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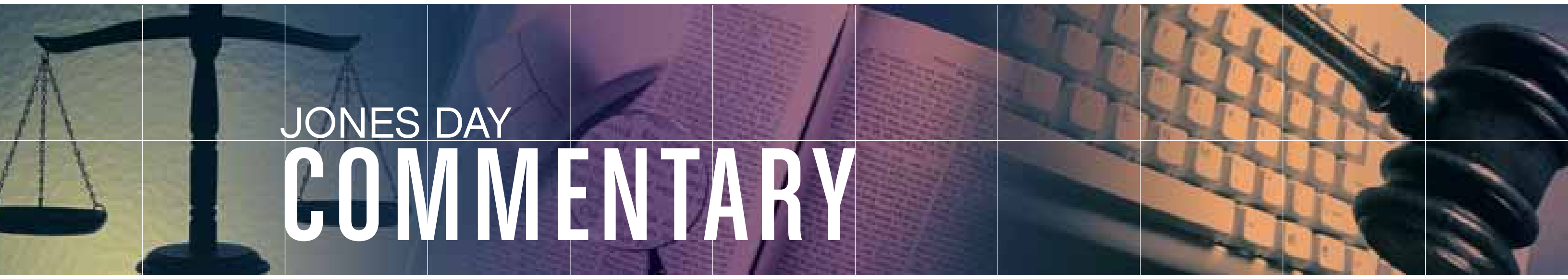

THE CREDIT CARD ACT OF 2009 – CHANGES WILL AFFECT CONSUMERS, CARD ISSUERS, RETAILERS, COLLEGES AND INVESTORS

On Friday, May 22, the President signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (2009). The final bill, as adopted by the Senate and the House of Representatives, is known as the "Credit CARD Act of 2009" (the "CARD Act").

The CARD Act modifies several existing federal statutes. It also delegates rulemaking authority generally to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and specifically mandates Federal Reserve rulemaking in several areas. Most significantly, the CARD Act amends the Truth in Lending Act ("TILA") to include additional consumer protections, enhanced consumer disclosures, and special protections for consumers under 21 years of age. The special protections for young consumers and provisions aimed at the deceptive marketing of credit reports also involve amendments to the Fair Credit Reporting Act ("FCRA"), while provisions targeting gift cards amend the Electronic Fund Transfer Act. Miscellaneous provisions of the CARD Act call for various reports and studies, and include some provisions unrelated to credit cards and prepaid cards.

Many of the CARD Act's provisions resemble regulations approved by the Federal Reserve, along with the Office of Thrift Supervision and the National Credit Union Administration, in December 2008. Those rules, which primarily involved amendments to Federal Reserve Regulations Z (Truth in Lending) and AA (Unfair or Deceptive Acts or Practices), generally are not scheduled to go into effect until July 1, 2010. The CARD Act has a broader scope and a more aggressive implementation timeline than the Federal Reserve's rules. The CARD Act generally requires compliance by February 2010, although a few provisions will be effective as soon as August 2009 and others will be effective as late as August 2010. This Commentary summarizes the key provisions of the Federal Reserve rules and the CARD Act, especially the areas in which the CARD Act introduces new or additional provisions not covered by the Federal Reserve's rules.

In summary, the Federal Reserve rules:

- Limit the circumstances under which interest rates may be increased (and thereby prohibit "universal default").
- Prohibit double-cycle billing.
- Limit the circumstances under which payments may be considered late;
- Limit the permissible methodologies for allocating payments in excess of the minimum amount due.
- Place restrictions on subprime credit cards.
- Mandate changes to certain disclosures.
- Address disclosures and certain practices associated with overdraft services and debit holds.

The provisions of the CARD Act address all of these same issues, with the exception of overdraft services and debit holds, and also:

- Limit changes to other account terms.
- Restrict the use and amount of certain fees.
- Require a consumer's ability to repay to be evaluated when opening a new account or increasing the credit limit on an existing account.
- Mandate the posting of credit card agreements on the Internet.
- Provide special protections for consumers under age 21, including limitations on the marketing of credit cards to college students.
- Impose rules governing prepaid and gift cards.
- Increase penalties for issuer violations of TILA.
- Place curbs on advertisements for free credit reports.
- Require completion of numerous studies, reports and regulations.

Credit cards are an important part of our economy due to their convenience, almost universal acceptance for payment, and the dollar value of transactions and outstanding receivables. As of April 30, 2009, the Federal Reserve reported total outstanding consumer credit of $2,524.0 billion (seasonally adjusted), of which $931.0 billion (37.4 percent) was revolving credit, including credit cards. FDIC-insured institutions held $403.1 billion of credit card receivables, and an additional $402.1 billion of credit card receivables were held in off-balance sheet securitizations at March 31, 2009. During the First Quarter of 2009, revolving consumer credit decreased at an annual rate of 6.5 percent.

The new rules are likely to affect the availability and cost of credit cards, consumer behaviors with respect to purchases using credit cards and payment patterns, and the revenues of credit card issuers and processors, as well as retailers, colleges, and others involved in affinity, private label, and co-branded credit card programs. Existing and future credit card securitizations' performance and credit ratings may also be affected.

THE FEDERAL RESERVE'S NEW CREDIT CARD RULES

Key provisions of the Federal Reserve's new credit card rules include:

Interest Rate Increases. Interest rates that will apply to the account must be disclosed at account opening. Rate increases are prohibited except where expressly permitted as follows:

- The rate in effect at account opening may be increased at the end of a specified period if the new rate was disclosed upfront.
- Variable rates that change due to operation of an index are permitted.
- After the account has been open for a year, interest rates for new transactions (but not existing balances) may be increased subject to compliance with a 45-day advance notice requirement.
- Rates may be increased when a minimum payment due is not received within 30 days of its due date.
- To avoid discouraging workout agreements, reduced rates imposed under such an agreement may be returned to their pre-existing level if the consumer fails to abide by the conditions of the workout.

One significant result of this structure is elimination of the practice known as "universal default," where a default on one account can be a default on other, unrelated accounts.

Prohibition on Double-Cycle Billing. Amounts in earlier billing cycles generally may not be taken into account when calculating interest charges for the current cycle. For consumers who pay their entire balance one month but not the next, the double-cycle billing method produces higher interest charges because the balances for days in the first period are included when calculating interest charges in the second period.

Payment Timing and Late Payments. Payments may not be treated as late unless the consumer has been provided a reasonable amount of time to make payments on their credit card. Issuers qualify for a safe harbor under this rule if they adopt reasonable procedures that are designed to ensure the mailing or delivery of periodic statements at least 21 days before the payment due date. Amendments to Regulation Z provide that when determining whether a payment is timely, cut-off times for mailed payments prior to 5 P.M. at the receiving location are considered unreasonable. If payment is due on a date when either the U.S. Postal Service does not deliver or the issuer does not accept mailed payments, payments received the next business day are considered timely.

Payment Allocation. When different balances on a card carry different interest rates, the issuer must allocate payment amounts in excess of the minimum payment either entirely to the highest interest rate or split the excess amount *pro rata* among the different balances. Additionally, recently proposed clarifications to the Federal Reserve rules would provide special treatment for deferred interest programs.

Subprime Credit Cards. Issuers' use of security deposits and fees are restricted, and upfront fees must be refundable upon review and rejection of account-opening disclosures. Specifically, security deposits and fees for the issuance or availability of credit may not be financed if, during the first year after account opening, the charges would exceed 50 percent of the initial credit limit. The deposits and fees charged at account opening may not be more than 25 percent of the initial credit limit, and amounts exceeding this threshold (up to a maximum of 50 percent) must be spread evenly over no less than the first six months after opening a credit card account. Additionally, if an issuer collects a fee or obtains an agreement to pay a fee before providing account-opening disclosures, the consumer must be allowed to reject the terms of the disclosures and have the fee cancelled or refunded.

Disclosures. The Regulation Z disclosure requirements for credit cards and other revolving credit plans (excluding home equity lines) are amended in several areas. For applications and solicitations, the format and content of the table summarizing key account terms are revised. Substantive changes include simplified variable interest rate disclosures, disclosure of penalty rate durations, and revised disclosures of when grace periods are or are not offered. At account opening, cost disclosures are enhanced and a summary table similar to those used for applications and solicitations must be provided.

Periodic statement formats are revised to make disclosures more understandable. The disclosure of "effective APR" is eliminated as not providing clear disclosure. Instead, monthly interest charges and fees must be grouped separately with a monthly total for each, while interest charges also must be itemized by type (purchases, cash advances, etc.) and separate year-to-date totals must be disclosed for fees and interest charges. Additionally, the effect on time to repay when only minimum required payments are made must be disclosed, consistent with the Bankruptcy Act of 2005.

Changes in interest rates and other terms will require 45 days' prior notice. This applies to interest rate changes due to terms applicable to the account and to rate changes resulting from delinquency, default, or penalties. When notice of any such change accompanies a periodic statement, the key terms being changed must be disclosed in a tabular form on the front of the statement.

Advertising provisions also were changed. An interest rate may be called "fixed" only if it will not increase for any reason during a time period that is specified or, if no time period is specified, the rate will not increase for any reason while the account is open. Furthermore, ads for financing of goods and services that state a periodic payment amount must disclose, in equal prominence, the time period required to repay the balance and the total of payments if only the minimum periodic payments are made.

Overdraft Services and Debit Holds. In addition to the Regulation AA and Regulation Z rules discussed above, the Federal Reserve's December 2008 rules also address the provision of overdraft services and the practice of debit holds in two ways. First, the Federal Reserve adopted a final rule effective January 1, 2010 that amends Federal Reserve Regulation DD (Truth in Savings). This final rule requires all depository institutions to disclose on periodic statements the aggregate amounts charged to the account for overdraft fees and returned item fees during the respective statement period and calendar year-to-date. The rule also requires that when institutions disclose account balance information to consumers using any automated system, they must exclude from such balances, any additional funds that may be provided by the institution or transferred from another account of the consumer to cover insufficient or unavailable funds. Alternatively, institutions are permitted to additionally disclose a balance figure that includes these amounts if the disclosure prominently states that such amounts are included in that balance figure.

The Federal Reserve also has proposed a rule to amend Federal Reserve Regulation E (Electronic Fund Transfers) with respect to overdraft and debit card hold practices by financial institutions. This proposal involves overdraft fees associated with automated teller machine withdrawals and one-time debit card overdrafts. The Federal Reserve's proposed rule solicits comments as to whether it should impose an opt-out procedure whereby overdraft fees would be prohibited if a consumer has declined an institution's overdraft services, or alternatively, an opt-in structure whereby overdraft fees would be prohibited, unless a consumer has affirmatively consented to use of the institution's overdraft services. The second part of the proposed rule would prohibit overdraft fees associated with an account being overdrawn solely due to a hold on funds associated with a debit card transaction where the amount on hold exceeds the actual transaction amount. This prohibition would be limited to circumstances in which the merchant can determine the actual transaction amount within a short period of time after authorization, such as fuel purchases at gas stations. The prohibition would not apply if the financial institution adopts procedures designed to release the hold within a reasonable period of time.

THE CARD ACT

When viewed in light of the new Federal Reserve rules, many of the CARD Act provisions hardly appear novel. Nevertheless, the CARD Act contains a number of additions and modifications that will have a substantial effect on issuers relative to the Federal Reserve rules. Examples of both overlapping provisions and distinctions include:

Interest Rates and Other Account Changes. Effective 90 days from the CARD Act's enactment, issuers will be required to provide 45 days' advance written notice for interest rate increases or other significant changes (as determined by the Federal Reserve) to a cardholder's account, except for rate increases related to

- The expiration of a rate at the end of a specified time period.
- The operation of an interest rate index used to determine credit card interest rates.
- Completion of, or failure to comply with the terms of, a workout or temporary hardship arrangement.

Any notice that is given must inform a cardholder of his or her rights to cancel the card before the effective date of the change (pursuant to rules established by the Federal Reserve). Any such cancellation of a credit card cannot constitute a default, or trigger any fee, penalty, or any obligation to immediately repay the card account balances in full.

Additional provisions regarding rates and fees will take effect in February 2010. The key distinction is between a cardholder's outstanding balance, which is defined as the amount owed on an account as of the end of the 14th day after an issuer provides notice of an increase in interest rates, fees, or finance charges, and new balances accrued after that time. While changes generally are permitted for new balances (subject to some limitations), increases in interest rates, fees, and finance charges applicable to outstanding balances are prohibited except for scheduled rate expirations, rates based on public indices and changes associated with workout arrangements, and where the obligor fails to make a required minimum payment within 60 days after its due date. These limitations have the effect of prohibiting the practice known as "universal default."

Each exception to the general rule imposes certain requirements and restrictions on issuers. For scheduled rate expirations, the issuer must have provided the consumer with a clear and conspicuous disclosure prior to commencement of the specified period stating how long the expiring rate would remain in effect and the rate that would apply after expiration. Additionally, the increased rate may not exceed what was previously disclosed and the increased rate may not be applied to transactions that occurred prior to commencement of the specified, lower rate period. For rates that vary according to an index, that index must not be under the control of the issuer, and it must be available to the general public. In the case of workouts and temporary hardship arrangements, the creditor must have clearly and conspicuously disclosed the terms of the arrangement prior to commencement, and the rates, fees, and finance charges applicable to a category of transactions after an increase cannot exceed those that applied prior to the arrangement. No rate increase may be applied as a result of failures to make minimum payments, unless the payment is more than 60 days late and 45 days' notice of a resulting increase is provided. This notice must clearly and conspicuously state the reason for the increase and also disclose that the increased rate will terminate not more than six months after it is imposed, if required minimum payments are timely received during that period.

The term "fixed" may only be used to refer to an interest rate that will not change or vary for any reason over the period specified clearly and conspicuously in the terms of the account.

Terms governing repayment of outstanding balances (including situations in which a consumer cancels a card prior to a noticed increase going into effect) may not be changed, except that an issuer may provide a consumer with one of the following payment methods:

- The issuer may provide for an amortization period of not less than five years, beginning on the effective date of the increase set forth in the required notice.
- A required minimum payment may be imposed that includes a percentage of the outstanding balance not to exceed twice the percentage required before the effective date of the increase set forth in the notice.
- A method no less beneficial to the consumer than one of these methods.

While rates applicable to new balances generally may be increased, beginning in August 2010, the CARD Act also will limit issuers' discretion by mandating defined assessment methodologies and providing for periodic reviews of rates to search for potential rate reductions. Specifically, increases based on credit risk, market conditions, and other factors require issuers to maintain reasonable methodologies for assessing such factors and review, at least every six months, accounts for which rates have increased since January 1, 2009 to assess whether such factors have changed. Where this review justifies a reduced rate, previously increased rates must be reduced. Where a rate increase is applied, the written notice discussed above must include a statement of the reason for the increase. The Federal Reserve must issue final rules to implement and evaluate compliance with these requirements no later than February 2010.

Finally, increases in rates, fees, and finance charges within the first year an account is open are prohibited, except for scheduled rate expirations, rates based on indexes, changes associated with workout arrangements, and cardholder failures to make minimum payments. Where a card utilizes a "promotional rate", such rate must be in effect for at least six months, subject to any reasonable exceptions the Federal Reserve may establish.

Prohibition on Double-Cycle Billing and Charges for On-Time Payments. Double-cycle billing is ended. Exceptions are provided for finance charge adjustments resulting from dispute resolutions or returns of a payment for insufficient funds.

Other Limitations on Fees and Interest Charges. Over-the-limit transaction fees are curtailed by requiring a cardholder to affirmatively opt-in to permit charges that would exceed a credit card's authorized limit subject to the assessment of an over-the-limit fee. Card issuers may still complete over-the-limit transactions without such elections, if no fee is charged. Before such an election can be effective, the cardholder must have received notice of the applicable fee. Any election will remain effective until revoked, but any periodic statement that includes such a fee must notify the cardholder of his or her right to revoke the election. The Federal Reserve will prescribe the form of election, which may be oral, electronic or written, as well as other related regulations governing disclosures aimed at preventing unfair or deceptive acts, with respect to over-the-limit or other penalty fees. Over-the-limit fees are limited to one per billing cycle. This fee also may be applied once in each of the two subsequent cycles, though it may continue longer if there are further extensions of credit exceeding the limit during these cycles. Such fees cannot continue if the outstanding balance is reduced below the credit card's credit limit at the end of a billing cycle.

Fees charged based on the method of payment used by cardholders to pay their bills generally may not be utilized, but an exception is made for payments involving expedited service by a representative of the card issuer.

Penalty fees for omissions or violations with respect to a cardholder agreement (including late payments, over-the-limit, and other fees) are also limited to amounts that are "reasonable and proportionate." The Federal Reserve is required to issue final rules implementing this by February 2010, and these provisions will go into effect in August 2010. Congress has dictated certain considerations that the Federal Reserve will take into account and has authorized the Federal Reserve to develop safe harbors that are presumed reasonable and proportionate.

Payment Timing and Late Payments. The date by which a payment is due, or, if different, the date on which a payment must be made to avoid a late fee must be disclosed conspicuously on a cardholder's billing statement, along with the amount of such late fee. If one or more late payments may result in an increased interest rate, the statement must disclose that fact and state the applicable penalty rate. Payments received by 5 P.M. must be considered timely, and payments made at local branches of the card issuer must be credited the same day for purposes of determining timeliness. If an issuer makes a material change to the location or procedures for handling payments that causes a material delay in crediting a cardholder's payment, no late fee or finance charge for late payment may be imposed during the 60-day period following such change.

Payment due dates must fall on the same day each month. If the due date falls on a day when the creditor does not receive or accept payments by mail (including weekends and holidays), payments will not be considered late if received on the next business day. Effective August 20, 2009, payments may not be considered late, and any additional finance charge associated with failure to pay before the end of a grace period may not be imposed, unless a card issuer has adopted reasonable procedures to ensure mailing or delivery of a cardholder's periodic statement at least 21 days before the due date.

Payment Allocation. When two or more different interest rates apply to an account, payments in excess of the minimum due must be allocated first to the highest interest rate and then to each successively lower rate. In the case of a deferred interest arrangement, the entire amount paid in excess of the minimum must be allocated to the deferred balance during the two billing cycles preceding the expiration of such deferred period.

Subprime Credit Cards. If the terms of a credit card account require payment of any fees (other than late, over-the-limit, or insufficient funds fees) during the first year an account is open, exceeding, in the aggregate, 25 percent of the initial credit limit, payment of such fees may not be paid from the credit available under the account.

Ability to Repay Must be Evaluated. An issuer may not open a new consumer credit card account or increase the credit limit on any account without first considering the consumer's ability to make the required payments under the terms of the account.

Disclosures. Periodic statements must include several disclosures related to minimum payments and interest charges. First, a general statement regarding the effect of making only minimum payments on the amount of interest to be paid and the time required for repayment must be provided. The number of months needed to repay and the total cost of repayment (both interest and principal) on each account, assuming only minimum payments and no further advances of credit, must be disclosed. Additionally, the required monthly payment amount and the total cost of repayment (both interest and principal) associated with full repayment in 36 months and assuming no further advances of credit must be disclosed. In calculating these figures, the interest rate currently in effect must be used, unless it is temporary and will contractually change to one utilizing an index or formula, in which case the current rate will be used for as long as it will be remain applicable, and the rate that would currently apply based on the index or formula shall be used thereafter. The disclosures must include a toll-free number for receiving credit counseling and debt management information. The Federal Reserve will determine the form and manner for implementing these requirements. Rules will be issued by the Federal Reserve by November 22, 2009 regarding the establishment and maintenance by creditors of the requisite toll-free telephone number, which shall ensure that referrals go only to certain nonprofit agencies. Finally, issuers generally must make disclosures prior to account renewal when account terms have been amended since the last renewal and either have not been previously disclosed or fit certain other criteria.

Internet Posting of Credit Card Agreements. Creditors are required to establish and maintain their own Internet sites where they will post their written consumer credit card agreements. These agreements must also be furnished to the Federal Reserve, which will then establish and maintain a central online repository that is accessible to the public and covers all issuers. These requirements will not apply to individually negotiated changes to contracts. The Federal Reserve and the Federal Trade Commission ("FTC") are responsible for making rules in this area, and they may establish exceptions where burdens outweigh benefits, such as for plans with a *de minimis* number of account holders.

Special Protections for Consumers Under Age 21. The CARD Act prohibits issuers from issuing credit cards to individuals under 21 without obtaining an application that either (1) includes the signature of an individual over 21 who has the means to repay and agrees to joint liability; or (2) shows that the individual has independent means to repay, which will include a safe harbor to be developed by the Federal Reserve. Cards issued with a joint obligor who is over 21 will require the jointly liable party's written approval for any credit line increases. The FCRA is amended to exclude individuals under age 21 from lists for prescreened credit offers, unless such persons consent to a consumer reporting agency providing their information.

Numerous restrictions and disclosure requirements are specified for marketing to college students. Issuers are prohibited from offering any tangible items as inducements to apply for a credit card if the offer is made on or near a campus of, or at an event sponsored by or related to, an institution of higher education. Institutions of higher education are required to publicly disclose any contracts or other agreements with card issuers or creditors for marketing purposes. Institutions of higher learning are encouraged to adopt additional policies limiting credit card marketing and to provide credit card and debt education and counseling at new student orientation.

Creditors are required to submit an annual report to the Federal Reserve regarding business, marketing, promotional, and affinity card agreements with each applicable institution of higher education (and their related alumni organizations and foundations), the amounts and terms of any payments to such institutions, and the number of relevant accounts open and outstanding. Initial reports are due under this provision by February 2010. The Federal Reserve will aggregate these reports by institution and submit an annual report to Congress that will be publicly available. Finally, the Comptroller General must review the reports submitted by creditors with regard to effects on credit card debt, and periodically report on these matters to Congress.

Prepaid and Gift Cards. The CARD Act institutes new rules that will become effective by August 2010 governing general-use prepaid cards, gift certificates, and store gift cards. Each of these categories is individually defined. Exclusions are provided for cards or devices:

- That are used solely for telephone purposes.
- That are reloadable and not marketed or labeled as a gift card or gift certificate.
- That qualify as loyalty, award, or promotional gift cards (as defined by the Federal Reserve).
- That are not marketed to the general public.
- That are issued in only paper form (including for tickets and events).
- That are redeemable solely for admission to events or venues that may also include certain services or goods.

The new rules generally prohibit dormancy fees, inactivity fees, and service fees (but not one-time initial issuance fees) on gift and prepaid cards, unless disclosure and other requirements are met. These prohibitions do not apply to any gift certificate distributed pursuant to an award, loyalty, or promotional program (as defined by the Federal Reserve), or with respect to which no money or other value is exchanged. Required disclosures must clearly and conspicuously state the existence, amount, and frequency of any such fees, and the purchaser must be informed of any such charges or fees prior to purchase. Subject to these disclosures, dormancy, inactivity, or service fees may be imposed so long as there has not been any activity on the certificate or card within the 12-months before the fee is imposed, and not more than one fee is charged in any month, *provided* any additional rules established by the Federal Reserve are met.

Expiration dates on gift and prepaid cards and gift certificates are prohibited, unless both:

- The expiration terms are clearly and conspicuously stated.
- The expiration date is at least five years from the date of issuance for gift certificates and from the date when funds were last loaded for store gift cards and general-use prepaid cards.

The Federal Reserve, in consultation with the FTC, will issue final regulations on these provisions by February 2010.

The new rules will not alter state laws unless, and only to the extent that, such state laws are inconsistent with the CARD Act.

Enhanced Penalties for Issuer Violations. Issuers are subject to increased penalties for violating TILA equal to twice the amount of any finance charge imposed, with a $500 minimum and $5,000 maximum, or a higher amount if based on an established pattern or practice.

Curbs on Deceptive Marketing of Credit Reports. Advertisements for free credit reports must prominently disclose where free reports are available under Federal law and that the advertised products are not what is provided for under Federal law. The FTC will issue final rules on this by February 2010.

Required Studies, Reports and Regulations. The CARD Act mandates a number of studies, reports, and regulations in addition to the items previously discussed. The Comptroller General is required to study and report to Congress on:

- Interchange fees and their effects on consumers and merchants.
- The marketing of products to consumers in conjunction with credit card offers.
- The relationship between fluency in English and financial literacy, along with any impediments on conduct of financial affairs resulting from having a native language other than English.

The Federal Reserve must:

- Review and report to Congress on the consumer credit card market, including terms, disclosures, adequacy of protections, and the effects of the CARD Act.
- In consultation with the FTC, prescribe regulations to ensure timely settlement of the estates of decedent obligors.
- In consultation with the Comptroller of the Currency and others, report on recent actions by creditors to reduce credit limits or raise interest rates based on certain factors.
- Review the use of credit cards by businesses with fewer than 50 employees and provide any relevant recommendations.

The FTC, together with the Attorney General and the Secret Service, will study and report on the cost-effectiveness of emergency PIN technology to alert law enforcement of incidents taking place at automated teller machines. The Secretary of the Treasury, in consultation with the Secretary of Homeland Security, is tasked with issuing final regulations implementing the Bank Secrecy Act regarding the sale, issuance, redemption, and international transport of stored value, including stored value cards. The Secretary of Education and others are tasked with evaluating and reporting on existing Federal financial and economic literacy programs and providing proposals for improvements. The Administrator of the Small Business Administration, in conjunction with the Secretary of Homeland Security, is instructed to establish a task force to address the information technology security needs of small businesses and prevent loss of credit card data.

CONCLUSIONS

The CARD Act makes broader changes than the Federal Reserve's new credit card rules. A number of changes were mandated by the Federal Reserve even in absence of the CARD Act, although their effective dates would be later. Such reforms provided by the CARD Act include the elimination of universal default and double-cycle billing, as well as many of the new requirements related to payment timing and late payments, restrictions on subprime cards, limitations on use of the term "fixed rate," and various key limitations on interest rate increases. The Federal Reserve rules even cover some items, such as certain disclosures, in more detail than the CARD Act, and it is expected that those particular rules will be implemented.

The Federal Reserve rules represented an attempt at consumer credit card reform to improve disclosure and reform credit card practices to be more transparent and less surprising to card holders. The CARD Act adds to the Federal

Reserve's rules, for example, by requiring 60 days' delinquency rather than 30 days' for imposition of penalty rates, mandating that all excess payments be allocated to the highest interest rate rather than permitting a *pro rata* option, and reducing the percent of the initial credit limit that can be allocated to fees for subprime cards. The CARD Act also introduces several completely new provisions, including those concerning protection of young consumers, regulation of gift cards, and the online posting of credit card agreements.

The CARD Act and the new Federal Reserve rules on credit cards are expansive and complex, and they will affect broad segments of the economy, including cardholders, consumers, card issuers, merchants, credit card securitizations, colleges and participants in affinity, private label and co-branded credit cards. All will be evaluating the effects of the new law and rules and taking action in light of the legislative and regulatory developments.

Losses on credit cards have risen due to the economy. According to the Federal Reserve and the FDIC, charge-off rates for credit cards in the First Quarter of 2009 were 7.49 percent and are trending towards 9 - 10 percent. The FDIC has reported that the credit card loss rate is at an all-time high. Most card issuers are commercial banks, which have been adversely affected by the credit crisis and increasing unemployment. One large credit card issuer's CEO recently indicated that credit cards were his bank's "most challenged business."

We believe the CARD Act and the new Federal Reserve rules will have widespread effects that require careful consideration and execution by market participants. Among other things, the following should be considered:

- Card issuers will likely change terms and adjust credit card provisions prior to the effectiveness of the CARD Act and the new rules in order to gain more flexibility for changes after the CARD Act and the rules become effective.
- Variable interest rates with rate floors are likely to expand as a popular pricing device.
- Card issuers, facing increased charge-offs, continued rises in unemployment, and poor credit performance on credit cards, are likely to seek ways to increase revenues from their card businesses including:
  - Reducing teaser rate promotions.
  - Reducing balance transfer promotional rates.
  - Reducing card benefits.
  - Imposing and/or increasing annual fees.
  - Increasing interest rates charged.
  - Reducing credit availability except to the most creditworthy customers who are regular users of that issuer's credit cards. Advanta already has determined to exit the credit card business.
- The Treasury and the Federal Reserve have recognized the importance of consumer credit and securitization of consumer credit in stimulating the economy and have tried to support such usage through the Term Asset-Backed Securities Loan Facility ("TALF"). Investors using TALF loans to finance purchases of new credit card securitizations have been among the largest participants in TALF. The CARD Act and the rules may make it more difficult and costly for card issuers to securitize new credit card receivables and for borrowers to participate in TALF, especially if the new rules increase losses on credit card receivables and make this asset class less attractive to rating agencies and buyers of credit card securitization securities. The ratings agencies are evaluating the effects of the new rules. Ratings agency downgrades could reduce the amount of credit card securities eligible for TALF and increase the cost to issuers of securitizing credit card receivables.
- The Financial Accounting Standards Board's ("FASB") amendments of FASB 140 and FIN 46, together with recent efforts by banks to provide additional support to their credit card securitizations, may return credit card assets that have previously been off-balance sheet. The new accounting rules, the CARD Act, and the Federal Reserve's rules will make existing and new credit card securitizations more costly, and the return of credit card receivables to issuers' balance sheets may require more bank capital to support these credit card assets.
- Since credit cards are unsecured debt, the delays in repricing for risk and in collecting balances inherent in the CARD Act and the Federal Reserve's rules will lead issuers to seek more creditworthy customers to reduce potential future losses. This likely will reduce the credit available to many cardholders, and available for spending in the economy. Less creditworthy customers, who may no longer qualify for credit cards, may be forced to rely on more costly forms of credit.
- The CARD Act's complexity and breadth, together with the Federal Reserve rules, will require immediate planning, market simulations, and responses to both consumer and

card issuer behavior. It would not be surprising to see cardholders using credit card debt more aggressively, to the extent available, in anticipation of potential defaults, given card issuers' new restraints on taking actions that generally promote consumer repayments.

- Credit card terms and disclosures will become more important. The reform of the timely payment rules will be helpful to all.
- Card issuers, merchants, colleges, and others participating in private label, co-branded, and affinity credit card programs should carefully consider the CARD Act, the Federal Reserve's rules, and their likely consequences. Consequently, these persons should plan now for potential amendments or restructuring of these programs in light of this new law and the Federal Reserve's rules.
- Credit availability to college students and those less than 21 years old, who might find credit cards useful and a means of establishing good credit, will be severely restricted.
- Some estimate these new laws and rules will reduce credit card issuers' aggregate revenue by $12-20 billion per year, putting more stress on bank earnings and capital adequacy.
- The costs of compliance will adversely affect cardholders, card issuers, merchants, and others, each of which will seek to recover and pass on these new costs to restore lost revenue.

Improved and more useful disclosures and more transparent credit card payment practices that reduce unexpected charges will be beneficial. Other provisions of the CARD Act may have adverse effects on the economy, influencing consumer spending and the profitability and capital of banks that issue credit cards. These effects would be inconsistent with many of the policy actions and programs introduced to rejuvenate the economy and strengthen the banking system. The CARD Act and related Federal Reserve rules are important and card issuers, retailers, investors in credit card securitizations, marketers of affinity programs, and colleges should begin planning now to make adjustments to operate profitably in a prudent manner commensurate with the risks of unsecured consumer credit.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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