AARP

March 28, 2005

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

**Re: Advance Notice of Proposed Rulemaking Review of the Open End (Revolving) Credit Rules of Regulation Z; Federal Reserve System;12 CFR Part 226; Docket No. R-127**

Dear Ms. Johnson:

We appreciate this opportunity to comment on the Federal Reserve Board's proposed comprehensive review of its rules implementing the Truth in Lending Act ("TILA"). We welcome the Board's decision to undertake, as its initial project, a thorough review of its rules applicable to open end credit. In the existing marketplace for open end consumer credit in which many state consumer protection laws have been preempted, TILA provides the primary, if not the sole constraint on the financial services industry in its dealings with consumers. As a result, this review is particularly timely and important, because it affords the Board the opportunity to adopt regulatory changes to protect consumers of open end credit and to enhance consumer understanding of credit card costs and charges by providing them with the information necessary to make intelligent choices about their credit.

Credit card debt among Americans 55 and older increased dramatically—by well over 100 percent—from 1989 to 1998.[1] As a result, the average credit card-indebted family in a household headed by someone between the ages of 55 and 64 now spends 31 percent of family income on debt payments, a 10 percentage point increase over the decade.[2] Consistent with their increasing load of credit card debt, Americans 50 and older have experienced significantly increased rates of personal bankruptcy filings; one of every four people filing for personal bankruptcy is now 50 or older.

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[1] Tamara Draut, *Borrowing to Make Ends Meet: The Growth Of Credit Card Debt in the 90's* (Demos, Sept. 2003).
[2] Heather G. McGee and Tamara Draut, *Retiring in the Red: The Growth of Debt Among Older Americans,"* Jan. 19, 2004, available at http://www.demos-usa.org/pub101.cfm.

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In fact, Americans 65 and older are the fastest growing group of bankruptcy filers[3] with debtors aged 70 and over having particularly high levels of credit card debt. In the group of bankruptcy filers who are 70 and older most are low income and have credit card debt that is more than double their annual income.[4]

Given these data, we are particularly concerned about the negative impact of proliferating credit card debt on older Americans and the need to increase transparency and ensure fairness in dealings between consumers and credit card providers.

AARP's comments will focus on the following five points:

- All open end disclosures should be clear, easy to read, accurate and informative;
- Initial contract terms for open end credit are presented in small print, are difficult to decipher and have limited value given the ability of credit card companies to unilaterally adopt changes in contract terms virtually without restriction;
- Credit card statements frequently fail to provide essential information in a manner useful to ordinary consumers for understanding the impact of various payment choices and can be deceptive; payments described as "minimum" often trigger additional charges;
- Open end fees can dramatically increase the cost of consumer credit; consumers should be provided information sufficient to enable them to avoid these fees at any stage of their transactions; and
- All fees should be included in the finance charge.

**Disclosures Must Be Clear, Accurate and Informative**

AARP has consistently supported the provision of clear, accurate and informative disclosures for all consumer financial products. We believe that consistent, universally formatted disclosures and easily comparable disclosures, such as the "Shumer box," are essential to deliver such information to consumers.

It is particularly important that complete and accurate information be available to consumers in their dealings with credit card providers because, as the Board has recognized, consumers of open end credit typically have an ongoing relationship with credit providers in which they are regularly called upon to make decisions about their credit. In order to make informed decisions about: (1) whether or not to use additional credit, either through purchases or cash advances; (2) how to manage their credit card debt, including how much is necessary and/or prudent for them to pay to reduce their credit balance, and (3) what impact credit use and/or payments have on their overall

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[3] *See* Theresa Sullivan, Deborah Thorne, Elizabeth Warren, *Young, Old and In Between: Who Files for Bankruptcy? Norton Bankruptcy Law Advisor*, September 2001 at 1.

[4] Edward Flynn and Gordon Bermant, *Bankruptcy By the Numbers, A CloserLook at Elderly Chapter 7 Debtors*, available at www.usdoj.gov/ust/press/articles/abi 042002.htm. .

credit picture, including credit balance, interest rate and fees, the information delivered to consumers must be complete, accurate and current.

The information delivered to credit card consumers under the existing regulatory regime and statutory scheme is notably deficient. Consumers today are simply not provided with the type of information needed to enable them to make decisions about how to minimize their credit costs. They are not provided information necessary to decide how much must be paid in any given month to ensure that their credit balance will decline. Similarly, they are not alerted at the point of sale that certain decisions may trigger the imposition of additional fees, such as over-the-limit fees. Moreover, and most problematic, when a minimum payment is identified in the billing monthly statement, consumers are rarely, if ever, informed when payment of the "minimum" will actually cause their credit card balance to exceed the credit limit and thereby *automatically* trigger an additional fee. In those situations, at least, disclosure of a dollar amount as a minimum is misleading and deceptive.

**The Usefulness of Initial Contract Documents and TILA Disclosures Is Dramatically Undermined By Credit Providers' Ability to Unilaterally Change Terms (Q. 25, 26, 27)**

The Board's apparent belief that consumers may rely on their initial credit card disclosures and contract terms in making decisions throughout the credit relationship with their credit provider is undermined by the realities of the open end credit marketplace. *See* 69 Fed. Reg. 70925, Part V. First, credit card contracts are frequently written in small print, and complex "legalese" that is not easily understood by consumers. Second, the usefulness of these initial disclosures and contract terms for making decisions in later years is significantly weakened by expansive change-in-terms provisions that afford credit providers the ability to revise key contract terms simply by sending notice to their customers.[5] Given the freedom that credit providers *retain* to change key terms (such as interest rates, fees, length of time to make payments, eligible forum for resolving disputes), these early disclosures and contract terms are of minimal value to consumers in making a credit decision at any time subsequent to opening their account.

Changes in credit terms are particularly problematic when they are made without prior notice to the consumer. For example, it is now often the practice for credit providers to retain the right to impose a significantly increased penalty interest rate upon the occurrence of specific triggering events. Thus, a consumer might discover that his/her provider has imposed a penalty interest rate to an existing credit balance -- in some

[5] *See* Patrick McGeehan, *The Plastic Trap: Mountains of Interest Add to Pain of Credit Cards*, New York Times, Nov. 21, 2004 ("A typical term sheet for a Visa card issued by Bank One . . . includes: 'We reserve the right to changes the terms at any time for any reason.' "); *see e.g.* the change-in-terms provisions in *Rossman v. Fleet Bank* (R.I.) N.A., 280 F.3d 384 (3d Cir. 2002); *Gaynoe v. First Union Direct Bank, N.A.* 571 S.E.2d 24 (N.C. Ct. App. 2002).

cases as high as 30 to 40 percent[6]-- simply because of a late payment. In some cases, penalty rates have been imposed for consumer behavior related to other credit relationships and not based on any failure to make timely payments on the account with that provider.[7] Thus, in some instances consumers may be blind-sided by unanticipated term changes that make it very difficult for them to control their cost of credit, forcing them into increasing and uncontrollable amounts of debt.[8]

**Periodic Statements Fail to Arm Consumers With Information Necessary to Make Intelligent Credit Decisions (Q 31)**

As the Board acknowledges, there are few rules applicable to the disclosure of open end credit, including periodic billing statements sent to consumers. *See* 69 Fed. Reg. 70925, Part V, A. This void presents a variety of challenges for consumers attempting to make informed decisions about their credit card account. A fundamental concern that has been expressed by consumer advocates and state and federal legislators arises in connection with the so-called "minimum payment" amount identified on the periodic statement. First, there is no definition of "minimum payment." Nor are there definitions provided for other key terms disclosed on the periodic statement and which are necessary for consumers to understand in order to make informed decisions.

The failure to provide definitions leads to significant problems. We believe consumers commonly assume that a "minimum payment" is just that—the smallest amount that they must pay to make progress in paying off their credit balance. Yet the minimum payment is often insufficient to reduce the credit balance at all and in some cases, is insufficient to pay the full amount of accrued interest. In such a situation, payment of the "minimum" actually causes the credit balance to increase. In the worst cases, payment of the "minimum" automatically triggers an additional fee because, even without any additional use of credit, the minimum payment causes the consumer to exceed his/her credit limit and triggers a corresponding over-the-limit fee.

Consumers must be provided the information necessary for them to evaluate the impact of their payment choices. At a minimum, the periodic statement should clearly identify the smallest dollar amount that the consumer can pay and still amortize his/her credit balance. The creditor could, at its option, adopt this amount as its minimum payment and obviate the need to add an additional disclosure. The periodic statement must provide other information necessary to informed decision-making. This would include

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[6] *See,* Kathleen Day and Caroline Mayer, "Credit Card Fees Bury Debtors, Washington Post, March 7, 2005, available at http://www.washingtonpost.com/wp-dyn/articles/A10361-2005Mar5.html?nav=hcmodule.

[7] Linda Sherry, *Annual Credit Card Survey 2003,* Consumer Action (Spring 2003).

[8] *See, e.g.* Patrick McGeehan, *The Plastic Trap: Mountains of Interest Add to Pain of Credit Cards,* New York Times, Nov. 21, 2004 (Discover card recently changed its contract with consumers to allow it "to raise the interest rate to 19.99 percent, from as low as zero, for a single late payment . . . [and] reserved the right to look back 11 months for a late payment that could justify the increase." ); *see also,* Complaint *Minnesota v. Capital One Bank filed 12/30/04 available at http://www.ag.state.mn.us/consumer/PDF/PR/CapitalOneComplaint.pdf*

the clear and prominent disclosure of the dollar payment amount necessary to avoid imposition of additional fees, such as over-the-limit fees. No "minimum payment" disclosure should be permitted that is not in fact a minimum. In our view this is a deceptive practice and violates, at the very least, the creditor's obligation to provide clear and conspicuous disclosures.

We recommend that the Board adopt rules requiring a uniform, accurate and easily understandable billing statement. These rules should require that essential definitions -- those necessary to understand the statement -- appear in clear and plain language on the monthly statement so that consumers do not have to search through other materials or websites to understand their bill. For example, a clear definition of "minimum payment" would inform the consumer whether the minimum suffices to reduce the balance. If not, the consumer should be provided, as a separate dollar amount, the smallest payment necessary to reduce the current balance shown on the statement. The statement should clearly identify the type and dollar amount of all fees that are being imposed on the consumer and the conditions that triggered imposition of those fees. The Board should retain useful disclosures such as the historic effective interest rate.

**Credit Card Fees Harm Consumers (Q 21, 22)**

In recent years, income from ancillary fees imposed on credit card customers has increased steeply,[9] raising many public policy concerns regarding their basic fairness. Industry asserts that fees are the result of unilateral breaches of contract by consumers.[10] The Board can empower credit card customers to redress that assertion by giving them the means to ascertain whether a particular credit transaction will cause them to trigger the imposition of a fee or other charge.

A typical household carries an average of eight credit cards. As a result, in many situations, consumers have a choice about which card to use to make a particular purchase or engage in a specified transaction. Given this choice, *many* consumers would not intentionally make use of a card which would trigger the imposition of a fee. Moreover, for those consumers who do not have multiple cards or for whom any purchase would trigger a fee, knowledge that the transaction would trigger an additional fee would enable them to make choices: to delay transactions or to knowingly engage in the transaction and incur the fee. Under the existing regulatory system, consumers lack sufficient information to make these assessments.

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[9] For example, MBNA's credit card fee income has increased 78% in the five years 2000 through 2004. www.cardweb.com.

[10] *See Household Credit Serv. Inc. v. Pfennig*, 541 U.S. 232, 124 S. Ct. 1741 (2004)

At a minimum, the Board can require providers to enable consumers to avoid fees or have the issuer be required to treat any such fees as finance charges. We recommend that the Board adopt rules that provide for an alert to consumers before they enter into a particular transaction that incurs an over-the-limit fee or that triggers some other penalty. We understand this to be a challenging task, but expect that numerous avenues might exist and should be explored to accomplish this goal. One option that has been mentioned is to permit consumers to contact their provider through a toll-free number to "authorize" the transaction. In that situation, the consumer could proceed with a transaction confident that it was permitted by the credit agreement. Another proposal to return control to consumers has arisen in connection with transactions in which consumers swipe their cards on a point of sale credit card device. In that situation, once the consumer had swiped the card in any transaction which would trigger a fee, a query could appear, as occurs in ATM transactions, advising the consumer that continuing the transaction will result in the imposition of a particular fee and inquiring whether they wished to continue with the transaction or cancel.

We recognize that there are any number of creative means to accomplish the goal of empowering the credit card customer, to give him or her the information tools for managing their credit card costs and debt. The Board can either afford providers the flexibility to select any means of accomplishing this goal or specify a limited number of options. At any rate, we believe that consumers should not be subjected to fees, whether treated as finance charges or otherwise, unless they have the ability to make decisions to eliminate or minimize them.

**The Finance Charge (Q 5)**

AARP has consistently taken the position with respect to all forms of consumer credit that all fees and charges that increase the cost of that credit — without exception — should be included in the finance charge. Without their inclusion, consumers simply have no means to make comparisons that will enable them to locate the most affordable source of credit. As a result, we believe that all credit card fees, however denominated, should be included in the finance charge.

## Impact of Recent Legislative Changes

AARP believes that currently there is a significant void in the regulation of credit card industry practices given the almost complete preemption of state regulation following deregulation of bank credit. Similarly, in the federal arena few limits have been placed on credit card practices with the exception of regulation under the Truth in Lending Act. TILA was intended to mandate uniformity in disclosing information about the costs and terms of credit to consumers and to provide consumers with the tools that would enable them to compare the costs of credit. However TILA's utility in protecting consumers of open end credit is limited by its primary function as a disclosure statute. TILA was never intended to be the sole vehicle for regulating the financial services industry in its dealings with individual consumers who borrow money for personal, family or household purposes. Consequently, AARP is concerned that the Board may not be able to fully redress all the questions of fairness in the open end credit market with current statutory authority.

## Conclusions

We have offered suggestions that we believe will substantively improve open end credit disclosures, thereby enhancing the consumer's ability to make informed decisions about their credit. But we also recognize that disclosures alone cannot enforce fairness in the open end credit arena. Congressional oversight and ultimately federal legislation may be required to establish appropriate standards for protecting the credit card customer. AARP supports the Federal Reserve Board's decision to make a comprehensive review of the role played by TILA in these rapidly changing financial times. We see the three phases of the Board's review of Regulation Z as an important and necessary step in assessing what, if any, legislative initiatives should be pursued.

Sincerely,

Chris Hansen
Associate Executive Director
State and National Initiatives