do not understand it, while consumer advocates acknowledge that it is not widely understood but suggest it should be improved rather than eliminated.

Another change to the periodic statement concerns the minimum payment warnings required by the 2005 amendments to the Bankruptcy Code. The proposal would require three new disclosures on periodic statements: (1) a warning that making only the minimum payment will increase the interest paid and the time it takes to repay the balance, (2) a hypothetical example of how long it would take to pay a specified balance in full if only minimum payments are made, and (3) a toll-free number consumers can call to obtain an estimate of how long it would take to repay their account balance using minimum payments.

Change-in-Terms Notice

Regulation Z currently requires creditors to provide 15 days' notice for changes to any account term required to be disclosed under section 6 of Regulation Z for initial disclosures. However, if the change resulted from a customer's default or delinquency, card issuers do not have to provide 15 days' notice (though

they still had to provide written notice). Certain other events required no notice at all, including late payment charges, over-the-limit charges, and changes that were disclosed in the initial account disclosures, such as an increase in the APR if the customer makes late payments. Testing revealed that consumers typically did not read change-in-terms notices because they were in small print and used dense text. As a result, consumers are often surprised to learn that important account terms have changed.

The proposed amendment addresses this problem in several ways. First, if the change-in-term notice pertained to a key term that must be disclosed in a Schumer Box for initial account disclosures (one of the new requirements discussed above), then the change-in-term notice must use a similar format. Many creditors send change-in-term-notices along with the periodic statement. Because testing revealed that consumers tend to disregard notices sent with the periodic statement, the notice included with a periodic statement must appear in a Schumer Box above the list of transactions on the statement. Testing revealed that most consumers examine the list of current transactions on the periodic statement.

Testing revealed that consumers typically did not read change-in-terms notices because they were in small print and used dense text.

The proposed amendment also requires that creditors send a change-in-terms notice 45 days prior to any change instead of the current 15 days. It would also expand the circumstances in which the notice must be sent. When a creditor increases an APR because of a default or delinquency, it would have to send a notice 45 days before the change, even if it had disclosed this possible change in the initial account disclosures. The purpose of this change is to allow consumers adequate time to shop for new credit prior to the rate increase taking effect or stop making purchases with the card to avoid increasing the balance that will be subject to a higher APR.

Advertising Provisions

The proposed amendment contains two new restrictions on advertisements for open-end credit. The first concerns advertisements that offer financing for products or services and mention the consumer's minimum monthly payments if financing is selected. The proposed amendment would require creditors to disclose, in equal prominence to the minimum payment, the time period required to pay the balance if only minimum payments are made.

The second restriction applies to advertisers who use the term "fixed" rate. Under the proposed amendment, if the advertiser uses the term "fixed" rate, it must identify the period during which the rate is fixed and cannot be increased. If a time period is not identified, the advertiser cannot use the term "fixed" rate unless the rate cannot increase while the credit plan is open.

Compliance Corner readers are encouraged to comment on the Board's proposed amendments to Regulation Z by October 12, 2007. All public comments received by the Board are available on its website at <www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>. All public comments appear as submitted unless changes are necessary for technical reasons. Comments are not edited to remove identifying or contact information.

If you have any questions regarding this article, please contact Consumer Regulation Specialist Kenneth J. Benton or Supervising Examiner John D. Fields through the Regulations Assistance line at (215) 574-6568. □

The Scope of Regulation E Now Covers Payroll Cards

...continued from page CC3

The history of account transactions provided electronically, or upon request, must include the same type of information required to be provided on paper periodic statements under section 205.9. This includes information about any EFT fees in connection with the payroll card account imposed during the period for which the information was requested.

In addition, a financial institution electing to use one of the alternatives to periodic statements must modify its account opening disclosures. The initial account disclosure must provide a number a customer can call to obtain his account balance and history of transaction information, and it must also disclose the customer's error resolution rights for payroll cards.

The 60-day period for reporting errors. Section 205.11 requires customers to notify financial institutions about errors with electronic funds transfers within 60 days after the institution sends a periodic statement in which the alleged error is first reported. This is done for purposes of determining the extent of the customer's liability for unauthorized transactions. If an institution elects an alternative to periodic statements, section 205.18(c) addresses the critical issue of when the 60-day period begins. If customers choose to access the account statement electronically, the 60-day period begins the date the customer accesses the electronic statement. If customers request a copy of the written statement, the 60-day period begins the date the institution mails the statement. If customers request both a written statement and electronic statement, the 60-day period begins on the earlier of the two dates.

Annual error resolution notice. Financial institutions must provide payroll card customers an annual error resolution notice substantially similar to the Board's model form notice. In lieu of the annual notice, institutions that elect one of the alternative methods to periodic statements can include an abbreviated error resolution notice, substantially similar to the model form abbreviated notice, each time the institution responds to a consumer request for transaction history, either electronically (e.g., through the Internet) or in writing. The Board specifically declined to allow financial institutions the option of providing the abbreviated notice exclusively through a telephone line because consumers would not be able to retain a copy of the notice.

Model Disclosure Clauses and Forms

The final rule includes model disclosure forms and clauses for account opening disclosures and error resolution notices, including those used by government agencies. Financial institutions are provided with a safe harbor if they use the model clauses and forms.

Final Remarks

Financial institutions that currently offer payroll cards should review their compliance programs to ensure that their policies and procedures incorporate the new rules. Additionally, institutions that choose to provide alternatives to periodic statements should revise their initial disclosure and error resolution procedures to comply with the requirements of the final rule.

Financial institutions that are considering developing a payroll card program should review the new rules carefully with their compliance officer to ensure compliance. The complexity of the payroll card will determine the associated compliance obligations. For example, check writing, fund transfers, or bill pay features will be subject to additional regulatory requirements.

If you have any questions about Regulation E and the recent amendments, please contact either Supervising Examiner Eddie L. Valentine or Supervising Examiner John D. Fields through the Regulations Assistance Line at (215) 574-6568. □

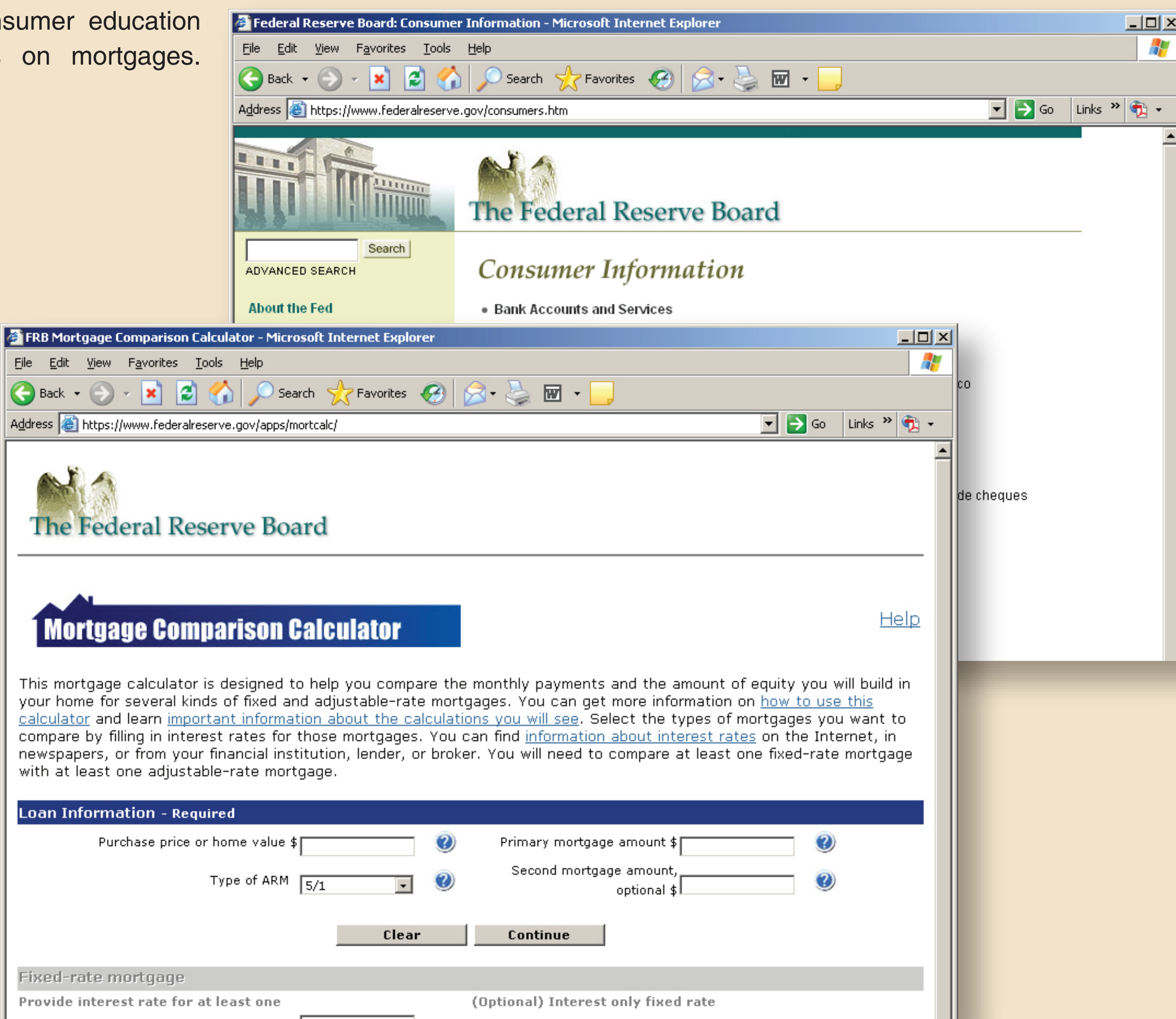
Mortgage Comparison Calculator Now Available on the Board's Website

On June 19, 2007, the Board of Governors of the Federal Reserve System (Board) introduced an online mortgage comparison calculator for consumers. This calculator lets users compare monthly mortgage payments and the amount of equity that will build for up to six types of fixed- and adjustable-rate mortgages. The calculator makes it easy for consumers to compare monthly payments and equity accumulation among 30-year and 15-year fixed-rate mortgages, interest-only fixed-rate mortgages, adjustable-rate mortgages (ARMs), interest-only ARMs, and payment-option ARMs. The calculator includes a mortgage shopping worksheet, a glossary of mortgage terms, and links to the Board's other consumer education resources on mortgages.

The calculator can be found on the Board's website at <www.federalreserve.gov/apps/mortcalc>.

The Board's website offers consumers many other resources on a variety of consumer finance topics, including credit cards, credit reports, identity theft, mortgages, leasing, and personal finance. Consumers can access this information at <www.federalreserve.gov/consumers.htm>.

Financial institutions and creditors are encouraged to provide these links to their customers to help increase their financial literacy.



FRS Alert: Federal and State Agencies Announce Pilot Project to Improve Supervision of Subprime Mortgage Lenders

On July 17, 2007, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Federal Trade Commission, and state agencies represented by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators announced an innovative pilot project to conduct targeted consumer-protection compliance reviews of selected nondepository lenders with significant subprime mortgage operations.

The collaborative pilot is scheduled to begin in the fourth quarter of 2007 and will focus on nondepository subsidiaries of bank and thrift holding companies, as well as mortgage brokers doing business with, or working for, these entities. Additionally, the states will conduct coordinated examinations of independent state-licensed subprime lenders and their associated mortgage brokers.

The agencies will evaluate the companies' underwriting standards, as well as senior management oversight of the risk management practices used for ensuring compliance with state and federal consumer protection regulations and laws. The agencies will then initiate the appropriate corrective or enforcement action as warranted by the findings of the reviews or investigations. At the conclusion of the reviews, the agencies will analyze the results and determine whether the project is to be continued.

Federal Financial Regulators Propose Illustrations of Consumer Information to Support Their Statement on Subprime Mortgage Lending

On August 14, 2007, the federal financial regulatory agencies issued proposed illustrations of consumer information for certain adjustable-rate mortgage (ARM) products described in the agencies' Statement on Subprime Mortgage Lending issued on June 29, 2007. The illustrations are intended to assist institutions in ensuring that consumers have clear, balanced, and timely information about the relative benefits and risks of certain ARM products.

The illustrations consist of: 1) an explanation of some key features and risks that the Statement on Subprime Mortgage Lending identifies, including payment shock, and 2) a chart that shows the potential consequences of payment shock in a concrete, easily understandable manner. The proposed illustrations are available at: <www.federalreserve.gov/boarddocs/press/bcreg/2007/20070814/attachment.pdf>.

The agencies are currently seeking public comment on all aspects of the proposed illustrations. All comments that are received will be posted by the Federal Reserve Board of Governors on the Board's website at: <www.federalreserve.gov/generalinfo/proposedregs.cfm>.

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