The Credit Card Market: Recent Trends and Regulatory Proposals

Darryl E. Getter
Specialist in Financial Economics

May 11, 2009

Congressional Research Service
7-5700
www.crs.gov
RL34393

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Rising consumer indebtedness and increased reliance on credit cards over the past two decades have generated concerns in Congress and among the general public that cardholders may be paying excessive credit card rates and fees. Specifically, some borrowers have reportedly been unaware of assessed penalty fees and interest rate increases. Consequently, legislation such as H.R. 627, Credit Cardholders' Bill of Rights Act of 2009 (introduced by Representative Carolyn B. Maloney with 42 co-sponsors); S. 235, Credit Cardholders' Bill of Rights Act of 2009 (introduced by Senators Charles E. Schumer and Mark Udall); and S. 414, Credit CARD Act of 2009 (introduced by Senator Christopher J. Dodd with 19 co-sponsors) have been introduced in the 111th Congress.

This report examines developments in the revolving credit market, including trends in profitability, consumer usage, funding, and repricing practices. It presents data on issuer profits, U.S. household credit card usage, and delinquency patterns. Next, the funding of credit card loans, with a particular focus on the securitization process, is discussed. Credit originators increasingly relied upon securitization to fund revolving credit because this method minimizes the costs to fund these loans. Payoff and default risks, however, may increase funding costs and result in repricing of such risks. A review of typical repricing practices will follow.

Finally, the report presents a summary of recent Federal Reserve policy actions pertaining to credit card repricing practices. A comparative analysis of H.R. 627, as passed by the House on April 30, 2009, and S. 414, as reported by the Senate Banking Committee on March 31, 2009, is also presented.

This report will be updated as events warrant.

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Introduction

Financial innovations have increased credit availability for U.S. households over the last two decades. For households with collateral assets, financial innovations, specifically those in the mortgage market, have allowed households to take on debt and finance large expenditures they might otherwise have had to forgo. Such developments can be advantageous because they make some households less sensitive to temporary disruptions in income or cash flow. Financial innovations, however, can also make consumers more vulnerable to unexpected changes in asset prices. A sudden increase in the value of underlying collateral assets used to secure consumer borrowing, such as house prices, may entice some households to increase their borrowing; a sudden decrease in asset values may translate into financial distress.[1]

Financial innovations also gave borrowers greater access to revolving credit or credit card loans. Although all types of lending may reduce sensitivity to cash flow disruptions, unsecured lending can be used by borrowers who hold few, if any, collateral assets to draw upon to avoid a financial crisis. Some credit card borrowers may therefore be less affected than those with collateralized or secured loans when asset values fall. Credit card borrowers, however, generally pay higher rates relative to secured credit borrowers. The relatively higher borrowing costs, fees, and repricing practices, therefore, may undermine or offset the financial benefit of being detached from a decline in collateral asset values, which adds to borrower financial distress.

Rising consumer indebtedness and increased reliance on credit cards over the past two decades have generated concerns in Congress and among the general public that cardholders may be paying excessive credit card rates and fees. Specifically, some borrowers have reportedly been unaware of assessed penalty fees and interest rate increases.[2] Because of this and other issues, legislation such as H.R. 627, Cardholders' Bill of Rights Act of 2009 (introduced by Representative Carolyn B. Maloney with 42 co-sponsors); S. 235, Credit Cardholders' Bill of Rights Act of 2009 (introduced by Senators Charles E. Schumer and Mark Udall); and S. 414, Credit CARD Act of 2009 (introduced by Senator Christopher J. Dodd with 19 co-sponsors) have been introduced in the 111th Congress.

This report discusses developments in the revolving credit market, including recent trends in profitability, usage, funding, and repricing practices that have prompted new regulatory action. The first section provides a brief summary of information regarding issuer profits as well as descriptive data documenting U.S. household credit card usage and delinquency patterns. The next section analyzes the funding of credit cards, and specifically the securitization process in detail, since this method minimizes those costs. Conversely, payoff and default risks, which are also explained, tend to increase funding costs for credit card loans. A brief summary of credit card repricing practices is presented, followed by policy responses by the Federal Reserve.

[1] For more discussion about why households may increase their indebtedness, see Karen E. Dynan and Donald L. Kohn, "The Rise in Household Indebtedness: Causes and Consequences," *Finance and Economics Discussion Series 2007-37*, Board of Governors of the Federal Reserve System (August 2007), at http://www.federalreserve.gov/Pubs/Feds/2007/200737/200737pap.pdf.

[2] For example, see Martin H. Bosworth, "Credit Card Fees Rise, Disclosure Statements Inadequate," at http://www.consumeraffairs.com/news04/2006/10/gao_credit_cards.html and Anita Hamilton, "Exposing the Credit-Card Fine Print," at http://www.time.com/time/printout/0,8816,1715293,00.html#.

Recent Profitability and Consumer Usage Trends

SourceMedia provides data that are useful for understanding industry profitability trends.[3] According to this source, credit card issuers' after-tax return on assets was $18.08 billion in 2007, which was down from $18.37 billion in 2006 or 1.58%. Total revenue for Visa and MasterCard issuers increased from $114.99 billion to $117.76 billion over this period or 2.41%. Penalty-fee revenue increased to $7.54 billion in 2007 compared with $6.44 billion in 2006 or 17.1%. Expenses, however, increased by 4% in part due to a 17% increase in charge-offs or account receivables deemed uncollectible due to missed payments.

The Survey of Consumer Finances (SCF) is useful for tracking consumer usage trends. The SCF, which is conducted tri-annually by the Federal Reserve Board, asks approximately 4,000 households to provide information about their income, assets, and debts. The most recent (2007) SCF suggests the following changes from 1989.[4] Approximately 73% of the U.S. families surveyed in 2007 had credit cards, and 60.3% of those families carried a balance. In 1989, 69.9% of families had credit cards, and 49.6% of those families carried a balance.

Several factors may arguably explain the SCF findings. First, households with riskier financial characteristics were granted increased access to revolving credit.[5] A greater proportion of low-income households and households with lower liquid asset levels became new cardholders. Although risk-based pricing, the practice of charging riskier borrowers higher rates to reflect the credit or default risk, may have increased borrowing costs for some borrowers, there is evidence to suggest that it allowed for increased participation in consumer credit markets and fewer credit denials.[6] Second, households increased their use of credit cards as a convenient way to make payments.[7] Third, the SCF also indicates a greater use of variable rate credit cards, with financing

[3] See Cards & Payments' 2008 Bankcard Profitability Study and Annual Report "Credit Card Issuers' Collective After-Tax Return on Assets Drops 1.58%," May 12, 2008, at http://www.marketwire.com/mw/release.do?id=854884, which summarizes industry profitability trends between 2006 and 2007. SourceMedia provides market information to the financial services and related industries through various publications, seminars, and conferences. For more information, see http://www.sourcemedia.com.

[4] The 2007 data in this section are reported from Brian K. Bucks, Arthur B. Kennickell, and Traci L. Mack, et al., "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Conusmer Finances," *Federal Reserve Bulletin*, vol. 95 (February 2009), pp. A1-A55, http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf. The 1989 data in this section are reported from Arthur B. Kennickell and Martha Starr-McCluer, "Changes in Family Finances from 1989 to 1992: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 80 (October 1994), pp. 861-882, http://www.federalreserve.gov/pubs/oss/oss2/92/bull1094.pdf.

[5] See Kathleen W. Johnson, "Recent Developments in the Credit Card Market and the Financial Obligations Ratio," *Federal Reserve Bulletin*, vol. 91, autumn 2005.

[6] For discussions about how the increased use of risk-based pricing strategies led to fewer credit denials and greater credit accessibility for higher risk borrowers, see Raphael W. Bostic, "Trends in Equal Access to Credit Products," in *The Impact of Public Policy on Consumer Credit*, eds. Thomas Durkin and Michael Staten, Massachusetts: Kluwer Academic Publishers, 2002, pp. 171-202; Wendy M. Edelberg, "Risk-based Pricing of Interest Rates in Household Loan Markets," *Finance and Economics Discussion Series 2003-62.* Washington: Board of Governors of the Federal Reserve System, 2003; Wendy M. Edelberg, "Risk-based Pricing of Interest Rates for Consumer Loans," *Journal of Monetary Economics*, vol. 53, November 2006, pp. 2283-2298; Mark Furletti and Christopher Ody, "Another Look at Credit Card Pricing and Its Disclosure: Is the Semi-Annual Pricing Data Reported by Credit Card Issuers to the Fed Helpful to Consumers or Researchers?", *Payment Cards Center Discussion Paper*, Federal Reserve Bank of Philadelphia, July 2006; Kathleen W. Johnson, "Recent Developments in the Credit Card Market and the Financial Obligations Ratio," *Federal Reserve Bulletin*, vol. 91, September 2005, pp. 473-486.

[7] In 2001, the SCF reported that the number of households having at least one credit card rose to 76.2%, the highest percentage reported to date; the percentage of families that reported carrying a balance was 44.4%. Despite the increase (continued...)

costs that fluctuate with market rates. Given more frequent usage of credit cards for making convenience transactions, households arguably grew more responsive to the interest rate movements, leading them to prefer cards that would allow them to benefit from market rate declines. On the other hand, it is also likely that lenders may have offered more variable rate cards to borrowers to benefit from market rate increases. All of these developments suggest increases in both the supply and demand for revolving credit, resulting in growth of the revolving credit market since 1989.

According to a Federal Reserve statistical release, card delinquency rates rose during 2008, at least for commercial banks.[8] Seasonally adjusted credit card delinquency rates, which dropped below 4% during all of 2005, rose to 5.56% in the fourth quarter 2008. Given that approximately 40% of credit card loan originations remain on bank balance sheets, the delinquency rates for commercial banks arguably reflect trends for the entire revolving credit industry. Nevertheless, it is difficult to identify a single numerical measure to evaluate the health of this sector given the dramatic increase in credit card receivables that have, in recent years, been funded or financed via securitization in modern financial markets.[9] Rising delinquency rates are likely to translate into higher borrowing costs in this sector, and the next section provides the institutional background to illustrate why this relationship may exist.

The Funding and Pricing of Revolving Credit

Credit cards were initially issued by department stores in the 1950s as a more efficient way to increase customer convenience and manage their accounts.[10] Stores selling big ticket items such as major appliances eventually allowed customers to decide whether to pay in full or in installments subject to a finance charge. Once commercial banks recognized the profit potential from providing open-ended, unsecured financing to consumers, the general-purpose credit card became more popular towards the late 1960s.[11] Of course, since this occurred prior to the rise of securitization, which will be discussed in more detail below, local banks set the rates on the credit cards they issued.

(...continued)

in credit access (but decline in usage from 49.6% in 1989), higher risk consumers may not have borrowed as much as desired given that their borrowing costs were relatively higher. See Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in the U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 89 (January 2003), pp. 1-32, http://www.federalreserve.gov/pubs/oss/oss2/2001/bull0103.pdf for the 2001 data; and Wendy M. Edelberg, "Risk-based Pricing of Interest Rates in Household Loan Markets," *Finance and Economics Discussion Series 2003-62.* Washington: Board of Governors of the Federal Reserve System, 2003.

[8] The Federal Reserve Board uses data from the Consolidated Reports of Conditions and Income, compiled by the Federal Financial Institutions Examination Council (FFIEC), to calculate a statistical release entitled "Charge-off and Delinquency Rates on Loans and Leases at Commercial Banks." Loans and leases are considered delinquent after 30 days, and charge-offs are the value of these loans and leases (net of recoveries) removed from bank balance sheets and charged against loss reserves. See http://www.federalreserve.gov/releases/chargeoff.

[9] See Mark Furletti, "Measuring Credit Card Industry Chargeoffs: A Review of Sources and Methods," *Payment Cards Center Discussion Paper*, Federal Reserve Bank of Philadelphia, September 2003.

[10] For more information on the historical development of the credit card market, see Glenn B. Canner, "Developments in the Pricing of Credit Card Services," *Federal Reserve Bulletin*, September 1992.

[11] A charge card must be paid in full every month, unlike a credit card.

During the late 1970s and early 1980s, the rise in inflation made unsecured lending unprofitable, especially since state regulations limited the interest rates banks could charge. Credit card lenders responded by charging annual fees and restricting the number of credit cards issued to supplement the income loss. Banks also began moving their credit card operations to states with high or no interest rate ceilings. [12] Inflation diminished towards the end of the 1980s; this development along with less restrictive interest rate caps, reduced the need to charge annual fees. In addition to falling inflation rates, the growth of banking on a national scale resulted in increased competition, which contributed to a drop in revolving credit interest rates below the 18% to 19% levels maintained through most of the 1980s and early 1990s.[13] Whenever the Federal Reserve decided to lower the federal funds rate, card-issuing banks also had the option to pass their lower borrowing costs onto cardholders, which would translate into lower credit card rates.

The Impact of Securitization on Funding Costs

The funding of revolving credit through securitization, which first began in 1987, also helped reduce the cost of credit.[14] Securitization occurs when financial institutions that originate credit card loans choose not to retain the loans on their balance sheets.[15] Loans originated in the primary market, where the credit card purchaser and the loan originator conduct business, are often sold in the secondary market, where the loan originator and an investor conduct business.[16] The securitization of assets helps originators manage liquidity and credit risk, which then may translate into lower interest rates for cardholders. Given that approximately 60% of credit card loans are securitized, a more detailed discussion of the process is provided.

Although loans may be funded by originators using bank deposits or surplus capital, securitization may be a lower cost funding alternative.[17] When depository institutions fund loans with deposits, the terms of the assets (loans), specifically the timing of the receivables, may not match perfectly the terms of the liabilities (deposits) that must be repaid. Depository institutions, therefore, are required to hold certain amounts of capital reserves against such timing mis-matches in the event the assets do not perform as expected. An opportunity cost, however, is incurred when capital held for regulatory safety reasons is not used for other, more profitable, lending activities or investments. Moreover, non-bank or non-depository institutions may enjoy a competitive funding cost advantage, since they are not subject to the same regulatory capital requirements as depository institutions. Even if greater capital requirements were not an issue, as in the case of non-bank institutions, originators would still incur servicing and monitoring costs if loans are funded from balance sheet activities. Hence, securitization allows for the off-balance-sheet funding of loans, which may lead to a reduction of funding costs and an elimination (to the

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[12] See Glenn B. Canner and Charles A. Luckett, "Developments in the Pricing of Credit Card Services," Federal Reserve Bulletin, September 1992.

[13] See Glenn B. Canner and Charles A. Luckett, "The Profitability of Credit Card Operations of Depository Institutions," *Federal Reserve Bulletin*, June 1999.

[14] See the *Risk Management Credit Card Securitization Manual,* The Federal Deposit Insurance Corporation, at http://www.fdic.gov/regulations/examinations/credit_card_securitization/pdf_version/index.html.

[15] The term "bank" may be used interchangeably to mean any type of financial institution that originates a credit card with a specified loan amount.

[16] For a more detailed explanation of the securitization process, see Mark Furletti, "Overview of Credit Card Asset-Backed Securities*," Payment Cards Center Discussion Paper*, Federal Reserve Bank of Philadelphia, December 2002.

[17] See Charles T. Carlstrom and Katherine A. Samolyk, "Securitization: More than Just a Regulatory Artifact," *Economic Commentary*, Federal Reserve Bank of Cleveland, May 1992.

depository institution) of risks associated with on-balance-sheet funding. These cost savings may or may not be passed on to cardholders in the form of lower credit card rates. Credit card interest rates, however, have become more responsive to issuers' costs of funds in recent years.[18] A more detailed discussion of the securitization process for credit card receivables may be found in the **Appendix C**.

Other Risks to Yield

The yield or return on investment from this lending activity must be sufficient enough to attract investors, the ultimate lenders, from alternative lending opportunities. The previous section explained how loans are held on or sold off the balance sheet of originators, depending upon which funding option was less expensive. Consequently, lower funding costs translate into higher yield. This section discusses other costs or risks that affect the profitability of credit card lending.

Convenience Users and Early Amortization Risk

The yield or profit from credit card receivables is dependent upon whether borrowers make minimum payments or pay off their balances every month. Consumers have the option during each billing cycle to pay the minimum balance, pay off the entire loan, or pay something in between. When credit cards are used for convenience transactions rather than for borrowing, this does not generate any investor yield. In addition, early amortization, which occurs when the outstanding balance of a credit card account is suddenly paid off, also reduces yield. (Early amortization also occurs when a credit card is paid off and the balance is transferred to another card issued by a competing card issuer.) A reduction in yield ultimately makes investing in credit card receivables less appealing to investors, a development which itself increases the funding costs to provide these loans in the future.

Default Risk

A revolving credit loan is higher in credit or default risk relative to other forms of bank lending. Credit card loans or receivables involve much higher operating costs and greater risks of default per dollar of receivables than do other types of lending.[19] The risk in revolving credit lending is derived from several factors. First, the loan is unsecured, which means the card holder has put forth no collateral assets that can be used to repay the loan in the event of default. Second, the card holder has the option to use the card when unemployed or lacking sufficient cash flow to cover routine expenses and payment obligations. The borrower may suddenly become highly leveraged (up to the credit card limit) without any prior notice. Without knowing whether or not

[18] See Glenn B. Canner and Charles A. Luckett, "The Profitability of Credit Card Operations of Depository Institutions," *Federal Reserve Bulletin*, June 1999. A publicly available index is typically used to express a component of the lending costs to the borrower and may be used to calculate the coupon payment accruing to a credit card asset-backed security investor. Hence, the use of a market index improves transparency for both the borrower and the investor, who is the ultimate lender. A market index plus a margin reflects the total borrowing cost or total investment return. The size of the margin or credit premium is tied to the default risk characteristics of cardholders included in the pool, which may be funded by credit card fees. For more information on the pricing of credit card asset-backed securities, see Mark Furletti, "An Overview of Credit Card Asset-Backed Securities," Payment Cards Center Discussion Paper, Federal Reserve Bank of Philadelphia, December 2002.

[19] Glenn B. Canner, "Developments in the Pricing of Credit Card Services," *Federal Reserve Bulletin*, vol. 78 no. 9, September 1992. A more detailed discussion about the costs of credit card operations is also included.

the cardholder intends to pay off the balance at the end of the billing cycle, every transaction made with a credit card is potentially a new loan, and the outstanding principal balance can change at any time. Next, a credit card is also far more susceptible to fraud than other types of loan. Should unauthorized charges be made on a lost or stolen card, the Fair Credit Billing Act limits the liability for cardholders to $50.[20] Hence, unrecoverable fraudulent charges may translate into sizeable losses for originators or investors.

Delinquencies may eventually turn into defaults, which are defined as 180 days delinquent. When borrowers initially fail to make timely credit card payments, the *servicer* attempts to contact the borrower within several days of delinquency to arrange payment. The servicer, and not necessarily the loan originator, is the designated collector of credit card payments (and forwards them directly to the lender or to a securitizer if the loan was sold). After 30 days, which is considered one complete billing cycle, the servicer must decide whether to cut off credit to the borrower and send the account to collections. Financial institutions may adopt various different policies for dealing with delinquencies. If, however, accounts are sent to collections, the Fair Debt Collection Practices Act (FDCPA) prohibits abusive, deceptive, and improper collection practices of third party debt collectors.[21] The collections process is regulated by federal guidelines.[22]

If the credit card issuer owns the loans, contractual charge-offs (which are account receivables deemed uncollectible due to missed payments) must be written off the issuer's books after 6 billing cycles or 180 days of nonpayment, according to guidances issued by the Federal Financial Institutions Examination Council (FFIEC).[23] When a borrower files for bankruptcy, accounts must be charged off 60 days after receipt of notification of the filing from the bankruptcy court. One expert estimated that 60% of charge-offs result from 180 days, or six billing cycles, of missed payments, and 40% of charge-offs are the result of bankruptcy.[24] If the loans are securitized, delinquency and default costs generated from the accounts may be subtracted from the proceeds paid to the securitizer, which may translate into losses to investors.

When revolving credit is securitized, issuers may find it difficult to attract investors to fund revolving credit loans without "implicit recourse." Implicit recourse refers to a perception among investors that credit card originators will repurchase non-performing loans from asset-backed security (ABS) pools and absorb default losses, which may seem to negate the benefits of securitization.[25] A Removal of Account Provision (ROAP), which is a provision that allows

[20] P.L. 93-495, as codified at 15 U.S.C. 1666j. See http://fdic.gov/regulations/laws/rules/6500-500.html.

[21] P.L. 90-321, as codified at 15 U.S.C. 1692 *et. seq.*, and as amended by P.L. 109-351, §§ 801-02, 120 Stat. 1966 (2006). See http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre27.pdf.

[22] For a summary of these guidelines, see http://www.ftc.gov/bcp/conline/pubs/credit/fdc.shtm.

[23] See the February 10, 1999, FFIEC press release entitled "Federal Financial Institution Regulators Issue Revised Policy For Classifying Retail Credits," at http://www.ffiec.gov/press/pr021099.htm.

[24] See Furletti, "Measuring Credit Card Industry Chargeoffs: A Review of Sources and Methods."

[25] According to FASB 140 accounting rules, a "true sale" means the seller is no longer responsible for the subsequent performance of the financial assets sold. If poor performance is transferred back to the originator, then a true accounting sale of assets did not occur, and the originator should be required to hold capital against the value of the collateral. The only permissible exception to this recourse provision is when the originator wants to remove a delinquent account from a pool to offer a workout solution to the borrower. The exception was not designed to simply allow issuers to absorb losses, for example, by removing early amortization accounts to enhance the performance of securitized tranches. For more details on this point, see Charles W. Calomiris and Joseph R. Mason, "Credit Card Securitization and Regulatory Arbitrage," *Working Paper No. 03-7*, Federal Reserve Bank of Philadelphia, April 2003.

issuers to remove delinquent accounts, or accounts with fraudulent charges, from an ABS pool, may be exercised. Exercising this option too often, however, may still imply that the ABS should receive lower credit ratings, which could make it more difficult to attract some investors.

Summary of Current Risks to Yield

More convenience users, early amortizations, and defaults reduce the yield on credit card ABSs. The impact on yield may be even more significant should all of these risks materialize simultaneously. Slightly more consumers, however, are carrying a balance and the median balance has increased, as discussed earlier in this report. Consequently, the payoff risk associated with an increase in convenience users has seen some decline. On the other hand, defaults are rising. Should defaults continue to accelerate, the increase in funding costs may encourage some lenders to re-evaluate the profitability of providing revolving credit. One option may be to curtail revolving lending activities and pursue more profitable business strategies. Another option may be to employ various repricing practices.

The Repricing of Revolving Credit

Repricing Credit Card Loans

The previous historical discussion noted that fee income, a component of the total cost of borrower credit, was used to help cover the increasing costs to supply credit during the late 1970s and early 1980s. The securitization discussion shows how a particular funding method, that minimizes the liquidity and default risk for credit card originators, may translate into lower rates for cardholders. Interest rate charges and fees, therefore, change when costs change.

For example, when a borrower is delinquent, exceeds credit limits, or bounces payment checks, the borrower may now be viewed as a greater credit risk. At that point, lenders may consider the borrower as a candidate for being re-priced for the credit. Penalties, increased fees, and increased loan rates are all tools available to credit suppliers to reprice the increased risk to yield. If cardholders are sensitive to increasing charges, then repricing may be used to encourage delinquent cardholders to repay their obligations faster and discourage them from further borrowing. Repricing, therefore, is an extension of risk-based pricing in that higher risk borrowers shoulder more of the costs associated with having access to borrowing services.

Repricing, however, can be initiated without any delinquency incident. When this happens, a borrower may shop for other card issuers that are willing to provide them with credit cards at lower prices or accept balance transfers. Hence, the lender's decision to charge higher interest and fees, whether to compensate for rising default risk or simply to increase profit margins, is likely to be affected by an assessment of the borrower's willingness and ability to shop for and find other lower-priced credit.

Repricing practices typically include "hair-trigger" repricing and "universal default"; and, in some cases, "double-cycle billing" practices may have the same effect.[26] Hair-trigger repricing

[26] For definitions of terms, see the following references. "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," *GAO-06-929*, Government Accountability Office (continued...)

refers to imposing fees and higher finance charges on cardholders almost immediately after a payment is late without any grace period. Universal default occurs when a borrower defaults on a loan serviced by a lender, and other revolving creditors respond by increasing the lending rates on the loans they are servicing for that particular borrower, even if the borrower has not defaulted on those loans. Double-cycle billing is the practice of calculating interest over a two-month billing cycle period, as opposed to a one-month billing cycle, that may result in higher finance charges. Although double-cycle billing may not often be described as a repricing practice, in particular if this billing method is universally applied to all customers, the economic impact on cardholders can be similar to standard repricing strategies. If the consumer misses a payment or switches from being a convenience user to a revolver, the typical grace period, or a specified time period in which payments can be made without incurring any finance charge, is *retroactively* eliminated under double-cycle billing. Forfeiture of interest-free grace periods results in higher finance charges; therefore, risk-based repricing has automatically been captured by the billing method.

Policy Options

Repricing practices are often unpopular with borrowers if they are perceived to be changes in the credit terms that were not part of the original agreement when the card was issued. It is also possible that borrowers unknowingly agreed to terms that were very difficult to understand.[27] Many loan originators, however, are concerned with the cash flow necessary to maintain lower funding costs, in particular at a time while defaults are rising. Moreover, maintaining cash flows sufficient to cover losses accruing to the lower tranche is also important if the subordinate tranche is being used as a credit enhancement for more senior tranches.

One policy response might be to eliminate repricing practices. A possible consequence of this response, however, is to make this type of lending unattractive to future investors. Less cash may be available to flow into excess spread tranches, which translates into a reduction either in profits or in funds to cover bank charge offs. Economic theory, specifically the law of supply, suggests that firms are less willing to supply products to the marketplace at lower prices. Credit card issuers could respond in a variety of ways to pricing restrictions. To recapture the fee income, issuers may increase loan rates across the board on all borrowers, making it more expensive for both good and delinquent borrowers to use revolving credit. Other options may include increasing minimum monthly payments, reducing credit limits, or reducing the number of credit cards issued to people with impaired credit.[28] Given that credit cards also serve a convenience transactions

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(September 2006) located at http://www.gao.gov/new.items/d06929.pdf; Sheila Bair, Chairman, FDIC, *Statement on Improving Credit Card Consumer Protection: Recent Industry And Regulatory Initiatives* before the Subcommittee On Financial Institutions and Consumer Credit of the Financial Services Committee, U.S. House of Representatives, June 7, 2007, at http://www.fdic.gov/news/news/speeches/archives/2007/chairman/spjun0707.html; Mark Furletti, Credit Card Pricing Developments and Their Disclosure, Federal Reserve Bank of Philadelphia, January 2003, at http://www.philadelphiafed.org/pcc/papers/2003/CreditCardPricing_012003.pdf; a glossary of revolving credit terms may be found at http://www.fdic.gov/regulations/examinations/credit_card/glossary.html; and see Testimony Before the Committee of Homeland Security and Governmental Affairs Permanent Subcommittee on *Investigations Regarding Credit Card Practices: Fee, Interest Rates, and Grace Periods,* March 7, 2007, at http://hsgac.senate.gov/public/_files/STMTCohenNCLC.pdf.

[27] The Government Accountability Office reported that disclosures of complex risk-based pricing practices in the credit card industry have become extremely difficult for consumers to understand. See "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," *GAO-06-929,* Government Accountability Office (September 2006) at http://www.gao.gov/new.items/d06929.pdf.

[28] For studies on the regulatory effects of credit card rates and fees, see Diane Ellis, "The Effect of Consumer Interest (continued...)

purpose, a reduction in card accessibility may increase the difficulty for affected households to make transactions.[29]

Other policy responses could include modifications or elimination of some repricing practices. For example, credit card issuers may choose not to respond by increasing the costs or limiting the availability of credit to borrowers. Some financial institutions had recently announced that they would no longer use pricing practices such as double-cycle billing and universal default.[30] When these announcements were made, there was no indication that subsequent increases in minimum payments or reductions in credit card issues would occur. Hence, it may be possible for other institutions to manage their cash flows and delinquencies without relying upon these more controversial pricing practices.[31]

Federal Reserve Actions

The Federal Reserve has conducted studies that use consumer focus groups and individuals to determine what types of disclosures are effective with helping them understand the possible charges they could face. Upon completion of the interviews, the Federal Reserve expects to propose revisions to disclosure regulations know as Regulation Z. The goal is to design a format that may be considered more transparent for consumers to evaluate the credit terms and facilitate their usage of credit cards.[32]

On December 18, 2008, the Federal Reserve also issued new regulations regarding credit card pricing practices.[33] The rules amended Regulation AA (Unfair Acts or Practices), Regulation Z (Truth in Lending), and Regulation DD (Truth in Savings). The rules prohibit unfair or deceptive bank practices in connection with credit card accounts and overdraft services for deposit accounts. For example, banks must give consumers a reasonable amount of time to make their payments, safe harbor would be given to banks that send periodic statements at least 21 days prior to the payment due date. Given that the double-cycle billing method eliminates an interest-free grace period for the consumer, the rule also eliminates this billing practice. Banks are allowed to apply rate increases to existing balances only when (1) the interest rate is variable; (2) a

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Rate Deregulation on Credit Card Volumes, Charge-offs, and the Personal Bankruptcy Rate," *Bank Trends*, FDIC Division of Insurance, March 1998, at http://www.fdic.gov/bank/analytical/bank/bt_9805.html; and Jonathan M. Orszag and Susan H. Manning, *An Economic Assessment of Regulating Credit Card Fees and Interest Rates*, a study commissioned by the American Bankers Association, at http://www.aba.com/aba/documents/press/regulating_creditcard_fees_interest_rates92507.pdf.

[29] For example, some businesses, such as those that make reservations to provide various services, rely primarily on credit cards to secure payment.

[30] For example, see "Chase ends double-cycle billing" at http://www.bankrate.com/brm/story_content.asp?story_uid=20919&prodtype=today; and "Citi Announces Industry Leading Changes to its Credit Card Practices: To End 'Universal Default' & 'Any Time for Any Reason' Changes" at http://www.citigroup.com/citigroup/press/2007/070301b.htm.

[31] See Adam J. Levitin, *All But Accurate: A Critique of the American Bankers Association Study of Credit Card Regulation*, at http://works.bepress.com/adam_levitin/4/.

[32] See http://www.federalreserve.gov/newsevents/press/bcreg/20070523a.htm.

[33] See http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm.

promotional rate expires; or (3) a minimum payment has not been received within 30 days of the due date. These rules go into effect on July 1, 2010.[34]

The Federal Reserve, along with the Federal Trade Commission, has also proposed implementing the risk-based pricing provisions in Section 311 of the Fair and Accurate Credit Transactions Act of 2003.[35] This rule would require creditors to notify consumers when an issuer used a credit report to grant credit at a relatively higher interest rate in comparison to rates offered to most of its customers, who are presumably more creditworthy.

[34] H.R. 627, S. 235, and S. 414 would put various repricing restrictions into statute, and such restrictions would be effective 3 months after the legislation has passed.

[35] P.L. 108-159. See http://www.treas.gov/offices/domestic-finance/financial-institution/cip/pdf/fact-act.pdf. More details about the proposed rule may be found at http://www.federalreserve.gov/newsevents/press/bcreg/20080508a.htm.

Appendix A. Comparison of H.R. 627 and S. 414[36]

This appendix provides a comparative analysis of H.R. 627 (the Credit Cardholders' Bill of Rights Act of 2009), as passed by the House on April 30, 2009, and S. 414, (the Credit CARD Act of 2009), as reported by the Senate Banking Committee on March 31, 2009. The table below sets out the major provisions of the bills.

An amendment to S. 414 adopted in the Banking Committee would increase the borrowing authority of the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Association (NCUA), and would establish a restoration plan for the credit union deposit insurance fund. Since these provisions—now Section 503 of the bill—do not affect credit card lending, and the House bill has no comparable provisions, they are omitted from the table.

Table A-1. Comparison of H.R. 627 and S. 414

Provision	H.R. 627	S. 414
Short Title	Credit Cardholders' Bill of Rights Act of 2009	Credit Card Accountability Responsibility and Disclosure Act of 2009
Increasing Rates on Outstanding Balances	Prohibits creditors from raising interest rates on an existing balance of a credit card account unless the increase is solely due to (1) a change in a published index not under the creditor's control; (2) the expiration of a promotional rate; (3) failure to comply with a workout plan (see below); or (4) the consumer's minimum payment being at least 30 days overdue. In the case of expiration of a promotional rate, the new rate may not exceed the rate that would have applied under the terms of the agreement absent the promotional rate. (Sec. 2(b)) Also prohibits imposition of fees in lieu of a rate increase on an existing balance. (Sec. 2(a))	Interest rate increases may not apply to existing balances unless the increase is due to the expiration of an introductory percentage rate, or due solely to a change in another rate of interest to which such rate is indexed. (Sec. 101)
Treatment of Existing Balances After a Rate Increase	If a creditor raises rates, but the higher rate does not apply to an existing balance, the creditor must offer a 5-year amortization period for repayment of the existing balance, and may not increase the percentage of the existing balance included in the minimum payment by more than double. Creditors may also offer an alternative method which is at least as beneficial to the consumer. (Sec. 2 (a))	No comparable provision.

[36] The analysis appearing in **Appendix A** was prepared by Mark Jickling, CRS Specialist in Financial Economics.

Provision	H.R. 627	S. 414
Increasing Rates on New Balances and Universal Default Clauses	No directly comparable provision.	Prohibits increases in rates based on adverse information not directly related to the account. Permits rate increases on new balances due to (1) expiration of an introductory rate, (2) an indexed rate, (3) a specific, material action or omission of a consumer in violation of an agreement that is directly related to such account and that is specified in the contract as grounds for an increase, (4) a change that takes effect when an account is renewed, or (5) failure to comply with the terms of a workout arrangement. When increases are due to a violation of an agreement, the creditor must disclose what the violation was, and must reduce the rate to the previous level after 6 months, if no further violations occur. (Sec. 108)
Advance Notice of Credit Card Rate Increases or Changes in Contract Terms	Requires creditors to provide written notice at least 45 days before any rate increase takes effect. The notice must describe in a complete and conspicuous manner the change in the rate and the extent to which such increase will apply to an existing balance. Except under specified circumstances (see "Increasing Rates on Outstanding Balances" above), banks may not increase rates for new balances during the first year the account is open.	No rate increase may take effect before a billing cycle beginning at least 45 days after the date on which the consumer receives notice of the increase. The notice shall include a brief statement of the right of the consumer to cancel the account before the higher rate takes effect. (Sec. 101)
Change of Terms of an Account	45-day notice is required for significant changes in the terms of an account. 30-day notice is required before the creditor closes an account. Promotional interest rates must be in effect for at least 6 months. (Sec. 2(c))	A card issuer may not amend or change the terms of a credit card contract or agreement until after the date on which the credit card will expire if not renewed. (Sec. 108)
Limits on Certain Fees and Charges	Prohibits fees based on method of payment (e.g., payment by telephone or electronic funds transfer).	Prohibits the charging of interest on fees, including cash advance fees, late fees, over-the-limit fees, or balance transfer fees. Separate fees linked to repayment of finance charges or extensions of credit are also prohibited. Fees for foreign currency exchange must be reasonable (related to the bank's actual transaction costs), and the method for calculating such fees must be disclosed. (Sec. 103)
Rates and Fees on Cancelled Card Accounts	No comparable provision.	If a consumer closes or cancels a credit card account, repayment of the outstanding balance shall be under the terms and rates that prevailed just before cancellation. Closing an account shall not constitute a default, nor trigger a demand for immediate repayment in full. (Sec. 102)

Provision	H.R. 627	S. 414
Workout Agreements	If a rate is reduced pursuant to a workout agreement between borrower and lender, and the borrower fails to comply with the agreement, lender may raise rates, but only to the level that prevailed before the workout agreement. Directs the Federal Reserve to set standards for workout agreements. (Sec. 2(b))	No comparable provision.
Double-Cycle Billing	Prohibits double-cycle billing, or finance charges on balances on a credit card account that are based on days in billing cycles preceding the most recent such cycle, as a result of the loss of a grace period. Exceptions are provided for finance charges following the return of a payment for insufficient funds, and for adjustment of finance charges following resolution of a billing dispute. (Sec. 3(a))	If credit card plan provides a time period within which a consumer may repay any portion of the credit extended without incurring an interest charge, and the consumer repays all or part of such credit within the specified time period, the creditor may not impose or collect an interest charge on the portion of the credit that was repaid within the specified time period. (Sec. 103)
Account Balances Attributable Only to Accrued Interest	If the outstanding balance on a credit card account consists only of accrued interest to previously-repaid credit, no fee may be imposed in connection with such a balance, and failure to make timely repayments on such a balance shall not constitute a default on the account. (Sec. 3(b))	No provision.
Periodic Account Statement Disclosures	Each periodic credit card account statement shall contain a telephone number and website address at which the consumer may request the payoff balance on the account. (Sec. 3(c))	No directly comparable provision, but Sec. 201 requires disclosures related to minimum monthly payments and outstanding balances.
Disclosure Requirements for Small Credit Card Issuers	Each periodic statement provided by small credit card issuers (those with fewer than 50,000 credit cards issued) must include a toll-free number or website at which the consumer may request the outstanding balance on the account.	No comparable provision
Right to Cancel Account Before First Notice of Open Account Provided to Credit Bureau	Requires creditors to remove any information provided to a consumer reporting agency (credit bureau) if the consumer does not use or activate the card, or cancels the account, during the 45 days after opening the account. Permits a creditor to furnish information about an application for a credit card account or any inquiry about such account to a consumer reporting agency. (Sec. 3(d))	A creditor may not furnish any information to a consumer reporting agency concerning a newly opened credit card account until the credit card has been used or activated by the consumer. (Sec. 104)

Provision	H.R. 627	S. 414
Use of Certain Terms Describing Interest Rates	Specifies the way certain terms may be used. "Fixed rate" may only refer to a rate that may not change for any reason over a specified time period. The term "prime rate" must not be used to describe a rate other than the rate published in Federal Reserve statistical releases. (Sec. 3(e))	Identical provisions. (Sec. 105)
Due Dates and Timely Payments	Payments received by 5 p.m. (local time) on the due date must be considered timely; electronic payments received by 5 p.m. must be credited to the consumer's account the same day; and evidence that a payment was mailed 7 days before the due date creates a presumption of timely payment. If payments are not accepted on the due date (if it falls on a weekend or holiday), payment received the next business day must be considered timely. (Sec. 3(e))	Payments received by 5 p.m. on the date on which such payments are due shall be considered timely. If a card issuer makes a material change in the mailing address or procedures for handling cardholder payments, and such change causes a material delay in the crediting of a cardholder payment made during the 60-day period following the change, no late fee or finance charge may be imposed for late payment. Evidence that a payment was mailed 7 days before the due date creates a presumption of timely payment. (Sec. 106)
Payment Allocations	If the balance of a credit card account is charged 2 or more different interest rates (e.g., separate rates for cash advances and purchases), the creditor must allocate all of a consumer's payment (in excess of the monthly minimum) to the outstanding balance carrying the highest interest rate. Notwithstanding the above, a creditor may allocate the entire amount paid to a balance on which interest has been deferred for the past 2 billing cycles. (Sec. 3(f))	Upon receipt of a payment from a cardholder, the card issuer shall (1) apply the payment first to the card balance bearing the highest rate of interest, and then to each successive balance bearing the next highest rate of interest, until the payment is exhausted; and (2) apply the payment in a way that minimizes the amount of any finance charge to the account. (Sec. 106)
Prohibition on Restricted Grace Periods	If a creditor offers cardholders a grace period within which to pay in full and not incur finance charges, that grace period must be available to cardholders who receive a promotional rate or deferred interest plan. (Sec. 3(f))	No comparable provision.
Timely Provision of Periodic Account Statements	Creditors must send consumers periodic account statements not less than 21 calendar days before the due date. (The current standard is 14 days.) (Sec. 3(g))	Identical provision. (Sec. 107)

Provision	H.R. 627	S. 414
Consumer Choice Regarding Over-the-limit Transactions, and Limits on Related Fees	If a credit card plan has a credit limit, and fees are charged for exceeding that limit, no such fee may be imposed unless the consumer elects to pay fees when the creditor completes transactions that exceed the credit limit. (Federal Reserve would issue regulations to provide for certain de minimis exceptions.) Over-the-limit fees may be imposed only once over the two billing cycles following the transaction that exceeded the credit limit. An over-the-limit fee due to a hold may not be imposed unless the actual transaction for which the hold was placed would have resulted in the consumer exceeding the credit limit. (Sec. 4)	If an account charges fees for exceeding a credit limit, consumers may elect to prohibit the creditor from completing any over-the-limit transaction that will result in a fee or constitute a default under the credit agreement, by notifying the creditor of such election. Annual notice that this "opt-out" election is available would be required. Over-the-limit fees may not be imposed if it was a fee or an interest charge that caused the limit to be exceeded, and may be imposed only for a single billing cycle. (Sec. 103)
Notification Requirements for Small Credit Card Issuers	Small credit card issuers issuers (those with fewer than 50,000 credit cards issued) must establish either a toll-free number or website to allow consumers to notify creditors not to authorize transactions that would extend their credit beyond the authorized amount, which would result in an over-the-limit fee. (Sec. 4)	No comparable provision.
Information Collection Regarding Credit Card Lending	Directs the Federal Reserve to collect semiannual data on the types of transactions for which different rates are charged, the various types of fees, the number of cardholders who pay fees, finance charges, or interest, and other matters. The Fed shall report annually to Congress on the amount of credit card lenders' income derived from: interest paid at above and below 25%; fees from cardholders and merchants; and other material sources of income. (Sec. 5)	Similar provisions related to collection of data on credit card interest rates, fees, and profits. (Sec. 110)
Subprime or "Fee Harvester" Cards	For cards whose annual fees exceed 25% of the credit limit, no payment of any fees (other than late fees, over-the-limit fees, or fees for payments returned for insufficient funds) may be made from the credit made available by the card. (Sec. 6)	No provisions.
Increased Penalties	No provision.	Sets money penalties for violations of the Truth in Lending Act related to credit cards and unsecured lending. (Sec. 109)
Enhanced Oversight	No provision.	Directs bank regulators to evaluate lenders' credit card policies and procedures and to promptly correct any violations. Directs the banking agencies to report annually to Congress on compliance and enforcement efforts. (Sec. 110)

Provision	H.R. 627	S. 414
Enhanced Consumer Disclosures	Requires a "Minimum Payment Warning," including information on how long it would take to pay off a balance by making only the minimum monthly payment, and a table showing the level of payment required to pay off a balance over various time periods. (Sec. 11) Requires disclosures to be made in a readable font, in at least 12-point type. (Sec. 14) Requires stores that accept credit card applications to post signs containing certain required disclosures. (Sec. 18)	Requires disclosures related to (1) the consequences of making only the minimum monthly payment, (2) late payment deadlines and penalties, and (3) any change in terms effective upon renewal of an account. Requires lenders to provide a toll-free number where consumers may obtain credit counseling or debt management information, and directs the Treasury to establish standards for debt counselors. Provides penalties for failure to make required disclosures. (Secs. 201, 202, and 203)
Underage Consumers	Prohibits the issuing of credit cards to consumers less than 18 years old, except to consumers who are emancipated under applicable state law, or unless a parent or guardian is designated as the primary account holder. (Sec. 7)	No credit card may be issued to a consumer less than 21 years old, unless the consumer submits a written application to the card issuer that includes (1) the signature of the parent or guardian indicating joint liability for debts incurred by the consumer in connection with the account; (2) financial information indicating an independent means of repaying any obligation arising in connection with the account; or (3) evidence of completion of a Treasury-certified financial literacy or financial education course designed for young consumers. (Sec. 301) Prohibits certain advertising and solicitation practices, including "pre-screened" offers of credit, aimed at consumers under 21, unless they have "opted-in" for inclusion on related marketing lists. (Sec. 303)
College Students	For full-time college students at least 18 years but under 21, credit extended in any year may not exceed $500 or 20% of the student's gross income. (Sec. 7)	Prohibits issuance of "affinity" credit cards linked to colleges or universities to consumers under 21 years old. (Sec. 302)
Active-Duty Military Personnel and Recently Disabled Veterans	Prohibits credit card lenders from making adverse credit reports for 2 years regarding active duty personnel or recently disabled veterans. (Sec. 9)	No comparable provision.
Posting Information on the Internet	Requires lenders to post the terms of credit card contracts on the Internet, and to furnish the Federal Reserve with electronic copies to permit the creation of a central repository of such information. (Sec. 10)	No comparable provision.
Timely Settlement of Deceased Debtors' Estates	Directs the Federal Reserve to issue regulations requiring creditors to establish procedures ensuring that outstanding balances can be resolved in a timely manner. (Sec. 16)	No comparable provision.

Provision	H.R. 627	S. 414
Federal Agency Coordination	No provision.	Amends the Federal Trade Commission Act to authorize each banking agency to make and enforce regulations governing unfair or deceptive practices by banks and thrifts. (Sec. 401)
Implementation Reports	Directs the Federal Reserve to report to Congress on the implementation of this legislation every 90 days until full industry implementation is achieved. (Sec. 17)	No comparable provision.
Review of Credit Card Plans and Regulations	Directs the Federal Reserve to conduct biennial reviews of credit card terms and lenders' practices, the effectiveness of required disclosures and protections against unfair practices, and the impact of this legislation. (Sec. 12)	No comparable provision.
Studies and Reports	Directs the Federal Reserve, in consultation with other bank regulators and the Federal Trade Commission, to study and report on the extent to which credit limits are lowered or interest rates raised based on (1) the type and geographical location of a consumer's transactions and (2) the identity of the holder of the consumer's home mortgage. The report shall also include the numbers and identities of lenders that engage in these practices and whether such practices have an adverse effect on minority and low-income consumers. (Sec. 9)	Directs GAO to study the impact of interchange fees on consumers and merchants and the extent to which such fees are disclosed, and to report to Congress within 180 days of enactment. (Sec. 501) Requires GAO to establish a Credit Card Safety Rating System Commission to explore the idea of a rating system for credit card agreements. (Sec. 502)
Effective Date	Most provisions would take effect 12 months after enactment, or June 1, 2010, whichever is earlier. The exception is for the required 45-day advance notification of an interest rate increase: this requirement would take effect 90 days after enactment. The regulatory agencies shall issue implementing regulations 12 months after enactment, or by or June 30, 2010, whichever is earlier. (Sec. 19)	9 months after enactment. (Sec. 2)

Source: Analysis provided by CRS

Appendix B. Comparison of H.R. 627 and Federal Reserve December 2008 Regulations

This appendix provides a comparative analysis of H.R. 627 (the Credit Cardholders' Bill of Rights Act of 2009), as passed by the House on April 30, 2009, and the Federal Reserve regulations issued on December 18, 2008. The table below sets out the major provisions.

Table B-1. Comparison of H.R. 627 and the Federal Reserve's December 2008 Credit Card Rules

Provision	H.R. 627	Federal Reserve Regulations
Increasing Rates on Outstanding Balances	Prohibits creditors from raising interest rates on an existing balance of a credit card account unless the increase is solely due to (1) a change in a published index not under the creditor's control; (2) the expiration of a promotional rate; (3) failure to comply with a workout plan (see below); or (4) the consumer's minimum payment being at least 30 days overdue. In the case of expiration of a promotional rate, the new rate may not exceed the rate that would have applied under the terms of the agreement absent the promotional rate. (Sec. 2(b)) Also prohibits imposition of fees in lieu of a rate increase on an existing balance. (Sec. 2(a))	Requires banks, at the time an account is opened, to disclose all interest rates that will apply to the account. Banks may not increase those rates, except under certain conditions: (1) if a promotional rate expires, the rate may rise to a higher, previously-disclosed level; (2) rates may rise in a variable rate account if the rate is linked to an index; (3) after one year, banks may raise rates for new balances after giving 45 days advance notice; and (4) rates may increase if a minimum payment is received more than 30 days after the due date. (Reg. AA)
Treatment of Existing Balances After a Rate Increase	If a creditor raises rates, but the higher rate does not apply to an existing balance, the creditor must offer a 5-year amortization period for repayment of the existing balance, and may not increase the percentage of the existing balance included in the minimum payment by more than double. Creditors may also offer an alternative method which is at least as beneficial to the consumer. (Sec. 2 (a))	No comparable provision.
Payment Allocations	If the balance of a credit card account is charged 2 or more different interest rates (e.g., separate rates for cash advances and purchases), the creditor must allocate all of a consumer's payment (in excess of the monthly minimum) to the outstanding balance carrying the highest interest rate. Notwithstanding the above, a creditor may allocate the entire amount paid to a balance on which interest has been deferred for the past 2 billing cycles. (Sec. 3(f))	When different interest rates apply to different balances in a credit card account, banks must allocate payments in excess of the monthly minimum to the balance with the highest rate, or divide the excess payment among all balances on a pro rata basis. (Reg. AA)

Provision	H.R. 627	Federal Reserve Regulations
Advance Notice of Credit Card Rate Increases or Changes in Contract Terms	Requires creditors to provide written notice at least 45 days before any rate increase takes effect. The notice must describe in a complete and conspicuous manner the change in the rate and the extent to which such increase will apply to an existing balance. Except under specified circumstances (see "Increasing Rates on Outstanding Balances" above), banks may not increase rates for new balances during the first year the account is open. (Sec. 2(c))	Consumers must be given written notice of an interest rate increase at least 45 days before the higher rate takes effect. This includes rate increases stemming from default, delinquency, or a penalty. Change-in-terms or penalty rate notices must include a summary table setting out the key terms being changed. (Reg. Z)
Change of Terms of an Account	45-day notice is required for significant changes in the terms of an account. 30-day notice is required before the creditor closes an account. Promotional interest rates must be in effect for at least 6 months. (Sec. 2(c))	45-day notice required before a changed term can be imposed to better allow consumer to obtain alternative financing or change their account usage.
Limits on Certain Fees and Charges	Aside from the exceptions mentioned above in "Increasing Rates on Outstanding Balances", no increase in the annual percentage rate of interest shall be effective before the end of a 1-year period beginning when the account is opened. Promotional rates must be in effect for at least 6 months. Prohibits fees based on method of payment (e.g., payment by telephone or electronic funds transfer).	A bank may not charge security deposits and fees for the issuance or availability of credit to consumer credit card accounts that constitute a majority of the initial credit limit for the account.
Workout Agreements	If a rate is reduced pursuant to a workout agreement between borrower and lender, and the borrower fails to comply with the agreement, lender may raise rates, but only to the level that prevailed before the workout agreement. Directs the Federal Reserve to set standards for workout agreements. (Sec. 2(b))	If a rate is reduced pursuant to a workout agreement between borrower and lender, and the borrower fails to comply with the agreement, lender may raise rates, but only to the level that prevailed before the workout agreement.
Double-Cycle Billing	Prohibits double-cycle billing, or finance charges on balances on a credit card account that are based on days in billing cycles preceding the most recent such cycle, as a result of the loss of a grace period. Exceptions are provided for finance charges following the return of a payment for insufficient funds, and for adjustment of finance charges following resolution of a billing dispute. (Sec. 3(a))	Prohibits banks from imposing interest charges using the "two-cycle" billing method. (Interest charges may not be calculated using the account balance for days in the previous billing cycle.) Exceptions are provided for deferred interest that may have accrued over several billing cycles, and for adjustment of finance charges following resolution of a billing dispute. (Reg. AA)

Provision	H.R. 627	Federal Reserve Regulations
Account Balances Attributable Only to Accrued Interest	If the outstanding balance on a credit card account consists only of accrued interest to previously-repaid credit, no fee may be imposed in connection with such a balance, and failure to make timely repayments on such a balance shall not constitute a default on the account. (Sec. 3(b))	No comparable provision.
Disclosure Requirements	Each periodic credit card account statement shall contain a telephone number and web site address at which the consumer may request the payoff balance on the account. (Sec. 3(c)) Creditors must post and maintain credit card agreements on the internet (Sec. 10) Creditors must include enhanced minimum payment disclosures. Disclosures shall be in the form and manner prescribed by the Federal Reserve Board by regulation. (Sec. 11) Adds a readability requirement pertaining to the font size of disclosures. (Sec.14)	Provides examples of new model forms presented as a compliance aid to help institutions meet disclosure requirements. For example, fees and charges must be grouped together. Both monthly and year-to-date totals for fees and interest charges are required. The effect of making only the minimum payment must also be disclosed. (Reg. Z)
Right to Cancel Account Before First Notice of Open Account Provided to Credit Bureau	Requires creditors to remove any information provided to a consumer reporting agency (credit bureau) if the consumer does not use or activate the card, or cancels the account, during the 45 days after opening the account. Permits a creditor to furnish information about an application for a credit card account or any inquiry about such account to a consumer reporting agency. (Sec. 3(d))	No comparable provision.
Use of Certain Terms Describing Interest Rates	Specifies the way certain terms may be used. "Fixed rate" may only refer to a rate that may not change for any reason over a specified time period. The term "prime rate" must not be used to describe a rate other than the rate published in Federal Reserve statistical releases. (Sec. 3(e))	Advertising may use the term "fixed rate" only if the rate cannot be increased for any reason during a specified time period. If no time period is specified, the rate may not increase for any reason as long as the account is open. (Reg. Z)
Due Dates and Timely Payments	Payments received by 5 p.m. (local time) on the due date must be considered timely; electronic payments received by 5 p.m. must be credited to the consumer's account the same day; and evidence that a payment was mailed 7 days before the due date creates a presumption of timely payment. If payments are not accepted on the due date (if it falls on a weekend or holiday), payment received the next business day must be considered timely. (Sec. 3(e))	Mailed payments received by 5 p.m. shall be considered timely. If payments are not accepted on the due date (if it falls on a weekend or holiday), payment received the next business day must be considered timely. (Reg. Z)

Provision	H.R. 627	Federal Reserve Regulations
Prohibition on Restricted Grace Periods	If a creditor offers cardholders a grace period within which to pay in full and not incur finance charges, that grace period must be available to cardholders who receive a promotional rate or deferred interest plan. (Sec. 3(f))	No comparable provision.
Timely Provision of Periodic Account Statements	Creditors must send consumers periodic account statements not less than 21 calendar days before the due date. (The current standard is 14 days.) (Sec. 3(g))	Banks may not treat a payment as late unless the consumer has been given a reasonable amount of time to make that payment. The "reasonable" standard will be met if banks mail statements at least 21 days before payment is due. (Reg. AA)
Consumer Choice Regarding Over-the-limit Transactions, and Limits on Related Fees	If a credit card plan has a credit limit, and fees are charged for exceeding that limit, no such fee may be imposed unless the consumer elects to pay such fees if the creditor completes transactions that exceed the credit limit. (Federal Reserve would issue regulations to provide for certain de minimis exceptions.) Over-the-limit fees may be imposed only once over the two billing cycles following the transaction that exceeded the credit limit. An over-the-limit fee due to a hold may not be imposed unless the actual transaction for which the hold was placed would have resulted in the consumer exceeding the credit limit. (Sec. 4)	No comparable provisions. (A provision regarding holds on accounts that cause an account to go over-the-limit was part of the proposed regulations, but was not adopted in the final rules. (See: *Federal Register*, Jan. 29, 2009, p. 5505.)
Information Collection Regarding Credit Card Lending	Directs the Federal Reserve to collect semiannual data on the types of transactions for which different rates are charged, the various types of fees, the number of cardholders who pay fees, finance charges, or interest, and other matters. The Fed shall report annually to Congress on the amount of credit card lenders' income derived from: interest paid at above and below 25%; fees from cardholders and merchants; and other material sources of income. (Sec. 5)	No comparable provision.
Subprime or "Fee Harvester" Cards	For cards whose annual fees exceed 25% of the credit limit, no payment of any fees (other than late fees, over-the-limit fees, or fees for payments returned for insufficient funds) may be made from the credit made available by the card. (Sec. 6)	Banks are prohibited from providing financing for security deposits and fees (such as account-opening or membership fees) if such charges during the first 12 months would exceed 50% of the initial credit limit. Such fees and deposits charged at the time the account is opened may not exceed 25% of the credit limit. Any additional fees (up to 50%) must be spread over at least 5 billing periods. (Reg. AA)
Underage Consumers	Prohibits the issuing of credit cards to consumers less than 18 years old, except to consumers who are emancipated under applicable state law, or unless a parent or guardian is designated as the primary account holder. (Sec. 7)	No comparable provision.

Provision	H.R. 627	Federal Reserve Regulations
College Students	For full-time college students at least 18 years of age but under 21, credit extended in any year may not exceed $500 or 20% of the student's gross income. (Sec. 7)	No comparable provision.
Active-Duty Military Personnel and Recently-Disabled Veterans	Prohibits credit card lenders from making adverse credit reports for 2 years regarding active duty personnel or recently-disabled veterans. (Sec. 9)	No comparable provision.
Posting Information on the Internet	Requires lenders to post the terms of credit card contracts on the Internet, and to furnish the Federal Reserve with electronic copies to permit the creation of a central repository of such information. (Sec. 10)	Lenders may post electronic forms to opt out of over-the-limit fees, such as a form that can be accessed and processed at an Internet Web site, provided that the institution directs the consumer to the specific Web site address where the form is located, rather than solely referring to the institution's home page.
Timely Settlement of Deceased Debtors' Estates	Directs the Federal Reserve to issue regulations requiring creditors to establish procedures ensuring that outstanding balances can be resolved in a timely manner. (Sec. 16)	No comparable provision.
Implementation Reports	Directs the Federal Reserve to report to Congress on the implementation of this legislation every 90 days until full industry implementation is achieved. (Sec. 17)	No comparable provision.
Review of Credit Card Plans and Regulations	Directs the Federal Reserve to conduct biennial reviews of credit card terms and lenders' practices, the effectiveness of required disclosures and protections against unfair practices, and the impact of this legislation. (Sec. 12)	No comparable provision.
Studies and Reports	Directs the Federal Reserve, in consultation with other bank regulators and the Federal Trade Commission, to study and report on the extent to which credit limits are lowered or interest rates raised based on (1) the type and geographical location of a consumer's transactions and (2) the identity of the holder of the consumer's home mortgage. The report shall also include the numbers and identities of lenders that engage in these practices and whether such practices have an adverse effect on minority and low-income consumers. (Sec. 9)	No comparable provision

Provision	H.R. 627	Federal Reserve Regulations
Effective Date	Most provisions would take effect 12 months after enactment, or June 30, 2010, whichever is earlier. The exception is for the required 45-day advance notification of an interest rate increase: this requirement would take effect 90 days after enactment. The regulatory agencies shall issue implementing regulations 12 months after enactment, or by or June 30, 2010, whichever is earlier. (Sec. 19)	July 1, 2010

Source: Analysis provided by CRS

Appendix C. Credit Card Securitizations

The modern securitization process begins with a credit card issuer or loan originator who, after approving and making loans with unsecured lines of credit for a specified amount to numerous applicants, decides to securitize these assets.[37] Next, the assets, which in this case are the loan receivables or repayment streams from the credit card loans, are sold to a trust that will be referred to as a special purpose entity (SPE).[38] SPEs are created as trusts, typically by financial institutions with a large amount of credit card originations, for two reasons. First, originators may sell assets to trusts without paying taxes on the sale of those assets. Second, the investors' rights to cash flows generated from the underlying assets are protected if the originator were to become insolvent or file for bankruptcy. Hence, the SPE may be defined as "bankruptcy remote." Given the associated tax and legal advantages, SPEs may not carry out any other activities unrelated to the specific purpose for which they were created. The SPE's specific purpose is typically to transform individual receivables into new financial securities with specific risk and return characteristics, the next step of the securitization process.[39] Securities backed by credit card loans can be created for any desired maturity, since new receivables are continually added to the pool as older receivables are paid off by borrowers.

When transforming the individual credit card loans into new issues of asset-backed securities (ABS), SPEs may subdivide them into various *tranches*, or groups of securities with specific risk and return characteristics. The ultimate lenders or purchasers of such assets are typically large investors, such as hedge funds, pension funds, or other financial institutions, who purchase securities from the different tranches. A common tranche arrangement, for example, is a senior-junior tranching structure. The senior tranche may be designated as the one that pays its investors first, but the yield may be lower than the junior tranche, which is designated to pay its investors last. When the securitizer decides to sell the tranches in the secondary market, the senior tranche will appeal to investors that prefer lower risk, quick paying investments, while the junior tranche will appeal to investors that prefer to take higher risks for the possibility of earning a higher yield. The senior-junior tranching structure is only one of the numerous disbursement structures securitizers use to entice investors.[40]

When the SPE can effectively identify and create ABS tranches satisfying specific needs, it can appeal to more investors and attract more credit to fund credit card loan originations in the primary market. To illustrate futher, suppose the SPE is currently using the senior-junior tranching structure described above. The junior tranche would consist of the cash flow remaining *after* both the principal and yield to senior tranche holders and any losses associated with default

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[37] For a more detailed overview of the underwriting and loan approval process, see the *Credit Card Activities Manual*, The Federal Deposit Insurance Corporation, at http://www.fdic.gov/regulations/examinations/credit_card/.

[38] See Gary Gorton and Nicholas S. Souleles, "Special Purpose Vehicles and Securitization," Working Paper No. 05-21, published by the Research Department of the Federal Reserve Bank of Philadelphia.

[39] In many cases, two SPEs may be involved in the securitization process. The first SPE receiving the assets from the originator subsequently transfers these receivables to a second SPE that does the actual repackaging and creates the new credit-card backed securities, which are then sold to investors. Each SPE would be created in response to an accounting and/or legal issue that would make it difficult for cash in-flows and out-flows to occur without financial and/or legal consequences impacting the ability to issue, sell, and re-invest the securities.

[40] Note that only the loan receivables are collected and securitized. Hence, the sum of all cash payments received is disbursed according to SPE tranching guidelines, but individual loans do not have to be assigned to any particular tranches.

were paid. The holder of the junior tranche, therefore, keeps whatever cash remains. This repayment structure reduces the credit risk for senior tranche holders, since junior tranche holders incur most of the credit risk. The senior tranche receives payment first, followed by the junior tranche; conversely, the junior tranche initially suffers the losses first, followed by the senior tranche. Of course, the junior tranche holder receives a higher yield or rate of return in exchange for assuming higher risk. The investors in the senior tranche would be adversely affected only if default costs exceed the value of payments that would have accrued to the junior tranche investors.[41] Hence, a tranching structure may also serve as a *credit enhancement*, or a method of reducing the credit risk of senior securities, which may attract more investors, in particular those restricted to purchasing high quality investment grade securities.

Rather than sell all of the ABS tranches to third party investors, the loan originator may also want to act as an investor in its own asset-backed securities. Whenever the originator chooses to keep one or more tranches in its own portfolio, the retained tranche is referred to as *excess spread*. Suppose an originator retains a junior tranche, which now is subsequently referred to as the excess spread, then the originator is also providing credit enhancement to senior tranches issued by the SPE. Again, the junior tranche consists of the cash flow remaining after the principal and yield to senior tranche holders, and any losses associated with default, are paid. A holder of the excess spread tranche, therefore, has a strong financial incentive to effectively minimize the costs of defaults.

Author Contact Information

Darryl E. Getter
Specialist in Financial Economics
dgetter@crs.loc.gov, 7-2834

Key Policy Staff

Area of Expertise	Name	Phone	E-mail
Specialist in Financial Economics	Mark Jickling	7-7784	mjickling@crs.loc.gov

[41] The "liquidity crisis" of August 2007 was triggered by senior tranche holders reassessing the riskiness of their exposure to financial problems that exceeded expectations. See CRS Report RL34182, *Financial Crisis? The Liquidity Crunch of August 2007*, by Darryl E. Getter et al. Rather than rely solely upon a tranching structure, investors may also choose to purchase bond insurance, which may serve as additional credit enhancement.