United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

October 12, 2007

Ms. Jennifer J. Johnson
Secretary
Office of the Secretary
The Board of Governors
Federal Reserve System
Marriner S. Eccles Federal Reserve Board Building
20th Street and Constitution Avenue, N.W. – B-2234
Washington, DC 20551

RE: Comments on the Proposed Amendments
to Regulation Z; Docket No. R-1286

Dear Ms. Johnson:

On May 23, 2007, the Board of Governors of the Federal Reserve System issued proposed amendments to Regulation Z, which implements the Truth in Lending Act (TILA). The purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices." (15 U.S.C. § 1601a) The purpose of this letter is to express support, with certain reservations, for the Board's proposed improvements to the format and content of required disclosures, and to express concern with the Board's failure to adequately implement an enumerated purpose of TILA, namely: the protection of consumers from unfair credit card practices.

I have become very familiar with the credit card industry through my work as Chairman of the U.S. Senate Permanent Subcommittee on Investigations. In October 2006, I released a report by the Government Accountability Office (GAO) that analyzed the credit card fees, interest rates, and disclosure practices of 28 popular credit cards from the six largest credit card issuers. Following the release of the GAO report, I directed the Subcommittee to initiate an investigation into the unfair credit card practices that mire so many Americans in debt. In March 2007, I chaired a Subcommittee hearing which heard testimony from the chief executive officers of the three largest credit card issuers in the country – Bank of America, JP Morgan Chase Bank and Citigroup – and from Wes Wannemacher, an Ohio consumer whose personal credit card experiences exemplified a number of unfair practices.

The March hearing focused on three fundamental issues: grace periods, interest rates, and fees.

Grace Periods. Although many consumers think that all credit cards provide them with a grace period before interest is charged, the investigation disclosed that, in fact, most credit card issuers do not provide a grace period to cardholders unless they pay their credit card balances in full each month. If a consumer owes any balance on a card from the prior month, there is no grace period on new purchases, and every purchase racks up interest charges from day one.

Interest Rates. Credit card issuers typically apply multiple interest rates to the same card, depending on the circumstances. For example, the credit card industry typically uses one interest rate for cash advances, another for regular purchases, a third for balance transfers, and if a cardholder pays late or exceeds a credit limit, the company may substitute a so-called penalty interest rate that can exceed 30 percent. In addition, these interest rates often vary, rising and falling with the prime rate. Multiple interest rates that change over time make it nearly impossible for consumers to track their finance charges. In addition, when a consumer pays off a portion – or even the majority – of a monthly balance, the investigation disclosed that credit card issuers charge interest on the entire amount previously owed, including the portion that was paid on time. These interest rate practices are little understood, shrouded in confusing disclosures, and in some cases are inherently unfair.

Fees. The need for pro-consumer fee protections is illustrated by the story of Mr. Wannemacher. In 2001 and 2002, Mr. Wannemacher charged about $3,200 on a new Chase credit card to pay for expenses mostly related to his wedding. Over the next six years, he paid about $6,300 toward that debt, yet in February 2007, Chase said that he still owed about $4,400.

How could Mr. Wannemacher pay nearly double his original credit card debt and still owe $4,400? As he explained in his testimony, in addition to repaying the original debt of $3,200, Mr. Wannemacher was socked with $4,900 in interest charges, $1,100 in late fees, and 47 over-limit fees totaling $1,500, despite going over his $3,000 credit limit by a total of only $200. These facts show that Mr. Wannemacher paid $2,600 in fees on a $3,200 debt. In addition, those fees were added to his outstanding credit card balance, and he was charged interest on the fee amounts, increasing his debt by hundreds if not thousands of additional dollars. There's something so wrong with this picture, that Chase didn't even defend its treatment of the account at the Subcommittee hearing; instead, Chase forgave the $4,400 debt that it said was still owed on the Wannemacher credit card.

Mr. Wannemacher's experience is not unusual, and Chase is certainly not the only culprit. The Subcommittee has received over one thousand letters in response to its March hearing – far more letters than any other Subcommittee hearing I've chaired during my 28 years in the Senate – and they tell a very troubling story about the state of the credit card industry, and the many, perhaps millions of Americans that suffer as a result of unfair and abusive credit card practices. My staff has followed up with scores of consumers and contacted the major issuers to discuss dozens of particularly noteworthy letters, and time and time again apologies have been offered, and debt has been forgiven. A consumer should not have to contact the U.S. Senate in order to get fair treatment from a credit card issuer. Clearly the current regulatory scheme is insufficient to prevent ongoing credit card abuses.

Improved Disclosure

Credit cards are a fixture of American life today. The credit card industry serves an important purpose in quickly and conveniently providing open-ended, usually unsecured, loans to hundreds of millions of Americans every day. Credit cards fuel commerce, facilitate financial planning, and help families deal with emergencies. Most Americans today cannot imagine life without credit cards. But our dependence on credit cards comes at a cost. Credit cards have contributed to record amounts of household debt. Some credit card issuers have burdened families with sky-high interest rates of 25%, 30%, and higher, and have hit consumers with hefty fees for late payments, for exceeding a credit limit, and other transactions. In too many cases, credit card issuers have made it all but impossible for working families to climb out of debt.

Effective disclosure is essential for enabling consumers to make educated decisions about credit cards. Unfortunately, the typical disclosure that accompanies a credit card contract or solicitation is all but impenetrable to a trained lawyer, let alone the average consumer. To the extent that the proposed amendments to Regulation Z improve the effectiveness of disclosures, by making the disclosures legible, meaningful, and accessible, I support them. But we need more than just improved disclosures to stop the unfair and abusive credit card practices that continue to load debt onto cardholders trying to meet their financial obligations.

A. Credit Card Applications and Solicitations

Table of Key Terms. I support the Board's effort to clarify and augment the information required to be disclosed in the table of key terms on credit card applications and solicitations. The Board is right to require that card issuers disclose, inside the table, cash advance fees, balance transfer fees, and the fees for paying late, exceeding the credit limit, or making a payment that is returned. In addition, the Board ought to require the disclosure of any "pay-to-pay" fees, such as fees for paying a credit card bill online or over the telephone.

Likewise, the Board's proposal to require issuers to use the term "penalty APR" in lieu of "default rate," is a good one, since it conveys to cardholders that this higher interest rate will be imposed as a penalty for violating the terms of the credit card agreement. Moreover, the proposed requirement to disclose, inside the table of key terms, the specific actions that could trigger a penalty interest rate will prove useful to consumers. Current practice will also be improved by requiring disclosure of the penalty rate, the balance to which the penalty rate will apply, whether the penalty rate will apply indefinitely, and if not, the circumstances under which the penalty rate will expire.

Fair Crediting of Payments. The penalty interest rate is often initiated by a late payment. Many cardholders have complained to the Subcommittee that card issuers have not credited their payments in a timely fashion, leading to late payment fees and the imposition of penalty rate hikes. In some cases, cardholders are justifiably confused by bills with due dates that fall on holidays or weekends. In one notable letter to the Subcommittee, a cardholder described paying his credit card bill in person at his bank on the Saturday the bill was due, only to be told that since it was a weekend the payment would not post until Monday, and late fees would apply. Other cardholders have complained that payments made electronically to meet a weekend due date have not been credited until the following business day, resulting in late fees and sometimes penalty rate hikes. The Board ought to strengthen the proposed rule by requiring either that credit card bills cannot be due on weekends and bank holidays, or that payments on these dates must be accepted as timely, if the weekend or bank holiday prevents the payment from being posted on the date it is actually paid.

Variable Rate Disclosure. While I understand the Board's concern that the current inside the table disclosure requirements regarding variable rates are excessive and confusing, reducing the disclosure to a single sentence indicating that the APR "varies with the market," along with reference to the type of index, such as "Prime," is insufficient absent a requirement that these indexes are transparently named. For instance, the rule should specify that any reference to the "Prime Rate," must refer only to the bank prime loan rate posted by the majority of the top 25 (by assets in domestic office) United States chartered commercial banks, as published by the Board of Governors. Some card issuers have stated that the prime rate used in credit card agreements does not necessarily match the lowest interest rates they provide to their most credit worthy borrowers. Litigation has arisen between cardholders and card issuers as to what is meant by the term and whether cardholders are being misled. See, for example *Lum v. Bank of* America, 361 F.3d 217 (3d Cir. 2004). Issuers must be prevented from pegging variable interest rates to indexes named or defined in a misleading manner.

Payment Allocation. The Board's proposal to add a new disclosure to the table about the effect on credit costs of creditors' payment allocation methods when payments are applied entirely to transferred balances at low introductory APRs, is an improvement, but it is not enough. Even with the added disclosure, only sophisticated consumers will realize that they will pay interest on purchases, without a grace period, until the transferred balance is paid in full. In the area of payment allocation as a whole, improved disclosure is also insufficient to overcome industry-wide unfair billing practices in which card issuers credit payments first to the balances with the lowest interest charges and apply payments in ways that maximize fees and interest charges. To stop these unfair billing practices, the Board should mandate that issuers apply payments first to card balances bearing the highest interest rate, and then to each successive balance bearing the next highest interest rate, until the payment is exhausted. The Board should also mandate that credit card issuers allocate payments in the most effective way to minimize the imposition of any finance charges. These provisions are needed measures that should be added to the proposed rule to carry out TILA's mandated purpose: to protect consumers against unfair credit card billing practices.

Subprime Account Disclosures. The Board proposes to improve disclosure on subprime credit card accounts by requiring the card issuer to include an example in the table of the amount of available credit the consumer would have after paying account opening fees or a security deposit, assuming the consumer receives the minimum credit limit, where those fees equal or exceed 25 percent of the minimum credit limit. Improved disclosure, however, is again insufficient to satisfy TILA's purpose of protecting consumers against unfair billing practices. The rule should instead prohibit the imposition of unreasonable and excessive credit card fees that equal or exceed 25 percent of the credit line made available to the cardholder.

Unilateral Repricing. One major deficiency in the proposed amendments to Regulation Z is the failure to address disclosure of a common credit card practice in which the card issuer unilaterally reprices accounts by raising the applicable interest rates.

The Permanent Subcommittee on Investigations has heard from dozens of consumers who have been burdened by skyrocketing debt, despite honoring all of the terms of their credit card agreement, because their interest rates have been increased unilaterally by their card issuer. Some credit card issuers call this practice "risk-based repricing," and justify changing the terms of the account because of a lower credit score on a credit report or higher borrowing costs in the marketplace. This repricing practice, sometimes referred to as universal default, is inherently unfair, because it penalizes consumers who have met their contractual obligations. It also defeats the purpose of requiring clear disclosures of key credit card terms to consumers so that they can shop for the best deal, since the most important of those terms, the interest rate, can be increased at will. In addition, in most cases, issuers apply the higher interest rate not only to future debt, but also retroactively to preexisting debt, to the clear detriment of the cardholder.

Consumers who incur debt on a credit card account, meet their contractual obligations, and make at least the minimum payment on time every month, should not be penalized with an interest rate increase. This practice is particularly disturbing when existing debt is made subject to the increased interest rate in the absence of any misconduct by the cardholder. And yet most of the major issuers engage in this practice, which has a burdensome, sometimes paralyzing, effect on people trying to work their way out of debt.

Regulation Z should prohibit unilateral repricing of accounts in which the cardholders have met their contractual obligations. At the very least, the Board should require clear and unambiguous disclosure inside the summary table of the card issuer's authority to impose a unilateral interest rate increase. The summary table should include a row heading entitled "**APR increase possible**," followed by the disclosure: "**[Credit card issuer] can raise your interest rate at anytime, even if you pay more than the minimum, on time, every month, if [credit card issuer] decides you are a greater credit risk or its borrowing costs increase. For example, if your credit score declines, even if you have met all of your obligations to [credit card issuer], [credit card issue] can increase your APR.**"

B. Account-Opening Disclosures

I support the Board's efforts to make account-opening disclosures clearer and more conspicuous by requiring a summary table for key information, similar to the summary table required in account applications and solicitations. My suggestions for improving the summary table for account applications and solicitations also apply to the summary table in account opening material.

Currency Exchange Fees. I also support the proposed requirement to disclose fees for transactions in a foreign currency or that take place in a foreign country. The Subcommittee has received complaints about excessive currency conversion fees and instances where the conversion fee was charged for U.S. dollar transactions processed by foreign merchants who never converted the dollars into a foreign currency. Improved disclosure alone is, again, insufficient to protect consumers; the Board should require foreign currency exchange fees to reasonably reflect the actual costs incurred by the creditor to perform the currency exchange.

C. Periodic Statement Disclosures

I support the Board's proposed amendments to Regulation Z that would make periodic statement disclosures more understandable, by grouping fees, interest charges, and transactions together, and by itemizing interest charges for different types of transactions and providing separate totals of fees and interest for the month and year-to-date. Likewise, I support the Board's proposal to require the disclosure of the late payment fee and the penalty APR that could be triggered by a late payment on the front side of the periodic statement, in close proximity to the due date.

Minimum Payments. Among the thousand letters the Subcommittee has received in response to our credit card investigation, a number have been notable in their demonstration of the great cost and difficulty, bordering on futility, of digging out of debt by making only minimum payments. The Board has proposed that card issuers provide a warning of the effects of making minimum payments on a balance, a hypothetical example of how long it would take to pay off a specified balance if only minimum payments are made, and a toll free number that consumers may call to get an estimate of the time it would take to repay their actual balance using minimum payments. While those disclosures would be an improvement, they don't go far enough. For too many cardholders, minimum payments offer an illusion of inexpensive debt, but in fact are among the most expensive ways to borrow money. Card issuers should be required to prominently disclose the actual cost and length of time to repay an existing balance if only *minimum payments are made.*

D. Change-In-Terms Notices

45-Day Notice Period. I strongly support the Board's proposal to give cardholders 45 days advance notice of a change in terms to a credit card contract. 45 days is the minimum time period in which a cardholder could reasonably seek out an alternative if the new terms are unsatisfactory. Dozens of the letters sent to the Subcommittee complain of card issuers unilaterally changing key credit card terms without any prior notice. While in some of these instances, the issuers may have mailed notice of the term change, it is also likely that the cardholder overlooked or missed the notice letter among the deluge of solicitations mailed by credit card issuers, numbering 8 billion last year alone. Many of the cardholders who have contacted the Subcommittee cite a change in terms, such as a higher interest rate, as the key event that triggered a decline into unmanageable debt and delinquency.

To address the deleterious effects of a unilateral change in terms, the Board should amend Regulation Z to require the following, in addition to 45 days prior notice: conspicuous notice of the proposed change in terms on the billing statement; a bona fide opportunity for the cardholder to opt out of the change within the 45-day notice period and to pay down any outstanding balance under pre-existing terms; and an additional opportunity for the cardholder to opt out of the change in terms within 30 days of receiving the first billing statement in which the change is operational. If these changes are made, cardholders who are meeting the terms of their card agreements will have a genuine opportunity to respond to an unsatisfactory change in terms by seeking a better agreement in the credit market.

Closing Accounts. Another key issue with respect to change in terms notices has to do with the ability of cardholders to close an existing account promptly – both to prevent unwarranted finance charges from being initiated and to end the cardholder's obligations on that account before seeking a better agreement in the credit market. Cardholders have complained to the Subcommittee that attempts to close accounts have been met with resistance from customer service representatives who warn that closing an account will adversely affect the cardholder's credit score. In fact, closing an account at the request of the cardholder can have a positive, negative, or neutral effect on the cardholder's credit score depending upon other factors. The Subcommittee has been told that the real problem with customer service representatives reluctant to close accounts is not due to their concern for the cardholder but because their own job security and income may be affected if they close too many accounts. To address this problem, the Board should amend Regulation Z to require that when a cardholder requests an account to be closed, the card issuer must close the account within 48 hours of the request and mail the cardholder written confirmation of the closure. The account closure must also be genuine and not reversible if a subsequent charge is made on the account; charges on a closed account must instead be rejected. Card issuers should also be prohibited from telling consumers that closing an account will necessarily lower their credit scores.

E. Advertising Provisions

During the course of the Subcommittee's investigation, we have heard from numerous consumers who have paid exorbitant prices, and gone into great debt, after purchasing goods or services through opening a merchant-sponsored credit card that seemed to offer reasonable terms and monthly payments. These financing decisions, often made hastily at a store register in an effort to receive an illusory discount, can subject cardholders to substantial finance charges and a variety of unfair billing practices. The Board's proposed amendment to Regulation Z would help address this problem by requiring that advertisements stating a minimum monthly payment for an open-end credit plan established to finance the purchase of goods or services must also state, with equal prominence, the time period required to pay the balance and the total of cost if only minimum payments are made.

Protection from Unfair Credit Card Practices

The proposed amendments to Regulation Z, if adopted, will improve existing credit card disclosures. While better credit card disclosures are critical to helping consumers, disclosures alone are no substitute for outlawing abusive credit card practices that unfairly mire American families in debt. The Federal Reserve needs to do more than require that unfair credit card practices be disclosed – it needs to end them. That includes eliminating unfair and retroactive penalty interest rate hikes, forbidding interest charges on debt that is paid on time, requiring card issuers to apply consumer payments to the portion of their debt with the highest interest rates, prohibiting repeated over-the-limit fees for a single over-the-limit purchase, and eliminating the practice of charging consumers a fee to pay their bills. Legislation to end these and other unfair credit card practices has been introduced in the Senate and House, but amending Regulation Z to prevent unfair credit card practices would be another way of addressing these abuses.

I have worked to identify the most egregious of current credit card practices and develop provisions to protect consumers who seek to pay off their debts in good faith. The product of this effort is the Stop Unfair Practices in Credit Cards Act, S. 1395, which has been cosponsored by Senators McCaskill, Durbin, Leahy, Bingaman, and Cantwell. I encourage the Board to review this legislation and through the authority provided to the Board by TILA and the Federal

Trade Commission Act's prohibitions against unfair or deceptive acts and practices, implement its provisions through the amending of Regulation Z. A copy of S. 1395 is attached; its key provisions can be summarized as follows.

No Interest Charges for Debt Paid on Time

The first section of the bill would put an end to an indefensible practice that imposes little known and unfair interest charges on many unsuspecting, responsible consumers. Most credit cards today offer a grace period. Cardholders are told that, if they pay their monthly credit card bill during this grace period, they will not be charged interest on the debt for which they are being billed. Many cardholders do not realize that this grace period typically provides protection against interest charges only if their monthly credit card bill is paid in full. If the cardholder pays less than one hundred percent of the monthly bill – even if the cardholder pays on time – he or she will be charged interest on the entire billed amount, including the portion that was paid by the specified due date. Cardholders should not have to pay interest on debt which was repaid on time under the terms of the credit card. The proposed amendment to Regulation Z improves the disclosure of how the grace period functions, but it is insufficient. This billing practice is unfair and should be stopped.

No Trailing Interest on Debt Paid on Time and In Full

The second section of S. 1395 would address a related unfair billing practice, which I call "trailing interest." Charging trailing interest on credit card debt is another widespread, but little known industry practice that squeezes responsible and largely unsuspecting consumers for additional interest charges on balances from the time from when the bill is sent until the day it is paid. Trailing interest adds a seemingly minimal amount of money to the monthly debt. That may be why many consumers don't notice this extra interest charge or bother to fight it. Even if someone had questions about the amount of interest on a bill, most consumers would be hard pressed to understand how the amount is calculated, much less whether it is correct. But by nickel and diming tens of millions of consumer accounts with trailing interest charges, credit card issuers reap large profits.

This little known billing practice, which squeezes consumers for a few more cents on the dollar, and targets responsible cardholders who pay their bills on time and in full, goes too far. If a consumer pays a credit card bill on time and in full – paying one hundred percent of the amount specified by the date specified in the billing statement – it is unfair to charge that consumer still more interest on the debt that was just paid. It would also be very difficult to disclose trailing interest in a comprehensible way. The Board ought to amend Regulation Z instead to prohibit credit card issuers from adding interest charges to a credit card debt which the consumer paid on time and in full in response to a billing statement.

Unilateral Interest Rate Hikes

A third problem examined by the Subcommittee involves a widespread industry practice in which credit card issuers claim the right to unilaterally change the terms of a credit card agreement at any time for any reason with only a 15-day notice to the consumer under TILA. The proposed amendments to Regulation Z would change the required notice to 45 days, but *simply disclosing this unfair practice is insufficient.*

As the National Consumer Law Center testified at the Subcommittee's hearing, this practice means that smart shoppers who choose a credit card after comparing a variety of card options are continually vulnerable to a change-in-terms notice that alters the favorable terms they selected, and provides them with only 45 days to accept the changes or find an alternative. By asserting the right to make unilateral changes to credit card terms on short notice, credit card issuers undermine not only the bargaining power of individual consumers, but also principles of fair market competition. Such unilateral changes are particularly unfair when they alter material terms in a credit card agreement such as the interest rate applicable to extensions of credit.

That's why S. 1395 would impose two types of limits on credit card interest rate hikes. First, for consumers who comply with the terms of their credit card agreements, the bill would prohibit a credit card issuer from unilaterally hiking an interest rate that was represented to, and included in the disclosures provided to, a consumer under the Truth in Lending Act, unless the consumer affirmatively agreed in writing to the increase at the time it is proposed. This prohibition is intended to protect responsible consumers who play by the rules from a sudden hike in their interest rate for no apparent reason – a complaint that the Subcommittee has heard all too often. Under S. 1395, issuers would no longer be able to unilaterally hike the interest rates of cardholders who meet their contractual obligations.

The bill's second limit would apply to consumers who, for whatever reason, failed to comply with the terms of their credit card agreement, perhaps by paying late or exceeding the credit limit. In that circumstance, credit card issuers would be permitted to impose a penalty interest rate on the account, but the bill would place a cap on how high that penalty interest rate could go.

Specifically, the bill would limit any such penalty rate hike to no more than a 7% increase above the interest rate in effect before the penalty rate was imposed. That means a 10% rate could rise no higher than 17%, and a 15% rate could not exceed 22%. This type of interest rate limit is comparable to the caps that today operate in many adjustable mortgages. The effect of the credit card cap would be to prohibit penalty interest rates from dramatically increasing the interest rate imposed on the cardholder, as happened in cases examined by the Subcommittee where credit card interest rates jumped from 10% or 15% to as much as 32%. Penalty interest rate hikes that double or triple existing interest rates are simply unreasonable and unfair.

If a credit card account were opened with a low introductory interest rate followed by a higher interest rate after a specified period of time, it is intended that the penalty rate cap proposed in the bill would apply to each of those disclosed rates individually. For example, suppose the credit card account had a 0% introductory rate for six months and a 12% rate after that. Suppose further that, during the six-month introductory period, the cardholder exceeded the credit limit. The bill would allow the card issuer to impose a penalty interest rate of up to 7% for the rest of the six month period. Once the six month period ended, it is intended that the 12% rate would take effect. If the consumer were to again exceed the limit, it is intended that any penalty rate imposed upon the account be no greater than 19%.

If a card issuer were to analyze an account and conclude that a penalty rate increase of up to 7% would be insufficient to protect against the risk of default on the account, the issuer could choose to reduce the credit limit on the account or cancel the account altogether. If the card issuer chose to cancel the account, it is intended that the consumer would retain the right to pay off any debt on the account using the interest rate that was in effect when the debt was incurred. The point of the bill's penalty interest rate cap is to stop penalty interest rate hikes which are disproportional; which too often stick families with sky-high interest rates of 25%, 30%, and even 32%; and which too often make it virtually impossible for working American families to climb out of debt.

Apply Interest Rate Increases Only to Future Debt

Still another troubling practice involving credit card interest rate hikes is the problem of retroactive application. Industry practice today is to apply an increased interest rate not only to new debt incurred by the cardholder, but also to previously incurred debt. Retroactive application of a higher interest rate means that pre-existing credit card debt suddenly costs a consumer much more to repay.

Take, for example, a $3,000 credit card debt that a consumer was paying down each month with timely payments. Suddenly, the cardholder falls ill, misses a payment or pays it late, and the card issuer increases the interest rate from 15% to 32%. If applied to the existing $3,000 debt, that higher rate would require the cardholder to make a much steeper minimum monthly payment and pay much more interest than originally planned. That is often enough to sink a working family into a deepening spiral of debt from which they cannot recover.

By making it a common practice to institute after-the-fact interest rate hikes for existing credit card debt – in effect unilaterally changing the terms of an existing loan – the credit card industry has unfairly positioned itself to reap greater profits at consumers' expense. S. 1395 would stop the retroactive application of interest rate hikes to lessen the financial impact on American households. Specifically, the bill would provide that interest rate hikes could be applied only to future credit card debt and not to any credit card debt incurred prior to the rate increase. Instead, any earlier debt would continue to accrue interest at the rate previously in effect.

No Interest Charges on Fees

It is no secret that credit card companies are making a great deal of money off the fees they are imposing on consumers. According to GAO, fee income now produces about 10 percent of all income obtained by credit card issuers. The GAO report that I commissioned on this subject identified a host of different fees that have become common practice, including fees for transferring balances, making a late payment, exceeding a credit limit, paying a bill by telephone, and exchanging foreign currency. According to GAO, late fees now average $34 per month and over-limit fees average $31 per month, with some of these fees climbing as high as $39 per month. As Mr. Wannemacher discovered, these hefty fees are not only added to the credit card's outstanding balance, they also incur interest. The higher the fees climb, the higher the balances owed, and the higher the interest charges on top of that.

Charging interest on money borrowed is certainly justified, but squeezing additional dollars from consumers by charging interest on transaction fees goes too far. Steep fees already deepen household debt from credit cards; those fees should not also generate interest income for the credit card issuer. The bill would ban this industry-wide practice by prohibiting credit card issuers from charging or collecting interest on the fees imposed on consumers; likewise, Regulation Z should be amended to ban this practice.

Over-the-Limit Fee Restrictions

Mr. Wannemacher exceeded the $3,000 limit on his credit card on three occasions in 2001 and 2002 for a total of $200. Over the following six years, he was charged over-limit fees on 47 occasions totaling about $1,500. In other words, Chase tried to collect over-limit fees from Mr. Wannemacher that were seven times larger than the amount he went over the limit.

At the Subcommittee's March hearing, Chase did not attempt to defend the 47 over-the-limit fees it imposed; instead, it announced that it was changing its policy and would join with others in the industry in imposing no more than three over-limit fees in a row on a credit card account with an outstanding balance that exceeded the credit limit. While Chase's voluntary change in policy is welcome, it doesn't go far enough in curbing abusive practices related to over-limit fees.

First, if a credit card issuer approves the extension of credit that allows the cardholder to exceed the account's established credit limit, the issuer should be allowed to impose only one over-limit fee for that credit extension. Card issuers should be allowed one fee for one violation; after all, the card issuer facilitated the violation by approving the excess credit charge.

Second, the fee should be imposed only if the account balance is over the credit limit at the end of the billing cycle. If a cardholder exceeds the limit in the middle of the billing cycle and then takes prompt action to reduce the balance below the limit, perhaps by making a payment or obtaining a credit for returning a purchase, there is no injury to the creditor and no justification for an over-the-limit fee.

Third, a credit card issuer should impose an over-limit fee only when an action taken by the cardholder causes the credit limit to be exceeded, and not when a penalty imposed by the card issuer causes the excess charge. The card issuer should not be able to pile penalty upon penalty, such as by assessing a late fee on an account and then, if the late fee pushes the credit card balance over the credit limit, also imposing an over-limit fee.

In addition, the bill would require credit card issuers to offer consumers the option of establishing a true credit limit on their account – a credit limit that could not be exceeded, because the account would be programmed to refuse approval of any extension of credit over the established limit. In too many cases, credit card issuers no longer provide consumers with the option of having a fixed credit limit, preferring instead to enable all of their cardholders to exceed their credit limits only to be penalized by a hefty fee, added interest, and, possibly, a penalty interest rate.

Regulation Z could and should be amended to end the unfair practices related to credit card over-limit fees.

Pay-to-Pay and Currency Exchange Fees

Another unfair but common fee is the "pay-to-pay fee," which is the $5 to $15 fee that many issuers charge consumers to pay their credit card bill on time by using the telephone. Charging consumers a fee to pay their bills is a travesty. S. 1395 would prohibit a credit card issuer from charging a separate fee to allow a credit cardholder to pay all or part of a credit card balance; Regulation Z could impose the same prohibition.

Another fee that has raised concerns is the one charged by credit card issuers to exchange dollars into or from a foreign currency. A number of issuers today charge an amount equal to two percent of the amount of currency being exchanged in addition to a one-percent "conversion fee" charged by Visa or Master Card, for a total of three percent. S. 1395 responds by requiring foreign currency exchange fees to reasonably reflect the actual costs incurred by the creditor to perform the currency exchange, and requiring regulators to ensure compliance with that standard. Simply disclosing the currency conversion fees under the proposed amendments to Regulation Z, without requiring these fees to be reasonable, is insufficient to protect consumers.

Fair Treatment of Cardholder Payments

The Subcommittee investigation uncovered several unfair industry practices involving how credit cardholder payments are applied to satisfy finance charges and other credit card debt. The industry-wide practice of applying consumer payments first to the balances with the lowest interest rates is another example of a practice that cannot be sufficiently addressed through better disclosure.

When a consumer payment is made, credit card issuers currently have complete discretion on how to apply that payment to various balances bearing different interest rates. Consumers are typically given no option to direct where their payments are applied. Today, virtually all credit card issuers apply a consumer payment first to the balance with the lowest interest rate. After that balance is paid off, card issuers apply the payment to the balance with the next lowest interest rate, and so on.

This payment practice clearly favors creditors over consumers. It allows the card issuers to direct payments first to the balances that provide them with the lowest returns, and minimize payments to the balances bearing the highest interest rates so those balances can accumulate more interest for a longer period. Consumers who want to pay off a cash advance bearing a 20% interest rate, for example, are told that they cannot make that payment until they first pay off all other balances with a lower interest rate.

S. 1395 would replace this unfair industry-wide practice with a pro-consumer approach. Reversing current industry practice, the bill would require cardholder payments to be applied first to the balance bearing the highest interest rate, and then to each successive balance bearing the next highest rate, until the payment is used up. The bill would also require credit card issuers to apply cardholder payments in the most effective way to minimize the imposition of any fees or interest charges to the account.

In addition, the bill would prohibit credit card issuers from imposing late fees on consumers if the issuer was itself responsible for the delay in crediting the payment. For example, if a card issuer changed the mailing address for payments, had to shut down its mail sorting equipment for repairs, or mistakenly routed a consumer payment to the wrong department, the issuer would not be allowed to assess a late fee on the cardholder for the resulting late payment. Instead, if the card issuer caused the late payment, it would be barred from assessing a late fee on the consumer.

Conclusion. Some argue that Congress and regulators should not ban unfair credit card practices because improved disclosure alone will empower consumers to seek out better deals. Sunlight can be a powerful disinfectant, which is why I support many of the Board's proposed amendments to Regulation Z. But credit cards have become such complex financial products that even improved disclosure will frequently not be enough to curb the abuses – first because some practices are so complex that consumers can't easily understand them, and second because better disclosure does not always lead to greater market competition, especially when virtually an entire industry is using and benefiting from practices that disadvantage consumers.

So for credit card practices that are inherently unfair, consumers are often best served, not by greater disclosure, but by stopping the unfair practices that take advantage of them. The Board has a statutory obligation under the Truth in Lending Act, "to protect the consumer against inaccurate and unfair credit billing and credit card practices." It is also obligated by the Federal Trade Commission Act to stop unfair or deceptive acts and practices. It ought to meet its obligations by amending Regulation Z to prohibit those practices. I am afraid that the practices are too entrenched, too profitable to the credit card companies, and too immune to consumer pressure for the companies to change them on their own, or for better disclosure to be a sufficient antidote.

Thank you for the opportunity to comment on the proposed rules.

Sincerely,

Carl Levin

Carl Levin
Chairman
Permanent Subcommittee on Investigations

Enclosure
(Stop Unfair Practices in Credit Cards Act, S. 1395)

110TH CONGRESS
1ST SESSION

S. 1395

To prevent unfair practices in credit card accounts, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 15, 2007

Mr. LEVIN (for himself and Mrs. MCCASKILL) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To prevent unfair practices in credit card accounts, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Stop Unfair Practices in Credit Cards Act of 2007".

SEC. 2. STOP UNFAIR INTEREST RATES AND FEES.

Section 163 of the Truth in Lending Act (15 U.S.C. 1666b) is amended—

(1) by striking the section title and all that follows through ''If an open'' and inserting the following:

''§ 163. Billing period and finance charges

''(a) BILLING PERIOD.—

''(1) FOURTEEN-DAY MINIMUM.—If an open'';

(2) by striking ''(B) Subsection (a)'' and inserting the following:

''(2) EXCUSABLE CAUSE.—Subsection (a)''; and

(3) by adding at the end the following:

''(b) NO INTEREST CHARGE ON DEBT THAT IS PAID ON TIME.—If an open end consumer credit plan provides a time period within which an obligor may repay any portion of the credit extended without incurring an interest charge, and the obligor repays all or a portion of such credit within the specified time period, the creditor may not impose or collect an interest charge on the portion of the credit that was repaid within the specified time period.

''(c) NO INTEREST ON DEBT THAT IS PAID ON TIME AND IN FULL.—In an open end consumer credit plan, if a billing statement requests an obligor to repay within a specified time period all of the credit extended under the plan and related finance charges, and the obligor pays all of the specified amount within the specified time period, the creditor may not impose or collect an additional interest charge on the amount that was paid in full and within the specified time period.

"(d) LIMITS ON INTEREST RATE INCREASES.—

"(1) IN GENERAL.—With respect to a credit card account under an open end consumer credit plan, the creditor shall not increase the periodic rate of interest applicable to extensions of credit while such account remains open, unless—

"(A) such increase is pursuant to the expiration of an introductory rate which was disclosed under section 127(c)(6);

"(B) such increase is pursuant to the application of a variable rate which was disclosed under section 127(c)(1)(A)(i)(II);

"(C) such increase is pursuant to the application of a penalty rate which was disclosed under subsections (a)(4) and (c)(1)(A)(i) of section 127; or

"(D) the obligor has provided specific written consent to such increase at the time such increase was proposed.

"(2) LIMIT ON PENALTY INTEREST RATE.—If an obligor fails to repay an extension of credit in accordance with the terms of a credit card account under an open end consumer credit plan, and the creditor determines to apply a penalty rate, as described in paragraph (1)(C), notwithstanding paragraph (1)(D), such penalty rate may not, while such account is open, exceed 7 percentage points above the interest rate that was in effect with respect to such account on the date immediately preceding the first such penalty increase for such account.

"(e) INTEREST RATE INCREASES LIMITED TO FUTURE CREDIT EXTENSIONS.—With respect to a credit card account under an open end consumer credit plan, if the creditor increases the periodic interest rate applicable to an extension of credit under the account, such increased rate shall apply only to extensions of credit made on and after the date of such increase under the account, and any extension of credit under such account made before the date of such increase shall continue to incur interest at the rate that was in effect on the date prior to the date of the increase.

"(f) NO INTEREST CHARGES ON FEES.—With respect to a credit card account under an open end consumer credit plan, if the creditor imposes a transaction fee on the obligor, including a cash advance fee, late fee, over-the-limit fee, or balance transfer fee, the creditor may not impose or collect interest with respect to such fee amount.

"(g) FIXED CREDIT LIMIT.—With respect to each credit card account under an open end consumer credit plan, the creditor shall offer to the obligor the option of obtaining a fixed credit limit that cannot be exceeded, and with respect to which any request for credit in excess of such fixed limit must be refused, without exception and without imposing an over-the-limit fee or other penalty on such obligor.

"(h) OVER-THE-LIMIT FEE RESTRICTIONS.—With respect to a credit card account under an open end consumer credit plan, an over-the-limit fee, as described in section 127(c)(1)(B)(iii)—

"(1) may be imposed on the account only when an extension of credit obtained by the obligor causes the credit limit on such account to be exceeded, and may not be imposed when such credit limit is exceeded due to a penalty fee, such as a late fee or over-the-limit fee, that was added to the account balance by the creditor; and

"(2) may be imposed only once during a billing cycle if, on the last day of such billing cycle, the credit limit on the account is exceeded, and no additional over-the-limit fee shall be imposed in a subsequent billing cycle with respect to such excess credit, unless the obligor has obtained an additional extension of credit in excess of such credit limit during such subsequent cycle.

"(i) OTHER FEES.—

"(1) NO FEE TO PAY A BILLING STATEMENT.—With respect to a credit card account under an open end consumer credit plan, the creditor may not impose a separate fee to allow the obligor to repay an extension of credit or finance charge, whether such repayment is made by mail, electronic transfer, telephone authorization, or other means.

"(2) REASONABLE CURRENCY EXCHANGE FEE.—With respect to a credit card account under an open end consumer credit plan, the creditor may impose a fee for exchanging United States currency with foreign currency in an account transaction, only if—

"(A) such fee reasonably reflects the actual costs incurred by the creditor to perform such currency exchange;

"(B) the creditor discloses publicly its method for calculating such fee; and

"(C) the primary Federal regulator of such creditor determines that the method for calculating such fee complies with this paragraph.

"(j) ANNUAL AUDIT.—The primary Federal regulator of a card issuer shall audit, on at least an annual basis, the credit card operations and procedures used by such issuer to ensure compliance with this section and section 164, including by reviewing a sample of billing statements to determine when they were mailed and received, and by reviewing a sample of credit card accounts to determine when and how payments and finance charges were applied. Such regulator shall promptly require the card issuer to take any corrective action needed to comply with this section.".

SEC. 3. STOP UNFAIR APPLICATION OF CARD PAYMENTS.

Section 164 of the Truth in Lending Act (15 U.S.C. 1666c) is amended—

(1) by striking the section heading and all that follows through "Payments" and inserting the following:

"§ 164. Prompt and fair crediting of payments

"(a) IN GENERAL.—Payments"; and

(2) by adding at the end the following:

"(b) APPLICATION OF PAYMENT.—Upon receipt of a payment from a cardholder, the card issuer shall—

"(1) apply the payment 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; and

"(2) after complying with paragraph (1), apply the payment in the most effective way to minimize the imposition of any finance charge to the account.

"(c) CHANGES BY CARD ISSUER.—If a card issuer makes a material change in the mailing address, office, or procedures for handling cardholder payments, and such change causes a material delay in the crediting of a cardholder payment made during the 60-day period following the date on which such change took effect, the card issuer may not impose any late fee or finance charge for a late payment on the credit card account to which such payment was credited.".

SEC. 4. STOP DECEPTIVE DISCLOSURE.

Section 127(e) of the Truth in Lending Act (15 U.S.C. 1637(e)) is amended by adding at the end the following:

"(3) INTEREST RATE LINKED TO PRIME RATE.—If a credit card solicitation, application, agreement, or plan specifies use of a variable interest rate established by reference to a 'prime rate', 'prime interest rate', or similar rate or index, the referenced rate shall be disclosed and defined as the bank prime loan rate posted by a majority of the top

25 (by assets in domestic offices) United States chartered commercial banks, as published by the Board of Governors of the Federal Reserve System. To avoid an unfair or deceptive act or practice, a card issuer may not use the term 'prime rate' to refer to any other type of interest rate.''.

SEC. 5. DEFINITIONS.

Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by adding at the end the following:

''(cc) PRIMARY FEDERAL REGULATOR.—

''(1) IN GENERAL.—The term 'primary Federal regulator', when used with respect to a card issuer that is a depository institution, has the same meaning as the term 'appropriate Federal banking agency', under section 3 of the Federal Deposit Insurance Act.

''(2) AREAS OF RESPONSIBILITY.—For each card issuer within its regulatory jurisdiction, the primary Federal regulator shall be responsible for overseeing the credit card operations of the card issuer, ensuring compliance with the requirements of this title, and enforcing the prohibition against unfair or deceptive acts or practices.''.

SEC. 6. STRENGTHEN CREDIT CARD INFORMATION COLLECTION.

Section 136(b) of the Truth in Lending Act (15 U.S.C. 1646(b)) is amended—

(1) in paragraph (1)—

(A) by striking "The Board shall" and inserting the following:

"(A) IN GENERAL.—The Board shall"; and

(B) by adding at the end the following:

"(B) INFORMATION TO BE INCLUDED.—The information under subparagraph (A) shall include, as of a date designated by the Board—

"(i) a list of each type of transaction or event for which one or more of the card issuers has imposed a separate interest rate upon a cardholder, including purchases, cash advances, and balance transfers;

"(ii) for each type of transaction or event identified under clause (i)—

"(I) each distinct interest rate charged by the card issuer to a cardholder, as of the designated date; and

"(II) the number of cardholders to whom each such interest rate was applied during the calendar month immediately preceding the designated date, and the total amount of interest charged to such cardholders at each such rate during such month;

"(iii) a list of each type of fee that one or more of the card issuers has imposed upon a cardholder as of the designated date, including any fee imposed for obtaining a cash advance, making a late payment, exceeding the credit limit on an account, making a balance transfer, or exchanging United States dollars for foreign currency;

"(iv) for each type of fee identified under clause (iii), the number of cardholders upon whom the fee was imposed during the calendar month immediately preceding the designated date, and the total amount of fees imposed upon cardholders during such month;

"(v) the total number of cardholders that incurred any interest charge or any fee during the calendar month immediately preceding the designated date; and "(vi) any other information related to interest rates, fees, or other charges that the Board deems of interest."; and

(2) by adding at the end the following:

"(5) REPORT TO CONGRESS.—The Board shall, on an annual basis, transmit to Congress and make public a report containing an assessment by the Board of the profitability of credit card operations of depository institutions. Such report shall include estimates by the Board of the approximate, relative percentage of income derived by such operations from—

"(A) the imposition of interest rates on cardholders, including separate estimates for—

"(i) interest with an annual percentage rate of less than 25 percent; and

"(ii) interest with an annual percentage rate equal to or greater than 25 percent;

"(B) the imposition of fees on cardholders;

"(C) the imposition of fees on merchants; and

"(D) any other material source of income, while specifying the nature of that income.".

SEC. 7. CONFORMING AMENDMENT.

Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988 (15 U.S.C. 1637 note) is repealed.

SEC. 8. EFFECTIVE DATE.

This Act and the amendments made by this Act shall become effective 180 days after the date of enactment of this Act.