



Credit Union National Association

# *CUNA Issue Summary*

## **CREDIT CARDS**

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**ISSUE:** Innovation in the financial services sector of the world economy has made credit more available, cheaper, and convenient than at any time in history.

The credit card is one such innovation. However, credit cards are rarely collateralized so the risk of borrower default rises with this type of credit line. This forces credit card issuing financial institutions to impose relatively higher costs, fees, and repricing practices on credit cards. Perceived abuses in the credit card industry have prompted Congress to hold hearings and introduce legislation to curb industry practices viewed as deceptive or abusive.

In the 110<sup>th</sup> Congress, both the House Financial Services Committee and the Senate Banking Committee held hearings on credit card marketing and billing practices. House Financial Services Committee Chairman Barney Frank (D-MA) has indicated that his committee will likely pass legislation to eliminate certain practices like “universal default”. However, he stated that the legislation would not impose artificial interest rates.

**CUNA POSITION:** While CUNA applauds Congressional and regulatory action to end discriminatory, predatory, deceptive, and abusive lending practices, it has several reservations regarding certain proposals aimed at achieving these ends.

A practice known as “universal default” allows a creditor to increase the interest rate on a credit card because of adverse information, including any information from a credit report, even if the information does not directly related to the card. CUNA is concerned that ending this practice would prevent card issuers from adjusting a card holder’s interest rate based on their total credit risk. Credit unions must often examine a card holder’s credit report, to approve a credit line increase for example. Negative information on a credit report would lower that credit score and thus a card issuer would have to consider that in its ongoing relationship with the card holder.

Some in Congress wish to prohibit what is referred to as “any-time, any-reason” changes in credit card terms. Card issuers would be prohibited from making any change in the terms (including interest rates) of the credit card until the renewal of the contract. This restriction would not allow card issuers to manage their risks in a sound and responsible manner. Credit cards are open-ended plans that don’t “renew.” This would likely lead to credit unions issuing cards at higher rates and fees, since disclosures would apply across-the-board. With a fixed rate card, it would be hard to anticipate every problem that could affect the terms, so it could be difficult to disclose.

Some Congressional proposals would require that a card holder get at least 45 days notice before the APR can increase on the card, and when the APR increases, the card holder must have the right to cancel the card and keep paying the outstanding balance at the lower rate. Allowing payment at the old rate may also affect the initial pricing of credit cards, as financial institutions would have to factor in increased risks and costs.

Perhaps the most controversial credit card practice is referred to as “double cycle billing”. It is a vague term but usually refers to a billing system where the creditor charges interest retroactively on debts that have been partially paid off. For example, if a card holder charges \$1,000 in month one, and pays only \$990 of the balance by the due date, \$10 is carried over into month two’s billing cycle. Even if no new transactions are made in month two, the creditor calculates the finance charge not on the average daily balance for month two, but on the average daily balance of \$1,000 in month one and \$10 in month two, which means interest owed on a debt already repaid.

Much debate in Congress has dealt with providing credit card customers payoff balance information. Some proposal would require each credit card periodic statement to contain a telephone number, Internet address and website at which the consumer could request the payoff balance on the account. However, a close-out figure may not always be accurate because of recurring and outstanding charges, as well as any fees or penalties associated with such transactions.

Some in Congress want to place restrictions on customer purchases that exceed their credit limit. Some proposals would prohibit the card issuer from completing any transaction that puts the card holder over the card’s limit if a fee will be charged for that transaction, with an annual notice in the periodic statement that such a choice is possible.

**IMPACT ON CREDIT UNIONS:** Initially, most in the financial services industry mobilized against well-intentioned legislation designed to curb some perceived abusive credit card practices. However, it appears that certain credit card issuer practices will be subject to new rules issued by federal banking regulators. However, CUNA remains concerned that unintended consequences of legislation or regulatory action could result in restricting the range of products and services that credit card issuers currently offer, which could result in cutting off credit to some and raising the price of credit for all.

**STATUS/OUTLOOK:** House Financial Services Committee Chairman Barney Frank has stated that he wants the Committee to pass credit card reform legislation.

On February 7, 2008, Congresswoman Maloney (D-NY), Chairwoman of the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, introduced H.R. 5244, the *Credit Cardholders’ Bill of Rights Act of 2008*. The bill would ban “universal default”, prohibit “any time, any reason” changes in credit card terms, require that card holders receive 45 days notice before the APR can be increased, end “double cycle billing”, require payoff balance information on each statement, and allow card holders to prevent over the limit transactions. The Subcommittee held a hearing on this legislation on March 13, 2008.

On March 12, 2008, Senate Banking Committee member Robert Menendez (D-NJ) introduced the *Credit Card Reform Act* (S. 2753). This legislation has many of the same provisions included in the Maloney and Dodd bills. On May 15, 2007, Senator Sander Levin (D-MI) introduced S. 1395, the *Stop Unfair Practices in Credit Cards Act of 2007*. The bill would prohibit interest charges for credit card debt that is paid on time, prohibit "trailing interest" charges for periods between when a bill is sent and the on-time payment is made, cap penalty interest rate increases to no more than 7 percent, restrict retroactive interest rate increases and several common fee practices. On February 7, 2008, Rep. Lincoln Davis (D-TN) introduced a House companion bill (H.R. 5280).

On July 10, 2008, Senate Banking Committee Chairman Christopher Dodd (D-CT) introduced legislation called the *Credit Card Accountability, Responsibility and Disclosure Act*, or the *Credit CARD Act*. Earlier this year, he floated a draft of the bill and stated that he would wait until regulators and the industry had a chance to curb perceived abuses. When introducing the bill, he stated that both have failed to address universal default, "any time, any reason" repricing, multiple over-limit fees, and youth marketing. His bill includes provisions from regulator proposals as well as from Senator Levin's legislation. The bill:

- prohibits interest to be charged for debt paid on time.
- prohibits interest charges on any portion of credit card debt which the credit card holder paid on time during the grace period.
- prohibits credit card issuers from increasing interest rates on cardholders who are in good standing for reasons unrelated to the cardholder's behavior with respect to that card.
- requires increased interest rates to apply only to future debt and not to debt incurred prior to the increase.
- prohibits the charging of interest on credit card transaction fees, such as late fees and over-the-limit fees.
- prohibits the charging of repeated over-the-limit fees for a single instance of exceeding a credit card limit.
- requires payments to be applied first to the credit card balance with the highest rate of interest and to minimize finance charges.
- requires the credit card issuers must offer consumers the option of operating under a fixed credit card limit that cannot be exceeded.
- prohibits charging a fee to allow a credit card holder to make a payment on credit card debt, whether that payment is by mail, telephone, electronic transfer, or otherwise.
- requires issuers to lower penalty rates that have been imposed on a cardholder after 6 months if the cardholder commits no further violations.
- gives each Federal banking agency the authority to prescribe regulations governing unfair or deceptive practices by banks and savings and loan institutions.
- requires issuers to provide individual consumer account information and disclose the total period of time and interest it will take to pay off the credit card balance if only minimum monthly payments are made.
- gives a number of protections for young consumers from credit card solicitations.
- requires a study on interchange fees.

On May 2, 2008, a joint proposal from the National Credit Union Administration (NCUA), the Federal Reserve Board, and the Office of Thrift Supervision was released regarding overdraft protection plans and practices relating to credit cards. In addition, the proposal included possible amendments to Regulation Z (Truth in Lending) and Regulation DD (Truth in Savings) to complement the unfair acts and deceptive practices proposals. For credit cards, the proposal addressed time periods for making payments, payment allocations, interest rate increases on outstanding balances, fees resulting from credit holds, methods for computing balances subject to interest charges, excessive security deposits and fees charged when credit is issued, and advertisement that include multiple interest rates and multiple credit limits. On overdraft protection plans, the draft requires consumers to be given an opportunity to "opt-out" of the plan, and addresses fees resulting from holds on debit card transactions. A comment period of 75 days was initiated (due August 4, 2008).

On May 19, 2008, additional proposed rules dealing with credit and overdraft programs were published in the Federal Register. The Federal Reserve Board initiated a comment period on an amendment to Regulation Z (Truth in Lending) seeking input on creditors' instructions for ensuring timely payments when a due date falls on a weekend or a holiday, their responsibilities in investigating a claim of unauthorized transactions or alleged billing errors, and advertisements for deferred interest plans. Comments are due July 18<sup>th</sup>. The other Fed proposed rule would amend Regulation DD (Truth in Savings) by addressing content and timing requirements for notices of the right to opt out of an overdraft services, disclosures of overdraft fees by all institutions (not just those which promote overdraft services) and balance disclosures. While not directly applied to credit unions, NCUA is required to adopt similarly substantial rules for credit unions. Comments on this proposal were due July 18th. Finally, the Fed and the Federal Trade Commission have proposed that card issuers be required to notify a consumer if the terms and rates offered are less favorable than for other borrowers due to information in the consumer's credit report. Comments on this proposal are due August 18th.

CUNA's Regulatory Affairs Department [comments](#) on proposed regulations. CUNA lobbyists will continue to monitor credit card legislation and support efforts to weed out questionable industry practices while also protecting card issuers and card holders from any unintended consequences that would hamper the availability and affordability of quality credit.

The House Financial Services passed H.R. 5244, the *Credit Cardholders' Bill of Rights Act of 2008*, on July 31, 2008. Prior to the anticipated House vote, CUNA sent a [letter](#) to the bill's chief sponsor, Rep. Carolyn Maloney (D-NY), expressing CUNA's views on the bill. CUNA stated that innovations in the financial services sector, such as the credit card, make credit more available, less expensive, and more convenient for consumers. Credit unions and other financial institutions must be able to price their attendant risks appropriately. CUNA also recommended to Maloney that it might be more prudent to let the regulatory process run its course prior to legislating a remedy. However, the House of Representatives voted 312-112 to approve H.R. 5244 on September 23, 2008. The bill is not expected to be considered by the Senate this year.

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