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The Credit CARD Act of 2009: An Effective but Incomplete Solution Evidencing the Need for a Federal Regulator

Jaclyn Rodriguez

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The Credit CARD Act of 2009: An Effective but Incomplete Solution Evidencing the Need for a Federal Regulator

I. INTRODUCTION

Don Cressman, a fifty-three year-old credit card holder, was shocked when his credit card company charged him a $29 over-the-limit-fee. Since he was hurting financially, he carefully monitored his card so that he would not exceed his credit limit. When Don called about his charge, the credit card issuer told him that the interest charge put his balance over his credit limit. Like many cardholders, Don was unaware that credit limit calculations include interest charges. Don is not alone: many Americans have difficulty understanding disclosure in the fine print of credit card agreements.

In response to controversial practices such as providing disclosures that are hard to comprehend and poorly organized, President Obama signed into law the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (CARD Act). The CARD Act amends the Truth in Lending Act (TILA) to "establish fair and transparent practices relating to the extension of credit under an open end consumer credit plan, and for other

2. Id.
3. Id.
4. See id.
6. Id. at 46.
purposes.” Key elements of the CARD Act require plain language disclosures for rate increases and fees, and implementation of protective measures for consumers, such as advanced notice requirements prior to a rate increase.

This Note will argue that while the CARD Act is a substantial step in addressing problems in the credit card industry that have led to allegations of credit card impropriety, the issuers will likely find ways to recover lost profit in a manner that some might find at odds with the spirit of the CARD Act. In order to monitor and respond to such actions, Congress should create a federal regulatory agency to monitor the practice of issuers and other consumer credit providers, divesting this authority from the Federal Reserve Board (FRB), which currently regulates consumer credit pursuant to the Truth in Lending Act (TILA) and Regulation Z (Reg. Z). Part II of this Note will review the current regulatory regime. Then, Part III will examine some controversial practices issuers engaged in prior to the CARD Act, and explain how the CARD Act eliminated these practices. Part IV will discuss the impact of the CARD Act on credit card issuers. Finally, Part V will propose that Congress should create a Financial Products Safety Commission (FPSC) to regulate the practices of credit card issuers.

II. CURRENT CREDIT CARD REGULATORY REGIME

Prior to the enactment of the CARD Act, TILA was the primary federal law regulating the issuance of credit cards to consumers. Congress passed TILA in 1968 and authorized the FRB to implement regulations, known as Reg. Z. Reg. Z

9. See id.
10. See infra Part IV.
11. See infra Part II, pp. 310-12.
includes Official Staff Interpretations (Commentary) that both
facilitates interpretation of TILA and protects the creditor who
relies on this Commentary from liability.17 TILA requires credit
card issuers to make certain disclosures so that consumers can
make informed choices based on terms and costs.18 As credit card
use and debt grew, however, experts began to question the extent
to which cardholders understood the disclosed terms of their
cards.19 Also, after the implementation of TILA, card issuers
began to engage in practices that, while legal under the terms of
TILA, increased the cost to consumers of using their card, without
their knowledge.20

In response to demands for stronger consumer protection,21
Congress, the FRB and other key federal bank regulators
responded with reforms designed to curb many of the card
industry’s controversial practices.22 First, on December 18, 2008,
the FRB and Office of Thrift Supervision approved an interagency
final rule (Final Rule) that banned five “unfair” practices used by
credit card issuers.23 These “unfair” practices used by credit card
issuers include: “(1) unfair time to make payments; (2) unfair
allocation of payments; (3) unfair increases in annual percentage
rates; (4) unfair balance computation methods; and (5) unfair
charging of security deposits and fees for the issuance or

17. Simmons, supra note 16.
18. See generally 12 C.F.R. § 226 (noting that the Truth In Lending Act was
enacted to promote the informed use of credit cards by requiring issuers to disclose
specific terms and conditions and giving consumers more transparency in their credit
cards).
19. GAO, supra note 5, at 2.
20. Id.
21. See Nancy Trejos, Major Changes in the Way Credit Cards Work, WASH.
22/AR2009052200430.html.
22. See Unfair or Deceptive Acts or Practices (Regulation AA), 12 C.F.R. §§ 227,
23. 12 C.F.R. § 535.22-26; Barkley Clark & Barbara Clark, New Credit Card Rule
Outlaws Five “Unfair” Practices, CLARKS’ BANK DEPOSITS AND PAYMENTS
MONTHLY, Dec. 2008, at 1 [hereinafter Five Unfair Practices] (noting that the
Proposed Rules listed seven “unfair practices” but the Final Rule decreased it to
five).
availability of credit to consumer credit card accounts.\textsuperscript{24} The new rule will not to come into effect until July 1, 2010.\textsuperscript{25}

In a companion move, the FRB amended Reg. Z to require better consumer disclosures for credit cards.\textsuperscript{26} These amendments to TILA, which will also become effective July 1, 2010, cover "applications and solicitation; account-opening; period statements, change-in-terms notices; and advertising."\textsuperscript{27}

Even with the Final Rule, Congress, concerned about the eighteen-month implementation period given to credit card issuers,\textsuperscript{28} passed the CARD Act by a sweeping majority in both chambers.\textsuperscript{29} Most of the provisions of the CARD Act were implemented February 22, 2010, although a few provisions went into effect as early as August 20, 2009.\textsuperscript{30} Unlike the Final Rule, most of the Card Act is codified as amendments to TILA instead of listing and doing away with "unfair practices."\textsuperscript{31}

While many of the same controversial practices are addressed in both the CARD Act and the Final Rule, the FRB still faces some coordination problems between the two pieces that need to be resolved.\textsuperscript{32} Not only do the CARD Act and the Final Rule have inconsistent effective dates of implementation, but also some of the provisions differ: the CARD Act is at times more restrictive than the Final Rule, and Congress deliberately left open

\textsuperscript{24} 12 C.F.R. §§ 535.22-26. On January 12, 2010, the FRB issued a press release stating that these amendments to Regulation AA had been withdrawn for consistency with the CARD Act. Press Release, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/newsevents/press/bcreg/20100112a.htm (Jan. 12, 2010). The Board is expected to publish a new Final Rule elsewhere in the Final Register. \textit{Id}. Many of these unfair practices are similar to those addressed in the CARD Act and will be discussed in Part III. \textit{See infra} Part III.

\textsuperscript{25} 12 C.F.R. § 706.

\textsuperscript{26} \textit{See Truth in Lending (Regulation Z),} 12 C.F.R. § 226 (2010).

\textsuperscript{27} \textit{Five Unfair Practices, supra} note 23, at 4-5.


\textsuperscript{29} White House Press Release, \textit{supra} note 7.


\textsuperscript{32} \textit{Id} at 8.
some definitions in the CARD Act that the FRB will have to clarify.\textsuperscript{33}

III. THE CARD ACT OF 2009

This Part will discuss the controversial practices used by credit card issuers prior to the enactment of the CARD Act and then address how Congress attempted to deal with these practices in the CARD Act.

A. Payment Applied to Low Interest Rate Balance

Prior to the CARD Act, card issuers were allowed to charge different interest rates for purchases, cash advances, and balance transfers.\textsuperscript{34} This often left the average cardholder with multiple interest rates on one card.\textsuperscript{35} Credit card issuers typically allocated payments to the lowest rate of interest, making cardholders fully pay off their lower interest balances before applying payment to the higher rates of interest.\textsuperscript{36} This increased the total amount of interest paid to the credit card issuer, extending the time it took consumers to pay down their debt.\textsuperscript{37} A recent study conducted by the Center for Responsible Lending found that only three percent of borrowers understood credit card issuers' payment allocation policies.\textsuperscript{38}

The CARD Act addresses this controversial practice: credit card issuers are required to apply the amounts in excess of the

\begin{itemize}
\item \textsuperscript{33} \textit{Id}.
\item \textsuperscript{34} \textit{Five Unfair Practices, supra note 23, at 2}.
\item \textsuperscript{35} \textit{Id}.
\item \textsuperscript{36} \textit{GAO, supra note 5, at 27}.
\item \textsuperscript{37} \textit{The Credit Cardholders' Bill of Rights: Hearing on H.R. 627 and H.R. 1456 Before the H. Subcomm. on Fin. Institutions and Consumer Credit, 110th Cong., 2nd Sess. (2008) (Written Testimony of Travis Plunkett, Legislative Director, Consumer Federation of America and Edmund Mierzwinski, Consumer Program Director, U.S. Public Interest Research Group) [hereinafter Plunkett & Mierzwinski Testimony].}
\end{itemize}
minimum payment to the highest interest rate balances. This provision is more restrictive than the Final Rule, which gives card issuers the option of distributing the payment pro rata among the balances at different interest rates. Nonetheless, both practices improve the previous state.

B. Universal Default

Since the early 2000s, credit card issuers have used “universal default clauses” that allow credit card companies to increase interest rates based on factors other than the customers payment history with the credit card issuer. Such clauses are often included in the fine print and hard to decipher. For example, if a cardholder failed to make a timely payment to another creditor or the borrowers credit score declined, the credit card company could increase the interest rate it charged the cardholder. While the six largest credit card issuers stopped using this practice prior to the enactment of the CARD Act, four of the six stated that they would instead raise interest rates through a change-in-terms, which unlike universal default may require prior notification to the customer.

Critics condemned universal default for several reasons. First, many argued that it was unfair to impose a penalty rate on a cardholder who has not defaulted on a payment with that particular issuer. Being late on any payment to another creditor

42. Id.
43. Plunkett & Mierzwinski Testimony, supra note 37, at 17.
44. GAO, supra note 5, at 26. A change-in-terms lists the circumstances in which consumers receive written notice of changes in their account terms under TILA. Five Unfair Practices, supra note 23, at 5; see 12 C.F.R. § 226.9.
45. See Plunkett & Mierzwinski Testimony, supra note 37, at 21.
46. See id.
could trigger such an increase. Second, credit card companies used universal default to raise interest rates without providing any notification to the cardholder. Finally, credit card companies did not take into account the various problems with credit reporting and scoring when they raised interest rates. One significant problem associated with credit scores is their lack of accuracy. One study found that seventy percent of credit reports contained some kind of error, and that twenty-nine percent of credit reports had errors that could result in a denial of credit. Another problem is that the data used to determine a credit score may be inaccurate. Converting the information from credit reports into a credit score is complicated and can result in “variance between scoring system designs.” How credit card issuers translate the reports to a credit score is a closely held secret that has not been examined by government regulators.

The CARD Act prohibits universal default clauses. If instead, an issuer increases the annual percentage rate (APR) based on the credit risk of the cardholder, the issuer must have methodologies to monitor those factors to determine whether a subsequent decrease is appropriate. The issuer must also monitor accounts whose APR has increased since January 1, 2009 every six

48. See Plunkett & Mierzynski Testimony, supra note 37, at 21.
50. Id. at 5.
51. CREDIT SCORE ACCURACY, supra note 49, at 6 (“Recently, after California passed a law requiring all consumers in the state to have access to their credit scores, several companies [ . . . ] have voluntarily provided general information about the information that is used to calculate a credit score or to evaluate a mortgage application, and how that information is generally weighted.”).
52. See Plunkett & Mierzynski Testimony, supra note 37, at 21; CREDIT SCORE ACCURACY, supra note 49, at 6.
53. Id. at 6 (“Recently, after California passed a law requiring all consumers in the state to have access to their credit scores, several companies [ . . . ] have voluntarily provided general information about the information that is used to calculate a credit score or to evaluate a mortgage application, and how that information is generally weighted.”).
55. Sec. 101(c), §§ 148(b)(1)-(2); Card Act Will Prohibit Widespread Practices, supra note 28, at 6.
months to determine whether factors contributing to the increase have changed.\(^{57}\) While the Final Rule also prohibits universal default, it has no similar provisions regarding subsequent monitoring.\(^{58}\)

### C. Retroactive Interest Rate Changes

Another common practice employed by the card industry was to apply penalty rates retroactively to prior purchases\(^{59}\) in response to cardholder behavior that allegedly presented a "greater risk of loss."\(^{60}\) For example, one issuer told the GAO that if a cardholder made a late payment or went over his credit limit, the issuer automatically increased the cardholder's interest rate, and the increased rate applied to purchases that had not yet been fully paid off.\(^{61}\) Similarly, in April 2004, Discover told its customers that it "reserved the right to look back eleven months for a late payment that could justify the increase."\(^{62}\) Retroactive interest rate increases were especially harsh on consumers who had a large balance.\(^{63}\) One expert stated that this practice was particularly problematic during the recession, as many consumers have less available cash.\(^{64}\)

Default interest rates, which are set in the cardholder agreement and represent the maximum interest rate a card issuer can charge in response to a violation of the cardholder agreement, have grown tremendously.\(^{65}\) Of all the credit cards reviewed by GAO as of 2005, only one did not include default interest rates.\(^{66}\)

\(^{57}\) Sec. 101(c), §§ 148(b)(1)-(2); Card Act Will Prohibit Widespread Practices, \textit{supra} note 28, at 6.

\(^{58}\) See Unfair or Deceptive Acts or Practices (Regulation AA), 12 C.F.R. § 535.24 (2009).

\(^{59}\) Plunkett & Mierzwinski Testimony, \textit{supra} note 37, at 16.

\(^{60}\) GAO, \textit{supra} note 5, at 24.

\(^{61}\) \textit{Id}.


\(^{63}\) \textit{Id}.

\(^{64}\) \textit{Id}.

\(^{65}\) GAO, \textit{supra} note 5, at 24.

\(^{66}\) \textit{Id}.
The levels of default interest rates, which have risen in recent years, averaged around 27.3 percent in 2005 and were much higher than typical non-default interest rates.\textsuperscript{67}

Under the CARD Act retroactive interest rate increases are prohibited except in certain conditions.\textsuperscript{68} A new rate may be applied retroactively if the cardholder fails to make a minimum payment within sixty days after the due date.\textsuperscript{69} The Final Rule allows default interest rates to take effect much sooner: the card’s APR could increase if the minimum payment has not been received within thirty days.\textsuperscript{70}

Under the CARD Act, credit issuers are also prohibited from increasing the APR in the first year of the account, except for promotional rates (which must last at least six months) unless payment is sixty days late.\textsuperscript{71} If the account has been open for more than a year, only four situations permit an issuer to increase the APR for new transactions: “(1) an expiration of a specified period of time, (2) a variable rate, (3) completion or failure of a workout, or (4) a [sixty]-day delinquency on the account provided that the cardholder can cure to the previous APR after six months of timely payment.”\textsuperscript{72}

If an issuer is going to increase the card’s APR for future balances, it must provide at least a forty-five day notice prior to the effective date of the increase.\textsuperscript{73} However, no advance notice is required if the increase is for a variable rate card, the completion or failure of a temporary hardship arrangement, or the expiration of an introductory rate.\textsuperscript{74}

\textsuperscript{67} Id.
\textsuperscript{69} Id.
\textsuperscript{71} Sec. 101(b), § 171(b)(4); Card Act Will Prohibit Widespread Practices, supra note 28, at 6.
\textsuperscript{72} Card Act Will Prohibit Widespread Practices, supra note 28, at 6; Sec. 101(b), § 171(b)(4) (effective February 22, 2010).
\textsuperscript{73} Sec. 101(a), § 127(i)(1) (effective August 20, 2009); Card Act Will Prohibit Widespread Practices, supra note 28, at 6.
\textsuperscript{74} Sec. 101(a), § 127(i)(1); Card Act Will Prohibit Widespread Practices, supra note 28, at 6.
Forty-five day advance notice is also required of any "significant change" in terms, which includes a fee increase.\textsuperscript{75} Since the term "significant change" is not defined in the CARD Act, the FRB will have to amend Reg. Z to provide for the definition.\textsuperscript{76} The CARD Act requires the notice to be clear and it must inform the cardholder of her right to decline the increase in interest rate by closing her account.\textsuperscript{77} The cardholder must then be allowed to pay off the balance within five years, under the previous interest rate, although the issuer may double the minimum payment.\textsuperscript{78}

\textbf{D. Complex Language and Fine Print}

Another problematic practice used by credit cards is to provide disclosures that are hard to comprehend, poorly organized and formatted, and unnecessarily detailed and long.\textsuperscript{79} While credit card companies are required to provide information that helps cardholders understand the terms and costs of their contracts, the GAO found that the structure of the disclosures prevented cardholders from understanding the costs associated with their cards.\textsuperscript{80} Although the average American adult reads at an eighth-grade level, most credit card disclosures were written at a tenth-grade level or higher.\textsuperscript{81} The credit card disclosure documents were excessively complicated, included more detail than necessary, and used complex terms when only simple ones were necessary.\textsuperscript{82} For example, one cardmember agreement used the phrase "rolling consecutive twelve billing cycle period" rather than using "over..."
the course of the next twelve billing statements” or “next twelve months.” Excessive detail both lengthened and complicated the disclosure document. Experts determined that this excess information made consumers less likely to read or understand the information presented.

Furthermore, credit card disclosures were poorly organized and formatted. Experts concluded that credit card documents “lacked effective organization” and “failed to group relevant information together.” They were also written in fine print decreasing readability and hindering the cardholder’s ability to locate relevant information. Experts have found that while larger font size makes it easier for the cardholder to understand the document, actual cardmember agreements used “small and condensed typeface.”

The CARD Act requires contract terms be disclosed in language that credit cardholders can easily understand to assist them in avoiding unnecessary costs. For example, the CARD Act requires that credit card issuers highlight fees cardholders may be charged as well as the reason they might be charged those fees. Issuers must include a written statement such as: “Minimum Payment Warning: Making only the minimum payment will increase the amount of interest you pay and the time it takes to repay your balance.” Credit card issuers are also required to show the implications associated with paying only the minimum required payment: how many months it would take and the total cost including interest and principal payments. They must also

83. Id.
84. Id.
85. GAO, supra note 5, at 46.
86. Id. at 38.
87. Id. at 39.
88. Id. at 41.
89. Id.
92. Sec. 201(a), § 127(b)(11)(A).
93. Under the FRB’s amendments to TILA, card issuers are also required to provide a hypothetical example of how long it will take to pay off their balances if
disclose how much a cardholder would have to pay each month in order to pay off the entire balance in thirty-six months. Finally, issuers must provide a toll-free telephone number where the cardholder can receive “credit counseling and debt management services.” This information must appear in a prominent location on the billing statement. The FRB has issued guidelines for credit card issuers to establish a toll-free telephone number. Referrals provided by the telephone number shall include “only those nonprofit budget and credit counseling agencies approved by a United States bankruptcy trustee.”

The CARD Act also requires that late payment deadlines be shown in a clear manner. A statement must include the date on which payment is due or, if different, the date on which a late payment fee will be charged, together with the fee to be charged if the payment is made after that date. Also, if a credit card company has changed any of the terms of the account since the card was last renewed, it must provide disclosures within a specified period either as part of the customer's billing statement or via a separate document.

E. Double-Cycle Billing

Double-cycle billing is the practice, previously used by some card issuers, of charging interest on debt already paid by a consumer, resulting in higher interest payments. This does not affect consumers who either pay in full or carry balances from month-to-month since there is either no balance to charge interest or interest is always accruing. Instead, this practice does affect

only the minimum payments are made each month. Truth in Lending (Regulation Z), 12 C.F.R. § 226 (2010).

94. Id.
95. Sec. 201(a), § 127(b)(11)(B)(iv).
96. Id.
97. See 12 C.F.R. § 226.
98. Sec. 201(c).
100. Id.
101. Sec. 202; § 127(b)(12)(B).
103. Id.
those consumers who pay off their balance one month but not the next.\textsuperscript{104}

The CARD Act\textsuperscript{105} and the Final Rule\textsuperscript{106} both prohibit double-cycle billing.

\textbf{F. Over-the-Limit Fees}

Before the passage of the CARD Act, credit card issuers had two options when a cardholder exceeded his credit limit.\textsuperscript{107} Card issuers could either decline the transaction or allow it and charge a fee.\textsuperscript{108} The issuers that charged over-the-limit fees provided for them in the credit card agreement.\textsuperscript{109} Yet many cardholders would not learn about the penalty until they went over their credit limit.\textsuperscript{110} Disproportionately high over-the-limit fees were common and could be up to twenty-five dollars for a $300 credit limit.\textsuperscript{111}

The CARD Act states that card issuers may not charge an over-the-limit fee for a particular credit card transaction unless the consumer “opts-in” and allows the cardholder to complete the relevant transaction.\textsuperscript{112} Therefore, unless a cardholder gives the bank authorization to allow a purchase that puts her over her credit limit, the issuer cannot charge an over-the-limit fee.\textsuperscript{113} If the

\begin{thebibliography}{99}
\bibitem{104} Id.
\bibitem{105} Id.; Sec. 201, § 127(j)(i) (effective February 22, 2010).
\bibitem{106} Unfair or Deceptive Acts or Practices (Regulation AA), 12 C.F.R. §§ 535.22-26 (2009).
\bibitem{108} Id.
\bibitem{109} Id.
\bibitem{110} Id.
\bibitem{111} Id.
\bibitem{112} Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, Sec. 102(a), § 127(k), 123 Stat. 1734, 1739 (2009). According to the American Bankers Association, consumers value and expect the banks to pay for overdraft fees. They claim that customers would pay more for the customer to avoid “the inconvenience, embarrassment, and fees charged by the merchant or payment recipient, were the payment to be declined.” The Credit Cardholders’ Bill of Rights: Providing New Protections for Consumers: Hearing before the H. Subcomm. on Fin. Institutions and Consumer Credit, 111th Cong., 1st Sess. (2009) (Written Testimony of Kenneth J. Clayton, Senior Vice President and General Counsel, American Bankers Association) [hereinafter Clayton Testimony].
\bibitem{113} Ataiyero, supra note 78.
\end{thebibliography}
cardholder chooses to “opt-in,” notice must be given regarding the right to revoke the “opt-in” every time the cardholder is charged an over-the-limit fee. The Act’s prohibition applies even if interest charges or fees put the cardholder over the credit limit.

Due to these provisions in the CARD Act, American Express and Discover both have announced that they will no longer charge a fee when consumers exceed their spending limit. This is most likely because the cost of building a mechanism where consumers can opt-in, as required by the CARD Act, exceeds the over-the-limit fees they might subsequently recover. Experts believe that credit card issuers may start implementing membership programs that charge an annual fee in exchange for a waiver of over-the-limit fees.

IV. IMPACT OF THE CARD ACT ON CREDIT CARD ISSUERS

A. Costs to Credit Card Issuers

While the cost to credit card issuers of implementing the CARD Act is unclear, it will affect every aspect of their current business model, including determining how credit is allocated and how cards are priced. Credit card companies will face costs under the CARD Act due to operational changes that must be made to “business practices, software programming, product design, period statements, advertisements, and contracts.” The current infrastructure must be completely revamped and this will likely require significant time and money. Customer service personnel will have to be retrained, and the technology that underpins the entire card system must be reworked in order to

115. Ataiyero, supra note 78.
117. Id.
118. Id.
119. Clayton Testimony, supra note 112, at 12.
120. Id.
121. Id.
comply with the provisions of the CARD Act. For example, "periodic statements must be completely revamped, involving programming changes, testing, legal analysis to ensure compliance, focus group testing, and modifications of services from outside vendors." Credit card issuers will also face lower revenue from a decrease in funding through the securitization market. Investors may be reluctant to buy securities backed by credit card receivables if they perceive that the implementation of the CARD Act will reduce the interest and interest and fee income. As one expert explained, "[t]he government on the one hand is trying to restart the securitization market but on the other hand Congress is zealously putting forth legislation that will not allow credit card firms to price the risks of their books, which basically cuts off access to consumers." The harder it is to price risk, the less willing investors will be willing to buy securities backed by those assets. The securitization market funds about forty percent of consumer lending.

The CARD Act requires credit card companies to rework many aspects of their business. Not only must each model be completely redesigned, but also all marketing materials will have to be changed along with the collections and chargeback system.

Finally, many provisions in the CARD Act are designed to make it easier for cardholders to avoid late fees or pay off more of their balance, thus leading to lower interest and fee payments to credit card issuers. According to the GAO report, credit card

122. Id.
123. Id.
124. Id.
127. Id.
128. Id.
129. Clayton Testimony, supra note 112, at 12.
130. Id.
issuers make approximately ten dollars in profit from interest for every one hundred dollars in outstanding credit card debt. Thus, interest payments represent a meaningful revenue stream for credit card issuers, and the CARD Act's changes could have drastic effects. For example, the Act requires cardholders to "opt-in" if they want to be able to use their credit cards to make a purchase that pushes the cardholder over the credit limit, and thus be charged a fee. Previously, credit card issuers collected billions of dollars by automatically charging a fee if a cardholder exceeded his credit limit. Now that this is banned, issuers could lose a substantial amount of money from this single provision.

B. Credit Card Issuers' Responses to the CARD Act

With the February 2010 provisions of the CARD Act recently going into effect, many credit card issuers have sought to maintain profit levels by raising interest rates. Prior to the provisions having gone into effect, Representative Betsy Markey, a co-sponsor of the CARD Act, asked credit card issuers not to raise interest rates. Rep. Markey said that the situation was particularly troubling since "[t]he effective date of the original Credit CARD Act legislation was set for February 2010 to give credit card companies enough time to comply with these new regulations - not additional time to violate the spirit of the law by hiking interest rates on consumers."

A recent study released by BillShrink found that "interest rates on purchases and balance transfers for card holders have

132. GAO, supra note 5, at 105.
135. See id.
137. Id.
138. Id.
grown nearly twenty percent from January to July of this year.\textsuperscript{139} According to the study, the companies that have increased their interest rates the most include Capital One, Citi, Discover, and US Bank.\textsuperscript{140} The global financial crisis is a contributing factor as well.\textsuperscript{141} Capital One told its cardholders that interest rates were doubling due to “changes in the credit environment.”\textsuperscript{142} According to issuers, these dramatic interest rate hikes are also due to the record number of defaults by cardholders.\textsuperscript{143}

One reason why issuers implemented these interest rate hikes and additional fees before February 2010 is that, under the CARD Act credit card issuers no longer have complete flexibility in raising interest rates.\textsuperscript{144} Previously, issuers could automatically raise interest rates for cardholders who had credit problems, which helped issuers maintain profits since these cardholders often generated substantial revenue in late fees and penalties.\textsuperscript{145} Under the current rules, “those who have managed their credit well and currently have very good credit card deals will find that card companies are limited in their ability to distinguish between them and those that have credit problems,” said Edward Yingling, president of the American Bankers Association.\textsuperscript{146}

Since card issuers will have less flexibility in increasing interest rates on defaulting credit holders, banks will likely reduce the amount of available credit for both high risk and low risk borrowers.\textsuperscript{147} One study found that credit lines “could be reduced by $931 billion (an average of $2,029 per account) and tightening lending standards could put credit cards out of reach for as many

\begin{thebibliography}{99}
\bibitem{Gomstyn} Gomstyn, \textit{supra} note 131.
\bibitem{Id} \textit{Id}.
\bibitem{Id} \textit{Id}.
\bibitem{Id} \textit{Id}.
\bibitem{Id} \textit{Id}.
\bibitem{Lazarus} Lazarus, \textit{supra} note 142.
\bibitem{See Clayton Testimony} \textit{See} Clayton Testimony, \textit{supra} note 111, at 10.
\end{thebibliography}
as forty-five million consumers. However, because issuers have less flexibility to raise interest rates retroactively on high-risk borrowers, low risk borrowers face overall increases in interest rates and fees as well. Thus, the inability of credit card issuers to price according to risk may have a significant impact for both the risky and the non-risky.

Another reason why banks are raising interest rates and charging additional fees is that personal bankruptcies were thirty-six percent higher in the first half of 2009 as compared to 2008. Although accounts in which cardholders are paying only the minimum payments every month are profitable to issuers, they are no longer profitable when the cardholder defaults or files for bankruptcy. Most major card issuers are currently reporting default rates around ten percent.

Credit card issuers have also been closing accounts due to high credit scores. Although the CARD Act prohibits issuers from engaging in universal default, using information from a consumer's credit report to raise interest rates, nothing in the CARD Act prohibits issuers from canceling an account because of information contained in a credit report. In recent years, credit card issuers have been closing accounts more frequently. Often, consumers learn of the closure only after having an attempted purchase with the card denied. With the CARD Act recently having gone into effect, this number will likely rise. "Although cancellations aren't directly affected by the new regulations, the

148. Id.
149. See id.; See Lazarus, supra note 142.
152. Id.
153. Id.
155. Id.
156. Id.
157. Id.
158. Id.
reassessment of customers by issuers ‘is part of the pro-active housekeeping’ before the new regulations take effect,” said John Ulzheimer, head of educational services for Credit.com.¹⁵⁹

A second way credit card companies will seek to maintain profit levels in spite of the new CARD Act is by charging additional penalties and adding annual fees to certain products, affecting those with good and bad credit.¹⁶⁰ For example, Fifth Third Bank is now charging a $19 penalty if a cardholder does not use the card for twelve months.¹⁶¹ Similarly, some issuers have started imposing an additional fee applied to purchases made outside of the United States.¹⁶² Credit card companies are also scaling down their rewards programs by making it more difficult to redeem points.¹⁶³

Lastly, in order to maintain profitability, credit card issuers have started switching accounts to variable-rate interest cards.¹⁶⁴ While credit card issuers now need to provide a forty-five day written notice prior to raising interest rates,¹⁶⁵ the CARD Act does not apply to variable-rate interest cards.¹⁶⁶ Credit card issuers have already started switching cardholders to these cards whose rates are likely to climb.¹⁶⁷ Bank of America and JP Morgan Chase, two of the largest U.S. credit issuing banks, have now started switching from fixed to variable rates.¹⁶⁸ Approximately seventy-five percent

¹⁵⁹. Id. (noting that issuers have also been closing accounts due to inactivity since open credit lines pose a risk of fraudulent use).
¹⁶¹. Id.
¹⁶². Id.
¹⁶³. Savage, supra note 151.
¹⁶⁴. Levisohn, supra note 160. A variable rate interest card is one in which the interest rate changes from time-to-time. The Fed. Reserve Bd., Choosing a Credit Card, http://www.federalreserve.gov/Pubs/shop/ (last visited Feb. 6, 2009). The rate may be tied to another interest rate such as the Treasury bill rate or the prime rate. Id.
¹⁶⁶. Sec. 101(b), § 171(b)(4); Levisohn, supra note 160.
¹⁶⁷. Levisohn, supra note 160.
of all cards used in 2009 were variable-rate interest cards, up from sixty-five percent in 2008, according to researcher Bankrate.com.169

V. FINANCIAL PRODUCTS SAFETY COMMISSION

With the recent global financial crisis, the FRB's role has expanded, and various lawmakers are proposing that its authority be curtailed.170 Upset that the FRB did not do more to prevent the recession, many lawmakers are seeking to take away some of its responsibilities.171 Currently, the FRB's responsibilities include: monetary policy, dealing with systematic risks to the financial system, regulating state member banks, and regulating bank holding companies and their subsidiaries.172

As this Note argues, one area of concern is the FRB's ability to regulate credit cards. While Congress addressed some of the credit card criticisms through the CARD Act, as the industry's response shows, the industry finds new loopholes to exploit.173 In order to help Congress respond to the complex and rapidly changing credit card industry, Professor Elizabeth Warren, a law professor at Harvard and head of the Congressional Oversight Panel, proposed creating a Financial Products Safety Commission (FPSC).174 This Commission would be modeled on the U.S. Consumer Product Safety Commission (CPSC), a successful independent agency that was founded to protect consumers from injury from consumer products.175 Since its establishment, product-related death and injury rates have decreased substantially in the United States.176

169. Levisohn, supra note 160.
171. Id.
173. See supra Part IV.
175. Id.
176. Id.
A. The Wall Street Reform and Consumer Protection Act of 2009

Professor Warren’s proposal has recently been proposed in both the House and Senate.\textsuperscript{177} The House bill, the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) (Bill), passed the full House on December 11, 2009. The Bill, which received no votes by Republicans, includes various measures aimed at overhauling the current U.S. financial regulatory system and creates a Consumer Financial Protection Agency (CFPA).\textsuperscript{178} House Financial Services Committee Chairman Barney Frank (D-Mass.), sponsor of the Bill, was able to defeat a proposal from fellow Democrats that would have created a council of regulators instead of the CFPA.\textsuperscript{179} Significant changes were made to the Bill, prior to its passage by the House under a manager’s amendment sponsored by Rep. Frank.\textsuperscript{180} Included in these changes, Rep. Frank agreed to change the leadership structure of the CFPA by “having an appointed agency director eventually cede power to an oversight board appointed by the president.”\textsuperscript{181} Rep. Frank has identified Professor Warren as a “possible head for the agency.”\textsuperscript{182} Other amendments are designed to protect small community banks by establishing an office within the CFPA to ensure that regulations do not disproportionately burden them.\textsuperscript{183}

Although the proposal will face opposition from other members of Congress and industry groups such as the American


\textsuperscript{179} Ferrulo et al., \textit{supra} note 178.

\textsuperscript{180} \textit{Id.}

\textsuperscript{181} \textit{Id.}

\textsuperscript{182} Schultz, \textit{supra} note 177.

\textsuperscript{183} Ferrulo et al., \textit{supra} note 178.
Bankers Association, experts say the creation of the agency is likely.\textsuperscript{184} Within the past year, support for the CFPA has spread.\textsuperscript{185} Prior to the Bill’s passage, various bills within both chambers of Congress had been introduced calling for the implementation of a CFPA. Also, the Department of the Treasury released a regulatory reform plan that created an agency “dedicated to the interests of the consumers.”\textsuperscript{186} The new agency, which has similar goals as the FPSC proposed by Professor Warren, would be created in order to eliminate abusive and unfair practices.\textsuperscript{187} In addition, Senator Dodd, Chairman of the Senate Banking Committee has proposed a plan for a consumer protection agency.\textsuperscript{188} Under Sen. Dodd’s proposal, the consumer protection agency would: “[h]ave broad regulatory and enforcement authority over credit and bank products, be responsible for protecting consumers from predatory practices of payday lenders, mortgage brokers, banks, and other financial institutions, and would have a seat next to the safety and soundness regulators as part of a systemic risk council.”\textsuperscript{189}

\textbf{B. Details of Professor Warren’s Financial Products Safety Commission}

Although various proposals recommend how to reform the current regulatory system, this Part will focus on the FPSC proposed by Professor Warren. As she explained, the FPSC would be “charged with responsibility to establish guidelines for consumer disclosure, collect and report data about the uses of different financial products, review new products for safety, and require modification of dangerous products before they can be

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\item[184.] Schultz, supra note 177.
\item[185.] See id.
\item[187.] Id.
\item[189.] Id.
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marketed to the public."\textsuperscript{190} It would also develop regulatory responses to the rapidly changing credit card issuer practices, promote uniform disclosures, collect various data including which cards are hard to understand, and review the safety of new products.\textsuperscript{191} The purpose of such a commission is "to concentrate the review of financial products in a single location, with a focus on the safety of the products as consumers use them."\textsuperscript{192}

The FPSC would also assure credit card holders that their purchase would meet minimum safety standards.\textsuperscript{193} It would guard against hidden tricks that make some products more dangerous than others, thus promoting competition.\textsuperscript{194} The FPSC would also collect data in order to determine which products are most popular with consumers and which products are least understood.\textsuperscript{195} It would develop universal regulatory responses to credit card action and decide which actions are permissible, which actions are permissible with more disclosure, and which actions should be banned altogether.\textsuperscript{196} Because the financial services industry is a complex, rapidly-changing business, consumers need an agency dedicated to assuring that minimum safety standards are met.\textsuperscript{197}

C. Objections

Critics raise various objections to the agency idea.\textsuperscript{198} One objection that can be raised is that the regulations imposed by such an agency would hinder innovation, thus causing economic losses.\textsuperscript{199} Supporters note, however, that there is "little evidence of either a theoretical or empirical nature that financial innovations"

\textsuperscript{190} Warren, \textit{supra} note 174, at 94.
\textsuperscript{191} Id.
\textsuperscript{192} Id.
\textsuperscript{193} Id.
\textsuperscript{194} Id.
\textsuperscript{195} Id.
\textsuperscript{196} Warren, \textit{supra} note 174, at 94.
\textsuperscript{197} Id.
\textsuperscript{198} Crotty & Epstein, \textit{supra} note 178, at 11.
\textsuperscript{199} Id.
have a large impact on the economy. A second objection is that creating such an agency is too complicated of an undertaking because of the difficulty in determining what a risky product is and how to test it. Various private reports, however, have been released which contain similar models of product monitoring. Regulatory agencies and investment bankers have already come up with checklists of factors banks should consider when deciding whether or not to implement a new financial product. A last objection is that lobbying firms and others wishing to get approval of their products could corrupt the process of product certification. One solution to avoiding this problem would be to have high-status regulators along with well-informed expert oversight groups who are able to guard against these corruptions.

VI. CONCLUSION

While the CARD Act addresses problems in the credit card industry that have led to allegations of credit card impropriety, credit card companies will adapt and create new anti-consumer practices in order to maintain profitability, some of which might be viewed as deceptive and abusive as the practices halted by the CARD Act.

Although the CARD Act is a good first step in the right direction, the credit card industry will continue to prioritize their profit over the cardholders’ understanding and financial safety. Given all the current responsibilities of the FRB, it may struggle to regulate credit card issuers’ responses to the CARD Act. Thus, as both Professor Warren and the Bill propose, an agency like the FPSC should be created in order and respond to credit card issuers’ ability to mold their products around regulation. The

201. Crotty & Epstein, supra note 178, at 11.
202. Id.
203. Id.
204. Id. at 12.
205. Id.
206. See Ferrulo et al., supra note 178.
FPSC would promote consumer safety in a single location by standardizing risk assessment and providing uniform disclosures to cardholders.\textsuperscript{207} It would also develop regulatory responses to impermissible actions by credit card issuers.\textsuperscript{208} Credit card holders need an agency to help them determine that products meet minimum safety standards\textsuperscript{209} in order to carry out their daily lives not worrying that they incur unexpected credit fees and interest.

\textit{Jaclyn Rodriguez}