Client Alert.

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Summary of Proposed CARD Act Clarifications

By Richard Fischer, Oliver Ireland and Obrea Poindexter

On November 2, 2010, the Federal Reserve Board ("Board") published a proposed rule to clarify certain recent amendments to Regulation Z, particularly those implementing the Credit Card Accountability Responsibility and Disclosure Act of 2009 ("CARD Act"). While the Board indicated that the proposed rule is intended to enhance consumer protection and to facilitate compliance by resolving areas of uncertainty, the proposed rule could significantly impact current industry practices and, in some instances, would require issuers to again revise compliance policies and procedures, application and account-opening disclosures, and change in terms notices and other consumer communications. The comment period will close on January 3, 2011, and final clarifications are expected in April 2011, with a mandatory compliance date in October 2011.

ABILITY TO PAY

(Section 226.51)

Section 226.51 requires an issuer to assess a consumer's ability to repay his or her credit card obligations prior to opening a new account or increasing the line of credit on an existing account. In addition, Section 226.51(b) prohibits an issuer from opening an account for a consumer under the age of 21, unless the consumer has submitted a written application and either has the "independent means" of repaying the obligation or provides the signature of a cosigner with such means.

Since the issuance of the final amendments to Regulation Z in February 2010 ("February 2010 rulemaking"), questions have arisen concerning information provided by a consumer in response to a request for household income and whether such information can be used by an issuer to satisfy the ability to pay requirements. In addition, there has been uncertainty and varying agency interpretations concerning whether there are different standards for underage consumers and other consumers with respect to the consideration of household income or assets. Moreover, there has been concern about whether and to what extent Regulation B, which implements the Equal Credit Opportunity Act, requires an issuer to consider spousal or other income when considering a consumer's ability to pay.

To address these concerns, the proposed rule would fundamentally change the ability to pay requirements. First, an issuer would not be permitted to use household income in evaluating a consumer's ability to pay. That is, even though the CARD Act uses the term "independent" only in the context of a young consumer, an issuer would have to consider the consumer's separate or "independent" ability to make the required payments, regardless of the consumer's age, unless, for example, the spouse or other household member is a joint applicant or accountholder, or applicable state law grants the applicant an ownership interest in the income of his or her spouse.

Second, the supplemental information accompanying the proposed rule indicates that, notwithstanding a consumer's age, Regulation B does not compel an issuer to consider spousal or other household income when considering an applicant's ability to pay. It is not clear, however, how the Board will reconcile this view with the prohibitions in Regulation B against discriminating against, or discouraging, an applicant on a prohibitive basis.

Third, the proposed rule would clarify the interrelationship of the obligation of an issuer to consider the ability of an applicant to repay amounts extended, on one hand, and the manner in which income information is requested on application forms, on the other. More specifically, for many years, issuers have used the phrase “household income” when requesting income information from applicants, initially at the apparent direction of the Office of the Comptroller of the Currency. However, if an issuer requests on its application forms that applicants provide their household income, the issuer would not be permitted to rely solely on that income information to satisfy the ability to pay requirements. Instead, an issuer would be required to obtain additional information about the applicants’ independent income, for example, by contacting applicants. The proposed rule also would provide that if an issuer requests on its application form that applicants provide their income, without any reference to household income, the issuer would be permitted to rely on information submitted on the application, and would not be required to verify that the income amount provided is the personal income of the applicant.

While language in the supplemental information accompanying the proposal states that “the Board acknowledges that the proposed amendments…could prevent a consumer without income or assets from opening a credit card account despite the fact that the consumer has access to (but not an ownership interest in) the income or assets of a spouse or other household member,” the Board does not address the potential impact that the proposed rule will have on consumers, especially married women who rely on their husbands’ income to obtain credit used to maintain their households, which is the origin of the existing Regulation B requirement. The Board solicits comment on whether it should provide greater flexibility in these circumstances.

PENALTY FEES

(Section 226.52(b))

The proposed rule provides a number of clarifications concerning the application of the penalty fee provisions, which prohibit the imposition of fees unless the fee is reasonable and proportional to the total costs incurred by the issuer or consistent with the applicable safe harbor amounts established by the Board. Specifically, the proposed rule would clarify that an issuer may impose a $35 penalty fee for a subsequent violation that occurs during the same billing cycle or during the next six billing cycles. While there are few instances where an issuer will be permitted to impose multiple penalty fees in the same cycle, the proposed rule clarifies that it would be possible, for example, if a consumer made two separate payments that are returned during the same billing cycle, for an issuer to impose a $35 returned payment fee for the second returned payment in that cycle.

The proposed rule would also require that for purposes of determining the amount of the penalty fee that an issuer can impose under the safe harbor, the issuer must actually have imposed the initial late fee and not just have the right to impose such a fee. For example, an issuer would have to actually impose the $25 fee for the first violation in order to subsequently impose a $35 fee for the second violation; on the other hand, if the issuer waives the $25 fee for the first violation, the issuer can only impose a $25 fee for the second violation, not a $35 fee. As a result, the proposed rule could discourage an issuer from ever waiving a penalty fee because if an issuer were to waive the fee for the first violation, the fee for the second violation could not be greater than $25.

On the other hand, the proposed rule would clarify that with respect to multiple violations based on the same event or transaction, an issuer would not be prohibited “from imposing fees for exceeding the credit limit in consecutive billing cycles based on the same over-the-limit transaction,” to the extent such fees would otherwise be permitted under revised Regulation Z.

Also, the proposed rule would clarify that if a consumer misses a payment for a particular billing cycle, in order for an issuer to impose an additional late fee the following cycle, the issuer would have to include the past due payment amount in the minimum payment due on the periodic statement for the following billing cycle and the consumer would have to fail to make that full minimum payment. However, if the past due payment amount is not included in the minimum payment due, the issuer would not be permitted to impose an additional late fee the following cycle if the consumer pays the minimum payment due as reflected on that periodic statement.

TEMPORARY RATE AND FEE EXCEPTION

(Section 226.9(c) and Section 226.55(b)(1))

As part of the February 2010 rulemaking, revised Regulation Z exempted increases in temporary rates upon the expiration of a period, provided the return to rate and length of the period were properly disclosed. However, the Board expressly declined to adopt a specific exception for temporary or promotional fee reductions. But recognizing that the failure to provide an exception for temporary fee reductions would discourage issuers from offering beneficial fee reductions, the Board is proposing to amend Section 226.9(c) and Section 226.55(b)(1) to expressly permit an issuer to impose a fee increase after a corresponding temporary fee reduction without providing 45 days' advance notice, and without being subject to rate and fee limitations, so long as the issuer provides the consumer with clear and conspicuous written disclosures of (1) the length of the period and (2) the fee or charge that will apply after the expiration of the period. Thus, an issuer would be permitted to increase an annual fee after a specified period of time if the issuer provides the consumer with appropriate disclosure of this fact. However, just like temporary rate reductions, a temporary fee would have to apply for a specified period of six months or longer before an issuer could increase the fee.

In addition, the proposed rule would clarify that compliance with the formatting requirements for the account-opening table would be deemed to meet the equal prominence and close proximity formatting requirements for the disclosures required for the temporary rate exception, even if the disclosure of the introductory period is in a smaller font and not in bold type as otherwise would be required. The Board said it believes that the account-opening table appropriately and sufficiently conveys key information to consumers.

Furthermore, to allow consumers to take immediate advantage of promotions they believe are beneficial, current Regulation Z permits an issuer to provide the disclosures required for the temporary rate exception orally so long as an issuer later provides the disclosures in writing and also gives the consumer the right to reject the promotion. Because such promotional offers will never result in a rate increase above the rate temporarily being decreased, the Board is proposing to delete as unnecessary the requirement that an issuer provide consumers with the right to reject such an offer.

PROMOTIONAL WAIVERS OR REBATES

(Section 226.55(e))

To address concerns that the revocation of a promotional waiver or rebate program based on a violation of the account terms may be inconsistent with the CARD Act, the Board used its exception authority to propose amendments limiting an issuer's ability to offer such a promotional waiver or rebate program. Specifically, a waiver or a rebate of interest, fees, or other charges limited by Section 226.55 that is later revoked would be considered an increase in a rate, fee, or charge for purposes of Section 226.55. As a result, the issuer would be prohibited from increasing the interest charges for existing balances by ceasing or terminating the waiver or rebate, unless the account becomes more than 60 days delinquent. Instead, under such circumstances, an issuer would be required to give 45 days' advance notice and the right to reject the change in the waiver or rebate program.

As proposed, however, the rule would only address a waiver or rebate program that is promoted by an issuer, rather than a waiver or rebate in connection with resolution of a dispute or to address compliance or other concerns. For instance, an issuer would not be considered to be promoting a waiver or rebate program if a consumer calls the issuer to dispute a fee that appears on his or her periodic statement and the issuer waives the fee. Thus, the proposed rule would add a commentary provision to clarify the circumstances under which an issuer would be considered to have promoted a waiver or rebate program. For example, an issuer would promote a program if the issuer discloses the waiver or rebate in a newspaper, magazine, leaflet, promotional flyer, catalog, sign or point-of-sale display, as is the case in the existing definition of an advertisement. Departing from the definition of an advertisement, however, an issuer could be deemed to promote a waiver or rebate program in its communications with existing consumers.

Furthermore, the proposed rule would clarify that an issuer would not be viewed as promoting a waiver or rebate if "[a]fter a card issuer has waived or rebated interest, fees, or other charges . . . the issuer discloses the waiver or rebate . . . on the periodic statement, or by telephone, letter, or electronic communication," unless, at the same time, the issuer discloses a prospective waiver or rebate in the same communication.

In an attempt to clarify the treatment of rewards, cash-back arrangements or similar benefits-based programs, the proposed rule provides that an issuer would not be viewed as promoting a waiver or rebate when an issuer "provides benefits (such as reward points or cash back on purchases or finance charges) that can be applied to the account as credits, provided that the benefits are not promoted as reducing interest, fees, or other charges subject to § 226.55."

RATE REEVALUATIONS

(Section 226.59)

Section 226.59(a) provides that if an issuer imposes a rate increase on an account and that rate increase is subject to a 45-day advance notice pursuant to Section 226.9(c) or Section 226.9(g), the issuer must reevaluate the account under Section 226.59 to determine whether the cardholder is eligible for a rate decrease.

To address questions concerning the circumstances in which a change in the type of rate, such as a change from a variable rate to a non-variable rate, would trigger the rate reevaluation requirements under Section 226.59, the proposed rule would clarify the applicability of the rate reevaluation requirements when an issuer changes the type of rates that would apply to an account. Specifically, the proposed commentary provides that "[a] change from a variable rate to a non-variable rate or from a non-variable rate to a variable rate is not a rate increase for purposes of § 226.59, if the rate in effect immediately prior to the change in type of rate is equal to…the rate in effect immediately after the change." However, the proposed commentary specifically provides that an increase in a variable rate "constitutes a rate increase for purposes of § 226.59 if the variable rate exceeds the…rate that would have applied if the change in the type of rate had not occurred." Thus, based on the proposed clarifications, subsequent increases in the actual rate would apparently trigger the rate reevaluation requirements at the time of the actual rate increase.

Based on the proposed clarifications, the same analysis could apply to the elimination of a rate floor or to an increase in the margin. That is, if the rate before and after the change are the same, the rate reevaluation requirements would not be triggered. While proposed commentary Section 226.59(a)(1)-3.ii only specifically addresses changes from a non-variable rate to a variable rate, the same analysis should apply to the elimination of a rate floor or to increasing the margin.

With respect to the amount of the rate reduction, Section 226.59(a) provides that an issuer is to reevaluate rate increases and, based on this review, reduce rates until the particular account is priced where it was before the price increase that gave rise to the obligation to reevaluate. Specifically, Section 226.59(f) provides that the obligation to review rate increases ceases to apply "[i]f the issuer reduces the annual percentage rate applicable to a credit card account…to the rate applicable immediately prior to the increase, or, if the rate applicable immediately prior to the increase was a variable rate, to a variable rate determined by the same formula (index and margin) that was used to calculate the rate applicable immediately prior to the increase."

The proposed rule would also clarify that an issuer is not required to reduce the rate for a reevaluated account to a rate that is lower than the rate that applied to that account immediately prior to the rate increase. That is, Section 226.59(f), by its own terms, permits an issuer to stop reducing the rate applicable to an account that was previously subject to a rate increase when the rate on that account has been reduced to the rate that applied to that account immediately prior to the rate increase—even if, based on the issuer's new account factors, some new cardholder might qualify for a lower rate under some circumstances.

LIMITATIONS ON UPFRONT FEES

(Section 226.52(a))

To address concerns about requiring consumers to pay application, processing, or similar fees prior to account opening that, when combined with other fees charged to the account, exceed 25 percent of the account's initial credit limit, the proposed rule would prospectively impose this limitation on fees an issuer imposes on a consumer prior to account opening. Specifically, the proposed rule would provide that the 25 percent limitation applies not only to fees charged to a credit card account once it has been opened, but also to fees charged prior to account opening, and fees collected through other sources during the first year the account is open.

INTERNET POSTING OF CREDIT CARD AGREEMENTS

(Section 226.58)

The proposed rule also would provide guidance on the entity that would be considered the issuer for purposes of complying with the requirement to post agreements on the Internet in Section 226.58. Specifically, the proposed rule would define a "card issuer" with respect to a particular agreement to be "the entity to which a consumer is legally obligated, or would be legally obligated under the terms of a credit card agreement." The Board solicits comment on the proposed definition of card issuer, and on whether there are alternative approaches.

Furthermore, the proposed rule would address additional questions that have arisen since the February 2010 rulemaking. Based on apparent compliance difficulties and to avoid consumer confusion, the definition of pricing information would be amended to exclude variable rate and other information required under Section 226.6(b)(4), such as periodic rates and corresponding annual percentage rates. In addition, the proposed rule would clarify that billing rights notices are not deemed to be part of the agreement for purposes of Section 226.58 and, therefore, need not be submitted to the Board.

EMPLOYEE RATES

(Section 226.5a and Section 226.6)

Based on the Board's stated rationale that the loss of an employee preferred rate upon termination of an account is akin to the imposition of a penalty rate or the loss of an introductory rate, the proposed rule would require a new disclosure to be included in application and account-opening disclosures relating to the loss of an employee preferred rate. In particular, an issuer would be required to disclose beneath the tabular disclosures: (1) the circumstances under which an employee preferred rate would be revoked; (2) the rate that would apply after the employee preferred rate is revoked; and (3) the duration of the rate increase or that the rate increase will apply indefinitely.

However, a footnote in the supplemental information accompanying the proposed rule provides that “45 days’ advance notice is required…prior to imposition of the higher rate…[and that] the limitations set forth in § 226.55 apply.” Thus, while an issuer should be permitted to disclose that the rate increase will apply indefinitely to meet the disclosure requirements for the temporary rate exception, it is not clear whether an issuer would be permitted to apply the rate increase to the existing balances on the account.

CHECK DISCLOSURES

(Section 226.9(b))

The proposed rule would require an issuer to include variable rate disclosures with the disclosures required to be provided with checks that access a credit card account. However, the rule would prohibit an issuer from including the value of the index or the amount of the margin in the tabular disclosures. In addition, the proposed rule would clarify that an issuer may include in the tabular disclosures, terms offered on non-check transactions, provided that such transactions are subject to the same terms. Further, the proposed rule would not permit an issuer to include additional information that is not required for disclosures with access checks.

SERVICEMEMBERS CIVIL RELIEF ACT EXEMPTIONS

(Section 226.9(b) and Section 226.55)

Revised Regulation Z provides an exception for rate increases when an issuer is required by the Servicemembers Civil Relief Act (“SCRA”) to reduce a rate, but then increases the rate when the SCRA no longer applies. The proposed rule would expand the SCRA exception to cover fees in addition to the rate. Specifically, the proposed rule would clarify that an issuer is permitted to increase fees, as well as the rate, once the SCRA no longer applies to the fees that applied prior to being called to duty.

To complement the expanded SCRA exception, the proposed rule would also amend the right to reject requirements to clarify that the same rule applies when an issuer returns fees to pre-existing levels once a consumer leaves military service and the legal requirements of the SCRA cease to apply. That is, the proposed rule would make clear that the right to reject would not apply to a fee increase when a fee has been reduced consistent with the SCRA or similar federal or state statute or regulation, provided that the increased fee does not exceed the amount of the fee prior to the reduction.

VARIABLE RATES FOR NON-CREDIT CARD ACCOUNTS

(Section 226.9(c)(2)(v)(C))

The proposed rule would provide that a variable rate plan, even for a non-credit card account, that is subject to a fixed minimum or “floor” does not meet the conditions of the variable rate exception to the 45-day advance notice requirements. Specifically, based on changes the Board made in the February 2010 rulemaking concerning credit card accounts that were subject to a rate floor or an index that is deemed to be within the issuer’s control, the proposed rule would require a creditor with a variable rate plan for non-credit card accounts with a rate floor or an index that is deemed to be within the issuer’s control to provide 45 days’ advance notice prior to a rate increase on such a plan. The supplemental information to the proposed rule states that “[t]he Board believes that it is appropriate to adopt a consistent interpretation of ‘an index that is not under the control of the creditor’ for all open-end” credit.

While the Board proposes to clarify that the rate and fee limitations under Section 226.55 would not apply to non-credit card accounts with a variable rate floor, creditors will have to either eliminate such rate floors or provide notice before making changes resulting from a change in the index. Because most creditors are unable to make mid-cycle changes, however, creditors would likely be required to wait 60 days before implementing such rate changes.

CHANGES TO CLOSED ACCOUNTS

(Section 226.55(b)(3))

After the first year, the advance notice exception permits a card issuer to increase the rate, fee or charge that will apply to new transactions after complying with the appropriate notice requirements. The proposed rule would prohibit an issuer from increasing a rate, fee or charge that is subject to the limitations in Section 226.55 to a closed account or to an account that "the card issuer does not permit the consumer to use…for new transactions."

CONFORMING VS. NONCONFORMING PAYMENTS

(Section 226.10(b))

The proposed rule would amend the rules distinguishing between conforming payments, which must be credited as of the date of receipt, and nonconforming payments, which must be credited within five days of receipt. Specifically, the proposed rule would provide that if a creditor promotes a specific payment method, any payment made through that method prior to the cut-off time specified by the creditor (to the extent permitted by the general rule for payments), would be considered a conforming payment.

In this regard, the Board has interpreted very broadly what constitutes "promoting a payment." For instance, "if a creditor promotes payment by telephone (for example, by including the option to pay by telephone in a menu of options provided to consumers at a toll-fee number disclosed on its periodic statement), payments made by telephone would generally be conforming payments."

RIGHT OF CARDHOLDER TO ASSERT CLAIMS OR DEFENSES AGAINST ISSUER

(Section 226.12(c))

To address uncertainty about the interaction between the allocation of payments requirement under Section 226.12(c) for disputed transactions, and the allocation of payments requirement under Section 226.53, the proposed rule would provide that with respect to a credit card account, an issuer must comply with the payment allocation rules in Section 226.53, but that for an account not subject to Section 226.53, such as a home-equity account, a creditor would continue to comply with the long-standing guidance contained in comment 226.12(c)-4.

TIMING FOR RESOLVING BILLING ERRORS

(Section 226.13(c))

Section 226.13(c) requires a creditor to conclusively determine whether an error occurred within two complete billing cycles (but in no event later than 90 days) after receiving a billing error notice. Once this period has expired, revised Regulation Z prohibits a creditor from reversing any amounts previously credited for an asserted billing error, even if the creditor subsequently obtains evidence indicating that the billing error did not occur as asserted.

To address situations where a consumer has received a credit from the issuer and subsequently receives a credit from the merchant that had honored the credit card, the proposed rule would clarify that the requirement to complete an error investigation within two billing cycles does not prevent a creditor from later reversing amounts it has previously credited to a consumer's account in circumstances where the account has been credited more than once for the same billing error. That is, the reversal of the credit would be permissible so long as the total amount of the remaining credit is equal to or more than the amount of the error, and the consumer does not incur any fees or other charges as a result of the timing of the creditor's reversal. To ensure compliance, the supplemental information accompanying the proposed rule and a commentary example explain that "a creditor should delay the reversal of the amounts the creditor has previously credited…until after the subsequent merchant credit has posted."

SCOPE OF CARD ACT PROVISIONS

(Section 226.2(a))

The scope of the CARD Act provisions is encompassed within the definition of a "credit card account under an open-end consumer credit plan." The proposed rule would clarify this definition in several ways. First, the proposed rule clarifies the circumstances under which an account number is considered a credit card; specifically, "accessed…by an account number" would be added to the definition, and proposed comment 226.2(a)(15)-2 would provide examples of credit devices that are and are not considered credit cards for purposes of the CARD Act provisions. In this regard, the proposed rule includes an example that "if a creditor provides a consumer with an open-end line of credit that can be accessed by an account number in order to transfer funds into another account (such as an asset account with the same creditor), the account number is not a credit card." However, "if the account number can also access the line of credit to purchase goods or services (such as an account number that can be used to purchase goods or services on the Internet), the account number is a credit card" under an open-end plan for purposes of Regulation Z and, therefore, would be subject to all of the CARD Act provisions. While this change could significantly impact lines of credit with retailers, it could also impact other open-end lines of credit to the extent that a consumer can use the account number to make purchases of goods or services, such as over the Internet.

In addition, to address confusion concerning the application of the CARD Act provisions to charge cards, the Board would clarify that a "credit card account under an open-end consumer credit plan" includes charge cards, except when charge cards are specifically excluded. Accordingly, for example, charge cards would be subject to the CARD Act provisions relating to the ability to pay.

TECHNICAL CLARIFICATIONS

In addition to the substantive revisions discussed above, below is a list of some of the technical revisions the Board is proposing to adopt.

- ***Disclosure of Limitations on Rate Increases (Section 226.5a and Section 226.6)***. The Board is proposing to delete as unnecessary the prohibition against disclosing any applicable limitations on rate decreases in the disclosure table on applications and solicitations.
- ***Disclosure of Limitations Based on Delinquencies or Rate Reevaluations (Section 226.5a and 226.6)***. To avoid overly technical and complex tabular disclosures, the Board is proposing to revise the commentary to clarify that an issuer must not disclose in the tabular disclosures limitations concerning the imposition of financial charges, such as the application of the partial grace requirements, or the impact of payment allocation.
- ***Balance Computation Methods***. To address compliance issues and to provide flexibility, the proposed rule would permit creditors to disclose a single balance computation method where the balance for each feature is computed using the same balance computation method.
- ***Rounding of Repayment Disclosures (Section 226.7(b)(12))***. To provide flexibility to issuers, the proposed rule would permit an issuer to choose to provide the following disclosures on the periodic statement, either rounded to the nearest whole dollar or to the nearest cent: (1) the minimum payment total cost estimate; (2) the estimated monthly

payment for repayment in 36 months; (3) the total cost estimate for repayment in 36 months; and (4) the savings estimate for repayment in 36 months.

- ***Significant Changes in Account Terms (Section 226.9(c)(2)(i) and (ii))***. As currently drafted, the triggers for providing 45 days' advance notice are not clear. That is, the definition of a significant change in Section 226.9(c)(2) is inconsistent with the references to Section 226.6(b)(3), (b)(4) and (b)(5). To clarify the advance notice requirements, the proposed rule would: (1) delete as unnecessary the section references; (2) amend the definition of a "significant change in account terms" to include variable rate disclosures, as well as other disclosures required under Section 226.6(b)(4); and (3) amend the specific disclosure requirements to require a summary of changes made to variable rate terms and other disclosures required pursuant to Section 226.6(b)(4). The proposed formatting requirements, however, would not require the variable rate disclosures or other disclosures required pursuant to Section 226.6(b)(4) or a description of any security interest taken, to be included in the tabular disclosures.

- ***Limitations on Fees Related to Method of Payment (Section 226.10(e))***. The proposed rule would clarify that a third-party service provider or another third party that collects payments that are passed on to an issuer would be prohibited from charging a separate fee for that payment, unless the issuer could impose a fee under similar circumstances. For instance, a third party would not be permitted to impose a separate fee for making a payment when a payment is made on the third party's website. The supplemental information accompanying the proposed rule states that "it would be inconsistent with the purposes of the [CARD Act] for consumers to pay a separate fee for making a payment through a third party who is receiving the payment on behalf of the issuer" where the issuer could not impose such a fee.

- ***Effect of Leap Year on the Annual Percentage Rate (Section 226.14)***. The proposed rule would clarify that a creditor need not take into account any variance in the annual percentage rate that occurs solely by reason of the addition of February 29 in a leap year. For example, the rule clarifies that a creditor may use either 365 or 366 days as the number of periods in a leap year. Moreover, the Board would clarify that if a creditor uses 366 days, a variance in rate that occurs solely because of the addition of February 29 would not trigger a change in terms notice under Section 226.9(c) or the rate or fee limitations under Section 226.55.

Contact:

Richard Fischer	**Oliver Ireland**	**Obrea Poindexter**
(202) 887-1566	(202) 778-1614	(202) 887-8741
lfischer@mofo.com	oireland@mofo.com	opoindexter@mofo.com

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