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Proposed Credit Card Rules Reflect More Federal Activism In Consumer Protection

Consumers' financial stress as well as actions by Congress and the states are causing a regulatory shift at the federal banking agencies. On May 1 and 2, 2008, the Federal Reserve Board ("Board"), the Office of Thrift Supervision ("OTS") and the National Credit Union Administration (collectively, the "Agencies") issued a proposed joint rule to ban certain unfair or deceptive credit card practices under Section 5 of the Federal Trade Commission Act ("FTCA").

The proposed rule would prohibit seven card issuer practices deemed to be unfair: (1) adopting too-short deadlines for on-time payments; (2) allocating payments first to account balances with the lowest interest rates; (3) increasing the annual percentage rate charged on outstanding balances not in default; (4) imposing overdraft fees when a credit limit is exceeded solely as a result of a merchant hold on an account; (5) calculating balances by including amounts paid off earlier; (6) using deceptive terms in the financing of security deposits and fees; and (7) offering misleading "firm" offers of credit. The Agencies' proposed rule also addresses certain unfair practices with regard to overdraft protection services on deposit accounts.

The proposed rule marks a pronounced shift in the position of the Agencies with regard to credit marketing and a trend toward a more proactive use of the FTCA. Until recently, the Board, in particular, has asserted that full and fair disclosures should be sufficient to arm consumers with the information they need to make informed decisions concerning credit. In an open and competitive financial environment, that approach relies on transparency to correct market abuses. This new action by the federal regulators is a pronounced step away from transparency and toward a more paternalistic approach to consumers, such as some states have taken. Movements like this tend to occur in times of financial turmoil and dislocations.

The current problems in banking, such as the widespread defaults and foreclosures attending the subprime mortgage meltdown, signal such times and have brought renewed calls for rule-setting and enforcement. Influential members of Congress have asked pointedly whether the Board has been energetic enough in using its powers to protect borrowers and whether the time has come for other federal regulatory authorities to step in. It is noteworthy that following such probing questioning, the Board reported in the notice for the proposed rule that extensive consumer testing of disclosures under Regulation Z, which implements the Truth in Lending Act, revealed

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that disclosures were ineffective in certain cases in helping consumers to make informed decisions. As a result, a sea change in regulatory philosophy may be taking shape.

The Board may be influenced by economic principles that favor market-driven solutions, but the strength of the challenge to the Board's efforts to protect consumers and, perhaps more importantly, the threat to the Board of losing rulemaking authority, have persuaded the Board to take a new approach in the area of consumer protection. This new direction is one phase of a larger shift toward more direct action to protect consumers.

Other examples of such a shift are the renewed efforts of the states to ban predatory practices in subprime lending, the public hearings held by the Board on the application of Bank of America to acquire Countrywide Financial, the acquiescence of the Office of Federal Housing Enterprise Oversight in the agreement of Fannie Mae and Freddie Mac with the New York Attorney General to ban certain appraisal practices, and the enforcement action taken by the Office of the Comptroller of the Currency in regard to a bank for its alleged failure to protect the customers of certain of its clients from telemarketing and payment processing fraud. These are not unrelated developments. We believe they are part of our entry into a period of more intrusive banking regulation and supervision, which will lead to increased enforcement actions in these areas as consumer protection is elevated within the overall enterprise-wide risk management priorities of the regulators. What this means for the continuing preemption wars between state and federal regulators remains to be seen, but it may suggest a new era of consumer protection issues and challenges to federal preemption for federally regulated institutions.

Authors and Contributors

For more information regarding this client alert, please contact your usual Fried Frank attorney or any of the attorneys listed below:

Washington, DC

Thomas P. Vartanian
+1.202.639.7200

Robert H. Ledig
+1.202.639.7016

David L. Ansell
+1.202.639.7011

Gordon Miller
+1.202.639.7173

Katie T. Dang
+1.202.639.7374

Fried, Frank, Harris, Shriver & Jacobson LLP

New York
One New York Plaza
New York, NY 10004-1980
Tel: +1.212.859.8000
Fax: +1.212.859.4000

Washington, DC
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505
Tel: +1.202.639.7000
Fax: +1.202.639.7003

Frankfurt
Taunusanlage 18
60325 Frankfurt am Main
Tel: +49.69.870.030.00
Fax: +49.69.870.030.555

Hong Kong
in association with
Huen Wong & Co.
9th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
Tel: +852.3760.3600
Fax: +852.3760.3611

Shanghai
No. 888 Wanhangdu Road
7th Floor, Unit D
Shanghai 200042
(until Summer 2008, when we will be located in Park Place, Nanjing Road West)
Tel: +86.21.2321.0188
Fax: +86.21.6326.6899

Fried, Frank, Harris, Shriver & Jacobson (London) LLP

London
99 City Road
London EC1Y 1AX
Tel: +44.20.7972.9600
Fax: +44.20.7972.9602

Fried, Frank, Harris, Shriver & Jacobson (Europe)

Paris
65-67, avenue des Champs Elysées
75008 Paris
Tel: +33.140.62.22.00
Fax: +33.140.62.22.29

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