

Section 226.53 Allocation of Payments

As amended by the Credit Card Act, TILA Section 164(b)(1) provides that, “[u]pon receipt of a payment from a cardholder, the card issuer shall apply amounts in excess of the minimum payment amount first to the card balance bearing the highest rate of interest, and then to each successive balance bearing the next highest rate of interest, until the payment is exhausted.” 15 U.S.C. 1666c(b)(1). However, amended Section 164(b)(2) provides the following exception to this general rule: “A creditor shall allocate the entire amount paid by the consumer in excess of the minimum payment amount to a balance on which interest is deferred during the last 2 billing cycles immediately preceding expiration of the period during which interest is deferred.” As discussed in detail below, the Board has implemented amended TILA Section 164(b) in new § 226.53.

As an initial matter, however, the Board interprets amended TILA Section 164(b) to apply to credit card accounts under an open-end (not home-secured) consumer credit plan rather than to all open-end consumer credit plans. Although the requirements in amended TILA Section 164(a) regarding the prompt crediting of payments apply to “[p]ayments received from [a consumer] under an open end consumer credit plan,” the general payment allocation rule in amended TILA Section 164(b)(1) applies “[u]pon receipt of a payment from a cardholder.” Furthermore, the exception for deferred interest plans in amended Section 164(b)(1) requires “the card issuer [to] apply amounts in excess of the minimum payment amount first to the card balance bearing the highest rate of interest. . . .” Based on this language, it appears that Congress intended to apply the payment allocation requirements in amended Section 164(b) only to credit card accounts. This is consistent with the approach taken by the Board and the other Agencies in the

January 2009 FTC Act Rule. See 74 FR 5560. Furthermore, the Board is not aware of concerns regarding payment allocation with respect to other open-end credit products, likely because such products generally do not apply different annual percentage rates to different balances. Commenters generally supported this aspect of the proposal.

53(a) General Rule

The Board proposed to implement amended TILA Section 164(b)(1) in § 226.53(a), which stated that, except as provided in § 226.53(b), when a consumer makes a payment in excess of the required minimum periodic payment for a credit card account under an open-end (not home-secured) consumer credit plan, the card issuer must allocate the excess amount first to the balance with the highest annual percentage rate and any remaining portion to the other balances in descending order based on the applicable annual percentage rate. The Board and the other Agencies adopted a similar provision in the January 2009 FTC Act Rule in response to concerns that card issuers were applying consumers' payments in a manner that inappropriately maximized interest charges on credit card accounts with balances at different annual percentage rates. See 12 CFR 227.23, 74 FR 5512-5520, 5560. Specifically, most card issuers currently allocate consumers' payments first to the balance with the lowest annual percentage rate, resulting in the accrual of interest at higher rates on other balances (unless all balances are paid in full). Because many card issuers offer different rates for purchases, cash advances, and balance transfers, this practice can result in consumers who do not pay the balance in full each month incurring higher finance charges than they would under any other allocation method.³² Commenters generally supported § 226.53(a), which is adopted as proposed.

³² For example, assume that a credit card account charges annual percentage rates of 12% on purchases and 20% on cash advances. Assume also that, in the same billing cycle, the consumer uses the account for

The Board also proposed comment 53-1, which clarified that § 226.53 does not limit or otherwise address the card issuer's ability to determine, consistent with applicable law and regulatory guidance, the amount of the required minimum periodic payment or how that payment is allocated. It further clarified that a card issuer may, but is not required to, allocate the required minimum periodic payment consistent with the requirements in proposed § 226.53 to the extent consistent with other applicable law or regulatory guidance. The Board did not receive any significant comment on this guidance, which is adopted as proposed.

Comment 53-2 clarified that § 226.53 permits a card issuer to allocate an excess payment based on the annual percentage rates and balances on the date the preceding billing cycle ends, on the date the payment is credited to the account, or on any day in between those two dates. Because the rates and balances on an account affect how excess payments will be applied, this comment was intended to provide flexibility regarding the point in time at which payment allocation determinations required by proposed § 226.53 can be made. For example, it is possible that, in certain circumstances, the annual percentage rates may have changed between the close of a billing cycle and the date on which payment for that billing cycle is received.

Industry commenters generally supported this guidance. However, consumer groups opposed it on the grounds that card issuers could misuse the flexibility to systematically vary the dates on which payments are allocated at the account level in

purchases totaling \$3,000 and cash advances totaling \$300. If the consumer pays \$800 in excess of the required minimum periodic payment, most card issuers would apply the entire excess payment to the purchase balance and the consumer would incur interest charges on the more costly cash advance balance. Under these circumstances, the consumer is effectively prevented from paying off the balance with the higher interest rate (cash advances) unless the consumer pays the total balance (purchases and cash advances) in full.

order to generate higher interest charges. The Board agrees that such a practice would be inconsistent with the intent of comment 53-2. Accordingly, the Board has revised this comment to clarify that the day used by the card issuer to determine the applicable annual percentage rates and balances for purposes of § 226.53 generally must be consistent from billing cycle to billing cycle, although the card issuer may adjust this day from time to time.

Proposed comment 53-3 addressed the relationship between the dispute rights in § 226.12(c) and the payment allocation requirements in proposed § 226.53. This comment clarified that, when a consumer has asserted a claim or defense against the card issuer pursuant to § 226.12(c), the card issuer must apply the consumer's payment in a manner that avoids or minimizes any reduction in the amount of that claim or defense. See comment 12(c)-4. Based on comments from industry, the Board has revised the proposed comment to clarify that the same requirements apply with respect to amounts subject to billing error disputes under § 226.13. The Board has also added illustrative examples.

Proposed comment 53-4 addressed circumstances in which the same annual percentage rate applies to more than one balance on a credit card account but a different rate applies to at least one other balance on that account. For example, an account could have a \$500 cash advance balance at 20%, a \$1,000 purchase balance at 15%, and a \$2,000 balance also at 15% that was previously at a 5% promotional rate. The comment clarified that, in these circumstances, § 226.53 generally does not require that any particular method be used when allocating among the balances with the same rate and that the card issuer may treat the balances with the same rate as a single balance or

separate balances.³³ The Board did not receive any significant comment on this aspect of the guidance, which is adopted as proposed.

However, proposed comment 53-4 also clarified that, when a balance on a credit card account is subject to a deferred interest or similar program that provides that a consumer will not be obligated to pay interest that accrues on the balance if the balance is paid in full prior to the expiration of a specified period of time, that balance must be treated as a balance with an annual percentage rate of zero for purposes of § 226.53 during that period of time rather than a balance with the rate at which interest accrues (the accrual rate).³⁴ In the proposal, the Board noted that treating the rate as zero is consistent with the nature of deferred interest and similar programs insofar as the consumer will not be obligated to pay any accrued interest if the balance is paid in full prior to expiration. The Board further noted that this approach ensures that excess payments will generally be applied first to balances on which interest is being charged, which will generally result in lower interest charges if the consumer pays the balance in full prior to expiration.

However, the Board also acknowledged that treating the rate on this type of balance as zero could be disadvantageous for consumers in certain circumstances. Specifically, the Board noted that, if the rate for a deferred interest balance is treated as zero during the deferred interest period, consumers who wish to pay off that balance in installments over the course of the program would be prevented from doing so.

³³ An example of how excess payments could be applied in these circumstances is provided in comment 53-5.iv.

³⁴ For example, if an account has a \$1,000 purchase balance and a \$2,000 balance that is subject to a deferred interest program that expires on July 1 and a 15% annual percentage rate applies to both, the balances must be treated as balances with different rates for purposes of § 226.53 until July 1. In addition, for purposes of allocating pursuant to § 226.53, any amount paid by the consumer in excess of the required minimum periodic payment must be applied first to the \$1,000 purchase balance except during the last two billing cycles of the deferred interest period (when it must be applied first to any remaining portion of the \$2,000 balance). See comment 53-5.v.

In response to the proposal, the Board received a number of comments from industry and consumer groups raising concerns about prohibiting consumers from paying off a deferred interest or similar balance in monthly installments. Accordingly, as discussed below, the Board has revised § 226.53(b) to address those concerns.

Finally, proposed comment 53(a)-1 provided examples of allocating excess payments consistent with proposed § 226.53. The Board has redesignated this comment as 53-5 for organizational purposes and revised the examples for consistency with the revisions to § 226.53(b).³⁵

53(b) Special Rule for Accounts With Balances Subject to Deferred Interest or Similar Programs

The Board proposed to implement amended TILA Section 164(b)(2) in § 226.53(b), which provided that, when a balance on a credit card account under an open-end (not home-secured) consumer credit plan is subject to a deferred interest or similar program, the card issuer must allocate any amount paid by the consumer in excess of the required minimum periodic payment first to that balance during the two billing cycles immediately preceding expiration of the deferred interest period and any remaining portion to any other balances consistent with proposed § 226.53(a). See 15 U.S.C. 1666c(b)(2).

The Board and the other Agencies proposed a similar exception to the January 2009 FTC Act Rule's payment allocation provision in the May 2009 proposed clarifications and amendments. See proposed 12 CFR 227.23(b), 74 FR 20814. This

³⁵ The commentary discussed above is similar to commentary adopted by the Board and the other Agencies in the January 2009 FTC Act Rule as well as to amendments to that commentary proposed in May 2009. See 74 FR 5561-5562; 74 FR 20815-20816.

exception was based on the Agencies' concern that, if the deferred interest balance was not the only balance on the account, the general payment allocation rule could prevent consumers from paying off the deferred interest balance prior to expiration of the deferred interest period unless they also paid off all other balances on the account.³⁶ If the consumer is unaware of the need to pay off the entire balance, the consumer would be charged interest on the deferred interest balance and thus would not obtain the benefits of the deferred interest program. See 74 FR 20807-20808.

As noted above, comments from industry and consumer groups raised concerns that the proposed rule would prohibit consumers who may lack the resources to pay off a deferred interest balance in one of the last two billing cycles of the deferred interest period from paying that balance off in monthly installments over the course of the period. These commenters generally urged the Board to permit card issuers to allocate payments consistent with a consumer's request when an account has a deferred interest or similar balance.

Because the consumer testing conducted by the Board for the January 2009 Regulation Z Rule indicated that disclosures do not enable consumers to understand sufficiently the effects of payment allocation on interest charges, the Board is concerned that permitting card issuers to allocate payments based on a consumer's request could create a loophole that would undermine the purposes of revised TILA Section 164(b). For example, consumers who do not understand the effects of payment allocation could

³⁶ For example, assume that a credit card account has a \$2,000 purchase balance with a 20% annual percentage rate and a \$1,000 balance on which interest accrues at a 15% annual percentage rate, but the consumer will not be obligated to pay that interest if that balance is paid in full by a specified date. If the general rule in § 226.53(a) applied, the consumer would be required to pay \$3,000 in order to avoid interest charges on the \$1,000 balance.

be misled into selecting an allocation method that will generally result in higher interest charges than applying payments first to the balance with the highest rate (such as a method under which payments are applied first to the oldest unpaid transactions on the account). For this reason, the Board does not believe that a general exception to § 226.53(a) based on a consumer's request is warranted.

However, in the narrow context of accounts with balances subject to deferred interest or similar programs, the Board is persuaded that the benefits of providing flexibility for consumers who are able to avoid deferred interest charges by paying off a deferred interest balance in installments over the course of the deferred interest period outweigh the risk that some consumers could make choices that result in higher interest charges than would occur under the proposed rule.

Accordingly, pursuant to its authority under TILA § 105(a) to make adjustments and exceptions in order to effectuate the purposes of TILA, the Board has revised proposed § 226.53(b) to permit card issuers to allocate payments in excess of the minimum consistent with a consumer's request when the account has a balance subject to a deferred interest or similar program.³⁷ Specifically, § 226.52(b)(1) provides that, when a balance on a credit card account under an open-end (not home-secured) consumer credit plan is subject to a deferred interest or similar program, the card issuer must allocate any amount paid by the consumer in excess of the required minimum periodic payment

³⁷ Although consumer group commenters urged the Board to require (rather than permit) card issuers to allocate consistent with a consumer's request, the Board understands that – while some card issuers currently have the systems in place to accommodate such requests – many do not. The Board further understands that card issuers without the ability to allocate payments based on a consumer request could not develop the systems to do so prior to February 22, 2010. Although these issuers could presumably develop the necessary systems by some later date, the Board believes that the difficulties associated with making informed decisions regarding payment allocation are such that a requirement that all issuers develop the systems to accommodate consumer requests is not warranted. Instead, the Board has revised § 226.53(b) to ensure that card issuers that currently accommodate consumer requests can continue to do so.

consistent with § 226.53(a) except that, during the two billing cycles immediately preceding expiration of the specified period, the excess amount must be allocated first to the balance subject to the deferred interest or similar program and any remaining portion allocated to any other balances consistent with § 226.53(a). In the alternative, § 226.53(b)(2) provides that the card issuer may at its option allocate any amount paid by the consumer in excess of the required minimum periodic payment among the balances on the account in the manner requested by the consumer.

The Board has revised the proposed commentary to § 226.53(b) for consistency with the amendments to § 226.53(b) and for organizational purposes. As an initial matter, the Board has redesignated proposed comment 53(b)-2 as comment 53(b)-1. Proposed comment 53(b)-2 clarified that § 226.53(b) applies to deferred interest or similar programs under which the consumer is not obligated to pay interest that accrues on a balance if that balance is paid in full prior to the expiration of a specified period of time. The proposed comment further clarified that a grace period during which any credit extended may be repaid without incurring a finance charge due to a periodic interest rate is not a deferred interest or similar program for purposes of § 226.53(b).³⁸ In response to requests for guidance from commenters, the Board has revised this comment to clarify that § 226.53(b) applies regardless of whether the consumer is required to make payments with respect to the balance subject to the deferred interest or similar program during the specified period. In addition, the Board has revised the comment to clarify that a temporary annual percentage rate of zero percent that applies for a specified period of time consistent with § 226.55(b)(1) is not a deferred interest or similar program for

³⁸ The Board and the other Agencies proposed a similar comment in May 2009. See 12 CFR 227.23 proposed comment 23(b)-1, 74 FR 20816.

purposes of § 226.53(b) unless the consumer may be obligated to pay interest that accrues during the period if a balance is not paid in full prior to expiration of the period. Finally, in order to ensure consistent treatment of deferred interest programs in Regulation Z, the Board has clarified that, for purposes of § 226.53, “deferred interest” has the same meaning as in § 226.16(h)(2) and associated commentary.

For organizational purposes, the Board has redesignated proposed comment 53(b)-1 as comment 53(b)-2. Proposed comment 53(b)-1 clarified the application of § 226.53(b) in circumstances where the deferred interest or similar program expires during a billing cycle (rather than at the end of a billing cycle). The comment clarified that, for purposes of § 226.53(b), a billing cycle does not constitute one of the two billing cycles immediately preceding expiration of a deferred interest or similar program if the expiration date for the program precedes the payment due date in that billing cycle. An example is provided. The Board believes that this interpretation is consistent with the purpose of amended TILA Section 164(b)(2) insofar as it ensures that, at a minimum, the consumer will receive two complete billing cycles to avoid accrued interest charges by paying off a balance subject to a deferred interest or similar program. The Board did not receive any significant comment on this guidance, which has been revised for consistency with the revisions to § 226.53(b).

The Board has also adopted a new comment 53(b)-3 in order to clarify that § 226.53(b) does not require a card issuer to allocate amounts paid by the consumer in excess of the required minimum periodic payment in the manner requested by the consumer, provided that the card issuer instead allocates such amounts consistent with § 226.53(b)(1). For example, a card issuer may decline consumer requests regarding

payment allocation as a general matter or may decline such requests when a consumer does not comply with requirements set by the card issuer (such as submitting the request in writing or submitting the request prior to or contemporaneously with submission of the payment), provided that amounts paid by the consumer in excess of the required minimum periodic payment are allocated consistent with § 226.53(b)(1). Similarly, a card issuer that accepts requests pursuant to § 226.53(b)(2) generally must allocate amounts paid by a consumer in excess of the required minimum periodic payment consistent with § 226.53(b)(1) if the consumer does not submit a request or submits a request with which the card issuer cannot comply (such as a request that contains a mathematical error).

Comment 53(b)-3 also provides illustrative examples of what does and does not constitute a consumer request for purposes of § 226.53(b)(2). In particular, the comment clarifies that a consumer has made a request for purposes of § 226.53(b)(2) if the consumer contacts the card issuer and specifically requests that a payment or payments be allocated in a particular manner during the period of time that the deferred interest or similar program applies to a balance on the account. Similarly, a consumer has made a request for purposes of § 226.53(b)(2) if the consumer completes a form or payment coupon provided by the card issuer for the purpose of requesting that a payment or payments be allocated in a particular manner and submits that form to the card issuer. Finally, a consumer has made a request for purposes of § 226.53(b)(2) if the consumer contacts a card issuer and specifically requests that a payment that the card issuer has previously allocated consistent with § 226.53(b)(1) instead be allocated in a different manner.

In contrast, the comment clarifies that a consumer has not made a request for purposes of § 226.53(b)(2) if the terms and conditions of the account agreement contain preprinted language stating that by applying to open an account or by using that account for transactions subject to a deferred interest or similar program the consumer requests that payments be allocated in a particular manner. Similarly, a consumer has not made a request for purposes of § 226.53(b)(2) if the card issuer's on-line application contains a preselected check box indicating that the consumer requests that payments be allocated in a particular manner and the consumer does not deselect the box.³⁹

In addition, a consumer has not made a request for purposes of § 226.53(b)(2) if the payment coupon provided by the card issuer contains preprinted language or a preselected check box stating that by submitting a payment the consumer requests that the payment be allocated in a particular manner. Furthermore, a consumer has not made a request for purposes of § 226.53(b)(2) if the card issuer requires a consumer to accept a particular payment allocation method as a condition of using a deferred interest or similar program, making a payment, or receiving account services or features.

~~**Section 226.54 – Limitations on the Imposition of Finance Charges**~~

~~The Credit Card Act creates a new TILA Section 127(j), which applies when a consumer loses any time period provided by the creditor with respect to a credit card account within which the consumer may repay any portion of the credit extended without incurring a finance charge (i.e., a grace period). 15 U.S.C. 1637(j). In these circumstances, new TILA Section 127(j)(1)(A) prohibits the creditor from imposing a finance charge with respect to any balances for days in billing cycles that precede the~~

³⁹ These examples are similar to examples adopted by the Board with respect to the affiliate marketing provisions of the Fair Credit Reporting Act. See 12 CFR 222.21(d)(4)(iii) and (iv).