

Board of Governors of the Federal Reserve System

Official Staff Commentary on Regulation Z Truth in Lending

12 CFR 226, supplement I; as amended effective April 9, 2002



12(d) Offsets by Card Issuer Prohibited

Paragraph 12(d)(1)

1. *"Holds" on accounts.* "Freezing" or placing a hold on funds in the cardholder's deposit account is the functional equivalent of an offset and would contravene the prohibition in section 226.12(d)(1), unless done in the context of one of the exceptions specified in section 226.12(d)(2). For example, if the terms of a security agreement permitted the card issuer to place a hold on the funds, the hold would not violate the offset prohibition. Similarly, if an order of a bankruptcy court required the card issuer to turn over deposit account funds to the trustee in bankruptcy, the issuer would not violate the regulation by placing a hold on the funds in order to comply with the court order.

2. *Funds intended as deposits.* If the consumer tenders funds as a deposit (to a checking account, for example), the card issuer may not apply the funds to repay indebtedness on the consumer's credit card account.

3. *Types of indebtedness; overdraft accounts.* The offset prohibition applies to any indebtedness arising from transactions under a credit card plan, including accrued finance charges and other charges on the account. The prohibition also applies to balances arising from transactions not using the credit card itself but taking place under plans that involve credit cards. For example, if the consumer writes a check that accesses an overdraft line of credit, the resulting indebtedness is subject to the offset prohibition since it is incurred through a credit card plan, even though the consumer did not use an associated check guarantee or debit card.

4. *When prohibition applies in case of termination of account.* The offset prohibition applies even after the card issuer terminates the cardholder's credit card privileges, if the indebtedness was incurred prior to termination. If the indebtedness was incurred after termination, the prohibition does not apply.

Paragraph 12(d)(2)

Security interest—limitations. In order to

qualify for the exception stated in section 226.12(d)(2), a security interest must be affirmatively agreed to by the consumer and must be disclosed in the issuer's initial disclosures under section 226.6. The security interest must not be the functional equivalent of a right of offset; as a result, routinely including in agreements contract language indicating that consumers are giving a security interest in any deposit accounts maintained with the issuer does not result in a security interest that falls within the exception in section 226.12(d)(2). For a security interest to qualify for the exception under section 226.12(d)(2) the following conditions must be met:

- The consumer must be aware that granting a security interest is a condition for the credit card account (or for more favorable account terms) and must specifically intend to grant a security interest in a deposit account. Indicia of the consumer's awareness and intent could include, for example:
 - Separate signature or initials on the agreement indicating that a security interest is being given.
 - Placement of the security agreement on a separate page, or otherwise separating the security interest provisions from other contract and disclosure provisions.
 - Reference to a specific amount of deposited funds or to a specific deposit account number.

The security interest must be obtainable and enforceable by creditors generally. If other creditors could not obtain a security interest in the consumer's deposit accounts to the same extent as the card issuer, the security interest is prohibited by section 226.12(d)(2).

2. *Security interest—after-acquired property.* As used in section 226.12(d), the term "security interest" does not exclude (as it does for other Regulation Z purposes) interests in after-acquired property. Thus, a consensual security interest in deposit-account funds, including funds deposited after the granting of the security interest, would constitute a permissible exception to the prohibition on offsets.

3. *Court order.* If the card issuer obtains a judgment against the cardholder, and if state

and other applicable law and the terms of the judgment do not so prohibit, the card issuer may offset the indebtedness against the cardholder's deposit account.

Paragraph 12(d)(3)

1. *Automatic payment plans—scope of exception.* With regard to automatic debit plans under section 226.12(d)(3), the following rules apply:

- The cardholder's authorization must be in writing and signed or initialed by the cardholder.
- The authorizing language need not appear directly above or next to the cardholder's signature or initials, provided it appears on the same document and that it clearly spells out the terms of the automatic debit plan.
- If the cardholder has the option to accept or reject the automatic debit feature (such option may be required under section 913 of the Electronic Fund Transfer Act), the fact that the option exists should be clearly indicated.

2. *Automatic payment plans—additional exceptions.* The following practices are not prohibited by section 226.12(d)(1):

Automatically deducting charges for participation in a program of banking services (one aspect of which may be a credit card plan)

Debiting the cardholder's deposit account on the cardholder's *specific* request rather than on an *automatic* periodic basis (for example, a cardholder might check a box on the credit card bill stub, requesting the issuer to debit the cardholder's account to pay that bill)

12(e) Prompt Notification of Returns and Crediting of Refunds

Paragraph 12(e)(1)

1. *Normal channels.* The term "normal channel" refers to any network or interchange system used for the processing of the original

charge slips (or equivalent information concerning the transactions).

Paragraph 12(e)(2)

1. *Crediting account.* The card issuer need not actually post the refund to the consumer's account within three business days after receiving the credit statement, provided that it credits the account as of a date within that time period.

References

Statute: §§ 103(1), 132, 133, 135, 162, 166, 167, 169, and 170

Other sections: § 226.13

Other regulations: Regulation E (12 CFR 205)

Previous regulation: § 226.13

1981 changes: The issuance rules in section 226.12(a) make clear that cards may be sent to the person making the request and also to any other person for whom a card is requested, except that no liability for unauthorized use may be imposed on persons who are only authorized users.

The principal differences in section 226.12(b) about conditions of liability are as follows: the requirement that the cardholder be given a postage-paid, preaddressed card or envelope for notification of loss or theft has been deleted (corresponding to an amendment to the act); the required disclosures of maximum liability and of means of notification have been simplified; and the required provision of a means of identification has been changed in that the issuer now may provide a means to identify either the cardholder or the authorized user. Finally, anyone may provide the notification to the card issuer, not just the cardholder.

Section 226.12(d) on offsets clarifies that the offset prohibition does not apply to consensual security interests. The separate promptness standard which used to apply in addition to the seven-business-day and three-business-day standards has been deleted from section 226.12(e) on prompt notification of returns. Section 226.12(f) now clarifies rules on clearing accounts.

Section 226.12(g), dealing with the relationship of the regulation to Regulation E (Electronic Fund Transfers), has been added.