Consumers Union

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March 24, 2005

Jennifer L. Johnson, Secretary
Board of Governors
Federal Reserve System
20th and Constitution Ave., N.W.
Washington, DC 20551

By email: regs.comments@federalreserve.gov
By fax: 202-452-3819

Re: Comments to Docket No. R-1217, Regulation of Credit Cards

Dear Ms. Johnson,

Consumers Union, the nonprofit independent publisher of *Consumer Reports*, comments on the Federal Reserve Board's advance notice of proposed rulemaking on open-ended credit, specifically on the regulation of credit cards. We believe that abusive practices of the credit card industry are placing millions of consumers in financial jeopardy. The widespread assertions of preemption of state credit laws made by nationally chartered banks which dominate the credit card market, and by their principal regulator, the OCC, highlights the need for the Federal Reserve Board and Congress to address abuses in the credit card industry.

Consumers Union urges the Federal Reserve Board to:

- Urge Congress to improve substantive protections to eliminate abuses by the credit card industry;
- Improve the clarity and effectiveness of disclosures with a redesigned and expanded "Schumer box;"
- Require disclosure on the first page of the credit card bill of the impact of making only the minimum payment on the time and cost to repay the debt;
- Tighten the finance charge rules so that the APR is a more accurate gauge of the cost of credit;
- Require the use of a "typical" APR in solicitations, applications, and at account opening to give consumers information that is more meaningful than just a periodic rate;
- Retain the effective APR in billing statements; and
- Urge Congress to overrule preemption regulations and interpretations that undermine the Truth in Lending Act's authorization of state consumer credit laws which add protections for consumers.

We discuss these recommendations more fully below.

An Industry Out of Control

The virtually unregulated credit card industry – lending more than $800 billion in revolving credit as of January 2005[1] – is a source of harm to consumers, and to the economic stability of many U.S. families. The amount of credit card debt per household has exploded in the past decade. The burden of this debt is increased by the harsh and expensive tactics of the credit card industry.

Credit card companies start by flooding consumers with billions of credit card solicitations, offering credit to just about anyone and heavily marketing to young consumers such as college students. The amount of credit card debt in America has almost quadrupled since 1981.

Credit card issuers have set up an intricate trap of terms, fees, and penalties that renders it hard for many Americans to pay off their balances. Credit card issuers set minimum payments at low levels, so that it takes consumers decades to pay off credit card debt even in the absence of new charges.

Credit card lenders have created new types of fees, increased the size of those fees, and adopted business practices whish make it more likely that fees will be incurred. For example, short grace periods and insistence on receipt of payment at a cut-off time before the day's mail arrives are just two of the ways that issuers have increased the incidence of late fees paid by consumers. According to the National Consumer Law Center, average late payment fees have more than doubled since 1996, from $14 to $30.

Advertising of low APRs that do not in fact apply to all balances on the card misleads consumers and yields a higher than expected cost of credit for the consumer. Aggressive provision of cash advances, including at the time of account opening and the through mailing of unsolicited "convenience checks," also promotes debt overload. Costs to consumers are increased by balance transfer fees, currency conversion fees, cash advance fees and other little-noticed fees.

Several tactics are so destructive that they should be targeted for quick action. First, penalty rates of 30% to as high as 40% APR are triggered by a single late payment or by a charge that goes over the credit limit by a very small amount. Second, credit card issuers use universal default clauses to sharply increase the price of credit. Under universal default, the consumer's APR may more than double simply because there has been a late payment to *another* creditor or a simple drop in credit score.

Last, but not least, is the fundamental issue of change in terms. Major credit card lenders use change in terms provisions that allow them to change at will <u>any</u> aspect of a consumer's credit card account, including raising the APR, adding new fees, raising existing fees, lowering credit limits, or shortening the grace period. Unilateral changes-in

[1] Federal Reserve Statistical Release G. 19, Jan. 2005.

key pricing terms are unfair and undermine the whole concept of comparison shopping. What is the use of being a savvy consumer -- reviewing disclosures and comparing terms -- if a credit card company can change any or even all of those terms with 15 days notice?

Credit Card Reforms Are Needed to Protect Consumers

Consumers Union asks the Federal Board to take action to address these abuses by the credit card industry. First, we ask the Board to use its authority under the Truth in Lending Act to amend Regulation Z to create an effective disclosure scheme that would truly inform consumers of the real costs of credit cards. Second, we urge the Board to ask Congress to pass laws that substantively regulate the credit card industry by limiting credit card rates, fees and practices.

➤ *Clear and Effective Disclosures*

The Board could use the Truth in Lending Act to require that credit card companies more effectively and clearly disclose their rates, fees, and terms. The Board has broad authority to issue regulations and impose requirements regarding disclosure. With this authority, the Board could help to ensure that credit card consumers receive useful information in a readable format.

We ask that the Board create a simple, effective, and understandable format for disclosures. Currently, some credit card disclosures (especially change in terms, notices and initial disclosures) are in tiny print and full of dense technical jargon that the ordinary consumer has no hope of understanding. The one disclosure that a consumer is likely to find useful is the "Schumer box," now required only for applications and solicitations. To assist consumers in deciphering the terms of their credit cards, we urge the Board to design and mandate an improved Schumer box at <u>every</u> stage of the credit card process, including initial disclosures, periodic statements, and change in terms notices. This will help a consumer know whether the credit card she received from the lender has the same terms that were advertised in the solicitations. If changes in terms are still permitted, a clear disclosure box printed on every statement would also help to bring new pricing, and thus the true cost of the credit to the attention of the consumer.

Furthermore, we recommend that the improved Schumer box disclose all of the fees that a credit card company may impose. For applications and solicitations, it should include both the periodic rate that the lender is actually offering as well as a "typical" APR for the particular credit card program being offered. The typical APR is *far more* informative than the periodic rate provided under the current regime in the Schumer box because a typical APR is an average APR based on actual fee income produced. The typical APR would be extremely helpful to customers in their efforts to comparison shop. The periodic rate does not take into account the effect of the added fees on the cost of credit. A "typical" APR would give consumers a more accurate picture of the cost of the credit to most consumers who use the particular credit card.

In addition, the Board should require that the first page of each credit card billing statement include a plain statement informing the consumer how long it would take to repay the full credit card balance if only the minimum payment is made. This could be done with specific, individual information, or it might also be accomplished with an example printed on the first page of the bill, such as "If you owe ___ on this card, and you make only the minimum payment, it could take you ____ years and ____ months to pay off this debt even if you make no new charges." The California Legislature found this information so important that it required not one, but three examples, in a statute which was rendered ineffective on preemption grounds.

➢ ***More Inclusive Finance Charge and Accurate APR***

At its core, TILA requires disclosure of all finance charges, defined as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." This is a simple and inclusive definition that could capture all of the junk fees imposed by credit card lenders. We ask the Board to go back to the roots of TILA, and eliminate the regulatory interpretations which have created exceptions and loopholes for junk fees and instead include fees in the finance charge.

➢ ***Substantive Protections***

Clear and inclusive disclosures are a necessary reform, but disclosures alone will not resolve the serious problems posed for consumers by practices in the credit card marketplace. Consumers need a new federal law regulating credit card terms. We request that the Board accompany its regulatory changes with a strong recommendation to Congress for new prohibitions and protections to benefit consumers. The Board should recommend federal legislation that will protect American consumers from the increasingly unfair and abusive practices of the credit card industry. Congress must impose real, substantive limits on the pricing and other terms of credit, including the interest rates and all fees and charges. We ask the Board to recommend to Congress all of the following:

- A cap on all periodic finance charges, for example, prime plus not more than 10%;
- A cap on all other charges, whether considered a finance charge or not, to amounts the card issuer can show are reasonably related to cost;
- No unilateral change in terms;
- No penalties or pricing increases allowed for any behavior not directly linked to the specific card account at issue;
- No improvident extensions of credit – real underwriting of the consumer's ability to pay;
- No mandatory pre-dispute arbitration clauses;
- Meaningful penalties attached to substantive and disclosure rules designed to provide real incentives to obey the rules;

- A private right of action to enforce Section 5 of the Federal Trade Commission Act prohibiting unfair or deceptive practices; and
- Restoration of TILA's authorization to states to add consumer protections by overturning contrary interpretations of the National Bank Act.

➢ ***State Authority***

Finally, the Federal Reserve Board should advise Congress that it should amend the National Bank Act to overturn the OCC's overbroad regulation, which purports to extend preemption under the National Bank Act to virtually all aspects of the credit process. Important innovations in consumer protection often come from the states, which can act when a problem begins to develop, rather than waiting for it to spread nationwide. For example, the disclosure on which the Schumer box is based was first enacted in California. States' desires to protect their residents should be honored, not defeated, in a federal system.

The Truth in Lending Act contemplates that states may, in fact, add stronger consumer protections, yet interpretations of the National Bank Act threaten to eviscerate that authorization as applied to nationally chartered banks. The Board should recommend that Congress reaffirm the role of the states in adding protections for credit consumers regardless of the type of charter held by the creditor.

Conclusion

The Federal Reserve Board has a unique and critical role in how one of the most prevalent forms of consumer credit is regulated. It could take the easy road and simply tweak the TILA regulations for open end credit, essentially maintaining the current uneven playing field between a giant, well financed credit industry and individual consumers. Instead, Consumers Union asks the Board to take the high road and make serious changes in the regulations as permitted by current law to provide some balance to the current regulatory structure, and to recommend to Congress more significant statutory changes to protect individual consumers, facilitate consumer understanding of the true cost of credit card debt, and to promote an eventual reduction in household debt and corresponding increase in family savings.

We ask the Board to take this opportunity to vigorously and directly address the problems faced by U.S. consumers created by current practices, marketing, pricing, and terms of credit cards. Because of the critical importance of these issues, Consumers Union may also join with other consumer groups in more extensive comments on these issues.

Very truly yours,

Gail Hillebrand
Senior Attorney