

Legislative Highlights

Proposed Fed Rules on Credit Cards Attract Thousands of Consumer Complaints

The Federal Reserve Board has proposed rules to prohibit unfair practices regarding credit cards and overdraft services that would, among other provisions, protect consumers from unexpected increases in the rate charged on pre-existing credit card balances. The rules, proposed for public comment under the Federal Trade Commission Act (FTC Act), also would forbid banks from imposing interest charges using the “two-cycle” billing method, would require that consumers receive a reasonable amount of time to make their credit card payments, and would prohibit the use of payment allocation methods that unfairly maximize interest charges. They also include protections for consumers that use overdraft services offered by their bank. The proposals attracted some 60,000 comments from consumers, mostly complaints about the subject practices.

“The proposed rules are intended to establish a new baseline for fairness in how credit card plans operate,” said Federal Reserve Chairman Ben S. Bernanke. “Consumers relying on credit cards should be better able to predict how their decisions and actions will affect their costs.” The proposed changes to the Board’s Regulation AA (Unfair or Deceptive Acts or Practices) would be complemented by separate proposals that the Board is issuing under the Truth in Lending Act (Regulation Z) and the Truth in Savings Act (Regulation DD). The provisions addressing credit card practices are part of the Board’s ongoing effort to enhance protections for consumers who use credit cards, and follow the Board’s 2007 proposal to improve the credit card disclosures under the Truth in Lending Act. The FTC Act proposal includes five key protections for consumers that use credit cards:

- Banks would be prohibited from increasing the rate on a pre-existing credit card balance (except under

limited circumstances) and must allow the consumer to pay off that balance over a reasonable period of time.

- Banks would be prohibited from applying payments in excess of the minimum in a manner that maximizes interest charges.

- Banks would be required to give consumers the full benefit of discounted promotional rates on credit cards by applying payments in excess of the minimum to any higher-rate balances first, and by providing a grace period for purchases where the consumer is otherwise eligible.

- Banks would be prohibited from imposing interest charges using the “two-cycle” method, which computes interest on balances on days in billing cycles preceding the most recent billing cycle.

- Banks would be required to provide consumers a reasonable amount of time to make payments.

The proposal would also address subprime credit cards by limiting the fees that reduce the available credit. In addition, banks that make firm offers of credit advertising multiple rates or credit limits would be required to disclose in the solicitation the factors that determine whether a consumer will qualify for the lowest rate and highest credit limit.

Target: Pre-dispute Arbitration Clauses

Opponents of ADR are adopting a multi-pronged strategy aimed at eliminating or limiting the use of pre-dispute arbitration clauses through the legislative process. Two bills (S. 1782 and H.R. 3010) are broad-based attacks on a perceived unfairness in the arbitration process, while a number of other bills are industry-specific, covering residential home mortgage contracts (S. 2452, H.R. 3915, H.R. 1519 and H.R. 2061) and consumer credit agreements (H.R. 1443; making many common consumer arbitration agreements unenforceable). Other bills target motor vehicle sales, nursing home arrangements and employment contracts, among other areas where

arbitration is frequently used to resolve disputes. Though these bills have little chance of enactment in the 110th Congress, prospective changes in the political makeup of the executive and legislative branches next year could improve their outlook.

Durbin: Federal Usury Cap Needed

Sen. Dick Durbin (D-III) has introduced the “Protecting Consumers from Unreasonable Credit Rates Act” (S. 3287) to establish a federal usury cap of 36 percent APR on all consumer credit transactions, similar to the cap enacted by many states and the federal cap for military personnel. The rate includes amounts charged for all interest, fees, defaults and other finance charges. The bill would not pre-empt any stricter state law and gives state attorneys general the power to enforce the new cap, up to three years after a violation. The bill was referred to the Senate Banking Committee.

BAPCPA: Profit for Credit Card Companies at Consumers’ and Homeowners’ Expense?

Two studies released this summer suggest that the 2005 amendments have helped produce record profits for credit card companies at the same time they led to an increase in foreclosures and mortgage defaults. An empirical study by Michael Simkovic (“The Effect of 2005 Bankruptcy Reform on Credit Card Industry Profits and Prices,” SSRN, available at <http://ssrn.com/abstract=1159662>), concluded that interest rates and fees continued to rise and grace periods continued to fall, post-BAPCPA, even while card issuers enjoyed tremendous gains from declining bankruptcy losses, with these gains not passed on to consumers. Another study by David Bernstein (“Bankruptcy Reform and Foreclosure”) concluded that the amendments, by restricting access to bankruptcy and the scope of relief available, have led to an increase in the number of individuals walking away from their mortgage obligations.

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GAO: BAPCPA Raised Costs for Government, Private Sector, Debtors

The U.S. Government Accountability Office published a report on July 28 examining the costs associated with implementing BAPCPA from FY 2005-07. GAO found that costs for the U.S. Trustee (UST) program went up approximately \$72.4 million (mostly for staffing related to the means test, debtor audits, data collection and credit counseling/debtor education). The federal judiciary's costs were estimated to rise about \$48 million due to one-

time start-up costs associated with staff training and revisions of rules, forms and procedures. A decline in bankruptcy filings immediately following BAPCPA's effective date, also reduced fee revenues to the government (both the judiciary and the UST program) as UST revenues fell from \$74 million to \$52 million and judiciary filing revenues declined from \$237 million to \$135 million. Consumers were found to pay higher legal and filing fees post-BAPCPA, with the estimated average attorney fee for a chapter 7 case increasing to \$1,078 from \$712 per case (based on a 500 case sample). So-called "no look" fees in chapter 13 cases rose

by 55 percent or more in more than half the cases examined, to a median fee of \$3,000. Filing fees rose to \$299 in chapter 7 and \$274 for chapter 13. Credit counseling and debtor education added another \$100 to the costs for consumers, on average, though many debtors received a reduction or fee waiver based on their financial circumstances. Private trustees also reported an increase in resources devoted to each case. The GAO study was requested by 14 Democratic members of the House and Senate Judiciary Committees. ■