

High Level Summary of Latest CARD Act Rules

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On June 29, 2010, the Federal Reserve Board published a final rule in the Federal Register to protect credit card users from unreasonable late payment and other penalty fees. The final rule also requires that credit card issuers reconsider annual percentage rate increases that they imposed on and after January 1, 2009. [75 FR 37526-37592]

The final rule changes or adds new provisions to Regulation Z, its Official Staff Commentary, and the model forms contained in Appendix G of the regulation. Compliance with these requirements became mandatory on August 22, 2010. The final rule represents the third and final stage of the rule-making required by the Credit CARD Act enacted in May 2009.

The final rule requires that the late payment and other penalty fees imposed by credit card issuers be reasonable and proportional to the violation of the account terms. There are certain safe harbors in the final rule that allow a card issuer to impose a \$25 fee or a higher fee of \$35 when a consumer repeatedly engages in the same type of conduct during a particular period (for example, authorizing a \$25 penalty fee for the first late payment and a \$35 penalty fee for any additional late payment that occurs during the following six billing cycles). These "safe harbor" penalty fees are subject to annual adjustments, based on changes to the Consumer Price Index. Alternatively, an issuer that can demonstrate that a higher fee is justified as a reasonable proportion of its internal costs may assess a penalty fee that is higher than the "safe harbor" fees, if its costs are spread evenly among its cardholders so that no individual consumer bears an unreasonable or disproportionate share. Card issuers that rely on the cost-based analysis to assess a higher penalty fee must comply with detailed requirements for calculating their costs. These card issuers must also reevaluate their costs each year. Many card issuers prefer the "safe harbor" provisions of the final rule, to limit their regulatory compliance risk.

The final rule prohibits card issuers from charging penalty fees that exceed the dollar amount associated with the consumer's violation. For example, card issuers may not require payment of a late fee that is any higher than the amount of any required minimum payment. Consequently, card issuers need to amend their application disclosures, account opening disclosures and periodic statements, to disclose that the issuer will impose a penalty fee "up to" the disclosed amount. Card issuers are barred from imposing a fee for violations when there is no particular dollar amount associated with the violation. For example, the final rule indicates that there is no dollar amount associated with violations, such as transactions that the issuer declines to authorize, account inactivity, or the closure or termination of an account.

The Official Staff Commentary explains the relationship between the rule prohibiting a penalty fee that exceeds the dollar amount associated with the violation and the "safe harbor" or cost-based rules that expressly authorize issuers to charge a particular penalty fee. Card issuers may not impose a "safe harbor" or cost-based penalty fee if that fee otherwise exceeds the dollar amount associated with the violation (e.g, the amount of the minimum payment). For example, issuers cannot require a customer who is late in making a \$15 minimum payment to pay a \$25 or \$35 "safe harbor" fee. In this case, the maximum late payment fee is an amount that does not exceed the late payment.

The final rule prevents card issuers from charging more than one penalty fee, based on a single late payment or other violation of account terms. For example, a consumer may be late in making a minimum payment to a card issuer, because the consumer's bank rejected a check drawn on an account with insufficient funds. In this event, the final rule prohibits a card issuer from charging the consumer for both a late payment fee and a returned payment fee.

The final rule requires issuers that increased interest rates on and after January 1, 2009 to evaluate whether their reasons for the increase have changed and, if appropriate, to reduce the rate. When the card issuer must reduce the rate, it must do so not later than 45 days after completing the account analysis required by the final rule. The reduced rates must then apply to outstanding account balances and new account transactions. Card issuers must have written policies and procedures in place to describe when and how they will conduct this rate review. Card issuers subject to this rule must conduct the rate review at least once every six months after the rate increase.

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