BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS

DATE: May 14, 2007

TO: Board of Governors

FROM: Governor Kroszner
Committee on Consumer and Community Affairs

SUBJECT: Proposed Amendments to Regulation Z (Truth in Lending)

The attached item has been reviewed by members of the Consumer and Community Affairs Committee and is now ready for Board consideration.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF CONSUMER AND COMMUNITY AFFAIRS

DATE:	May 14, 2007
TO:	Board of Governors
FROM:	Division of Consumer and Community Affairs*
SUBJECT:	Proposed Amendments to Regulation Z (Truth in Lending)

ACTION REQUESTED: Approval to publish proposed amendments to Regulation Z (Truth in Lending) for public comment. The amendments would revise the disclosure requirements for open-end (revolving) plans that are not home-secured, including credit card accounts.

Summary

The goal of the proposed amendments to Regulation Z is to improve the effectiveness of the disclosures that creditors provide to consumers at application and throughout the life of an open-end account. The proposed changes are the result of the staff's review of the provisions that apply to open-end (not home-secured) credit. The Board's last comprehensive review of Regulation Z was in 1981. The staff recommends changes to format, timing, and content requirements for the five main types of open-end credit disclosures governed by Regulation Z: (1) application and solicitation disclosures; (2) account-opening disclosures; (3) periodic statement disclosures; (4) change-in-terms notices; and (5) advertising provisions.

Applications and Solicitations. The proposal contains changes to the format and content to make the application and solicitation disclosures more meaningful and easier

*S. Braunstein, L. Chanin, J. Michaels, J. Ahrens, K. Ayoub, A. Burke, K. Tran-Trong, D. Sokolov, V. Wong, J. Wood for consumers to use. The proposed changes (which are discussed in detail on pages 13 to 18 of this memorandum) include:

- Adopting new format requirements for the summary table[1], including rules regarding: type size and use of boldface type for certain key terms, placement of information, and the use of cross-references.

- Revising content, including: a requirement that creditors disclose the duration that penalty rates may be in effect, a shorter disclosure about variable rates, new disclosures highlighting the effect of creditors' payment allocation practices, and a reference to consumer education materials on the Board's web site.

<u>Account-opening Disclosures</u>. The proposal also contains revisions to the cost disclosures provided at account opening to make the information more conspicuous and easier to read. The proposed changes (which are discussed in detail on pages 18 to 23) include:

- Disclosing certain key terms in a summary table at account opening, which would be substantially similar to the table required for applications and solicitations, in order to summarize for consumers key information that is most important to informed decision-making.

- Adopting a different approach to disclosing fees, to provide greater clarity for identifying fees that must be disclosed. In addition, creditors would have flexibility to disclose charges (other than those in the summary table) in writing or orally.

<u>Periodic Statement Disclosures</u>. The proposal also contains revisions to make disclosures on periodic statements more understandable, primarily by making changes to the format requirements, such as by grouping fees, interest charges, and transactions together. The proposed changes (which are discussed in detail on pages 23 to 32) include:

- Itemizing interest charges for different types of transactions, such as purchases and cash advances, and providing separate totals of fees and interest for the month and year-to-date.

- Modifying the provisions for disclosing the "effective APR," including format and terminology requirements to make it more understandable.[2] Because of

---

[1] This table is commonly referred to as the "Schumer box."
[2] The "effective" APR reflects interest and other finance charges such as cash advance fees or balance transfer fees imposed for the billing cycle.

concerns about the disclosure's effectiveness, however, staff also recommends soliciting comment on whether this rate should be required to be disclosed.

- Requiring disclosure of the effect of making only the minimum required payment on repayment of balances (changes required by the Bankruptcy Act).

Changes in Consumer's Interest Rate and Other Account Terms. The proposal would expand the circumstances under which consumers receive written notice of changes in the terms (e.g., an increase in the interest rate) applicable to their accounts, and increase the amount of time these notices must be sent before the change becomes effective. The proposed changes (which are discussed in detail on pages 32 to 35) include:

- Generally increasing advance notice before a changed term can be imposed from 15 to 45 days, to better allow consumers to obtain alternative financing or change their account usage.

- Requiring creditors to provide 45 days' prior notice before the creditor increases a rate due to the consumer's delinquency or default.

- When a change-in-terms notice accompanies a periodic statement, requiring a tabular disclosure on the front of the periodic statement of the key terms being changed.

Advertising Provisions. The proposal would revise the rules governing advertising of open-end credit to help ensure consumers better understand the credit terms offered. These proposed revisions (which are discussed in detail on pages 35 and 36) include:

- Requiring advertisements that state a minimum monthly payment on a plan offered to finance the purchase of goods or services to state, in equal prominence to the minimum payment, the time period required to pay the balance and the total of payments if only minimum payments are made.

- Permitting advertisements to refer to a rate as "fixed" only if the advertisement specifies a time period for which the rate is fixed and the rate will not increase for any reason during that time, or if a time period is not specified, if the rate will not increase for any reason while the plan is open.

Model forms. Model forms that illustrate proposed disclosures to be provided (1) with applications and solicitations, (2) at account opening, and (3) on periodic statements are attached to this memorandum.

Background

The Truth in Lending Act

Congress enacted the Truth in Lending Act (TILA) based on findings that economic stability would be enhanced and competition among consumer credit providers would be strengthened by the informed use of credit resulting from consumers' awareness of the cost of credit. The purposes of TILA are (1) to provide a meaningful disclosure of credit terms to enable consumers to compare 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.

TILA's disclosures differ 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. TILA is implemented by the Board's Regulation Z. An Official Staff Commentary interprets the requirements of Regulation Z. By statute, creditors that follow in good faith Board or official staff interpretations are insulated from civil liability, criminal penalties, or administrative sanction.

The Board's Rulemaking Authority

TILA mandates that the Board prescribe regulations to carry out the purposes of the act. TILA specifically authorizes the Board, among other things, to do the following:

- Issue regulations that contain such classifications, differentiations, or other provisions, or that 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.

- 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 it proposes an exemption for comment.

- Add or modify information required to be disclosed with credit and charge card applications or solicitations if the Board determines the action is necessary to carry out the purposes of, or prevent evasions of, the application and solicitation disclosure rules.

- Require disclosures in advertisements of open-end plans.

Board's Review of Open-end Credit Rules

The Board began a review of Regulation Z in December 2004.[3] (The Board's previous comprehensive review of Regulation Z was completed in 1981.) The Board initiated its review of Regulation Z by issuing an advance notice of proposed rulemaking (December 2004 ANPR).[4] At that time, the Board announced its intent to conduct its review of Regulation Z in stages, focusing first on the rules for open-end (revolving) credit accounts that are not home-secured, chiefly general-purpose credit cards and retailer credit card plans. The December 2004 ANPR sought public comment on a variety of specific issues relating to three broad categories: the format of open-end credit disclosures, the content of those disclosures, and the substantive protections provided for open-end credit under the regulation. The December 2004 ANPR solicited comment on the scope of the Board's review, and also requested commenters to identify other issues

---

[3] The review was initiated pursuant to requirements of section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, section 610(c) of the Regulatory Flexibility Act of 1980, and section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

[4] ANPRs are published to obtain preliminary information prior to issuing a proposed rule or, in some cases, deciding whether to issue a proposed rule.

that the Board should address in the review. The comment period closed on March 28, 2005.

The Board received over 200 comment letters in response to the December 2004 ANPR. More than half of the comments were from individual consumers. About 60 comments were received from the industry or industry representatives, and about 20 comments were received from consumer advocates and community development groups. The Office of the Comptroller of the Currency, one state agency, and one member of Congress also submitted comments. A summary of the comments is attached as Appendix A to this memorandum, beginning at page 42.

The Bankruptcy Act's Amendments to TILA

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Bankruptcy Act") primarily amended the federal bankruptcy code, but also contained several provisions amending TILA. The Bankruptcy Act's TILA amendments principally deal with open-end credit accounts and require new disclosures on periodic statements, on credit card applications and solicitations, and in advertisements.

In October 2005, the Board published a second ANPR to solicit comment on implementing the Bankruptcy Act amendments (October 2005 ANPR). In the October 2005 ANPR, the Board stated its intent to implement the Bankruptcy Act amendments as part of the Board's ongoing review of Regulation Z's open-end credit rules. The comment period for the October 2005 ANPR closed on December 16, 2005.

The Board received approximately 50 comment letters in response to the October 2005 ANPR. Forty-five letters were submitted by financial institutions and their trade groups. Five letters were submitted by consumer groups. A summary of the

Bankruptcy Act amendments and the comments received in response to the October 2005 ANPR is provided in Appendix A to this memorandum, at page 47.

Consumer Testing

A principal goal for the Regulation Z review is to produce revised and improved credit card disclosures that consumers will be more likely to pay attention to, understand, and use in their decisions, while at the same time not creating undue burdens for creditors. In April 2006, the Board retained a research and consulting firm (Macro International) that specializes in designing and testing documents to conduct consumer testing to help the Board review Regulation Z's credit card rules. Specifically, Board staff used consumer testing to develop proposed model forms for the following credit card disclosures required by Regulation Z:

- Summary table disclosures provided in direct-mail solicitations and applications;
- Disclosures provided at account opening;
- Periodic statement disclosures (typically provided monthly); and
- Subsequent disclosures, such as notices provided when key account terms are changed, and notices on checks provided to access credit card accounts.

Working closely with Board staff, Macro International conducted several tests. Each round of testing was conducted in a different city, throughout the United States. In addition, the consumer testing groups contained participants with a range of ethnicities, ages, educational levels, credit card behavior, and whether a consumer likely has a prime or subprime credit card.

Exploratory focus groups. In May and June 2006, Board staff worked with Macro International to conduct two sets of focus groups with credit card consumers, in part, to learn more about what information consumers currently use in making decisions about their credit card accounts. Each focus group consisted of between eight and thirteen people that discussed issues identified by Board staff and raised by a moderator from Macro International. Through these focus groups, Board staff gathered information on what credit terms consumers usually consider when shopping for a credit card, what information they find useful when they receive a new credit card in the mail, and what information they find useful on periodic statements.

Cognitive interviews on existing disclosures. In August 2006, Board staff worked with Macro International to conduct nine cognitive interviews with credit card customers. These cognitive interviews consisted of one-on-one discussions with consumers, during which consumers were asked to view existing sample credit card disclosures. The goals of these interviews were: (1) to learn more about what information consumers read when they receive current credit card disclosures; (2) to research how easily consumers can find various pieces of information in these disclosures; and (3) to test consumers' understanding of certain credit card-related words and phrases.

Initial design of disclosures for testing. In the fall of 2006, Board staff worked with Macro International to develop sample credit card disclosures to be used in the later rounds of testing, taking into account information learned through the focus groups and the cognitive interviews.

Additional cognitive interviews and revisions to disclosures. In late 2006 and early 2007, Board staff worked with Macro International to conduct four rounds of cognitive interviews (between seven and nine participants per round), where consumers were asked to view new sample credit card disclosures developed by Board staff and Macro International. The rounds of interviews were conducted sequentially to allow for revisions to the testing materials based on what was learned from the testing during each previous round.

Results of testing. Several of the model forms were developed through the testing. Some of the key findings are summarized below, in the Discussion section of this Board memorandum beginning at page 12, and in the draft Federal Register notice containing the proposal. Macro International will also issue a report summarizing the results of the testing, and this report will be available on the Board's public web site along with the Regulation Z proposal.

Testing participants generally read the summary table provided in direct-mail solicitations and applications and ignored information presented outside of the table. Thus, the proposal requires that information about events that trigger penalty rates and about important fees (late-payment fees, over-the-credit-limit fees, balance transfer fees, and cash advance fees) be placed in the table. Currently, this information may be placed outside the table.

With respect to the account-opening disclosures, consumer testing indicates that consumers commonly do not review their account agreements, which are often in small print and dense prose. The proposal would require creditors to include a table summarizing the key terms applicable to the account, similar to the table required for applications and solicitations. Setting apart the most important terms in this way will better ensure that consumers are apprised of those terms.

With respect to periodic statement disclosures, testing participants found it beneficial to have the different types of transactions grouped together by type. Thus, the proposal requires creditors to group transactions together by type, such as purchases, cash advances, and balance transfers. In addition, many consumers more easily noticed the number and amount of fees when the fees were itemized and grouped together with interest charges. Consumers also noticed fees and interest charges more readily when they were located near the disclosure of the transactions on the account. Thus, under the proposal, creditors would be required to group all fees together and describe them in a manner consistent with consumers' general understanding of costs ("interest charge" or "fee"), without regard to whether the fees would be considered "finance charges," "other charges" or neither under the regulation.

With respect to change-in-terms notices, consumer testing indicates that much like the account-opening disclosures, consumers may not typically read such notices, because they are often in small print and dense prose. To enhance the effectiveness of change-in-terms notices, when a creditor is changing terms which were required to be disclosed in the summary table provided at account opening, the proposed rules would require the creditor to include a table summarizing any such changed terms. Creditors commonly provide notices about changes to terms or rates in the same envelope with periodic statements. Consumer testing indicates that consumers may not typically look at the notices if they are provided as separate inserts given with periodic statements. Thus, in such cases, a table summarizing the change would have to appear on the periodic statement directly above the transaction list, where consumers are more likely to notice the changes.

<u>Additional testing after comment period</u>. After receiving comments from the public on the proposal and the revised disclosure forms, Board staff will work with Macro International to revise the model disclosures. Macro International then will

conduct additional rounds of cognitive interviews to test the revised disclosures. After the cognitive interviews, quantitative testing will be conducted. The goal of the quantitative testing is to measure consumers' comprehension and the usability of the newly-developed disclosures relative to existing disclosures and formats.

Other Outreach and Research Efforts

Board staff also solicited input from members of the Board's Consumer Advisory Council on various issues presented by the review of Regulation Z's open-end credit rules. During 2005 and 2006, for example, the Council discussed the feasibility and advisability of reviewing Regulation Z in stages, ways to improve the summary table provided on or with credit card applications and solicitations, issues related to TILA's substantive protections (including dispute resolution procedures), and issues related to the Bankruptcy Act amendments. In addition, Board staff met or conducted conference calls with various industry and consumer group representatives throughout the review process leading to this proposal. Board staff also reviewed disclosures currently provided by creditors, consumer complaints received by the federal banking agencies, and surveys on credit card usage to help inform the proposal.[5]

Discussion

The goal of the proposed revisions is to improve the effectiveness of the Regulation Z disclosures that must be provided to consumers for open-end accounts. A summary of the key account terms must accompany applications and solicitations for credit card accounts. For all open-end credit plans, creditors must disclose costs and terms at account opening, generally before the first transaction. Consumers must receive

[5] Surveys reviewed include: 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).

periodic statements of account activity, and creditors must provide notice before certain changes in the account terms may become effective.

To shop for and understand the cost of credit, consumers must be able to identify and understand the key terms of open-end accounts. But the terms and conditions affecting credit card account pricing can be complex. The proposed revisions to Regulation Z are intended to provide the most essential information to consumers when the information would be most useful to them, with content and formats that are clear and conspicuous. The proposed revisions are expected to improve consumers' ability to make informed credit decisions and enhance competition among credit card issuers. Many of the changes are based on the consumer testing that was conducted in connection with the review of Regulation Z.

In considering the proposed revisions, staff has also sought to balance the potential benefits for consumers with the compliance burdens imposed on creditors. For example, the proposed revisions seek to provide greater certainty to creditors in identifying what costs must be disclosed for open-end plans, and when those costs must be disclosed. More effective disclosures may also reduce customer confusion and misunderstanding, which may also ease creditors' costs relating to consumer complaints and inquiries.

A. Credit Card Applications and Solicitations

Under Regulation Z, credit and charge card issuers are required to provide information about key costs and terms with their applications and solicitations.[6] This information is abbreviated, to help consumers focus on only the most important terms and

---

[6] Charge cards are a type of credit card for which full payment is typically expected upon receipt of the billing statement. To ease discussion, this memorandum will refer simply to "credit cards."

decide whether to apply for the credit card account. If consumers respond to the offer and are issued a credit card, creditors must provide more detailed disclosures at account opening, before the first transaction occurs.

The application and solicitation disclosures are considered among the most effective TILA disclosures principally because they must be presented in a standardized table with headings, content, and format substantially similar to the model forms published by the Board. In 2001, the Board revised Regulation Z to enhance the application and solicitation disclosures by adding rules and guidance concerning the minimum type size and requiring additional fee disclosures.

Summary of Proposed Revisions

The draft proposal contains a number of revisions to the format and content of application and solicitation disclosures, to make the disclosures more meaningful and easier to understand. Format changes would affect type size, placement of information within the table, use of cross-references to related information, and use of boldface type for certain key terms. Information concerning penalty APRs and the reasons they may be triggered would be more noticeable, and information would be added about how long penalty APRs may apply. The existing disclosures about how variable rates are determined would be shortened and simplified. Creditors that allocate payments first to transferred balances that carry low rates would be required to disclose to consumers that they will pay interest on their (higher rate) purchases until (lower rate) transferred balances are paid in full. Creditors also would be required to include a reference to the Board’s web site where additional information about shopping for credit cards is available.

To address concerns about subprime credit cards programs that have high fees with low credit limits, additional disclosures would be required if the fees or security deposits required to receive the card are 25 percent or more of the minimum credit limit that the consumer may receive. For example, the initial fees on an account with a $250 credit limit may reduce the available credit to less than $100.

Under the proposal, the disclosure of the balance computation method, which now appears in the table, would be required to be outside the table so that the table emphasizes other information that is more useful to consumers when they are shopping for a card.

Penalty pricing. The proposal would make several revisions that seek to improve consumers' understanding of default or penalty pricing. Currently, credit card issuers must disclose inside the table the APR that will apply in the event of the consumer's "default." Some creditors define a "default" as making one late payment or exceeding the credit limit once. The actions that may trigger the penalty APR are currently required to be disclosed outside the table.

Consumer testing indicated that many consumers did not notice the information about penalty pricing when it was disclosed outside the table. Under the proposal, card issuers would be required to include in the table the specific actions that trigger penalty APRs (such as a late payment), the rate that will apply, the balances to which the penalty rate will apply, and the circumstances under which the penalty rate will expire or, if true, the fact that the penalty rate could apply indefinitely. The regulation would require card issuers to use the term "penalty APR" because the testing demonstrated that some consumers are confused by the term "default rate."

Similarly, the proposal requires card issuers to disclose inside (rather than outside) the table the fees for paying late, exceeding a credit limit, or making a payment that is returned, along with a cross-reference to the penalty rate if, for example, paying late could also trigger the penalty rate. Cash advance fees and balance transfer fees would also be disclosed inside the table. This proposed change is also based on consumer testing results; fees disclosed outside the table were often not noticed. Requiring card issuers to disclose returned-payment fees would be a new disclosure.

Variable-rate information. Currently, applications and solicitations offering variable APRs must disclose inside the table the index or formula used to make adjustments and the amount of any margin that is added. Additional details, such as how often the rate may change, must be disclosed outside the table. Under the proposal, information about variable APRs would be reduced to a single phrase indicating the APR varies "with the market," along with a reference to the type of index, such as "Prime." Consumer testing indicated that few consumers use the variable-rate information when shopping for a card. Moreover, participants were distracted or confused by details about margin values, how often the rate may change, and where an index can be found.

Payment allocation. The proposal would add a new disclosure to the table about the effect on credit costs of creditors' payment allocation methods when payments are applied entirely to transferred balances at low introductory APRs. If, as is common, a creditor allocates payments to low-rate balances first, consumers who make purchases on the account will not be able to take advantage of any "grace period" on purchases, unless they pay off the entire low-rate balance. Consumer testing indicated that consumers are often confused about this aspect of balance transfer offers. The new disclosure would alert consumers that they will pay interest on their purchases until the transferred balance is paid in full.

Web site reference. The proposal would also require card issuers to include a reference to the Board's web site, where additional information is available about how to compare credit cards and what factors to consider. This responds to commenters who suggested that the Board consider nonregulatory approaches to provide opportunities for consumers to learn about credit products.

Subprime accounts. The proposal also addresses a concern that has been raised about subprime credit cards, which are generally offered to consumers with low credit scores or credit problems. Subprime credit cards often have substantial fees associated with opening the account. Typically, fees for the issuance or availability of credit are billed to consumers on the first periodic statement, and can substantially reduce the amount of credit available to the consumer. For example, the initial fees on an account with a $250 credit limit may reduce the available credit to less than $100. Consumer complaints received by the federal banking agencies state that consumers were unaware when they applied for cards of how little credit would be available after all the fees were assessed at account opening.

To address this concern, the proposal would require additional disclosures if the card issuer requires fees or a security deposit to issue the card that are 25 percent or more of the minimum credit limit offered for the account. In such cases, the card issuer would be required to include an example in the table of the amount of available credit the consumer would have after paying the fees or security deposit, assuming the consumer receives the minimum credit limit.

Balance computation methods. TILA requires creditors to identify their balance computation method by name, and Regulation Z requires that the disclosure be inside the table. However, consumer testing suggests that these names, such as the "two-cycle average daily balance method," hold little meaning for consumers, and that consumers do not consider such information when shopping for accounts. Accordingly, the proposed rule requires creditors to place the name of the balance computation method outside the table, so that the disclosure does not detract from information that is more important to consumers.

B. Account-Opening Disclosures

Regulation Z requires creditors to disclose costs and terms before the first transaction is made on the account. The disclosures must specify the circumstances under which a "finance charge" may be imposed and how it will be determined. A "finance charge" is any charge that may be imposed as a condition of or an incident to the extension of credit, and includes, for example, interest, transaction charges, and minimum charges. The finance charge disclosures include a disclosure of each periodic rate of interest that may be applied to an outstanding balance (e.g., purchases, cash advances) as well as the corresponding annual percentage rate (APR). Creditors must also explain any grace period for making a payment without incurring a finance charge. They must also disclose the amount of any charge other than a finance charge that may be imposed as part of the credit plan ("other charges"), such as a late-payment charge. Consumers' rights and responsibilities in the case of unauthorized use or billing disputes must also be explained. Currently, there are few format requirements for these account-opening disclosures, which are typically interspersed among other contractual terms in the creditor's account agreement.

Summary of Proposed Revisions

The proposal seeks to make the cost disclosures provided at account opening more conspicuous and easier to read. Accordingly, the revised rules identify specific costs and terms that creditors would be required to summarize in a table that would be substantially similar to the summary table that would be provided with credit card applications and solicitations. Consumers could use the new table provided at account opening to compare the terms of their account to the creditor's original offer or to other solicitations. They would no longer be required to search for the information in the credit agreement.

Revisions are also being proposed to reduce compliance burdens for creditors and provide consumers with fee information at times when it is most useful. Currently, the account-opening disclosures must specify any "finance charges" and any "other charges" that may be imposed under the credit plan. The current rules provide broad definitions for how to determine if a fee is a "finance charge" or an "other charge." Except with respect to specific fees identified in the regulation or commentary, whether a fee is a finance charge or an "other" charge is often unclear. In addition, the regulation identifies fees that are not considered to be either "finance charges" or "other charges" and, therefore, do not need to be included in the account-opening disclosures (for example, returned-check fees, document copying fees, or attorneys fees for collection of an account). The proposed revisions seek to address two problems with the current rules. First, creditors are sometimes uncertain about how to characterize and disclose fees that the regulation does not specifically address. Second, listing some fees in the account-opening disclosures may not be helpful to consumers if the fees are infrequently charged. This may be the case with fees that are associated with optional services that consumers might use months or years after opening an account, such as a fee for documentary evidence related to a billing error.

To address these concerns, the proposed revisions to Regulation Z would specifically identify all of the charges creditors must disclose in writing and in a form the consumer may keep at account opening (without regard to their broad characterization as "finance charge" or "other charge."). These would include interest, annual fees, transaction fees, and penalty fees. For any charges not specifically identified, creditors would have the option of disclosing the charges in writing or orally, at any time before the consumer agrees to or becomes obligated to pay the charge. Thus, consumers who request a service by telephone, such as a request to send a replacement credit card by expedited mail service, may be informed orally at the time of the request of the charge that will apply. Allowing consumers to receive cost disclosures orally departs from the general rule under Regulation Z that disclosures must be provided in a written retainable form.

<u>Account-opening summary table</u>. Account-opening disclosures have often been criticized because the key terms TILA requires to be disclosed are often interspersed within the credit agreements, and such agreements are long and complex. The proposal to require creditors to include a table summarizing the key terms addresses that concern by making the information more conspicuous. Creditors may continue, however, to

provide other account-opening disclosures, aside from the fees and terms specified in the table, with other terms in their account agreements.

The new table provided at account opening would be substantially similar to the table provided with direct-mail applications and solicitations. Consumer testing and surveys indicate that consumers generally are aware of the table on applications and solicitations. Consumer testing also indicates that consumers may not typically read their account agreements, which are often in small print and dense prose. Thus, setting apart the most important terms in a summary table will better ensure that consumers are aware of those terms.

The table required at account opening would include more information than the table required at application. For example, it would include a disclosure of any fee for transactions in a foreign currency or that take place in a foreign country. For various reasons, some creditors may provide account-opening disclosures with the application or solicitation. To reduce compliance burden for creditors that do so, the proposal would allow creditors to provide the more specific and inclusive account-opening table at application in lieu of the table otherwise required at application.

How charges are disclosed. Under the current rules, a creditor must disclose any "finance charge" or "other charge" in the written account-opening disclosures.

A subsequent written notice is required if one of the fees disclosed at account opening increases or if certain fees are newly introduced during the life of the plan. The terms "finance charge" and "other charge" are given broad and flexible meanings in the regulation and commentary. This ensures that TILA adapts to changing conditions, but it also creates uncertainty. The distinctions among finance charges, other charges, and charges that do not fall into either category are not always clear. As creditors develop new kinds of services, some find it difficult to determine if associated charges for the new services meet the standard for a “finance charge” or “other charge” or are not covered by TILA at all. This uncertainty can pose legal risks for creditors that act in good faith to comply with the law. Examples of included or excluded charges are in the regulation and commentary, but these examples cannot provide definitive guidance in all cases. Creditors are subject to civil liability and administrative enforcement for underdisclosing the finance charge or otherwise making erroneous disclosures, so the consequences of an error can be significant. Furthermore, overdisclosure of rates and finance charges is not permitted by Regulation Z for open-end credit.

The fee disclosure rules also have been criticized as being outdated. These rules require creditors to provide fee disclosures at account opening, which may be months, and possibly years, before a particular disclosure is relevant to the consumer, such as when the consumer calls the creditor to request a service for which a fee is imposed. In addition, an account-related transaction may occur by telephone, when a written disclosure is not feasible.

The proposed rule is intended to respond to these criticisms while still giving full effect to TILA’s requirement to disclose credit charges before they are imposed. Accordingly, under the proposal, the rules would be revised to (1) specify precisely the charges that creditors must disclose in writing at account opening (interest, minimum charges, transaction fees, annual fees, and penalty fees such as for paying late), which would be listed in the summary table, and; (2) permit creditors to disclose other less critical charges orally or in writing before the consumer agrees to or becomes obligated to pay the charge. Although the proposal would permit creditors to disclose certain costs orally for purposes of TILA, the staff anticipates that creditors will continue to identify fees in the account agreement for contract and other reasons.

Under the proposal, some charges would be covered by TILA that the current regulation, as interpreted by the staff commentary, excludes from TILA coverage, such as fees for expedited payment and expedited delivery. It may not have been useful to consumers to cover such charges under TILA when such coverage would have meant only that the charges were disclosed long before they became relevant to the consumer. The staff believes it would be useful to consumers to cover such charges under TILA as part of a rule that permits their disclosure at a relevant time. Further, as new services (and associated charges) are developed, the proposal minimizes risk of civil liability associated with the determination as to whether a fee is a finance charge or an other charge, or is not covered by TILA at all.

C. Periodic Statements

Creditors are required to provide periodic statements reflecting the account activity for the billing cycle (typically, about one month). In addition to identifying each transaction on the account, creditors must identify each "finance charge" using that term, and each "other charge" assessed against the account during the statement period. When a periodic interest rate is applied to an outstanding balance to compute the finance charge, creditors must disclose the periodic rate and its corresponding APR. Creditors must also disclose an "effective" or "historical" APR for the billing cycle, which, unlike the corresponding APR, includes not just interest but also finance charges imposed in the form of fees (such as cash advance fees or balance transfer fees). Periodic statements must also state the time period a consumer has to pay an outstanding balance to avoid additional finance charges (the "grace period"), if applicable.

Summary of Proposed Revisions

Under the proposed revisions, creditors would no longer be required to characterize particular costs on the periodic statement as "finance charges."[7] Costs would be described either as "interest" or as a "fee." Fees would still have to be itemized by type as they currently are (such as a late-payment fee or cash advance fee). To enhance consumers' awareness of the overall cost for the billing period, creditors would be required to group all fees together and state the total amount of fees rather than interspersing the fees with purchase transactions.

The proposal also offers for comment two alternative approaches to address concerns about the effective APR. The first approach would make several revisions intended to simplify the disclosure of the "effective APR" to make it easier for consumers to understand and to ease creditors' compliance burden. The second approach would eliminate the requirement to disclose the effective APR.

With regard to revisions to improve the effective APR, the revised rules would contain an exclusive list of transaction charges and fixed fees that creditors must include in calculating the effective APR (such as interest, cash advance fees, balance transfer fees, and any minimum or fixed finance charge). These costs would be identified by type and grouped together to show they are included in the effective APR. Creditors would be required to label the effective APR as the "fee-inclusive APR" to distinguish it from the

---

[7] Creditors would still make the distinction to calculate the effective APR, which reflects the cost of certain "finance charges" imposed during the billing cycle.

advertised APR, which is based solely on the periodic interest rate. Staff plans to conduct additional consumer testing to determine the efficacy of this approach.

The proposal also would require creditors to provide additional information to consumers about payment due dates and the penalties for making late payments. Disclosures related to late payments implement provisions in the Bankruptcy Act, with some revisions. On each periodic statement, creditors generally would be required to disclose, closely proximate to the payment due date, the amount of the late-payment fee that may be imposed and the penalty APR that could be triggered by a late payment. Creditors that use a cut-off time before 5:00 p.m. on the payment due date would be required to specify the cut-off time on the front of the statement.

The proposed revisions also implement Bankruptcy Act amendments that require creditors to warn consumers about the effects of making only minimum payments on the account. As required by the statute, creditors must include a generic example stating the repayment period for a hypothetical balance if only minimum payments are made. Creditors must also provide a toll-free telephone number that consumers can use to obtain an estimated repayment period for their own account balance.

<u>Fees and interest costs</u>. The proposal contains a number of revisions to the periodic statement to improve consumers' understanding of fees and interest costs. Currently, creditors must identify on periodic statements any "finance charges" that have been added to the account during the billing cycle, and creditors typically list these charges with other transactions, such as purchases, chronologically on the statement. The finance charges must be itemized by type. Thus, interest charges might be described as "finance charges due to periodic rates." Charges such as late payment fees, which are not

"finance charges," are typically disclosed individually and are interspersed among other transactions.

Consumer testing indicated that consumers generally understand that "interest" is the cost that results from applying a rate to a balance over time and distinguish "interest" from other fees, such as a cash advance fee or a late payment fee. Consumer testing also indicated that many consumers more easily determine the number and amount of fees when the fees are itemized and grouped together.

Thus, under the proposal, creditors would be required to group all charges together and describe them in a manner consistent with consumers' general understanding of costs ("interest charge" or "fee"), without regard to whether the charges would be considered "finance charges," "other charges," or neither. Interest charges would be identified by type (for example, interest on purchases or interest on balance transfers) as would fees (for example, cash advance fee or late-payment fee).

Consumer testing also indicated that many consumers more quickly and accurately determined the total dollar cost of credit for the billing cycle when a total dollar amount of fees for the cycle was disclosed. Thus, the proposal would require creditors to disclose the (1) total fees and (2) total interest imposed for the cycle. The proposal would also require disclosure of year-to-date totals for interest charges and fees. For many consumers, costs disclosed in dollars are more readily understood than costs disclosed as percentage rates. The year-to-date figures are intended to assist consumers in better understanding the overall cost of their credit account and would be an important disclosure and an effective aid in understanding annualized costs, especially if the Board were to eliminate the requirement to disclose the effective APR on periodic statements, as discussed below.

<u>The effective APR</u>. The "effective" APR disclosed on periodic statements reflects the cost of interest and certain other finance charges imposed during the statement period. For example, for a cash advance, the effective APR reflects both interest and any flat or proportional fee assessed for the advance.

For the reasons discussed below, the staff recommends two alternative approaches to address the effective APR. The first approach would try to improve consumer understanding of this rate and reduce creditor uncertainty about its calculation. The second approach would eliminate the requirement to disclose the effective APR.

Creditors believe the effective APR should be eliminated. They believe consumers do not understand the effective APR, including how it differs from the corresponding (interest rate) APR, why it is often "high," and which fees the effective APR reflects. Creditors say they find it difficult, if not impossible, to explain the effective APR to consumers who call them with questions or concerns. They note that callers sometimes believe, erroneously, that the effective APR signals a prospective increase in their interest rate, and they may make uninformed decisions as a result. And, creditors say, even if the consumer does understand the effective APR, the disclosure does not provide any more information than a disclosure of the total dollar costs for the billing cycle. Moreover, creditors say the effective APR is arbitrary and inherently inaccurate, principally because it amortizes the cost for credit over only one month (billing cycle) even though the consumer may take several months (or longer) to repay the debt.

Consumer groups acknowledge that the effective APR is not well understood, but argue that it nonetheless serves a useful purpose by showing the higher cost of some credit transactions. They contend the effective APR helps consumers decide each month whether to continue using the account, to shop for another credit product, or to use an alternative means of payment such as a debit card. Consumer groups also contend that reflecting costs, such as cash advance fees and balance transfer fees, in the effective APR creates a "sticker shock" and alerts consumers that the overall cost of a transaction for the cycle is high and exceeds the advertised corresponding APR. This shock, they say, may persuade some consumers not to use certain features on the account, such as cash advances, in the future. In their view, the utility of the effective APR would be maximized if it reflected all costs imposed during the cycle (rather than only some costs as is currently the case).

As part of the consumer testing, mock periodic statements were developed in an attempt to improve consumers' understanding of the effective APR. A written explanation and varying terminology were tested. In most rounds participants showed little understanding of the effective APR, but the form was adjusted between rounds as to terminology and format, and in the last round a number of participants showed more understanding of the effective APR.

Thus, the draft proposal includes a number of revisions to the presentation of the effective APR intended to help consumers understand the figure. In addition, the proposal seeks to improve consumer understanding and reduce creditor uncertainty by specifying more clearly which fees are to be included in the effective APR.[8] As mentioned, however, staff also recommends seeking comment on an alternative proposal to eliminate the disclosure on the basis that it may not provide consumers a meaningful benefit.

Transactions. Currently, there are no format requirements for disclosing different types of transactions, such as purchases, cash advances, and balance transfers on periodic statements. Often, transactions are presented together in chronological order. Consumer testing indicated that participants found it helpful to have similar types of transactions grouped together on the statement. Consumers noticed fees and interest charges more readily when they were located near the purchase transactions. Consumers also found it helpful, within the broad grouping of fees and transactions, when transactions were segregated by type (e.g., listing all purchases together, separate from cash advances or balance transfers). For these reasons, the proposal requires creditors to: (1) group similar transactions together by type, such as purchases, cash advances, and balance transfers, and (2) group fees and interest charges together, itemized by type, with the list of transactions. The periodic statement model form illustrates the proposed requirement.

Late payments. Currently, creditors must disclose the date by which consumers must pay a balance to avoid finance charges. Creditors must also disclose any cut-off time for receiving payments on the payment due date; this is usually disclosed on the reverse side of periodic statements. The Bankruptcy Act amendments expressly require creditors to disclose the payment due date (or if different, the date after which a late-payment fee may be imposed) along with the amount of the late-payment fee.

---

[8] The proposal also would reverse a staff commentary provision that excludes ATM fees from the finance charge and effective APR; and it would address for the first time foreign transaction fees, which it would clarify are to be treated as a finance charge and included in the effective APR.

Under the proposal, creditors would be required to disclose the payment due date on the front side of the periodic statement and, closely proximate to the date, any cut-off time if it is before 5 p.m. Consumer testing indicates that many consumers believe cut-off times are the close of the business day and more readily notice the cut-off time when it is located near the due date.

Creditors would also be required to disclose, in close proximity to the due date, the amount of the late-payment fee and the penalty APR that could be triggered by a late payment. Applying the penalty APR to outstanding balances can significantly increase costs. Thus it is important for consumers to be alerted to the consequence of paying late.

Minimum payments. The Bankruptcy Act requires creditors offering open-end plans to provide a warning about the effects of making minimum payments. The proposal would implement this requirement solely for credit card issuers. Under the proposal, card issuers must provide (1) a “warning” statement indicating that making only the minimum payment will increase the interest the consumer pays and the time it takes to repay the consumer’s balance; (2) a hypothetical example of how long it would take to pay a specified balance in full if only minimum payments are made; and (3) a toll-free telephone number that consumers may call to obtain an estimate of the time it would take to repay their actual account balance using minimum payments. Most card issuers must establish and maintain their own toll-free telephone numbers to provide the repayment estimates. However, the Board is required to establish and maintain, for two years, a toll-free telephone number for creditors that are depository institutions having assets of $250 million or less. This number is for the customers of those institutions to call to get answers to questions about how long it will take to pay their account in full making only the minimum payment. The Federal Trade Commission (FTC) must maintain a similar toll-free telephone number for use by customers of creditors that are not depository institutions. In order to standardize the information provided to consumers through the toll-free telephone numbers, the Bankruptcy Act amendments direct the Board to prepare a “table” illustrating the approximate number of months it would take to repay an outstanding balance if the consumer pays only the required minimum monthly payments and if no other advances are made (“generic repayment estimate”).

Pursuant to the Bankruptcy Act amendments, the proposal also allows a card issuer to establish a toll-free telephone number to provide customers with the actual number of months that it will take consumers to repay their outstanding balance (“actual repayment disclosure”) instead of providing an estimate based on the Board-created table. A card issuer that does so need not include a hypothetical example on its periodic statements, but must disclose the warning statement and the toll-free telephone number.

The proposal also allows card issuers to provide the actual repayment disclosure on their periodic statements. Card issuers would be encouraged to use this approach. Participants in consumer testing who typically carry credit card balances (revolvers) found an estimated repayment period based on terms that apply to their own account more useful than a hypothetical example. To encourage card issuers to provide the actual repayment disclosure on their periodic statements, the proposal provides that if card issuers do so, they need not disclose the warning, the hypothetical example and a toll-free telephone number on the periodic statement, nor need they maintain a toll-free telephone number to provide the actual repayment disclosure.

As described above, the Bankruptcy Act also requires the Board to develop a "table" that card issuers, the Board and the FTC must use to create generic repayment estimates. Instead of creating a table, the proposal contains guidance for how to calculate generic repayment estimates. Consumers that call the toll-free number could be prompted to input information about their outstanding balance and the APR applicable to their account. Although issuers have the ability to program their systems to obtain consumers' account information from their account management systems, the proposal does not require issuers to do so. The statute contemplates allowing issuers to use a "consumer input" system.

D. Changes in Consumer's Interest Rate and Other Account Terms

Regulation Z requires creditors to provide advance written notice of some changes to the terms of an open-end plan. The proposal includes several revisions to Regulation Z's requirements for notifying consumers about such changes.

Currently, Regulation Z requires creditors to send, in most cases, notices 15 days before the effective date of certain changes in the account terms. However, creditors need not inform consumers in advance if the rate applicable to their account increases due to default or delinquency. Thus, consumers may not realize until they receive their monthly statement for a billing cycle that their late payment triggered application of the higher penalty rate, effective the first day of the month's statement.

Summary of Proposed Revisions

The proposed revisions seek to address concerns that consumers do not have enough time to evaluate the effect of a change in terms and consider their choices to avoid the change or limit its impact. Under the proposal, creditors would be required to send a change-in-terms notice at least 45 days, rather than 15 days, before the effective date of the change; after receiving the notice consumers would have about a month to consider whether to shop for and obtain a different credit product with better terms. The proposed revisions would also require creditors to notify consumers 45 days before applying a rate increase that is triggered by a late payment or default, even if the reason for the increase was provided in the account agreement. Comment would be solicited on whether a shorter time period would be adequate.

Currently, there are few format requirements for change-in-terms notices. Creditors often disclose amendments to the account agreement in pamphlets using small print and dense prose. Under the proposal, when a creditor is proposing to change a term required to be disclosed at account opening in the summary table, the creditor would also summarize the new term in a table provided with the change-in-terms notice. If a creditor provides the notice in the same envelope with the periodic statement, the table must appear on the periodic statement directly above the transaction list, where consumers are more likely to notice the changes.

<u>Timing</u>. Currently Regulation Z generally requires creditors to mail a change-in-terms notice 15 days before a change takes effect. Consumer groups and others have criticized the 15-day period as providing too little time after the notice is sent for the consumer to receive the notice, shop for alternative credit and possibly pay off the existing credit card account. Under the proposal, notice must be sent at least 45 days before the effective date of the change, which would give consumers about a month to pursue their options.

Penalty rates. Currently, creditors must inform consumers about rates that are increased due to default or delinquency, but not in advance of implementation of the increase. Contractual thresholds for default are sometimes very low, and penalty pricing commonly applies to all existing balances, including low-rate promotional balances. An event triggering the default may occur a year or more after the account is opened. For example, a consumer may open an account, and a year or more later may take advantage of a low promotional rate to transfer balances from another account. That consumer reasonably may not recall reading in the account-opening disclosure that a single transaction exceeding the credit limit could cause the interest rates on existing balances, including on the promotional transfer, to increase. Thus, the proposal would expand the events triggering advance notice to include increases triggered by default or delinquency. Advance notice of a potentially significant increase in the cost of credit is intended to allow consumers to consider alternatives before the increase is imposed, such as making other financial arrangements or choosing not to engage in additional transactions that will increase the balances on their account. Actions creditors may engage in to mitigate risk, such as by lowering credit limits or suspending credit privileges, are not affected by the proposal.

Format. Currently, there are few format requirements for change-in-terms disclosures. As with account-opening disclosures, creditors commonly intersperse change-in-terms notices with other amendments to the account agreement, and both are provided in pamphlets in small print and dense prose. Consumer testing indicates many consumers set aside and do not read densely-worded pamphlets.

Under the proposal, creditors may continue to notify consumers about changes to terms required to be disclosed by Regulation Z, along with other changes to the account agreement. However, if a changed term is one that must be provided in the account-opening summary table, creditors must also provide that change in a summary table to enhance the effectiveness of the change-in-terms notice.

Creditors commonly enclose notices about changes to terms or rates with periodic statements. Under the proposal, if a notice enclosed with a periodic statement discusses a change to a term that must be disclosed in the account-opening summary table, or announces that a penalty rate will be imposed on the account, a table summarizing the impending change must appear on the periodic statement. The table would have to appear directly above the transaction list, in light of testing that shows many consumers tend to focus on the list of transactions. Consumers who participated in testing set aside change-in-terms pamphlets that accompanied periodic statements. Participants uniformly looked at the front side of periodic statements and reviewed at least the transactions.

E. Advertisements

Advertising minimum payments. Consumers commonly are offered the option to finance the purchase of goods or services (such as appliances or furniture) by establishing an open-end credit plan. The monthly minimum payments associated with the purchase are often advertised as part of the offer. Under current rules, advertisements for open-end credit plans are not required to include information about the time it will take to pay for a purchase or the total cost if only minimum payments are made; if the transaction were a closed-end installment loan, the number of payments and the total cost would be disclosed. Under the proposal, advertisements stating a minimum monthly payment for an open-end credit plan that would be established to finance the purchase of goods or services must state, in equal prominence to the minimum payment, the time period required to pay the balance and the total of payments if only minimum payments are made.

Advertising "fixed" rates. Creditors sometimes advertise the APR for open-end accounts as a "fixed" rate even though the creditor reserves the right to change the rate at any time for any reason. Consumer testing indicated that many consumers believe that a "fixed" rate will not change, and do not understand that creditors may use the term "fixed" as a shorthand reference for rates that do not vary based on changes in an index or formula. Under the proposal, an advertisement may refer to a rate as "fixed" if the advertisement specifies a time period the rate will be fixed and the rate will not increase during that period. If a time period is not specified, the advertisement may refer to a rate as "fixed" only if the rate will not increase while the plan is open.

F. Other Disclosures and Protections

"Open-end" plans comprised of closed-end features. Some creditors give open-end credit disclosures on credit plans that include closed-end features, that is, separate loans with fixed repayment periods. These creditors treat these loans as advances on a revolving credit line for purposes of Regulation Z even though the consumer's credit information is separately evaluated and he or she may have to complete a separate application for each "advance," and the consumer's payments on the "advance" do not replenish the "line." Provisions in the commentary lend support to this approach. The proposal would revise these provisions to indicate closed-end disclosures rather than open-end disclosures are appropriate when the credit being extended is individual loans that are individually approved and underwritten.

Checks that access a credit card account. Many credit card issuers provide accountholders with checks that can be used to obtain cash, pay the outstanding balance on another account, or purchase goods and services directly from merchants. The solicitation letter accompanying the checks may offer a low introductory APR for transactions that use the checks. The proposed revisions would require the checks mailed by card issuers to be accompanied by cost disclosures.

Currently, creditors need not disclose costs associated with using the checks if the finance charges that would apply (that is, the interest rate and transaction fees) have been previously disclosed, such as in the account agreement. If the check is sent 30 days or more after the account is opened, creditors must refer consumers to their account agreements for more information about how the rate and fees are determined.

Consumers may receive these checks throughout the life of the credit card account. Thus, significant time may elapse between the time account-opening disclosures are provided and the time a consumer considers using the check. In addition, consumer testing indicates that consumers may not notice references to other documents such as the account-opening disclosures or periodic statements for rate information because they tend to look for percentages and dollar figures when looking for the costs of using the checks. Under the proposed revisions, checks that can access credit card accounts must be accompanied by information about the rates and fees that will apply if the checks are used, and about whether a grace period exists. To ensure the disclosures are conspicuous, creditors would be required to provide the information in a table, on the front side of the page containing the checks.

Credit insurance, debt cancellation, and debt suspension coverage. Under Regulation Z, premiums for credit life, accident, health, or loss-of-income insurance are considered finance charges if the insurance is written in connection with a credit transaction. However, these costs may be excluded from the finance charge and APR (for both open-end and closed-end credit transactions), if creditors disclose the cost and the fact that the coverage is not required to obtain credit, and the consumer signs or initials an affirmative written request for the insurance. Since 1996, the same rules have applied to creditors' "debt cancellation" agreements, in which a creditor agrees to cancel the debt, or part of it, on the occurrence of specified events.

Under the proposal, the existing rules for debt cancellation coverage would also be applied to "debt suspension" coverage (for both open-end credit and closed-end transactions). "Debt suspension" products are related to, but different from, debt cancellation. Debt suspension products merely defer consumers' obligation to make the minimum payment for some period after the occurrence of a specified event. During the suspension period, interest may continue to accrue, or it may be suspended as well. Under the proposal, to exclude the cost of debt suspension coverage from the finance charge and APR, creditors must inform consumers that the coverage suspends, but does not cancel, the debt.

Under the current rules, charges for credit insurance and debt cancellation coverage are deemed not to be finance charges if a consumer requests coverage after an open-end credit account is opened or after a closed-end credit transaction is consummated (the coverage is deemed not to be "written in connection" with the credit transaction). Because in such cases the charges are defined as non-finance charges, Regulation Z does not require a disclosure or written evidence of consent to exclude them from the finance charge. The proposed revisions to Regulation Z would implement a broader interpretation of "written in connection" with a credit transaction and require creditors to provide disclosures, and obtain evidence of consent, on sales of credit insurance or debt cancellation or suspension coverage during the life of an open-end account. If a consumer requests the coverage by telephone, creditors may provide the disclosures orally, but in that case they must mail written disclosures within three days of the call to confirm the consumer's affirmative request.[9]

Issuing additional cards to existing cardholders. TILA generally prohibits creditors from issuing credit cards except in response to a request or application, unless a card is issued to renew or substitute for a card the consumer has previously accepted. This rule has been interpreted in the staff commentary to mean that when issuing a renewal or substitute card, card issuers may issue one, and not more than one, new card for each accepted card.

In 2003, Board staff revised the commentary to allow card issuers to replace an accepted credit card with more than one card, subject to certain conditions, including the limitation that a consumer's total liability for unauthorized use for the account could not increase due to the additional cards. This allows card issuers to issue, for example, credit cards using a new format or technology to existing accountholders, even if the new card

---

[9] The proposed revisions to Regulation Z requiring disclosures to be mailed within three days of a telephone request for these products are consistent with the rules of the federal banking agencies governing insured depository institutions' sales of insurance and with guidance published by the Office of the Comptroller of the Currency concerning national banks' sales of debt cancellation and debt suspension products.

supplements rather than replaces the traditional card. When the commentary was published, Board staff noted the forthcoming review of open-end rules, and indicated staff would ask the Board to consider whether the rule should be expanded so that creditors could send additional cards on existing accounts outside of renewal or substitution. The Board also invited public comment on the issue in the December 2004 ANPR.

Consumers and consumer groups believe additional credit cards should only be sent if the consumer specifically requests an additional card. They are concerned about identity theft if cards could be sent without any advance notice. Industry commenters support a rule allowing card issuers to issue additional cards on existing accounts even when a previously accepted card is not being replaced. They believe the current restriction impedes industry innovation to provide more convenient methods for consumers to access their accounts. They also dispute concerns about identity theft associated with unsolicited additional cards as opposed to renewal or substitute cards, because consumers who receive a renewal or substitute card do not know with precision when the card will actually arrive. Moreover, industry commenters say, consumers should not be concerned about risk of loss if liability for unauthorized use on an account does not increase with additional cards, as the rule currently provides.

After analyzing the issue, the staff recommends that the Board retain the current rule, and not propose to expand card issuers' ability to issue multiple cards at any time to existing cardholders. Currently, when one or more cards are sent to renew or to substitute for an accepted card, card issuers commonly require that the new cards must be activated before they can be used. Based on current card issuer practices, Board staff understands that some issuers are unable to require separate activation procedures for additional cards on a single credit card account. As a result, additional cards sent on an unsolicited basis outside the context of a renewal or substitution might be sent in activated form which could present considerable risks to consumers. For example, even if the card issuer were not permitted to impose any additional liability on the consumer for unauthorized use, consumers could nevertheless have to deal with potential identity theft loss and suffer the inconvenience of refuting unwarranted claims of liability.

Conclusion

Staff recommends that the Board publish for public comment the draft proposed amendments to Regulation Z's rules for open-end credit accounts that are not home-secured.

Appendix A

Summary of Public Comments

A. December 2004 Advance Notice of Proposed Rulemaking

In December 2004, the Board issued an advance notice of proposed rulemaking (the December 2004 ANPR), announcing its intent to conduct its review of Regulation Z in stages, focusing first on the rules for open-end (revolving) credit accounts that are not home-secured, chiefly general-purpose credit cards and retailer credit plans. The Board also indicated its future plans for reviewing other areas of Regulation Z, in particular, predatory mortgage lending, closed-end mortgage credit (including adjustable-rate mortgage loans), and home-equity lines of credit.

The December 2004 ANPR sought public comment on a variety of specific issues relating to three broad categories: the format of open-end credit disclosures, the content of those disclosures, and the substantive protections provided for open-end credit under the regulation. The ANPR solicited comment on the scope of the Board's review, and also requested that commenters identify other issues that the Board should address in the review. The comment period closed on March 28, 2005.

The Board received over 200 comment letters in response to the December 2004 ANPR. More than half of the comments were from individual consumers. About 60 comments were received from the industry or industry representatives, and about 20 comments were received from consumer advocates and community development groups. The Office of the Comptroller of the Currency, one state agency, and one member of Congress also submitted comments.

Scope

Commenters' views on a staged review of Regulation Z were divided. Some believe reviewing the regulation in stages makes the process manageable and focuses discussion and analysis. Others supported an independent focus on open-end credit rules because they believe open-end credit by its nature is distinct from other credit products covered by TILA and Regulation Z.

Some commenters supported the Board's approach generally, but voiced concern that looking at the regulation in a piecemeal fashion may lead to decisions in the early stages of the review that may need to be revisited later. If the review is staged, these commenters want all changes implemented at the same time, to ensure consistency between the open-end and closed-end rules.

Some commenters urged the Board to include open-end rules affecting home-equity lines of credit (HELOCs) in the initial stage of the review. If the Board chooses not to expand its review of open-end credit rules to cover home-secured credit, these commenters urged the Board to avoid making any revisions that would be inconsistent with existing HELOC requirements.

A few commenters concurred with the Board's approach of reviewing Regulation Z in stages, but they preferred that the Board start with rules of general applicability, such as definitions. These commenters generally urged the Board to provide additional clarity on the definition of "finance charge," TILA's dollar cost of credit.

Finally, a few commenters stated the Board needs to review the entire regulation at the same time. They suggested a staged approach is not workable, and cited concerns about duplicating efforts, creating inconsistencies, and re-visiting changes made in earlier stages of a lengthy review.

Format

In general, commenters representing both consumers and industry stated that the tabular format requirements for TILA's direct-mail credit card application and solicitation disclosures have proven useful to consumers, although a variety of suggestions were made to add or delete specific disclosures. Many, however, noted that typical account-opening disclosures are lengthy and complex, and suggested that the effectiveness of account-opening disclosures could be improved if key terms were summarized in a standardized format, perhaps in the same format as TILA's direct-mail application and solicitation disclosures. These suggestions were consistent with the views of some members of the Board's Consumer Advisory Council. Industry commenters supported the Board's plan to use focus groups or other consumer research tools to test the effectiveness of any proposed revisions.

To combat "information overload," many commenters asked the Board to emphasize only the most important information that consumers need at the time the disclosure is given. They asked the Board to avoid rules that require the repetitive delivery of complex information, not all of which is essential to comparison shopping, such as a lengthy explanation of the creditor's method of calculating balances now required at account opening and on periodic statements. Commenters suggested that the Board would most effectively promote comparison shopping by focusing on essential terms in a simplified way. They believe some information could also be provided to consumers through nonregulatory, educational methods. Taken together, these approaches could lead to simpler disclosures that consumers might be more inclined to read and understand.

Content

In general, commenters provided a variety of views on how to simplify TILA's cost disclosures. For example, some suggested that creditors should disclose only interest as the "finance charge" and simply identify all other fees and charges. Others suggested all fees associated with an open-end plan should be disclosed as the "finance charge." Creditors sought, above all, clear rules.

Comments were divided on the usefulness of open-end APRs. TILA requires creditors to disclose an "interest rate" APR for shopping disclosures (such as in advertisements and solicitations) and at account opening, and an "effective" APR on periodic statements that reflects interest and fees, such as transaction charges assessed during the billing period. In general, consumer groups suggested that the Board mandate for shopping disclosures an "average" or "typical" APR based on an historical average cost to consumers with similar accounts. An average APR, consumer representatives stated, would give consumers a more accurate picture of what consumers' actual cost might be. Regarding the effective APR on periodic statements, consumer advocates stated that it is a key disclosure that is helpful, and can provide "shock value" to consumers when fees cause the APR to spike for the billing cycle. Commenters representing industry argued that an effective APR is not meaningful, confuses consumers, and is difficult to explain. Some commenters suggested that a disclosure on the periodic statement that provides context by explaining what costs are included in the effective APR might improve its usefulness.

Regarding advance notice of changes to rates and fees, comments were sharply divided. Creditors generally believe the current notice requirements are adequate, although for rate (and other) changes not involving a consumer's default, a number of creditors supported increasing the advance notice requirement from 15 to 30 days. Consumers and consumer representatives generally believe that when terms change, consumers should have the right under TILA to opt out of the new terms, or be allowed a much longer time period to find alternative credit products. They suggested a two-billing cycle advance notice or as long as 90 days. More fundamentally, these commenters believe card issuers should be held to the initial terms of the credit contract, at least until the credit card expires.

Where triggering events are set forth in the account agreement such as events that might trigger penalty pricing, creditors believe there is no need to provide additional notice when the event occurs; they are not changing a term, they stated, but merely implementing the agreement. Some suggest that instead of providing a notice when penalty pricing is triggered, penalty pricing and the triggers should be better emphasized in the application and account-opening disclosures. Consumers and consumer representatives agree that creditors' policies about when terms may change should be more prominently displayed, including in the credit card application disclosures. They further believe the Board should provide new substantive protections to consumers, such as prohibiting the practice of increasing rates merely because the consumer paid late on another credit account.

B. October 2005 Advance Notice of Proposed Rulemaking

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Bankruptcy Act") contained amendments to TILA, principally dealing with open-end (revolving) credit accounts. The Bankruptcy Act amendments require new disclosures on periodic statements, on credit card applications and solicitations, and in advertisements.

The Board published a second ANPR in October 2005 to solicit comment on issues the Board should consider when implementing the Bankruptcy Act amendments (October 2005 ANPR). The Board stated its intent to implement the Bankruptcy Act amendments as part of the Board's ongoing review of Regulation Z's open-end credit rules, in part to minimize compliance burden. The comment period for the second ANPR closed on December 16, 2005.

The Board received approximately 50 comment letters in response to the October 2005 ANPR. Forty-five letters were submitted by financial institutions and their trade groups. Five letters were submitted by consumer groups. The following is a summary of these comments.

Minimum Payment Warnings

Creditors that offer open-end accounts must provide standardized disclosures on each periodic statement about the effects of making only minimum payments, including an example of how long it would take to pay off a specified balance, along with a toll-free number that consumers can use to obtain an estimate of how long it will take to pay off their own balance if only minimum payments are made. The Board must develop a table that creditors can use in responding to consumers requesting such estimates.

Industry commenters generally favored limiting the minimum payment disclosure to credit card accounts (thus, excluding home-equity lines of credit and overdraft lines of credit) and to those consumers who regularly make only minimum payments. Consumer groups generally favored broadly applying the rule to all types of open-end credit and to all open-end account holders.

Industry commenters supported having an option to provide customized information (reflecting a consumer's actual account status) on the periodic statement or in response to a consumer's telephone call, but also wanted the option to use a standardized formula developed by the Board. Consumer group commenters asked the Board to require creditors to provide more customized estimates of payoff periods through the toll-free telephone number and to not allow creditors to use a standardized formula, and supported disclosure of an "actual" repayment time on the periodic statement.

Late-payment Fees

Creditors offering open-end accounts must disclose on each periodic statement the earliest date on which a late payment fee may be charged, as well as the amount of the fee.

Industry commenters urged the Board to base its disclosure requirement on the contractual payment due date and to disregard any "courtesy" period that creditors informally recognize following the contractual payment due date. Although the industry provided mixed comments on any format requirements, most opposed a proximity requirement for disclosing the amount of the fee and the date. Comments were mixed on adding information about penalty APRs and "cut-off times" to the late payment disclosures. While supporters (a mix of industry and consumer commenters) believe the additional information is useful, others were concerned about the complexity of such a disclosure, and opposed the approach for that reason. Consumer commenters suggested substantive protections to ensure consumers' payments are timely credited, such as considering the postmark date to be the date of receipt.

Internet Solicitations

Credit card issuers offering cards on the Internet must include the same tabular summary of key terms that is currently required for applications or solicitations sent by direct mail.

Although the Bankruptcy Act refers only to solicitations (where no application is required), most commenters (both industry and consumer groups) agreed that Internet applications should be treated the same as solicitations. Many industry commenters stated that the Board's interim final rule on electronic disclosures, issued in 2001, would be appropriate to implement the Bankruptcy Act. Regarding accuracy standards, the majority of industry commenters addressing this issue indicated that issuers should be required to update Internet disclosures every 30 days, while consumer groups suggested that the disclosures should be updated in a "timely fashion," with 30 days being too long in some instances.

Introductory Rate Offers

Credit card issuers offering discounted introductory rates must clearly and conspicuously disclose in marketing materials the expiration date of the offer, the rate that will apply after that date, and an explanation of how the introductory rate may be revoked (for example, if the consumer makes a late payment).

In general, industry commenters asked for flexibility in complying with the new requirements. Consumer groups supported stricter standards, such as requiring an equivalent typeface for the word "introductory" in immediate proximity to the temporary rate and requiring the expiration date and subsequent rate to appear either side-by-side with, or immediately under or above, the most prominent statement of the temporary rate.

Account Termination

Creditors are prohibited from terminating an open-end account before its expiration date solely because the consumer has not incurred finance charges on the account. Creditors are permitted, however, to terminate an account for inactivity.

Regarding guidance on what should be considered an "expiration date," several industry commenters suggested using card expiration dates as the account expiration date. Others cautioned against using such an approach, because accounts do not terminate upon a card expiration date. Regarding what constitutes "inactivity," many industry commenters stated no further guidance is necessary. Among those suggesting additional guidance, most suggested "activity" should be measured only by consumers' actions (charges and payments) as opposed to card issuer activity (for example, refunding fees, billing inactivity fees, or waiving unpaid balances).

High Loan-to-value Mortgage Credit

For home-secured credit that may exceed the dwelling's fair-market value, the Bankruptcy Act amendments require creditors to provide additional disclosures at the time of application and in advertisements (for both open-end and closed-end credit). The disclosures would warn consumers that interest on the portion of the loan that exceeds the home's fair-market value is not tax deductible and encourage consumers to consult a tax advisor.

In general, creditors asked for flexibility in providing the disclosure, either by permitting the notice to be provided to all mortgage applicants, or to be provided later in the approval process after creditors have determined the disclosure is triggered. Similarly, a number of industry commenters advocated limiting the advertising rule to creditors that specifically market high loan-to-value mortgage loans. Creditor commenters asked for guidance on loan-to-value calculations and safe harbors for how creditors determine property values. Consumer advocates favored triggering the disclosure when the possibility of negative amortization could occur.

Because these amendments deal with home-secured credit, staff is not proposing revisions to Regulation Z to implement these provisions at this time. Staff proposes to implement these provisions in connection with the upcoming review of Regulation Z's rules for mortgage transactions.