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Office of Thrift Supervision
Department of the Treasury

Montrice G. Yakimov
Managing Director, Compliance and Consumer Protection

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6173

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MEMORANDUM FOR: **CHIEF EXECUTIVE OFFICERS**

Montrice Godard Yakimov

FROM: Montrice G. Yakimov, Managing Director
Compliance and Consumer Protection

SUBJECT: Revised Truth in Lending Act (TILA) Open-End Credit and Closed-End Examination Procedures:
Credit Cards, Private Student Loans and Mortgage Transfers

OTS has updated its examination procedures to address recent amendments to TILA by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), the Higher Education Opportunity Act (HEOA) and the Helping Families Save Their Homes Act, and accompanying revisions to Regulation Z.[1] These examination procedures address changes in open-end credit requirements, and new requirements for student loans and mortgage transfer notices. The revised examination procedures were developed on an interagency basis. They reflect a risk-focused approach to comprehensive examinations.

I. Open-end provisions.

Because the Credit CARD Act was designed to become effective in three stages, the Board is in the process of adopting rules to implement the new law in three stages. To ensure that examiners have the tools that they need to examine for compliance with the implementing rules as they become effective, OTS and the other federal financial institution regulatory agencies have also taken a phased approach to updating the TILA examination procedures. The attached procedures add new sections to address the provisions of the Credit CARD Act and revisions to Regulation Z that became effective on February 22, 2010. They also incorporate previous revisions to the TILA examination procedures that were made to

[1] The Board of Governors of the Federal Reserve System ("Board") issued final rules to implement provisions of the Credit CARD Act that became effective on February 22, 2010, see Truth in Lending Final Rule, 75 Fed. Reg. 7658 (February 22, 2010), provisions of HEOA that became mandatory on February 14, 2010, see Truth in Lending Final Rule, 74 Fed. Reg. 41194 (August 14, 2009), and interim final rules on consumer notices of transfer of mortgage ownership that became mandatory on January 19, 2010, see Truth in Lending Interim Final Rule, 74 Fed. Reg. 60143 (November 20, 2009).

address provisions of the law and rule that became effective on August 20, 2009.[2] Key aspects of the attached procedures are set out below.

A. Preventing unfair increases in interest rates and changes in terms.

As required by the Credit CARD Act, Regulation Z now protects consumers from unexpected increases in credit card annual percentage rates (APRs) by restricting such increases during the first year after a credit card account is opened, and requiring promotional rates to last at least six months.[3] An APR may increase during the first year when a promotional rate expires, or when a change occurs in a variable rate that is subject to an index. After the first year, issuers may increase the APRs that apply to new transactions if they comply with the 45-day advance notice requirement.[4]

In addition, credit card issuers are now prohibited from increasing rates and fees on existing balances unless specific exceptions apply. Consequently, a credit card issuer may increase the APR on an existing balance only if the consumer is 60 days late in making the minimum payment, if a workout arrangement terminates, or if a rate ceases to apply that was reduced under the Servicemembers Civil Relief Act.

B. Enhanced disclosure of card terms and conditions.

Disclosure requirements have changed in several ways:

- Minimum payment disclosures. A major change in Regulation Z requirements is the revised minimum payment disclosure.[5] This disclosure includes an estimate of the amount of time needed and the total cost of paying off the balance if the consumer makes only the minimum payments, an estimate of the monthly amount needed to pay off the balance in 36 months, the total cost (principal and interest) of repaying the balance in 36 months, and an estimate of the total interest a consumer would save by repaying the balance in 36 months, instead of making minimum payments.

- Disclosures of terms. Issuers must disclose changes in card terms that take effect upon renewal, and provide payment due dates and late payment penalty amounts in periodic statements. These requirements supplement each issuer's obligation to provide cardholders with 45 days notice of changes in significant terms, including

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[2] With today's issuance, OTS has rescinded CEO Letter 322 (September 29, 2009), which revised the TILA examination procedures to address first set of changes made by the Credit CARD Act. The revisions announced through CEO Letter 322 have been incorporated into the attached procedures.

[3] See 12 C.F.R. §226.55.

[4] See §226.9, issued through Truth in Lending Interim Final Rule, 74 Fed. Reg. 36077 (July 22, 2009) and amended by Truth in Lending Final Rule, 74 Fed. Reg. 7658 (February 22, 2010).

[5] See §226.7(b)(12).

APR increases.[6] In addition, the new rules prohibit issuers from using the term "fixed rate" unless the APR will not vary for any reason over the period specified.

- Posting of agreements. Regulation Z now requires issuers to post account agreements on the Board's website.[7] However, posting is not required for issuers with less than 10,000 card accounts, or for non-public agreements, test agreements, or private label agreements for merchants.

C. Fairness in the timing and application of card payments.

Regulation Z now requires that due dates be the same day of the month for each billing cycle.[8] In addition, credit card issuers must have reasonable procedures to deliver periodic statements at least 21 days prior to the payment due date or the date when a grace period expires.[9] A "grace period" is a period during which the consumer may pay without being charged a periodic interest rate.

Under Regulation Z, creditors are subject to new restrictions on allocating payments.[10] If there are different rates for different balances, issuers must allocate payments that exceed the minimum payment to first pay the balance with the highest rate, then to the other balances in descending order by APR. However, for deferred interest programs, during the last two billing cycles of the deferred interest period, issuers must allocate excess payments first to the deferred interest balance, or they may allocate payments in the manner requested by the consumer.

D. Evaluating the consumer's ability to pay.

Before issuing a credit card or increasing a credit limit, issuers must consider a consumer's ability to pay the required minimum payment.[11] However, issuers may rely on information provided by the consumer without verifying that information. They may also consider information from empirically derived, demonstrably and statistically sound models that reasonably estimate a consumer's income or assets. Issuers must consider the ratio of debt obligations to income, the ratio of debt obligations to assets, or the income the consumer will have after paying debt obligations (i.e., residual income). However, it is unreasonable under the rule for an issuer to fail to review any information about a consumer's income, assets, or current obligations, or to issue a

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[6] The 45-day notice of significant changes must include a summary of the changes, a statement that changes are being made and the date when they will take effect, and if the rate is being changed, a description of the balances to which the rate will apply. §226.9(c)(2)(iv)(A). Because this information shows how rate increases would affect an account, Regulation Z no longer requires issuers to provide consumers with the right to reject such increases for future balances. However, issuers must provide consumers with the right to reject certain other terms, and if applicable, notify consumers that if they reject the change, their ability to use the account for further advances will be terminated or suspended. See § 226.9(c)(2)(iv)(B).

[7] See §226.58.

[8] See §226.7(b)(11)(i)(A).

[9] See §226.5(b).

[10] See §226.53.

[11] See §226.51.

credit card to a consumer who does not have any income or assets. To estimate the minimum payment, the rule provides a safe harbor where the issuer: (1) assumes full use of the line of credit, and (2) uses the formula for setting the minimum payment that will apply to the offer. The formula must include all required interest charges and/or mandatory fees.

E. Restrictions on certain fees and interest charges.

Fees and charges are limited in several ways:

- Double-cycle billing and grace period. Creditors are banned from using the "two-cycle" billing method to impose interest charges.[12] When a consumer pays some, but not all, of a balance before the grace period expires, an issuer may not charge interest on the repaid portion of the balance.[13]

- Fees to make payments. Issuers may not charge a fee to pay a credit card debt by mail, telephone, or electronic transfer, except for live services to make expedited payments.[14]

- Limits on excessive fees. Applying excessive fees to the credit available on low-credit, high-fee credit cards is banned.[15] Fees are limited during the first year after account opening to no more than 25% of the initial credit limit. Issuers may charge fees for late payments, returned payments, and exceeding the credit limit.

- Overlimit fees. Before charging overlimit fees, issuers must have the consumer’s consent.[16] Before the consumer may consent, or opt in, the issuer must notify the consumer of the dollar amount of any fees that may be assessed or the increased rates that may apply if the consumer exceeds the credit limit. Even if the consumer consents, an issuer may charge only one overlimit fee or charge per billing cycle, cannot charge an overlimit fee for the same transaction in more than three billing cycles, and may not charge fees for the second or third billing cycle if the consumer reduces the balance below the credit limit by the due date in that cycle. Issuers may not assess overlimit fees caused by the issuer’s failure to promptly replenish the consumer’s available credit or make opting-in a condition for a consumer to obtain a higher credit limit. Finally, an issuer may not charge an overlimit fee if the account limit is exceeded because of accrued interest charges or fees.

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[12] See §226.54.

[13] Id.

[14] See §226.10(e).

[15] See §226.52(a).

[16] See §226.56.

F. Underwriting and marketing safeguards for young people.

Before issuing credit cards to consumers who are under the age of 21, issuers must have a written application, and information showing that the young person has independent means to repay the debt. Alternatively, the issuer may obtain the signature of a cosigner, who is 21 years or over who assumes joint liability and has the means to repay the debt. The cosigner's consent will be necessary before the credit limit is increased in the future.[17]

An issuer that markets credit cards to college students must follow new requirements.[18] Issuers may not offer tangible items to induce college students to apply for credit cards or other open-end credit offers, on or near the campus of an institution of higher education, or at an event sponsored by or related to an institution of higher education. A tangible item means physical items, such as gift cards, coins and currency, t-shirts, or magazine subscriptions, but does not include non-physical items such as discounts, reward points, or promotional credit terms.

G. Timely resolution of estates.

To facilitate estate settlement, Regulation Z now requires issuers to respond quickly to requests from estate administrators and to stop charging fees or interest if the account is paid off in 30 days.[19]

II. <u>Private student loans</u>.

In addition to the credit card protections for students and underage account holders described above, Regulation Z includes disclosure, timing and marketing requirements that apply only to private education loans.[20]

A. Disclosures.

Creditors must provide disclosures at several points in time – (1) at application or solicitation, (2) at approval and before consummation on or with any notice of approval, and (3) final disclosures after the consumer accepts the loan. The disclosures make it clear that the consumer has 30 days to accept the terms of an approved loan and the terms will not change during that period except for variable rates tied to an index. The disclosures lay out the fees and default costs, repayment terms, including deferral options, and cost estimates. In addition, the disclosures must notify consumers of alternatives to private education loans for which the consumer may qualify. The consumer has three days to cancel the loan, without penalty, after receiving the final disclosures. Loan proceeds can not be disbursed until the three-business day period has expired.

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[17] <u>See</u> §226.51(b)(1).

[18] <u>See</u> §226.57(c).

[19] <u>See</u> §226.11(c).

[20] <u>See</u> §§226.46 through 226.48.

B. Co-branding prohibited.

In marketing private education loans, Regulation Z prohibits creditors from using words, pictures, or symbols readily identified with the educational institution in a way that implies an endorsement by the educational institution. Marketing that refers to an educational institution should have a clear and conspicuous statement that the educational institution does not endorse the creditor's loans, and that the creditor is not affiliated with the educational institution. If the educational institution actually does endorse the creditor's loans, the marketing must clearly and conspicuously disclose that the creditor, not the educational institution, is making the loan.

III. Notice of mortgage transfers.

Under Regulation Z, when a mortgage loan is transferred to a new owner, the new owner must notify the borrower in writing.[21] The notice must be made within 30 days after the new owner acquires the mortgage. It must identify the loan, and provide the identity, address, telephone number of the new owner, the date of acquisition, information on reaching the owner's agent, and the location of the recording. Because this notice must be provided for any consumer credit transaction secured by the consumer's principal dwelling, it is therefore necessary for both closed-end mortgage loans and open-end home equity lines of credit. Even if the servicer does not change, this notice must be provided.

For more information, please contact Suzanne McQueen, Consumer Regulations Analyst, at (202) 906-6459 or Suzanne.McQueen@ots.treas.gov. The revised Examination Handbook Section 1305 is available through the link provided below.

Link: Examination Handbook Section 1305

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[21] See §226.39.