

**Unfinished Business:
Consumers Need More Protection From
Unfair Credit Card Practices**

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**Consumers
Union**

Introduction and Summary

U. S. consumers owe over \$900 billion in credit card debt¹ and the burden of paying for this debt has increased over the past twenty years.² Unfair credit card lending practices have contributed to these record levels of debt. These practices include: increases in the interest rate after the money is borrowed; over limit fees caused when a fee or hold placed by the issuer pushes the account over limit; and abrupt reductions in credit limits that damage consumers' credit scores. Three federal regulatory agencies have finally declared some credit card practices unfair, but more remains to be done.

In the face of mounting evidence that a “disclosure only” approach simply was not effective to protect consumers,³ the Federal Reserve Board, Office of Thrift Supervision and the National Credit Union Administration decided for the first time to exercise their power under the Federal Trade Commission Act to prescribe regulations to end certain unfair or deceptive credit card practices. In May of 2008 these three federal banking regulators released a proposed rule to stop certain credit card practices and the public responded with an unprecedented 66,000 comments submitted to the agencies.

In December 2008, the Agencies released the Final Rule. The rule, which is described in the Appendix, is an important first step in curbing some of the most outrageous tricks and traps used by credit card issuers. **But there is a great deal of unfinished business left to do before consumers are adequately protected in the credit card marketplace.** In addition, the rule leaves consumers unprotected until July 1, 2010.

This report uses examples from consumer comments, submitted to the Federal Reserve, to describe some of the current practices by credit card issuers that unfairly burden consumers and remain unaddressed by the new rule. Consumers Union identified these practices we call “unfinished business” primarily by reviewing thousands of the comments individuals submitted to the Federal Reserve Board.

¹ FEDERAL RESERVE BOARD, G.19 RELEASE – CONSUMER CREDIT 1 (2008), *available at* <http://www.federalreserve.gov/releases/g19/Current/>.

² The Center for American Progress found that a larger share of families (46.2 percent) than ever before carried credit card balances, up from 39.6 percent in 1989. CHRISTIAN E. WELLER, CENTER FOR AMERICAN PROGRESS, PUSHING THE LIMIT: CREDIT CARD DEBT BURDENS AMERICAN FAMILIES 1 (2006), *available at* http://www.americanprogress.org/kf/creditcarddebtreport_pdf.pdf. The average credit card debt of a low- and middle-income indebted household in America in 2005 was \$8,650. TAMARA DRAUT ET. AL., DEMOS & CENTER FOR RESPONSIBLE LENDING, THE PLASTIC SAFETY NET: THE REALITY BEHIND DEBT IN AMERICA (2005), *available at* http://www.demos.org/pubs/PSN_low.pdf.

³ In 2006, the Government Accountability Office (GAO) found that current “disclosures have serious weaknesses that likely reduced consumers’ ability to understand the costs of using credit cards,” because they were too complicated for many consumers to understand. GOVERNMENT ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 6 (2006), *available at* <http://www.gao.gov/new.items/d06929.pdf>. The Federal Reserve Board then did extensive testing to determine how to improve the content and format of disclosures, but the testing “identified the limitations of disclosure, in certain circumstances, as a means of enabling consumers to make decisions effectively.” Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28,904, 28,905 (proposed May 16, 2008) (to be codified at 12 C.F.R. pt. 227, 12 C.F.R. pt. 535, 12 C.F.R. pt. 706).

Unfinished Business

Credit Card Problems Not Resolved by the Final Rule

Tens of thousands of consumers submitted comments to the Federal Reserve Board and told the agency about a host of credit card troubles they face. Although Consumers Union applauds the credit card reforms in the December 2008 Final Rule, the comments from individual consumers show the need for continued work by the agencies and Congress to protect consumers from other harmful credit card practices.⁴

The unfinished business for consumer protection in credit cards includes:

- The size and duration of penalty interest rates
- Fees for paying over the phone or on the Internet
- Abrupt reductions in credit limits
- Prescreened offers describing interest rates for which the consumer is not likely to qualify
- Over limit fees caused by approved purchases, credit holds and finance charges
- High fees
- Issuing credit cards to young people without adequate income

In addition, the long delay in the effective date on the new rule, until July 1, 2010, poses a serious risk to consumers.

⁴ During the comment period for the proposed rule, the Consumers Union website provided information about the proposed rule and a portal for consumers to submit their comments directly to the Federal Reserve Board from the site. For this report we reviewed more than 2,000 of these comments.

The size and duration of penalty interest rates:

The unrestricted size and duration of penalty interest rates is an enduring problem for consumers. The Federal Reserve noted in the proposed rule that “penalty rates can be more than twice as much as the consumer’s normal rate...and may apply to all of the balances on the consumer’s account for several months or longer.”⁵

The Final Rule takes one important step to address this issue by restricting rate increases, except in certain circumstances (see Appendix). But consumers whose payment is not received within 30 days after the due date will still be subject to penalty rates. Once a penalty rate increase is triggered, there is no limit on how high it can be or how long it can last. The amount and duration of the penalty rate is unrestricted by law and is determined by the card issuer. Many consumers asked the Fed, in their public comments, to address the size and duration of penalty interest rates and reported that high and enduring penalty rates keep them in debt. Even when consumers pay their bill on time for six months or longer, the interest rate may not return to the pre-penalty rate.

Here is what two consumers told the Fed about this problem.

PierAngeli from Maryland

Last year, in error I paid 2.00 less than my minimum payment on my Bank of America platinum visa. As a result, Bank of America charged me a default interest rate of 22.8%. I endured this penalty rate for 6 months. I had never made a late payment on my credit card. I find that while I understand that credit card companies are entitled to make a profit, I find that they are not entitled to put Americans in what I consider indentured servitude for their debt. I feel that credit card companies should be held to some level of financial accountability regarding their business practices. This goes right to the heart of their financial and social responsibility. Please pass this proposal ASAP.

Steve from Pennsylvania

...I found my modest interest rate jacked up to a whopping 32% for 1 late payment. This was during a period when I had heavily used the credit and had the card(s) maxed out. It was previously a modest 9.8% prior to a missed payment. Now I continue to pay the penalty rate even though on-time payments have been occurring for over a year...

CU Recommends:

Lawmakers and policymakers should expressly restrict the amount of time that a penalty rate may remain in effect, so that consumers can earn their way out of penalty rates. In addition, lawmakers and policymakers should expressly restrict the amount by which a penalty rate can exceed the rate in effect before the penalty rate began, to reduce excessive interest hikes, which can create an unsustainable debt burden on family budgets.

⁵ Unfair or Deceptive Acts or Practices, 73 Fed. Reg. at 28,917.

Fees for paying over the phone or on the Internet:

By requiring issuers to mail statements at least 21 days prior to the due date, the Rule takes one step to ensure that consumers have time to make a payment and don't incur unjustified late fees. But the rule does not address the practice of charging as much as \$10-\$15 to consumers who pay their bills over the phone or for a same day payment on the Internet. Consumers may call in to pay by phone, or schedule an internet payment on the due date, in order to be sure that they pay on time, and to avoid penalties for paying late.

Here is what two consumers told the Fed about this problem.

Alma from North Carolina

We always pay in full but if we are away on vacation for a full week (Friday to Sunday night), we return to a bill that is due the next day. To "pay over the phone", we pay a fee larger than the finance charge would be, to protect our credit. This makes no sense. Please protect the people and stand up to the credit card companies. We, the people, are sick of bad government!

Judy from Montana

...Stop charging a fee for pay by phone and not allow you to pay it, but it automatically goes on the credit card balance. If you speak to a representative about this it doubles the cost (used a service) and they just say this is the way it is.

CU Recommends:

Lawmakers should outlaw fees to make a payment, including by phone or Internet.

Abrupt reductions in credit limits:

In recent months credit card issuers have been lowering credit limits on consumer credit card accounts. Many consumers have reported to Consumers Union that their limits have been lowered to the level of their existing balances, despite impeccable payment histories and strong credit scores. This practice is especially damaging because it can result in lower credit scores for consumers. That's because credit scores are determined in part by a consumer's credit utilization ratio, which measures debt as a percentage of the total credit line. For example, if a consumer has a \$14,600 balance and a \$50,000 credit limit, that is a utilization ratio of 29.2%. If that credit limit is cut to the \$14,600, the existing balance, the utilization ratio shoots up to 100%. This can have a damaging effect on the credit score at a time when credit scores have become increasingly important in the tight economy.

Realistic credit limits, based on sound underwriting, are an overall social good. But the dramatic reductions in credit limits taking place in recent months suggest that credit card issuers did a poor job of setting credit limits and are now engaged in post-hoc underwriting decisions to reduce those limits. Consumers and credit card issuers will both benefit if credit card issuers are required to do a better job of underwriting up front, when issuing cards and setting credit limits. Making up for a lack of adequate underwriting through sudden decreases in the credit limit is an unfair way to mitigate risk.

Here is what one consumer told the Fed about this problem

Jolene from Louisiana

I use credit cards only for annual 1 week vacations, or for household emergencies; i.e. new water well, new washer, roof leak, repair termite damage, etc. One company increased my rate from 7.9 to 29% because another card was "close" to limit; then another company lowered my credit limit, so then I was close to the max, so another card increased my rate to 25%. I pay more than the minimum payment and always on time. Is this fair?

CU Recommends:

Lawmakers and policymakers should require credit card issuers to underwrite before issuing credit cards and setting credit limits, and prohibit credit card issuers from imposing any adverse consequence on a cardholder as a result of the issuer's decision to reduce a credit limit.

Prescreened offers describing interest rates for which the consumer is not likely to qualify:

Consumers often receive “prescreened” offers for interest rates and credit limits with a lower rate and a higher limit than what the consumer is given when later opening an account. The proposed rule contained a vague disclosure, but the new rule omits any coverage of that topic.

A consumer who is offered one rate or a range of rates, and receives a card at the high end of that range can’t simply say “no thanks” and start the process over with another card company, because multiple credit requests can depress the credit score.

Here is what two consumers told the Fed about this problem.

Martin from New York

I receive "offers" from credit card companies and banks every single day despite formal phone and written requests to stop. I am offered lines of credit of \$50,000 - \$300,000. I am offered credit cards and teasers of every conceivable kind. I am offered rates that are lower than the going rate, but when I enquire I find that I “don't qualify” and the rate would be not 7% or 9% but 17 or 19%, even though I have never been late, have a sizeable net worth and stable income...

Christopher from Maryland

As Americans, we rely heavily on credit cards to conduct our business efficiently. Please enact your proposed rules to put a stop to the unfair and extremely confusing practices of most credit card companies....Also very important, we should not have our credit scores lowered simply by applying for new credit cards, especially because we don't know exactly how much credit we will be offered until after we apply and thus can't make a fully informed decision as to whether we want a certain credit card until we have completed the application process. To put it another way, we should never be penalized in any way for obtaining complete information as to what is being offered prior to making a decision whether to accept the offer.

CU Recommends:

Lawmakers and policymakers should require that firm offers of credit for new credit cards describe only interest rates and credit limits for which a person would in fact qualify if the person meets the prescreening criteria used by the credit card issuer to send that offer.

Over limit fees caused by approved purchases, credit holds, and finance charges:

Consumers have reported that they incur over limit fees on charges that were approved by the credit card issuer through an authorization process at the time the charge was made. Consumers told the Fed in their comments that they would rather have credit card issuers deny their transactions rather than use them as opportunities to levy additional fees on their accounts.

Consumers have also reported that there are times when a fee, finance charge, or credit hold puts the account over the credit limit and results in over limit fees. It is the issuer's own fee, not the consumer's credit transactions, which causes the account to go over the limit. In certain circumstances the fee trigger is a penalty fee, such as a late payment fee. In those cases, the issuer is effectively penalizing the consumer twice for one incident. A neutral fee, such as annual service fee, maintenance fee or finance charge can also push an account over the limit.

Here is what three consumers told the Fed about this problem.

Carol from California

Federal Reserve Board: It is important to include in your new rules, a prohibition on credit card companies charging interest on over limit fees and other penalties. Vice versa, I have also experienced credit card companies charging late fees and then using that late fee to put you over your limit and create another fee. This puts credit card holders who are anywhere near their limits in a constant cycle of extra fees every month and added interest every month...

Kevin from Virginia

...If the charge would possibly cause an over limit transaction, just reject the transaction or possibly increase the credit limit and save the person money. To slam everybody with these excessive fees - as has now become the most major part of bank income profits - must be ended.

Benjamin in Virginia

... I find overlimit fee rules to be frequently abusive. First of all, as a consumer, I would like to be able to require my credit card grantor to refuse any inadvertant overlimit point of sale transactions. Secondly, if an overlimit fee is chargable, it should apply only once in a billing cycle. And thirdly, if an account was under-limit, it should not be allowable for a overlimit fee to be triggered solely by interest, late penalties, or such fees in the absence of any purchases. This could easily happen for example in the event of a lost statement or payment.

CU recommends:

Lawmakers and policymakers should prohibit credit card issuers from assessing over limit fees when the issuer approved the transaction that causes the account to go over the credit limit, and also when it was the issuer's fee, finance charge, or credit hold that puts the account over the limit.

High Fees:

The Final Rule does not go far enough to address the size of credit card fees. Consumers are charged substantial fees for late payments, balance transfers, or simply opening some types of new credit card accounts. The fees don't seem to be tied to the actual cost to the issuer of providing a particular service. Consumers have reported that they typically incur \$39 late fees for being one day late or for accidentally paying the wrong amount.

Here is what two consumers told the Fed about this problem.

Pilar from Guam

I want to comment on all the additional fees (some are hidden) being added to my credit card bill. Late fees even if you are only 1 day past due, which they should only charge if you are over 30 days late. The additional charges for foreign transactions (3-5%) when they already gave me a lousy exchange rate and now they want to charge me a fee. Fees for using the points I earned from my reward credit card. I could probably go on and on...

Stephen from Massachusetts

I think credit card companies need to be more consumer friendly. The card agreements are not readily understood (I have a Ph.D.) and give me little protection. Also the card companies charge fees that are totally out of proportion to the cost of the service. For example foreign transactions, why do they charge a percentage of the transaction amount? It doesn't cost more to process a \$100 charge than it does to process a \$20 charge...

CU Recommends:

Lawmakers and policymakers should set limits on the size of credit card fees on consumer accounts, as well as the circumstances under which a fee may be assessed.

Issuing credit cards to young people:

The Final Rule does not address the problem of credit card issuers offering and issuing credit cards to young people who may have no visible means of repayment. Credit card companies market aggressively to young people in a variety of ways. One survey found that 80% of college students surveyed received credit card solicitations in the mail each month.⁶ Consumers told the Fed about young and inexperienced consumers being lured by issuers into opening credit card accounts only to find themselves in massive debt.

Here is what three consumers told the Fed about this problem.

Katherine from Illinois

I have extensive credit card debt. My first credit card came from a folding table on my college campus. Credit card companies prey upon 18 year olds without any experience, assuming that they will have a steady income following college or that their parents will foot the bill of their debt. I did not understand how much I was being charged. I did not know how long it was going to take me to pay off even \$100 of debt at an APR of almost 30%. These high interest rates are impossible to manage. I made a payment late and my APR skyrocketed. I struggled for work when I graduated from college in 2000, just as the dotcom bubble burst. And that is when my credit card debt exploded. Our currently loose laws, allowing credit card companies' to follow the laws of whichever state their phantom headquarters is based, allow for extraordinary interest rates. This is usurious...

Roger from Ohio

I feel strongly that there should be some limitation and, certainly, some education and counseling before you send credit card applications to college students. I saw the easy credit offers on my daughter's campus, but I did not know that she was signing up for them. She had been warned by us (her parents) about the dangers of debt - but we never knew that she had created a mountain of debt by the time she rec'd her degree. She had more consumer credit than college loans - and she bought junk. I agree that there is a need for personal responsibility - but the credit industry makes it much too easy and "Cool". Now my daughter is 34 years old and has an \$ 835.00 per month payment for 8 years to get rid of all her debt. This is on top of house payments and a car payment. She cannot have a child because she must work to pay off that debt for 5 more years. Thankfully, she has a good job as a Physical Therapist or she would have been another bankruptcy case. We did not have any idea of what was happening until creditors started calling on our home phone (she didn't live there)...

Michael from California

I was sent numerous unsolicited credit cards when I was in college. I couldn't resist the temptation to use them. And use them I did, running up thousands of dollars in debt that I was unable to pay. So the added late fees to the already exorbitant interest driving me further into debt. Being young, I was taken advantage of by these unscrupulous banks. There are many, many people in the same boat as I am.

CU Recommends:

Lawmakers and policymakers should prohibit credit card companies from issuing credit cards to young people that do not have either a viable means of repayment or parental consent.

⁶ THE U.S. PUBLIC INTEREST RESEARCH GROUP EDUCATION FUND, THE CAMPUS CREDIT CARD TRAP: A SURVEY OF COLLEGE STUDENTS AND CREDIT CARD MARKETING (2008), available at <http://www.truthaboutcredit.org/uploads/E4/5s/E45s1AWAIToWzWm6hblF9A/Campus-Credit-Card-Trap-Report.pdf>.

Conclusion

The unprecedented number of comments that flooded the Federal Reserve Board in response to the proposed rule is evidence of how abusive credit card lending practices can put a significant strain on family finances. The Final Rule addresses some of the most egregious unfair practices and provides significant and long overdue reforms to the credit card marketplace. But there are other credit card tricks that will continue to trap many consumers in a cycle of debt. More needs to be done by Congress and the Federal Reserve Board to protect consumers from unfair or deceptive credit card practices.

During the 110th Congress, bills were introduced in the Senate and House to enact certain credit card protections. Representative Maloney authored HR 5244, the Credit Cardholders Bill of Rights, which passed the House and Senator Dodd authored S 3253, the Credit CARD Act.⁷ It is likely that these bills will be reintroduced in the 111th Congress in 2009.⁸ Even with the Final Rule, legislation is needed to include these agency restrictions into a statute and address the unfinished business in credit card reform.

⁷ For more information on these legislative efforts visit: <http://www.creditcardreform.org/learn2.html>.

⁸ Another proposed piece of legislation was introduced by Senator Durbin during the 110th Congress. S.3629, would create a Consumer Credit Safety Commission. This bill would create a new agency with rulemaking and enforcement authority over credit products. It would not excuse banking regulators of their obligation to protect consumers. The goal of the Commission would be to minimize unreasonable risk and prevent unfair practices that are often associated with the buying and using of credit. S. 3629, 110th Cong. (2008).

Appendix: The Final Rule on Credit Card Practices

Effective July 1, 2010

Restricts increases in APR, especially on money you already borrowed:

Credit card issuers can raise interest rates on existing balances only:

- 1) If the minimum payment is not received within 30 days after the due date.
- 2) The card issuer can set more than one rate at the time the card is opened, if it tells the cardholder what the new rate will be and when it will start. For example, the card could offer 3% for the first six months and then 12% after that.
- 3) The rate increase is under a variable interest rate and following the variable rate formula for that card.

Credit card issuers can raise the rate on future purchases for any of these reasons and also:

- 4) After the first year, the card issuer can raise the rate (for any reason or for no reason) for future purchases with 45 days notice. The new rate can be applied to purchases made more than seven days after notice is provided. This one year limitation does not apply to accounts opened prior to July 1, 2010.

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.

Ensures payments are fairly allocated to different balances: The rule requires companies to more fairly apply the payments that cardholders make to balances with different interest rates. Companies must apply payments, in excess to the minimum, in one of these two ways:

- 1) Apply the entire amount to the balance with the highest APR.
- 2) Split the payment proportionally among the balances (pro rata rule.)

Ensures consumers have time to make a payment: The rule prohibits credit card companies from treating a payment as late unless the bill is mailed or delivered at least 21 days before the due date. If statements are provided and accepted only electronically, the company can deliver the statement via electronic means less than 21 days before the due date.

The Truth in Lending Act requires credit card companies to mail the bill at least 14 days before the expiration of a grace period, if one is provided. Currently most credit card companies offer a single due date which serves as the expiration of a grace period and the date after which late fees can be assessed. The interaction between the Rule and TILA means that under the law consumers can lose their grace period seven days before their payment can be considered late for other purposes, such as assessing a late fee, but companies must disclose these two dates clearly on the statement.

Eliminates two-cycle billing: Under the rule, a credit card company cannot reach back to an earlier billing cycle when calculating the amount of interest charged in the current cycle.

Restricts the financing of security deposits and issuance fees: The rule 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.