United States Senate
COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

November 23, 2009

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

RE: Comments on the Proposed Rule to
Amend Regulation Z; Docket No. R-1370

Dear Ms. Johnson:

The purpose of this letter is to express support for the Board's proposed rule to implement the provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) that takes effect on February 22, 2010. The Board is to be commended for issuing a straightforward, comprehensive, and understandable rule that largely implements the Act as Congress intended. Unfortunately, since the law's enactment earlier this year, some credit card issuers have already initiated actions that seem designed to circumvent or undermine the CARD Act's consumer protections and to continue the industry's history of subjecting consumers to abusive practices. As a result, the proposed rule requires further clarification and strengthening to ensure effective implementation of the consumer safeguards established by the CARD Act.

Background

Credit cards provide hundreds of millions of Americans with convenient short-term loans that aid in financial planning and management, but these benefits often come at a steep cost. Some credit card issuers have subjected credit cardholders to an array of unfair and deceptive lending practices. In the last five years, for example, the credit card industry has hit working families with interest rates of 25 or 30 percent or more, charged interest for debt that was paid on time, hiked interest rates on consumers despite years of on-time payments, applied higher interest rates retroactively to existing debts, assessed excessive fees, and employed unfair practices in accepting and crediting consumer payments. Many Americans are now facing the worst economic hardship of their lifetimes, and their hardship is being compounded by abusive credit card fees and interest charges. The taxpayer has already been required to foot the bill for our biggest banks' irresponsible lending practices; excessive fees and interest rates amount to another coerced industry bailout.

Subcommittee Investigation

Since 2005, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has been conducting an extensive inquiry into unfair credit card practices. The Subcommittee initiated this investigation with a request that the Government Accountability Office (GAO) analyze the credit card fees, interest rates, and disclosure practices of 28 popular credit cards from the then six largest credit card issuers. The resulting GAO report, which we released in 2006, presented data on key credit card practices, showing how interest rates and fees had proliferated and credit card disclosures had deteriorated. Following the GAO report, the Subcommittee began a series of detailed interviews with participants in the credit card industry, including consumers, credit card issuers, credit card payment networks, federal regulators, credit bureaus, debt collectors, legal advocates, and public interest groups.

In March and December 2007, the Subcommittee held hearings that received testimony from consumers and the chief executive officers of major credit card issuers including Bank of America, Chase Bank, Citi Cards, Capital One, and Discover Financial Services. The hearings examined a host of abusive credit card practices, including excessive and duplicative fees, interest charges for debt that was paid on time, interest rates as high as 32 percent, the application of higher interest rates retroactively to existing credit card debt, the unfair allocation of credit card payments, and unfair interest rate hikes.

The Subcommittee also received thousands of letters from consumers alleging unfair treatment by credit card issuers, more letters than the Subcommittee has received on any other topic in the last ten years. The complaints stretch across all income levels, all ages, and all areas of the country. In reviewing these letters, the Subcommittee found solid evidence of abusive practices. The Subcommittee featured a few of these case histories, but substantiated many more than could be addressed in our hearings.

Protecting Consumers

The purpose of the Truth in Lending Act (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 Subcommittee investigation made it clear that the existing regulations were not sufficient to protect the consumer against unfair credit card practices.

In 2007, the Board of Governors of the Federal Reserve System proposed rules amending Regulation Z, which implements TILA. I submitted a comment letter at the time expressing my concern that the proposed rules were not adequate. My letter also recommended that the Board adopt the consumer protection provisions I had included in a bill that I introduced that year, S. 1395, the Stop Unfair Practices in Credit Cards Act.

In 2008, the Board proposed rules amending Regulation AA, exercising its authority under the Federal Trade Commission Act to prohibit deceptive acts or practices. The proposed rules represented a significant step in the right direction. But, as I commented at the time, the rules addressed only some of the abusive practices indentified in the Subcommittee investigation. I recommended that the Board adopt additional consumer protection provisions that Senator Dodd and I had included in S. 414, the Credit Card Accountability, Responsibility, and Disclosure Act of 2008.

Our investigations had demonstrated that many of the credit card abusive practices were too entrenched, too profitable, too pervasive, and too immune to consumer pressures for us to have any confidence that the companies would change them on their own. In May 2009, Congress decided it was necessary to return common sense, responsibility, and fairness to the credit card industry by enacting a comprehensive reform bill, the CARD Act of 2009.

Response to Enactment of the CARD Act

According to a study released in October by the Pew Charitable Trusts, "One hundred percent of credit cards from the largest 12 banks used practices deemed 'unfair or deceptive' under Federal Reserve guidelines. None of these bank issued cards would meet the requirements of the Credit CARD Act of 2009." Pew also found that 99.7 percent of bank card agreements allowed the issuer to engage in unilateral retroactive repricing of interest rates on existing balances, a practice banned by the Act. Consequently, the time period from the passage of the bill in May, to its primary effective date in February, has been a time of adjustment for the credit card industry.

In addition, due to the collapse of the economy, most credit card portfolios have become riskier, and most card issuers have responded by tightening lending standards, increasing interest rates, adding annual fees, switching to variable rates, closing inactive accounts, and reducing credit lines on many active accounts. The average cardholder, already struggling to cope with the worst economy since the Great Depression, has had to bear the brunt of those changes.

Some card issuers have adjusted to the new economic and regulatory environment by embracing the purpose of the CARD Act and developing fairer, more transparent products. Other issuers, however, seem to be developing new mechanisms to evade or circumvent the law, before it is even fully implemented.

Stopping Abusive Practices

While the proposed rule does a commendable job in implementing credit card consumer protections and stopping the abusive practices in effect at the time the CARD Act was enacted, it needs to be strengthened to address the additional abusive practices that have emerged in the last six months and that threaten to undermine the statutory protections, even before they have been implemented.

Anti-Evasion Rule. First, the rule needs to be strengthened by adding a general prohibition against credit card industry actions that bypass or undermine the consumer protections established by the CARD Act. Regulators cannot be expected to repeatedly issue new rules to address the ongoing, rapid changes and new abusive practices in the credit card industry. Instead, a broad anti-evasion prohibition should be added to the rule to ensure the

Board has adequate authority to identify, deter, and stop new credit card abuses. This anti-evasion provision could state, for example: "A creditor may not employ any credit card interest rate or fee structure, grace period restriction, minimum payment requirement, account closing mechanism, disclosure practice, rebate, or other device or practice that would evade, circumvent, or undermine the effectiveness of the consumer protections established by the CARD Act or this rule."

Hybrid Fixed-Variable Interest Rates. One of the most common interest rate changes since the CARD Act was enacted has been the adoption of hybrid fixed-variable interest rates. A recent report by the Pew Charitable Trust states: "A significant number of issuers [have] shifted toward a combination fixed/variable rate mechanism that allows rates to go up as indexes rise, but prevents rates from falling below a fixed minimum of the issuer's choosing." The Subcommittee's research confirms that such hybrid fixed-variable interest rates are proliferating. In my view, as one of the authors of the CARD Act, this type of interest rate does not and should not qualify under the exemption for variable interest rates provided by Section 171(b)(2) of the statute. If a credit card issuer establishes a floor for a variable interest rate, then the creditor is exercising a measure of control over that interest rate, which will then be unable to freely change "according to [the] operation of an index that is not under the control of the creditor," as required by law. The proposed rule should make it clear that such hybrid fixed-variable interest rates do not meet the requirements of the exemption and thus would not comply with the CARD Act's restrictions on retroactive repricing or its 45-day notice requirement for interest rate increases.

Pick-A-Rate. Another emerging credit card industry practice involves altering the way in which variable rates function. Instead of specifying that a variable rate will vary according to an index value at a specified date and time, some creditors have indicated that the variable rate will be the highest index value that occurs during a specified period of time, sometimes months long. In effect, the issuers are picking the highest rate during a specified window. By lengthening the time period during which the variable rate is selected, these creditors are often able to increase the rates imposed on consumers. The Center for Responsible Lending has calculated, for example, that credit card issuers using "pick-a-rate" methodologies have raised rates for 117 million accounts an average of 0.3 percentage points above traditional pricing methods. These credit card issuers are raising interest rates in subtle ways that consumers cannot detect or prevent and which make comparison shopping extremely difficult, unless the proposed rule bans this practice.

Interest Rate Rebates. Some credit card issuers have begun designing new interest rate structures which rely on rebates. At least one credit card issuer has unilaterally changed the interest rates of existing customers by increasing the rate substantially, to as high as 29.99 percent, and promising a substantial rebate if they exceed a specified spending threshold each month and make on-time payments of at least the minimum balance. The Subcommittee is aware of one case in which this spending threshold was set at $1,500 per month and the promised "rebate" would allow the consumer to "earn back" a credit equal to "10% of the total interest charge on purchase balances."

This interest rate structure is confusing and potentially unfair and abusive. It is confusing, because the notice provided to consumers does not adequately explain when the rebate would be paid, what the 10 percent applies to – whether it would, for example, reduce the 29.99 percent interest rate to 19.99 percent or 27.00 percent – or how the interest rate charges would be calculated on a daily basis. If such explanations were provided, this rebate concept is so complex that many consumers would likely be unable to understand exactly what was being offered, unable to compare the rates being offered to those on other credit cards, and unable to monitor their bills for improper charges.

The interest rate rebate structure is potentially unfair, because it increases a consumer's interest rate on an existing balance if the consumer fails to exceed a specified spending threshold, even for consumers with large balances who want to reduce their spending and concentrate on paying down their debt. In addition, if a consumer were to pay a bill one day late, the consumer would lose any chance of a rebate and become subject to a higher interest rate, even though the CARD Act prohibits interest rate hikes on existing balances unless a consumer's payment is 60 days late.

This interest rate rebate structure also invites a variety of abuses. For example, a credit card issuer could later reduce a promised rebate, in effect hiking the consumer's interest rate on a retroactive and unilateral basis – exactly the abuses that the CARD Act sought to end. Or an issuer could hike the spending threshold to a level that would force the consumer to spend a substantial amount – perhaps more than the consumer could afford -- to qualify for the rebate and the lower rate. Issuers could also structure payment of the rebates to undermine the CARD Act's prohibitions against double cycle billing and charging interest for debt paid on time. Unscrupulous issuers could even retain or delay paying a promised rebate, forcing consumers to try to get their money back.

This interest rate rebate structure does not serve consumers. It creates layers of complexity that are confusing and invite a host of abuses. The final rule should prohibit such interest rate structures entirely.

Grace Period Rebates. Some credit card issuers have also designed credit cards with complex new grace period limitations that also utilize rebates. Essentially, these credit cards would eliminate any guaranteed grace period for the payment of debt without interest charges, and charge interest from the day that credit is extended, but then promise to rebate all or a portion of the levied interest in the next billing cycle under certain circumstances. The circumstances include whether the consumer had a preexisting balance, whether the consumer's purchases exceeded a specified threshold in prior months, and whether prior interest charges were rebated.

These grace period limitations and rebate promises, like those for interest rate rebates, are confusing as well as potentially unfair and abusive. The notice of these complex credit card terms is difficult to understand, impedes comparison shopping, and makes monitoring an account for improper charges nearly impossible. The structure is unfair because it does not clearly provide the grace period which is a staple for most credit cards, but makes it contingent upon factors that are difficult to predict. In addition, like interest rate rebates, such grace period rebates invite abuses. Credit card issuers could shorten a promised grace period or tighten the rebate terms such as by increasing the specified spending threshold or capping rebate totals, making it much less likely that a consumer would qualify for a rebate. And again, unscrupulous issuers could simply retain or delay payment of a promised rebate.

In the end, the new complicated grace period structures may circumvent or undermine the CARD Act's new consumer protections for grace periods, in particular the new prohibition on charging interest for debt that was paid on time during a grace period. The final rule should prohibit such grace period structures as a transparent attempt to resurrect unfair credit practices involving the charging of interest during promised grace periods.

45-Day Notice for Account Terminations. Over the past year, credit card issuers have reduced hundreds of billions of dollars in contingent liabilities by closing active and inactive accounts, and reducing credit lines. Reducing contingent liabilities may be prudent for credit card companies, but account closings often have adverse consequences on the affected cardholders. Therefore sufficient notice is critical. Recognizing that card issuers sometimes have a justifiable reason to close an account quickly, the Board should require a 45-day notice for account termination unless there is a documented credit risk specific to the affected consumer.

Effective Date. Some credit card issuers have asked the Board to grandfather in existing accounts to circumvent certain CARD Act reforms. The CARD Act was intended to apply to all credit cards, not just credit cards issued after the effective date of the Act. Exempting current accounts from any statutory or regulatory requirement would be inconsistent with the Act's clear purpose. For example, Section 172 of the Act limits the ability of card issuers to increase interest rates in the first year of an account. That limitation is intended to apply to all credit card accounts that will have been open for less than one year at the time of the Act's effective date, not just to accounts opened after the effective date. Likewise, the law clearly intends that if a cardholder makes a late payment on January 15, 2010, the card issuer cannot assess a penalty interest rate on an existing balance even with a 45-day notice, because the retroactive repricing exception under Section 171 (b)(4) of the CARD Act provides for a 60 day delinquency, and the law will be in effect by the time the penalty rate is assessed.

Conclusion

Credit cards have evolved from straightforward short-term consumer loans to complex financial tools that many consumers are unable to understand or reasonably evaluate. Over the last few months, in some cases, credit card issuers have used convoluted schemes to create additional complexities and even hidden financial traps for consumers.

Federal Reserve Governor Elizabeth A. Duke announced on September 29, 2009, that the proposed rules amending Regulation Z represented "another step forward in the Federal Reserve's efforts to ensure that consumers who rely on credit cards are treated fairly." The proposed rules do indeed go a long way towards ensuring the fair treatment of credit card holders as contemplated in the CARD Act. However, since the CARD Act was signed into law in May, card holders have been hit with an array of unfair practices, some of which seem to have been designed specifically to evade or circumvent the Act. To fulfill its responsibility to the American people the Board needs to strengthen the proposed rule to prevent such evasions from undermining the law.

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

Sincerelv.

Carl Levin
Chairman
Permanent Subcommittee on Investigations