FEDERAL RESERVE SYSTEM

12 CFR Part 226

[Regulation Z; Docket No. R-1217]

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance Notice of Proposed Rulemaking

SUMMARY: The Board is publishing for public comment an advance notice of proposed rulemaking (ANPR) to commence a review of the open-end (revolving) credit rules of the Board's Regulation Z, which implements the Truth in Lending Act. The Board periodically reviews each of its regulations to update them, if necessary. The ANPR seeks comment on a variety of specific issues relating to three broad categories: the format of open-end credit disclosures, the content of the disclosures, and the substantive protections provided under the regulation. The ANPR solicits comments on the scope of the review, and also requests commenters to identify other issues that the Board should consider addressing in the review.

DATES: Comments must be received on or before March 28, 2005.

ADDRESSES: You may submit comments, identified by Docket No. R-1217, 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.

- FAX: 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, N.W., Washington, DC 20551.

See Supplementary Information, Section I., for further instructions on submitting comments.

All public comments are available from the Board's web site at www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, except as necessary 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 in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Elizabeth A. Eurgubian, Attorney, Dan S. Sokolov and Krista P. DeLargy, Senior Attorneys, Daniel G. Lonergan and John C. Wood, Counsel, or Jane E. Ahrens, Senior Counsel, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for users of Telecommunications Device for the Deaf ("TDD") only, contact (202) 263-4869.

SUPPLEMENTARY INFORMATION:

I. Form of Comment Letters

This ANPR requests data or comment on specific issues relating to Regulation Z's open-end credit rules. These requests are numbered consecutively. Commenters are requested to refer to these numbers in their submitted comments, which will assist the Board and members of the public that review comments online. Questions are presented by subject matter as follows:

<u>Scope of the review</u>: Q1.

<u>Format of Disclosures</u>:

Account-opening disclosures, Q2 – Q3.
Periodic statements, Q4 – Q6.
Credit card application disclosures (the "Schumer box"), Q7 – Q8.
Subsequent disclosures, Q9.
Model forms and clauses, Q10 – Q12.

<u>Content of Disclosures</u>:

Classifying and labeling fees as "finance charges" and "other charges," Q13 – Q20.
Over-the-credit-limit fees, Q21 – Q22.
"Effective" or "historical" annual percentage rate on periodic statements, Q23 – Q25.
Disclosures about rate changes, Q26 – Q27.
Balance calculation methods, Q28 – Q30.
Minimum payments, Q31 – Q33.
Payment allocation, Q34 – Q36.
Tolerances, Q37.
Other questions, Q38 – Q42.

Substantive protections:

General, Q43.
Accessing credit card accounts, Q44.
"Convenience checks," Q45.
Unsolicited issuance of credit cards, Q46.
Prompt crediting of payments, Q47 – Q51.

Additional Issues:

Providing guidance not expressly addressed in existing rules, Q52.
Adjusting exceptions based on de minimis amounts, Q53.
Improving plain language and organization; identifying technical revisions, Q54.
Deleting obsolete rules or guidance, Q55.
Recommendations for legislative changes, Q56.
Recommendations for nonregulatory approaches, Q57.
Reviewing other aspects of Regulation Z, Q58

The Board also requests that when possible, comment letters should use a standard typeface with a font size of 10 or 12. This enables the Board to convert text submitted in paper form to machine-readable form through electronic scanning, and eases automated retrieval of comments for review.

II. Background

The Congress based the Truth in Lending Act (TILA) on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit, which results from consumers' awareness of the credit's cost. The purposes of the TILA are: (1) to provide a meaningful disclosure of credit terms to enable consumers to compare the various credit terms available in the marketplace more readily and avoid the uninformed use of credit; and (2) to protect consumers against inaccurate and unfair credit billing and credit card practices. 15 U.S.C. 1601(a).

TILA's disclosures differ somewhat depending on whether consumer credit is an open-end (revolving) plan or a closed-end (installment) loan. TILA also contains procedural and substantive protections for consumers, for both open-end and closed-end transactions.

TILA is implemented by the Board's Regulation Z. 12 CFR part 226; 15 U.S.C. 1604(a). An Official Staff Commentary interprets the requirements of Regulation Z. 12 CFR § 226 (Supp I). Creditors that follow in good faith Board or official staff interpretations are insulated from civil liability, criminal penalties, or administrative sanction. 15 U.S.C. 1640(f).

III. Reviewing the Open-end Credit Rules

TILA, enacted in 1968, was substantially revised by the Truth in Lending Simplification Act of 1980. Regulation Z was revised and reorganized to implement the new law, effective in 1982 (46 FR 20892, April 7, 1981). Since then, the regulation has not been reviewed in its entirety, although much of it has been reviewed in individual rulemakings, to implement new legislation, in response to congressional requests for reports, or pursuant to public hearings.[1] The Official Staff Commentary is typically updated annually.

Scope of the Review. The Board periodically reviews it regulations to update them. The Board plans to review Regulation Z over the next few years. The regulation is sufficiently lengthy and complex, however, that conducting the review in stages appears to be the most appropriate approach. The Board is proposing to focus the first stage of the review on Regulation Z's rules for open-end (revolving) credit accounts that are not home-secured, chiefly general-purpose credit cards and merchant-specific credit plans, although the rules apply to open-end lines generally. Other aspects of the regulation would also be addressed if the Board determines that it is necessary or appropriate to do so. Accordingly, comment is also requested on other ways that Regulation Z could be improved in **Section VI**, below. Plans for future stages of the review of Regulation Z are discussed in **Section VII,** below. Some provisions in Regulation Z apply to both open- and closed-end credit. Even though the Board is proposing to review Regulation Z in stages, the Board will consider the need for consistency across the regulation in proposing revisions.

Q1. The Board solicits comments on the feasibility and advisability of reviewing Regulation Z in stages, beginning with the rules for open-end credit not home-secured. Are some issues raised by the open-end credit rules so intertwined with other TILA rules that other approaches should be considered? If so, what are those issues, and what other approach might the Board take to address them?

Goals. In reviewing Regulation Z, the Board's primary goal is to improve, if possible, the effectiveness and usefulness of open-end disclosures and substantive protections. Consumers' use of open-end credit, especially lines accessed by credit cards, has grown markedly. The ways in which consumers can access open-end lines and the uses they can make of these lines have both expanded. Pricing has become more complex and products increasingly diverse, especially for general purpose credit cards. Taken together, these factors suggest it is appropriate to consider whether the open-end disclosure rules and substantive protections of Regulation Z are achieving their intended purposes, which are to permit consumers to make informed decisions about the use of

[1] Amendments to Regulation Z have addressed adjustable-rate mortgage loans (52 FR 48665, December 24, 1987); home equity lines of credit (54 FR 24670, June 9, 1989), credit and charge card applications and solicitations (54 FR 13855, April 6, 1989 and 65 FR 58903, October 3, 2000), and potentially abusive mortgage lending practices (high-cost loans and reverse mortgages, 60 FR 15463, March 24, 1995, and 66 FR 65604, December 20, 2001). In connection with reports to the Congress, the Board reviewed the rules relating to consumers' right to rescind certain mortgage transactions (1995); finance charges (1996); home–equity lines of credit (1996); and closed–end mortgage loans (1998).

credit and to protect consumers against inaccurate and unfair credit billing and credit card practices. The review will also consider ways to address concerns about information overload, which can adversely affect how meaningful the disclosures are to consumers. Disclosures required under TILA are required to be clear and conspicuous; the Board intends to study alternatives for improving the format of disclosures, including revising the model forms and clauses published by the Board, to ensure that consumers get timely information in a readable form.

TILA also seeks to establish uniformity in creditors' disclosures to promote comparison shopping. Thus, in conducting the review, the Board will consider ways that the rules can be clarified for creditors to facilitate compliance and promote consistency in their disclosures. Pursuant to the Board's mandate under the Economic Growth and Regulatory Paperwork Reduction Act, the Board also intends to consider ways to reduce unnecessary regulatory burden consistent with the purposes and requirements of TILA. (See 68 FR 35589, June 16, 2003; 69 FR 2852, January 21, 2004; 69 FR 43347, July 16, 2004.)

Following the ANPR, the Board may determine that proposed revisions to Regulation Z's open-end credit rules are appropriate, but there may be other responses to the issues raised. For example, the Board may consider whether to recommend legislative changes. The Board may conclude that a non-regulatory response would be the most effective approach in addressing some issues, for example the issuance of recommended best practices or consumer education efforts. These alternative approaches are discussed in **Section VI**, below.

The Board's Authority under TILA. TILA mandates that the Board prescribe regulations to carry out the purposes of the act. 15 U.S.C. 1604(a). In promulgating open-end credit rules to implement TILA, the Board is also authorized, among other things, to do the following:

- Issue regulations that contain such classifications, differentiations, or other provisions, or provide for such adjustments and exceptions for any class of transactions, that in the Board's judgment are necessary or proper to effectuate the purposes of TILA, facilitate compliance with the act, or prevent circumvention or evasion. 15 U.S.C. 1604(a).

- Exempt from all or part of TILA any class of transactions if the Board determines that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection. The Board must consider factors identified in the act and publish its rationale at the time a proposed exemption is published for comment. 15 U.S.C. 1604(f).

- Exempt from TILA certain transactions involving consumers who first provide a written waiver of their TILA protections and whose annual earned income or net assets at the time of the transaction exceeds a certain dollar figure ($200,000 and

$1,000,000, respectively), which the Board may adjust for inflation. 15 U.S.C. 1604(g).

- Provide tolerances for numerical disclosures other than the annual percentage rate (APR), so long as the tolerances are narrow enough to prevent disclosures that are misleading or that circumvent TILA's purposes. 15 U.S.C. 1631(d).

Open-end Consumer Credit in Today's Marketplace. The principal examples of open-end credit not home-secured are general-purpose credit cards and merchant-specific credit plans, which may or may not involve cards. In determining how the Board's goals for the Regulation Z review can best be met, the Board will consider the nature and function of open-end credit accounts, and how the market for open-end credit has developed since the last major review of the open-end rules.

Recent studies and consumer surveys (including a 2001 survey of consumers with general purpose credit cards discussed in the April 2002 article noted below) provide some data on open-end credit plans and how consumers use them, particularly credit card accounts, as follows:[2]

- Increased number of cards held. In 2001, 73 percent of households had at least one general purpose credit card with a revolving feature, compared to 43 percent in 1983. The 2001 consumer survey noted above showed that 20 percent of the respondents obtained a new general purpose credit card within the previous year, and that around 84 percent of those respondents did so as a result of a solicitation. The survey also showed that nearly two-thirds of the respondents who had acquired a new card in the previous year already held two other credit card accounts, and over one-third of respondents with general purpose credit cards with a revolving feature held three or more.

- Wide range of uses. Open-end plans, credit cards in particular, are widely used in today's marketplace. Credit cards serve as a substitute for cash and checks for millions of routine purchases, and allow consumers to engage in transactions such as telephone and Internet purchases. Also, credit limits can be high, and consumers now commonly finance the purchase of "big-ticket" items (such as appliances and furniture) under an open-end plan rather than a closed-end installment loan, as they did in the past. Card issuers have also developed other access methods for consumers to use their accounts, such as by offering "convenience checks" that may be used for purchases or to transfer balances from other accounts. In the 2001 survey noted above, about 20 percent of respondents having general purpose credit cards with a revolving feature had transferred balances in the previous year.

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[2] Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970-2000*, FEDERAL RESERVE BULLETIN, (September 2000); Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, FEDERAL RESERVE BULLETIN (April 2002).

- More complex pricing. General purpose credit-card pricing has become more complex. A single account may have multiple APRs for different types of credit extensions, or that apply for limited time periods. Credit cards are available to consumers with a much wider range of credit risks, due to improved technology for risk-evaluation. As a result, pricing is more varied. Also, competition has reduced "front-end" costs for general purpose credit cards as card issuers eliminate annual fees and offer substantial discounts in initial interest rates. On the other hand, "back-end" costs have increased through higher late fees, over-the-credit-limit fees, and the use of penalty rates for late payers. In the surveys noted above, about 30 percent of credit card users reported paying a late fee within the previous year.

- Additional account features. The 2001 survey noted above showed that in making choices about opening or replacing card accounts, consumers consider a variety of factors, ranging from cost information about rates, annual fees, and minimum payments, to benefits such as rebate and reward programs.

- Consumers' perceptions about account information. The 2001 survey of consumers with general purpose credit cards asked the respondents about their perceptions of information available for these accounts. Sixty-five percent said that useful information on credit terms was either "very easy" or "somewhat easy" to obtain, and only 6 percent thought it very difficult. But when asked questions about consumers' understanding and use of Truth in Lending disclosures at account opening or on monthly bills for general purpose credit cards, nearly one-third of the respondents suggested improvements could be made regarding format and clarity.

IV. Summary of TILA's Rules for Open-end Credit Accounts

Under TILA, as implemented by Regulation Z, open-end credit exists when consumer credit is extended under a plan in which (1) the creditor reasonably contemplates repeated transactions, (2) the creditor may impose a finance charge from time to time on an outstanding unpaid balance, and (3) the credit is replenished as it is used, up to any limit set by the creditor. 15 U.S.C. 1602(i); 12 CFR § 226.2(a)(20). The rules that apply to open-end credit also apply to creditors that issue "charge cards" that typically require outstanding balances to be paid in full at the end of each billing cycle. 12 CFR § 226.2(a)(17)(iii). For purposes of this ANPR, the terms "open-end credit" and "credit card" encompass "charge card."

Disclosures. TILA and Regulation Z require creditors offering open-end credit plans to disclose costs and other terms related to the plan. To summarize:

- Disclosures must be provided with credit card applications and solicitations. Consumers receive key cost information in an abbreviated manner, to help consumers decide whether to apply for the card account. For direct mail solicitations, the disclosures are presented in a highly structured table.

- Disclosures provided at account-opening describe how charges associated with the plan will be determined. Consumers receive information about the periodic rate, disclosed as an APR, that will be applied to the outstanding balance, along with other fees that may be assessed on the account. Consumers' rights and responsibilities in the case of unauthorized use or billing disputes are also explained. Consumers must receive these disclosures before the first transaction on the account.

- Disclosures on periodic statements reflect the activity on the account for the statement period. In addition to the APR based on the periodic rate, periodic statements must also disclose the effective or "historical" APR for the billing cycle. The effective APR includes finance charges imposed in addition to interest (such as cash advance fees or balance transfer fees). Transactions that occurred and any fees imposed during the cycle must be identified on the statement, along with any time period a consumer may have to pay an outstanding balance and avoid additional finance charges (the "grace period").

- Disclosures about changes in account terms and about the terms for using a new credit feature or means of access are provided on an ad hoc basis.

Substantive and procedural protections. TILA and Regulation Z also provide procedural and substantive protections to consumers with open-end accounts, including special protections for credit cardholders, summarized below:

- Consumers using an open-end credit plan may assert a billing error, which triggers creditors' duty to investigate the allegation within prescribed time limits.

- Cardholders may assert against a card issuer claims or defenses arising from a credit card purchase, if the merchant honoring the card fails to resolve any dispute about the quality of the goods or services.

- Cardholders' liability for the unauthorized use of a credit card is capped at $50.

- Credit cards may be issued to consumers only upon request. One or more credit cards may be issued to cardholders in renewal of, or substitution for, an accepted card, with some conditions.

- Consumers' payments on the account must be credited as of the date the creditor receives the payment and creditors must refund credit balances.

- Creditors cannot offset consumers' credit card debt with funds held on deposit with the card issuer except in specified circumstances.

V. Request for Information and Comments on TILA's Disclosures and Protections

Under open-end plans, consumers generally control how the plan is accessed and the amount and timing of credit extensions and payments. Because consumers' decisions about using their open-end credit accounts are continuous, the relevance of key account terms to consumers' use of the account varies over the life of the account. Thus, the effectiveness of disclosures must be considered in light of the multiple functions they serve.

For example, some information received at account-opening may become relevant years later, for example, when a consumer who uses a credit card account for purchases decides for the first time to obtain a cash advance. Information provided on periodic statements tells consumers about account activity for the statement period, but it also allows consumers to make ongoing credit decisions about how much credit to use and how much of the outstanding balances to pay on various accounts. And consumers may use existing account-opening or periodic statement disclosures to compare offers they receive to apply for another account or transfer existing balances to another account.

A. Would format changes enhance consumers' ability to notice and understand disclosures by making them more clear and conspicuous?

Open-end disclosures are subject to few formatting rules. Creditors have great flexibility in designing account-opening, periodic statement, and other open-end disclosures. The primary exception to TILA and Regulation Z's flexible formatting rules for open-end credit is the abbreviated and segregated tabular disclosures required for credit card solicitations and applications (known as the "Schumer box"). 15 U.S.C. 1637(c); 12 CFR § 226.5a(a)(2). TILA disclosures must be "clear and conspicuous," which is generally interpreted to be in a "reasonably understandable form." 15 U.S.C. 1632; 12 CFR § 226.5(a)(1); comment 5(a)(1)-1.[3]

In June 2004, the Board withdrew regulatory proposals that would have established a uniform standard for "clear and conspicuous" disclosures under Regulations B, E, M, Z, and DD. 69 FR 35541, June 25, 2004. Instead of adopting general definitions or standards that would apply across the five regulations, the Board decided to focus on individual disclosures and to consider ways to make specific improvements to the effectiveness of each disclosure. The Board noted that the effort to review individual disclosures would be undertaken in connection with the Board's periodic review of its regulations, commencing with the issuance of an ANPR to review the rules for open-end credit accounts under TILA and Regulation Z. Although the proposals defining "clear and conspicuous" were withdrawn, they reflected principles that will guide the Board in reviewing individual disclosures and revising the regulation and the Board's model forms and clauses.

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[3] For purposes of credit card application and solicitation disclosures, the "clear and conspicuous" standard is interpreted to mean that the disclosures must also be "readily noticeable to the consumer." See Comment 5a(a)(2)-1.

In the questions that follow, the Board seeks comment on ways to make the disclosures for open-end credit accounts more understandable and noticeable. Commenters are specifically requested to identify any particular concerns relating to the format of electronic disclosures.

Account-opening disclosures. TILA's account-opening disclosures are provided to consumers before the plan is opened (or before the first transaction). 15 U.S.C. 1637(a); 12 CFR § 226.5(b)(1). Creditors typically provide the TILA disclosures in an account agreement that also contains contract terms and state-law disclosures. The agreement is typically a lengthy document in a small type size.

A primary purpose of the account-opening disclosures is to allow consumers to have key information about the account before they use the plan at all. Because consumers' use of the plan may change over time, however, these disclosures remain important over the life of the plan. Consumers may also refer to their account-opening disclosures when comparing the terms of their existing account to offers subsequently received from other card issuers. As stated above, data from a 2001 survey indicate that a significant number of consumers respond to solicitations for new credit card accounts.

Data from the 2001 survey of consumers with general purpose credit cards reveals that about two thirds of the respondents said that useful information on credit terms was either "very easy" or "somewhat easy" to obtain.[4] However, about three-fourths of consumers also agree (strongly or somewhat) with the statement that TILA statements "are complicated." Nearly one-third suggested improvements could be made to the format and clarity of Truth in Lending disclosures at account opening or on monthly bills for general purpose credit cards, such as by providing information that is "clearer, simpler, easier to understand, written in lay terms, or in larger print."

The Board has received comments about the format of account-opening disclosures in connection with recent rulemakings. The views of the members of the Board's Consumer Advisory Council (CAC) have also been solicited. Many who commented believe that much of the information considered to be important is already contained in the disclosures; because a lot of information is provided at account opening, however, there is the potential for information overload, which can impair the disclosures' effectiveness. Accordingly, in connection with the review of Regulation Z, the Board proposes to consider ways to ease consumers' ability to navigate through the disclosures.

Several format changes have been suggested that might assist in this regard. Some members of the CAC believe that disclosures would be improved by including a page-one "executive summary" paragraph or a disclosure table to highlight key features and terms of the account, similar to the Schumer box disclosure provided with credit card solicitations. Such an executive summary need not be limited to information included in the Schumer box, but could incorporate other information, such as abbreviated description of items that, based on consumer surveys, are considered to be most important to

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[4] Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, FEDERAL RESERVE BULLETIN (April 2002), p. 207.

consumers (e.g., an annual fee, potential rate changes, amount of credit line, minimum monthly payment, special account benefits). Either as a part of this notion, or as a stand-alone change, consumers might benefit from a directory or "table of contents" box that would highlight for readers where specific terms might be found, to assist consumers in navigating through the document (for example, "Late fees…see paragraphs 12, 14"). This concept addresses the anecdotal evidence that consumers often choose not to read the entire disclosure at once, but seek out information on specific terms from time to time, at the outset of the account relationship and subsequently.

Q2. What formatting rules would enhance consumers' ability to notice and understand account-opening disclosures? Are rules needed to segregate certain key disclosures from contractual terms or other information so the disclosures are more clear and conspicuous? Should the rules require that certain disclosures be grouped together or appear on the same page? Are minimum type-size requirements needed, and if so, what should the requirements be?

Q3. Are there ways to use formatting tools or other navigational aids for TILA's account-opening disclosures that will make the disclosures more effective for consumers throughout the life of the account? If so, provide suggestions.

<u>Periodic statements</u>. TILA and Regulation Z contain few formatting rules for disclosures provided on periodic statements. Periodic statement disclosures provide information about account activity during the statement period; but consumers might also use information on the statements to make decisions about payments and the future use of their account, which affects the overall cost of credit. The Board solicits comment on the general need for format requirements for periodic statements, including the following:

Q4. Format rules could require certain disclosures to be grouped together or appear on the same page where it would aid consumer's understanding. For example, some card issuers disclose a 25-day grace period on the back of the periodic statement that can be used to calculate the payment due date; the same card issuer might also show a "please pay by date" on the front of the periodic statement that is based on a 20-day period. Some consumers might assume the 20-day period reflects the due date; other consumers may ascertain the actual due date by looking on the back of the statement. Potential consumer confusion might be reduced by requiring creditors to disclose the grace period or the actual due date on the first page of the statement, adjacent to the "please pay by" date. Is such a rule desirable? Are there other disclosures that should be grouped together on the same page?

Q5. Could the cost of credit be more effectively presented on periodic statements if less emphasis were placed on how fees are labeled, and all fees were grouped together on the periodic statement? Are there other approaches the Board should consider? If so, provide suggestions.

Q6. How could the use of formatting tools or other navigational aids make the disclosures on periodic statements more effective for consumers?

Credit card application disclosures (the "Schumer box"). The disclosures required for credit card solicitations and applications have the most regimented format requirements. TILA disclosures must be presented in a table (known as the "Schumer box") with headings substantially similar to those published in the Board's model forms. (Format requirements for "take-one" applications are quite flexible; card issuers have the option to use the format required for direct-mail applications.)

In 2000, the Board revised the format requirements for these tabular disclosures. 65 FR 58903, October 3, 2000. The regulation's sole type-size requirement applies to direct-mail application disclosures; the APR for purchases must be in at least 18-point type size. 12 CFR § 226.5a(b)(1). Also, the "clear and conspicuous" standard is interpreted to mean that application disclosures must be "in a reasonably understandable form and readily noticeable to the consumer." Disclosures that are printed in a 12-point type size have a safe harbor in the regulation under this standard. Comment 5a(a)(2)-1.

Q7. Is the "Schumer box" effective as currently designed? Are there format issues the Board should consider? If so, provide suggestions.

Q8. Balance transfer fees and cash advance fees may be disclosed inside the "Schumer box" or clearly and conspicuously elsewhere on or with the application. 12 CFR § 226.5a(a)(2)(i). Given the prevalence of balance transfer promotions in credit card applications and solicitations, should balance transfer fees be included in the Schumer box?

Subsequent disclosures. Creditors have great flexibility under TILA and Regulation Z in disclosing changes in account terms and the terms for new credit features or access devices offered after the account is opened.

Q9. Are there formatting tools or navigational aids that could more effectively link information in the account-opening disclosures with the information provided in subsequent disclosures, such as those accompanying convenience checks and balance transfer checks? If so, provide suggestions.

Model forms and clauses. The Board publishes model forms and model clauses to ease compliance. Creditors are not required to use these forms or clauses, but creditors that use them properly are deemed to be in compliance with the regulation regarding those disclosures. See 15 U.S.C. 1604(b). The Board has few model clauses and forms for account-opening or periodic statement disclosures.

Q10. Should existing clauses and forms be revised to improve their effectiveness? If so, provide specific suggestions.

Q11. Would additional model clauses or forms be helpful? If so, please identify the types of new model clauses and forms that the Board should consider developing.

Q12. In developing any proposed revisions or additions to the model forms or clauses, the Board plans to utilize consumer focus groups and other research. The Board is aware of studies suggesting that, for example, bolded headings that convey a message are helpful, but using all capital letters is not.[5] Is there additional information on the navigability and readability of different formats, and on ways in which formatting can improve the effectiveness of disclosures?

B. How can the content of disclosures be improved or simplified to enhance consumers' understanding of the cost of credit?

TILA is designed to provide consumers with information about costs and terms to enable them to make comparisons among creditors and different credit programs, or determine whether they should use the credit line at all. In the questions that follow, the Board solicits comment generally on how the content of disclosures can be improved to enhance consumers' understanding about costs and terms. In addition, comment is specifically requested on how disclosures can be simplified while ensuring that consumers have the information they need to make informed decisions about the use of their credit accounts.

<u>Can the rules for classifying and labeling fees as "finance charges" and "other charges" be improved</u>?

How a particular fee is classified affects when and how the fee is disclosed under TILA. Creditors offering open-end credit must disclose fees that are "finance charges" as well as "other charges" that are part of the credit plan.

A "finance charge" is broadly defined as any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor, as an incident to or a condition of the extension of credit. 15 U.S.C. 1605; 12 CFR § 226.4. Interest, cash advance fees, and balance transfer fees are examples of finance charges. Finance charges must be disclosed in the account-opening statement. If imposed in a particular billing cycle, finance charges must be disclosed on the periodic statement, where the fee must be labeled as a "finance charge." If a finance charge fee increases, a change-in-terms notice is generally required. If imposed in a particular billing cycle, a finance charge must also be included in the effective (or "historical") APR, which expresses the total finance charge, not just interest, as an annual rate. 15 U.S.C. 1606(a)(2). Non-recurring loan fees, points, or similar finance charges related to the opening, renewing, or continuing of an open-end account are excluded from the effective APR. 12 CFR § 226.14(c)(3), footnote 33, comment 14(c)-7.

If the fee is not a finance charge, but is significant and imposed as part of the plan, it is an "other charge" and must be disclosed at account-opening; on each applicable statement, though not with any particular label; and, for some but not all "other charges," on a change-in-terms notice when the amount of the fee increases. 15 U.S.C. 1637(a)(5),

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[5] Colin Wheildon, *Type & Layout; How Typography and Design Can Get Your Message Across – or Get in the Way,"* Berkley: Strathmoor Press; Revised edition (March 1, 1995).

12 CFR §§ 226.6(b), 7(h); comment 6(b)-1. Examples of “other charges” are penalty fees for late payment or exceeding a credit limit, and periodic membership or participation fees that are payable whether or not the consumer actually uses the credit plan.

If the fee is neither a finance charge nor an “other charge” (for example, returned check fees), TILA does not require that it be disclosed initially. If such a fee is charged to the consumer and billed to the account, the fee must be disclosed on the relevant periodic statement just as any other transaction item must be disclosed.

For the credit card industry as a whole, fee income has grown significantly in importance. With that trend, the types of fees creditors charge on open-end consumer credit accounts have grown in number and variety. As creditors charge new fees that are not specifically addressed by Regulation Z, creditors are sometimes unsure if the fee should be disclosed under TILA, and if so, whether it should be characterized as a finance charge or “other charge.” The rules for open-end accounts provide no tolerance for errors in disclosing the finance charge. In reviewing Regulation Z, the Board plans to consider whether there are ways to provide more clarity for creditors as to how particular fees should be classified.

Regulation Z follows TILA in giving the terms “finance charge” and “other charge” broad and flexible meanings. This ensures that the rules are adaptable to changing conditions, but also creates some degree of uncertainty. Regulation Z and the staff commentary diminish the uncertainty somewhat by expressly identifying examples of charges that constitute finance charges and types that do not. 15 U.S.C. 1605; 12 CFR § 226.4(b) and (c). Nevertheless, rules that specifically address every fee generated in the marketplace are not practicable.

In response to a December 2002 staff proposal to clarify the status of two new fees in the staff commentary, many industry commenters called for a different approach to cost disclosures that would provide more certainty about fees’ proper classification. 67 FR 72618, December 6, 2002; 68 FR 16185, April 3, 2003. Some industry commenters suggested that more certainty could be provided, for example, if fees were classified as finance charges based on whether payment of the fee is required as a condition to obtaining credit. They asserted that this standard would ease compliance and reduce litigation risks and promote comparison shopping by decreasing the risk that creditors might disclose the same fee differently.

Q13. How could the Board provide greater clarity on characterizing fees as finance charges or “other charges” imposed as part of the credit plan? Under Regulation Z, finance charges include fees imposed as a condition of the credit as well as fees imposed “incident to” the credit. This includes “service, transaction, activity, and carrying charges.” 12 CFR § 226.4(b)(2). What types of fees imposed in connection with open-end accounts should be excluded from the finance charge, and why? How would these fees be disclosed to provide uniformity in creditors’ disclosures and facilitate compliance?

Q14. How do consumers learn about the fees that will be imposed in connection with services related to an open-end account, and any changes in the applicable fees?

Q15. What significance do consumers attach to the label "finance charge," as opposed to "fee" or "charge"?

Q16. Some industry representatives have suggested a rule that would classify fees as finance charges only if payment of the fee is required to obtain credit. How would creditors determine if a particular fee was optional? Would costs for certain account features be excluded from the finance charge provided that the consumer was also offered a credit plan without that feature? Would such a rule result in useful disclosures for consumers? Would consumers be able to compare the cost of the different plans? Would such a rule be practicable for creditors?

Q17. Some industry representatives have suggested a rule that would classify a fee as a finance charge based on whether the fee affects the amount of credit available or the material terms of the credit. How would such a standard operate in practice? For example, how would creditors distinguish finance charges from "other charges"? What terms of a credit plan would be considered material?

Q18. TILA requires the identification of other charges that are not finance charges and may be imposed as part of the plan. The staff commentary interprets the rule as applying to "significant charges" related to the plan. Has that interpretation been effective in furthering the purposes of the statute? Would another interpretation be more effective? Criteria that have been suggested as relevant to determining whether the Board should identify a charge as an "other charge" include: the amount of the charge; the frequency with which a consumer is likely to incur the charge; the proportion of consumers likely to incur the charge; and when and how creditors disclose the charge, if at all. Are those factors relevant? Are there other relevant factors?

Q19. What other issues should the Board consider as it addresses these questions? For instance, in classifying fees for open-end plans generally, do home equity lines of credit present unique issues?

Q20. How important is it that the rules used to classify fees for open-end accounts mirror the classification rules for closed-end loans? For example, the approach of excluding certain finance charges from the effective APR for open-end accounts is not consistent with the approach recommended by the Board for closed-end loans. In a 1998 report to the Congress concerning reform of closed-end mortgage disclosures, the Board endorsed an approach that would include "all required fees" in the finance charge and APR. (The report is at www.federalreserve.gov/boarddocs/press/boardacts/1998.)

Over-the-credit-limit fees. Anecdotal evidence indicates that "penalty" fees imposed on open-end credit accounts, such as over-the-credit-limit fees and late-payment fees, have increased in recent years. Adequate disclosure of over-the-credit-limit fees may be of particular importance to consumers who have low-limit credit card accounts.

Fees for paying late or exceeding a credit limit are disclosed with credit card applications and solicitations; in account-opening statements; and on periodic statements for billing cycles when the fees are imposed. Although TILA does not specifically address the characterization of these fees, Regulation Z provides that the fees are not "finance charges" but must be disclosed as "other charges." 12 CFR § 226.4(c)(2); comment 6(b)-1. In a recent case involving the disclosure of an over-the-credit-limit fee, the United States Supreme Court upheld the Board's regulation excluding such fees from the finance charge. See Household Credit Services v. Pfennig, 541 U.S. 232 (2004).

Concerns have been raised about some card issuers' practice of allowing consumers to remain over their credit limit for multiple billing cycles. For example, a creditor may establish an initial credit limit, but once that limit is exceeded the creditor might not require the consumer to bring the account balance below the originally established credit limit. As a result, the creditor may impose an over-the-credit-limit fee on a continuing basis for each month the consumer carries a balance in excess of the original credit limit.

Q21. The staff commentary to Regulation Z provides guidance on when a fee is properly excluded from the finance charge as a bona fide late payment charge, and when it is not. See Comment 4(c)(2)-1. Is there a need for similar guidance with respect to fees imposed for exceeding a credit limit, for example, where the creditor does not require the consumer to bring the account balance below the originally established credit limit, but imposes an over-the-credit-limit fee each month on a continuing basis?

Q22. Because of technical limitations or other practical concerns, credit card transactions may be authorized in circumstances that do not allow the merchant or creditor to determine at the moment of the transaction whether the transaction will cause the consumer to exceed the previously established credit limit. How do card issuers explain to consumers their practice of approving transactions that might result in the consumer's exceeding the previously established credit limit for the account and being charged an over-the-credit-limit fee? When are over-the credit-limit fees imposed; at the time of an approved transaction, or later such as at the end of the billing cycle? The Board specifically requests comments on whether additional disclosures are needed regarding the circumstances in which over-the-credit-limit fees will be imposed.

How do consumers use the "effective" or "historical" annual percentage rate disclosed on periodic statements?

Under TILA the finance charge is also disclosed as an annualized rate, the APR. The APR is based on the periodic rate (interest) for purposes of credit card solicitations and applications, account-opening disclosures, and advertisements for open-end plans. But for periodic statements, creditors must also disclose an "effective" or "historical" APR that includes any finance charges other than interest imposed during the billing cycle (such as cash advance fees). TILA requires non-interest finance charges to be amortized over one billing cycle for purposes of calculating the effective APR, and as a result, such fees can result in a high double-digit (or sometimes, triple-digit) effective APR on periodic statements. That is why under the regulation and staff commentary, non-recurring loan fees, points, or similar finance charges related to the opening, renewing, or continuing of an open-end account are currently excluded from the effective APR that is disclosed for a particular billing cycle.

The utility of disclosing the effective APR, which is mandated by the statute, is controversial. The legislative history of TILA suggests that Congress adopted the effective APR for open-end credit to ensure that the cost of credit in the form of transaction charges or minimum or fixed finance charges was fully and uniformly disclosed. The history also indicates that Congress was aware that the effective APR would vary from the nominal APR, possibly substantially, when such charges were imposed. Moreover, in at least one hearing Congress heard testimony that an effective APR would not be useful to consumers, and might confuse them.

Consumer advocates believe the effective APR is a key disclosure. They contend that a sharp rise in the APR caused by the imposition of a fee makes consumers more likely to notice the fee and, therefore, to understand that their action triggering the fee increased the overall cost of credit. Consumer advocates have also stated that the effective APR should be used by consumers in evaluating their credit options and how they might avoid such charges in the future. Consumer advocates sometimes refer to this theory as the “shock value” of the APR.

Over the years, industry representatives have provided comments questioning the value to consumers of disclosing the effective APR on periodic statements. They believe the effective APR could be eliminated without diminishing consumer protections because in their view it confuses consumers who do not understand how it differs from the APR based on the periodic interest rate. Industry representatives also assert that the effective APR overstates the cost of cash advances because it is based on amortizing the fees over one billing cycle even though some consumers may carry the advance for a longer period.

Q23. Have changes in the market and in consumers’ use of open-end credit since the adoption of TILA affected the usefulness of the historical APR disclosure? If so, how? The Board seeks data relevant to determining the extent to which consumers understand and use the historical APR disclosed on periodic statements. Is there data on how disclosure of the historical APR affects consumer behavior? Is it useful to consumers to include in the historical APR transaction charges such as cash advance fees and fees to transfer balances from other accounts?

Q24. Are there ways to improve consumers’ understanding of the effective APR, such as by providing additional context for the disclosure? For example, should consumers be informed that the effective APR includes fees as well as interest, and that it assumes the fees relate to credit that was extended only for a single billing period?

Q25. Are there alternative frameworks for disclosing the costs of credit on periodic statements that might be more effective than disclosing individual fees and the effective APR? For example, would consumers benefit from a disclosure of the total dollar amount of all account-related fees assessed during the billing cycle, or the total dollar amount of fees by type? Would a cumulative year-to-date total for certain fees be useful for consumers?

Disclosures about rate changes. Under Regulation Z, some changes to the terms of an open-end plan require additional notice. (The statute does not address changes in terms to open-end plans.) The general rule is that 15 days' advance notice is required to increase the finance charge (including the interest rate) or an annual fee. 12 CFR § 226.9(c)(1). However, advance notice is not required in all cases. For example, if the interest rate or other finance charge increases due to a consumer's default or delinquency, notice is required, but need not be given in advance. 12 CFR § 226.9(c)(1); comment 9(c)(1)-3. And no change-in-terms notice is required if the creditor specifies in advance the circumstances under which an increase to the finance charge or an annual fee will occur. Comment 9(c)-1. For example, some credit card account agreements permit the card issuer to increase the interest rate if the consumer pays late, or if card issuer learns the consumer paid late on another credit account, even if the consumer has always paid the card issuer on time. Under Regulation Z, because the circumstances are specified in advance in the account agreement, the creditor need not provide a change-in-terms notice 15 days in advance of the increase; the new rate will appear on the periodic statement for the cycle in which the increase occurs.

Consumer advocates have expressed concerns that consumers who have triggered certain penalty rates may not be aware of the possibility of the increase, and thus are unable to shop for alternative financing before the increased rate takes effect.

Q26. Is mailing a notice 15 days before the effective date of a change in interest rates adequate to provide timely notice to consumers?

Q27. How are account-holders alerted to increased interest rates due to consumers' default on this account or another credit account? Are existing disclosure rules for increases to interest rates and other finance charges adequate to enable consumers to make timely decisions about how to manage their accounts? If not, provide suggestions.

Do consumers need additional information about other factors that affect the cost of credit?

In addition to rates and fees, the cost of credit can also be affected by the creditor's method of calculating the outstanding credit balance; the size of the consumer's monthly payment; and the creditor's allocation of that payment among different charges and transactions. As explained below, the Board seeks comment on the need for regulatory revisions to enhance consumers' understanding of the effect of these factors on the cost of credit.

Balance calculation methods. Under TILA and Regulation Z, consumers receive information on how account balances are calculated for open-end accounts although TILA does not govern which calculation methods creditors must use. Creditors may identify common balance calculation methods by name on credit card application disclosures. The method is described in more detail in account-opening disclosures and on periodic statements. See 15 U.S.C. 1637(a)(2), (b)(7), (c)(1)(A)(iv); 12 CFR §§ 226.5a(b)(6), 226.6(a)(3), 226.7(e). The Board has published model clauses for some common balance calculation methods. 12 CFR 226, Appendix G-1.

The balance calculation method used by a creditor can affect the cost of credit. For example, for purposes of assessing finance charges on unpaid balances, some creditors include balances from the previous cycle, although some do not. Others may include purchases made during the current cycle, although not all do.

Q28. How significantly does the balance calculation method affect the cost of credit given typical account use patterns?

Q29. Do consumers understand that different balance calculation methods affect the cost of credit, and do they understand which balance calculation methods are more or less favorable for consumers? Would additional disclosures at account-opening assist consumers and, if so, what type of disclosures would be useful?

Q30. Explanations of balance calculation methods are complex and may include contractual terms such as rounding rules. Precise explanations are required on account-opening disclosures and on periodic statements. Should the Board permit more abbreviated descriptions on periodic statements, along with a reference to where consumers can obtain further information about the calculation method, such as the credit agreement or a toll-free telephone number?

Disclosing the effects of making only minimum payments. Subject to any required minimum payment, consumers are free to decide each billing period how much to pay on outstanding balances. The consumer's payment amount each period affects the overall cost of credit, and can result in negative amortization if the payments are insufficient to cover the accrued interest charges. Furthermore, if a consumer's account balance exceeds the established credit limit and the consumer's payment is not large enough to bring the balance below the limit, an over-the-credit-limit fee might be assessed even if the payment satisfied the minimum amount specified by the creditor.

TILA and Regulation Z do not require disclosures associated with payment amounts, except to require an advance notice when a change in the method of calculating the minimum payment will increase it. 12 CFR § 226.9(c)(1). Minimum-payment amounts are set by agreement and disclosed in the periodic statement at the creditor's option or because of other applicable law. The banking agencies, through the Federal Financial Institutions Examination Council, have provided guidance to card issuers on safety-and-soundness issues relating to minimum payments, but the guidance does not mandate particular consumer disclosures. See the Board's Division of Banking

Supervision and Regulation SR 03-1, Account Management and Loss Allowance Methodology for Credit Card Lending, January 8, 2003.

In recent years, consumer advocates have raised concerns about whether consumers understand the effects of making only minimum payments on their open-end accounts. Provisions in certain proposed bankruptcy reform bills before Congress would require creditors to provide standardized examples of the time it would take to pay off an assumed balance if the consumer makes only the minimum payment. See, for example, Sec. 1301 of H.R. 975, 108th Congress. The bills would allow consumers to obtain an estimate of how long it would take to pay their actual account balance by calling a toll-free telephone number established by the creditor. Industry representatives note that disclosures based on the status of individual accounts are burdensome; they also say that the disclosure would not be helpful to consumers because it would be based on an unrealistic assumption that the consumer has stopped using the account for new extensions of credit.

Consumer advocates have also expressed concerns about open-end accounts that are specifically established to finance a single purchase that is equal to or nearly equal to the credit limit, because consumers do not receive disclosures about the total payment amount and the time it will take to repay the debt based on the minimum payment. But industry representatives have noted that requiring separate disclosures at account opening in such cases would unfairly disadvantage merchants' credit plans because issuers of general purpose credit cards would not provide such disclosures at the point of sale for an identical transaction.

Q31. Is it appropriate for the Board to consider whether Regulation Z should be amended to require: (1) periodic statement disclosures about the effects of making only the minimum payment (such as, disclosing the amortization period for their actual account balance assuming that the consumer makes only the minimum payment, or disclosing when making the minimum payment will result in a penalty fee for exceeding the credit limit); (2) account-opening disclosures showing the total of payments when the credit plan is specifically established to finance purchases that are equal or nearly equal to the credit limit (assuming only minimum payments are made)? Would such disclosures benefit consumers?

Q32. Is information about the amortization period for an account readily available to creditors based on current accounting systems, or would new systems need to be developed? What would be the costs of implementing such a rule?

Q33. Is there data on the percentage of consumers, credit cardholders in particular, that regularly or continually make only the minimum payments on open-end credit plans?

Payment allocation. Some accounts that have multiple features apply different periodic rates to particular features such as purchases, cash advances, and balance transfers. How a consumer's payment is allocated to the balance for each feature affects the consumer's cost of credit. For example, assume a consumer has a $100 outstanding balance for purchases carrying a 0% promotional APR, and a $150 outstanding balance from cash advances carrying an 18% APR. If the consumer makes a $100 payment, and the payment is allocated first to the balance carrying the lowest rate (the purchase balance), the consumer will pay finance charges on $150, the entire cash advance balance. Had the creditor allocated the consumer's payment to the cash advance, the consumer would incur finance charges only on the remaining cash advance balance of $50.

A creditor's method for allocating payment may be included in the credit contract, but neither TILA nor Regulation Z requires a creditor to use a particular payment allocation method or to disclose the method it uses. Indeed, the staff commentary expressly indicates that disclosure of the allocation of payments is not required. Comment 6(a)(3)-2.

Q34. What are the common methods of payment allocation and how much do they affect the cost of credit for the typical consumer?

Q35. Do creditors typically disclose their allocation methods, and if so, how?

Q36. Is it appropriate for the Board to consider whether Regulation Z should be amended to require disclosure of the payment allocation method on the periodic statement? Would such a disclosure materially benefit consumers? Some creditors offer a low promotional rate, such as a 0% APR for cash advances for a limited time and a higher APR for purchases. Creditors typically do not allocate any payments to purchases until the entire cash advance is paid off. Are additional disclosures needed to avoid consumer confusion or misunderstanding? What would the cost be to creditors of providing such a disclosure? What level of detail would provide useful information while avoiding information overload?

Tolerances

TILA authorizes the Board to permit tolerances for numerical disclosures other than the APR. 15 U.S.C. 1631(d). Such tolerances are required to be narrow enough to prevent the tolerance from resulting in misleading disclosures or disclosures that circumvent the purposes of TILA.

Q37. What tolerances should the Board consider adopting pursuant to this provision? Should the Board expressly permit an overstatement of the finance charge on open-end credit? Would that adequately address concerns over proper disclosure of fees? How narrow should any tolerance be to ensure TILA's goal of uniformity is preserved?

Other questions regarding the content of disclosures

Q38. In considering changes to the disclosures required by Regulation Z, the Board seeks data relevant to the costs and benefits of the proposed revisions. Accordingly, commenters proposing revisions to the disclosure requirements are requested to provide data estimating the cost difference in complying with the existing rules compared to any proposed alternatives, including any one-time costs to implement the changes.

Q39. Are there particular types of open-end credit accounts, such as subprime or secured credit card accounts, that warrant special disclosure rules to ensure that consumers have adequate information about these products?

Q40. Are there additional issues the Board should consider in reviewing the content of open-end disclosures? For example, in 2000, the Board revised the requirements for disclosures that accompany credit card applications and solicitations. 65 FR 58903, October 3, 2000. Is the information currently provided with credit card applications and solicitations adequate and effective to assist consumers in deciding whether or not to apply for an account?

Q41. Are there classes of transactions for which the Board should exercise its exemption authority under 15 U.S.C. 1604(a) to effectuate TILA's purpose, facilitate compliance or prevent circumvention or evasion, or under 15 U.S.C. 1604(f) because coverage does not provide a meaningful benefit to consumers in the form of useful information or protection? If so, please address the factors that the Board is required to consider under the statute.

Q42. Should the Board exercise its authority under 15 U.S.C. 1604(g) to provide a waiver for certain borrowers whose income and assets exceed the specified amounts?

C. Is there a need to modify the rules that implement TILA's substantive protections for open-end accounts?

TILA and Regulation Z provide protections to consumers who obtain open-end credit. Some protections apply only to transactions involving credit cards; others apply to all extensions of credit under an open-end plan. Protections involving billing disputes generally allow consumers to avoid paying the disputed amount while the card issuer investigates the matter, and prohibit card issuers from assessing finance charges on the disputed amount or reporting the amount as delinquent until the investigation is completed. To summarize the rules:

- Consumers using an open-end credit plan may assert a billing error, which triggers creditors' duty to investigate the allegation within prescribed time limits. A "billing error" includes a periodic statement that reflects an extension of credit for property or services: (1) not authorized by the consumer; or (2) not accepted by the consumer, or not delivered to the consumer as agreed (for example, when clothing is sent in the wrong size or color). A billing error also includes creditors' failure to credit payments or to deliver statements to a consumer's address of record. 15 U.S.C. 1666; 12 CFR § 226.13.

- A cardholder may assert against the card issuer a claim or defense for defective goods or services purchased with a credit card, as to unpaid balances for the goods or services, if the merchant honoring the card fails to resolve the dispute. This right is limited to disputes exceeding $50 for purchases made in the consumer's home state or within 100 miles. 15 U.S.C. 1666i; 12 CFR § 226.12(c).

- Cardholders' liability for the unauthorized use of a credit card is capped at $50. But cardholders have no liability for charges made after notification is given to the card issuer, or charges made when the card itself (or other sufficient means of identifying the cardholder) is not presented. 15 U.S.C. 1643; 12 CFR § 226.12(b).

- Credit cards may be issued to consumers only upon request. One or more credit cards may be issued to cardholders in renewal of, or substitution for, an accepted card, with some conditions. 15 U.S.C. 1642; 12 CFR § 226.12(a).

- Payments received from a consumer on an open-end credit plan must be posted promptly to the consumer's account. Under Regulation Z, payments generally must be credited to a consumer's account as of the date of receipt, except when a delay in crediting does not result in a finance charge or "other charge" being imposed. Creditors may specify requirements for the consumer to follow in making payments. 15 U.S.C. 1666c; 12 CFR § 226.10.

Q43. The Board solicits comments on whether there is a need to revise the provisions implementing TILA's substantive protections for open-end credit accounts. For example, are the existing rules adequate, and if not, why not? Are creditors' responsibilities under the rules clear? Do the existing rules need to be updated to address particular types of accounts or practices, or to address technological changes?

<u>Accessing credit card accounts</u>. TILA defines a credit card as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit." 15 U.S.C. 1602(k). In addition, Regulation Z provides that a credit card must be a device "that may be used from time to time to obtain credit." 12 CFR § 226.2(a)(15).

It is increasingly common for consumers to access their credit card plans without presenting the card, for example, in making purchases over the Internet and by telephone. Credit card transactions conducted by telephone or Internet receive all of TILA's protections, even though the physical device is not presented to the merchant when the account number is transmitted.

Q44. Information is requested on whether industry has developed, or is developing, open-end credit plans that allow consumers to conduct transactions using only account numbers and do not involve the issuance of physical devices traditionally considered to be credit cards. If such plans exist, what policies do such creditors have for resolving accountholder claims when disputes arise?

"Convenience checks." Credit card issuers also provide account-holders with "convenience checks" that can be used to obtain cash, purchase goods or services, or pay the outstanding balance on another account. Convenience checks are mailed to consumers unsolicited, sometimes with consumers' monthly statements. The amount of each check issued by the consumer will be billed to the consumers' credit card account. Convenience checks allow consumers to use their credit card account to finance the purchase of goods or services at merchants that do not accept credit cards. Anecdotal evidence also suggests convenience checks are used for large-dollar transactions, such as college tuition payments.

Currently, a convenience check is not treated as a credit card under Regulation Z because it can be used only once and not "from time to time." Although the rules for resolving billing errors apply to all transactions conducted under an open-end plan, including those involving convenience checks, TILA's protections regarding merchant disputes, unauthorized use of the account, and the prohibition against unsolicited issuance apply only to credit cards and do not cover transactions using convenience checks.[6]

In discussing the issue at the October 2003 meeting of the Board's Consumer Advisory Council, some members stated that Regulation Z's protections for credit cards should be revised to apply to all credit extended under a credit card account, whether the card itself or another device, such as a convenience check, is used. They noted that the Board could cover convenience checks by revising the regulation's definition of a "credit card" for this purpose, to eliminate the requirement that the device be usable "from time to time." But others stated that convenience checks should not be covered by TILA's protections and should be treated the same way as a check drawn on a deposit account.

Q45. Have consumers experienced problems with convenience checks relating to unauthorized use or merchant disputes, for example? Should the Board consider extending any of TILA's protections for credit card transactions to other extensions on credit card accounts and, in particular, convenience checks?

Unsolicited issuance of credit cards. Limitations on issuing unsolicited credit cards were added to TILA in 1970 to address concerns about theft, inconvenience to consumers, and consumers' management of their personal finances. TILA generally prohibits creditors from issuing credit cards except in response to a request or application but exempts cards issued as renewals or substitutions to replace an accepted card. 15 U.S.C. 1642.

In 2003, Board staff revised the commentary to the relevant provision of Regulation Z, § 226.12(a), to allow card issuers to replace an accepted card with more than one card, subject to certain conditions. 68 FR 16185, April 3, 2003. Based on the revisions, card issuers can, for example, issue credit cards using a new format or technology to existing accountholders, even though the new card is intended to supplement rather than replace the traditional card. Based on the public comments, staff

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[6] For convenience checks, the Uniform Commercial Code (UCC) provisions governing checks apply; under the UCC a consumer generally has no liability for a forged check. UCC 4-401, 3-401.

stated it planned to recommend that the Board consider amending § 226.12(a) to allow the unsolicited issuance of additional cards on an existing account even when the accountholder's existing card is not being replaced, under certain conditions.

Q46. Should the Board consider revising Regulation Z to allow creditors to issue additional credit cards on an existing account at any time, even when there is no renewal or substitution of a previously issued card? If so, what conditions or limitations should apply? For example, should the Board require that the additional cards be sent unactivated? If activation is required, should the Board allow issuers to use alternative security measures in lieu of activation, such as providing advance written notice to consumers that additional cards will be sent?

Prompt Crediting of Payments

Payments received from a consumer on an open-end credit plan must be credited to the account as of the date the payment is received by the creditor. Creditors cannot impose a finance charge or "other charge" if the creditor has received payment in a readily identifiable form in the amount, manner, location, and time indicated by the creditor to avoid the imposition of the charge. 12 CFR § 226.10(a). Creditors may specify requirements for making payments such as setting a cut-off hour for payment to be received, but the requirements must be reasonable and it should not be difficult for most consumers to make conforming payments. Comments 10(b)-1, -2.

Consumer advocates have raised concerns about the reasonableness of card issuers' cut-off hours. They note that some creditors' service centers are open 24 hours 7 days a week to receive mail delivery and electronic payments continuously. In addition, questions have arisen concerning creditors' use of third-party payments processors, and whether the receipt of payments by the third-party is deemed to be receipt by the creditor.

Q47. What are the cut-off hours used by most issuers for receiving payments? How do issuers determine the cut-off hours?

Q48. Do card issuers' payment instructions and cut-off hours differ according to whether the consumer makes the payment by check or electronic fund transfer, or by using the telephone or Internet? What is the proportion of consumers who make payments by mail as opposed to using expedited methods, such as electronic payments?

Q49. Do the existing rules and creditors' current disclosure practices clearly inform cardholders of the date and time by which card issuers must receive payment to avoid additional fees? If not, how might disclosure requirements be improved?

Q50. Do the operating hours of third-party processors differ from those of creditors, and if so, how? Do creditors treat payments received by a third-party processor as if the payment was received by the creditor? What guidance, if any, is needed concerning creditors' obligation in posting and crediting payments when third-party processors are used?

Q51. Should the Board issue a rule requiring creditors to credit payments as of the date they are received, regardless of the time?

VI. Request for Comment on Additional Issues

In addition to responding to the Board's request for comments on the open-end credit issues identified above, the Board invites the public to discuss other ways that Regulation Z might be improved and to provide specific suggestions for implementing those changes, including:

Q52. Providing guidance not expressly addressed in existing rules. Board staff is asked to provide informal oral advice on an ongoing basis about how Truth in Lending rules may apply to new products and circumstances not expressly addressed in Regulation Z and its official staff commentary. The Board invites the public to identify issues where they believe staff's informal advice should be formalized or addressed anew. Should such changes be adopted after notice and public comment, they would apply prospectively and compliance would become mandatory after an appropriate implementation period.

Q53. Adjusting exceptions based on de minimis amounts. To facilitate compliance, the Board has provided a number of exceptions based on de minimis dollar amounts. For example, TILA's open-end rules require creditors to transmit periodic statements at the end of billing cycles in which there is an outstanding balance or a finance charge is imposed; the regulation relieves creditors of that duty if the outstanding debit or credit balance is $1 or less (and no finance charge is imposed). 15 U.S.C. 1637(b); 12 CFR § 226.5(b)(2)(i). Similarly, the Board provides for a simplified way to calculate the effective APR on periodic statements when a minimum finance charge is assessed and is 50 cents or less. 12 CFR § 226.14(c)(4). Should de minimis amounts such as these be adjusted, and if so, to what extent?

Q54. Improving plain language and organization; identifying technical revisions. The Board is required to use "plain language" in all proposed and final rules published after January 1, 2000. 12 U.S.C. 4809. The Board invites comments on whether the existing rules are clearly stated and effectively organized, and how, in the upcoming review of Regulation Z, the Board might consider making the text of Regulation Z and its official staff commentary easier to understand. Are there technical revisions to the regulation or commentary that should be addressed?

Q55. Deleting obsolete rules or guidance. A goal of the Regulation Z review is to delete provisions that have become obsolete due to technological or other developments. Are there any such provisions?

Q56. Recommendations for legislative changes. Are there any legislative changes to TILA the Board should consider recommending to the Congress? For example, where a rule is based on a dollar amount established by the statute, the Board seeks comment on whether to recommend adjustments of those dollar amounts to the Congress, and if so, the amount of such adjustments.

Q57. Recommendations for nonregulatory approaches. In addition to requesting comment on suggestions for regulatory or statutory changes, the Board seeks comment on nonregulatory approaches that may further the Board's goal of improving the effectiveness of TILA's disclosures and substantive protections. Such approaches could include guidance in the form of best practices or consumer education efforts. For example, calculation tools are widely available on the Internet. How might the availability of those tools be used to address concerns that consumers need better information about the effects of making only minimum payments on their account? Are there any data that indicate the extent to which consumers access calculation tools that are publicly available?

Q58. Reviewing other aspects of Regulation Z. Although the Board is proposing to focus the review primarily on the rules for open-end credit, are there other areas or particular sections of Regulation Z that should be included in this initial stage of the review? For example:

(a) Definitions and rules of construction. Are changes needed to the definitions or rules of construction in § 226.2 of the regulation? Unless defined in the regulation, terms have the meaning given to them by state law or contract. Are there specific terms that are not defined in Regulation Z that should be? For example, the Board's staff has received questions about § 226.20, which generally requires creditors to provide new TILA disclosures when a closed-end loan is refinanced. Under the regulation and staff commentary, a "refinancing" is generally deemed to occur when an existing obligation has been satisfied and replaced by a new obligation, "based on the parties' contract and applicable law." See Comment 20(a)-1. Concerns have been raised about the current approach, and whether it results in uniform application of Regulation Z because different states are free to draw different conclusions about when a particular set of circumstances constitutes a "satisfaction and replacement." Courts may take a case-by-case approach to ascertain the parties' intent before deciding whether a new promissory note satisfied and replaced the original note, or whether the new note merely "relates back" to the original note that is not deemed to be extinguished. The issue raised is whether the Board should consider adopting a definition of "refinancing" that does not rely on state law and seeks to create a more uniform approach in determining when new disclosures are required.

(b) Exempt transactions. Section 226.3 of Regulation Z implements the provisions of 15 U.S.C. 1603, which specifies classes of transactions not covered by TILA. Do rules implementing 15 U.S.C. 1603 need to be updated?

VII. Plans for Reviewing Other Areas

Although the focus of this ANPR is TILA and Regulation Z's rules for open-end credit not secured by a home, the Board has the following plans for reviewing other areas of Regulation Z:

- Predatory mortgage lending. Issues related to predatory mortgage lending will be examined in public hearings held pursuant to the Home Ownership and Equity Protection Act (HOEPA), which amended TILA in 1994. HOEPA uses rate and fee triggers to identify a class of high-cost closed-end mortgage loans, and it provides consumers entering into these transactions with additional disclosures and special protections. HOEPA requires that the Board periodically hold public hearings on home-equity lending and the adequacy of protections under HOEPA. After holding hearings in 2000, the Board amended the rules implementing HOEPA, which became effective on October 1, 2002. Board staff plans to ask the Board to consider holding further hearings under HOEPA during 2006.

- Closed-end mortgage credit. From 1996 to 1998, the Board and HUD studied possible regulatory changes to TILA and the Real Estate Settlement Procedures Act (RESPA) to improve mortgage-related disclosures. The Board concluded that meaningful changes to the disclosures required legislative action. The Board and HUD submitted a joint report to the Congress outlining a framework that could be used as a starting point for considering legislative changes. Although legislation has not been enacted, in 2002 HUD commenced a rulemaking that sought to adopt many of the changes recommended in the Board-HUD joint report. HUD's proposal was not finalized, and HUD has announced that it will issue a revised proposal for public comment in the near future. The Board believes that significant changes to mortgage disclosures under TILA would best be considered in connection with HUD's future rulemaking.

- Home-equity lines of credit and adjustable-rate mortgage loans. Staff plans to initiate a separate review, in 2005, of Regulation Z's rules requiring brochures and generic disclosures when consumers obtain applications for closed-end adjustable-rate mortgages (ARMs) and open-end home-equity lines of credit (HELOCs). The issues to be considered deal mainly with variable-rate mortgage lending, which are distinct from issues affecting general open-end credit rules. The ARM rules would be reviewed in consultation with the other federal agencies. Because the HELOC and ARM rules are similar, these rules are best reviewed simultaneously to maximize consistency.

By order of the Board of Governors of the Federal Reserve System, December 3, 2004.

Jennifer J. Johnson (signed)

Jennifer J. Johnson
Secretary of the Board