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

January 3, 2011

VIA EMAIL (regs.comments@federalreserve.gov)

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-1393; RIN No. 7100-AD55

Dear Secretary Johnson:

The purpose of this letter is to express support for the Board's proposed rule to clarify certain aspects of the final rules amending Regulation Z's provisions implementing the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) that took effect on February 22, 2010. The Board is to be commended for clarifying its final rules from February 22, 2010 and June 29, 2010 in order to facilitate compliance with the CARD Act as Congress intended. Unfortunately, since the enactment of the CARD Act last 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. The recent proposed rule offers important clarifications that will ensure the 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.[1] 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 stretched 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."[2] 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

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[1] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," GAO, Report No. GAO-06-929 (9/06).

[2] 15 U.S.C. § 1601a.

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 addressed only some of the abusive practices indentified in the Subcommittee investigation. My comment letter recommended that the Board adopt additional consumer protection provisions included in a Dodd-Levin bill, 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 2009 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 banks 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 2009, to its primary effective date in February 2010, was a time of adjustment for the credit card industry.

In addition, due to the collapse of the economy, most credit card portfolios became riskier, and most card issuers 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. While these trends have started to abate as the economy has started to find its footing, the average cardholder, still struggling, 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, have developed new mechanisms seemingly intended to evade or circumvent the law. It is important to ensure a level playing field for the credit card issuers that are playing by the rules.

Stopping Abusive Practices

Some credit card companies have sought to exploit loopholes or imagined ambiguities in the final rules implementing the CARD Act. The Board has done an admirable job identifying these loopholes and ambiguities and addressing them. The proposed rule goes a long way towards ensuring compliance with the CARD Act as Congress intended. When finalizing the proposed rule the Federal Reserve needs to hold its ground against industry commentators seeking to reintroduce abusive practices. A few of the clarifications in the proposed rule, detailed below, are particularly important.

No Pay-to-Pay Fees from Third Parties. The proposed rule contains an important clarification that would prohibit third-party service providers from charging cardholders "pay-to-pay" fees that the CARD Act prohibited card issuers from charging. The proposed rule states:

> The Board understands that card issuers may use third-party service providers to provide payment-related services on behalf of the issuer, such as receiving or processing payments from consumers. In some circumstances, the third-party service provider may charge consumers a separate fee for making a payment—for example, when a payment is made electronically through a Web site. The Board believe that it would be inconsistent with the purposes of the Credit Card Act for consumers to pay a separate fee for making a payment through a third party who is receiving payment on behalf of the issuer, unless the issuer itself would be permitted to charge the fee. Accordingly, the Board proposes to adopt a new comment 10(e)-4 to prohibit third party service providers or other third parties who receive payments on behalf of a card issuer from charging a separate fee for payment....[3]

As one of the authors of the "No Pay-to-Pay" provision of the CARD Act, I applaud the Board's action. To allow third-party service providers to charge pay-to-pay fees would undermine the intent of the law, allow credit card issuers to do indirectly what they cannot do directly, and render the statutory ban on these fees meaningless. It is critical that the Federal Reserve retain this provision in the final rule.

Upfront Fees Cannot Be Used to Circumvent Fee Harvester Card Prohibitions. Before the implementation of the CARD Act, some less scrupulous credit card issuers targeted vulnerable consumers with predatory "Fee Harvester" credit cards. Fee Harvester cards purported to offer a credit line, and then assessed various unavoidable fees that could utilize a significant percentage of available credit. The CARD Act prohibited such credit cards by adding language to the Truth in Lending Act that prevents card issuers from charging fees, in the first year after the account is opened, in excess of 25 percent of the total amount of credit authorized under the account (other than any late fee, over-the-limit fee, or fee for a payment returned for insufficient funds).

Some predatory credit card issuers have subverted the intent of this provision by charging upfront processing fees that attempt to avoid the 25 percent fee limit by imposing the fees prior to activation of the credit card. The Board is correct that such upfront fees are "inconsistent with [the] intent of of Section 127(n)(1) insofar as it disturbs the statutory relationship between the

[3] **Federal Register**, Vol 75, No. 211 (11/2/2010) at 67471.

costs and benefits of opening a credit card account."[4] The clarification made by the Board in the proposed rule will ensure that the intent of the statute is carried out.

Interest Waivers Cannot Be Used to Circumvent Rate Increase Prohibitions and Notice Requirements. Some credit card issuers have begun to offer so-called "interest rate waiver" programs which are not only complex, but appear to be designed to circumvent key safeguards in the CARD Act. My November 2009 comment letter responding to proposed rules amending Regulation Z raised a number of concerns about such efforts:

> 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….'
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> 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. ...
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> 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.[5]

[4] **Federal Register**, Vol 75, No. 211 (11/2/2010) at 67475.

[5] Letter from Senator Levin to Secretary Johnson, "Comments on the Proposed Rule to Amend Regulation Z; Docket No. R-1370 (11/23/09).

The same analysis applies to interest rate waiver programs, which can also be abused to subvert the intention of the CARD Act. The Board should simply ban these confusing and potentially abusive rate structures.

Although the better course is to ban such interest waiver and rebate gimmicks altogether, the proposed rule at least makes it clear that such schemes cannot re-create the very types of hair-trigger rate increases that the CARD Act prohibited. In its proposed rule, the Board acknowledges that, "the revocation of promotional waiver or rebate programs based on so-called 'hair trigger' violations of the account terms may be inconsistent with the purposes of the Credit Card Act."[6] Hair-trigger revocations of waivers or rebates that would result in immediate interest rate increases would, indeed, contravene the purpose of the CARD Act. Short of banning such gimmicks entirely, the Board's proposal to require 60-days notice prior to any rate changes in a waiver or rebate program is a reasonable measure.

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. In response to the CARD Act, many credit card issuers have resorted to convoluted schemes that attempt to preserve profits by creating additional complexities and even hidden financial traps for consumers. Many of these schemes seem to have been designed specifically to evade or circumvent the Act. The Board's proposed rule helps clarify areas of possible confusion in the final rules implementing the Act, and helps ensure it is implemented as Congress intended. I commend the Board for a well reasoned, well founded, and fair proposal.

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

Sincerely,

Carl Levin

Carl Levin
Chairman
Permanent Subcommittee on Investigations

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[6] **Federal Register**, Vol 75, No. 211 (11/2/2010) at 67480.