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# Credit Cardholders' Bill of Rights — The Pendulum Swings for Card Issuers

The recent consumer financial crisis and the surging consumer debt load, when viewed against dramatically escalating credit card penalties, fees and interest rates and issuer-friendly practices, have resulted in card issuers being in the “cross hairs” of regulatory and Congressional scrutiny.



Over the past two years, credit card pricing, billing and underwriting practices that have become common in the industry have been examined in a more hostile environment. Thus, it was almost inevitable that increased regulation would result, and Congress acted swiftly and overwhelmingly this year to pass legislation designed to curb practices which are commonplace in the credit card industry.

In doing so, Congress has legislated a sweeping overhaul of federal consumer credit law and one that will force issuers to revamp their systems, procedures, risk models and marketing programs. The broad new requirements are certain to be expensive and time consuming for the industry at a time it can least afford it, and, for better or for worse, may result in less credit being available for the consumer public.

H.R. 627, the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009, also known as the “Credit Cardholders’ Bill of Rights” (the “Act”), was signed into law by President Obama on May 22, 2009. Credit card issuers will have nine months to make major overhauls of their credit card practices and programs. Debit card issuers too need to be aware of this law since they will have fifteen months to institute several required changes to their practices. The Act also contains new restrictions on issuing credit cards to college students, and requires the GAO to conduct a study and report to Congress on interchange fees which are charged to credit card merchants and the effect such fees have on consumers.

The following is a summary of the major provisions of the Act.

Client Advisory  
June 2009

“This legislation . . . will end the most abusive practices of the credit card industry and level the playing field between cardholders and credit card companies.”

—Rep. Carolyn Maloney, Sponsor of H.R. 627

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## New Credit Card Rules

The credit card portions of the Act amend the Truth-in-Lending Act (“TILA”), the federal law enacted in 1968 that contains disclosure requirements for credit cards and open-end credit. There has not been a significant overhaul of TILA for many years. The provisions in the Act that apply to credit cards use terms as they are defined in TILA (and its implementing Regulation Z). This section of the Act applies to “creditors” and “credit card accounts under an open end consumer credit plan”. Under TILA and Regulation Z, a “credit card” is defined as “a card, plate, coupon book or other single credit device that may be used from time to time to obtain credit”. A credit card can be a general purpose credit card or a private label credit card. A “creditor” generally is a person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments.

TILA primarily imposes disclosure requirements, although the amendments imposed by the Act will now result in substantial restrictions on the actions of card issuers, including their ability to raise the annual percentage rate (“APR”) on cards, and the fees they may charge cardholders. In addition, in response to the customer ire over extremely high late fees and other penalty provisions that apply when payments are received late — or not late, such as the “universal default” terms that have been in widespread use recently, there are new prohibitions and requirements imposed on issuers regarding the acceptance of payments and payment deadlines. There also are several new terms that must be disclosed by card issuers, such as a notice of an increase in the APR or other material changes to the cardholder agreement.

### Restrictions on Increases in Interest Rates

The ability of issuers to raise rates, at any time and for any reason, and on both new and old balances, will now be severely controlled.

- **Limits on Increases to Existing Balances.** With limited exceptions, no increase in the APR can be applied to an outstanding balance. (For this purpose, the “outstanding balance” is the balance owed 14 days after the date on which notice of the increase was sent.) An APR applicable to an existing balance on an account can be increased only under four specified conditions: (1) the increase is under a variable rate plan, as per the terms of the plan, (2) a promotional rate period has expired (but note that under the Act, any promotional rate must be effective for at least 6 months), but the card issuer must have disclosed, at the start of the promotional period, its length and the APR after the promotional period ends, (3) the cardholder fails to pay the minimum payment within 60 days after the due date (subject to further notice of the increase), or (4) a scheduled workout arrangement has ended (subject to certain conditions).

A 2009 study found that between 2007 and 2008, credit card issuers raised interest rates on nearly one quarter of cardholder accounts, or approximately 70 million accounts. Penalty APRs were almost 17 percentage points over the standard APRs.



- **Universal Default Prohibited.** Since the APR can be increased on an existing balance only for the reasons specified above, issuers can no longer use a “universal default” clause to increase rates on an account not in default with that issuer.
- **APR Increases During First Year.** There can be no increase in the APR during the first year after a credit card account is opened, except under the four conditions described above. (After the first year, the APR can be increased on future purchases, with proper notice, as discussed below.)
- **Increased Rate Due to Delinquency or Risk Factors.** If the card issuer has increased the APR due to delinquency (now considered to be the failure to make the minimum payment within 60 days of the due date), market risk or other risk factors, the issuer must reduce the APR to the original APR if the consumer makes the minimum payment on time for 6 months. The issuer must review the account at least every 6 months to determine whether the APR should revert back to the original rate. The Federal Reserve Board (the “FRB”) must conduct a rulemaking to consider the factors the creditor must take into account to determine when the APR must be reduced.
- **Prohibition on Two-Cycle Billing.** Two-cycle billing is prohibited. An issuer cannot reach back to an earlier billing cycle when calculating the amount of interest in the current cycle. (An exception is the limited case where resolution of a billing error allows the issuer to charge interest on the purchase.)

#### Limits on Fees and Penalties

The testimony before Congress revealed significant criticism over the size of late fees, how much they have increased in recent years, and the practice of charging an overlimit fee when the issuer elects to authorize the purchase. This has resulted in limits on when these fees can be charged, and in a significant change from prior law, all penalty fees must be reasonable and proportional to the cardholder’s default.

- **Overlimit Fees.** No overlimit fee may be charged unless the consumer affirmatively opts-in to allow transactions to exceed the credit limit, and then the fee can only be charged once in the current and (subject to certain conditions) in the following two billing cycles. The issuer must disclose on each periodic statement on which an overlimit fee is charged that the cardholder can revoke the election to opt-in. The FRB must prescribe regulations prohibiting unfair and deceptive issuer practices involving credit lines and overlimit fees.
- **“Pay-By-Phone” Fees.** No fee can be charged to make a payment (such as by phone or EFT), except when an expedited payment is arranged through a service representative of the issuer.

According to a 2008 survey, 77% of card issuers “price for risk” by being able to increase the APR on old and new balances under “any time, any reason” clauses. But, a 2005 GAO study found no empirical support for the idea that “risk based” pricing led to lower rates for creditworthy consumers.



- **Penalty Fees.** Any penalty fee (e.g., late fee, over-the-limit fee) must be reasonable and proportional to the omission or violation. The FRB must issue standards to establish the fee levels that will be considered reasonable and “safe harbors” for acceptable levels. The FRB can take into account both the issuer’s costs and the objective to deter defaults, among other factors.
- **Fees on Subprime Accounts.** Fees and charges payable in the first year that are in excess of 25% of the credit limit cannot be financed using the line of credit that is being extended. (This excludes penalty fees such as late, overlimit and NSF fees.) This will apply primarily to subprime cards that carry hefty initial fees.

### Payment Deadlines and Applying Payments

Current law allows issuers to set reasonable conditions for the receipt of payments. However, there was testimony and criticism that the conditions established were unfair, resulting in cardholder payments being deemed late, which subjected cardholders to unwarranted late fees and finance charges. The result is that there are now several new mandates relating to receiving and applying payments, payment deadlines and related matters.

- **Applying Payments to Balance with Highest APR.** Payments made in excess of the minimum payment must be applied first to the balance charged at the highest APR, with any remaining amount applied to the next highest interest rate and so on (except in the last two months before a deferred interest balance is due).
- **Repayment of Outstanding Balances.** Related to the above, an issuer cannot change the terms for repaying an outstanding balance unless the issuer gives the cardholder: (1) five or more years to pay off the balance, or (2) the increased minimum payment is no more than twice the percentage required under the old minimum payment, or another method no less favorable to the cardholder.
- **Receiving Payments.** There can be no early deadline for payments to be received on the due date. Payments received by 5:00 p.m. local time at the location designated by the issuer are considered timely made. Payment by a cardholder at a branch of the bank must be considered made on the date the bank receives it at the branch.
- **Due Dates.** Due dates must be the same day of the month for each month. If the payment due date falls on a weekend or holiday, a payment received on the following business day must be deemed to be on time.
- **Mailing of Statements.** A payment cannot be treated as late, and no interest-free grace period can expire, unless the issuer uses reasonable procedures to ensure that the periodic statement is mailed or delivered no later than 21 days before the due date.

A GAO study found that late fees jumped by 160% from 1995 to 2005, from approximately \$13 to over \$33 and overlimit fees went from \$13 to \$31 per month. The six largest issuers earned almost \$7.4 billion in 2005 from late and overlimit fees.



### New Disclosure Requirements

To ensure transparency of issuer practices, several new notices, by both mail and on periodic statements, will be required.

- **Notice of APR Increase.** The issuer must give at least 45 days prior written notice before raising the APR or making any other “significant change” (including an increase in any fee or finance charge) to the terms of the cardholder agreement. The FRB is to determine what constitutes a “significant change”. The issuer must provide notice of the right to cancel the card before the change in terms becomes effective, and closing the account cannot be treated as a default, require immediate repayment of the entire card balance, or generate penalty fees.
- **Minimum Payment Warning.** Issuers will be required to print a “Minimum Payment Warning”, in a tabular format, on periodic statements telling consumers the effect of making only the minimum payment each month. Several disclosures must be made, including: (1) the number of months to pay the outstanding balance if only minimum payments are made, (2) the total pay-off cost if only the minimum payments are made, (3) the amount of the monthly payment needed to pay off the balance in 36 months, and (4) a toll-free phone number for information on how to obtain credit counseling.
- **Notice of Payment Due Date and Penalty.** Periodic statements must conspicuously disclose the due date for payments (or the date a late fee will be charged, if different), the amount of the late fee, and any penalty APR, if late payment will result in an increase in the APR.
- **Notice of Account Renewal.** If an issuer charges an annual or other periodic fee, at least 30 days prior to the renewal date, the issuer must send a notice disclosing any changed term since the last renewal that was not previously disclosed.
- **Website Posting of Card Agreements.** Issuers must post their cardholder agreements online and send a copy to the FRB. The FRB must maintain a website to provide them to the public.
- **Use of Terms.** The Act for the first time defines “fixed rate” and “prime rate” and these terms must be used accurately in advertisements for credit cards.

### New Limits on Student Card Programs

As a reaction to the easy availability of credit to students, based on the Act, it will be more difficult for college students to obtain credit cards and for issuers to promote their school affinity card programs. Title 3 of the Act contains the following restrictions:



- **Written Applications.** Student cards will need to have written applications.
- **Creditworthiness of Student or Co-signer.** Before issuing a credit card to a person under the age of 21, the card issuer must obtain (1) the signature of a creditworthy co-signer over the age of 21, or (2) financial information from the applicant showing that he has an independent means of repaying the credit.
- **Credit Line Increases.** There can be no increase in the credit limit on an account held by a person under the age of 21 for which a co-signer is liable without the written consent of the co-signer.
- **Prescreened Offers.** In an amendment to the Fair Credit Reporting Act, there can be no prescreened credit offers (for any type of credit) to an individual under the age of 21, unless the consumer has consented to receive prescreened offers.
- **Incentives.** There can be no tangible gifts made to students on or near campus in exchange for filling out a credit card application.
- **Disclosure by Schools.** Colleges and universities are required to publicly disclose any credit card marketing contracts made with a card issuer. Congress also recommended that colleges monitor and limit when and where card solicitations on campus will take place.

### New Gift Card Rules

#### Protections for Gift Cards

Although the credit card sections of the Act have received most of the attention, Title IV, which will amend the Electronic Fund Transfer Act (the “EFTA”), also will enforce new restrictions on issuers of gift cards.

Title IV of the Act applies to plastic and electronic store gift cards redeemable at one merchant, and prepaid general use gift cards redeemable at multiple merchants, such as those branded as Visa, MasterCard or American Express cards. It does not cover rewards, loyalty, telephone or promotional cards, or paper gift cards or paper gift certificates. It also excludes cards which are reloadable and not marketed or labeled as a gift card. (Presumably, this would exclude stored-value cards such as payroll and health care cards.)

The new rules are as follows:

- **Expiration Dates.** A gift card cannot expire less than 5 years from the date the card was purchased or money was last added to the card, whichever is later. The terms of the expiration must be disclosed clearly and conspicuously.



- **Fees.** No dormancy, inactivity or service fee can be charged if the card has been used within the previous 12 months. If such a card remains unused for 12 months or more and, at the time of purchase, the issuer (or seller) disclosed clearly and conspicuously that a fee would be charged, the amount of the fee and when it would be charged, the issuer can charge a dormancy fee, but not more than once per month.
- **State Law Preemption.** The law preempts state laws having to do with expiration dates and dormancy, inactivity or service fees on store gift cards, and general purpose gift cards which are inconsistent with these provisions, but only to the extent of the inconsistency. As with the general preemption scheme of the EFTA, state laws affording greater protection to consumers are not preempted.

### Miscellaneous Provisions

#### Ability to Repay

Following a theme which has emerged in the mortgage crisis, Congress wants to insure that credit is given only to consumers who are able to repay it. Thus, under the Act, card issuers must now consider the consumer's ability to make the required payments under the account terms before issuing a new credit card or raising the credit limit on an existing account.

#### TILA Civil Penalties Increased

The Act increases civil penalties under TILA for violations of the credit card provisions. In an individual action for violations by a creditor under an open-end consumer credit plan, the current minimum penalty for a violation of TILA is twice the amount of the finance charge in connection with the transaction. Under the Act, there will be a minimum penalty of \$500 and a maximum penalty of \$5,000 per violation, or such higher amount as the court may award in the case of a pattern or practice of violations.

### Effective Dates

Congress has given card issuers a very short period of time to comply with the new requirements, particularly when considering the extent of time which will be needed to make systems changes, changes to periodic statements and other disclosures, and risk modeling.

- **General Card Time Frame.** With a few exceptions, the new credit card requirements in the Act take effect on February 22, 2010, nine months after enactment of the law.
- **Prompt Applicability.** The following two sections have shorter effective dates: (1) the requirement to give 45 days advance notice prior to any increase in the interest rate or other significant change in the account terms, and (2) the requirement that periodic statements must be delivered



at least 21 days before the payment due date or the “free ride period” (the grace period for purchases) cannot expire and no late fee can be charged. These requirements become effective on August 22, 2009, ninety days after enactment. Card issuers will need to act promptly in order to be in compliance by that date.

- **Gift Cards.** The new restrictions relating to gift cards will become effective on August 22, 2010, fifteen months after enactment.

### Federal Reserve Board Rulemaking

The FRB must complete its rulemaking to implement the provisions of the Act no later than nine months after the date of enactment (e.g., February 22, 2010), except that it has fifteen months to issue final rules with regard to (i) the conditions under which an issuer would be required to reduce an APR which was previously increased due to credit risk factors, and (ii) the determination as to when a penalty fee or late fee will be deemed to be “reasonable and proportional” to the violation or omission.

It is worth noting that in December 2008, the FRB concluded a lengthy rulemaking process and promulgated a Final Rule amending Regulation Z and Regulation AA (which prohibits unfair and deceptive acts and practices), also with regard to various practices of credit card issuers. While the requirements and prohibitions contained in the Final Rule are reflected in the Act, Congress went much further than the FRB in outlawing what it considered deceptive and abusive practices of the credit card industry. In fact, the Senate Report on the bill referred to the FRB’s Rulemaking as “an important first step”, but stated that further consumer protections were needed. The time frame for compliance with the Act is shorter than under the Rule (where issuers were generally given until July, 2010 to come into compliance), another significant difference.

The FRB will now be required to take another look at the regulations and reconcile any differences or new requirements as a result of the Act, in addition to numerous studies and reports it must now make.

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Evidence of the degree of consumer dissatisfaction with card issuer practices is that the public responded to the proposed rules with an unprecedented number of comments — over 66,000.