



Summary of Federal Reserve Board's Proposed Rule Unfair and Deceptive Credit Card Practices

On May 2, 2008 the Federal Reserve Board, the Office of Thrift Supervision and the National Credit Union Administration issued a joint proposed rule (Regulation AA) that would define certain practices in credit cards and in overdraft loan programs as unfair or deceptive.¹

The proposed rule, if adopted, would protect consumers from certain unexpected increases in the interest rate charged on pre-existing credit card balances, forbid credit card companies from imposing interest charges using the "two-cycle" billing method, require that consumers receive a reasonable amount of time to make their credit card payments, and prohibit the use of payment allocation methods that unfairly maximize interest charges and deprive the consumer the benefit of promotional interest rates.

The rule proposes seven key provisions regarding credit card company practices.

Restricts increases in APR

The proposed rule prohibits credit card companies from applying an increased APR to an outstanding balance except in three circumstances. The prohibition does not apply to: 1) variable rate cards, 2) when a promotional rate is lost or expires, or 3) if the minimum payment is not received within 30 days after the due date. If a consumer loses the promotional rate, the proposed rule would limit increases in the interest rate only to a regular rate, not a higher penalty rate.

Also, the proposed rule would require that when a credit card company raises the rate on a category of transactions for everyone holding the card, it must give people who owe money in that category either five years to pay off the balance at the old rate or an increased minimum payment that has no more than twice as much going to the principal as the old minimum payment.

Time to make a payment

Under the proposal, credit card companies would be prohibited from treating a payment as late unless consumers have been provided a reasonable amount of time to make the payment. If a bill is mailed or delivered at least 21 days before the due date, it would be considered reasonable.

If a credit card company offers a grace period, the current law requires that it mail a bill at least 14 days before the due date so that the consumer has enough time to take advantage of the free time. The proposal explicitly exempts grace periods from the new 21 day rule. Therefore the 14 day rule will still apply when determining whether a consumer has lost the grace period.

Payment allocation

Credit card companies would be required to more fairly apply the payments that cardholders make to balances with different interest rates under the proposed rule. Payments made in

¹ Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28903 (proposed May 19, 2008) (to be codified at 12 C.F.R. pt. 227) at <http://www.ots.treas.gov/docs/7/73419.pdf>.

excess to the minimum payment will have to be allocated in a manner that is no less beneficial to the consumer than one of the following methods: 1) apply the entire amount to the balance with the highest APR, 2) split the payment equally among the balances, or 3) split the payment proportionally among the balances.

Credit card companies would also be prohibited from denying consumers a grace period on purchases solely because they have not paid off a balance at a promotional rate.

Overlimit fees

Credit card companies would be prohibited from assessing a fee if a consumer exceeds the credit limit on an account solely due to a hold placed on the available credit.

Two-cycle billing

Under the proposed rule, a credit card company could no longer reach back to an earlier billing cycle when calculating the amount of interest charged in the current cycle.

Security deposits and issuance fees

The proposal restricts credit card companies from financing fees and charges for opening a credit card where the fees and charges total more than half the credit limit. This part of the rule should go further. The rule should say that it is unfair to offer a credit card where the fees to open the account are more than 10% to 25% of the credit limit, whether or not those fees are financed.

Advertising disclosure for firm offers of credit

The proposal requires a new disclosure on advertisements of credit with multiple APR's or credit limits.

The rule also proposes two provisions related to overdraft loan programs in connection with consumer deposit accounts.

It is common practice for banks to automatically enroll customers in overdraft loan programs even when the customer does not request this expensive form of credit. These services result in fees (which average \$34 per transaction) when the bank covers a transaction that overdraws an account. Banks claim that these "services" benefit consumers but in reality overdraft programs are small loans with abusive terms that cost consumers almost \$18 billion per year for approximately \$16 billion in loans.²

Opt out of overdraft loan programs

The proposed rule would create an opt-out right for overdraft loan programs. It would require banks to provide consumers with notice and an opportunity to opt out of the payment of overdrafts, once before an overdraft fee or charge is assessed and again during any statement period in which an overdraft fee is assessed.

Consumer advocates believe this does not go far enough because it does not require an opt-in, particularly for debit card transactions. Though the proposed rule acknowledges that overdraft

² Leslie Parrish and Peter Smith, *Billion Dollar Deal*, Center for Responsible Lending, Sept. 24, 2007, at <http://www.responsiblelending.org/pdfs/billion-dollar-deal.pdf>.

loan programs can be unfair and deceptive, it fails significantly by requiring consumers to opt out, rather than having them affirmatively opt in to these high cost programs.

Debit holds

The proposal will prohibit banks from assessing an overdraft fee when the overdraft would not have occurred but for a debit hold placed on funds in the account that exceeds the actual purchase amount.

This provision is a positive step towards curbing an unfair practice, but it does not go far enough. The rule ignores the issue of overdraft fees and bounced check (NSF) fees caused by a check hold rather than by a debit hold. A check hold is a delay in the use of deposited funds. Consumers whose banks choose to impose long check hold times may still get stuck with overdraft fees or bounced check fees due to this practice. The rule should be strengthened to recognize that it is an unfair practice for a bank to charge an overdraft fee or bounced check fee for a problem caused by the bank's decision to place a hold on the consumer's check deposit.

There is more for banking regulators to do to curb unfair practices that are not included in the proposed rules.

Missing items related to unfair credit card practices:

- Limits need to be placed on how high credit card companies can make “penalty” interest rates and how long they are permitted to keep consumers at these often extremely high interest rates.
- Fees to pay a credit card by phone or internet should be prohibited.
- Credit card companies should not be able to raise interest rates and change the terms of a credit card for *future* purchases at “any time for any reason.”
- Young adults need protection from abusive credit card practices, on and off college campuses.
- No more than one overlimit fee should be permitted during a single billing cycle.
- Companies should be prohibited from offering credit cards where the fees to open the account are more than 10% to 25% of the credit limit.
- Consumers who have been prescreened should only receive advertisements for interest rates and credit limits for which the consumer is likely to qualify.

Missing items related to unfair deposit account practices:

- Banks should not be able to charge overdraft fees or bounced check fees when the overdraft would not have occurred but for a hold placed on deposited funds.
- Banks should be required to deny a debit card transaction, rather than trigger an overdraft loan fee, if the account contains insufficient funds to cover the transaction.
- The proposed rule only requires that banks provide an opportunity for consumers to opt out of overdraft loan programs. There should be a provision requiring consumers to affirmatively opt in to these programs.