Consumer Action

www.consumer-action.org

PO Box 1762
Washington, DC 20013
202-544-3088

717 Market St, Suite 310
San Francisco, CA 94103
415-777-9648

523 W. Sixth St., Suite 1105
Los Angeles, CA 90014
213-624-4631

March 28, 2005

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Regulation Z - Docket No. R-1217

These comments are submitted by:

Linda Sherry
Editorial Director
Consumer Action
Phone: (202) 544-3088
Fax: ((270) 573-4104
E-mail: linda.sherry@consumer-action.org

Consumer Action is a non-profit 501(c)(3) advocacy and education organization, with offices in San Francisco, Los Angeles and Washington, DC that has served consumers since 1971. CA distributes two million free educational brochures annually on consumer financial services and other issues, through its national network of 7,300 community organizations. Consumer Action has been conducting surveys of credit card rates and terms since the mid-1980s, to track trends in the industry and assist consumers in comparing cards and understanding their rights when using credit.

Q. 14: The credit card application disclosure known as the "Schumer box" should contain a space for all credit card fees, including late payment fees, over-the-limit fees, cash advance fees, balance transfer fees, convenience check fees, currency conversion fees, and bounced check fees. The current practice of allowing credit card companies to list such fees "outside the box" means that they are often overlooked by consumers.

Consumer Action believes that the "loophole" of allowing credit card companies to list a toll-free number along with the statement, "There are costs associated with this offer," does not serve consumers at all. Some of the highest-priced credit, such as that available from retailers, is often marketed in this way, and we are convinced that few consumers take the time to call. The Schumer box concept has served consumers quite well for more than two decades, but this toll-free number loophole should not be allowed to continue.

Q. 20: Adequate disclosure of over-the-credit-limit fees is of particular importance to consumers who have low-limit credit card accounts, especially as it is very common to allow and process charges that exceed an individual's credit limit. It is unfortunate that these fees are not characterized by law as finance charges, as it has led to the 2004 Supreme Court affirmation of a lower court finding in the *Household Credit Services v. Pfennig* case that allows over-the-limit fees to be added to a cardholder's principal balance month after month. Because card issuers allow consumers to remain over their credit limit for multiple billing cycles, this can only lead to growing indebtedness and perhaps default, making it a risky loophole.

Consumer Action believes that over-the-credit limit fees should be characterized as finance charges, because they are a cost associated with using a credit card. We view over-the-limit fees as having no purpose other than to serve as a profit center for banks, as there are no hard costs associated with an over-the-credit limit purchase, unlike a late payment, which *might* impinge on the bank's operating income. In processing charges that exceed the credit limit instead of rejecting them at the time of verification, the banks are capitalizing on this loophole that allows them to reap repeated additional monthly profits from a situation they could easily control.

Q. 26: Current law allows for mailing a notice 15 days before the effective date of a change in a cardholder's interest rate. Consumer Action believes that a full billing cycle is a much more reasonable time frame for disclosures of a change in interest rates or other substantive terms such as higher minimum payments, increased late fees, etc. Changes in rates and terms often arrive in the form of easy-to-overlook "bill stuffers." Banks should be required to send a separate notice that does not in any way resemble a solicitation or other "junk" mail. This is especially important because, by using the card again, you have agreed to the new terms even if you haven't read them.

Consumer Action believes that it is unconscionable to allow credit card companies to apply penalty or universal default rate hikes to existing balances on the cardholder's account at the time of the rate increase. We strongly recommend that the current practice of applying universal default rate hikes on existing balances be prohibited.

Q. 27: The general rule is that 15 days' advance notice is required to amend finance charges (including the interest rate) or other fees, except in cases where finance charges increase due to a consumer's default or delinquency. In that case notice need not be given in advance—and may even be given months or years ahead of a default "repricing," through disclosure in the original solicitation and/or cardholder agreement.

For practical purposes, most consumers find out about penalty increases and universal default rate hikes only when they receive a statement reflecting the higher rate. This is unfair to consumers because in many cases they continue to use the card, which many companies consider to be an express acceptance of the new terms. Cardholders are given no time to adjust to the idea of a higher minimum payment and miss any chance to transfer the balance to a card with a more favorable rate.

It is wrong to allow no change-in-terms notice in advance of a penalty increase or universal default rate hike just because the creditor has specified in advance that it reserves the right to increase the interest rate under these circumstances. It is not right to allow consumers to be blindsided by these often staggeringly high increases.

In addition to giving consumers advance notice of penalty increases and universal default rate hikes, Consumer Action believes that cardholders should have the right to close the account and pay off the balance at the former rate. We believe that by allowing consumers to elect to freeze the interest rate and fee terms on a closed card, there will be less opportunity for the balance to spiral out of control due to continued purchases, the effect of a higher interest rate on existing balances and new purchases, and the possibility of continued and compounding over-the-limit fees.

In its 2004 annual credit card survey, Consumer Action was startled to find that 44% of surveyed issuers said they will raise existing cardholders' rates because of their poor credit record with other creditors — even if the cardholder has made no late payments or other missteps with them.

Consumer Action sees great potential for abuse in these at-will rate hikes because the industry capitalizes on the fact that no advance disclosure or explanation is required. Raising cardholders' rates on existing balances without prior notice because of their poor credit records with other creditors, violates the spirit of Truth-in-Lending Act notice requirements. When you're turned down for credit, the law requires that you receive a letter explaining why. But if you are the victim of a penalty rate hike, you don't learn about it until your next statement arrives.

Consumer Action also finds that the credit industry has failed to alert consumers as to what can cause a universal default rate hike. Each bank has its own set of guidelines and they have no compunction to share the details with consumers. All consumers get is the most meaningless boilerplate. Consumers need to know that if they finance a new car, their credit card rate might skyrocket unexpectedly.

Consumer Action strongly suggests substantive protections for cardholders who improve their credit in the period following a penalty rate hike or universal default increase. Consumers who respond favorably to the repercussions of worsening credit quality by "cleaning up their acts" should be assured that their APRs will revert within a set period of time to the lower rate they were paying before the penalty increase.

Q. 30: Consumer Action believes that alerting cardholders to the effects of making only minimum payments should become a core credit card disclosure requirement. Many people today pay interest rates as high as 24% and many banks require that consumers pay only 2% of the outstanding balance each month as a minimum payment. This combination of factors means that the cardholder's minimum payment would not cover any of the outstanding balance and would trap the person in a never-ending cycle of debt. Even cardholders with more reasonable interest rates are alarmed to learn that it would take years, even decades to pay off a balance by sending in only the minimum payment each month.

Banks have argued that it is too difficult to provide each cardholder with a specific disclosure of the time it will take to pay off a balance when paying only the minimum payment. Consumer Action believes that it is not difficult at all and the banks have the technology to do this. At the very least, banks should be required to notify cardholders prominently that they can visit the company's web site to individually figure this information on a free balance and minimum payment calculator.

Q. 31: There needs to be a mandatory disclosure of how the minimum payment is arrived at, and the disclosure needs to appear on solicitations as well as account statements. At this time, minimum payment calculation methods are rarely, if ever, disclosed to cardholders unless they specifically ask, and even then it is difficult to get a straight answer.

Low minimum payments combined with high late fees and over-the-credit limit fees help cardholders slide deeper into debt. In the simple example below, which assumes a $400 balance, a $500 credit limit and a 14% interest rate, fees alone cause the balance to jump more than 20% in one month, from $392 to $482.70.

<u>May Monthly Statement</u>
Balance including interest charges: $400
Minimum Payment: $8
Payment received one day late: ($8)
Penalty Interest Rate Applied: 29.99%

<u>June Monthly Statement</u>
Balance: $599.72
Previous month's balance: $392
New purchases: $117.00
Interest charges: $12.72
Late fee (May): $39
Over-limit fee: $39
New balance: $599.72
Balance excluding new purchases: $482.70

Q. 34: When you make a balance transfer to get a better rate, or when you take cash advances on your credit card, your card issuer can apply your payments to the low-rate portion of your balance before the high-rate portion. This can cause the higher-interest portion of the balance to grow faster. It would make sense to require that companies allocate the entire payment to the higher interest portion of the balance first, or at the very least to allocate a proportionate amount of the payment to the higher interest balance in each billing cycle. Many banks disclose the fact that they apply the payments first to the low-rate portion of the balance; however, we have never seen a disclosure that includes mention of the simple fact that this causes the higher-rate portion of your balance to compound faster.

Q. 44: Regulation Z's protections for credit cards should be extended to apply to all credit extended under a credit card account, including convenience checks.

Q. 45: Convenience checks should clearly state on their face—preferably near the signature line—that the use of this check will trigger a cash advance fee and a higher interest rate accruing immediately on the amount of credit extended by the check. A mandatory disclosure also is needed that informs consumers that the check could possibly bounce if they write it for an amount that is higher than their credit limit, which would subject them to over-the-limit fees and possibly merchants' fees as well.

In addition, it should be mandatory for consumers to contact the bank or card issuer by phone to activate convenience checks before they can be used, in order to prevent fraud associated with the use of stolen credit card checks. These checks often are stolen and used to pay off someone else's credit card balances.

Q. 46: No, the board should not consider revising Regulation Z to allow creditors to issue additional credit cards on an existing account at any time. New cards should be sent only upon request. The board should require that consumers be notified in writing or by phone before replacement or renewal cards are sent. No credit card should ever be mailed to a consumer in an activated state.

Q. 47 - Q. 51: Current law requires that consumers' payments must be credited as of the date the creditor receives the payment. This is an enormous gray area since the companies are not required to use any subjective measure—such as U.S. Postal Service postmarks—to document when the payment was sent. Consumer Action believes that federal law would be greatly clarified if banks were required to consider postmarks when posting payments. If the Internal Revenue Service can do it, why can't credit card issuers?

Consumer Action has also documented examples of statement due dates that fall on non-business days, including Sundays. When this is the case, the bank should be required to use the next business day as the due date. How can a payment be received and credited on a non-business day?

Many card issuers specify that a payment is late if received after a certain time (such as 1 p.m.) on the due date. Consumers should be protected from this practice. If you can reach your credit card company at all hours, why should it be allowed to place limits on on-time payments within the actual due date. (The postmark rule would certainly help end this travesty as well.)

With late fees so high, companies might be tempted to assess late fees by simply not posting a payment in a timely manner. We have heard from many people who have been hit with late fees even when they have allowed 7 days for a mailed payment to reach their credit card bank by the due date.