United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

August 4, 2008

Ms. Jennifer J. Johnson
Office of the Secretary
The Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W. – B-2234
Washington, D.C. 20551

RE: Comments on Proposed Rule on Unfair or Deceptive Acts or Practices
Related to Consumer Credit Cards under Regulation AA; Docket No. R-1314

Comments on Related Proposed Rule under Regulation Z; Docket No. R-1286

Dear Ms. Johnson:

The purpose of this letter is to express support for the proposed rule of the Federal Reserve Board of Governors, Office of Thrift Supervision, and the National Credit Union Administration aimed at unfair or deceptive acts or practices affecting consumer credit cards. In addition, because the proposed rule addresses only some of the abusive practices that mire consumers in debt, the letter requests that the proposed rule be expanded to prohibit or restrict additional unfair and deceptive practices, including the charging of interest for debt paid on time, the charging of interest on transaction fees, the imposition of fees on consumers paying their bills on time, and the billing of amounts that force consumers to pay four or five times their original credit card debt.

This letter is also intended to express support for the proposed rule under Regulation Z to strengthen credit card disclosures and requests that the rule be strengthened in certain respects.

General Comments

Credit card lending is a highly profitable business in the United States. For the past ten years, it has been the most profitable sector of U.S. consumer lending. In 2005, U.S. families used nearly 700 million credit cards to buy goods and services worth $1.8 trillion. Outstanding U.S. credit card debt has climbed steadily and now approaches $1 trillion.

Credit cards provide individuals with convenient payment mechanisms, ready access to lines of credit, and the means to manage their finances. But credit cards have also subjected Americans to a raft 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%, 30%, 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

and duplicative fees, and employed unfair practices in accepting and crediting consumer payments. Increased regulation and oversight are essential to stop these unfair and deceptive lending practices that injure Americans, create mountains of debt, and undermine confidence in U.S. credit markets.

Stronger consumer protections and clearer prohibitions against unfair and deceptive credit card lending practices are long overdue.

Subcommittee Investigation of Unfair Credit Card Practices

Since 2005, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has been conducting an ongoing, 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, presents data on key credit card practices, showing how interest rates and fees have proliferated and credit card disclosures have deteriorated. Following the GAO report, the Subcommittee began a series of detailed interviews with participants in the credit card industry, including interviews with 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 from the chief executive officers of some of the largest credit card issuers in the country, 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%, 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 more than 2,000 letters from consumers alleging unfair treatment by credit card issuers. In reviewing these letters, the Subcommittee found solid evidence of abusive practices. A few of these case histories were featured in the Subcommittee hearings, but many more were substantiated than could be addressed in the hearings.

For example, the personal credit card experiences of one individual who was not featured in a Subcommittee hearing, but whose allegations were investigated and substantiated by the Subcommittee, help illustrate the unfair and deceptive credit card practices that are all too common in the United States today and demonstrate the need for stronger consumer protections.

Charles McClune, a 51-year-old Michigan resident who is married with one child, has a credit card account which he closed in 1998, and has been trying to pay off for more than 10 years. Due to excessive fees and interest rates, and despite paying more than four times his original credit card debt of less than $4,000, Mr. McClune still owes $3,300 on his credit card, with no end in sight.

Mr. McClune first opened his credit card account while in college, in 1986, at Michigan National Bank through a student-targeted credit promotion. After leaving college, the credit limit on his card was increased to $4,000. By 1993, although he had not exceeded the credit

limit through purchases, Mr. McClune had missed some payments and was assessed interest and fees that pushed his balance over the $4,000 limit. From 1993 to 1996, he exceeded his limit again, on several occasions, due to interest and fee charges. He stopped making purchases on the credit card in 1995.

In 1996, Mr. McClune's credit card account was purchased by Chase Bank. In 1998, Mr. McClune asked Chase to close the account, and Chase did so. Although he never made a single purchase on his credit card while the account was with Chase, Chase repeatedly increased the interest rate on his account, including after the account was closed. In 2002, for example, his interest rate was about 21%; by October 2005, it had climbed to 29.99% where it remained for more than two years until March 2008; it then dropped slightly to 29.24%. The higher interest rates were applied retroactively to Mr. McClune's closed account balance, increasing the size of his minimum payments and his overall debt.

Chase also assessed Mr. McClune repeated over-the-limit and late fees, which began at $29 and increased over time to $39 per fee. Chase cannot locate statements for Mr. McClune's account prior to February 2001, so there is no record of all the fees he has paid. The records in existence show that, since February 2001, he has paid 64 over-the-limit fees totaling $2,200. Those fees stopped after a March 2007 hearing before my Subcommittee, in which Chase promised to stop charging more than three over-the-limit fees for a single violation of a credit card limit. In addition, since February 2001, Chase has charged Mr. McClune nearly $2,000 in late fees.

The records also show that since 2001, Mr. McClune was contacted by telephone on several occasions by Chase representatives seeking payment on his account. If he agreed to make a payment over the telephone, Chase charged him -- without notifying him at the time -- a fee of $12 to $15 per payment. When asked about these fees, Chase told the Subcommittee that the fees were imposed, because on each occasion Mr. McClune had spoken with a "live advisor." Since 2001, he has paid a total of $160 in these pay-to-pay fees.

Altogether, since 2001, Mr. McClune has paid nearly $4,400 in fees on a debt of less than $4,000. If the more than four years of missing credit card bills were available from 1996 to 2000, this fee total would be even higher. In addition, each fee was added to Mr. McClune's outstanding credit card balance, and Chase charged him interest on the fee amounts, thereby increasing his debt by thousands of additional dollars.

In February 2001, Chase records show that Mr. McClune's credit card debt totaled nearly $5,200. For the next 7 years, although he did not pay every month, Mr. McClune paid nearly $2,000 per year toward his credit card debt, but was unable to pay it off. At one time, he paid $150 every two weeks for several weeks. Those payments did not bring his debt under the $4,000 credit limit, or reduce his interest rate.

In January 2007, Mr. McClune received a letter from Chase stating that if he made his next payment on time, he would receive a $50 credit on his debt. Mr. McClune cashed out his IRA and paid $4,000 on his credit card debt. Because he made this payment in February, however, he did not receive the $50 credit for an on-time payment. Instead, he was assessed a

$39 late fee, a $39 over-the-limit fee, and a $14.95 payment fee for making the $4,000 payment over the telephone.

Mr. McClune was never offered a payment plan or a reduced interest rate by Chase to help him pay down his debt. His credit card bills show that from February 2001 to June 2008, he paid Chase a total of $15,800. If the four years of missing credit card bills from 1996 to 2000 were available, his total payments would likely exceed $20,000. In June 2008, his credit card bill showed he was charged 29% interest and a $39 late fee on a balance of $3,300.

How could Mr. McClune pay $15,000 to $20,000 on credit card purchases of less than $4,000, and still owe $3,300? His credit card statements since 2001 show that he was socked with over $9,700 in interest charges, $2,200 in over-the-limit fees, $2,000 in late fees, and $160 in pay-to-pay fees. All of these interest charges and fees were assessed by Chase while the account was closed and without a single purchase having been made since 1995. Despite his lack of purchases and payments totaling $15,800, Chase records show that, from February 2001 until June 2008, Mr. McClune was able to reduce his credit card balance by only about $1,850.

Mr. McClune is not trying to avoid his debt. He has made years of payments on a closed credit card account that he has not used to make a purchase in 13 years. He has paid thousands and thousands of dollars – four and possibly five times what he originally owed – in an attempt to pay off his credit card account. He is still paying. But his thousands of dollars in payments are not enough for his credit card issuer which is squeezing him for every cent it can, fair or not, for years on end.

Mr. McClune has, tragically, a lot of company in his credit card experience. The many case histories investigated by the Subcommittee show that responsible cardholders across the country are being squeezed by unfair and deceptive credit card lending practices. The current regulatory regime is totally insufficient to prevent these ongoing credit card abuses. Your proposed rule represents a small step that will help stop these abusive practices.

Proposed Rule to Stop Unfair or Deceptive Credit Card Practices

The proposed rule identifies seven unfair or deceptive credit card practices which it proposes to prohibit or restrict. The identified practices are: (1) treating a payment as late without giving the cardholder a reasonable amount of time to make the payment; (2) requiring credit card payments to be allocated first to fees and penalties before principal and interest, and first to the balances with the least expensive rates of interest instead of those with the most expensive rates of interest; (3) applying increased interest rates retroactively to pre-existing credit card debt; (4) assessing over-the-limit fees for cardholders who exceed the credit limit solely due to holds placed on the available credit; (5) assessing finance charges for balances incurred in the month that predates the billing cycle, a practice known as "double-cycle billing"; (6) imposing fee and security deposit requirements that utilize the majority of available credit on so-called "fee harvester cards"; and (7) advertising credit cards without disclosing the factors that will determine whether a consumer qualifies for the low interest rates and high credit limits being advertised.

Each of these credit card practices meets the legal standard for unfair practices; it causes substantial injury to consumers, is reasonably unavoidable, and is not outweighed by any countervailing benefit to consumers or to industry competition. Because the Subcommittee's credit card investigation provides a factual foundation for the prohibitions and restrictions being proposed, this letter describes the facts our Subcommittee uncovered that support the proposed provisions and, in many instances, justify stronger protections. In addition, the Subcommittee investigation provides evidence of unfair or deceptive credit card practices that are not currently addressed by the proposed rule, but should be.

Fair Billing Practices. Section 227.22 of the proposed rule would prohibit credit card issuers from treating a payment as late for any purpose, unless the consumer has been provided a reasonable amount of time to make the relevant payment. This consumer protection is critical, because late payments can lead to a cascade of adverse consequences, including the imposition of a substantial late fee, increased debt after the fee is added to the outstanding credit card balance, increased interest charges from the increased balance, a possible over-the-limit fee if the larger balance exceeds the card's limit, and possible imposition of a penalty interest rate if the late fee is treated as a "default" on the account. To satisfy the requirement that card issuers provide a reasonable amount of time to make a payment, the proposed rule would create a "safe harbor" for credit card issuers that mail or deliver billing statements to consumers at least 21 days before the payment due date. This proposed safe harbor would strengthen the current requirement that card issuers mail or deliver credit card bills at least 15 days before the due date.

The proposed rule provides a welcome and much needed consumer protection that would help curb a host of unfair practices that too often result in unwarranted late fees and related penalties. The Subcommittee has substantiated case histories of consumers who received credit card bills a few days before the due date, making it difficult to avoid a late fee and, in some cases, a penalty interest rate for paying late. Several major credit card issuers have admitted to the Subcommittee that they shorten the time period available for payment by cardholders who usually pay their credit card bills on time and in full, in order, in the words of Bank of America, "to minimize the time period in which we are extending [an] interest-free loan."

Other consumers told the Subcommittee about sending payments 10 to 14 days before the due date, only to be told the payment arrived late. For example, one Montana consumer mailed her February, May, and August 2006 credit card payments to her card issuer's address in St. Louis, Missouri, five, ten, even fifteen days before the specified due date. Each time, the payment was posted as received after its due date, and she was assessed a late fee. The consumer consulted the clerk at her local U.S. post office, and decided to pay $4.50 for Priority Mail with Delivery Confirmation for each of her future payments. For three months her payments arrived on time, until December 2006, when her Priority Mail payment was lost until January 11, 2007. By then, she had paid the bank $29 to put a "stop" on her payment check, and paid an additional $10.00 to the credit card issuer to process her payment by telephone. Thus, in 2006, despite having mailed every monthly payment in advance of its due date, she paid $221.09 in finance charges and late fees, $18 in postal delivery confirmation fees, $10 in a telephone payment fee, $29 for a stop check fee, and $35 for a return payment fee for the stopped check, for a grand total of $313.09, in her attempts to pay her bills on time. The proposed rule encouraging credit card

bills to be sent 21days before the due date will help cure these types of problems and make late fees less likely for responsible cardholders.

The proposed changes to Regulation AA are not, however, sufficient to stop all of the abusive billing practices that result in unwarranted late fees. Section 226.10 in Regulation Z proposes two additional changes that are important to ensure consumers have a reasonable amount of time to make a payment. The first change would establish a reasonable deadline during the day for accepting consumer payments. A number of consumers wrote to the Subcommittee about the practice of some card issuers of establishing an unreasonably early deadline during the day for payments made on the due date, such as 1:00 p.m. These early deadlines can trap unwary consumers seeking to pay their bills on time or render them vulnerable to penalty depending upon the time during the day when their payment happens to be delivered to the card issuer. Section 226.10(b) would eliminate unreasonably early deadlines by establishing a 5:00 p.m. deadline for due date payments. Unfortunately, as written, the section would apply only to payments made by mail and not to payments delivered through electronic systems, telephones, or other means. The Subcommittee is aware of no rationale for applying the 5:00 p.m. deadline to just one payment delivery system, particularly when card issuers are urging cardholders to make their payments electronically and the Subcommittee observed abusive practices related to electronic payments. Applying different deadlines for different forms of payments is also likely to confuse responsible consumers trying to pay their bills on time. The proposed Regulation Z provision should be strengthened and simplified to apply the 5:00 p.m. deadline to all payments made on the due date, no matter how delivered.

Section 226.10 would correct another abusive practice as well. A number of cardholders wrote to the Subcommittee about card issuers that require payments on a weekend day or holiday, but prohibit cardholders from making payments on the specified due date. In one case brought to the Subcommittee's attention, a cardholder made a payment in person at a bank on a Saturday, the day before the payment was due, only to be informed that since it was a weekend the payment would not post until Monday, and a late fee would apply. Another cardholder made a payment electronically on a weekend due date, and had the payment credited on the next business day, incurring a late fee. The proposed Section 226.10(d) would end this unfair practice by requiring card issuers who specify payment on a date on which the Post Office does not deliver mail or the creditor does not accept mail, to treat a payment delivered by mail on the next business day as an on-time payment. As before, however, there is no rationale for limiting this consumer protection to payments made by mail; the same consumer protection should be extended to payments made electronically, by telephone, or other delivery method.

The proposed rule may also want to consider adopting two additional consumer protections in S. 3252, the Dodd-Levin credit card reform bill, to end unfair billing practices that result in unwarranted late fees. The first would ensure that weekend payments at bank branches are credited on the day the payments are made (Sec. 202); the second would create a rebuttable presumption that a payment shown by a consumer to have been mailed seven days prior to a due date is an on-time payment (Sec. 106). Either the proposed rule under Regulation AA or under Regulation Z would be strengthened if it were to incorporate these provisions to prevent unfair late fees.

Fair Allocation of Cardholder Payments. Section 227.23 of the proposed rule is another welcome provision that would overturn a long-time, industry-wide practice of allocating credit cardholder payments in ways that maximize card issuer profits at cardholder expense. Currently, when a cardholder makes a payment, card issuers have complete discretion over how to apply that payment to various credit card balances bearing different interest rates. Consumers typically have no authority to direct how their payments should be applied. Today, industry practice is to allocate a cardholder payment first to the balance with the lowest interest rate, then to the balance with the next lowest interest rate, and so on until the payment is used up.

This allocation practice clearly favors creditors over consumers. It allows card issuers to direct payments first to the balances that generate the lowest profits. By minimizing payments to the balances bearing the highest interest rates, the card issuers ensure that those balances accumulate more interest for longer periods, generating more profits for the issuer. Consumers who want to pay off a cash advance bearing a 20% interest rate, for example, are told that they cannot pay off that balance until they first pay off all other balances with lower interest rates.

Section 227.23 would put an end to this unfair allocation practice. It would instead give card issuers one of four options for allocating cardholder payments: (1) allocating payments first to the balance with the highest interest rate and any remaining portion to the other balances in descending order; (2) allocating payments in equal amounts to each pending balance; (3) allocating payments to each balance according to its proportion of the overall amount owed; or (4) choosing an allocation method that is no less beneficial to the consumer than the previous three enumerated methods.

While Section 227.23 is a clear improvement over the status quo, it is needlessly complex and would make it difficult for consumers to compare credit card issuer practices. The better approach would be to require all card issuers to use option (1), which affords the greatest consumer protection and would ensure all card issuers use the same payment allocation method. The provision would also benefit from adopting a provision similar to Section 106 of S. 3252, the Dodd-Levin credit card reform bill, which would require payments to be applied "in a way that minimizes the amount of any finance charge to the account."

No Retroactive Interest Hikes. Perhaps the most important provision in the proposed rule is Section 227.24 which would prohibit credit card issuers from applying interest rate increases retroactively to credit card debt incurred prior to the rate hike. Common sense exceptions to this prohibition are made for rate increases at the end of a promotional interest rate, due to indexed interest rates, or after a cardholder fails to make the minimum payment due on the account.

Currently, virtually all credit card issuers claim the authority to apply interest rate hikes to previously incurred credit card debt. This unfair credit card practice, which is not authorized in any law, is unknown in other areas of consumer lending. It is only credit card issuers that claim the right to unilaterally change a key term of an existing loan – the interest rate -- even for borrowers who have met all of their loan obligations and made every payment on time.

The Subcommittee uncovered numerous case histories where retroactive interest rate hikes were applied to pre-existing credit card debt. These rate hikes increased cardholders'

monthly finance charges and minimum payments, ballooned their overall credit card debt, and extended their payments for years, often without the cardholders' having done anything wrong. In its December hearing, for example, the Subcommittee presented eight case histories of cardholders who had made on-time payments for years, in full compliance with their credit card agreements, yet were subjected to retroactive interest rate hikes applied to their pre-existing credit card debts. One cardholder from Florida with a track record of on-time payments was hit with a retroactive rate hike that tripled her interest rate from 8% to 23%, tripled her monthly finance charge from about $150 to about $450, and tripled her minimum monthly payments. Two cardholders from Wisconsin and Texas, each of whom had a record of on-time payments, were hit with retroactive interest rate hikes while paying off credit card accounts that had been closed years earlier.

Retroactive interest rate hikes unilaterally change the terms of a credit card debt without the borrower's consent, mire cardholders in unexpected debt, and penalize even consumers who have met their credit card obligations or are paying off closed accounts. The proposed prohibition on this inherently unfair credit card practice is long overdue.

Fair Over-the-Limit Fees. Section 224.25 of the proposed rule would prohibit credit card issuers from assessing a fee on cardholders for exceeding the limit on their credit card accounts, if the credit limit would not have been exceeded but for a hold placed on the available credit by a merchant.

While this rule is a welcome prohibition to stop the imposition of unfair over-the-limit fees in one set of circumstances, it does not address other blatantly unfair practices involving these fees, which now average $31 and often reach $39 per fee. For example, the proposed rule does not address a common complaint received by the Subcommittee about the repeated imposition of over-the-limit fees in response to a single violation of a credit limit. In the Michigan case history that begins this letter, for example, the consumer was charged 64 over-the-limit fees totaling $2,200, after his $4,000 credit limit was exceeded – not by any purchase he made – but by the interest charges and fees assessed by his card issuer. After Chase promised to stop charging more than three over-the-limit fees for a single instance of exceeding a credit limit, he was no longer subjected to a monthly $39 fee that was steadily increasing his minimum payments, interest charges, and overall debt. Chase made that promise at a March 2007 Subcommittee hearing after another cardholder, a consumer from Ohio, showed that he had been charged 47 over-the-limit fees totaling $1,500 for exceeding his $3,000 credit limit on three occasions for a total of $200. In his case, he had been charged over-the-limit fees that were seven times greater than his excess charge.

The proposed rule currently does nothing to end duplicative and excessive over-the-limit fees. The rule would be strengthened if it were to adopt the restrictions in Section 103 of S.3252, the Dodd-Levin credit card reform bill, to stop over-the-limit fee abuses. The bill provides, first, that if the card issuer allowed the cardholder to exceed the account's established credit limit, the issuer may impose only one over-the-limit fee for that credit extension -- one fee for one violation. Second, the fee could be imposed only once per month and only if the account balance exceeded the limit at the end of the billing cycle. Third, the fee could be imposed only when an action taken by the cardholder caused the credit limit to be exceeded, and not when a fee or

penalty imposed by the card issuer caused the excess charge. Card issuers should not be able to pile penalty upon penalty, such as by assessing a late fee on an account and then, if the late fee pushes the credit card balance over the limit, also imposing an over-the-limit fee.

The bill would also require credit card issuers to offer consumers the option of establishing a fixed credit limit on their account that could not be exceeded. In too many cases, card issuers no longer provide consumers with the option of having a fixed credit limit, preferring instead to enable all of their cardholders to exceed their credit limits only to be penalized by a hefty over-the-limit fee, followed by added interest and, possibly, a penalty interest rate. The proposed rule would be strengthened if it, too, required card issuers to offer cardholders the option of obtaining a fixed credit limit that could not be exceeded.

Fair Balance Computation Methods. Section 227.26 of the proposed rule would make another important change by prohibiting the calculation of finance charges using balances taken from the month preceding the billing cycle, a practice known as "double-cycle billing." Characterizing this practice as an "unfair balance computation method," the proposed rule would put a stop to it. This proposal is a welcome consumer protection, though its practical effect will be limited to changing the practice of only one major card issuer, Discover, the last of the major issuers still using double-cycle billing.

It is disappointing that the proposed rule fails to take on another unfair balance computation method that is industry-wide in its application, is largely hidden from consumers, and has been one focus of the Subcommittee's work and of credit card legislation dating back at least seven years. This indefensible practice involves card issuers imposing interest charges for credit card debt that is paid on time by the due date specified in a credit card billing statement.

Today, most consumer credit cards offer a grace period. Cardholders are told that, if they pay their monthly credit card bill during this grace period, they will not be charged interest on the debt for which they are being billed. Many cardholders are not told and do not realize, however, that this grace period typically provides protection against interest charges only if the consumer pays 100% of the monthly credit card bill. If the cardholder pays one penny less than 100% of the amount due – even if the cardholder pays the majority of the bill on time – he or she will be charged interest for the entire billed amount, including the portion paid by the specified due date. Moreover, the industry-wide practice is to charge interest on the entire debt beginning on the first day of the billing period, with the interest charges compounded daily.

For example, suppose a consumer who owes no credit card debt, makes purchases during December, and gets a January 1 credit card bill for $5,020. The bill is due January 15. Suppose the consumer pays the bill on time, but pays $5,000 instead of the full amount owed. The credit card issuer will then charge interest, compounded daily, on not just the unpaid $20, but the entire balance of $5,020, even though $5,000 of that balance was paid on time during the grace period. The credit card issuer would begin assessing interest on the entire $5,020 from the first day of the billing cycle, January 1, through January 15, when the $5,000 was paid, and additional interest on the unpaid $20 from January 15 to January 31. Applying an interest rate of 17.99%, for example, would cause the $20 debt, in one month, to rack up $35 in interest charges and produce a February 1 bill for $55.21.

Why is the credit card issuer allowed to charge interest on the portion of the $5,020 debt that was paid on time during the grace period? Because, as the credit card issuers told the Subcommittee, there is no law against it and that is the way the credit card industry has operated for years.

The card issuers don't stop there. Using the same $5,020 example, suppose that the consumer confronted with the $55.21 bill on a $20 debt pays the entire bill by the due date, February 15. Even though the consumer paid the February bill in full and on time – all $55.21 – the card issuer sends the consumer another bill in March with an additional interest charge. In this case, the charge is for the interest that accumulated on the $55.21 debt from February 1 to 15, which is time period from the day when the bill was sent to the day when it was paid. The Subcommittee refers to these interest charges as "trailing interest." Using the same interest rate as earlier, the total amount of trailing interest in this case would come to 38 cents. While some issuers will waive trailing interest if the next month's bill is less than $1, other issuers fold the 38 cents into an end-of-month billing statement reflecting a new purchase. Trailing interest is another widespread, but little known industry practice that squeezes responsible consumers for additional interest charges that, when applied over millions of accounts, produce substantial profits for card issuers.

Interest charges applied during a grace period or during the period in which a credit card bill is awaiting payment are common industry practices, but are largely unknown to consumers. Disclosures alerting consumers to these interest charges are either missing from credit card billing statements or difficult to understand due to the complex nature of the charges. The Subcommittee's experience is that most consumers have no idea they are paying these charges and are indignant when informed.

Cardholders should not have to pay interest on debt that is paid by the due date specified in a credit card bill. Balance computation methods that charge interest for debt that is paid on time are unfair, deceptive, and predatory. Section 103 of S. 3252, the Dodd-Levin credit card reform bill, would prohibit these interest charges that penalize consumers for on-time payments. The proposed rule should be strengthened by including a similar prohibition against charging interest on any portion of a credit card debt that is paid on time.

Fee Harvester Card Restrictions. A recent report by the National Consumer Law Center, "Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers," identifies a host of unfair practices involving subprime credit cards in which the card issuer appears to give consumers a credit card with a credit limit of, perhaps, $250, but then assesses multiple start-up fees and security deposit requirements that consume all but $50-$75 of the supposedly available credit. Section 224.27 of the proposed rule would curb these abuses by limiting the allowable fees and security deposit requirements that can be charged on a credit card, to less than half the available credit in a year and less than 25% of the available credit each month. These restrictions are useful tools to help curb predatory practices associated with these subprime credit cards.

Firm Offers of Credit. Section 227.28 of the proposed rule would require banks, when advertising a credit card, to disclose the criteria that will determine whether a consumer will qualify for a low interest rate or high credit limit being advertised. Such disclosures would reduce deceptive advertising in credit card solicitations that entice consumers to apply for cards

for which they may not be qualified. Consumers should be informed, before applying for a credit card, that the advertised rates and limits depend on their credit history, income, and debts.

Additional Unfair and Deceptive Credit Card Practices

In addition to the credit card practices already discussed, there are at least five other unfair or deceptive credit card practices that should be addressed by the proposed rule, involving interest charges on transaction fees, universal default, pay-to-pay and unreasonable currency fees, deceptive uses of the term "prime rate," and billing practices that force consumers to pay four or five times their original credit card debt.

Each of these credit card practices injures consumers, is reasonably unavoidable due to widespread use in the credit card industry, and is not outweighed by a countervailing benefit to consumers or industry competition.

No Interest Charges on Fees. Charging interest on money borrowed is fair, but squeezing additional dollars from consumers by charging interest on transaction fees is not. Credit card companies today make substantial profits from fees imposed on consumers. According to the GAO report mentioned earlier, fee income now produces about ten percent of all income obtained by credit card issuers. Steep fees already deepen household debt; those fees should not also generate interest income for card issuers at consumer expense. After all, when a credit card issuer imposes a fee on a consumer, the issuer is not lending funds to the cardholder – it is demanding that funds be taken out of the cardholder's pocket and handed over. Insisting that consumers pay interest on fees that are not immediately satisfied is not only unfair, but creates incentives for card issuers to impose large fees that are difficult to pay right away. Section 103 of S. 3252, the Dodd-Levin credit card reform bill, would ban this industry-wide practice by prohibiting credit card issuers from collecting interest on transaction fees imposed on consumers; the proposed rule should do the same.

No Universal Default. One of the most common credit card complaints the Subcommittee has received involves the practice in which card issuers unilaterally hike the interest rate on a credit card, not because of any misstep by the cardholder with respect to that card, but because of adverse information unrelated to the credit card whose rate is being increased. This practice is often referred to as "universal default." The Subcommittee investigation found that, although some card issuers such as Capitol One have never used universal default to raise interest rates, and others such as CitiCard and Chase have abandoned the practice, major card issuers such as Bank of America and Discover still routinely increase interest rates on cards due to unrelated adverse information. The Subcommittee's December hearing presented multiple cases of individuals with unblemished records of on-time credit card payments whose interest rates were nevertheless hiked after receiving a lower credit score rating stemming from conduct unrelated to the affected credit card.

The proposed amendments to Regulation AA would stop the retroactive application of higher interest rates, but would not ban interest rate hikes based on unrelated adverse information. The proposed amendments to Regulation Z would require card issuers to give consumers 45 days notice before putting a higher interest rate into effect, but again would not prevent universal default from being used to increase the interest rate. The proposed 45-day

notice period offers an important consumer protection that would give consumers more time to evaluate a proposed rate increase and comparison shop for a new credit card, but it would not eliminate the inherently unfair practice of universal default. Consumers who incur debt on a credit card account, meet their contractual obligations, and make at least the minimum payment on time every month, should not be penalized with an interest rate increase. Section 108 of S. 3252, the Dodd-Levin credit card reform bill, would eliminate universal default; the proposed rule should follow suit.

At the least, either Regulation AA or Regulation Z should require a clear and unambiguous disclosure on billing statements regarding the card issuer's authority to impose a unilateral interest rate increase, even for consumers who comply with all their credit card obligations. The disclosure should include a heading entitled, "**Interest Rate Increases**," followed by: "**[Credit card issuer] can raise your interest rate at anytime, even if you pay more than the minimum, on time, every month, if [credit card issuer] decides you are a greater credit risk or its borrowing costs increase. For example, if your credit score declines, even if you have met all of your obligations to [credit card issuer], [credit card issuer] can increase your APR.**"

Pay-to-Pay Fees. Another unfair, industry-wide credit card practice is charging consumers a separate fee to pay their bills. In the Michigan case history that began this letter, the card issuer charged the consumer a $12 to $15 fee to make a payment on his account over the telephone, even though it was the card issuer who initiated the call and requested immediate payment. Most card issuers also charge consumers a $5 to $15 fee to use the telephone to make an on-time payment, even when a credit card bill has arrived too late to allow payment by mail. Charging consumers a fee to pay their bills is a travesty. Section 103 of S.3252, the Dodd-Levin credit card reform bill, would prohibit credit card issuers from charging a separate fee to allow a cardholder to pay their credit card bill, whether payment is by mail, telephone, electronically, or some other method; the proposed rule should also prohibit "pay-to-pay" fees.

Currency Exchange Fees. Still another fee that has raised concerns is the fee charged by credit card issuers to exchange dollars into or from a foreign currency. Issuers today often charge an amount equal to two percent of the amount of currency being exchanged in addition to a one-percent "conversion fee" charged by Visa or Master Card, for a total of three percent. Critics believe these charges are disproportionate to the costs involved and constitute price gouging. While Regulation Z has proposed requiring card issuers to disclose their currency fees on credit card billing statements, more is needed to stop unfair practices. Section 103 of S. 3252, the Dodd-Levin credit card reform bill, would require card issuers to use only regulator-approved methods for calculating currency exchange fees that reasonably reflect the card issuer's actual costs to perform the currency exchange. The proposed rule should adopt a similar provision.

Prime Rate Claims. Another industry practice that has raised concerns involves credit card solicitations that claim to offer interest rates linked to the "prime rate." Litigation has arisen between cardholders and card issuers over what is meant by the term "prime rate." See, for example, Lum v. Bank of America, 361 F.3d 217 (3d Cir. 2004), in which the cardholder asserts that the prime rate being used by the card issuer differed from the commonly accepted prime rate and resulted in his being assessed higher interest charges than he had agreed to accept. The

cardholder apparently felt that he had been deceived by the card issuer. To resolve this problem, Section 104 of S. 3252 would require card issuers who provide interest rates linked to the "prime rate" to use only the bank prime rate published by the Federal Reserve. The proposed rule should follow a similar course to end any deceptive use of the term "prime rate."

Overall Debt Limit. This letter began with a Michigan case history in which the cardholder was assessed such high interest and fee charges that he has paid four or five times his original credit card debt, with no end in sight after 13 years of payments. Forcing a consumer to pay four or five times his original debt is inherently unfair and predatory. The proposed rule should impose a total debt limit that would prevent any credit card issuer from requiring a cardholder with a closed account to pay more than three times the debt created by the cardholder's own purchases.

Overdraft Protections

Although the focus of this letter is unfair and deceptive credit card practices, the proposed rule also contains provisions prohibiting unfair or deceptive acts or practices related to overdraft services provided in connection with consumer deposit accounts. Abusive overdraft practices injure consumers by imposing excessive, inappropriate, and duplicative fees that can deplete savings, trigger other penalties, and cause consumers to go into debt. Related proposed rules seek to prevent overdraft abuses by, for example, prohibiting the use of potentially misleading balance disclosures. These important consumer protections can help end abusive practices related to overdraft services.

Conclusion

The credit card industry today is rife with unfair, deceptive, and predatory practices. The proposed rule would put an end to some of these abusive practices, including retroactive interest rate hikes, some billing practices that encourage unwarranted late fees, some payment allocation methods that unfairly disadvantage consumers, some over-the-limit fee abuses, double-cycle billing, and fee and security deposit requirements that erase much of the credit promised by fee-harvester cards. Unless expanded, however, the proposed rule would leave untouched some of the most blatantly unfair credit card practices in existence today, including interest charges on debt that is paid on time, universal default interest rate increases, interest charges on transaction fees, duplicative and inappropriate over-the-limit fees, unreasonable pay-to-pay and currency exchange fees, deceptive use of the term "prime rate," and credit card excesses that force some consumers to pay four or five times their original debt. I respectfully ask the Board to consider expanding the proposed rule to end these unfair, deceptive, and predatory practices as well.

Thank you for the opportunity to comment.

Sincerely,

Carl Levin, Chairman
Permanent Subcommittee on Investigations