

Consumer Financial Services Alert

An informational newsletter from Goodwin Procter LLP

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➤ **FRB Proposes Rules for Credit Card and Overdraft Services**

The FRB proposed rules regarding credit cards and overdraft services. The proposals would amend Regulations AA (Unfair Acts or Practices), Z (Truth in Lending) and DD (Truth in Savings). The unfair acts or practices proposal is a joint proposal of the FRB, OTS and NCUA.

Regulation AA

Regulation AA would be amended to prohibit certain acts or practices by banks in connection with credit card accounts and overdraft services for deposit accounts.

Credit Cards

Time to Make Payments. Banks would be prohibited from treating a payment as late unless the consumer has been provided a reasonable amount of time to make that payment. There would be a safe harbor for banks that send periodic statements at least 21 days prior to the payment due date.

Allocation of Payments. When different APRs apply to different balances on a credit card account (for example, purchases and cash advances), banks would have to allocate payments exceeding the minimum payment using one of three methods or a method equally beneficial to consumers. They could not allocate the entire amount to the balance with the lowest rate. A bank could, for example, split the amount equally between two balances. In addition, to enable consumers to receive the full benefit of discounted promotional rates (for example, on balance transfers), during the promotional period payments in excess of the minimum would have to be allocated first to balances on which the rate is not discounted.

Applying Rate Increases to Existing Balances. Banks would be prohibited from increasing the interest rate on outstanding balances unless the increase is due to: (1) the operation of an index; (2) the expiration or loss of a promotional rate (provided

the rate is not increased to a penalty rate); or (3) the minimum payment not being received within 30 days of the due date.

Two-Cycle Billing. Banks would be prohibited from imposing finance charges based on balances on days in billing cycles preceding the most recent billing cycle.

Financing of Security Deposits and Fees. Banks would be prohibited from financing security deposits and fees for credit availability (such as account-opening fees or membership fees) if charges assessed during the first 12 months would exceed 50% of the initial credit limit. The proposal would also require financed security deposits and fees exceeding 25% of the initial credit limit to be spread over the first year.

Credit Card Holds. Banks would be prohibited from imposing a fee when the credit limit is exceeded solely because a hold was placed on available credit.

Firm Offers of Credit. The proposal would require banks making firm offers of credit advertising multiple APRs or credit limits to disclose the factors that determine whether a consumer will qualify for the lowest APR and highest credit limit advertised (for example, the consumer's credit history, income, and debts). A safe harbor disclosure is provided.

Overdraft Services

Right to Opt Out. Banks would be prohibited from imposing a fee for paying an overdraft unless the bank has provided the consumer with an opportunity to opt out of the payment of overdrafts and the consumer has not done so. The opt-out right would apply to all transaction types. Banks also would be required to provide consumers a partial opt-out for overdrafts resulting from ATM and point-of-sale transactions.

Debit Holds. Banks would be prohibited from imposing a fee when the account is overdrawn solely because a hold was placed on funds in the consumer's deposit account.

Regulation Z

The Regulation Z proposal would provide that mailed credit card payments received by 5 p.m. on the due date must be considered timely. In addition, if a creditor does not receive or accept mailed payments on the due date (for example, when the due date falls on a Sunday or holiday), a payment received by mail on the next business day would be considered timely.

Regulation DD

The Regulation DD proposal contains overdraft disclosure requirements, including:

Disclosure of Aggregate Overdraft Fees. Banks would be required to disclose on periodic statements the aggregate dollar amounts charged for overdraft fees and for returned item fees (for the month and the year-to-date). Currently, only banks that promote or advertise the payment of overdrafts must disclose aggregate amounts.

Disclosure of Balance Information. Banks that provide account balance information through an automated system would be required to disclose the amount of the consumer's funds available for immediate use or withdrawal, without including additional funds the bank may provide to cover overdrafts.

The comment period for the Regulation AA proposal ends 75 days after publication in the *Federal Register*; the Regulation Z and DD proposals have 60-day comment periods. [Click here](#) for the Regulation AA proposal, [here](#) for the Regulation Z proposal and [here](#) for the Regulation DD proposal.

➤ **Federal Appeals Court Rules Credit Card Customers Have Standing to Sue Over Arbitration Agreements**

The Second Circuit recently held that credit card customers have constitutional standing to sue credit card issuers for violations of federal antitrust law when those issuers impose mandatory arbitration agreements. Plaintiffs' complaint alleged that credit card issuers violated federal antitrust law by conspiring to force customers to sign arbitration agreements. The Court held that plaintiffs alleged more than hypothetical injuries if forced to arbitrate in the future, but also sufficiently alleged present injuries, including the "reduction in choice and diminished quality of credit services." The Court found the allegation of such present injuries sufficient to create constitutional standing, thus making the claims ripe for adjudication. The Court did not address whether the plaintiffs had standing to sue under federal antitrust law. [Click here](#) for a copy of *Ross v. Bank of America*, No. 06-4755 (2d Cir. Apr. 25, 2008).

➤ **Federal Court Rules Unwritten Overdraft Agreements Are Not Subject to TILA and Reg Z**

The U.S. District Court for the Central District of California has ruled that the Truth in Lending Act and Regulation Z do not apply to "non-written-agreement overdraft programs." Plaintiffs alleged a bank had violated TILA by providing ATM cards with overdraft protection features without giving certain TILA disclosures. Following a Ninth Circuit remand, the district court held that TILA did not apply. Because the written agreement between the parties gave the bank discretion not to pay overdrafts, i.e., there was no written agreement requiring the bank to pay them, the bank was not a "creditor" under TILA. The Court further found that promotional materials describing the overdraft protection as "automatic" were not part of the written agreement. The Court then deferred to the FRB's position that TILA is not applicable to overdraft programs where there is no written agreement, even where plaintiffs can establish the bank had a practice of automatically paying all overdrafts. Finally, the Court dismissed the plaintiffs' related state law claims because each state law claim relied on allegations concerning checking accounts, disclosure requirements, and service charges and fees, all areas preempted by the Home Owners' Loan Act. [Click here](#) for a copy of *In re: Washington Mutual Overdraft Protection Litigation*, No. 03-2566 (C.D. Cal. March 17, 2008).

➤ **GAO Releases Health Savings Account Report**

The GAO published a report on health savings accounts. The report examines participation in HSA-eligible high-deductible health plans and HSAs, the income characteristics of HSA account holders, and contributions made to, and withdrawals made from, HSAs. The number of individuals covered by HSA-eligible plans

increased significantly from about 438,000 in September of 2004 to approximately 4.5 million in January 2007. Despite the growth, these plans represented a small share of individuals with private health coverage—about 2% in 2006. The number of tax filers reporting HSA activity also increased, nearly tripling between 2004 and 2005, from about 120,000 to about 355,000. Industry estimates suggest continued growth in HSA participation in 2006 and 2007. The total value of all HSA contributions reported to the IRS in 2005 was about twice that of withdrawals—\$754 million compared with \$366 million. Among all filers reporting HSA activity in 2005, average contributions were about \$2,100, compared to average withdrawals of about \$1,000. [Click here](#) for a summary of the report and [here](#) for the full report.

➤ **OCC Issues Payment Processors Risk Management Guidance**

The OCC issued a bulletin containing guidance for national banks regarding the higher risk presented by relationships with companies that process payments for telemarketers and certain other merchants. The guidance centers on due diligence, underwriting, and monitoring of such payment processors. [Click here](#) for a copy of the bulletin.

➤ **Massachusetts Appeals Court Rejects Challenge to Preliminary Injunction Preventing Foreclosure of “Presumptively Unfair” Mortgage Loans Without Court Approval**

A single justice of the Appeals Court of Massachusetts recently rejected Fremont Investment & Loan’s appeal of a preliminary injunction limiting the ability of Fremont to foreclose on property in Massachusetts. The Massachusetts Superior Court issued the injunction on February 25, 2008 preventing Fremont from foreclosing on certain categories of “presumptively unfair” loans without court approval, and later modified that injunction to prevent future sales of Massachusetts loans unless the purchaser agreed to be bound by the terms of the injunction. Fremont sought an interlocutory appeal to overturn the injunction. Justice Cynthia J. Cohen first rejected Fremont’s claim that the Superior Court impermissibly expanded the reach of M.G.L. ch. 183C, which governs “high cost” loans. She determined that the lower court simply interpreted the Attorney General’s unfair trade practices claim in light of Chapter 183C, which is permissible under Massachusetts law. The Appeals Court also rejected Fremont’s assertion that the transactions were exempt under M.G.L. ch. 93A, §3 because, although the loan terms at issue were not prohibited by Massachusetts law, Fremont did not identify any law or regulation that affirmatively permitted or approved of the terms used in the loans subject to the injunction. Finally, Justice Cohen declined to overturn the injunction regarding the sale of Fremont’s loans, finding that the potential interference with Fremont’s ability to improve its financial condition by selling its loans did not outweigh the benefits of ensuring that the injunction would apply to foreclosures of loans sold to third parties. For these

reasons, Justice Cohen determined that the Superior Court did not abuse its discretion in granting the injunction and denied Fremont's single justice appeal in full. Under the Court's Order, Fremont has until May 15, 2008 to seek review before a full panel. [Click here](#) for a copy of *Commonwealth v. Fremont Investment & Loan.*, No. 08-J-118 (Mass. App. Ct. May 2, 2008).

➤ **Massachusetts Division of Banks Proposes Guidelines Regarding Satisfactory Credit History for Licensure**

The Massachusetts Division of Banks issued proposed Regulatory Bulletin 5.2-102, which provides guidelines on the proper use of an applicant's personal financial history in determining whether the applicant meets the financial responsibility requirement for obtaining a particular license. The guidelines, which apply to licenses issued by the Division, including mortgage lender and originator licenses, would be used during the Division's review of individual licensees as well as the control persons and branch managers of a company applicant. The proposal would require every qualifying individual to submit a credit report, current within 30 days of the application date, to the Division. The proposal would assist Division staff in determining how to treat particular elements in an individual's credit report, like adverse credit information, when determining the financial responsibility of the individual. The Division is accepting comments on the proposed Bulletin until May 23, 2008. [Click here](#) for a copy of the proposal.

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