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Credit card rates headed for federal slap down?

White House, Congress get involved in practices

By Kathy Chu

The movement to reform credit card practices is gaining speed as the White House and Congress target punishing fee practices they say are contributing to a growing number of Americans' financial distress.

Today, President Obama and economic adviser Lawrence Summers are meeting at the White House with executives from more than a dozen credit card companies to discuss whether, and to what extent, issuers' policies have saddled consumers with unaffordable debt. The administration — which scheduled the meeting at the request of some issuers — has promised to address credit card practices that Summers recently blamed for coaxing consumers "into paying extraordinarily high rates that they wouldn't have paid if they knew what they were getting themselves into."

The meeting comes as issuers aggressively raise borrowers' credit card rates to as high as 30% amid ballooning loan losses. Wednesday, the House Financial Services Committee approved legislation to crack down on issuers' ability to raise interest rates on existing credit card debt. A Senate bill would clamp down even more on how credit card issuers do business. These proposals — on top of recent restrictions imposed by the Federal Reserve — mark the most significant efforts to reform industry practices in decades.

"The sweep of this takes my breath away," says Robert Hammer, chief executive of R.K. Hammer, an investment bank that consults with issuers. "I've never seen anything like this in 30 years. Banks and credit card companies have a target on their foreheads."

Whether the proposals will lead to significant change in the industry remains to be seen. Already, two bills aimed at protecting consumers from credit card practices have been amended during congressional markups, delaying when some provisions take effect. Yet the White House is pushing for quick action as a record number of consumers struggle to pay their bills.

"The president believes immediate reform of the credit card market is needed," says Jennifer Psaki, a White House spokeswoman.

Scott Talbott, a senior vice president at the Financial Services Roundtable, which represents large financial institutions, says the card industry supports "regulations that don't stifle the availability of credit but still protect the consumer."

The Federal Reserve's rule, issued in December, already addresses key concerns about credit cards, issuers say. The rule restricts issuers' ability to raise interest rates on existing debt and requires payments to be applied at least partly to higher-rate card debt.

Yet Rep. Carolyn Maloney, D-N.Y., says a law to reform such practices is needed because rules can be changed. The Fed regulation also doesn't take effect until mid-2010 — too late, some advocates say, to protect the most vulnerable borrowers.

The reality is that putting off the start date has allowed issuers to increase rates and fees on card borrowers to boost their profits, says Duncan MacDonald, former group counsel of Citigroup.

From March 2007 through February 2008, about 70 million credit card accounts — nearly one in four accounts — had their interest rates raised, costing consumers at least $10 billion in additional finance charges, estimates Pew Charitable Trusts, a public policy group.

Rates increased

Michael Busch, 28, says he and his wife, Mindy, pay all their bills on time and have steadily chipped away at their $6,000 in credit card debt. Even so, four issuers recently raised the couple's credit card rates, to as high as 28%.

The Busches, who recently found out they're having a baby, say the rate increases have crimped their already frugal lifestyle.
"We have no disposable income as it is, so we thought, 'Now we really have to budget,' " says Michael Busch, a college student who lives in Englewood, Colo. "We're going to have to hit the super sales at (the supermarket). We're going to have to buy frozen instead of fresh food."

It's not a question these days of which bank has raised interest rates but, rather, which has not. Over the past two years, Bank of America has raised rates for about 14% to 20% of its customer base, USA TODAY's research has found. Capital One, Chase and Citi are also among the issuers that have raised rates on credit card borrowers.

Banks say that higher funding costs, along with surging loan delinquencies and defaults, have forced them to reassess credit card risk.

Pam Girardo, a spokeswoman for Capital One, says, "Account changes are necessary in order for us to appropriately account for the increased risk of lending to consumers in an economic downturn."

Samuel Wang, a spokesman at Citi, says the bank has raised rates for consumers who haven't seen price changes in

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at least two years. It did so, says Wang, to deal with an "unprecedented market cycle" and "appropriately manage these risks."

Record delinquencies

Yet the rate and fee increases are often stripping consumers of what little disposable income they have left and threatening to become another drag on the economy, USA TODAY's research has found. Banks' actions come after they sharply raised card limits during the housing boom partly because of a surge in home equity— now vanished — then guided borrowers to use mortgages to pay off card balances, according to USA TODAY research.

Now, as the economy slumps, a record number of consumers are paying late on their credit card bills, and a growing number are giving up on them entirely. In the fourth quarter of 2008, the latest data available, 6.3% of all credit card debt was in default and a record 5.6% of card loans were delinquent, according to the Federal Reserve.

Howard Dvorkin, founder of Consolidated Credit Counseling Services, says rate increases could make it harder for consumers to pay their bills, pushing up delinquencies and defaults.

Brad Nickum, a consultant who played a key role in developing banks' credit card fees and policies in the 1990s, says that issuers' aggressive policies today may be inviting regulatory scrutiny.

"The problem for the card industry right now is they could be creating their own systemic risk," says Nickum. "It must be creating a nightmare for the administration, for the Federal Reserve and Treasury."

Nickum, who now consults mainly with regional banks, says, "At the very time when we're making it easier on homeowners to reduce rates, the credit card industry is going in the opposite direction. It makes no sense."

The barrage of rate increases is why struggling consumers need immediate protection from credit card practices, says Travis Plunkett, legislative director for the Consumer Federation of America.

Kenneth Clayton, senior vice president of card policy for the American Bankers Association, says that unemployment and other life events, rather than rate increases, have historically driven consumers into bankruptcy.

In March, employers shed 663,000 jobs, pushing the nation's unemployment rate to 8.5%. Consumers' household wealth has also plunged along with investment portfolios and home prices, likely making it harder for them to juggle bills.

Before Congress and the White House impose greater restrictions on credit card practices, they should "step back and consider the broader context, that credit can become more scarce and come at a higher price," Clayton says.

'Pure scare tactics'

The rates consumers pay on credit cards are tied to their risk, issuers say. If issuers can't raise rates on the consumers who become riskier, they'll have to pass along the costs to everyone, they say.

Adam Levitin, a law professor at Georgetown University, believes these arguments are "pure scare tactics."

"If bank rates go up after these regulations, it will not be because of the regulations, but because the banks see it as an opportunity to raise prices," Levitin says.

Already, banks have pulled back on credit for a growing number of consumers and raised rates sky-high, says Sen. Chris Dodd, D-Conn.

"I don't know how much more costly (credit cards) can be," says Dodd, the author of a Senate credit card reform bill.

Paul Murray, 55, says issuers should be barred from raising rates solely because the economy is squeezing their profits. Rate increases, he says, should be based on "ongoing problems," such as consumers regularly going over their credit limits or paying late.

"They shouldn't be able to jump rates on people who pay their bills on time" because they've extended too much credit, says Murray, who closed two accounts after his credit card rates jumped to as high as 18%.

When banks change credit card rates, consumers are often given the option of opting out, meaning they can pay off the debt at the same interest rate as long as they don't make any new purchases. But if the bank raises rates because of a late payment, the consumer generally doesn't have the option of refusing the higher rate.

Protections for consumers

Dodd says his efforts to pass credit card reform in past years have been stymied by lobbying from the powerful credit card industry. He's hopeful that with the White House's support, consumers will see relief soon from what he believes to be egregious credit card abuses.

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His bill goes further than the Federal Reserve's restrictions by curtailing the marketing of credit cards to college students. Maloney's bill also includes greater protections for consumers, including restricting when issuers can charge borrowers over-limit fees.

Kamran Imen, 53, of San Ramon, Calif., says that without reform, he feels powerless against a credit card industry he compares to a "gigantic bulldozer which is crushing everything in its way."

Imen admits he made a mistake by paying his Bank of America credit card bill four days late. But he says he doesn't deserve the surge in his interest rate — from 3% to 28% — which made it harder to pay his other bills.

Saddled with high-interest-rate card debt, as well as rental properties that were falling in value, he sought help from a credit-counseling agency. Bank of America eventually lowered his rate to 5%, but he says the damage was already done.

Bank of America spokeswoman Betty Riess says the bank looks at factors including "an individual's performance with us as well as external credit risk indicators" in deciding whether to raise rates. Consumers could see higher rates if they pay late or go over their credit limit twice in 12 months, she notes.

Those who have trouble paying their bills should contact the bank, Riess says.

Since 2008, the bank has modified more than 1.3 million credit card loans by lowering interest rates, reducing monthly payments, eliminating fees or referring consumers to debt-management agencies.

Five tips to manage your credit card account

1 Negotiate fees and rates.

As issuers raise fees and interest rates, consumers shouldn't be afraid to ask for a waiver. Credit card companies may be willing to negotiate — especially if consumers have good credit — to keep their business, says Adam Levin, co-founder of Credit.com, a consumer information site.

2 Be careful about closing your card accounts.

Closing an account can hurt your credit score because it raises your so-called credit utilization ratio, basically how much of your available credit you're using. That's why you might want to "pull everything off (the card) and leave it an empty shell as long as you're not facing an annual fee on the card," says Joe Ridout, spokesman for Consumer Action, an advocacy group. If an issuer closes an account or drastically reduces your credit line, consider
getting a new card. The application will hurt your credit score temporarily but will raise it in the long run because you have more credit available. Of course, that's only true if you don't rack up debt on the new card.

3 Be careful about closing your card accounts.

Taking 10 minutes out of your day to check your transactions online could help keep your debt under control. "It'll give you a reality check onyour spending," Levin says. "The best guardian of the consumer is the consumer itself." He suggests that consumers use every tool available — including mobile and e-mail alerts — to stay on top of their money.

4 Aggressively pay down debt.

Ridout says consumers who have credit card debt should consider using job bonuses or emergency funds to pay it off. This will give them more flexibility to manage their finances.

5 Read the fine print.

As a growing number of issuers change credit card terms and conditions, it behooves consumers to read their statements closely. You have to make sure you understand everything that issuers disclose, Levin says.

Imen says banks shouldn't be able to raise consumers' rates to unaffordable levels in the first place.

"I understand profits, but if I have trouble paying my bill, how is that going to help if (the bank) raises the rate by nine times?" he says. "A fair penalty is to charge me a late fee, but they shouldn't be able to raise rates" for paying a few days late.

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Objectives

- Read the article “Credit card rates headed for federal slap down?”
- Recognize the cost of a credit card
- Evaluate credit card managing tips
- Identify additional credit card managing tips

Preparation

Each student will need:

- A copy of the article “Credit card rates headed for federal slap down?”
- A copy of the lesson

Read the article and answer discussion questions (35 minutes)

- There are three main groups in this article: who/what are they?
- On average, a $100 purchase would cost $17 more after one year on the credit card at 30% interest. Do you think consumers would choose a credit card if they knew the interest rate was 30%? Why or why not?
- Does it make sense to increase interest rates on accounts on which people are having a hard time making payments? Why or why not?
- What are some reasons credit card companies charge such high rates?
- What do you see as some of the dangers in using a credit card?

Protesting the changes (10 minutes)

Pair up with one other classmate and read over the following information.

The new credit card legislation is partially in effect. Others go into effect in February 2010.
Credit card companies must now:

1. Ensure consumers have 21 days between when they receive their credit card bill and the payment due date
2. Give consumers 45 days to protest significant changes in their credit card terms such as interest rate increases. If a consumer protests, the old interest rate applies to the balance on the credit card if no additional charges are made.
3. Apply payments to highest-rate balances on the credit cards.
4. Show how long it will take a consumer to pay off the whole credit card debt if only minimum payments are made.
5. Not charge over-limit fees unless a consumer has requested she be allowed to go over her limit.
6. Prove an applicant is 21 years old, unless he has proof of employment or parental permission.

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By inference, you might guess that some credit card companies were:

1. Giving consumers a short amount of time between receiving their bills and when they would have to mail a check in for payment
2. Increasing interest rates on balances and requiring consumers to close their account and pay off the entire balance if they didn't want the new rates to affect them
3. Putting principal payments toward the balances with the lowest interest rates. (Some credit cards may have more than one interest rate tied to different parts of the card's balance.)
4. Marketing credit cards to college students, many of whom got into deep credit card debt.

None of the changes put any rules on how high interest rates can go. As consumers, we can't always count on someone else, the government in this case, to help us out by changing the rules. With your partner, look over the "Five tips to manage your credit card account." Which two guidelines make the most sense to you? What other guidelines do you think should be included (create at least one)?

Debrief/Application Questions (10 minutes)
As a class, discuss which guidelines made the most sense to you. Then have each group share at least one other guideline they think would be helpful for managing credit cards.

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