Credit Card Reform:
An Analysis of the Credit CARD Act

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Introduction

Congress has passed the “Credit Card Accountability Responsibility and Disclosure Act of 2009,” also known as the “Credit CARD Act of 2009” (CARD Act). The measure amends the Truth in Lending Act (15 USC 1601 et seq.) to “establish fair and transparent practices relating to the extension of credit under an open-end consumer credit plan, and for other purposes.” The legislation is intended to ban abusive credit card practices, enhance consumer disclosures and protect underage consumers.

The House gave final approval to H.R. 627 on May 20, 2009, by a vote of 361-64. The vote follows the Senate passage of the bill by a vote of 90-5 on May 19.

The bill contains a number of provisions intended to provide protection to consumers from unreasonable interest rate increases and credit card fees. It increases supervision of credit card issuers, enhancing transparency of their practices, and includes measures intended to shield consumers from misleading use of terms in credit card statements and solicitations.

The legislation bans double-cycle billing and retroactive interest rate hikes on existing balances, unless payment is at least 60 days late, and requires card issuers to provide 45 days advance notice of any impending rate hike. Statements must be mailed 21 days before the bill is due, rather than the 14 days presently required.

The measure targets credit card marketing to consumers under the age of 21, prohibiting issuers from making pre-screened credit card solicitations to under-age individuals unless the individual expressly opts into receiving the solicitations.

The Act amends the Federal Trade Commission Act (15 USC 41-58, as amended) by providing each federal banking agency with the authority to prescribe regulations governing unfair or deceptive practices with respect to the depository institutions it supervises.

The House also passed an amendment to allow firearms owners to carry their weapons into national parks, by a vote of 279-147.

The CARD Act generally becomes effective nine months after enactment, with the exception of Title IV—Gift Cards.

Background

Revolving consumer credit in the United States has more than quadrupled over the past two decades, growing from $238.6 billion in December 1990 to its peak of $977 in September 2008. Households' credit card debt also increased significantly during this period, with close to 75 percent of U.S. households using at least one general-purpose credit card.

With the U.S. economy in crisis mode, households increasingly have used credit cards for routine expenses. As usage of credit cards has grown, so have the variety of fees and practices. In a 2006 report by the Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers,* the GAO noted that "After 1990, card issuers began to introduce cards with a greater variety of interest rates and fees, and the amounts that cardholders can be charged have been growing."

In its analysis, the GAO found that:

- some issuers charged up to three different interest rates for different types of transactions;
- penalty fees had more than doubled since 1990;
- penalty rates rose above 30 percent; and
- various new fees for foreign currency exchange, bill payment by telephone, cash advances and balance transfers were not necessarily incorporated into written disclosures.

According to the Center for Responsible Lending, penalty rates in 2008 averaged 16.9 percentage points above the standard rate, more than doubling from an 8.1 percentage point difference between standard and penalty rates in 2000.

Supporters of credit card reform claim that these penalties have contributed to the growing credit card debt in the United States, with the average household carrying a credit card balance close to $10,000.

Regulators Take Action

Against the backdrop of consumers' increasing credit card debt, the Federal Reserve Board, Office of Thrift Supervision and National Credit Union Administration finalized rules intended to prohibit unfair and deceptive credit card practices in December 2008. The agencies, exercising their authority under Sec. 5(a) of the FTC Act to prohibit unfair or deceptive acts or practices, adopted a final rule amending Regulation AA (12 CFR 227) barring institutions from engaging in certain acts or practices in connection with consumer credit card accounts.

In addition, the Fed exercised its authority under the Truth in Lending Act (TILA) to prescribe regulations on consumer disclosures in credit card solicitations, applications and statements under Regulation Z (12 CFR 226). The proposal to amend Regulation Z followed what the Fed termed a “comprehensive review” of TILA's rules for open-end (revolving) credit that is not home-secured. Consumer testing was conducted as a part of the review.

Under the final rules:

- disclosures accompanying credit card applications and solicitations must highlight fees and reasons penalty rates might be applied, such as for paying late;

- creditors are required to summarize key terms at account opening and when terms are changed;

- specific fees are identified that must be disclosed to consumers in writing before an account is opened, and creditors are given flexibility regarding how and when to disclose other fees imposed as part of the open-end plan;

- costs for interest and fees are separately identified for the cycle and year to date; and

- creditors are required to give 45 days' advance notice prior to certain changes in terms and before the rate applicable to a consumer's account is increased as a penalty.

The rules become effective on July 1, 2010.

"The revised rules represent the most comprehensive and sweeping reforms ever adopted by the Board for credit card accounts," Federal Reserve Chairman Ben S. Bernanke said upon adoption of the amendments. "These protections will allow consumers to access credit on terms that are fair and more easily understood."

Agency Rules Spur Reform Legislation

Lawmakers applauded the agencies' adoption of credit card reform rules, but many felt that the new rules, while an important step in reform, were only the first step in curbing what they saw as abusive practices by credit card issuers. Supporters of reform believed that Congress needed to act to ensure adequate consumer protection. There also was concern among lawmakers that the 2010 effective date of the rules would leave consumers unprotected for too long a period.

Senators Christopher J. Dodd, D-Conn., the Chairman of the Banking, Housing, and Urban Affairs Committee, and Charles E. Schumer, D-N.Y., wrote a letter to Fed Chairman Bernanke and other regulators urging them to "speed up" the rules and implement an emergency freeze on interest rates tied to existing credit card balances.

"Over the past year, the Federal Reserve has cited the financial crisis as one of the reasons for acting quickly to implement new lending facilities and programs to protect financial institutions," the senators wrote. "It is long past time for the regulatory agencies to act with the same sense of urgency to protect consumers from the behavior of those same financial companies."

Spurred on by the need to speed reform, legislation in both the House and Senate was introduced in early 2009.

Legislative Tracking

January 22, 2009—A credit card reform bill building on the federal banking agencies' rules is introduced in the House. The measure, "The Credit Cardholders' Bill of Rights Act of 2009" (H.R. 627), was sponsored by Rep. Carolyn B. Maloney, D-N.Y.

"This landmark legislation helps level the playing field between cardholders and card companies," Maloney said. "For too long the relationship has been one-sided; but markets function best when all sides know what they're getting into—and these deceptive practices need to be stopped. The Credit Cardholders' Bill of Rights brings more transparency to the contractual relationship and give[s] consumers the tools they need to responsibly manage their own credit."

Maloney added that "The substantial reforms in this bill are needed now more than ever, as working Americans have increasingly turned to credit cards to help pay medical bills, buy groceries, and make ends meet in this troubled economy."

February 11, 2009—A bill similar to the House bill is introduced in the Senate. The bill, the "Credit Card Accountability Responsibility and Disclosure Act of 2009" or the "Credit CARD Act of 2009" was authored by the outspoken proponent of credit card reform, Sen. Dodd. Like the House bill, the Senate bill expanded the rules adopted by the federal banking agencies.

April 22, 2009—H.R. 627 clears the House Financial Services Committee by a vote of 48-19.

April 30, 2009—The House passes H.R. 627 by a vote of 357 to 70.

May 19, 2009—The Senate passes the House measure, with amendments, by a vote of 90-5. The bill is sent back to the House for consideration of the amendments made by the Senate.

May 20, 2009—The House approves the bill, as amended. These amendments include:

- A change in the short title of the bill, from the "Credit Cardholders' Bill of Rights Act of 2009" to the title previously given to Sen. Dodd's bill, S. 414, the "Credit Card Accountability Responsibility and Disclosure Act of 2009" or the "Credit CARD Act of 2009."
- The addition of Title IV covering gift cards.
- A change in effective date, from 12 months to nine months in most cases.
- A provision allowing individuals to possess functional firearms in the National Park System or the National Wildlife Refuge.

Credit Card Reform Debate

The introduction of credit card reform bills in the Senate and House prompted an ongoing debate between supporters of reform and the banking industry.

On passage of the House bill, the American Bankers Association issued a statement rife with concerns about the measure.

Any additional legislative efforts beyond steps already taken by the banking agencies should “strive to achieve the right balance between enhancing consumer protection and ensuring that credit remains available to consumers and small businesses at a reasonable cost,” the ABA said.

“As policymakers are aware, it is vitally important to maintain access to credit at this difficult economic time. This is especially true for credit cards, which serve as a driver of economic activity and are relied on by consumers and small businesses as a way to bridge short-term financial gaps.”

The ABA weighed in again after passage of the Senate bill on May 19. Edward L. Yingling, chief executive of the ABA, noted that the bill contained provisions that were “tough, but workable” but added that the bill “fundamentally changes the entire business model of credit cards by restricting the ability to price credit for risk.”

“It will be a different business,” Yingling said. “Those that manage their credit well will in some degree subsidize those that have credit problems.”

“While the recent Federal Reserve Rule also contained restrictions on pricing card credit for risk,” he said, “this bill goes much further in this and other areas.” Yingling added that the ABA is concerned “that the Senate bill will have a dramatic impact on the ability of consumers, students, and small businesses to obtain and use credit cards.”

Critics say that by limiting the penalties credit card issuers can place on riskier borrowers, a prime source of billions of dollars in fee revenue for the industry, the legislation would force card companies to take aim at people with strong credit in order to make up that lost income.

Major banks such as American Express, Citigroup and Bank of America, faced with rising default rates that they say have made it harder for them to extend credit at favorable prices, already have begun to raise interest rates, with some banks targeting consumers who timely pay their bills. Critics of the legislation note that because interest rates would not be capped, banks could continue to lift them, provided they give greater disclosure.

In addition, critics argue, the legislation will force banks to issue fewer credit cards at greater cost to current cardholders.

Consumer advocates, on the other hand, argue that credit card issuers have made billions in recent years with unfair and sometimes deceptive practices.

"The business model will change because the business model doesn't work for the public," said a spokesperson for the Consumers Union. "In order to do business under the new rules, they'll actually have to tell you how much it's going to cost."

Not surprisingly, consumers angry over mounting debt and what they argue is "gouging" by credit card companies, broadly support reform legislation. Acting on consumers' expressed discontent with the credit card industry, the Obama Administration stepped into the debate, signaling strong support of reform legislation.

President Obama on April 23, 2009, met with executives from 13 of the largest credit card issuers to urge them to curb excessive fees and provide consumers with more straightforward contracts.

"I think that there has to be strong and reliable protections for consumers—protections that ban unfair rate increases and forbid abusive fees and penalties," Obama said. "The days of anytime, any reason rate hikes and late fee traps have to end."

Obama pressed for plain language to be used in credit card statements, saying "No more fine print, no more confusing terms and conditions. We want clarity and transparency from here on out."

The president also stressed the need for increased accountability in the system which, he noted, would require stronger monitoring and enforcement as well as penalties for violations.

Provisions of the Credit Card Act

The CARD Act is comprised of five titles:

- **Title I**—Consumer Protection
- **Title II**—Enhanced Consumer Disclosures
- **Title III**—Protection of Young Consumers
- **Title IV**—Gift Cards
- **Title V**—Miscellaneous Provisions

Title I: Consumer Protection

Title I of the CARD Act contains provisions addressing consumer protection.

Sec. 101 amends Sec. 127 of TILA (15 USC 1637) to require:

- Advance written notice, within 45 days, of an increase in an annual percentage rate, and any other "significant" change in terms.
- "Clear and conspicuous" notice of a consumer's right to cancel a credit card when the APR is raised or significant changes are made.

The effective date for these provisions is 90 days after enactment of the CARD Act.

Sec. 101 also amends Chapter 4 of TILA (15 USC 1666 et seq.) by:

- Prohibiting creditors from increasing the APR, fees or finance charges on outstanding balances, with some exceptions.
- Barring card issuers from changing the repayment terms of outstanding balances except by one of two methods:

    1. using an amortization period of not less than five years; or
    2. applying a required minimum periodic payment that includes a percentage of the outstanding balance equal to no more than twice the percentage required before the increase.

- Requiring that should a card issuer increase the APR on a credit card account, based on factors such as the credit risk of the cardholder or market conditions, the card issuer also much consider changes in those factors in determining whether to subsequently reduce the APR.
- Providing that the Federal Reserve Board must issue, within nine months of enactment, final rules implementing the requirements of the section.

Sec. 102 limits fees and interest charges. Specifically, the section:

- Prohibits double-cycle billing, that is, imposing interest charges on any portion of a balance that is paid by the due date.

- Includes over-the-limit fee restrictions by requiring that cardholders must be given the option of having a fixed credit limit that cannot be exceeded. Card companies cannot charge overlimit fees on cardholders with fixed limits. Overlimit charges only can be charged when an extension of credit, as opposed to a fee or interest charge, causes the credit limit to be exceeded. Overlimit charges only may be applied once per billing cycle. Opt-in by the cardholder is required for over-the-limit transactions if fees are imposed.

- Prohibits the charging of interest on credit card transaction fees such as late fees and overlimit fees.

- Prohibits card issuers from charging a fee to allow a cardholder to pay a credit card debt, whether payment is by mail, telephone, electronic transfer or other method.

- Amends Chapter 3 of TILA (15 USC 1661 et seq.) by providing that penalty fees imposed by creditors must be “reasonable and proportional” to the violation. (This provision is effective 15 months after enactment.)

Title I also amends TILA by:

- Adding a definition of the term “fixed rate.” The term “fixed,” when used in conjunction with a reference to the APR or interest rate on a credit card account, only may be used to refer to an APR or interest rate that will not change or vary over the period specified “clearly and conspicuously” in the terms of the account.

- Adding provisions defining “prompt” payments and fair crediting of those payments. On receiving payment from a cardholder, the card issuer must first apply amounts in excess of the minimum required payment amount to the card balance that bears the highest interest rate, and then to each successive balance bearing the next highest rates.

- Requiring that the payment due date for a credit card account must be the same day each month.

- Requiring that, prior to opening a credit card account for a consumer, the card issuer must consider the ability of the consumer to make the required payments.

Title II—Enhanced Consumer Disclosures

Title II contains provisions intended to increase and improve consumer disclosures by credit card issuers. Specifically, the sections under Title II amend Sec. 127(b)(11) of TILA (15 USC 1637(b)(11)) to require, in "clear and conspicuous" language in a "conspicuous and prominent" location on the billing statement:

- A written statement warning consumers that making only the minimum payment will increase the amount of interest paid and the time it takes to repay the balance.

- Repayment information on the outstanding balance should the consumer make only the required minimum payments each month, such as the number of months it would take to repay the balance and the total cost to the consumer.

- Information on the monthly payment amount that would be required for the consumer to eliminate the outstanding balance in 36 months.

- A toll-free number the consumer may use to receive information about credit counseling.

Under an amendment to TILA section 127(b)(12) (15 USC 1637(b)(12), card issuers also must disclose:

- Late payment deadlines.

- Any increase in interest rates for late payments.

- The date on which a cardholder makes a payment at a branch that accepts account payments is the date on which the payment is made for purposes of late fees or charges.

Title II also governs Internet posting of credit card agreements. Sec. 122 of TILA (15 USC 1632) is amended to require that:

- Creditors must establish and maintain an Internet site on which the creditor posts the written agreement between the creditor and the cardholder.

- Card issuers must provide to the Federal Reserve Board, in electronic format, credit card agreements they post on their Internet sites. The Fed is required to establish a central repository of these credit card agreements.

Additionally, Sec. 205 of Title II amends Sec. 612 of the Fair Credit Reporting Act (15 USC 1681j) to add provisions intended to prevent deceptive marketing of credit reports. Any advertisement for a free credit report must “prominently” disclose that free credit reports are available under federal law at AnnualCreditReport.com or a comparable source authorized by federal law.

The section requires the Federal Trade Commission to issue a final rule implementing the requirements within nine months of the date of enactment.

Title III—Protection of Young Consumers

Sec. 301 of Title III amends Sec. 127(c) of TILA (15 USC 1637(c)) by providing that a credit card may not be issued to a consumer under the age of 21 unless the consumer has submitted a written application to the card issuer that contains:

- the signature of a co-signer over the age of 21 who has the means to repay debts incurred by the consumer in connection with the account; or

- financial information submitted by the consumer indicating an independent means of repaying debts incurred under the account.

Sec.127 also is amended to provide that written parental approval is required to increase credit lines for accounts on which the parent is jointly liable.

Sec. 140 of TILA (15 USC 1650) is amended to provide provisions aimed toward protecting college students who are cardholders. Specifically, Sec. 304 requires that:

- An institution of higher education must publicly disclose any contract or agreement made with a credit card issuer for marketing purposes.

- Card issuers may not offer students at an institution of higher education any tangible item intended to induce the student to apply for a credit card if the offer is made on or near the institution's campus or at an event sponsored by the institution.

The legislation notes that "it is the sense of the Congress" that institutions should consider adopting policies stating that:

- Card issuers that market credit cards on a campus must notify the institution.
- The number of locations on the campus where the marketing of credit cards can take place be limited.
- Credit card and debt education and counseling sessions will be offered as part of orientation.

Title III also includes provisions on creditor reports related to college student cardholders.

Title IV—Gift Cards

Title IV governs the use of prepaid cards, gift certificates and store gift cards.

The title amends the Electronic Fund Transfer Act (15 USC 1693 et seq.) to prohibit the imposition of a dormancy fee, inactivity charge or fee or service fee on a gift certificate, store gift card or general-use prepaid card, with some exceptions.

A fee or charge may be imposed if: there has been no activity to the certificate or card in the 12-month period prior to the date of the fee or charge and disclosure requirements are met. No more than one fee may be charged in any given month.

Disclosure requirements are met if the certificate or card "clearly and conspicuously" states:

- that a fee or charge may be imposed;
- the amount of the fee or charge;
- how often the fee or charge may be assessed; and
- that the fee or charge may be assessed for inactivity.

The issuer or vendor of the certificate or card must inform the purchaser of any charges or fees before purchase.

The legislation notes that the prohibitions in this title do not apply to a gift certificate:

- distributed pursuant to an award, loyalty or promotional program; or
- for which no money or other value is exchanged.

Sec. 403 of the title provides that the provisions become effective 15 months after the date of enactment of the CARD Act.

Title V—Miscellaneous Provisions

Title V is comprised of a number of miscellaneous provisions, the bulk of the provisions requiring various related studies and reports by the federal banking agencies—the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision—the National Credit Union Administration and the Federal Trade Commission.

There are several sections of Title V, however, that make a departure from the bulk of the sections requiring the commission of a report or study.

Sec. 504 amends Chapter 2 of TILA (15 USC 1631 et seq.) by adding a new section on the procedure for timely settlement of states of decedent obligors.

Sec. 507 requires the Small Business Administration, in conjunction with the Secretary of Homeland Security, to establish a task force charged with addressing the information technology security needs of small businesses. The purpose of the task force is to help small businesses prevent the loss of credit card data.

Sec. 510 requires the Secretary of Education and the Director of the Office of Financial Education to coordinate with the President's Advisory Council on Financial Literacy to evaluate existing federal financial and economic literacy education programs and report findings to Congress.

Sec. 512, titled "Protecting Americans From Violent Crime," provides that no regulation may prohibit individuals from possessing a firearm, including an assembled or functional firearm, in any unit of the National Park System or the National Wildlife Refuge system if: the individual is not otherwise prohibited by law from possessing the firearm; and the possession of the firearm is in compliance with the law of the state in which the national park or wildlife refuge is located.

This section notes that while the Bush Administration had issued new regulations on the Second Amendment rights of “law-abiding citizens” to bear arms in the National Park and Wildlife Refuge systems, effective Jan. 9, 2009, the United States District Court for the District of Columbia on March 19, 2009, issued a preliminary injunction against the implementation and enforcement of the Bush Administration’s regulations.

Conclusion

The passage of the “Credit Card Accountability Responsibility and Disclosure Act of 2009,” or the “Credit CARD Act of 2009,” is being lauded by supporters of credit card reform as a significant strike against abusive credit card industry practices.

“We stood up for consumers and stood up to abusive credit card companies,” Senate Majority Leader Harry Reid, D-Nev., said after passage. “We said that big banks can no longer take advantage of hardworking Americans. We demanded that when Americans use a credit card—as almost everyone does almost every day—they no longer have to fear that they’ll be abused.”

According to House Speaker Nancy Pelosi, D-Calif., the bill "will give consumers the rights and information they need to make educated decisions about their financial lives and could save some families thousands of dollars."

Senator Chris Dodd, D-Conn., the Chairman of the Banking, Housing, and Urban Affairs Committee, said the House passage "cements a victory for every American consumer who has ever suffered at the hands of the credit card industry. Many Americans depend on credit cards to get by in this economy, and today they have won a giant victory that ensures they are protected from practices that would drive them further into debt, while also making our economy stronger."

Critics of the legislation warn, however, that the measure may backfire by forcing banks to issue fewer credit cards at greater cost to current cardholders and making credit more difficult to get at the very time many Americans need it.

As federal regulators prepare to promulgate regulations implementing the measure, focus will be on actions taken by banks in response to the legislation and the effects of those actions on consumers. ❐

About the Author

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