Pew Health Group

Safe Credit Cards Project

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Moving Towards Safer Credit Cards

On February 22, major new consumer protections will take effect as part of the second implementation phase of the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009. Just two practices addressed in this second phase will save American consumers at least $10 billion a year.[1] Below, we look ahead to the third and final phase of the Credit CARD Act, to take effect August 22, which will require all credit card penalties to be "reasonable and proportional" and will direct card issuers to review all interest rate increases since the beginning of 2009.

The Federal Reserve Has a New Opportunity to Protect American Consumers From Excessive Credit Card Penalty Fees and Charges.

The Credit CARD Act directed the Federal Reserve to issue new rules, including rules limiting credit card penalty fees and charges that will take effect on August 22. Between now and then, the Federal Reserve will consider public comments in establishing these limits. At present, penalty fees and charges can exceed 100 percent of the amount due. **The Pew Safe Credit Cards Project encourages the Federal Reserve to scrutinize penalty costs that are significant relative to the amount *past due*, not just the overall account balance.**

Currently in the credit card marketplace:[2]

- The median penalty fee is $39.
- The median penalty interest rate is 28.99 percent per year.

For a typical balance of $3,000, a cardholder must pay a minimum of about $68 by the due date or else receive a $39 late fee. This $39 fee adds a **penalty of nearly 60 percent** to the amount that is past due for the month.[3] It is difficult to call a $39 fee on a $68 payment "proportional" under the law. If penalty interest charges are also applied, the penalty can be more than double the amount past due, as shown below.

The Combined Effect of Penalty Interest and Fees[4]

Penalty interest rates and fees can dramatically increase the minimum payment due.

If Your Balance is:	Your Minimum Payment Without Penalties:	Your Minimum Payment With Penalties:	How Much Your Payment Will Increase:
$3,000	$68	$141	107%
$10,000	$225	$381	69%

The Federal Reserve can ensure reasonable and proportional penalty fees and charges by:

- Restraining the size of penalties relative to the amount that is past due.
- Discouraging "hair trigger" penalties, such as late fees that apply immediately on the due date. *Currently a cardholder can be charged a $39 fee for paying even one day late or for going even one dollar over the credit limit.*
- Limiting penalty interest rate increases to seven percentage points above non-penalty rates, and requiring issuers to restore non-penalty rates whenever a cardholder resumes on-time payment.

For more on Pew's research, the Safe Credit Card Standards or relevant state laws, see our website.[5]

Congressional Mandate to Review All Account Increases Since January 2009

An additional provision effective in August 2010 will require issuers to review all previous account rate increases from January 2009 and lower the rate if circumstances, such as the cardholder's credit score or market conditions, have improved. Upcoming rules issued by the Federal Reserve are key to this important protection and could go far in addressing recent interest rate increases.

Summary of the Major Provisions of the Credit CARD Act

In addition to the 2009 protections giving cardholders the right to 45 days advance notice of any interest rate increase or other significant change and the right to close the account if they do not agree to certain changes in terms, the new law required the following:

February 22, 2010:

- New application of payment rules will reduce interest charges for anyone who pays more than the minimum payment.
- Issuers can no longer raise rates on existing balances with few exceptions (such as when an account becomes 60 days past due).
- Cardholders charged a penalty APR will be able to return to the regular, non-penalty rate by making the first six months of payments on-time after the penalty is imposed.
- Due dates must be the same day every month.
- Card issuers cannot charge more than 25 percent of the available credit in up-front fees on subprime cards. This restriction does not include penalty fees.
- Monthly statements must be mailed 21 days before a payment is due.
- Applicants under age 21 must have a co-signer or provide proof of ability to repay before they can be issued a card.

August 22, 2010:

- Penalty fees and charges must be reasonable and proportional to an act or omission of the cardholder.
- Card issuers must review all accounts with increased rates going back to January 2009. If the relevant circumstances have changed, the issuer must consider lowering rates.

For more information please visit www.pewtrusts.org/creditcards

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[1] Pew's research shows that the Credit CARD Act will save American cardholders a minimum of $10 billion dollars just by stopping two practices the Federal Reserve has already labeled "unfair or deceptive"– retroactive rate increases and "hair-trigger" penalty interest rate increases. The Pew Charitable Trusts, "Safe Credit Card Standards: Policy Recommendations for Protecting Credit Cardholders and Promoting a Functional Marketplace" (March, 2009), available at http://www.pewtrusts.org/our_work_report_detail.aspx?id=50550&category=630

[2] The Pew Charitable Trusts, "Still Waiting: 'Unfair or Deceptive' Credit Card Practices Continue As Americans Wait for New Reforms to Take Effect " (October, 2009), available at http://www.pewtrusts.org/our_work_report_detail.aspx?id=55627&category=630

[3] According to the 2007 Survey of Consumer Finances, the median credit card balance for families carrying a balance was $3,000. http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf. The median late fee is $39. See The Pew Charitable Trusts (October, 2009), supra note 2. Every month a cardholder must make a minimum payment towards the outstanding balance. For a balance of $3,000 the minimum payment will be $68 assuming the issuer requires a one percent payment of principle. Fees add to the minimum payment due, and a $39 fee would add approximately 60 percent to this minimum payment. For further explanation of this calculation see infra note 4.

[4] We estimate the cardholder's monthly minimum payment assuming a payment of one percent towards principle, plus current interest and fee charges: Balance * .01 + Balance * (APR/12) + Current Fees. We estimate a purchase APR of 15 percent, the mid-point between the highest and lowest advertised purchases rates, the median penalty interest rate of 28.99 percent and the median late fee of $39 (see "Still Waiting," supra note 2). For further analysis see Nick Bourke, "Reasonable and Proportional Rules under Credit CARD Act of 2009 (Pub L. 111-24)" (The Pew Charitable Trusts, June 25, 2009), http://www.pewtrusts.org/news_room_detail.aspx?id=53840. In the chart, column two represents a cardholder's standard minimum payment due at the standard purchase rate with no penalty fees. Column three represents the minimum payment due at the penalty interest rate and including a $39 late fee. Column four shows the percentage increase in the minimum payment due from non-penalty status to penalty status.

[5] Pew's recommendations are based on our latest research and our Safe Credit Card Standards. Also, some state rules limiting the size and severity of credit card penalties exist as a model for the Federal Reserve. See e.g., Nick Bourke (June 25, 2009), supra note 4 at pg 21.