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Issues to Consider in Connection with the Reevaluation of Credit Card Lending and Charge-Off Policies

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While the full effect of the Emergency Economic Stabilization Act of 2008 on the economy remains to be seen, it is clear that current economic conditions are impacting financial services broadly, including the credit card industry. Recent statistics indicate that the current economic situation has significantly affected credit card debt performance and has triggered an increase in the overall rate of credit card delinquencies and charge offs.

As a result, many credit card lenders have begun to reevaluate their lending and charge-off policies in an attempt to stem, to the extent possible, the economic fallout from deteriorating credit card portfolios. In addition, to assist cardholders who are at risk of default, many credit card lenders are implementing or fine-tuning their consumer workout/reage programs.

Given the potential impact of these actions on both consumers and the institutions themselves, increased regulatory scrutiny of credit card issuer practices in these areas is likely. Moreover, as regulators focus on the possible threat posed by growing credit card delinquencies and charge offs, it is possible that the current legal and regulatory framework associated with these issues will be revisited and revised. Below are examples of current regulations and regulatory guidance that affect these areas of concern.

Federal Financial Institutions Examination Council ("FFIEC")

FFIEC's Uniform Retail Credit Classification and Account Management Policy.

In part, this policy permits an open-end account, such as a credit card account, to be reaged once every twelve months and twice within five years.^[1] In addition, a delinquent account may be reaged after it enters a workout program, but only after the receipt of at least three consecutive minimum monthly payments or the equivalent cumulative amount.^[2] Reaging for workout program purposes is limited to once in a five-year period, which is in addition to the once-in-twelve-months/twice-in-five-year limitation applicable while the account was an open-end account.^[3] Reage is defined as "returning a delinquent, open-end account to current status without collecting the total amount of principal, interest and fees that are contractually due."^[4]

With respect to charge-off time periods, the policy statement requires that open-end accounts that have become past due 180 cumulative days from the contractual due date, and closed-end accounts that have become past due 120 cumulative days from the contractual due date, be charged off.^[5] However, one variation to the general rule provided in this policy is that once an open-end retail account is placed on a fixed-payment schedule, it then should follow the charge-off time period for a closed-end account, namely 120 days.^[6]

Account Management and Loss Allowance Guidance.

In part, the guidance provides that workout programs should be designed to maximize principal reduction and should be structured to facilitate repayment of credit card debt within 60 months.^[7] Exceptions to this requirement should be clearly documented and supported by compelling evidence that less conservative terms and conditions are warranted.^[8]

Truth in Lending Act and Federal Reserve Board Regulation Z

Change in Terms.

For an open-end credit card account, a creditor may reduce a consumer's credit limit without providing any notice under current Regulation Z. A change in terms notification is required only when a creditor changes a term included in the initial disclosures, or increases the minimum periodic payment.^[9] In that situation, an issuer must send a written notice to the affected consumer 15 days prior to the effective date, with some exceptions.^[10]

Complicating matters, however, is the Federal Reserve Board's proposed revisions to Regulation Z. Under the 2007 proposal, the Board suggested changes to the timing, substance, and formatting of the change in terms notice. As to the timing, the Board proposed extending the notice period from 15 days to 45 days.^[11] As to the substance, the Board proposed expansion of the changes that would trigger the advance notice.^[12] For example, advance notice would be required for default or penalty pricing, even if such changes were set forth in the contractual agreement. Advance notice also must be provided 45 days before imposing any fee or penalty rate for exceeding that new limit.^[13] As to the format, the Board proposed that creditors provide a summary of the change in terms in a tabular format.^[14]

Complicating matters further is an additional 2008 proposal of the Board which would amend the Board's Regulation AA and further amend Regulation Z. Regulation AA defines and describes banking practices that are "unfair" or "deceptive." In its 2008 proposal, among other things, the Board states that certain practices regarding payment allocation and the application of increased rates to outstanding balances are "unfair" practices. Specifically, the 2008 proposal would prohibit increasing the APR applicable to balances outstanding, unless: (1) the rate is increased due to operation of an index that is not under the institution's control and is available to the general public; (2) a promotional rate expires; or (3) the consumer's minimum payment has not been received within 30 days after the due date.^[15]

While it is difficult to predict how these issues will be addressed in the final versions of these rules, this will become evident soon, since the final versions of the rules are expected to be released before the end of the year.

Beth Frank assisted with the preparation of this article.

Footnotes

^[1] 65 Fed. Reg. 36,903, 36,905 (June 12, 2000).

^[2] *Id.*

^[3] *Id.*

^[4] *Id.* at 36,905 n.3.

^[5] *Id.* at 36,904.

^[6] *Id.* at 36,905.

^[7] Federal Deposit Insurance Corporation, Financial Institution Letter FIL-2-2003, Attachment (Jan. 8, 2003), available at <http://www.fdic.gov/news/news/financial/2003/FIL0302a.html>.

^[8] *Id.*

^[9] 12 C.F.R. pt. 226.9(c)(1).

^[10] *Id.*

[11] Truth in Lending, 72 Fed. Reg. 32,948, 33,009 - 33,010 (proposed June 14, 2007).

[12] *Id.* at 33,012.

[13] *Id.*

[14] *Id.* at 33,010.

[15] Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28,904, 28,920 (proposed May 19, 2008).