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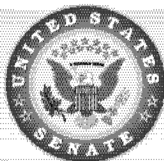

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U.S. SENATE REPUBLICAN POLICY COMMITTEE

Legislative Notice

No. 12 May 12, 2009

Dodd-Shelby Substitute to H.R. 627—Credit Card Accountability Responsibility and Disclosure Act of 2009

Calendar No. 55

H.R. 627 was read twice and placed on the Senate Calendar on April 30, 2009.

Noteworthy

- Senators Dodd and Shelby have offered a substitute amendment to H.R. 627. This legislative notice summarizes the text of the Dodd-Shelby substitute.
- The House of Representatives passed H.R. 627 on April 30, 2009, by a vote of 357 to 90. The Senate Banking Committee passed similar legislation, S. 414, by a voice vote on April 29, 2009.
- The Obama Administration issued a Statement of Administration Policy on May 11, 2009, indicating strong support for the Dodd-Shelby substitute.

Background

Credit cards are a form of unsecured, revolving debt (i.e., debt that is not backed by fixed collateral and does not have a fixed payment, although repayment is usually a percentage of the outstanding balance and made at regular intervals) used by consumers and businesses to conduct commerce and business transactions. In fact, credit cards complete $2.5 trillion in transactions in a year, handling 1,000 transactions per second.[1] Given their wide availability, credit cards can be used for a range of activities from temporary substitutions for cash to long term financing; they can cover emergency situations to mundane purchases. Approximately 73% of American families hold credit cards, with approximately 60% of these maintaining a monthly balance for a total of 46% of all American families who carry a balance.[2] For college students, Sallie Mae

[1] Testimony of Kenneth Clayton, Senior Vice President and General Counsel for American Bankers Association before the House Committee on Financial Services, Hearing on March 19, 2009, page 1.
[2] Federal Reserve, 2007 Survey of Consumer Finances, page A46.

found that 84% have at least one credit card, with 92% having used credit cards for textbooks, school supplies, and other direct education expenses and 30% using credit cards for some part of tuition.[3] Total outstanding revolving consumer debt was approximately $945.7 billion of the end of February 2009, a reduction of $5.4 billion from February and total reduction of $15.1 billion from January.[4]

Banks are the issuers of the most widely held credit cards, with credit card associations (e.g., MasterCard and Visa) used to process transactions, notify banks of consumer purchases in order to charge an account, and conduct advertising campaigns.[5] Associations generate revenue from fees charged to issuers and merchant banks for transaction processing and other payment-related services and assessments on the dollar volume of activity on the cards that carry their brands. In contrast, credit card issuers generate revenue by charging merchants' banks a percentage, known as an interchange fee, for processing transactions, and charging consumers interest payments and fees.

Today's credit card issuers typically charge consumers a low or zero annual fee for use of the card and charge interest, based on an annual percentage rate calculation, against the monthly card balance. In addition, card issuers charge delinquent consumers fees for payments that are made after a due date, with the average penalty late fee equaling $39, which can double in the event of default.[6] Similar fee rates apply for card users who exceed their credit limits. In exchange for these costs and fees, consumers benefit from the convenience of card use, and in many instances, the reward programs offered (e.g., cash back, or points or mileage earned that can redeemed for various purposes). Consumers also benefit from a wide array of credit card choices that offer varying interest rates and price points, and can actively shop for additional cards or switch card issuers through billions of annual solicitations.[7]

The credit card industry is a commercial undertaking designed to produce profits for its issuing companies and build brand loyalty; it is not an altruistic, non-profit venture. The Federal Reserve's report to Congress indicates that for credit card banks with assets in excess of $200 million, the reported net earnings before taxes were 2.75% percent return on assets, compared to 1.44% return on assets for total activities by all commercial banks in 2007.[8] These profits are expected to be significantly lower for 2008 and 2009. For instance, JP Morgan Chase noted that while it added 14.9 million new cardholders in 2009, it does not expect to make any profit on its large credit card portfolio this year (its credit card earnings dropped from $2.9 billion in 2007 to

[3] Sallie Mae, "How Undergraduate Students Use Credit Cards: Sallie Mae's National Study of Usage Rates and Trends," April 2009, page 11.

[4] Federal Reserve, Statistical Release on Consumer Credit, May 7, 2009. Experts dispute whether this number is a good proxy for total outstanding credit card debt or is slightly inflated to also capture non-revolving debt and non-credit card debt.

[5] Of consumers with credit cards, approximately 96% hold cards issued by a bank. Federal Reserve, 2007 Survey of Consumer Finances.

[6] Testimony of James Sturdevant, Sturdevant Law Firm, before the Senate Committee on Banking, Housing and Urban Affairs, Hearing on February 12, 2009, page 4.

[7] Mintel Comperemedia data indicates that 5.4 billion credit card direct mail offers were sent to Americans in 2008.

[8] Board of Governors of the Federal Reserve System, "Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions," June 2008, page 4.

$780 million in 2008); in fact, JP Morgan Chase has increased its reverses from $3 billion to $8 billion as it prepares for higher losses in the business line.[9]

The current economic recession has had a two-fold impact on credit card practices. First, banks squeezed by losses in other parts of their business have been forced to find profits elsewhere. At the same time, they are seeking to limit their total leverage exposure and future losses. The credit card portion of a bank's activities can consist of both: it represents potential new revenues from some consumers and represents new potential write-downs for those consumers unable or unwilling to pay. As those uncollectable accounts are soaring, continuing growth in unemployment and the drop in home prices have increased credit card consumer complaints.[10]

An important concept that became more popular for credit card issuers during the mid-1990s was to move from uniform credit card rates and fees to a risk-based system. Under risk-based pricing, credit card interest rates and fees are priced according to the riskiness of the consumer being issued the credit. A necessary component of the risk-based system is re-pricing (i.e., increasing or decreasing the rates or fees charged to a consumer based on the individual's behavior and credit practices). To the extent that legislation alters the ability of credit card issuers to re-price interest rates or limits the ability to conduct future re-pricing, consumers may see the return of higher, standardized rates and fees that could be imposed against all cardholders. This may mean higher interest rates and fees (such as the return of annual membership fees) to compensate for the loss of revenue from higher-risk consumers. In addition, it may result in a reduction in the overall amount of credit available as card issuers reduce their credit exposure. Equally important, it may eliminate the attractive features that entice consumers to switch to less expensive credit cards.

Federal Reserve Rules

On December 18, 2008, the Federal Reserve Board approved final rules pertaining to credit cards under authority provided in the Federal Trade Commission Act (issued in cooperation with the Office of Thrift Supervision and the National Credit Union Administration), the Truth in Lending Act, and the Truth in Savings Act. The rules, which were completed after an 18-month process that received over 70,000 total comments, provide a comprehensive approach to address recent criticisms and questionable practices of credit card issuers. Specifically, the new final rules, which become effective on July 10, 2010, make changes to four existing Federal Reserve regulations (i.e., Regulations AA, E, DD and Z). Highlights of the new rules include:

- Prohibit banks from treating a payment as late unless the bank provides a reasonable amount of time to make a payment, with a safe harbor provided for banks that issue statements at least 21 days prior to the payment due date.

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[9] Letter from Jamie Dimon, Chairman & CEO, JP Morgan Chase to shareholders, March 23, 2009.

[10] A recent report by Moodys.com found credit card write-downs soared to 8.82% in February, marking the sixth consecutive month of increases. The level is more than 300 basis points higher than a year ago. In another measurement, the Federal Reserve Board found the 30-day credit card delinquency rate increased from 4.54 to 5.56 from the Q4 2007 to Q42008 and the chare-off rate increased comparably from 4.10 to 6.25 over the same period of time.

- Require banks to allocate payments to the balance with the highest rate first or pro rata among all of the balances.
- Require banks to disclose at account opening all interest rates that will apply to the account and prohibit increases in those rates, except in certain circumstances.
- Prohibit banks from calculating interest using a method referred to as "two-cycle billing."
- Prohibit financing security deposits and fees for credit availability (such as account-opening fees or membership fees) if charges assessed during the first 12 months would exceed 50% of the initial credit limit.
- Require changes in the format and content of credit and charge card application and solicitation disclosures.
- Enhance the cost disclosures provided at account opening.
- Revise disclosures on statements, including making changes to the format requirements.
- Clarify the disclosures for making only the minimum payments to repay balances.
- Expand the circumstances under which consumers receive written notice of changes in the account terms, and increase the amount of time these notices must be sent before the change becomes effective.
    - Increases the amount of advance notice before a changed term can be imposed from 15 to 45 days.
    - Creditors must provide 45 days' prior notice before the creditor increases a rate due to the consumer's delinquency or default, or as a penalty.
- Allow advertisements to refer to a rate as "fixed" only if a time period is specified for which the rate is fixed and the rate will not increase for any reason during that time, or if a time period is not specified, if the rate will not increase for any reason while the plan is open.
- Require creditors to set reasonable cut-off hours for mailed payments to be considered timely on the due date, deeming 5 p.m. to be a reasonable time.
- Expand to all institutions requirements that statements disclose the aggregate dollar amounts charged for overdraft fees and for returned item fees.
- Require institutions that provide account balance information through an automated system to provide a balance that does not include additional funds that may be made available to cover overdrafts.

In addition, the Federal Reserve Board issued interim rules that, if enacted, would provide consumers a choice regarding the payment of ATM and one-time debit card overdrafts and prohibit institutions from imposing overdraft fees when the account is overdrawn because of a hold placed on funds in the consumer's account that exceeds the actual transaction amount.

A longer lead time for the new rules to become effective was provided to the credit card industry given the difficulty in redesigning systems and processes necessary for compliance, including training staff. In particular, regulators were concerned that a shorter compliance time period would lead to greater expenses for companies, which would have been passed onto consumers, or caused certain activities to be ended in the short-term in order to avoid compliance problems. In testimony before Congress, the Federal Reserve defended the delayed effective date by indicating that the rules will apply to more than 1 billion credit card accounts and will "require card issuers to adopt different business models and pricing strategies and then develop new products. . . In addition to these changes, issuers must revise their marketing materials, application and solicitation disclosures, credit agreements, and periodic statements so that the

documents reflect the new products and conform to the rules. Changes to issuers' business practices and disclosures will involve extensive reprogramming of automated systems which subsequently must be tested for compliance, and personnel must receive appropriate training."[11]

Legislative History

S. 414 was introduced by Senator Dodd on February 11, 2009, and referred to the Committee on Banking, Housing, and Urban Affairs. On April 29, 2009, the bill was reported favorably, as amended, by voice vote by the committee. The bill was placed on the Senate Legislative Calendar on April 29, 2009.

H.R. 627 was introduced by Representative Carolyn Maloney on January 22, 2009, and referred to the House Financial Services Committee. On April 27, 2009, the committee reported the bill, as amended, to the House. On April 30, 2009, the House of Representatives passed the bill by a vote of 357-90, and the bill was subsequently read twice and placed on the Senate Legislative Calendar. On May 11, 2009, the bill was laid before the Senate by unanimous consent. Subsequently, Senators Dodd and Shelby filed a substitute amendment (Senate Amendment 1058) for purposes of considering amendments.

Bill Provisions

Section 2. Rulemaking Authority. Authorizes the Federal Reserve Board to issue rules and publish model forms as necessary to implement the provisions of the bill.

Section 3. Effective Date. Establishes the effective date for the provisions of the bill at nine months from date of enactment, unless otherwise specified.

Section 101. Credit Card Restrictions.

Subsection (a) – Rate Increases. Requires credit card issuers to provide card holders with a written notice 45 days in advance of any: 1) increase in the annual percentage rate, or 2) significant change, as determined by the Federal Reserve, in other terms regarding the card. Cardholders would have to be given notice of the right to cancel the card before the rate increase or other term changes become effective. Moreover, the closure of an account cannot be treated as a default, force immediate repayment of the card balance, or generate new penalties or fees. Notice is considered given 14 days after being sent. Rules under this provision would become effective 90 days after date of enactment.

Subsection (b) – Outstanding Balances. Prohibits a creditor from increasing the annual percentage rate to an existing outstanding balance on a credit card unless:

[11] Testimony of Sandra F. Braunstein, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, before the House Committee on Financial Services, March 19, 2009, pages 10-11.

(1) It reflects the expiration of a promotional rate or loss of promotional rate pursuant to the credit agreement (rate increase cannot exceed that provided in the credit agreement);
(2) The increase is done pursuant to the cardholder agreement that ties increases to an index or formula;
(3) The cardholder failed to make payments under any workout plan with the creditor; or
(4) The cardholder did not make the minimum payments within 60 days of the date due, as long as the creditor provides the cardholder a notice of the reason for the increase and the fact that the increase will terminate if the consumer makes six straight minimum payments.

The subsection also prohibits changes to the terms for repayment of an outstanding balance, except to allow the consumer the opportunity to repay the balance by a mechanism that is better for the consumer than either amortizing the cost over five years or paying no more than double the portion that the existing balance contained in the monthly minimum payments. Additionally, the subsection establishes the "outstanding balance" as being the existing balance 14 days from providing notice, as required under the provision.

Subsection (c) – Interest Rate Reduction. Requires card issuers, to the extent they permit interest rate increases on new balances, to consider reducing the rate increase based on a number of factors. The cardholder would be required to: (1) set a specific method for determining credit risk of cardholders, market conditions, or other factors; (2) conduct a bi-annual review of a cardholder's interest rate to determine whether it should be reduced; (3) reverse any recent rate increase if justified by the bi-annual review; and (4) provide written justification to cardholders for any rate increase. Rules under this provision would become effective 15 days after date of enactment.

Subsection (d) – First Year Interest Rates. Prohibits card issuers from increasing the interest rate of cardholders during the first year unless it is related to the expiration of a promotional rate, which must last not less than six months.

Section 102. Limits on Fees and Interest Charges. Prohibits card issuers from imposing "double cycle" billing. This does not apply to deferred interest or resolution of billing errors.

The section also prohibits the imposition of any fees for extension of credit above the established credit limit unless a cardholder affirmatively opts-in to the related fees via an election, and requires notice to cardholders of the over-the-limit fees, the right to elect to participate, and right to revoke the election. Additionally, the section prohibits card issuers from imposing a separate fee based on the technology used to pay, unless it relates to an expedited service provided by a service representative via the issuer.

Lastly, the section requires that penalty fees to be imposed by card issuers be reasonable and proportional to an omission or violation of the cardholder agreement. The Federal Reserve would issue regulations, based on a number of factors established by the section, regarding what qualifies as reasonable and proportional and could establish a safe harbor based on a set amount in order for card issuers to be in compliance. Rules under this provision would become effective 15 months after the date of enactment.

Section 103. Definition of Fixed Rate. Establishes a statutory definition for the term "fixed rate."

Section 104. Time Due and Crediting of Payments. For purposes of a periodic statement's due date, sets the time due at 5:00 p.m. local time. For those cardholders with multiple balances with the same card issuer, the section requires card issuers to allocate any cardholder payment above the minimum payment to the balance with the highest interest rate, with any remaining being applied to the balance with the next highest interest rate, and so on. A card issuer would be prohibited from imposing a late fee or finance charge for late payment penalty if the issuer makes a material change in its mailing address, office, or process for handling cardholder payments that resulted in a material delay in the crediting of cardholder payments.

Section 105. Harvester Fees. Prohibits card issuers from financing more than 25 percent of the annual fee.

Section 106. Periodic Statements. Requires a card issuer to maintain the same date for a payment due each month by a cardholder. Additionally, the section prohibits card issuers from imposing late fees, penalties, or additional finance charges unless cardholders' monthly bills are mailed or delivered not less than 21 calendar days prior to the due date.

Section 107. Enhanced Penalties. Increases the minimum penalty for a violation of the Truth in Lending Act to $500 per violation and not more than $5,000 (changed from $200 and $2000), except for a pattern or practice of violations.

Section 201. Payoff Disclosures.

Subsection (a) – Periodic Statement Disclosures. The subsection: (1) amends the current warning label to be included on a cardholder's periodic statement for only making minimum payments to provide more discretion to the Federal Reserve; (2) requires a card issuer to include repayment information regarding making only minimum payments, such as the months needed pay the entire balance, the total costs to the consumer under a minimum payment program, a cost comparison to paying off the entire balance in three years, and a telephone number for consumer counseling and debt management; and (3) requires a card issuer to conduct a separate calculation if the interest rate would be subject to change (i.e., promotional rate).

Subsection (b) – Liability. Updates and amends the civil liability provisions for violations under the Truth in Lending Act, as amended by the bill.

Subsection (c) – Consumer Counseling. Requires the Treasury Department to issue rules to establish a toll-free telephone number to be maintained by creditors for purposes of credit counseling and debt management. Calls received would be referred to non-profit budget and credit counseling agencies, subject to specified requirements.

Section 202. Late Payments. Expands the requirements that a card issuer must put on periodic statements to include notification of the fact if one or more late payments may increase the annual percentage rate and the new penalty interest rate that would be imposed under such circumstances. The section also requires credit card issuers that take payments at local branches

(i.e., banks) to post cardholders' payments on the account on the day the payment was made at the branch.

Section 203. Renewal Disclosures. Expands the credit card renewal notice procedures to require card issuers to issue a renewal notice if any of the terms of a cardholder's account are changed instead of just if the fees changed.

Section 204. Internet Posting. Requires card issuers to post on the Internet, and provide the Federal Reserve, a copy of the card agreements for any card it issues. The Federal Reserve would be required to establish a central repository of credit card agreements to be posted on the Internet.

Section 301. Consumers Under 21 Restrictions. Prohibits a credit card issuance to a consumer the age of 21, unless the consumer: (1) provides a written application with parental signature and acceptance of financial liability for the card; or (2) demonstrates ability to repay the extension of credit through a written application. The section requires the Federal Reserve to establish a safe harbor for card issuers in order to be in compliance with this restriction.

Section 302. Consumers Under 21 Solicitations. Prohibits the issuing of a credit report by a credit bureau to a person for a credit or insurance transaction if the consumer is under 21.

Section 303. Co-signers for College Students. Prohibits an increase in a credit limit for a consumer under 21 that a parent (or guardian or spouse) is financially liable for unless the parent approves of the increase in writing.

Section 401. Definitions for Gift Cards/Store Cards/Gift Certificates. Establishes definitions for the treatment and regulation of gift cards/store cards/gift certificates; prohibits the imposition of dormancy or inactivity fees on gift cards/store cards/gift certificates unless dormancy/inactivity is greater than one year, consumer was notified, and the fee is not imposed more than once a month; establishes notification requirements for gift cards/store cards/gift certificates; prohibits the expiration of a gift card/store card/gift certificate unless the expiration is greater than five years and terms of expiration are provided in capital letters not less than 10-point font. Rules to implement this provision by the Federal Reserve, which would include the appropriateness of fees on gift cards/store cards/gift certificates, would be issued within nine months of date of enactment and become effective 15 months after date of enactment.

Section 501. Interchange Fees Study. Requires a Government Accountability Office study, due within 180 days after the date of enactment, on various aspects of interchange fees.

Section 502. Federal Reserve Study. Requires the Federal Reserve to conduct a biennial study and report on the various aspects of the consumer credit market.

Cost

No official score is available on the Dodd-Shelby substitute to H.R. 627.