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UDAP Final Rules and Board Regulatory Actions

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UDAP Final Rules

The National Credit Union Administration (“NCUA”) approved a joint final rule addressing unfair or deceptive acts or practices (“UDAP”) relating to credit cards written by the Board of Governors of the Federal Reserve System (“Board”), the Office of Thrift Supervision and the NCUA (collectively, the “Agencies”).

The implementation of the UDAP rule will have a dramatic impact on both credit card issuers and consumers and will be the most substantial overhaul of disclosure rules and restrictions on lender practices in decades.

The UDAP rule limits or prohibits:

Interest Rate Increases on New and Existing Balances: Significantly, the UDAP rule would prohibit issuers from increasing rates disclosed at account opening on existing and new credit card balances, unless expressly permitted under one of five exceptions. The UDAP rule is a notable departure from the proposed rule, which would have prohibited issuers from increasing the APR on all existing balances unless the increase fell within one of the express proposed exemptions.

- For example, the UDAP rule requires issuers to disclose the APR that will apply to each category of transactions on the account and prohibits increases in the APR for a category of transactions unless the increase falls within one of the express exceptions. The rates disclosed at account opening can include a rate that comes into effect at a later point in time. The rate cannot be increased unless the rate is disclosed at account opening upon expiration of a period of time disclosed at account opening. Contingent future rates and ranges of future rates are prohibited.
- Also, a rate for new balances can be increased pursuant to advance notice under Regulation Z. However, issuers are prohibited from applying increased rate changes that are based on the advance notice exception to existing balances in most cases.
- In addition, the UDAP rule expressly limits all rate changes during the first year after the account is opened. The combination of these limitations will prevent card issuers from repricing accounts based on risk and could raise a host of challenges for card issuers.
- The UDAP rule provides an exception for increasing rates upon delinquency if an account is 30 or more days past due and for failure to comply with the terms of a workout agreement.

Payment Allocation Methods: Issuers are prohibited from allocating payments in excess of the minimum payment first to the balance with the lowest APR. Instead, the UDAP rule requires issuers to apply payments in one of two ways. An issuer must either apply amounts in excess of the minimum payment: (1) first to the balance with the highest APR; or (2) pro rata among the balances. The Agencies did not adopt proposed rules that would limit payment allocation methods for promotional balances. The Agencies, however, have adopted, under the rate limitation, provisions that prohibit the assessment of deferred interest. Furthermore, the Agencies clarify that the UDAP rule does not limit or otherwise address an issuer’s ability to determine the amount of the required minimum periodic payment or how that payment is allocated.

Assessment of Late Fees and Related Charges: Similar to the proposed rule, issuers are prohibited from treating a payment as late unless they provide a consumer with a reasonable amount of time to make payment. A safe harbor is provided for institutions that establish procedures to ensure that billing statements are mailed or delivered at least 21 days before the payment due date. In addition, the Agencies have added a provision to the regulation to require issuers to establish that they have complied with the timing requirements.

Double-Cycle Billing: Similar to the proposed rule, issuers are prohibited from including finance charges for prior billing cycles when calculating the amount of interest charged in the current cycle. The Agencies have addressed, at least in part, industry concerns that the proposed rule was not limited to circumstances in which the two-cycle method resulted in greater interest charges. In this regard, the Agencies indicate that they did not intend this result and have added commentary clarifying this point.

Fee-based Account Limitations: Card issuers would be prohibited from financing during the first year security deposits or fees for the issuance or availability of credit if those deposits or fees, in the aggregate, utilize the majority of the available credit on the account at account opening. In addition, security deposits and fees exceeding 25% of the credit limit would have to be spread out over six months (rather than the proposed twelve months) and, therefore, could not be applied during the month the account is opened.

The UDAP rule is effective July 1, 2010. This is approximately eighteen months after the rule's anticipated appearance in the Federal Register. In this regard, the Supplementary Information accompanying the UDAP rule states that "the final rule is not intended to suggest that [covered practices] are unfair or deceptive prior to the effective date," and clarifies that "prior to the effective date, institutions may [continue to take] actions that will be prohibited once the final rule is effective."

Issues Not Addressed by UDAP Rule

The Agencies are not taking action on proposed provisions addressing credit holds. Similarly, the UDAP rule does not address firm offers of credit advertising multiple APRs. Instead, the Board will address this practice by amendments to Regulation Z.

The Agencies are not taking action on overdraft services on deposit accounts or debit holds at this time. Rather, the Board will issue under Regulation E a proposal on overdraft services to determine whether to take further action.

Board Regulatory Actions

In addition to approving amendments to Regulation AA concerning unfair or deceptive credit card practices, the Board approved final amendments to Regulation Z, final amendments to Regulation DD and proposed amendments to Regulation E.

Regulation Z. The final amendments to Regulation Z include:

- Revisions to the five main types of open-end credit disclosures governed by Regulation Z, including application and solicitation disclosures, account-opening disclosures, periodic statement disclosures, change-in-terms notices, and advertising disclosures;
- Substantive revisions in the change-in-terms requirements, including increasing the amount of time notice must be sent before a change takes effect and requiring a 45-day advance notice before a rate is increased due to consumer delinquency or default; and
- Additional consumer protections for credit card accounts to complement the final amendments to Regulation AA, such as cut-off hour restrictions for mailed payments to be considered timely.

Regulation DD. The final amendments to Regulation DD include:

- Revisions extending to all institutions (even those institutions that do not promote or advertise payment of overdrafts) the requirement to disclose the aggregate dollar amounts charged for overdraft fees and returned item fees on periodic statements; and

- Revisions requiring institutions that provide account balance information through an automated system to provide a balance that does not reflect funds that may be made available to cover overdrafts.

Regulation E. The proposed amendments to Regulation E would:

- Require financial institutions to provide consumers the right to opt out of, or alternatively opt in to, the payment of overdrafts for ATM withdrawals and one-time debit card transactions; and
- Prohibit institutions from assessing overdraft fees caused by certain debit holds.

Proposed overdraft revisions originally set forth under Regulations AA and DD have been withdrawn. The comment period for proposed revisions to Regulation E closes 60 days after publication in the Federal Register.

Final amendments to Regulation Z are effective July 1, 2010 (an approximate 18-month implementation period) and final amendments to Regulation DD are effective January 1, 2010 (an approximate 12-month implementation period).

Below is a link to the UDAP rule, the NCUA Board Action Memorandum, Board Press Release and Board Open Meeting Materials. If you have questions, you may contact: Rick Fischer, at **(202) 887-1566** and rfischer@mofo.com; Oliver Ireland, at **(202) 778-1614** and oireland@mofo.com; or Obrea Poindexter, at **(202) 887-8741** and opoindexter@mofo.com.

[Board Action Memorandum](#) (pdf)

[Text of UDAP Rule](#) (pdf)

[Federal Reserve Board Press Release](#)

[Federal Reserve Board Open Meeting Materials](#)

– Materials on Regulations AA, DD, E, and Z, including the model forms and samples