

The New "Independent Ability to Pay" Requirement for Open-End Credit Under the Federal Reserve Board's Reg Z

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On March 18, 2011 the Board of Governors of the Federal Reserve System (FRB) adopted amendments to Regulation Z.¹ These amendments clarify certain aspects of the open-end credit rules that FRB adopted last year to implement changes to the Truth in Lending Act² (TILA) made by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act).³ The most significant aspect of the clarifying amendments is the change to the general "ability to pay" requirement under which issuers are no longer permitted to request and rely on "household income" when issuing credit. Credit card issuers, retailers, and other business interests strongly opposed this change, believing it will reduce the availability of credit, particularly to consumers who do not have independent sources of income (*e.g.*, non-working spouses), but who have historically been able to repay their debts.

The availability, desirability, and necessity of consumer financial products, and the appropriate terms of such products, have been the subject of lively public debate since the onset of the financial and housing crisis. Legislative and regulatory responses to the national financial downturn are ongoing, and range from the CARD Act to the Dodd-Frank Wall Street Reform and Consumer Protection Act⁴ (and its creation of the Bureau of Consumer Financial Protection), and recent orders by several banking agencies to home mortgage companies to

reimburse homeowners whose homes may have been wrongly foreclosed.⁵ Many of the reforms address creditors' policies and practices that can be directly linked to problems revealed during the crisis. Others, such as the new ability to pay requirements, address issues that cannot be directly tied to the crisis.

Among other things, the CARD Act amended TILA to state that an issuer may not open a credit card account for any consumer or increase any credit limit unless the card issuer considers the consumer's ability to repay the debt. In a separate section, it also amended TILA to prohibit issuers from opening credit card account for consumer under the age of 21 unless the consumer submits a written applicant and there is a cosigner on the account or the consumer has an "independent" means of repaying the obligation.

To address the CARD Act amendments, in February 2010, FRB adopted amendments to Regulation Z to implement these and other provisions of the CARD Act that were effective that month.⁶ New Section 226.51(a) provided that a card issuer must not open a credit card account or increase the credit limit unless the card issuer considers the ability of the consumer to make the required minimum payments based on the consumer's income or assets and the consumer's current obligations. The commentary

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provided that a card issuer may consider "[a]ny current or reasonably expected assets or income." New Section 226.51(b) provided that a card issuer may not open a credit card account for a consumer less than 21 years old unless the consumer submits a written application and the card issuer has:

- financial information indicating an independent ability to repay consistent with the standards of Section 226.51(a); or
- a signed agreement of a cosigner, guarantor, or joint applicant and financial information indicating that person has the general ability to repay.

In November 2010, FRB published proposed amendments to clarify confusion over certain aspects of the previously adopted rules.⁷ While most of the proposed changes were clarifications without significant impact on the majority of issuers, the proposed changes to the ability to pay requirements of Section 226.51(a) and the related FRB commentary were highly controversial. On March 18, 2011, these changes were adopted substantially as proposed and will result in significant changes to the application processes and underwriting practices of many issuers.⁸

Under these clarifications, Section 226.51(a)(1) was revised by adding the word "independent" to the general requirement to consider the ability of a consumer to repay his or her debts. FRB clarified that this change means that issuers are no longer permitted to request and consider "household" income when considering an individual consumer's ability to pay under Section 226.51(a). The revised commentary clarifies that an issuer may only consider the income or assets of persons who are liable for debt incurred on the account.⁹ An issuer may not use the income and assets of a person who is not liable for debts incurred on the account unless a federal or state statute or regulation grants the consumer an ownership interest in the income or assets (*i.e.*, in community property states).

The commentary states that consideration of household income or assets does not by itself satisfy the requirement to consider the consumer's independent ability to pay. However, if an issuer requests income information, without reference to household income, the issuer may rely on the information provided by the consumer to satisfy its ability to pay analysis. On the other hand, if an issuer requests "household income," the issuer may not rely on that income but must obtain additional information about the applicant's independent income. A new comment clarifies that information regarding income and assets that satisfies the requirements of Section 226.51(a) also satisfies the requirements in Section 226.51(b)(1) for consumers under the age of 21.¹⁰

The adoption of these clarifications was a disappointment for card issuers. Many issuers commented on the proposal, explaining that their inability to issue individual credit cards to applicants who have *access* to spousal income or assets sufficient to make the account payments would reduce the availability of credit to many consumers and negatively impact their businesses. The credit and retail industries claimed that married women not working outside their homes are apt to feel the greatest impact of the new rules, as they are less likely to be able to obtain individual credit.

These issuers argued that inserting the word "independent" was not required, or even permissible, under the CARD Act, and thus should not be inserted into Section 226.51(a). Revised TILA Section 150 requires credit card issuers to consider the consumer's repayment ability before opening an account. It does not specify how that repayment ability is to be determined. In practice, many card issuers rely on an applicant's household income to evaluate repayment ability. Thus, prior to the amendment, a non-working spouse may have been deemed to have account repayment ability based on the wages of his or her working spouse. In contrast, under revised TILA Section 127(c)(8), credit card accounts may not be opened for

applicants under age 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 under 21 consumer's *independent* means of repaying the obligation. Thus, arguably, Congress meant something different when it used the word "independent" in one context but not the other.

In adopting the amendments to Section 226.51(a), FRB rejected this argument, stating that it believed that imposing an ability-to-pay requirement to consumers over 21 years of age was consistent with TILA Section 150. It pointed to the words "the ability of the consumer" to argue that Congress intended card issuers to consider only the ability to pay of the consumer or consumers who are responsible for making payments on the account. FRB also considered, but rejected, the claims of card issuers that if unemployed spouses are unable to rely on spousal income when applying for credit, the credit is less likely to be granted. FRB noted that these claims were not substantiated. FRB was also not persuaded by the claims of retailers and card issuers that married women not employed outside the home would suffer reduced access to credit. Moreover, FRB observed that Section 150 was intended to strengthen credit card underwriting standards in order to protect families "from incurring unaffordable levels of credit card debt."¹¹

FRB's amended rule describes alternatives for preserving credit availability to applicants without independent income. First, it mentions the joint account approach, under which both applicants are jointly responsible for repayment, even if only one is employed or has income. Second, FRB endorses the "authorized user" approach, by which a consumer without independent income can build a credit history with another person, such as a spouse. Neither of these alternatives addresses the various issues raised by creditors, such as the inconvenience of requiring both applicants to apply for a card at point of sale.

In adopting the amendment, FRB noted that there is confusion regarding whether Regulation B under the Equal Credit Opportunity Act requires a card issuer to consider spousal or other household income when considering a consumer's ability to pay. FRB, however, stated that a card issuer would not violate Regulation B by virtue of complying with Section 226.51. Moreover, FRB gave short shrift to comments that suggested military families and the retired would be especially harmed by the independent ability to pay standard. In the case of military members serving abroad, FRB acknowledged they might be unavailable to co-sign joint credit applications, noting "a joint application could be inconvenient or impracticable in certain circumstances, such as when a consumer's spouse is not available to apply in a retail setting." However, "[FRB] does not believe that these concerns warrant permitting issuers to extend credit based on the income of persons who are not liable on the account."¹²

It remains to be seen whether creditors' fears of reduced credit card availability will be realized and what effect the new independent ability to pay standard will have on the country's economic recovery. What is undeniable is that American consumers, even those without independent incomes or assets, are avid credit card users. An environment of reduced credit card availability, if it occurs, may lead consumers to join with industry to promote reconsideration of the independent ability to pay standard.

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¹ 12 C.F.R. Part 226.

² 15 U.S.C. § 1601 *et seq.*

³ Pub. L. 111-24, 123 Stat. 1734 (2009).

⁴ Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

⁵ See Board of Governors of the Federal Reserve System, *Press Release* (April 13, 2011); Office of the Comptroller of the Currency, *OCC Takes Action Against Eight Servicers for Unsafe and Unsound Foreclosure Practices*, Press Release N 2011-47 (April 13, 2011); Office of Thrift Supervision, *OTS Takes Action to Correct Foreclosure Deficiencies*, OTS 11-008 (April 13, 2011); see also, Bloomberg Banking & Finance Law Report, *Federal Banking Regulators Announce Results of Foreclosure Review; Issue Enforcement Actions Against Servicers* (April 21, 2011).

⁶ 75 Fed. Reg. 7658 (Feb. 22, 2010).

⁷ 75 Fed. Reg. 67458 (Nov. 2, 2010).

⁸ Board of Governors of the Federal Reserve System, *Press Release* (March 18, 2011); see also, 76 Fed. Reg. 22948 (April 25, 2011).

⁹ Comment 51(a)(1)-4.

¹⁰ Comment 51(b)(1)-2.

¹¹ 76 Fed. Reg. at 22975 (Apr. 25, 2011).

¹² 76 Fed. Reg. at 22976 (Apr. 25, 2011).