

**WHO'S ENTITLED TO A CREDIT CARD?
PERSPECTIVES ON THE FED'S INDEPENDENT ABILITY TO PAY AMENDMENT**

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*Note: On March 18, 2011 the Federal Reserve Board adopted the amendments to Regulation Z discussed in the article below generally as proposed. For more information see:
<http://www.federalreserve.gov/newsevents/press/bcreg/20110318b.htm>.*

Americans are devoted to credit cards,¹ as evidenced by the nearly \$800 billion in credit card debt and other revolving credit outstanding at year-end 2010.² More than half of all US households have credit card debt. But our fixation on credit has led to some hard landings recently, with credit card delinquencies rising more than 150% from 2006 to 2009.³ As delinquencies triggered late payments, increased interest rates, and over-the-limit fees, the contractual rate and fee provisions in credit card agreements became a rallying point for public protest and media attention. Among the outcomes of a Congressional focus on credit card practices was the Credit Card Accountability Responsibility and Disclosure Act of 2009 (known as the CARD Act), which President Obama signed on May 22, 2009.⁴

The CARD Act mandated increased disclosures about changes to annual percentage rates on cards, and limited the conditions for increased APRs on existing balances. It also added new restrictions on the timing and content of billing statements. Significantly, it required card issuers to consider the consumer's ability to repay the debt and prohibited extending credit to consumers under age 21 who can neither demonstrate an independent means of repaying the credit nor obtain a co-signer over age 21 with the ability to repay the debt. These last changes, referred to

¹ The increasing role of credit card debt as part of consumers' overall financial pictures is not limited to the United States. A recent study of Canadians who filed bankruptcy found that the average debt of bankruptcy filers increased 17% between 2008 and 2010, with the largest increase accounted for by credit card debt. See Madhavi Acharya & Tom Yew, "Portrait of a bankrupt," The Spec.com, February 28, 2011 (online at <http://www.thespec.com/news/world/article/494129--portrait-of-a-bankrupt-male-41-married-with-4-credit-card>, viewed March 8, 2011).

² Federal Reserve Statistical Release G-19 (Consumer Credit) – January 2011 (release date March 7, 2011).

³ Source: "National Credit Card Delinquency and Charge-off Rates," Card Hub, online at <http://education.cardhub.com/statistics/historical-rates/> (viewed February 28, 2011).

⁴ P.L. 111-24 (2009).

as the “ability to pay” requirements, are among the matters covered by a still-pending Federal Reserve Board rule-making, and are the subject of this article.

CARD Act reforms have been both applauded and criticized. Media and consumer observers have pointed out what they see as the numerous loopholes,⁵ while consumer advocate-in-chief Elizabeth Warren announced on the first anniversary of the CARD Act that consumers now have better information and fewer surprises.⁶ Meanwhile, card issuers and representatives of the retail industry have criticized the ability to pay requirements, claiming that they will curtail credit availability to large segments of the population. Perhaps unwilling to wait for the effects of regulatory fixes, consumers have reduced their credit card debt by double digits since the height of the recession, but some experts believe these reductions will prove temporary and an improving economy will cause credit card debt to rise again.⁷

Regardless of whether CARD Act reforms prove to have a salutary effect, those responsible for implementing them will be hard at work interpreting the law and communicating the new norms. This may be particularly challenging with respect to the ability to pay provision.

The Federal Reserve Board implements and interprets ability to pay under Regulation Z, implementing the Truth in Lending Act (TILA).⁸ On February 22, 2010, the Fed adopted a regulation to implement the ability to pay rule and other provisions of the CARD Act.⁹ However, in November, the Fed issued another proposed rule covering ability to pay, explaining that it had “become aware that clarification is needed to resolve confusion regarding how institutions comply” with these and other aspects of the new CARD Act rules, including in particular the extent to which ability to pay requirements apply to consumers not under the age of

⁵ See, for example, Stacey Vanek-Smith, “The loopholes of credit card reform,” February 19, 2010, online at American Public Media, <http://marketplace.publicradio.org/display/web/2010/02/19/mm-openandnewrules/> (viewed March 1, 2011).

⁶ “Challenges Facing President Obama’s Budget, Financial Reforms,” February 22, 2011, online at C-Span.org, <http://www.c-span.org/Events/Challenges-Facing-President-Obamas-Budget-Financial-Reforms/10737419740/> (viewed March 1, 2011).

⁷ See Tamara Holmes, “Experts’ 11 credit card and debt predictions for 2011,” online at Today Money, <http://today.msnbc.msn.com/id/40955064/ns/today-money/> (viewed March 8, 2011).

⁸ 15 USC §1601 *et seq.*

⁹ 75 FR 7658 (February 22, 2010).

21.¹⁰ The comment period ended on January 3, 2011, but the Fed has not yet issued the rule in final form.

The amendment would require card issuers to consider the *independent* ability to pay of every applicant for individual credit, *regardless* of his or her age. Adoption of the amendment would mean that card issuers could not rely on “spousal” or “household” income when considering whether to extend credit to adults 21 or older, unless the spouses are joint applicants on the account or the spouse applying alone lives in a community property state. Card issuers fear they could not issue individual credit cards to applicants without adequate income or assets, even if those applicants have access to spousal income or assets sufficient to make the account payments.

Response to the Fed’s proposal shows the credit and retail industries to be united in their opposition and the consumer advocacy community nearly as united in support. Retail credit card issuers say the proposed amendments will “shut[] off credit availability to wide swaths of the population,”¹¹ while creditors claim the greatest negative fallout will be felt by women not working outside the home who are less likely to be able to obtain individual credit.¹²

The CARD Act added new ability to pay requirements in TILA Section 150,¹³ requiring credit card issuers to consider the ability of a consumer to repay before opening an account. Section 150 applies to *all* consumers.

A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.

¹⁰ 75 FR 67458, 67473 (November 2, 2010).

¹¹ Comment letter of Retail Industry Leaders Association, from Doug Thompson, January 3, 2011, online at http://www.federalreserve.gov/SECRS/2011/February/20110209/R-1393/R-1393_010311_59078_577575920511_1.pdf (viewed March 1, 2011).

¹² Comment letter of World Financial Capital Bank, from Marvin H. Corne, January 3, 2011, p. 2.

¹³ Section 109A of P.L. 111-24 (123 Stat. 1743), effective May 22, 2009.

Under TILA Section 127(c)(8), credit card accounts may not be opened for applicants under 21 *unless* the applicant has submitted an application co-signed by a joint obligor aged 21 or older with means to repay the debt, *or* the application reflects the consumer’s independent means of repaying the obligation.

Despite the fact that only TILA Section 127(c)(8) requires consideration of a consumer’s “*independent*” ability to repay the debt and that section only applies when the consumer is younger than 21, the Fed’s amendment would require card issuers to consider the *independent* ability to pay of an applicant for individual credit, *regardless* of his or her age. Retailers and bank card issuers say the requirement for independent income will both reduce their ability to extend credit and cause them to be sued for discrimination. The financial community made these arguments in dozens of comment letters on the Fed’s proposal,¹⁴ noting that the CARD Act’s ability to pay language was specifically intended to protect young consumers from starting out life with significant debt loads, unless they already had means to repay. Applying this standard to adults with access to household or spousal income is inappropriate in their view, because many cardholders use household income rather than their personal independent income to repay debts. The appropriate test for determining an over-21 consumer’s ability to pay should be *access* to income, rather than actual *ownership* of income.

The Fed’s suggestion that joint accounts are an effective alternative to individual accounts in which the credit underwriting is based on household income is unpalatable to both credit-issuers and consumer advocates. With joint credit, both account holders are fully responsible for repayment. If one of the joint account holders has no independent income, or a much smaller income than the other, and the relationship ends or the account holders stop cooperating on debt payments, the non-working person will be just as liable for the debt as the income-earning account holder. For this reason, some non-working persons, even spouses, may not want joint credit – preferring not to obligate themselves for debts knowing that they have no independent income.

¹⁴ A link to the public comments received is here:
http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R%2D1393&doc_ver=1&ShowAll=Yes

Retailers also point to the practical difficulty of opening joint credit accounts when both applicants are not present to apply. Macy's says joint applications are not practical when stay-at-home spouses shop for the household, because joint applicants are not typically together in the store when the credit application is submitted. At Macy's and its sister store, Bloomingdales, most credit cards issued are applied for at point-of-sale in the store.¹⁵

Adam Levin, co-founder of Credit.com and a former New Jersey consumer affairs official, is also skeptical of joint credit: "I don't know if it's ever really good to combine credit. I think it's a natural tendency that couples want to do it as part of the process of bringing themselves closer together. But I think that couples must always maintain separate credit files because death, illness or divorce requires that each member of the couple be able to stand on his or her own two feet."¹⁶ Consumer advocates note that consumers individually obligated for debt and unable to access household income for the payments will be in a *worse* position than if they had never obtained the credit. The National Consumer Law Center, a vocal proponent of this view, therefore wants card issuers to be required to verify the income of applicants for individual credit.¹⁷

In addition to parsing the statutory language of TILA and the CARD Act, and their separate age-based standards on ability to pay, responses to the Fed's proposal invoke a variety of public policy considerations. Creditors claim that non-working women (what some retailers describe as their "core customers") will be net losers if the amendment is adopted, with far less ability to obtain independent credit. A credit squeeze for women without an independent income could continue throughout a woman's life in the case of divorce or death of her husband because a divorced or widowed woman without an individual credit history may be unable to re-establish credit.

¹⁵ Comment letter of Macy's, Inc. from Steven L. Franks, January 3, 2011 (hereafter, Macy's letter), p. 1.

¹⁶ Mr. Levin is quoted in "Five Financial Miscues in the Name of Love," by Joe Mont, February 14, 2011, online at the Yahoo Finance website, <http://financiallyfit.yahoo.com/finance/article-112071-8464-3-5-financial-miscues-in-the-name-of-love?ywaad=ad0035&nc> (viewed March 9, 2011).

¹⁷ Comments of the National Consumer Law Center and Center for Responsible Lending (plus others) Regarding Notice of Proposed Rulemaking Amendments to Regulation Z Provisions Implementing the Credit Card Accountability, Responsibility and Disclosures Act of 2009, January 3, 2011 (corrected January 5, 2011), pp. 9-10.

Creditors also fear the amended rule will guarantee lawsuits. Their concern is that evaluating independent income is contrary to the Equal Credit Opportunity Act and implementing Regulation B, both of which were intended to promote credit for non-working applicants (primarily women) who might have trouble getting credit in their own names. Card issuers do not want to attempt to evaluate applicants' individual incomes while simultaneously raising their risk of noncompliance with Regulation B.

In addition to women, opponents of the amendment identify military families and the retired as potential victims of the Fed's ability to pay proposal. Spouses of military members are less likely than spouses of non-military to work outside the home according to USAA, an insurer for military families, so they would be disproportionately affected by a requirement that they demonstrate independent income to get credit cards. Moreover, spouses of military personnel serving abroad would be unable to apply for joint credit because the absent service member would be unavailable to sign a credit application. Retailer Macy's asks the Fed: "Does the Board contend that Congress intended to prohibit them from applying for credit cards until their spouse's/partner's return to this country to complete a joint application? Are they expected to put their lives and the lives of their children on hold?"¹⁸ Macy's also anticipates the amendment would deprive non-working military spouses of the discounts offered to branded card users. The retailer claims it would be "unfortunate to deny such discounts to an unemployed spouse."¹⁹

A broad theme running through many of the financial industry's comment letters is the potential damage to the economic recovery that may result from implementation of the independent ability to pay amendment. Bank of America noted that adoption would result in an overall contraction in credit card availability.²⁰

With the battle lines drawn between the credit and consumer advocacy communities on the ability to pay issue, some members of Congress are once again getting involved. Two female

¹⁸ Macy's letter, p. 2.

¹⁹ Macy's letter, p. 5.

²⁰ In its comment letter on the proposed amendment (Letter from Stacie E. McGinn to Board of Governors of the Federal Reserve System, January 3, 2011), Bank of America cited tests showing that more than 10% of applications that pass today would not pass under the ability to pay calculation of the proposed rules. Bank of America letter, p. 2.

members of Congress who worked on CARD Act language and the ability to pay requirements recently called upon the Fed to revise its proposed amendment, siding with the credit community in concluding that “stay-at-home moms” and other adults “without certifiable income” might be unjustly denied credit.²¹

In a credit-centric economy, most consumers use credit cards, even those who do not earn wages. The Federal Reserve Bank of Boston reported that 78% of consumers (176.8 million Americans) owned a credit card in January 2010.²² More than 80% of the student population has credit cards, according to Sallie Mae.²³ Yet the civilian labor force participation is closer to 65% or 66%.²⁴ Obviously, many consumers without independent income are using credit cards. The banking and card-issuing industries accept (and rely upon) the reality that some of their customers pay their accounts with funds of others, including spouses, partners, and parents. These creditors grant credit to some individuals based on credit histories that reflect access to funds rather than individual income. Not surprisingly, card issuers promote credit availability. The Fed’s proposed requirement for demonstrable independent income on the part of every card holder, on the other hand, is a “significant – and potentially dangerous – set-back” which was unintended by Congress when it enacted the CARD Act.²⁵

²¹ See Press Release of Representative Carolyn B. Maloney, “Maloney, Slaughter call on Federal Reserve to revise proposed ‘ability to pay’ rules implementing the Credit CARD Act to reduce impact on stay-at-home moms,” January 18, 2011, online at http://maloney.house.gov/index.php?option=com_content&task=view&id=2254&Itemid=61 (viewed March 8, 2011).

²² Survey of Consumer Payment Choice, Federal Reserve Bank of Boston, January 2010.

²³ “How Undergraduate Students Use Credit Cards,” Sallie Mae, April 2009.

²⁴ U.S. Department of Labor, Bureau of Labor Statistics, Economic News Release, “Employment status of the civilian population by sex and age,” online at <http://www.bls.gov/news.release/empsit.t01.htm> (viewed March 8, 2011).

²⁵ Letter from Carolyn B. Maloney and Louise Slaughter, Members of Congress, to Jennifer J. Johnson, Board of Directors of the Federal Reserve System, January 12, 2011.

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